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 June 2011 to 30 November 2011.

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

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

Thank you for your Explanatory Memorandum 13235/11, dated 1 September 2011, on the Commission’s Recommendation on access to a basic payment account. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 1 November.

We agree with the Government’s conclusion that the Commission’s Recommendation would add little in terms of consumer access to UK bank accounts. Pending consideration of any future legislation on the subject, we have agreed to clear this document from scrutiny.

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

I refer to the Competitiveness Council’s meeting of 30 May 2011, which passed a compromise package to partially exempt micro-entities from the 4th Company Law Directive.

An explanatory Memorandum (EM) on this subject was submitted on 17 March 2009, and was cleared by your committee. In my letter dated 11 August 2010 I updated the Committee outlining amendments to the original proposal.

The 4th Company Law Directive, which establishes minimum requirements for the annual accounts of companies and certain partnerships, forms the basis for financial reporting by small and medium enterprises (SMEs) in the EU. Currently, micro-entities are mostly subject to the same rules as larger companies. Those rules put a burden on them which is disproportionate. The package agreed at the Competitiveness Council would allow Member States the option to simplify how micro-entities draw up annual accounts. This would enable the UK to harmonise tax and accounting rules for these companies, significantly reducing administrative and compliance burdens on them.

An earlier proposal was approved by the European Parliament in February 2010 but was blocked by a minority of Member States in the Council. The subsequent package is a compromise that is designed to balance the concerns of all parties. It aims to relieve burdens for micro-entities and provides a balance between simplification and transparency. The key amendments agreed by the Competitiveness Council are:

A change in the definition of micro-entity with a company defined as a micro-entity if it does not exceed the limits of two out of three criteria:

— a balance sheet of €250,000;
— a net turnover of €500,000; and
— an average number of 10 employees

Partial exemption rather than full exemption from the 4th Company Law Directive has been agreed. This still offers significant simplification as it allows Member States to exempt micro-entities from:

a) presenting accruals in accounts
b) drawing up notes to the accounts on the condition that 2 key notes are disclosed at the foot of the balance sheet. These are:
   (i) the amount of advances and credits granted to members of the administrative, managerial and supervisory bodies with indications of the interest rates, main conditions and amounts repaid as well as commitments entered into on their behalf by way of guarantees of any kind, with an indication of the total for each category;
   (ii) Information referred to in Article 22 (2) of Directive 77/91/EEC concerning the acquisition by a company of its own shares is given in the notes to their accounts.

c) Drawing up an annual report in accordance with the Directive, providing the information specified in (b) is disclosed.
d) Publication of annual accounts provided balance sheet information is filed in accordance with national law with at least one competent authority. If the competent authority is not the register, it will have to provide the information to the register.

In addition, Member States may permit micro-entities to:

a) draw up a limited and simplified balance sheet
b) draw up a limited and simplified profit and loss account

The package agreed at the Competitiveness Council will now transfer to the European Parliament for its second reading.

27 June 2011
Letter from the Chairman to Baroness Wilcox, Parliamentary Secretary for Business, Innovation and Skills, Department for Business, Innovation and Skills

Thank you for your Explanatory Memorandum 13400/11 on a Commission proposal regarding certain provisions relating to financial management for certain Member States experiencing or threatened with serious difficulties with respect to their financial stability. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 4 October.

We recognise your desire to ensure that the EU Budgets 2012, and 2013, do not rise in real terms. However, this proposal would be of immediate benefit to those countries hit hardest by the recent financial and euro area crises. Consequently, as long as EU spending in this area remains within the limits set by the multi-annual financial framework from 2007-13, we would support the Commission’s proposal.

We have agreed to clear the proposal from scrutiny, but we would welcome a letter from you setting out the Government’s agreed position on this proposal, and your reasons for it. We would be grateful for a response within the standard ten working days.

5 October 2011

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

Thank you for your letter of 5 October to Baroness Wilcox, confirming that the House of Lords European Union Committee has agreed to clear this proposal from scrutiny. I am replying as the Minister responsible.

We agree that this proposal would be of immediate benefit to those countries hit hardest by the recent financial crisis and the Government supports the provision of additional assistance to those countries that are experiencing the largest difficulties in providing national cofinancing for Structural and Cohesion Fund projects. However, the Government is keen to ensure that this proposal is considered in the context of the budgetary restraints facing all Member States. This means that it must be consistent with the Government’s stated goal of curbing the annual growth in payment appropriations in the remaining years of this Financial Perspective (2007-13), not just the Financial Perspective ceilings.

Although this proposal is budget neutral in the long-term, the Government is clear that it should not lead to an increase in the 2012 EU Budget at this point. As such the Government is working to ensure that any increase in payments should be accommodated through the procedure for the Commission to present updated figures concerning payment appropriations under sub-heading 1b by September 2012 and if necessary to utilise the Global Transfer exercise for 2012, subject to other possible needs under other financial framework headings, and if then still necessary to present a draft amending budget for this sole purpose. The Government believes that in practice there could be some headroom in Heading 1b (the Cohesion policy area of the EU budget) to absorb the additional payments that will result without the need for such an amending budget, as long as the pattern of significant under-implementation across all Member States continues.

I understand the Committee’s wish for clarity on the Government’s position on this matter and I hope that this letter meets that need.

26 October 2011

COMMISSION’S MANAGEMENT ACHIEVEMENTS (11264/11)

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

Thank you for your Explanatory Memorandum 11264/11, dated 6 July 2011, on the Commission Communication Synthesis of the Commission’s Management Achievements in 2010. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 4 October 2011.
We note the concerns you express about the management of EU funds. We welcome your efforts to ensure that EU spending adheres to the highest possible standards of financial management and transparency. We particularly welcome your call for Member States to take greater responsibility for spending EU funds and greater transparency. Would you agree that it would be desirable for the European Court of Auditors (ECA) to assess in more detail how effectively individual Member States have managed EU funds under their control?

You state that you have recommended “concrete actions that would improve financial management”, that you continue to “call on the Commission to improve the various management shortcomings identified by the ECA and to speed up its corrective measures”, and that you continue to support “appropriate simplification of rules and regulations on EU spending.” Which specific measures would you wish to see implemented to bring about improvements in these areas?

We note the Commission’s statement that inter-institutional discussions on a Tolerable Risk of Error for Research, Energy and Transport policies and for Rural Development are “ongoing”. We continue to welcome updates as and when any progress is made in this area.

We note that the reservations included two in relation to the UK: i) a Reservation on ERDF (European Regional Development Fund) management and control systems for certain programmes in the period 2007-13; and ii) management and control systems in ESF (European Social Fund) for certain programmes in the period 2007-13. We note your statement that the reservations and suspensions of funds were due to “financial control issues”, that they are “of a technical nature”, and that “UK authorities are working with the Commission to get these reservations lifted (and some already have been) and to improve the control environment going forward.” We would be grateful for further information on these cases, including an update on the steps that are being taken to rectify the problem.

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

5 October 2011

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

Thank you for your letter dated 5 October regarding the EM on the Commission’s Communication Synthesis of the Commission’s Management Achievements in 2010. I am responding to you given my new responsibilities in this area.

Regarding the effectiveness of individual EU Member States’ management of EU funds, the Government fully supports the European Court of Auditors (ECA) and the work it already undertakes. The quality of Member States’ financial management is already part of the ECA’s annual report and is reflected in the error rates it reports. The Government emphasises, as you note, that Member States should themselves take greater responsibility for disbursing EU funds correctly and improve transparency. We will explore whether the ECA may do more to synthesise and convey this data through its publications.

The UK has been a strong advocate for improvements to EU financial management. The UK set out its priorities together with the Netherlands and Sweden as part of a Joint Declaration on 15 February 2011, as outlined here:

— A continued focus on simplification of the rules and regulations on implementing EU funds;
— Member States to take responsibility for upgrading their internal control systems;
— Compulsory publication of the Annual Summaries that Member States submit to the Commission, and at the same time for the Summaries to include more meaningful information;
— Introduction of more risk-based approach to auditing;
— The Commission to set up a “one-stop-shop” information service for implementing authorities, to help reduce the number of errors; and
— The Commission or the ECA to publish a “scorecard” of recovery orders issued against Member States.
In support of a risk-based approach to auditing, a more structured dialogue between the Court of Auditors, the Commission and Member States is necessary. The Commission should bring forward proposals to enable a stronger focus on the audit of larger projects and some programmes, which have a proven track record of risk.

We are seeking to promote this agenda through ongoing negotiations on the new EU Financial Regulations, and more informally with the Commission and EU member states. Some specific areas of simplification we would like to see are:

— Any increase in the administrative burdens of CAP reform should be balanced by a more proportionate controls regime, to prevent an overall increase in costs;

— A greater acceptance of participants' usual accounting practices when these are compatible with national regulations – including in respect of full economic cost accounting, time-recording systems (the requirement for paper time sheets is archaic) and eligible personnel costs;

— EU rules and regulations for programmes should describe the principles, not the required systems for accounting;

— The removal of the requirement to open interest-bearing bank accounts to hold EU pre-financing, and to recover and return to the Commission interest so earned (this has already been removed the new draft of the Financial Regulations ; and Greater consistency in interpretation and application of the rules by Commission or EU agency project officers and auditors.

Discussions are ongoing on the concept of a proposed Tolerable Risk of Error (TRE) for error rates across different programmes of the EU budget. Currently, the Commission and European Parliament are in disagreement over who should set such a rate, with each seeking for the other to take responsibility for it. The Council is opposed to its introduction – there is concern that it is too early to introduce TRE and other changes to financial management procedures, such as simplification and the streamlining of implementation procedures, should be used reduce the error rate first. Trilogue discussions are currently ongoing prior to a European Parliament vote in Plenary (no date is currently set for this). I will keep you updated on this matter.

Finally, you enquire about interruptions to UK programmes. Six English programmes had their payments interrupted earlier this year when they were found to have high draft error rates. The English Audit Authority has now concluded its reports and these error rates have been reduced significantly. The Managing Authority (MA) – the Department for Communities and Local Government (DCLG) – has also set out for the European Commission a detailed Action Plan showing the steps that had been taken and would continue to be taken to improve performance management and correct errors in relation to the English European Regional Development Fund (ERDF) programmes. As a result, all of the interruptions to English ERDF programmes were lifted at the end of July. Interruptions late last year and earlier this year to Scottish ERDF and European Social Fund programmes have also all been lifted with management and control systems now operating to Commission satisfaction.

To improve financial management within the UK’s Structural Funds programmes in England, the ERDF MA in England will use the opportunity presented by centralisation of the programmes within DCLG, which were previously administered on their behalf by Regional Development Agencies up to 30 June 2011, to improve and standardise monitoring and verification procedures.

The MA has implemented a schedule of extensive checks on projects in those programmes that had a high error rate in the 2010 Annual Control Report. Our expectation is that, as implementation proceeds, these changes will help to identify and remove irregularities, and reduce the risk of major errors being found at closure in future.

31 October 2011
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 11762/11, dated 20 July 2011, on a proposal for a Regulation amending certain regulations relating to the common commercial policy as regards to the granting of delegated powers for the adoption of certain measures. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 4 October 2011.

We note that the Government’s initial assessment is broadly supportive of the Commission proposal. Does this remain your assessment?

You state your wish to press the Commission during discussions in Council on, in particular, the justification for the: delegation of powers to the Commission being conferred for an indeterminate rather than a fixed period; inclusion of urgency procedures on a Regulation-by-Regulation basis; and the use of delegated powers for safeguard action in the two Textiles related Regulations (3030/93 and 517/94) in contrast to the examination procedure applicable under other Regulations. We would be grateful if you could provide us with further details of your concerns in relation to these questions. Have you as yet received any assurances in relation to these matters?

You state that your current information is that the earliest that the Regulation is likely to go to Council is in the last quarter of 2011. We would be grateful for any update on the proposed timetable.

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

5 October 2011

Letter from Edward Davey MP to the Chairman

Thank you for your letter of 5 October reporting that your committee has agreed to keep this proposal under scrutiny and posing a series of questions.

You will appreciate that due to the summer break that to date there has, despite a further discussion in the Commercial Questions Council Working Group, been little movement so far in relation to this proposal since the EM was submitted on 20 July. There has therefore been no cause to change our initial assessment of broad support for the Commission proposal.

In relation to the specific issues highlighted in the EM and on which you ask for further detail:

— It is central HMG policy preference for fixed rather than indeterminate periods for powers delegated to the Commission unless there is a good justification to the contrary;

— As originally envisaged urgency procedures are intended for use in exceptional cases only such as security and humanitarian crises. While acknowledging potential commercial security concerns, these issues seem unlikely to arise in the Regulations covered by this proposal and we need to hear the Commission justification for their inclusion before coming to a final position; and

— In trade defence instruments decisions on safeguard action is subject to the examination committee procedure and we see no reason why the position should be different in the case of textiles and clothing products.

As yet these concerns have not been addressed in detail in Brussels.

The timetable for presentation to the Council remains unclear with the European Parliament consideration of this proposal yet to get fully underway. Realistically the Regulation is unlikely to now go to Council until Q1 and possibly Q2 of 2012.

18 October 2011
Letter from the Chairman to Edward Davey MP

Thank you for your letter, dated 18 October 2011, on Explanatory Memorandum 11762/11 on a proposal for a Regulation amending certain regulations relating to the common commercial policy as regards the granting of delegated powers for the adoption of certain measures. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 29 November 2011.

We are grateful for the update on negotiations and on the Government’s position in relation to this proposal. We would be grateful for further updates as negotiations progress. In the meantime, we have agreed to clear the proposal from scrutiny.

29 November 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 letter, dated 20 May, on EM 7263/11 on a Commission proposal for a Common Consolidated Corporate Tax Base. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 13 September.

We welcome your comprehensive response to our questions on this document.

You note that the Government will not agree to any proposal that would jeopardize its ability to shape the UK’s tax policy. Would the Commission’s proposal not inevitably have this effect given that it would remove one element of national decision-making by influencing the shape of the corporate sector tax base?

You state that the Commission should undertake a fuller quantitative impact assessment of both the long-term impact of the proposal and the one-off costs associated with the implementation of a new system. Is this work currently underway? Likewise, you express concern that the impact assessment has some significant omissions and rests on some unfounded assumptions: is the Commission currently re-working the impact assessment in light of these concerns?

You argue that the impact assessment does not quantify the resources that companies will devote to deciding whether or not to opt-in to the CCCTB, and that this is “crucial to understanding whether or not a CCCTB could actually reduce compliance costs”. Is this not a purely short-term cost that would not affect the compliance costs of a CCCTB in the medium- to long-term?

We recognise your concern that this proposal will have a largely negative short-term impact at a time when EU economies are struggling to recover from the recent financial crisis. To what extent should this short-term negative impact be balanced against potential benefits in the longer-term?

You note that if a CCCTB was taken forward under enhanced cooperation it would still have implications for UK businesses. What would these implications be, and what work has the Government undertaken to quantify the impact on the UK if these proposals were, for example, taken forward by euro area Member States, or those countries which have signed up to the euro plus pact?

You note that views from business have been mixed. Given that the proposal calls for an optional CCCTB, should the emphasis not be given to those companies which are supportive of the proposals, since those businesses which have concerns can simply choose not to opt-in to the CCCTB?

Your letter lists some of the existing working groups, bilateral treaties and conventions which govern cross border tax issues. It is not clear to us why companies will face more “uncertainty and complexity” dealing with a single CCCTB than with the EU Joint Transfer Pricing Forum, the EU Arbitration Convention, a network of bilateral Double Tax Treaties, and the Mutual Agreement Procedure framework.

We note that France and Germany have recently called for negotiations on the CCCTB to be concluded by the end of 2012. How much support is there within Council for this proposal? Which other Member States have also expressed serious reservations about the substance of this proposal?

14 September 2011
Letter from David Gauke MP to the Chairman

Thank you for your letter, dated 14 September, which raises a number of questions about the EU Commission’s proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), and the Government’s approach to negotiations.

You raise the issue of whether the proposal would inevitably jeopardize the Government’s ability to shape the UK’s tax policy, given it would remove the Government’s ability to decide on the UK’s tax base. This would be correct, if the UK was to agree to the proposal. My key concern is that the Government retains the ability to define its own tax base, as well as tax rate, and that the Government makes the decisions that will affect the British economy.

You queried whether the Commission is undertaking a fuller quantitative impact assessment of the proposal, or re-working its impact assessment. Although during negotiations the UK has argued, and will continue to argue, that such work should be undertaken, I am unaware of any such work underway, nor of any commitment by the Commission to do so. During negotiations, the Commission has stressed that the impact assessment it produced was passed by the Impact Assessment Board.

In relation to 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, I do not see this as a one-off short term cost. As a business representative body with which we have discussed the proposal highlighted, if a business decided to opt-in, it would remain necessary to continuously monitor tax developments in the Member States where its operations were based, in order to establish whether remaining within the CCCTB after the initial five year opt in period provided the best tax outcome. I continue to be of the view that taking account of these costs is crucial to understanding whether or not a CCCTB could actually reduce compliance burden.

You raise the issue of whether the short-term negative impact of the proposal may be balanced against potential benefits in the longer-term. The Government is not convinced there are strong longer-term benefits to the proposal, and I note that the Commission has made no attempt to quantify the longer-term benefits of the proposal. I wish to reiterate that I do not believe relinquishing the flexibility to shape our tax policy to suit our economic circumstances and compete in a global environment would be of long-term benefit to the UK.

You ask about the potential implications for UK businesses 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 the relevant permanent establishments should opt into a CCCTB, and also to monitoring whether they would be better off in or out, as I have previously highlighted. The Government has undertaken work to analyze the implications for the UK of other Member States taking the proposal forward under enhanced cooperation. The Government is engaging to ensure that tax proposals made by the Commission are discussed at EU 27 level, and continue to be subject to unanimity, in line with the EU Treaties.

You suggest that in considering the views of business on the proposal, emphasis should be given to those companies which are supportive of the proposal, as those businesses which have concerns can simply choose not to opt into the CCCTB. I believe we should listen to both businesses which are supportive of the proposal, and those which have concerns, given that even businesses with concerns would be likely 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 point was made by business representatives at HMRC’s Business Tax Forum’s International Sub Group on 28 April 2011.

Turning to the issue of an optional CCCTB adding complexity and uncertainty, I would see CCCTB as introducing an optional ‘28th’ corporate tax system in the EU, which in itself adds another layer of complexity. There would be likely to be new forms of dispute associated with the operation of a CCCTB, for example around an appropriate alternative method to apportion tax profits to a given company under the Safeguard clause set out at Article 87.

I also believe that the proposal lacks detail in a number of areas, and that this is likely to contribute towards uncertainty for businesses and tax administrations. For example, there seems to be insufficient detail in the hedging rule outlined at Article 28 in relation to the two sides of the hedge being held by companies that are part of the same group, but one is within the CCCTB and the other is outside it. Another example can be found at Article 9(3) which states that “The calculation of the tax base shall be carried out in a consistent manner unless exceptional circumstances justify a change.”
No attempt is made to define the term “consistent”, or indeed the “exceptional circumstances” which could justify a change. I believe that detailed rules and definitions are needed, in order to provide certainty to businesses and tax administrations.

You raise the issue of President Sarkozy’s and Chancellor Merkel’s call for negotiations on the CCCTB to be concluded by the end of 2012. To date there has been no discussion at ECOFIN Council on the CCCTB proposal, or any firm timeline for completing negotiations.

I hope you find this information helpful.

28 September 2011

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 28 September 2011, on EM 7263/11 on the proposal for a Directive on a Common Consolidated Corporate Tax Base (CCCTB). The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 29 November.

We welcome your comprehensive response to our questions on this document. We would however be grateful for further clarification in relation to a number of matters.

Your letter states that “The Government has undertaken work to analyze the implications for the UK of other Member States taking the proposal forward under enhanced cooperation.” What details can you give us about this analysis and its conclusions?

You state that the Government are engaging to ensure that tax proposals made by the Commission are discussed at EU 27 level, and continue to be subject to unanimity, in line with the EU Treaties. We urge you to continue in your efforts in this regard.

Your letter also states that the Government should listen to business which are supportive of the proposal and those which have concerns. What discussions have you had with UK businesses about the implications of the Commission’s proposals?

You update us on the current progress of negotiations. However, in our letter of 14 September we also asked how much support there is within Council for this proposal, and which other Member States have also expressed serious reservations about the substance of the proposal. We would be grateful if you could respond to this point.

We would also welcome further updates as negotiations progress. In the meantime we will continue to hold the document under scrutiny.

29 November 2011

CUSTOMS 2013 PROGRAMME (13884/11)

Letter from the Chairman to Chloe Smith MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memorandum 13884/11, from your predecessor Justine Greening, dated 17 September 2011, on a report on the midterm evaluation of the Customs 2013 Programme.

We note that the Government support the majority of the review’s recommendations, but we also recognise your concerns in relation to two recommendations: iv) to establish mechanisms to assist customs authorities in preventing, investigating and fighting illegal operations; and viii) to expand support to candidate countries and potential candidates (including non-participating countries). Bearing in mind the first of these concerns, what steps need to be taken to ensure that effective cooperation between law enforcement agencies and customs authorities can nonetheless occur? You state that you will continue to work to build support for the UK’s position. What do you understand to be the current position of other Member States in relation to these areas of concern? We would be particularly grateful for an update on developments in relation to the Schengen Area.

We have agreed to clear the document from scrutiny. However, we would be grateful to receive updates in relation to these points, and as and when further developments occur. We would be particularly interested to receive an update on the outcome of discussions at the Customs 2013 Management Committee on 28 November 2011.

18 October 2011
Letter from Chloe Smith MP to the Chairman

Thank you for your letter of 18 October on the midterm evaluation of the Customs 2013 Programme and the questions raised on customs cooperation and support for EU candidate countries and potential candidates.

Customs cooperation in criminal matters is an area of shared competence under the Treaty on the Functioning of the European Union. Effective cooperation in these matters is achieved through the Customs Cooperation Working Party (CCWP). The CCWP is a Council working group, formerly under the third pillar. It coordinates work under the law enforcement area of customs activities through two groups, plenary and experts. The plenary works towards an 18 month action plan of activities which centre on sharing best practice and enhancing cooperation between member states. The experts group focuses on operational cooperation mainly through Joint Customs Operations (JCOs).

The operational activities of the group are overseen by COSI (Standing Committee on Operational Cooperation on Internal Security) which ensures effective operational cooperation in this field as well as evaluating the general direction and efficiency of operational cooperation.

Funding for this area of customs cooperation is currently obtained through the ISEC programme, a DG Home administered funding programme which covers projects and actions under the banner of 'the Prevention of and Fight against Crime'. Member states’ customs administrations can also apply direct for funding to participate in activities in this area.

I note your comments on the Schengen Area. This is not an issue in terms of customs cooperation, as all member states participate on equal terms in the CCWP and operational activities of the action plan.

Turning to the question of the support provided to candidate and potential candidate countries, we support the involvement of candidate and potential candidate countries in the programme, as part of their progress towards EU Accession. In addition, we continue to provide assistance, primarily through the EU twinning programme, to enable these countries to meet the Acquis for EU Membership.

Our note of caution relates to any proposed increase in funding for the successor Programme, at a time of public spending restraint, to fund additional support to candidate and potential candidate countries. Equally we would be wary of any move to direct resources away from existing activities related to the development of e-Customs systems and the introduction of the Modernised Customs Code which may have an impact on revenue collection and UK trade interests.

We are aware that a number of member states share our concerns about a potential increase in the budget. Some Eastern Border Member States favour additional funding to enhance customs controls and cooperation on both sides of the border. This would be achieved through the funding of equipment such as scanners and technical assistance to the candidate countries.

As requested we will provide an update on the discussions and any information on the successor Programme following the Customs 2013 Committee Meeting on 28 November 2011.

16 November 2011

DEPOSIT GUARANTEE SCHEMES (12386/10)

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

I am writing to update you on progress on the Deposit Guarantee Schemes Directive (DGSD), following on from my letter of 26 May. The Committee cleared the Directive from scrutiny on 8 February.

On 17 June, a qualified majority was found in Council on the DGSD with Ambassadors agreeing a general approach at COREPER. On the basis of this agreement, the Polish Presidency will take forward negotiations with the European Parliament, with trialogues starting on 14 September.

This letter sets out the key points coming out of Council negotiations. The Government’s view is that negotiations on the Directive have come a long way since the Commission published its draft proposals, and the final agreement represents a significant achievement for the UK.
The key outstanding issue during negotiations has been the proposal to establish a harmonised pre-fund for deposit guarantee schemes. The Commission originally proposed that Member States build up a pre-fund of at least 1.5% of deposits by 2020. The Government opposed this on the grounds that it would place unreasonable burdens on industry. Our priority during negotiations has been to improve protection for depositors, whilst ensuring that the costs to the industry of funding schemes continues to be manageable and do not jeopardise the stability of the deposit-taking sector.

The Government is pleased to report that Member States agreed to reduce the size of the pre-fund to 0.5% of deposits. Along with the change to base funding on the amount of deposits covered by the scheme rather than the amount of deposits eligible for the scheme, the total cost to UK deposit takers is reduced by over two thirds. In return for accepting a pre-fund, the Government negotiated concessions that will reduce the burden on the deposit-taking sector and allow Member State discretion when levying industry to build up the fund.

These concessions include extending the amount of time that schemes have to build up the pre-fund from 2020 to 2027, thereby significantly lowering the annual cost. Member States will also have discretion over whether to adopt risk-based levies when building up the pre-fund, a key Government priority. The Government also secured a concession that will allow Member States the flexibility to vary annual levies to take account of financial stability and the existing liabilities on the scheme. This will allow the Financial Services Authority (FSA) to take account of the Financial Services Compensation Scheme’s (FSCS) legacy repayments resulting from the financial crisis when setting new levies to build up the pre-fund, and to ensure that the levies are manageable and do not jeopardise the stability of the sector.

The additional flexibility added to the funding proposal will greatly alleviate the impact of the proposals on industry. Final levies on FSCS members to build up the pre-fund will be set by the FSA and will be subject to consultation, but initial calculations suggest that if spread evenly, the annual costs of the pre-fund to deposit-takers would now be in the low hundreds of millions, as compared to well over £1 billion under the original Commission proposals. I hope that you will agree that this represents a greatly improved outcome for the UK. The final agreed funding package will be subject to negotiations with the European Parliament in trialogues.

With regard to the other main elements of the directive, as I set out in my letter of 26 May, Member States have agreed that non-eurozone Member States can convert the deposit coverage limit into national currencies and that the level can be rounded by up to €2,500 and reviewed every five years. This will ensure a clear and stable sterling coverage level for UK depositors. Member States also agreed to retain the 20 working days deadline for schemes to payout to depositors in the event of a bank failure rather than accept the Commission’s original proposal for a reduction to 7 days. However, this does not prevent the FSCS from maintaining its current aim of paying out to the majority of depositors within 7 days. Finally, in line with UK aims, the Commission’s requirements for schemes to lend to one another (“mutual borrowing”) have been deleted from the final Council text. The Government is content with this outcome.

I submitted an Explanatory Memorandum on 7 March (EM 6767/11) on the European Central Bank’s opinion document on the Directive. I can confirm that there has been no detailed discussion of the opinion in Council and there is therefore nothing significant to report in relation to this.

13 July 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letters on the recast of the Deposit Guarantee Scheme Directive (EM 12386/10) dated 26 May and 13 July 2011. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 13 September.

We are grateful for your updates on the progress made on the Directive by the Council, and we welcome your assurance that the proposal, as it currently stands, is in line with the UK’s aims.

We would welcome clarification on three separate points. First, does the £85,000 coverage limit provided by the FSCS apply to an unlimited number of different deposits per person? Secondly, does the FSCS cover National Savings and Investments deposits, or are these guaranteed separately by the Government? And, finally, under what circumstances, if any, might the Government become liable for any commitments of the FSCS, and how great might these liabilities be?

We would be grateful for continuing updates as negotiations with the European Parliament progress, and for a response to this letter within the standard ten working days.
Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 15 September on the Deposit Guarantee Schemes Directive (EM 12386/10).

You asked for clarification on three aspects of the Financial Services Compensation Scheme (FSCS). The FSCS deposit compensation limit of £85,000 applies per depositor, per authorised institution. Consumers are covered up to £85,000 for every account they hold with a separate authorised institution. If the consumer has a number of accounts with the same institution, their deposits will be aggregated and compensation will be paid up to the compensation limit.

You asked whether National Savings & Investment (NS&I) are covered by the FSCS. NS&I is both a government department and an Executive Agency of the Chancellor of the Exchequer. When customers invest in NS&I products, they are lending to the Government. In return, the Government pays interest, stock market linked returns or prizes for Premium Bonds. As customers are lending to the Government, HM Treasury offers 100% security on all deposits. Therefore, NS&I investments do not fall under the FSCS.

Finally, you asked whether the Government would ever become liable for FSCS commitments. If compensation payouts are larger than the FSCS’s immediate capacity, the Government can extend a loan to the FSCS from the National Loans Fund, as was the case with Bradford and Bingley and the Icelandic banks. The FSCS would then be liable to the Government for any funds borrowed, and would use its power to levy the financial services industry to raise the funds needed to allow repayment. The maximum amount the FSCS can levy is capped in any one financial year, therefore repayment may be spread over several years.

Trialogue negotiations between the Council and the European Parliament on the Directive started this month with further meetings expected in October. I will provide further updates to the Committee as negotiations progress.

29 September 2011

DRAFT AMENDING BUDGET NO 2 AND THE MOBILISATION OF THE EU SOLIDARITY FUND (8243/11, 8244/11)

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

I am writing to update you on negotiations of Draft Amending Budget No. 2 to the General Budget 2011 (DAB 2/11). You will recall that DAB 2/11 concerns the mobilisation of the European Union Solidarity Fund (EUSF) for EUR 19.5 million (£17.0 million) to provide aid in the wake of flood damage last year.

On 10 May 2011, I wrote to explain that the Government had succeeded in ensuring that DAB 2/11 would finance EUSF aid entirely via redeployments, rather than additional payments to the 2011 EU budget. The Council’s position on DAB 2/11 was subsequently considered by the European Parliament’s (EP) budget committee. On 24 May, the Council was informed that the EP had blocked DAB 2/11, owing to its preference to use new funds to mobilise the EUSF rather than undertake redeployments.

To resolve this situation, the Commission circulated a non-paper on alternative funding for DAB 2/11 earlier this month. Within the framework of budget implementation forecasts for 2011, the Commission identified EUR 352 million (£307 million) of under-spending in payment appropriations by year-end for energy projects to aid economic recovery, under the European Economic Recovery Plan (EERP). Of this amount, EUR 277 million (£242 million) is accounted for by operational implementation delays to seven energy networks projects: the remaining EUR 75 million (£65 million) owes to delays to the submission of payments requests this year. At present, the Commission considers that no EERP project is at risk of being abandoned and no de-commitments of EERP funds are anticipated. The Commission proposed to fund DAB 2/11 using part of this forecast under-spending on EERP projects, and invited the EP to consider amending DAB 2/11 accordingly.

In addition, the Commission also indicated that it intended, in parallel, to propose to use the remaining, forecast under-spending in EERP to:
— Replenish, as far as possible, the ‘negative reserve’, via a transfer. You will recall that EUR 182.4 million (£159.1 million) was put into the ‘negative reserve’ via Draft Amending Budget No. 1 to the General Budget 2011 (DAB 1/11), in order to finance the mobilisation of the EUSF for aid to Poland, Slovakia, the Czech Republic, Hungary, Croatia and Romania following heavy flooding last year.

— Reinforce the European Globalisation Adjustment Fund (EGF), for which only EUR 7.0 million (£6.1 million) in payments would remain available of EUR 47.6 million (£41.5 million) allocated in 2011, if all current applications are approved;

— Provide additional funds to manage migration and refugee flows, further to the recent developments in the Southern Mediterranean; and

— Transfer EUR 26 million (£23 million) within chapter 32 04 (Conventional and renewable energies), to cover additional needs for other programmes, notably for the Intelligent Energy – Europe programme.

The Commission’s non-paper was first discussed in Council’s budget committee on 14 June. The Government indicated its reluctance to reconsider Council’s position on DAB 2/11. While it could agree to the Commission’s proposal to fund DAB 2/11 via redeployments from EERP, the Government was not willing to do so as part of the wider set of redeployments envisaged by the Commission: aspects of the proposal not directly related to DAB 2/11 should be considered separately on their own merits. The Presidency committed to approach the EP to explore ways of resolving DAB 2/11 independently of other issues.

On 15 June the EP’s budget committee decided to amend DAB 2/11 to use underspend on energy projects to: i) fund EUSF aid totalling EUR 19.5 million (£17.0 million); ii) replenish the negative reserve by EUR 182.4 million (£159.1 million); and iii) reinforce the EGF by EUR 50 million (£44 million).

The EP’s position was unexpectedly put to Council’s budget committee on 16 June. The Government maintained its position that DAB 2/11 should be treated independently from other issues. However, many Member States were willing to accept the EP’s position and its amendments were approved by a qualified majority.

The substance of the EP’s amendments is not a serious concern to the Government. First, there is no increase in the overall level of payments to the 2011 EU budget, which remains capped at 2.91% above 2010 levels. Second, although the Government opposed use of the ‘negative reserve’ for DAB 1/11 in favour of immediate redeployments, replenishing the negative reserve, in effect, executes such redeployments early. However, the Government is not keen to encourage repeated use of the negative reserve in-year, as this would weaken incentives for the Commission to undertake accurate ex-ante programming. Finally, the Government has become concerned by the frequency of applications to the EGF and supports redeployments to fund future requests: a transfer to replenish the EGF is a roughly equivalent outcome. DAB 2/11 will now progress to COREPER and the European Council, but substantive discussions are not expected. The precise timetable is not yet clear.

Finally, I would like to update your Committee on other developments in Council’s budget committee last week:

— On 15 June, the Commission issued a proposal to draw down EUR 9.4 million (£8.2 million) from the EGF to fund two applications for support from Austria, relating to redundancies in its telecommunications and metals sectors owing the economic and financial crisis. An explanatory memorandum on this proposal will be deposited shortly. This proposal was approved in Council’s budget committee on 16 June: the Government has placed a scrutiny reserve. This proposal will progress to COREPER and the European Council, but substantive discussions are not expected. The precise timetable is not yet clear.

— On 17 June, the Commission released a Draft Amending Budget No. 4 to the General Budget 2011, relating to funding to manage migration and refugee flows. Again, an explanatory memorandum on this proposal will be deposited shortly. This proposal was discussed in Council’s budget committee on 21 June. Again, the Government has placed a scrutiny reserve.
Letter from Justine Greening MP, Economic Secretary, HM Treasury, to the Chairman


As you know, the Commission originally proposed an increase in EU spending for 2012 of 4.9% above 2011 levels. The Government stated from the start that, at a time of ongoing economic fragility in Europe and tight constraints on domestic public spending, a proposal at this level of growth was completely unacceptable.

In December last year, the Prime Minister’s joint letter on future EU budgets set out a responsible plan to deliver budgetary restraint at EU level, in order to reflect Member States’ efforts to consolidate public finances domestically. This letter made clear that growth in EU spending in 2012 should be lower than the 2.91% cap the Government successfully imposed on EU spending in 2011. This remains our goal for a final outcome on the 2012 EU budget following conciliation negotiations with the European Parliament (EP) later this year.

To deliver this, the Government worked hard to foster a strong, broad alliance for EU budget discipline in 2012, aiming for a position in Council that kept the growth of payments to below forecast EU inflation in 2012. At ECOFIN in May, the Government supported a number of other Member States who made clear that the 2012 EU budget should be held at inflation. We continued to make the case for significant savings throughout technical discussions on the 2012 EU budget in Council’s budget committee, focusing on the need to reduce waste and inefficiency, and ensure that EU spending delivers high added-value across all areas of the EU budget.

On 1 July, Council’s budget committee agreed, by a qualified majority, amendments to the 2012 EU budget that limit growth in EU spending in 2012 to 2.02% on 2011 levels, putting total EU spending at EUR 129.1bn. This is less than half the 4.9% increase in EU spending proposed by the Commission, delivering savings of EUR 3.65bn in payments and driving spending plans further below the ceilings for 2012 set out in the current Financial Framework. On commitments, Council agreed to cuts that limit growth to 2.9% on 2011 levels, compared to 3.7% growth in the original draft 2012 EU budget, thereby saving EUR 1.59bn.

The revised proposal in Council takes a significant step towards reflecting ongoing economic fragility in Europe and tight constraints on domestic public spending in many Member States. It is also a stronger position than Council adopted at the same stage of negotiations on the 2011 EU budget, which provides a good platform to deliver a better outcome on the 2012 EU budget, as called for by the Government in its joint letter last December.

The Government, however, has not supported the proposal, because it believes that further savings can and should have been made. This is also consistent with the parliamentary scrutiny reserve in place on this dossier. We would have preferred a Council position that capped spending below rather than at EU inflation in 2012, which is currently forecast at 2.0%, in order to establish an even stronger basis for negotiations with the EP later this year. Five other Member States also refused to support the deal on similar grounds, but this was not sufficient to block the proposal. As you may have seen, the detail on the vote on 1 July has been reported on in the European press.

While the proposal has not yet been formally adopted, it will go to COREPER on 7 July and is expected to be adopted by Council later this month. The European Parliament will adopt its position on the 2012 EU budget and negotiations on a final deal between Council and the EP will occur in the autumn this year. We will continue to work with others to get the very best deal possible for UK taxpayers in future negotiations on the 2012 EU budget.

6 July 2011
Letter from the Chairman to Justine Greening MP

Thank you for your letter of 6 July on the draft EU Budget 2012. The EU Economic and Financial Affairs and International Trade Sub-Committee considered it at its meeting on 19 July.

We note the Council’s position agreeing a 2.02% increase in the EU Budget 2012 leading into negotiations with the European Parliament. Do you believe that other Member States will be willing to negotiate upwards from that position, or will the Council act in a similar manner to last year and refuse to move from a position that is already, in effect, a compromise position between Member States? We hope that this represents an upper limit beyond which the Council is not prepared to go.

We would appreciate further updates as negotiations with the European Parliament progress.

19 July 2011

Letter from Justine Greening MP to the Chairman

Thank you for your letter of 16 July on the draft 2012 EU budget. In relation to the position adopted by Council on EU spending in 2012, namely a cap of 2.02% above 2011 levels, you ask whether this represents an upper limit beyond which Council is not prepared to go.

As I mentioned in my previous letter, Council’s position was agreed at COREPER on 7 July. The UK, the Netherlands, Sweden, Denmark, Austria and Finland voted against the proposal, but did not form a blocking minority. Council’s position was formally adopted by a written procedure on 25 July, with no change to voting positions.

At COREPER the following statement, put forward by the UK, was supported by France, Germany, the Netherlands, Sweden, Austria, Denmark and Finland: ‘The 2012 EU Budget is being agreed at a time of considerable austerity in domestic budgets. As such, the Budget must rise by no more than inflation.’ This equates to a blocking minority in Council against any increase in EU spending above a real freeze. As EU inflation in 2012 is currently forecast at 2.0%, this also amounts to a broad coalition to hold firm at Council’s current position in future negotiations with the EP.

Of course, I cannot predict with certainty the outcome of future negotiations with the European Parliament on the 2012 EU budget, especially while economic conditions in the Eurozone remain volatile. I am certain, however, that the Government is doing all that it can not to concede extra spending to the European Parliament later in the year. We continue to aim to deliver the best possible final outcome on the 2012 EU budget, consistent with the terms of the December letter last year.

Of course, I will keep your Committee updated as negotiations progress in the autumn.

2 August 2011

Letter from the Chairman to Justine Greening MP

Thank you for your letters, dated 16 July and 2 August, on the EU Budget 2012. The Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 13 September.

We welcome your letter identifying more specifically which efficiency savings the Government is seeking in the EU Budget. We note, however, that these are all administrative savings. Given that administration makes up a relatively small proportion on the EU Budget, we urge you to look more closely at possible efficiencies in other spending areas where other savings might be found.

In addition, we would be grateful if you could provide practical examples of where the Government has sought and obtained efficiency savings in the EU Budget over the past year, given your experience of negotiating the EU Budget 2011.

In the meantime, we continue to support your efforts to ensure the EU Budget 2012 rises no more than the rate of inflation.

14 September 2011

Letter from Justine Greening MP to the Chairman

Thank you for your letter of 14 September on the 2012 EU Budget, in which you requested further information on efficiency savings relating to EU spending.
In the UK domestic context, the term 'efficiency savings' refers to reducing central Government’s operational expenditure, especially by cutting waste and reducing spending on low priority areas, in order to free up funds for use in frontline activities. For example, one target for efficiency savings is central departments’ running costs, which can be tackled via more efficient procurement, reducing marketing spending and the use of consultants, rationalising the Government’s property estate and freezing recruitment.

Applying this standard definition of ‘efficiency savings’ to EU spending naturally focuses attention on EU administrative spending, which is why my previous letter dealt primarily with savings secured in this area. In the context of the draft 2012 EU budget, further specific examples include: cuts to expenditure on administrative management of programmes totalling EUR 0.6 million under Heading 3a (Freedom, Security and Justice) and over EUR 18 million under Heading 4 (EU as a Global Player).

As you are aware, the UK Government’s top priority is to limit the size of the EU budget, including by reducing spending on low priority, low added-value areas of EU spending. During negotiations on the 2011 EU budget last year, the Government limited growth in payments to the EU budget in 2011 to 2.91% rather than 6%, saving the UK around £350 million.

Building on this, the Government has successfully worked with other Member States this year to agree cuts to the Commission’s draft 2012 EU budget totalling EUR 3.65bn in payments appropriations, as part of Council’s position reached in July this year. Again, the Government has sought to target such cuts on low priority spending across all EU budget headings. In particular, the Council has agreed cuts of EUR 1.3 billion to Heading 1b (Cohesion for Growth and Employment) and over EUR 0.8 billion to Heading 2 (Preservation and Management of Natural Resources), where the Government believes there is serious cause for concern about EU added-value and accurate financial programming by the Commission. Notwithstanding future negotiations with the European Parliament to reach a final deal on EU spending in 2012, the outcomes should deliver yet further efficiency savings.

I trust that this offers suitable clarification of the Government’s pursuit of efficiency savings at EU level to conclude discussion of this matter.

28 September 2011

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

The formal conciliation period on the draft 2012 EU budget started on 1 November and will finish on the 21 November. During this time, the Council and European Parliament (EP) will aim to agree a final deal on EU spending for next year. These negotiations will focus on two conciliation meetings: the first on 8 November and the second on 18 November (Budget ECOFIN). I shall attend the latter meeting.

At this stage, I am writing to update you and your Committee on negotiations on the draft 2012 EU budget to date, focusing on the Council and EP’s overall positions and recent amendments to its original draft proposed by the Commission.

COUNCIL’S POSITION

In early July, Council’s budget committee agreed, by a qualified majority, amendments to the 2012 EU budget to limit growth in EU spending in 2012 to 2.02% above 2011 levels, implying total EU spending at EUR 129.1bn. This is less than half the 4.9% increase in EU spending proposed by the Commission, delivering savings of EUR 3.65bn in payments. On commitments, Council agreed to cuts that limit growth to 2.9% above 2011 levels, compared to 3.7% growth in the original draft 2012 EU budget, thereby saving EUR 1.59bn.

A brief overview of major changes is below:

— Heading 1a (Competitiveness for Growth and Employment): Council cut commitments by EUR 696m, of which EUR 650m results from removing commitments for ITER until an agreement on a funding solution for its current shortfall over 2012-13 is agreed. Council cut payments by EUR 1.13bn, distributed as follows: EUR 563m in the field of research; EUR 99m million from competitiveness; EUR 147m on budget lines related to the European economic recovery plan; and EUR 102m from transport.
— **Heading 1b (Cohesion for growth and employment):** There was no change in commitments. However, Council cut payments by EUR 1.3bn. These cuts were concentrated in the field of the European Regional Development Fund (EUR 706m), the European Social Fund (EUR 394m) and the Cohesion Fund (EUR 199m).

— **Heading 2 (Preservation and Management of Natural Resources):** Council cut commitments by EUR 546m, including: EUR 198m in the field of agriculture; EUR 338m on the budget line for clearance of accounts; and EUR 10m on various other budget lines. Payments were cut by EUR 787m, of which the largest cuts were: EUR 338m on clearance of accounts; EUR 230m in the field of agriculture; EUR 140m in the field of Rural Development; and EUR 47m on the European Fisheries Fund.

— **Heading 3a (Citizenship, Freedom, Security and Justice):** Council cut commitments by EUR 56m. Payments were cut by EUR 44 million, focusing on cuts to the External Borders Fund, the prevention of and fight against crime, and agencies.

— **Heading 3b (Citizenship):** Council cut commitments by EUR 16m. Payments were cut by EUR 15m, targeting cuts on agencies, multimedia actions and civil protection within the EU.

— **Heading 4 (EU as a Global Player):** Council cut commitments by EUR 204m and payments by EUR 300m, of which the largest cut was EUR 110m to the Emergency Aid Reserve. Council’s position also accepted Amending Letter No. 1 to the Draft Budget 2012 (AL 1/2012), relating to the EU’s response to the Arab Spring, but agreed to finance it fully under the current ceilings for Heading 4 via additional redeployments.

— **Heading 5 (Administration):** Council agreed an additional EUR 74m of efficiency savings, reducing total growth in 2012 from 1.3% to 0.5%. This delivers a saving of EUR 546m compared to the level of administrative spending pre-programmed in the current Financial Framework. To demonstrate leadership, the Council agreed to cut its own administrative budget by 5.45% in 2012, by finding efficiencies in discretionary areas of spending, such as interpretation and travel costs.

Council’s position was formally adopted by a written procedure on 25 July. The UK, the Netherlands, Sweden, Denmark, Austria and Finland voted against the proposal, but did not form a blocking minority. The Government opposed the position, because it felt that further savings were available at that stage.

**EUROPEAN PARLIAMENT’S POSITION**

On 26 October, the EP voted at plenary on its amendments to the Council’s position. It called for an increase of 5.23% in payments above 2011 levels and 3.95% in commitments. This means that the EP is demanding an EU budget in 2012 of over EUR 133bn, which is an increase of more than EUR 6.6bn on 2011, EUR 4.0bn above Council’s position and even EUR 0.4bn above the Commission’s proposal.

The EP has sought to reverse the vast majority of cuts agreed in Council, thereby restoring the Commission’s original proposal. In particular, the following changes are noteworthy:

— **Heading 1a (Competitiveness for Growth and Employment):** The EP proposed reinforcements to budget lines relating to the EU2020 growth strategy, which would require mobilisation of the Flexibility instrument by roughly EUR 31m, as total commitments would exceed the relevant ceiling in the Financial Framework.

— **Heading 2 (Preservation and Management of Natural Resources):** The EP proposed an extra EUR 250m of funds for fruit and vegetable producers.

— **Heading 3a (Citizenship, Freedom, Security and Justice):** An increase (in reserve) of EUR 25m to the EU border agency Frontex, in order to manage maritime borders in the Mediterranean.
— **Heading 4 (EU as a Global Player):** To accommodate funding for AL 1/2012, the EP proposed to mobilise the Flexibility Instrument for EUR 209m, as total commitments would exceed the relevant ceiling of the Financial Framework.

— **Heading 5 (Administration):** While reversing most of Council's cuts, the EP reduced the increase in its own budget in 2012 to 1.9% above 2011, mainly by cutting translation and interpretation costs and travel expenditure.

In such challenging economic and fiscal conditions, high growth in the EU budget is both unaffordable and out of kilter with consolidation efforts in many Member States. So it is very disappointing that the EP wants the EU to spend more than even the Commission had proposed. Furthermore, the EP's position would increase UK contributions to the 2012 EU budget by £500m compared to the Council's position: this is unacceptable to the Government and UK taxpayers.

**AMENDING LETTERS**

The Commission has issued two further amending letters to its draft 2012 EU budget, neither of which is incorporated in the Council's or EP's current positions yet. Amending Letter No. 2 to the Draft Budget 2012 proposes to integrate the budgetary implications of Croatia's accession into the EU's administrative expenditure. Further details are set out in Explanatory Memorandum (EM) 14327/11, submitted on 7 October. As noted in that EM, the Government cannot accept any additional funding for Croatian accession, and believes that new staffing and administrative requirements should be met through redeployments in Heading 5.

Amending Letter No. 3 to the Draft Budget 2012 (AL3/2012) concerns updates for estimated needs for agricultural expenditure, reflecting changing market factors, revised estimates of needs for some direct payments, and legislative decisions this year, which are expected to affect this policy area next year. It also updates on the situation for International Fisheries Agreements. The net budgetary impact of AL3/2012 are reductions in commitments of EUR 86m and in payments of EUR 83m compared to the Commission's original draft 2012 EU budget. The Government is broadly content with these changes. Further details will be set out in an EM, which will be submitted shortly.

The Council's position on these amending letters will be finalised as part of conciliation negotiations with the European Parliament later this month.

**CONCILIATION NEGOTIATIONS**

As usual, there is some distance between the Council and EP's positions on the draft 2012 EU budget. This is a result of both the significant steps Council took to limit EU spending, reflecting both the UK's and many other Member States' resolve to deliver real budgetary restraint at EU level, but also the EP's unwillingness to adapt EU spending to ongoing economic fragility and tight constraints on domestic public spending across Europe.

Looking ahead, it is impossible to predict with certainty the outcome of conciliation, which is subject to qualified majority voting in Council. The EP and Council are still formulating their approaches to these negotiations. These will become clearer in time, largely through the process of negotiation itself, and I will ensure that your Committee receives timely updates.

Finally, I am confident that the Government is doing all that it can to cement a strong alliance of budget-disciplined Member States, in order to deliver the best possible final outcome on the 2012 EU budget, consistent with the terms of the December letter last year.

3 November 2011

**DRAFT EU BUDGET 2012 (14327/11)**

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

Thank you for the Explanatory Memorandum from Justine Greening, dated 7 October 2011, on EM 14327/11 on Amending Letter No. 2 to the Draft General Budget 2012. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 8 November.
The Committee concur with the Government’s support for EU enlargement, and welcome the future accession of Croatia. Notwithstanding this, we acknowledge the Government’s concerns regarding the rationale for additional funds, and your consequent unwillingness to accept any additional funding for Croatian accession. What have the Commission proposed, and what view have the Government taken, in relation to previous cases of national accession? We note that the Commission explains that it was not possible to include these requests in the original draft budget because accession negotiations were only closed in June. Should any additional expenditure arising from Croatia’s accession not have been anticipated in the original draft budget?

You state that the Government are aiming to secure proper justification for new spending. Of the proposed additions, which cause you most concern? You also state that new staffing and administrative requirements should be met through redeployments in Heading 5. We would be grateful to know the views of other Member States to this proposal for increased expenditure.

We would be grateful if you could provide us with a response to these questions within the standard ten working days. In the meantime we have agreed to continue to hold this document under scrutiny.

8 November 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 8 November in which you requested further information on Amending Letter No. 2 to the draft 2012 EU budget (AL2/2012).

In relation to past national accessions, the previous enlargement involved Bulgaria and Romania in 2007. At that time, a package of accession aid was provided for these countries, including additional administrative expenditure, notably for increased interpretation and translation needs.

Of course, equitable treatment of nations acceding to the EU is important. To clarify, I do not dispute that some financial provision for administrative costs relating to Croatian accession is appropriate. However, I believe that any such provision must be minimised by making the most effective and efficient use of existing resources, including human resources, and funded by redeployments from other areas of EU administrative spending, without increasing the 2012 EU budget overall.

The Government is not convinced that extra funds at the level proposed in AL2/2012 are necessary. The EU institutions have already commenced preparatory work for Croatian accession this year, for which existing staff and financial resources were allocated. I believe it is possible to undertake further reallocations of existing resources, especially staff, by more strictly prioritising policy work, reducing duplicative activities such as some audit functions, streamlining administrative processes and cutting levels of support staff, especially for senior EU officials. Of the proposed additions, extra funds for the European Parliament and the Commission cause most concern. These are large institutions with sizable budgets, which are most able to absorb additional responsibilities via redeployments and rationalising activities.

The Government agrees that it was possible to anticipate Croatia’s forthcoming accession at the time when the original draft 2012 EU budget was compiled. The Commission argued that it would not have been appropriate to budget for the full costs at that time, as negotiations with Croatia had not yet concluded.

The first discussion on AL2/2012 took place in Council’s Budget Committee on 21 September. The concerns raised by the UK, including the importance of using redeployments to meet provisions for Croatian accession, were widely shared. This reflected ongoing cooperation between the UK and like-minded Member States to limit, as far as possible, increases to EU spending under Heading 5 (Administration) in 2012.

As I mentioned in my letter of 3 November, the Council’s position on AL2/2012 will be finalised as part of conciliation negotiations. To date, a final position on AL2/2012 has not been agreed. Conciliation is expected to conclude at ECOFIN-Budget on 18 November, where the Government will take a position on the 2012 EU budget as a whole. I regret that it has not been possible to finalise the scrutiny process on AL2/2012 in advance of this meeting. I hope, however, that you and your Committee will understand that, depending on the outcome of negotiations tomorrow, the Government might need to support a final deal on the 2012 EU budget, incorporating AL2/2012. Of course, I will inform you of the outcome of ECOFIN-Budget as soon as possible.

17 November 2011
Letter from Justine Greening MP, Economic Secretary, HM Treasury, to the Chairman

On 28 June, I gave evidence on the Draft General Budget for 2012 (2012 EU budget) to the Lords EU Economic and Financial Affairs and International Trade Sub-Committee. During this session, I agreed to write to the Committee about efficiency savings the Government has recently identified in the EU budget.

The Government’s primary lever to deliver efficiency savings at EU level is negotiation of the EU’s annual budget. As the Committee is aware, the Government has adopted a tough stance on budget discipline at EU level both this year and last. This approach has involved a concerted effort to reduce waste and inefficiency in EU spending, especially administrative costs, and ensure it delivers high added-value.

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

To some extent, the Commission has responded this year. While the Commission was compiling its draft 2012 EU budget, Commissioner Lewandowski wrote to all EU institutions and agencies asking that they limit bids for funds in 2012 to at most 1% above 2011 levels. In the draft 2012 EU budget, the Commission proposed to freeze its own administrative budget and is maintaining its commitment to zero growth in its staff numbers. This demonstrates the impact of the Government’s lobbying to reduce administrative expenditure.

We have continued to push for further savings during negotiations in Council and built a strong coalition of other budget-disciplined Member States in support. As a result, Council has agreed an additional EUR 73.7 million of efficiency savings in Heading 5 (Administration), which reduces total growth in 2012 from 1.3% to 0.5%. This delivers a saving of EUR 546 million compared to the level of administrative spending preprogrammed in the current Financial Framework. To demonstrate leadership, the Council will cut its own administrative budget by 5.45% in 2012, by finding efficiencies in discretionary areas of spending, such as interpretation and travel costs.

The Council also tackled administrative spending within programmes under different headings of the EU budget: for example, Council has agreed efficiency savings totalling EUR 45.9 million in Heading 1a (Competitiveness for Growth and Employment), and cut EUR 40.1 million from EU decentralised agencies’ budgets in 2012. Finally, Council’s position includes a statement on administrative expenditure that reiterates the importance of keeping such spending under firm control and invites all institutions and bodies to contribute to these objectives.

The Government believes that even further efficiency savings are available in administrative expenditure, including by: redeploying staff rather than recruiting new staff; recruiting at lower grades; toughening up the appraisals procedure, so that less staff are eligible for biannual salary step adjustments; limiting the scope of buildings upgrade projects; renegotiating procurement contracts that come up for renewal in 2012; and reducing discretionary expenditure such as that for office supplies and equipment, travel expenditure and publications, and removing over-budgeting on lines that under-spent in 2010. We will continue to maintain pressure for efficiency savings in further negotiations on the 2012 EU budget.

As I noted in the evidence session, the Government is already setting the agenda to deliver efficiency savings over the longer term, via its approach to reform of the Staff Regulations, for example. EU officials’ pay, pensions and allowances make up more than 60% of the EU’s administrative spending and are underpinned by the Staff Regulations. The Government has set out proposals for an ambitious and wide-ranging review of EU officials’ pay and conditions in a recent paper addressed to the Commission, acting in concert with 11 other Member States. This paper states that the EU institutions cannot be exempt from the very tough budget decisions being taken in light of the fiscal consolidation happening right across Europe. This means very substantial reductions in administrative spending over the next Multi-annual Financial Framework are required, as well as modernisation and reform of the EU institutions to create more effective and dynamic institutions.

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

I am writing to update you on the status of the WTO waiver request for the Emergency Autonomous Trade Preferences for Pakistan.

As you will be aware, The UK has actively lobbied at official and Ministerial level for agreement to the package both internally within the EU and in the WTO so as to obtain a waiver. MEPs have approved the proposal albeit with a number of proposed amendments. However, before final approval can be given by the EU a waiver needs to be agreed unanimously in the WTO. Currently the waiver request remains blocked in the WTO by a small number of countries including India, a state of affairs which has been the case since November.

Due to the short-term and humanitarian nature of these measures it is not feasible that they remain under discussion indefinitely. Therefore, the Commission reported at the Trade Policy Committee meeting on 17 June that following a lack of agreement in the WTO it was stopping any further consultations. The UK Government accepts this decision.

The UK remains committed to championing greater market access for Pakistan in the EU. In May 2011, the Commission tabled a proposal to revise the EU’s Generalised System of Preferences Plus (GSP+) scheme that would, amongst other things, increase the vulnerability criteria of GSP+ to allow additional vulnerable countries, including Pakistan, to become eligible, provided they meet the human rights criteria. The UK Government supports this aspect of that proposal and will be seeking to ensure it is agreed by the European Council and European Parliament.

27 June 2011

ENERGY TAXATION DIRECTIVE (9267/11, 9270/11)

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

Thank you for your Explanatory Memorandum 9267/11 & 9270/11, dated 10 June, on a Commission proposal for a revision on the Energy Taxation Directive. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 4 October.

The Committee has considered the objections raised in your Explanatory Memorandum to the proposal on the grounds that it exceeds its legal basis and breaches the principle of subsidiarity. These objections are based on the proposition that the functioning of the internal market does not require national taxation on energy products to be structured on the basis of two distinct elements, namely their CO2 emissions and their energy values. We do not consider that such arguments will prevail taking account of the following:

— The proposal is firmly linked to existing EU legislation in that it amends the existing Energy Taxation Directive and does so with the objective of ensuring consistency with existing environmental legislation;

— The Government’s view, with which we agree, is that minimum rates of taxation for energy products, which remains a substantive objective of the proposal, promotes the effective functioning of the internal market;

— We further consider there to be sufficient internal market justification for the EU to be able to pursue, within a broader framework for energy taxation, the objectives of avoiding distortions to the internal market that could arise from diversity of national taxation on CO2 emissions, and also promoting fiscal neutrality as between energy products - even when this concerns taxation above the minimum level; and

— To prescribe the calculation of tax on energy products on the basis of their CO2 emissions and energy values is a legitimate policy choice to achieve all these internal market objectives. The fact that there is also a strong environmental motivation does not alter the position because the TFEU integrates environmental protection requirements into all other EU policies, including the internal market.
We note that your EM states that the EU framework for energy taxes should “take account of the environmental impact of different fuels”. To what extent does the current ETD do so?

What impact might the Commission’s proposed double tax base have on the relative prices of different fuels in the UK? Which fuels would be likely to be most affected?

We note that you raise concerns about the effect of this proposal on the Government’s proposed carbon price floor for electricity generation, which aims to encourage carbon emitters to invest in low-carbon technologies and change consumer spending patterns. Would this not also be the result of the Commission’s proposal to tax the carbon emissions of energy products separately from the energy content? We note that concerns have been raised that the Government’s carbon price floor will impact negatively on UK industries since other European countries will not be implementing similar schemes. If the Commission’s proposal were to be implemented, would it not have a similar effect (properly taxing the negative externalities of carbon emissions) but without subjecting UK companies to increased costs compared to their European competitors?

The Commission proposal would remove an existing differentiation between business and non-business use of electricity and of the energy products for heating, as well as a differentiation between commercial use of diesel as a motor fuel and non-commercial use. What impact might these changes have on the competitiveness of UK businesses in relation to the wider global economy? How does the Government reconcile provisions such as these, which will negatively impact on the competitiveness of EU companies, with the need to support and encourage the UK’s manufacturing base?

We would be interested to know what the reaction of other Member States to this proposal has been. Do other Member States share the Government’s concern over the subsidiarity and proportionality of this proposal? To what extent is it likely that a smaller group of Member States might seek to take it forward through enhanced cooperation if agreement at the level of the EU27 proves difficult?

5 October 2011

EU FINANCIAL STABILISATION MECHANISM (14331/11, 14332/11)

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

Thank you for your Explanatory Memorandum 14331/11 and 14332/11, dated 3 October 2011, on proposals for a Council Implementing Decision amending Implementing Decision 2011/77/EU on granting Union financial assistance to Ireland, and for a Council Implementing Decision amending Implementing Decision 2011/344/EU on granting Union financial assistance to Portugal. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 11 October 2011.

I am writing to advise you that we have agreed to clear the document from scrutiny.

11 October 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 your letter, dated 19 May, on an EU framework for crisis management in the financial sector. The EU Economic and Financial Affairs and International Trade Sub-Committee considered it at its meeting on 7 June.

We recognise that formal legislative proposals on this subject are likely to be published in the next few months. In the meantime, we would appreciate updates on any progress made in discussions, especially with regard to the implications of the inclusion in the proposal of a debt write down tool (also called a bail-in) and the extent to which the use of such tools is contemplated by the work of the Financial Stability Board.

In addition, we recognise that crisis situations often require speedy responses from governments. Is the Government satisfied that the European authorities such as the EBA can move fast enough in the crisis situations envisaged by this Communication? Should the ECB have a role?
Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 8 June 2011 concerning the European Commission’s proposed debt write-down tool (commonly referred to as ‘bail-in’) and the role of European authorities in a crisis in the EU Framework for crisis management.

As you note, the publication of the legislative proposal on the EU crisis management framework has been delayed from June and is now likely to be in the autumn 2011. The Government believes that it is essential that all Member States have a credible toolkit to avert or manage a crisis to reduce the cost of bank failure and ensure creditors bear the losses, not the taxpayer. My officials have been engaging closely with the Commission in regards to the detailed provisions of the framework.

At this stage there is nothing new on the inclusion in the proposal of a debt write down tool in the EU crisis management framework, or the extent to which the use of such tools is contemplated by the work of the Financial Stability Board (FSB).

I believe the Committee shares our views that it is vital that resolution authorities have effective tools to manage the distress or failure of a financial institution. It is also crucial to ensure that any new powers do not have unintended consequences that could damage market confidence or undermine financial stability. We believe bail-in is a key element in the crisis management framework to improve market discipline, forcing creditors to bear losses. This should mitigate the impact of bank failure on taxpayers. The Independent Commission on Banking has also reported favourably on bail-in in its interim report published in April.

As noted in the G20 April 2011 Communique, the FSB will publish its recommendations on SIFI loss absorbency and resolution, including some early findings on bail-in, for public consultation during summer 2011.

Separately, you also asked about the Government’s view of the role and response time of the European Banking Authority (EBA), and the role of the European Central Bank (ECB), during a crisis.

The Government is of the view that EBA should not have a role in resolution during a crisis as EBA cannot take decisions that impinge on Member States’ fiscal responsibilities. This will ensure that national governments retain their frontline responsibility to protect national taxpayer interests and national regulators for supervision.

Should EBA be provided with competence over the resolution authorities, this would represent a broad extension to the scope of its power, and risk legal challenge. As national competent authorities retain responsibility for resolution, this will help ensure a swift and effective response in the event of a crisis.

However, the Government does envisage that the EBA will play a positive role in the crisis management framework, facilitating quick reactions by the national competent authorities. We believe that they will add value in the preparation and prevention elements of the framework by ensuring the supervisory quality of a firm by issuing guidance to establish consistent, efficient and effective supervisory practices, undertaking peer reviews and facilitating cooperation amongst supervisors.

Central banks, including the ECB, may play a role in a crisis via the provision of euro liquidity against eligible collateral under published terms, but this is not to be pre-determined by any legislation or ex-ante agreements and should be done on a case-by-case basis. As with the EBA, the ECB cannot take decisions that impinge on Member States’ fiscal responsibilities; therefore we do not think the ECB should have a role in resolution mediation.

I will of course keep the Committee updated as negotiations progress.

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 20 June, on EM 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 this document at its meeting on 19 July.

We appreciate your comprehensive reply. We have previously cleared this document from scrutiny, and we will defer any further consideration of this subject until firm legislative proposals are published in the autumn.
EU INVESTMENT POLICY: TOWARDS A COMPREHENSIVE EUROPEAN INTERNATIONAL INVESTMENT POLICY (11953/10, 11952/10)

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

Thank you for your letter of 13 October 2010 regarding the above proposal. I apologise for not writing sooner, this is due to the continuous changes to the European Parliament's timetable. I am now in a position to provide you with an update on the progress of this Regulation.

As mentioned in my explanatory memorandum, my concerns on this regulation, are centred on the scope of the powers the draft Regulation would give the Commission to remove authorisation to maintain in force existing bilateral agreements, and in particular the fact that this would threaten the legal security investors enjoy under existing agreements. The Committee supported my position that existing agreements should only be removed once new EU level agreements are in place and provide investors with at least the same level of protection.

I have actively advanced this view in Europe to build consensus amongst Member States and to explain our position to the Commission. On 25 October 2010, this was reflected in Council conclusions, which stated: “In accordance with Article 351 of the Treaty on the Functioning of the European Union, bilateral investment agreements concluded by Member States should continue to afford protection and legal security to investors till they are replaced by at least equally effective EU agreements.”

In the European Parliament, the International Trade (INTA) Committee’s initial report was less favourable, with Rapporteur Schlyter (Green, Sweden) proposing amendments that would have caused all Member State IPPAs to lapse after eight years. These amendments were opposed by other parties, including the EPP, ECR and ALDE. On 12 April INTA voted by 15 votes to 13 in favour of the regulation with a number of compromise amendments. On 10 May, these amendments were endorsed by the plenary of the European Parliament, with 345 votes in favour, 246 votes against and 16 abstentions (see attached document). These amendments, whilst a step in the right direction compared to both the Commission’s initial proposal and Schlyter’s first report, still fall significantly short of satisfying the UK’s concerns and the Council Conclusions of 25 October.

The Council must now respond to this and we are in the progress of agreeing a Council negotiating position, in order to reach agreement with the European Parliament at Second Reading. We will be clear that the UK is ready and willing to support the Hungarian Presidency in discussions with the Parliament, although we are not prepared to accept an agreement at any cost.

8 June 2011

Letter from the Chairman to Edward Davey MP

Thank you for your letter, dated 8 June, on EM 11953/10 on a draft Regulation establishing transitional arrangements for bilateral investment agreements between Member States and third countries. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 19 July.

We fully support your desire to ensure that existing bilateral agreements are not withdrawn unless they are replaced by EU agreements which offer the same level of protection. The European Parliament’s position, while an improvement on the Commission’s original text, still allows for the possibility that an EU level agreement offering less protection could replace a more favourable bilateral agreement.

In addition, the suggestion that the Commission should review all 1600 existing bilateral investment agreements is redundant if the principle that they should only be terminated if replaced by equivalent EU level investment agreements is adhered to.

We note that the European Parliament’s text proposes that the Commission may review existing bilateral agreements to determine whether they constitute an “obstacle” to the conclusion of future EU investment agreements. Has there been any clarification of what might constitute an ‘obstacle’?

We would welcome further updates as negotiations on this proposal progress. In the meantime, we will continue to hold this item under scrutiny.
Letter from Edward Davey MP to the Chairman

Thank you for your letter dated 19 July 2011.

I am now in a position to provide you with an update on the progress of this Regulation.

Member State delegations have given broad support to a compromise proposal from the Presidency which reflects the UK’s concerns, as set out in my previous correspondence and my Explanatory Memorandum. COREPER has mandated the Presidency on this basis to embark on trilogue discussions between the Council (represented by the Presidency), Commission and European Parliament. These trilogue discussions have now started with the aim of reaching an early Second Reading agreement.

The trilogue discussions are at an early stage, and there has been no clarification as yet of how the European Parliament sees existing agreements a third country might constitute a ‘serious obstacle’ to the conclusion of future agreements with that country. I will however keep you updated as progress is made.

26 September 2011

Letter from the Chairman to Edward Davey MP

Thank you for your letter, dated 26 September 2011, providing an update on EM 11953/10 on a draft Regulation establishing transitional arrangements for bilateral investment agreements between Member States and third countries.

We are grateful for the update on the progress of trilogue discussions, and would welcome further updates as progress is made, including clarification of what the European Parliament consider might constitute an “obstacle”. In the meantime, we will continue to hold this document under scrutiny.

8 November 2011

EUROPEAN GLOBALISATION ADJUSTMENT FUND (11967/11)

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

I am writing briefly to update you on EM 11967/11 regarding the Commission’s application for technical assistance funds from the European Globalisation Adjustment Fund (EGF), which remains under scrutiny. This dossier went to COREPER on 14 July and to the General Affairs Council on 18 July, where the Government abstained, in order to indicate that it did not agree to the substance of the proposals and also due to the dossier remaining under scrutiny.

28 September 2011

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

Thank you for your letter to Justine Greening MP of 11 October regarding Explanatory Memorandum 11967/11 on the European Globalisation Adjustment Fund (EGF) and the application for technical assistance at the initiative of the Commission, and regarding scrutiny of proposals on EU budgetary matters (this referenced EM 12122/11 but actually refers to EM 11967/11). As the Treasury Minister now responsible for the EU budget, I am writing in response to the issues you raised.

Regarding the EGF application for technical assistance at the initiative of the Commission, this was adopted at the General Affairs Council on 18 July, under qualified majority voting (QMV), although the Government abstained. As this is a co-decision dossier, it then went to the European Parliament, who agreed the proposal on 14 September.

The Government’s concerns regarding this application were as noted in the Government’s Explanatory Memorandum of 8 July, and which the UK raised at working group level. Although the Government welcomes attempts to improve performance monitoring and transparency of the EGF and to share information and best practice on the programme, the Government believes that much of the proposed expenditure represents poor value for money. For example, it is not clear why it necessary to spend €70,000 to hold two meetings of the Expert Group of Contact Persons of the
EGF (with one representative from each Member State), as well as €200,000 to share best practice of EGF implementation among Member States. The Government is also highly sceptical of the importance of expenditure to film a video on EGF case studies.

On the timetabling of EGF applications and other dossiers handled by Council's budget committee, the Government takes this issue very seriously and is maintaining pressure to bring about positive change in Brussels.

In August, the UK Permanent Representation in Brussels wrote to the Council General Secretariat and the Polish Presidency setting out the Government’s concerns and seeking assurances that the scheduling of business in Council’s budget committee will return to a pace that allows Member States to fully consider proposals, including a longer period for Parliamentary scrutiny before Council’s position is finalised at working level. I am pleased to report that the Presidency has noted the Government’s concerns in this matter and will endeavour to improve future timetabling to accommodate better national scrutiny procedures where possible.

I would note, however, few other Member States share the UK’s concerns. This is in part due to minimal pressure from domestic parliaments in other Member States. In addition to the efforts of the Government, I would encourage your Committee to coordinate with national parliaments in other Member States to highlight this issue and the need for improvement.

The Government will continue to monitor timetabling of dossiers in Council's budget committee and will consider further action if there is no improvement.

25 October 2011

EUROPEAN GLOBALISATION ADJUSTMENT FUND (12122/11)

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

Thank you for your Explanatory Memorandum 12122/11, dated 19 July 2011, on a proposal for the amendment of the Regulation on Establishing the European Globalisation Adjustment Fund (EGF). The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 4 October 2011.

The Commission propose to extend the temporary derogations until 31 December 2013. Do you agree that the derogation is still needed?

The 2009 amended Regulation provided for a review, including of the temporary derogation, on the basis of a mid-term evaluation before the end of 2011. It would appear to us to have been sensible for such a review to have been completed before it became necessary for further amendments to be introduced. Do you agree? Why was this not possible? You state that you expect the review to follow in due course. Do you have any more information as to when the review can be expected?

The Commission state that the proposed extension of the derogation does not prejudge the future of the EGF beyond the end of 2013, and the next Multi-Annual Financial Framework. What is your assessment of the likelihood that the Commission will propose that the EGF should continue, and that these temporary derogations will become permanent revisions in the future?

You state that, to date, the UK has not made an application to the fund, relying instead on existing UK support for large scale redundancies, including via Jobcentre Plus. You cite the significant delays that would be involved in any EGF application. Is this sufficient justification for not taking advantage of the fund in the current economic climate? Can you envisage any circumstances in which the UK would make an application to the fund?

You state that there is scope to reform arrangements for disbursing aid currently provided by the EGF. What specific proposals for reform do you have in mind?

You state that the Government have not yet formed a final negotiating position and will be using the time before substantive negotiations to seek further information. Can you provide us with any update in this regard, in particular in the light of the planned preliminary discussion in Council Working Group during the summer and the substantive discussions scheduled to follow during the autumn?

We would be grateful for a response to this letter in the standard ten working days. In the meantime, we have agreed to keep the proposal under scrutiny.
Letter from the Rt. Hon. Chris Grayling MP to the Chairman

Thank you for your letter of 5 October on the European Globalisation Adjustment Fund (EGF), and the proposal for a draft regulation amending Regulation (EC) No 1927/2006 on establishing the EGF. You have raised several salient points which I will address.

You asked whether I agree with the Commission’s proposal to extend the temporary derogations until 31 December 2013 and whether the derogation is still needed. The EGF is not an efficient instrument but some Member States with insufficient capacity (e.g. in their employment services) do need support for managing labour market shocks and these are likely to continue given the current economic conditions. However, the UK Government is concerned about a blanket extension for all countries without any formal and full evaluation of EGF to date.

With regard to the mid-term evaluation, ideally we would have the review before the current proposed amendments but the 2006 Regulation only committed to evaluation by the end of 2011, and as yet no specific publication date has been identified. Given that the derogations are also due to end in December, the Presidency was seeking to get agreement by the Employment Council on 1 December. We understand now that the decision could be made after 31 December and backdated as necessary.

In the Council Working Group there has been sufficient opposition among Member States to the proposal, as initially drafted, to form a small blocking minority. A key argument of this block is that the efficiency of the EGF is in doubt in lieu of the evaluation, although the majority of Member States are prepared to accept the proposal as drafted to show solidarity with redundant workers, and the European Parliament also supports the proposal on the same grounds. The UK Government has joined this block, reflecting our position on the EGF to date and on the next Multi-Annual Financial Framework, as I set out in my original Explanatory Memorandum.

The Commission proposal for the EGF in the next Multi-Annual Financial Framework (MFF) was published on 5 October and a new Explanatory Memorandum will be submitted shortly. This Explanatory Memorandum will also cover your questions on the proposals for reforming arrangements for disbursing aid. While the EGF offers some benefit to Member States with poor labour market structures, the Government believes that there is scope to reform arrangements for disbursing aid currently provided by the EGF to direct it where it is needed most and with a more rigorous assessment of that need, applying the Regulation’s criteria. The Government will closely scrutinise future applications for the EGF to promote this discipline and to reflect the position the Government will take on the next MFF where we will seek increased efficiency overall.

Regarding the UK’s use of the Fund, in practice, the EGF would not provide any more support for redundant workers in the UK than is already available, as the EGF only makes provision for what the UK Government already does in the case of large redundancies through Rapid Response coordinated by Job Centre Plus. The EGF could only reimburse some of the cost but with additional burdens of evaluation, and cost relating to the effect of additional EU receipts on the UK’s abatement. The Government has not ruled out using the EGF completely, but there would have to be a strong business case proving how the EGF could add value for the UK in specific circumstances to make an application.

You asked about the UK Government’s final negotiating position and discussions in Council Working Group. As noted above, the Government has joined a number of other Member States to form a blocking minority against the Commission’s proposal. While seeking to maintain this for as long as possible, the Government is also preparing for the possibility that the blocking minority will not last the course, and so is also considering with its allies a range of options for amending the proposal which aim to limit the disbursements from the Fund or to limit the derogations extension to one year only. The latter option would allow the forthcoming evaluation to be considered before deciding on rules for EGF funding in 2013.

I am happy to write to the Committee to update them as negotiations progress.

17 October 2011

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

Thank you for your letter, dated 17 October 2011, on Explanatory Memorandum 12122/11, on a proposal for a Regulation on Establishing the European Globalisation Adjustment Fund (EGF). The EU
We welcome your response to the Committee’s questions on this document.

We acknowledge your concerns about the effectiveness of the EGF. We believe, like you, that further scrutiny of the EGF is necessary before decisions on the Fund’s future are made. In particular we agree with you that the EGF needs to be directed where it is needed most, such as to those Member states with poor labour market structures. We note that the Commission has recently published its proposal for the EGF in the next Multi-Annual Financial Framework. We also look forward to the publication of the Commission’s mid-term evaluation, although we are concerned to note that no specific date for publication has been identified.

We note that the Government understand that the decision could be made after 31 December and backdated as necessary. What is your view of the appropriateness of seeking to backdate any amendment to the Regulation?

We also note the Government’s explanation as to why the UK has not thus far made an application to the Fund. Has the requirement on the UK to give back some of the money in rebate calculations had any impact on the UK’s decision not to make use of the Fund?

Thank you for the update on the Government’s negotiating position with regard to this proposal. We would be grateful for an update on developments as negotiations progress.

In the meantime, we have decided to continue to hold the proposal under scrutiny.

25 October 2011

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

Thank you for your letter of 25 October on the European Globalisation Adjustment Fund (EGF), and the proposal for a draft regulation amending Regulation (EC) No 1927/2006 on establishing the EGF. You have raised two issues: firstly, the appropriateness of seeking to backdate the amendment; and whether the requirement on the UK to give back some of the money in rebate calculations has had an impact on the UK’s decision not to use EGF.

The appropriateness of seeking to backdate the amendment has precedence, e.g. the revision to the regulation that introduced the temporary derogations entered into force on 18 June 2009 and applied to applications received from 1 May 2009. Of course, the timetable for negotiations is largely in the hands of the Presidency and I understand currently that they aim to get agreement at a COREPER in November before EPSCO Council on 1 December.

As for the rebate calculations, I would like to clarify that the UK would not have to hand money back to the Commission, but receipts from the EGF would lower the UK’s abatement, further limiting the instrument’s value for the UK. This consideration has not been a primary driver of the UK’s position to date. The few large redundancies that Ministers were asked to consider previously did not sufficiently meet the EGF criteria. Moreover, using EGF for them may have fallen foul of the Regulation since existing national measures at the time, including some that had received ESF investment in some form, were applied to those facing redundancy or had been made redundant. Given that EGF would not allow the UK to do any more than it did in these cases then it could not supplement our standard activity.

With regard to the mid-term evaluation, I understand that this will now be available in early December. I will send it on to the Committee.

I will keep the Committee updated on the progress of negotiations.

2 November 2011

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

Following my letter dated 2 November, the Presidency has amended the agenda for the 1 December Employment & Social Affairs Council (EPSCO) to allow for a possible Political Agreement on the EGF derogations’ extension. In forthcoming negotiations, the Government will strive either to prevent the extension of the crisis derogations or if necessary seek to reduce disbursements to the Fund (such as reducing the extension period from two to one year; or reducing the co-financing requirements).

I consequently ask that the document be cleared from scrutiny on this basis.
I am happy to write to the Committee to update them after the Council.

16 November 2011

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

Thank you for your letters, dated 2 November and 16 November 2011, on Explanatory Memorandum 12122/11, on a proposal for a Regulation on Establishing the European Globalisation Adjustment Fund (EGF). The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 22 November 2011.

Thank you for the further information on the reasons why the UK has not so far used the Fund. You state that “the few large redundancies that Ministers were asked to consider previously did not sufficiently meet the EGF criteria.” We would be grateful for further information on these cases, and for details of which specific elements of the criteria were not sufficiently met. You also state that “using EGF for them may have fallen foul of the Regulation”. Again, we would be grateful for further clarification as to why you believe this may have been the case, and which specific aspects of the Regulation would in your view have been infringed.

Whilst we continue to agree with you that further scrutiny of the EGF is necessary before decisions on its future are made, and that the EGF needs to be directed where it is needed most, such as to those Member States with poor labour market structures, we do not believe that this should mean that the UK should rule out applying for its use. We urge the Government to consider applying to use the Fund should appropriate cases arise in the future.

We note that the proposal is scheduled to go before Council on 1 December, and your update on the negotiating position that the Government intend to take. In the light of this we have agreed to clear the document from scrutiny. We would, however, be grateful for an update after Council both on the outcome of negotiations and in reply to the points raised above.

24 November 2011

EUROPEAN GLOBALISATION ADJUSTMENT FUND (13626/11)

Letter from the Chairman to Chloe Smith MP, Economic Secretary, HM Treasury

Thank you for the Explanatory Memorandum 13626/11, from your predecessor Justine Greening, dated 26 September 2011, on a report on the activities of the European Globalisation Adjustment Fund (EGF) in 2010. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 25 October 2011.

We share the Government’s view that the report raises a number of issues of concern. In particular, we agree with you that there appears to have been an extremely poor return on EGF investments. We also share your concerns at the large discrepancy in the amount of funding per worker, the low number of applications from, and grants to, newer Member States, and the apparently opaque way in which funding for EGF expenditure has been identified.

In the light of these concerns, we believe, like you, that further scrutiny of the EGF is necessary before decisions on the Fund’s future are made. The Committee continue to hold EM 12122/11 (on a proposal to amend the regulation of the EGF) under scrutiny, and we are in correspondence with the Minister for Employment, Chris Grayling MP, in relation to this proposal. We note that the Commission has recently published its proposal for the EGF in the next Multi-Annual Financial Framework. We also look forward to the publication of the Commission’s mid-term evaluation, due by the end of this year. We welcome your commitment to press for this review to set out a critical and robust assessment of the value-added and effectiveness of the EGF, and to explore ways to improve it, including dealing directly with the problems seen in 2010. We would be grateful for an update on further developments in this regard.

In the meantime we have agreed to clear this document from scrutiny.

25 October 2011
Letter from the Chairman to Mark Hoban MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum 14942/11, dated 12 October 2011, on the Commission’s proposal for a common system of financial transaction tax (FTT). The EU Economic and Financial Affairs and International Trade Sub-Committee considered the document at its meeting on 29 November.

Given that London is Europe’s largest financial centre, we consider that the proposal for an FTT has profound implications for the UK. At present, we remain to be convinced about the need for a financial transaction tax. We share your concerns in terms of the implications of the tax for financial activities occurring in London and the potential risk of relocation of business outside of the UK. We note that Jean-Claude Trichet has warned that an FTT could damage the competitiveness of financial centres in the EU.

We are also concerned that the proposal that tax revenues should accrue to the government where the party to a financial transaction resides will result in revenue being transferred from the UK to the other EU governments on the basis that most of the EU’s wholesale financial transactions take place in London.

We remain to be convinced that such a tax would either reduce instability in the market or prevent another financial crisis. We note with concern, not least in the context of the ongoing economic difficulties across the EU, that the Commission’s Impact Assessment concludes that the tax is likely to induce a loss in GDP between five and 20 times larger than the revenues raised from the tax.

The Government state that they would not accept an FTT unless implemented globally. We recognise the pressure you are facing in Brussels from other EU leaders, and are aware that, should the UK veto this proposal, other Member States may seek to introduce an FTT via enhanced cooperation. We are concerned that, should such an FTT be introduced, it could still have a detrimental impact on the UK. What steps are the Government taking to prepare for such an outcome? How much support is there for the UK’s position amongst other Member States?

We have launched an inquiry on this subject to seek clarity on all of these matters. We will reserve our conclusions on this proposal until our deliberations have been completed. Accordingly, we intend to hold the proposal under scrutiny until the conclusion of our investigation. However, we wanted to draw your attention to these concerns at an early stage. We would be grateful for regular updates as negotiations progress.

29 November 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter dated 14 July. I am very pleased that the Lords Scrutiny Committee continues to take an interest in the EU economic governance legislation – I understand from my Ministerial colleague Lord Sassoon that you had a lively and interesting debate on the Government’s response to your Sub Committee’s report on 16 June, which cleared this matter from formal scrutiny.
I will write to you again in the autumn once negotiations on the economic governance legislation resume.

I note that, for the future, you would like the Government to respond to each individual conclusion or recommendation in your reports. I have passed this request on to my officials, and we will look to provide a response to each recommendation in future reports of this kind, consistent with the need to respect market sensitive information or relations with international partners. I hope that you will find this helpful.

20 July 2011

Letter from Mark Hoban MP to the Chairman

In my letter of 20 July I undertook to write to you again on this subject in the autumn once negotiations resumed. In the event, there was informal contact between the Polish Presidency and the European Parliament (EP) on this matter over the course of the summer: I am now writing to update you on the progress that was made.

In the course of earlier discussions between the Hungarian Presidency and the EP there were three issues in particular on which the EP felt very strongly and agreement could not be reached. However, efforts by the Polish Presidency led to agreement with the EP at the end of September. ECOFIN approved the texts in October and, once work on their translation was completed, formally adopted them on 8 November.

I am setting out below details of the three areas on which negotiations over the summer were mainly focused.

VOTING ARRANGEMENTS IN THE PREVENTIVE ARM OF THE STABILITY AND GROWTH PACT (SGP)

The EP wanted to limit the extent of politicians’ power in making decisions that might lead to new disciplinary measures; its proposals would have made it harder for the Council to reject the recommendations of the Commission. A number of Member States were opposed to this.

The agreed compromise is that, where a Member State has previously been warned regarding its budgetary position and has received a recommendation for the necessary policy measures (under Article 121(4) of the Treaty) then, if the Commission subsequently recommends to the Council that it adopt a decision that no effective action has been taken, the decision will be made by normal QMV. However, if the Commission’s recommendation is not adopted by Council, then after one month the Commission will be able to repeat its recommendation and the decision will then be made by reverse simple majority (i.e. it will be deemed adopted unless a simple majority rejects the recommendation within ten days).

This assumption in favour of the Commission’s recommendation, the time-limited opportunity to overturn it, and the need to mobilise a simple majority in order to do so, will mean that in future it will be slightly more difficult for Member States - including the UK - to avoid a decision that they have not taken effective action in response to policy recommendations. Of course, in the case of the UK – and other non-euro area Member States – such a decision will not result in any financial or other sanctions, as all such measures will apply to the euro area only.

The Government is satisfied that this is a suitably balanced solution. It provides for a modest increase in automaticity at the preventive stage, to complement the increased automaticity already agreed in the later stages of the Stability and Growth Pact; however it continues to, recognise and respect ECOFIN’s role in decision-making.

A POLITICAL ROLE FOR THE EP IN EU ECONOMIC SURVEILLANCE

The EP was keen to establish a role for itself in the surveillance process. ECOFIN was amenable to committing to keeping the EP informed of progress and decisions under the process; however the EP additionally sought the power to insist on EU officials and representatives and national Finance Ministers appearing before its Committees.

The UK Government, in common with many of its EU partners, made it very clear that this would be unacceptable. The Government is, and must remain, accountable to our national Parliament and there must be no question of any European process eclipsing this.

The agreed text respects this principle. It merely aims ‘to enhance the dialogue between the Union institutions’ and ‘to ensure greater transparency and accountability’, by acknowledging the EP’s right
to invite the President of the Council, the Commission and, where appropriate, the President of the European Council or the President of the Eurogroup, to appear before its Committees, and to ‘offer the opportunity’ to Member States to engage with it.

**SYMMETRY IN THE TREATMENT OF CURRENT ACCOUNT SURPLUSES AND DEFICITS**

The scoreboard and indicators are not set out in the legislation and are still under discussion (I have already undertaken to update you on the outcome in due course). The EP was keen to secure a commitment to the symmetrical treatment of current account surpluses and deficits. This has been an area of much – indeed continuing – debate between Member States. The Government’s view is that both surpluses and deficits may be indicative of underlying imbalances that need to be addressed, but that this does not mean that they need necessarily be treated – or punished – equally.

Language agreed with the EP indicates that both upper and lower alert thresholds will generally be applied to the various indicators to be used, but acknowledges that surpluses and deficits may be assessed differently. This provides broad parameters within which discussions may continue, whilst enabling agreement on, and implementation of, the broader legislative package without further delay.

The Government welcomes agreement on this legislation. The UK’s unique relationship to the SGP – by virtue of our Protocol opting out of the single currency - has been recognised by way of our partial opt-out from the Budgetary Frameworks Directive. New financial sanctions will apply to the euro area only, where the need for coordination and cooperation is greatest. However, there is a clear and urgent need for measures to protect and strengthen both the euro area and the wider European economy: this requires strong and responsible economic governance across the EU and I believe this legislation to be a very positive contribution.

For your information, I am enclosing copies of four reports on the European Parliament’s first reading process which were recently received from the Council’s Secretariat.

*29 November 2011*

**GENERALISED TARIFF PREFERENCES (10052/11)**

**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 10052/11 on a Proposal for a Regulation applying a scheme of generalised tariff preferences. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 4 October.

We took evidence from the EU Trade Commissioner Karel de Gucht on this issue in September 2011. He argued that “the problem for developing markets trying to export is not tariffs ... it is about putting their act together ... reciprocal relationships are much more fruitful and will bear more fruit in the future”. You suggest that narrowing the scope of the standard GSP will hurt countries which “do not have a prospect of entering into alternative trading arrangements ... with the EU in the medium-term”. To what extent can alternative arrangements be made with those countries that will no longer be covered by the standard GSP scheme? Do the Government agree with the Commissioner’s view that such reciprocal arrangements would be more beneficial for such countries compared with the GSP scheme? In light of the continued failure of global multilateral agreements on trade (such as Doha), putting in place alternative arrangements between the EU and third parties seems ever more important.

We note that the proposed revisions to the GSP+ would see more countries become eligible for this scheme, provided they meet certain criteria related to human rights, good governance, etc. How many additional countries might become eligible under this proposal? We also note that the Commission propose stricter supervision by the EU for eligibility – how would this stricter supervision be carried out?

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

*5 October 2011*
Letter from Edward Davey MP to the Chairman

Thank you for your letter of 5 October asking a number of follow-up questions to the Explanatory Memorandum submitted earlier in the year.

You asked to what extent alternative arrangements can be made with those countries that would, under the Commission’s current proposal, no longer be eligible for the standard Generalised System of Preferences (GSP) scheme. The Government has consistently argued that tariff preferences are an important way to promote trade and reduce poverty in developing countries.

The alternative arrangements to which Commissioner De Gucht makes reference are bilateral Free Trade Agreements (FTAs) and the Economic Partnership Agreements (EPAs) with African, Caribbean and Pacific (ACP) countries. The Government believes that there are real potential benefits for developing countries in reciprocal arrangements in terms of promoting economic reform, so we would certainly encourage them to look at the alternatives where a country could potentially lose preferences under the proposed changes to the GSP scheme. However, negotiating such arrangements can be a long and drawn-out process (years in the case of the India FTA).

You also asked how many countries might become eligible under the Commission’s proposed revisions to the GSP+ element of the GSP regulation. If Higher Income and Upper Middle Income countries are removed from the GSP provisions altogether (as the Commission proposes) only the Philippines and Pakistan would become eligible in terms of economic vulnerability and lack of trade diversification. To be granted the additional preferences they would also need to demonstrate that they had met the criteria on sustainable development and good governance.

In terms of tighter supervision, as you know the Commission foresees that the additional preferences granted under GSP+ would only be given where the country meets the vulnerability and export diversification criteria, and where the beneficiary country has ratified and is ensuring effective implementation of 27 sustainable development and good governance conventions. A request for GSP+ would need to be accompanied by a binding undertaking that ratification of the conventions would be maintained and effectively implemented, and the reporting requirements met and supervised by the relevant monitoring body of each convention. It would be a condition of receiving the additional preferences that the relevant monitoring bodies do not identify a serious failure by the country to effectively implement the conventions, although the Commission would be able to use wider sources for monitoring implementation. If a GSP+ beneficiary country was found to be failing in its implementation, this would be grounds for temporary withdrawal of the preferences.

I hope that these answers will be helpful to the Committee in its scrutiny of the proposal. I stand ready to answer any further questions that you may have. As you may already be aware, a scrutiny debate is scheduled for the House of Commons on 15 November.

19 October 2011

Letter from the Chairman to Edward Davey MP

Thank you for your letter, dated 19 October 2011, on Explanatory Memorandum 10052/11 on a Proposal for a Regulation applying a scheme of generalised tariff preferences. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 29 November.

Thank you for your comprehensive response to the Committee’s questions. In particular, we welcome your support for developing countries entering into alternative, reciprocal arrangements, although we do note your concern that negotiating such arrangements can be a long and drawn-out process.

We would be grateful to receive further updates as negotiations progress. In the meantime we have agreed to clear the proposal from scrutiny.

29 November 2011
INVESTOR COMPENSATION SCHEMES (12346/10)

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


PROGRESS IN COUNCIL

The Government has negotiated the Directive through both expert and attaché working groups during the Belgian and Hungarian Presidencies. Discussions are ongoing; in the last six months there have been three attaché meetings in Brussels. We expect a new compromise text from the Polish Presidency after the summer ahead of the next attaches meeting, scheduled for late September.

PROGRESS ON KEY UK CONCERNS

In your last letter dated 02 March you noted the Government’s continued opposition to a maximum harmonised level of compensation. You suggested that the lack of evidence of regulatory arbitrage would imply that a reduced compensation limit would have negligible effect on investor confidence. Nevertheless, it remains a Government priority to retain current levels of protection for UK investors and I would strongly oppose any maximum limit that would mean reducing the protection on offer. The Hungarian Presidency has put forward a compromise of a €30,000 minimum harmonised limit, meaning that Member States must offer at least €30,000, but may offer a higher level. Along with the majority of other Member States, the UK has expressed support for this solution.

Mutual borrowing remains in the latest Council text but is currently optional rather than mandatory. The Government will continue to oppose mutual borrowing for the reasons set out in my last letter, including the risk of contagion and potentially breaching national fiscal sovereignty.

The extension of the scope of the Directive to include failure by UCITS depositaries has been removed, following strong opposition from the UK and other Member States. However, the extension of scope to include the failure of third party custodians remains in the latest Council compromise text and the Government will continue to oppose their inclusion.

As I set out in my last letter, the Government will continue to argue for a more proportionate approach on funding that recognises that Member States are best placed to ensure schemes are able to meet their obligations. We currently have strong support from a number of key Member States who agree that there should be national discretion over the funding mechanism. In relation to the proposed pre-fund, the latest compromise text has reduced the target level of the proposed pre-fund to 0.5% of monies held by the firm and 0.05% of financial instruments held, administered or managed by the investment firms that are covered by the protection of the scheme. Although this revised proposal reduces the potential cost implications for industry of pre-funding, it remains a key negotiating aim for the UK to ensure that the Directive does not place an unreasonable burden on firms, both in terms of the specific funding requirements and the consequential operational requirements.

EP NEGOTIATIONS

EP has also been progressing with negotiations in parallel to the Council. On 5 July 2011, the rapporteur Mr Olle Schmidt’s report was adopted by Parliament but, in the absence of an agreed Council position, a first reading deal now looks highly unlikely.

The EP text goes much further than the original Commission proposal. It increases the compensation level to €100,000 and although it also reduces the size of the pre-fund to 0.3%, it also reduces the time to build up the pre-fund from ten years to five years. The requirement for mutual borrowing and the extension of scope to include the failure of third party custodians remain in the EP version. Furthermore, the EP text includes a new provision requiring compensation to be paid for ‘bad advice’ which represents a significant extension of scope. As you know, the FSCS already covers investment losses resulting from breaches of conduct of business rules, but this extension will significantly increase costs for other Member States. I have attached the EP report for reference.

Negotiations on this directive will continue after the summer. I will provide a further update and write to request clearance once the Council is in a position to agree a general approach.
Further to my last letter of 3 August, the House of Commons Committee requested a preliminary assessment of the likely impact of the Directive on UK interests. As I noted, officials will complete a full formal impact assessment on agreement of the directive, which I will of course share with the Committee. In the meantime I thought it would be helpful to provide you with an initial assessment of the key possible impacts of the Directive.

The main reforms proposed under the Directive are:

1. To introduce pre-funding for the investments class of the Financial Services Compensation Scheme (FSCS).
2. To harmonise and increase the coverage limit for all EEA investor protection schemes.
3. To extend coverage under the FSCS to third-party custodians of funds.
4. To introduce a provision for mandatory mutual borrowing.

1. PRE-FUNDING

The most significant cost associated with the Directive would result from the proposal to introduce pre-funding for the investments class of the FSCS.

The original Commission proposal required a target pre-fund of 0.5% of the total value of the monies and financial instruments held, administered or managed by the investment firms which are covered under the Directive. It is difficult to calculate accurately the value of the pre-fund since the Government does not currently collect data on the amount of covered funds held by firms. However, we estimate that the target pre-fund would be likely to be of the order of £4.5 billion. This cost would be levied on the industry over a period of ten years.

In addition, there is a secondary cost associated with pre-funding. To comply with the Directive and develop an accurate estimate of the target pre-fund it is likely that the Financial Services Authority would need to collect additional data from the industry. This may involve significant IT infrastructure changes. It is difficult to assess the cost of this, but a similar exercise for deposits class cost the sector in the region of approximately £900 million (which included 18 months implementation costs and 36 months’ ongoing costs).

Although the pre-fund target has been reduced since the original proposal, securing a cost-effective outcome for the UK that does not place unreasonable burdens on firms remains a key negotiating objective for the UK. We will therefore continue to negotiate for UK interests in the funding model.

2, 3, 4: OTHER REFORMS

As you know, the UK position is to maintain our current coverage level for investors, which would not increase cost to industry. We will continue to oppose the inclusion of third party custodians and any inclusion of mutual borrowing, as set out in previous letters.

BENEFITS

This costing does not take account of any benefits to consumers that arise from updating the directive, which are very difficult to quantify. These include enhanced investor protection, increased confidence in EEA financial markets and more harmonised schemes across Member States.

I hope that the Committee will find this update useful. The next attaché meeting is expected to take place in mid October. I will continue to provide updates as negotiations progress; we are expecting a new compromise text before the next attaché meeting, and the directive is provisionally on the November ECOFIN agenda.

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1 This is based on findings in the IMA Annual Survey (Asset Management in the UK 2009-2010) that close to £3.9tn of assets are under management in the UK, of which approximately 23% (£900bn) are with retail or private clients. This is an initial estimate and does not discriminate between covered and non-covered funds in the key areas highlighted by the Commission: whether they are retail investments (except in the broadest terms); and whether they amount to more than £/€50k. Nor does it include client money or financial instruments held or administered in the UK.
3 October 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 3 August 2011, on Explanatory Memorandum 12346/10 on investor compensation schemes. The EU Economic and Financial Affairs and International Trade Subcommittee considered these documents at its meeting on 4 October.

We welcome the useful update on negotiations. We note that the mutual borrowing provisions are now optional, rather than mandatory. Which Member States have indicated that they would opt-in to this optional provision? Would an optional scheme, which the UK would not take part in, have any implications for the UK?

We have previously expressed our concern that, in the absence of a harmonised mechanism for funding investor compensation schemes, some Member States might not provide suitable coverage. You suggested that you would use the UK’s experience of compensation schemes to work with the Commission and other Member States to address these concerns, while still maintaining national discretion and flexibility. What alternatives have the UK proposed in negotiations to provide this balance of security and national discretion?

5 October 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 5 October in which you raised two points that I shall address in turn.

On mutual borrowing, you asked which Member States would opt in to the optional provision. Opposition to mandatory mutual borrowing was almost unanimous in working group meetings, with only Portugal in favour of the proposal. The latest compromise text keeps the change made by the Hungarian Presidency to make mutual borrowing optional, where both parties would have to consent to the loan. While to my knowledge no Member State has stated that they would actively seek to use the borrowing provision, the version of the Directive currently in force (Directive 97/9/EC) does not prevent national schemes from borrowing from each other so the optional provision would not alter the status quo. Therefore the optional scheme should not have any implications for the UK.

You also asked what alternatives the UK has proposed to provide a balance between security and national discretion. As you note, the UK is experienced in the operation of compensation schemes. The funding model of the Financial Services Compensation Scheme (FSCS) comprises five broad classes, including a wide investment class which is further divided into two sub-classes: provision and intermediation. The FSCS is currently funded on a post-funded ‘pay-as-you-go’ basis, raising levies on an annual basis to cover each sub class’ projected liabilities over the following 12 months. If the annual levy proves insufficient, the FSCS can then raise interim levies to supplement the annual levy. The FSCS can cross-subsidise between classes and sub-classes, or utilise a commercial borrowing facility to ensure claims are met. In total, FSCS can raise a maximum of £370m per year from the investments class of its members. If necessary, it may apply to borrow from the Treasury via the National Loans Fund.

During negotiations the UK has argued that the directive should include strong principles in line with how the FSCS currently operates. This includes ensuring all schemes are properly funded with clearly defined processes to deal with any shortfall in funding, but recognising that Member States are best placed to ensure schemes can meet their obligations.

19 October 2011

Letter from Mark Hoban MP to the Chairman

In my last letter of 19 October I wrote to the Committee to respond to your questions on mutual borrowing and alternative funding models.

Over the last few weeks, we have made significant progress on this directive and I would like to update you further on negotiations in Council as this document remains under scrutiny.

I am pleased to inform you that we have now secured all of our key negotiating aims in the last compromise text. The Presidency is expected to take the final text to a Coreper meeting on 17 November as an A point (no discussion) to agree a general approach in Council. As you know, the UK’s main aims were:
1. **To ensure a cost effective funding model that does not place unreasonable burdens on firms.**

2. **To retain our current coverage level of £50,000.**

3. **To remove third party custodians and UCITS depositaries from the scope of the directive.**

4. **To remove mandatory mutual borrowing from the directive.**

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**1. FURTHER DETAIL ON THE FUNDING MODEL.**

As I explained in my August letter, the UK secured the support of other key Member States in our opposition to harmonised funding arrangements. Following successful lobbying, the latest Council compromise text (received on 19 October 2011) allows Member States discretion in their funding model, but includes a number of provisions to ensure schemes are adequately funded. These provisions include a clear process for raising funds that starts with ensuring sufficient funding is raised from scheme members. Where that is not adequate, additional contributions can be raised from scheme members. Finally, schemes must have in place adequate alternative funding arrangements, including borrowing from public institutions and other schemes in the same Member State.

The article also requires that Member States annually inform the European Securities and Markets Authority of the systems and arrangements referred to above.

This is a significant achievement as it will allow the UK the flexibility to determine the most appropriate funding model, while ensuring that investors in EEA firms are adequately protected/ safeguarded. The proposal also does not place any additional burdens on the UK investment industry.

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**2. FURTHER DETAIL ON THE COVERAGE LEVEL**

The Polish compromise text amended this article to require schemes to offer a range of compensation between €30,000 and €100,000.

This appears to satisfy the majority of Member States, although France and Spain are still pushing for greater harmonisation. The UK can support this proposal as it allows us to retain our coverage level of £50,000 and also increases the minimum that Member States offer by 50%.

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**3. FURTHER DETAIL ON THIRD PARTY CUSTODIANS AND UCITS DEPOSITORIES**

As I detailed in earlier letters, the UK has opposed the inclusion of third party custodians and UCITS depositaries. The Hungarian presidency consequently removed UCITS from scope and I am pleased to inform you that the Polish presidency has now also removed third party custodians from the proposal. The latest draft includes a review clause that requires the Commission to submit a report to the European Parliament and the Council after the adoption of the Securities Law Directive, and the review of the Markets in Financial Instruments Directive.

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**4. FURTHER DETAIL ON MUTUAL BORROWING**

The latest compromise text removes the article concerned with mutual borrowing and the UK supports this removal.

To conclude, I am pleased with the outcome that we have achieved in Council negotiations on this directive and the balance that has been struck between increasing investor protection and reducing burdens on firms.

3 November 2011

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

Thank you for your letters, dated 3 October 2011, 19 October 2011 and 3 November 2011 on EM 12346/10 on investor compensation schemes. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 8 November.

Thank you for your response to the questions raised in my letter of 5 October, and for the subsequent update on the progress that has been made in negotiations. In the light of these developments, we have agreed to clear this document from scrutiny. However we would be grateful
for an update on the outcome of the COREPER meeting scheduled for 17 November. Should the
general approach outlined in your letter be agreed at that meeting, we would urge you, in order to
provide clarity in the context of the evolving negotiations, to make clear to depositors that the UK’s
coverage level of £50,000 will now be retained.

8 November 2011

ORIGIN MARKING OF CERTAIN PRODUCTS IMPORTED FROM THIRD COUNTRIES

(5091/06)

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

Following our exchange in February this year on the state of play on this Commission proposal I
thought it would be helpful to update you by summer recess.

There has been considerable activity in the Council over the last 6 months but this did not lead to any
major shift in the division between Member States.

The Hungarian Presidency made considerable efforts to achieve progress arranging discussions on the
dossier at five Commercial Questions Council Working Group meetings during the first half of 2011.
As the Presidency has reported to the European Parliament, the Working Party thoroughly examined
the proposal and the modifications adopted by the European Parliament. Discussion focused on the
general purpose of the proposal, the definitions, product coverage, geographical coverage and the
decision-making process. The latter involved Member State Customs Authorities as well as trade
policy experts. However it was not possible to obtain the required majority for their adoption of any
first reading position by the Council.

The UK made a full and constructive contribution to these discussions. Our position however
remains unchanged: we continue to have strong reservations about the proposal.

The dossier now passes to the incoming Polish Presidency to take forward.

4 August 2011

Letter from the Chairman to Edward Davey MP

Thank you for your letter, dated 4 August, on EM 5091/06 on a proposal for country of origin
labelling. The EU Economic and Financial Affairs and International Trade Sub-Committee considered
this document at its meeting of 13 September.

We note that you continue to have concerns over the current proposal being considered in Council,
and that negotiations remain stalled.

Would you confirm whether the proposal, as it currently stands, would have any impact on UK
hallmarking?

We have agreed to continue to keep this proposal under scrutiny, and would appreciate further
updates should progress be made.

14 September 2011

Letter from Edward Davey MP to the Chairman

Thank you for your letter of 14 September confirming that your committee has agreed to keep this
proposal under scrutiny.

You ask in your letter whether the proposal would have any impact on UK Hallmarking.

When we consulted UK interests we were told by the Hallmark Council that the proposal was not
welcomed by the Assay Offices because it is believed that origin marking on precious metal articles
and plated wares was likely to have adverse consequences in the UK. In particular, the market was
likely to be adversely affected because through deterring UK consumers as a result of UK designer
brand strength being weakened by information to the effect that the goods concerned are not made
in the EU. Further, the proposal must result in price increases because the marking process would be
an additional cost element in the manufacture/supply chain.
Further, the proposal was considered to amount to an additional regulatory burden for business and an additional burden on the legislative and enforcement processes. The view of the Assay Offices was that in the UK and potentially across the whole EU the necessary consumer comfort/protection and market underpinning could be provided by hallmarking through the UK and the Convention regimes.

12 October 2011

Letter from the Chairman to Edward Davey MP

Thank you for your letter, dated 12 October 2011, on EM 5091/06 on a proposal for a Regulation on the indication of the country of origin of certain products imported from third countries.

We are grateful for your response regarding the impact on UK Hallmarking. We have agreed to continue to keep this proposal under scrutiny, and would appreciate further updates should progress be made.

8 November 2011

OTC DERIVATIVES (13917/10)

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

Thank you for your letter, dated 19 May, on a Commission proposal for a Regulation on OTC Derivatives. The EU Economic and Financial Affairs and International Trade Sub Committee considered it at its meeting on 7 June.

We welcome your clarification of some significant aspects of the proposal. We would appreciate a further update of the result of discussions at the ECOFIN meeting in June, and of the vote in the European Parliament.

8 June 2011

Letter from Mark Hoban MP to the Chairman

I am writing to provide a further update following the discussions at the ECOFIN meeting held on 20 June. Although the Hungarian Presidency had hoped for agreement to a general approach, it was clear that proposals were not yet ready. Further work will continue with a view to agreement later in the year.

Discussion focused principally on two issues, namely supervision of Central Counterparties (CCPs) and the scope of the legislation.

Debate continued on authorisation and supervision, with some Member States remaining of the view that there should be a greater role for the European Securities and Markets Authority (ESMA) and the supervisory college and others wanting responsibility to rest with the National Competent Authority.

With regard to scope, there is debate as to whether the legislation should apply only to over the counter (OTC) derivatives or extend to exchange traded derivatives as well. This question of scope refers both to the obligation on market participants to centrally clear, and to the obligation on CCPs and trading venues to provide fair and open access to competitors.

The Chancellor made it clear that further work was needed to achieve a regulation consistent with G20 commitments and in line with single market principles. He highlighted the specific areas which were causing concern to the Government. On scope, it was important that all derivatives were within the scope of the regulation due to the need to avoid creating loopholes. Further, not to impose fair access requirements on all derivatives would be to establish an uncompetitive environment and restrict market access.

On supervision, the Chancellor reiterated the Government view that the approach should reflect the political agreement of 2009. Where there are fiscal implications, the National Competent Authority should have the final say in relation to authorisation and supervision.

In the meeting, there was also some discussion of the issue of CCP access to Central Bank liquidity. There was support for the Government view that Central Banks should be free to act at their own discretion, and that there are moral hazard risks to providing a clear route to Central Bank money
which could undermine our goal of ensuring CCPs are able to manage their risks effectively themselves. The European Central Bank registered a strong objection to any approach that might undermine the independence of central banks.

The Chancellor also highlighted the importance of bringing the file back to ECOFIN at a later date.

11 July 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 11 July, on OTC Derivatives. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 19 July.

We appreciate the update you have provided on the progress of negotiations in Council. However, we have also asked for an update on the position taken by the European Parliament on these matters, and the Government’s view of that position. We would appreciate a response on this point.

19 July 2011

Letter from Mark Hoban MP to the Chairman

I am writing in response to your letter of 19 July 2011, in which you requested an update on the position taken by the European Parliament on certain issues relating to the ongoing negotiations on OTC Derivatives.

Werner Langen, the European Parliament’s Rapporteur on this regulation, published his initial report on 4 February 2011, with the final committee vote on the tabled legislative report taking place on 24 May. Encouraged by unanimity in committee, the Rapporteur took the decision to take the dossier to first reading in the July plenary, with a view to putting pressure on the Council and potentially pushing for a second reading deal.

However, by the July plenary session, following a great deal of dialogue between various parties, the Rapporteur decided to limit the vote to amendments only, as opposed to the legislative proposal as a whole. MEPs voted strongly in favour of the amended proposal on 5 July 2011.

With regard to the scope of the clearing and access measures in the legislation, MEPs endorsed the Commission proposal that only OTC derivatives should be governed by this regulation. The Government’s view is that all derivatives should be covered.

On authorisation of Central Counterparties (CCPs), the European Parliament envisages a central role for the CCP supervisory college with binding mediation powers given to the European Securities and Market Authority (ESMA). The Government’s view is that the national competent authority should have the final say on authorisation decisions.

Finally, on the issue of access to central bank liquidity, the European Parliament is in favour of the Commission’s proposal where this provision is not included in this regulation; however there would be a review clause allowing the matter to be revisited at a later date. The Government agree that there should be no measures on access to central bank liquidity and would rather this issue was not included in a review clause.

We are currently awaiting the full first reading of the Regulation from the European Parliament.

29 July 2011

Letter from Mark Hoban MP to the Chairman

I am writing to provide an update on the above referenced regulation following the ECOFIN meeting on 4 October. We have exchanged a number of letters on this regulation and I hope this letter, which details the final outcome, will serve to address your concerns on the issues that you have raised in our past exchanges.

As you know, this regulation was on the ECOFIN agenda for Ministers to agree a general approach, to allow the trialogue process to commence. However, prior to the meeting, the Government was clear that the regulation as it stood was unacceptable.

A key issue for the Government was concerning the authorisation of central counterparties (CCP). The Government has always made it clear that in this regard it was important that the National Competent Authority (NCA) would have the final say in relation to authorisation of a CCP. Going
into the ECOFIN meeting, the regulation stated that a simple majority of members of a college facilitated by the European Securities and Markets Authority (ESMA) could overrule the NCA in a decision to authorise a CCP.

At ECOFIN, the Chancellor negotiated robustly on this issue, resulting in a final outcome which means that in order for the college to block an authorisation of a CCP, all members of the college, excluding the relevant NCA, must vote against it. This all but eliminates the opportunity for politicisation or abuse of the process and maintains a pre-eminent role for the NCA.

Linked to our concerns on authorisation of CCPs, was the possibility of this regulation being used as a means of implementing the ECB’s eurozone location policy.

In July, the ECB published a location policy which states that central counterparties that clear euro-denominated credit derivatives above certain thresholds (€5bn average daily net credit exposure or 5% of certain product categories) must “be legally incorporated in the euro area with full managerial and operational control and responsibility over all core functions, exercised from within the euro area.”

The Government considers that this policy is contrary to fundamental single market principles and fundamental principles of EU law and has submitted a challenge to the policy with the ECJ.

However, with there being a significant possibility that the location policy could be used in conjunction with this regulation, the Chancellor secured wording in an article that would forbid any decisions on CCPs being made on a basis that would discriminate against any member state as a venue for clearing services in any currency.

Throughout negotiations, the Government has argued that this regulation mandates the use of clearing houses thereby risking the creation of monopolistic for-profit service providers. In light of this, it is essential that the legislation enables competition to reduce the negative externalities likely to arise from imposing a clearing obligation on the market.

This was disputed by some Member States going into ECOFIN, and the limited access provisions previously in the regulation had been removed. The Chancellor managed to reverse this situation by securing access requirements for over the counter (OTC) derivatives clearing, and also a public statement from the Commission that fair and open access would be dealt with properly in forthcoming legislation.

The Government also had concerns about the scope of the regulation and the need to cover both OTC and exchange traded derivatives. The Chancellor forcefully put the point across that it needed to be dealt with. While the general approach did not cover this issue, the Chancellor did secure a public statement that the issue of scope and ensuring adequate coverage to meet the G20 agreement would be dealt with in upcoming legislation.

Prior to ECOFIN, another concern which the Committee raised was resolved. During the attachés’ meetings in September, an agreement was reached in regard to the problem of an obligation on Pension Schemes to centrally clear trades and as a result post cash margin. The solution in the Council text of this regulation means that Pension Schemes are exempt from the clearing obligation for an initial period of three years, at which time there would be a review. If no technical solution to the problem has been found to the problem that Pension Schemes have posting cash margin at that time, the exemption can then be extended for another two years after that. This provides a possible five year period for a technical solution to be found so as to avoid a disproportionate cost being laid on pensioners.

I think you will agree that the Chancellor secured an agreement which addressed many of the Government’s longstanding concerns.

10 October 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letters dated 29 July and 10 October 2011 on a Commission proposal for a Regulation on OTC derivatives, the so-called EMIR (EM 13917/10). The EU Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 25 October.

We are delighted that agreement was found on EMIR, a key piece of legislation in financial services that the Committee has scrutinised with careful attention. We welcome your comprehensive update on the points raised in previous correspondence in relation to the CCP, coverage of the Regulation
and access to central bank liquidity. In particular, we would like to commend your efforts in arguing in favour of competition in the clearing of derivatives and resisting the argument that CCPs should be based in the euro area. CCP clearing houses are privately owned entities, and, as such, their location and number are subject to market forces. We would welcome an update on the legal action brought up against the ECB. We would also be interested to know whether you believe that enough is being done to limit the risk faced by non-financial institutions, such as manufacturing companies, who use OTC derivatives to hedge business risks.

25 October 2011

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

Thank you for your letter of 25 October 2011 on EMIR.

You asked about the legal action brought against the ECB location policy. I can inform you that the process is still ongoing. As you know, the Government considers that the ECB’s location policy is contrary to fundamental principles of the single market and EU law.

The Government also considers that the policy, if implemented globally, would be a significant step towards a fragmentation of financial markets by currency zone. This would have profoundly negative consequences for the single market, international capital flows and carry very significant costs for the European and global financial markets. It would also increase costs and risks to financial market infrastructure and to market participants.

The timetable of the next steps in the process is determined by the General Court of the Court of Justice of the European Union (ECJ). However, we understand that the basis of the Government’s case is being translated into the official languages of the EU and we expect it to be published in the Official Journal of the European Union shortly. The ECB will be able to make a formal response to our challenge from mid-December. The Government’s preference would of course be to discuss and resolve our concerns with the ECB before the case reaches the ECJ. However we stand ready to pursue the matter in court should that prove necessary.

Your letter also raised the question about whether enough is being done in EMIR to limit the risk faced by non-financial institutions. The impact of forcing central clearing onto buy-side and corporate firms has been an important part of the negotiation. As a result the Council general approach specifically states that non-financial firms using derivatives to hedge their risk will not be subject to the clearing obligation.

15 November 2011

**PROCEDURES FOR ADOPTING MEASURES RELATING TO THE COMMON COMMERCIAL POLICY (7455/11)**

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

Thank you for your letter of 17 May raising two questions in relation to EM on Council doc. no. 7455/11. I apologise for not replying sooner.

The question of whether the Commission has chosen the appropriate procedure for each of the 24 Regulations covered is one which we examined closely. Our assessment is that the Commission has chosen appropriately when it has proposed that the examination procedures should apply for future core decision-making for these Regulations. This is in line with Article 2(2)(b)(iv) of Regulation 182/2011 and maintains an appropriate level of Member State control over the Commission.

Similarly, we also believe the Commission has chosen appropriately on the two occasions when it has proposed use of the delegated legislation procedure to allow it to supplement or amend certain non-essential elements of a legislative act, i.e. in Regulations 2271/96 and 1528/2007.

There are no instances where the Government feel that examination procedures have been proposed when the delegated legislation procedure would be more appropriate, or vice versa.

Your second question relates to reserved powers. This issue was also carefully considered by the Government. Our key concern was not so much in retaining powers for the Council as in maintaining a two-stage decision-taking process for the common commercial policy. The current proposal does
this in a way which is not that dissimilar from previous practice: that is the consultation of Member States in a Commission-chaired committee followed by formal decision-making in Council is now replaced by voting by Member States in an examination committee followed by, if necessary, further consideration in the Appeal Committee.

We consider this to be an adequate and appropriate approach, given the volume of decision-making on trade issues covered by these Regulations. By contrast, Article 291(2) makes clear that implementing powers may only be conferred on the Council in duly justified specific cases.

I hope these comments respond fully to your questions.

21 June 2011

Letter from the Chairman to Edward Davey MP

Thank you for your letter, dated 21 June, on EM 7455/11 on procedures for adopting measures relating to the common commercial policy. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 19 July.

We note your assurances that the Commission has correctly identified whether the delegated legislation procedure or the implementing legislation procedure is most appropriate in each case.

We also note that Regulation 182/2011 includes specific provisions which would make the exercise by the Commission of its new powers broadly equate, in practice, with the current practice under which the Council presently exercises those implementing powers.

We have agreed to clear this document from scrutiny.

19 July 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 letter of 19 May 2011 on EM 5053/11 on a proposal regulation on national and regional accounts. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 13 September.

We welcome your assurance that this proposal is not expected to have any impact on existing legislation or policies, or result in accounts that are not comparable with previous years.

We have previously cleared this item from scrutiny, and we do not require a response to this letter.

14 September 2011

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

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

Please find enclosed the Government’s Impact Assessment on the Commission’s proposal to replace the Capital Requirements Directive (Directives 2006/48/EC and 2006/49/EC, as amended by Directives 2009/111/EC and 2010/76/EU) with a Regulation on prudential requirements for credit institutions and investment firms, and a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

3 October 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your Explanatory Memorandum 13284/11, dated 5 September 2011, on proposals to reform EU prudential requirements. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 4 October 2011.

Capital regulation is a key aspect in the reform of the financial sector. We agree that the package of reforms envisaged by CRD IV marks the beginning of a new phase for a prudential capital regime and
banking regulation in general. The Commission’s proposals raise a number of important points to be discussed. These are tackled in turn below. First, however, we turn to the concerns you raise about the subsidiarity of this proposal.

SUBSIDIARITY

We note your argument that the proposed principle of maximum harmonisation goes beyond the action necessary to achieve the Commission’s objectives and limits Member States’ ability to impose higher capital requirements. We understand your concerns that maximum harmonisation would limit the UK’s ability to go beyond the requirements proposed by the Commission. We believe that this may, however, be a point of policy rather than a breach of subsidiarity. In addition, we note that while the Commission is proposing removing any national discretion to increase the minimum capital requirements in the CRD IV regulation, it is stated clearly in the Directive that Member States will retain some control to require their banks to hold more capital in certain circumstances.

We consider that it may be hard to justify subsidiarity concerns over the specific provisions of a recast of an existing proposal (albeit one which strengthens the existing provisions) rather than over a new proposal for legislation where EU action is novel. In other words, this is an area where it has been accepted without objection that EU action is necessary – including on issues such as the harmonisation of minimum capital.

We note that the Commission argues that the proposal is justified on the grounds that, without maximum harmonisation: risk could migrate to the shadow banking sector; there will be inhibitions to the cross border provision of services and to an institution setting up in another Member State; and conditions of competition would be distorted. We would like to know your specific reasons for disagreeing with each of these justifications. If we become convinced that the proposal does breach the principle of subsidiarity, it is of course open to us to recommend to the House that it issue a Reasoned Opinion on this proposal.

We note that you also object, under the heading of subsidiarity, to the delegation to the Commission of a power to require stricter requirements. We are not clear how this is a subsidiarity issue. If the area of delegation concerns an “essential element” of the legislation then delegation is not possible at all under Article 290. If it is non-essential then delegation is possible although it is a policy choice whether to do so and if so how.

BASEL III/ CRD IV

The CRD IV proposals are intended to be a translation of Basel III into EU law. You make the point that the Commission’s proposals weaken the Basel agreement in crucial areas. We note in particular that you express concern that the Commission’s proposal would “significantly dilute” the quality of capital that has to be held by institutions. Quality of capital is, of course, as important as quantity when determining how well institutions will be able to weather difficult economic conditions. To what extent do you believe the Commission’s changes would undermine the effectiveness of the Basel III rules? How likely are banks to meet the capital requirements contained in Basel III/ CRD IV given that banks across Europe are still under-capitalised? We also note that the markets have proved sceptical that recent bank stress tests have proved a reliable indicator of a bank’s creditworthiness. We hope that the market will place greater confidence in future stress tests that are applied once these rules have been implemented.

On the other hand, many provisions included in the package go beyond the requirements of Basel III and pursue EU-specific policy objectives for banks and investment firms which are not covered by the original Basel agreement. We would welcome clarification on what you consider to be the material differences between Basel III and CRD IV and the extent to which you perceive the EU rules to be watering down the original agreement.

SINGLE RULE BOOK

We consider that the legal form of the legislation proposed by the Commission, which opts for a Regulation to set out quantitative requirements over a Directive, is a significant change. We interpret this approach as a big step towards achieving a “single rule book” in banking, a tool for which we have expressed support in our recent report on the EU financial supervisory architecture. Does the Government also support the use of a Regulation, rather than Directive?
What is your assessment of the case for maximum harmonisation among euro area Member States alone? Could this be achieved without undermining the principle of a single rule book?

MAXIMUM HARMONISATION VS MINIMUM HARMONISATION

We note that you dispute the Commission’s proposal that a single rule book should rely on maximum harmonisation to discourage regulatory competition between different EU jurisdictions, favouring instead minimum harmonisation. This is a matter of considerable concern to the Committee, and we recognise your fear that maximum harmonisation might impinge on the national supervisor’s ability to impose more stringent capital requirements. The Vickers Commission, for example, recommended a minimum capital requirement of 10% for the UK retail banking operations of universal banks which exceeds the limit proposed by Basel III/CRD IV. If the CRD IV recasting package was to be adopted in its current form, do the Government believe that the UK could implement the Vickers Commission’s recommendations?

We find it difficult to believe that maximum harmonisation is appropriate in this case. At the same time, we note that the Commission has insisted that flexibility remains for countries that wish to impose stricter capital requirements by referring to the provisions on a countercyclical capital buffer contained in the proposed CRD IV Directive, rather than the Regulation itself. This was the view put by Mr Andrea Enria, Chair of the European Banking Authority, when he provided evidence before the House of Lords Economic Affairs Committee.

Has the Commission provided sufficient reassurance about the discretion of national supervisors to set capital requirements to reflect risks taken by individual banks to guarantee the UK’s ability to set higher capital requirements? To what extent will the proposed prudential system give national supervisors sufficient flexibility to address financial stability concerns as and when they arise? Is it ultimately possible to reconcile the need for capital levels that reflect the relative size of a country’s banking sector with the principles of a single market in financial services?

We note that the Commission proposes potentially very high fines as sanctions for firms that break the proposal’s rules – up to 10% of the total annual turnover of an institution. Does the Government believe that such large fines are a realistic deterrent, or is it more likely that fines this severe would never be levied?

PRO-CYCLICALITY

A significant point of capital requirements involves pro-cyclicality. There was a deep problem with the way Basel II was structured. The method used to calculate capital had the effect of exaggerating the amount of capital that banks had on hand during boom times while doing the opposite during a recession, thus exacerbating the economic cycle.

We took a stance against the pro-cyclical nature of Basel II in our report The future of regulation and supervision in the EU where we recommended that the Commission worked towards an overt counter-cyclical capital regime through further amendments to the Capital Requirements Directive in conjunction with changes to the Basel rules to ensure international consistency.

Jacques de Larosière, Chair of the high-level group on EU supervision, argued that dynamic provisioning was the best method of creating counter-cyclical capital requirements. Instead of forcing banks to hold a static amount of capital at all times, this dynamic method would allow it to vary over time. It would also increase the ability of banks to continue normal lending levels during a downturn.

While you express concern over the definition of capital provided in CRD IV, we find no reference to the problems of pro-cyclical and method used to calculate capital. Are the new rules as envisaged by CRD IV countercyclical enough to avoid the exacerbation of a recession? Is dynamic provisioning suggested as a method of creating counter-cyclical capital requirements?

REDUCED RELIANCE ON EXTERNAL CREDIT RATINGS

We welcome the Commission’s proposal to reduce over-reliance on external ratings to determine the level of capital for financial institutions and to estimate the risk of instruments and activities in which an investment might be made. The Commission’s approach reflects conclusions we reached in our recent report on credit rating agencies that “investors should not follow ratings blindly, but view them as opinions that need to be balanced and confirmed by other market indicators.”
Rating agencies have argued before the Committee that they never wanted ratings to be incorporated into legislation and that they would be happy for ratings not to be used in the calculation of capital requirements. We have supported the view that as far as possible the Commission should remove the reliance on ratings for regulatory purposes, in conjunction with similar changes to the Basel rules.

Hence it is still significant that the proposed CRD IV continues to allow the use of external credit ratings. To what extent will external ratings determine the level of capital that the institution is required to hold? Would the level of capital ultimately depend on internal rather than the external ratings? How will the interaction between the two work? And with reference to sovereign ratings, how will risk weighting of sovereigns be treated under CRD IV? Will the Basel II system of sovereign risk ratings be maintained?

COUNTERPARTY CREDIT RISK

With regard to counterparty credit risk, CRD IV encourages banks to clear their over-the-counter derivative through CCPs, provisions that we see as a complement to the draft European regulation on OTC derivatives known as EMIR which we have scrutinised closely. In particular, we discussed, at length, the proposal to apply higher capital charges to trades not centrally cleared, concluding that bespoke products should be appropriately risk-managed though the use of capital charges proportionate to risk. Increased capital charges on non-centrally cleared products could discourage the use of derivatives to hedge against risk by non-financial businesses.

While the final draft of the EMIR regulation accommodates our concerns by recognising that there are derivatives that are not suitable for CCP clearing especially for non-financial business, it is not clear whether CRD IV also does so. Could you confirm that CRD IV is in line with EMIR in that it exempts non financial business from the central clearing obligation with no additional penalties through additional charges?

During our inquiry on derivatives we recognised that CCPs themselves will become systemically significant given the increased number and proportion of contracts they clear, and a potential CCP collapse would pose a significant risk to the stability of the market as a whole. Will the CRD IV’s provisions on counterparty credit risk provide for increased capital to reflect the exposure of banks to the systemic risk of CCPs?

IMPACT AND IMPLEMENTATION AT INTERNATIONAL LEVEL

A final observation concerns the impact of the CRD IV. As suggested by a recent report by the EP, Basel III might have a bigger impact in Europe than in the United States since investments in the EU depend on the lending capacity of banks whilst the US economy is largely financed via the capital markets. Hence our concern is how changes to capital requirements will impact on the supply of credit into the economy. Do you believe that the Commission proposals strike the right balance between ensuring financial stability and the provision of credit by banks? Will stricter regulation of the EU banking sector encourage the proliferation of non-regulated shadow banking? And ultimately, will the entry into force of CRD IV be conditional on implementation in other important financial markets, in particular the US? If not, what will you do to ensure that rules are implemented consistently at international level?

We have agreed to keep the Commission’s proposals under scrutiny. We would be grateful for a response to our letter within the standard ten working days.

7 October 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 7 October following consideration by your Sub-Committee of the Explanatory Memorandum (EM) on the European Commission’s proposals to reform EU prudential requirements.

As your Committee will be aware, it is crucial that those areas of prudential regulation that proved deficient during the recent financial crisis are repaired in order to provide a more robust framework for the banking sector going forward. Turning to the specific questions in your letter, firstly let me clarify our concerns that the Commission’s proposal may breach the EU principle of subsidiarity.
SUBSIDIARITY

Although, it has already been accepted without objection that EU action in this area is necessary, our concern lies with the degree of EU intervention in Member States’ ability to conduct macro-prudential policy and where necessary to go further than the minimum standards to safeguard financial stability and mitigate fiscal risks. By eliminating the majority of national options and discretions in the EU prudential regime and ensuring minimum prudential requirements throughout the EU that are in line with the Basel agreement (although there are some very significant notable exceptions and exemptions from the minimum standards which are a cause for concern), the legislative proposals would significantly improve prudential regulation, increase depositor protection and ensure the competitiveness of the EU banking industry, according to the objectives identified by the Commission. However, whilst we accept the need for a Single Rule Book, a maximum harmonised Regulation would not allow Member States the discretion needed to ensure financial stability in their jurisdictions, as the section below on maximum harmonisation highlights. Furthermore it was never the intention that the agreement on the single rulebook at the European Council would lead to maximum standards which no discretion for Member States to go further on a systemwide basis. The attached Annex sets out the relevant extracts from the de Larosière report.

As far as achieving the general objective of financial stability is concerned, we do not believe the Commission’s proposals, which constrain action at national level in favour of exclusive action at EU level (and represent a different approach from the previous Directive), are consistent with the principle of subsidiarity. We do not believe this approach will better achieve the objective of financial stability than the ability for Member States to act flexibly at national level. Furthermore in working parties, the Commission have started to assert that with the implementation of this legislation raising prudential standards will, in practice, become an “exclusive competence” at the Union level. This is entirely inconsistent with the Treaty under which the regulation of financial services is a shared competence and also makes clear that fiscal policy remains a matter for Member States.

Turning to the justifications put forward by the Commission for maximum harmonisation, you highlight the Commission’s argument (at paragraph 5.1 of its Explanatory Memorandum to the draft Regulation) that without maximum harmonisation, risk might migrate to the shadow banking sector. The Commission, as with many aspects of this proposal, does not set out any evidence for this suggestion, so it is unclear precisely what its concerns are. Whilst the Commission’s objective of reducing burdens on cross-border firms is valid, this does not outweigh the need for Member States to take action at a national level where necessary. A single rule book, establishing harmonised definitions and minimum requirements throughout the EU, would significantly reduce the burdens on cross-border firms without infringing on a Member State’s ability to implement higher prudential standards. Therefore, unified regulatory requirements should not come at the expense of greater fiscal and financial stability risk to Member States.

Furthermore the European Stability Risk Board (ESRB) has made clear they consider that the Basel agreement represented an agreement about minimum standards including for Member States within the EU. The Chair of the ESRB, Jean-Claude Trichet, said the following in the press conference after the ESRB meeting on 22 June 2011: “If I may taking advantage of your question, sum up what I see the sentiment of a very large majority, an overwhelming majority of the board, I would say, first message apply the Basel accord, second message, the Basel requirements are minimum, and they have to be considered as minimum, they harmonise minimum at the level of the world and by way of consequence at the level of Europe. The figures that you have pronounced are a very important one which might be at the academic debate but we did not discuss that, but this idea that the requirements are a minimum I would say is the overwhelming sentiment of the members of the board”.

Furthermore we consider that one of the most significant distortions to the single market is the perceived implicit guarantee from states to banks. This perception is present to different degrees in different Member States. For example, credit rating agencies attribute different assumptions about likely governmental support to banks in different Member States. Maximum harmonisation will inhibit Member States from tackling this issue decisively.

Article 443 of the Regulation provides the Commission with the power to adopt delegated acts to impose stricter prudential requirements, for a limited period of time, for all exposures or for exposures to one or more sectors, regions or Member States, where necessary to address financial risks. By extension of our belief that Member States are best placed to identify risks to financial stability, it seems to us that the reservation of the power to impose stricter prudential requirements to the Commission and lack of power for Member States to impose stricter requirements themselves, raises significant subsidiarity issues. We do not consider that financial stability is an exclusive EU
competence as explained above. This is particularly the case where we consider that Member States are better placed to take appropriate action concerning their own financial stability, especially where it is the individual Member State that bears the burden of a financial crisis and the failure of an institution. It does not seem clear that the Commission would be able to respond faster than the competent authorities of Member States to risks as they arise. Furthermore, there are very limited constraints or checks and balances on the Commission’s powers in this proposal. They could in theory double minimum capital requirements in one Member State against the wishes of the Member State in question with very limited accountability mechanisms.

In August, the ESRB produced a paper that assesses the implications of the Commission’s proposal on the macro-prudential framework in the EU. It highlights significant differences in national economies and financial systems within the EU that require the need for national-adjusted policies, even in the context of a single rule book, which include:

— the structures of national banking systems;
— national monetary (outside euro area) and fiscal policy regimes;
— exchange rate regimes;
— economic cycles;
— deposit insurance arrangements and recovery and resolution regimes; and
— national supervisory arrangements and practices.

In addition, the ESRB paper questions the proportionality of preventing national authorities from taking measures where necessary for the effective fulfilment of national financial stability or macro-prudential mandates. Given the considerable experience, expertise, information and knowledge available to Member States, it is difficult to see how a delegation mechanism (such as Article 443) operated centrally at the EU-level can be better placed to assess macro-prudential conditions, systemic risks and appropriate policies for each Member State, than the Member States itself.

BaseL 3 / CRD 4

Basel 3 introduces significant reforms to the global regulatory framework for banks and the banking system, which aim to improve the banking sector’s ability to absorb shocks arising from financial and economic stress. For financial stability reasons, it is important that the prudential legislation adopted in the EU does not weaken the internationally agreed Basel 3 standards. However, the Commission’s proposal significantly weakens the agreement reached by the Basel Committee and, therefore, undermines the effectiveness of the regulatory framework set out in Basel 3.

In the policy implications section of the EM, I highlighted what the Government believes to be the significant divergences between the Basel agreement and the Commission’s proposal in relation to capital, liquidity and the leverage ratio. Of particular concern is the diluting of the quality of capital that institutions are required to hold, as you rightly suggest is important when determining how well institutions will be able to weather difficult economic conditions, through the treatment of deductions for capital held by banking groups in insurance subsidiaries and the definition of capital.

As the EM indicates, the inclusion of Article 46 allows institutions to deviate from the Basel treatment of deductions, which would provide considerable discounts from what would be the minimum capital requirements for certain institutions. This presents considerable risks to financial stability and raises competition issues across the EU, since this would be especially beneficial to certain institutions. On the definition of common equity tier 1 capital, the Basel committee agreed that the only instruments that should qualify as common equity tier 1 capital should be ordinary shares that meet 14 criteria. Ordinary shares were chosen by the Basel Committee because they were the instruments that were proven to be the most loss absorbent and transparent during the financial crisis. Despite this the Commission’s proposals do not limit the instruments that can qualify as common equity tier 1 to ordinary shares, potentially opening up scope for financial engineering. Therefore, the Commission’s proposal could significantly water down the Basel agreement.

You asked how likely banks are to meet the Basel 3 capital requirements. A considerable transition (or phasing-in) period was agreed as part of Basel 3. This means that, although minimum prudential requirements will be introduced from 2013, they will be phased-in until 1 January 2019. As the Basel Committee highlights, this will help to ensure that the banking sector can meet higher capital standards through reasonable earnings retention and capital raising, while still being able to lend to the economy.
The Government believes that the report from the High Level Group on financial supervision chaired by Mr Jacques de Larosière should form the basis of the single rule book. This report was endorsed by Finance Ministers at the June 2009 ECOFIN and clearly sets out that common minimum standards should be established across the EU allowing Member States to implement more stringent measures, if necessary, to protect financial stability in their jurisdiction. In particular, recommendation 10 of the de Larosière report states that ‘...a Member State should be able to adopt more stringent national regulatory measures considered to be domestically appropriate for safeguarding financial stability as long as the principles of the internal market and agreed minimum core standards are respected’

While the Government acknowledges there are benefits in setting out the Basel 3 requirements in the form of a Regulation rather than a Directive, the Government is concerned that it may be more difficult to accommodate appropriate national powers for Member States to take action in response to financial stability concerns in the context of a Regulation. We would like to see a single rule book providing a core set of EU-wide rules, which are based on the Basel agreement.

The case for maximum harmonisation among the euro area Member States alone would ultimately be a decision for euro area Member States. However, careful consideration would need to be given as to whether those Member States credit cycles are sufficiently correlated for it to provide a net benefit. It may be possible that this could be achieved without undermining the principle of the single rulebook, as it could be an extension of agreed harmonised definitions and minimum requirements throughout the EU, as part of these legislative proposals. In its paper on the macro-prudential framework in the EU, the ESRB highlights the potential benefits that macro-prudential policies set nationally could provide, even in countries where economic integration has advanced the most, such as the euro area, as a means of managing differences within a monetary union.

**MAXIMUM HARMONISATION VS MINIMUM HARMONISATION**

You asked whether the Commission’s proposal would allow implementation of the Vickers recommendations or allow sufficient flexibility to address financial stability concerns. As explained in the EM, the Commission proposes three ways in which Member States would be able to implement additional prudential requirements on banks, these are through:

1. the countercyclical capital buffer, the setting of which may take into account risks to financial stability in a Member State;
2. Pillar 2 requirements, applicable institutions or groups of institutions to address risks of a systemic nature; and
3. adjusting risk weights on exposures secured by land mortgages under the standardised approach.

The Government does not believe that these mechanisms go far enough to allow the implementation of the Vickers’ proposals on loss absorbency on a permanent basis or to provide sufficient macroprudential flexibility to address financial stability concerns. A minimum harmonised rather than maximum harmonised regulation would allow such flexibility, which is why we are arguing strongly for this in Europe.

The countercyclical capital buffer is not a mechanism to implement a permanently higher capital requirement. Firstly, it is designed to vary over time and be calculated on the basis of credit to GDP growth. If calculated on the basis of other variables, it is subject to review by European Banking Authority (EBA) and the ESRB on an annual basis. Therefore there is no guarantee that the buffer could be used to implement the higher capital on a permanent basis. Secondly, Member States can set a buffer level of above 2.5% only when justified under certain circumstances. It is unlikely that the UK could argue that such circumstances, and therefore a buffer above 2.5% should apply on a permanent basis. Thirdly, the buffer is designed to apply to all banks with exposure in the UK in the same manner, whereas the Vickers proposal is a requirement on UK retail banks.

The extension of the Pillar 2 measures to apply to groups of firms which are exposed to or pose similar risks (Article 95) is a welcome development, but we have concerns about how this new power is intended to operate in practice and to what extent it can be used to impose stricter requirements than those set out in the Regulation. We do not believe Pillar 2 measures are suitable to apply a permanently higher capital requirements or macroprudential policy either, as Pillar 2 measures must be:
in compliance with the evaluation of Pillar 2 risks as set out in the Directive and satisfy the binding guidelines of the EBA;

— reviewed annually through the EBA and reached via a joint decision process; and

— justified with reference to the inadequacy of other measures to contain the risks referenced in Directive.

If they breach any of these conditions it will be subject to legal challenge. Therefore implementing permanently higher capital requirements through this mechanism would carry with it uncertainty and considerable legal risk. Furthermore, the risks addressed through Pillar 2 and the supervisory review process retain an institution specific rather than systemic focus, which do not make it suitable for macroprudential purposes.

As highlighted in the EM, it is possible to complete the single rule book through a set of harmonised definitions and minimum requirements throughout the EU, without preventing Member States from implementing stricter requirements. Therefore, under this approach it would be possible for a Member State to choose to adopt prudential levels that are based on the relative size of the Member State’s banking sector, providing that the minimum prudential requirements that are set out in Basel 3 are met.

You asked whether potentially very high fines as sanctions for firms that break the proposal’s rules are a realistic deterrent, or whether it is more likely that fines this severe would never be levied. It is important that competent authorities have the flexibility to apply a wide range of sanctions to firms that do not comply with national laws, including, where appropriate, severe financial penalties. As provisions relating to the administrative sanctions and measures that should be available to competent authorities are set out in the Directive, they will be subject to transposition into national law, and application may therefore vary according to Member State. We note, however, that the sanctions are subject to publication requirements which will bring a degree of transparency into competent authorities’ practices and that the EBA guidelines, which are required to be issued on this matter, could further assist consistent and proportionate application of such penalties.

**PRO-CYCLICALITY**

The Commission’s proposal attempts to address pro-cyclicality through:

1. the conservation and countercyclical capital buffers. The Commission indicate that conservation capital buffer is aimed at ensuring institutions capacity to absorb losses in stressed period, which can be used during a downturn in economic conditions. Therefore the conservation buffer could play some role in addressing pro-cyclicality. Furthermore, the countercyclical capital is specifically intended to achieve the broader macro-prudential goal of tackling the credit cycle, by requiring institutions to hold more capital as credit growth significantly rises.

2. the introduction of a leverage ratio and higher prudential standards across the board, which will considerable constrain the ability of institutions from getting in such a dire position in the upturn, softening the blow of a downturn.

In addition, the International Accounting Standards Board is reconsidering the ‘incurred loss’ accounting model that was used before the crisis and contributed to the procyclicality of provisions. They are now developing an ‘expected loss’ model that will anticipate losses by at least two years which will help to smooth provisions over the smooth.

However, as the EM sets out, the Government believes that the legislation adopted should allow Member States the ability to impose more stringent requirements to respond flexibly and in a timely manner to systemic risks in their jurisdiction or to mitigate fiscal risk, through requiring higher levels for the application of system wide macro-prudential policy. Therefore, by limiting Member States to the tools outlined above to address pro-cyclicality, the Commission’s proposal presents a significant fiscal risk to Member States, by constraining Member States to ability to respond to merely adjusting capital buffers.

The Commission’s proposal does not suggest that dynamic provisioning should be used as a method of creating countercyclical capital requirements. But this is potentially an important macro-prudential tool that could be implemented in addition to the tools in the Commission’s proposal, to reduce pro-cyclicality.
REDUCE RELIANCE ON EXTERNAL CREDIT RATINGS

Banks, especially those which are more sophisticated, are being encouraged to develop their internal models where they conduct their own credit assessment. However, the expansion of internal ratings needs to be considered carefully because they haven’t always been robust. Often, banks lack the data to reliably predict how estimates and outcomes will vary with the cycle. As a result, internal models are currently often linked back to Credit Rating Agencies (CRA) ratings or CRAs’ default histories as external independent measures of risk. While internal models could be developed to link to a wider range of external measures of risk, it is unlikely that banks’ risk assessment practices would be improved by not using external ratings at all.

The Basel Committee’s securitisation workstream is currently developing a ‘hybrid’ approach to using to assessing the risk of securitisation exposures. This is where an external rating will be used in conjunction with internal estimates to assess the creditworthiness of exposures. If this is a successful approach, they will consider rolling this out to other asset classes to help reduce reliance on CRA ratings.

COUNTERPARTY CREDIT RISK

You asked whether the Commission’s proposal is in line with the European Markets Infrastructure Regulation (EMIR) in that it exempts non financial business from the central clearing obligation with no additional penalties through additional charges. The Commission’s proposals do not place any obligations of central clearing; rather they determine the capital requirements for banks exposures to central counterparties (CCPs) and bi-lateral derivative trades. It is likely that the capital that banks are required to hold against bi-lateral exposures to non financial business exposures will increase, however it is not clear that this will prevent non financials from accessing bi-lateral contracts.

IMPACT AND IMPLEMENTATION AT INTERNATIONAL LEVEL

The Government has consistently argued for a high standard of financial regulation, whilst recognising that the short-term impact on economic recovery is mitigated through appropriate transitional arrangements. Basel has agreed an extended transition period, with most elements of the package phased in gradually from 2013 to 2019. As noted in the Impact Assessment presented to Parliament, the studies by the Basel Committee show that the Basel reforms are well-calibrated and will provide large net benefits to the UK economy.

As mentioned above in response to your questions on maximum harmonisation, the Government is concerned that the Commission’s proposal does not provide sufficient flexibility for Member States to implement macro-prudential policy, in order to address financial stability concerns whenever they may arise. Therefore, the Government does not believe that Member States have sufficient ability to tackle the build up of excessive credit during the credit cycle.

At the September 2011 Washington Summit, Finance Ministers and Central Bank Governors of the G-20 reiterated the commitment made by the G-20 leaders at the 2010 Seoul Summit to fully implement Basel 3 along the agreed timelines. Full, consistent and non-discriminatory implementation of these new international standards is now crucial to minimise the risks of regulatory arbitrage and the fragmentation of international financial markets. Therefore, it is important that the US, and other nations that have publically committed to fully implement Basel 3, maintain their support by adopting legislation that implement the Basel 3 agreement.

20 October 2011

ANNEX

ANNEX – RELEVANT EXTRACTS FROM THE DE LAROSIÈRE REPORT ON FINANCIAL SUPERVISION

Page 28 – 29, paragraphs 107 - 109

107) How to correct such a situation?

First of all, it must be noted that harmonisation is not an end in itself and that consistency does not need identical rules everywhere. There are national approaches that can be beneficial to the interested countries while not falling into the drawbacks mentioned above. National exceptions should be looked at with this in mind.
Furthermore, allowing a country, under appropriate circumstances, to adopt safeguards or regulatory measures stricter than the common framework should not be rejected. As long as agreed minimum core standards are harmonized and enforced, a country could take more restrictive measures if it considers they are domestically appropriate to safeguard financial stability. This should of course be done while respecting the principles of the internal market.

This being said the problem of regulatory inconsistencies must be solved at two different levels:

— the global level. The EU participates in a number of international arrangements (e.g. Basel committee, FSF) and multilateral institutions (e.g. IMF) that cannot be unilaterally changed by the EU. If and when some changes in those global rules appeared necessary, Europe should "speak with one voice" as we will mention in the global chapter;

— the European level. The European Institutions and the level 3 committees should equip the EU financial sector with a set of consistent core rules. Future legislation should be based, wherever possible, on regulations (which are of direct application). When directives are used, the co-legislator should strive to achieve maximum harmonisation of the core issues. Furthermore, a process should be launched to remove key-differences stemming from the derogations, exceptions and vague provisions currently contained in some directives (see chapter on supervision).

RECOMMENDATION NO. 10 (PAGE 29)

In order to tackle the current absence of a truly harmonised set of core rules in the EU, the Group recommends that:

— Member States and the European Parliament should avoid in the future legislation that permits inconsistent transposition and application;

— the Commission and the level 3 Committees should identify those national exceptions, the removal of which would improve the functioning of the single financial market; reduce distortions of competition and regulatory arbitrage; or improve the efficiency of cross-border financial activity in the EU. Notwithstanding, a Member State should be able to adopt more stringent national regulatory measures considered to be domestically appropriate for safeguarding financial stability as long as the principles of the internal market and agreed minimum core standards are respected.

RESIDENTIAL PROPERTY DIRECTIVE (8680/11)

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

Thank you for your Explanatory Memorandum 8680/11, dated 8 June 2011, on a proposal for a Directive on credit agreements relating to residential property. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 13 September 2011.

We agree that it is important to create a sustainable mortgage market for consumers across the EU and to promote the stability of a financial sector which has indulged in unsustainable lending and borrowing practices. Does the Government believe, however, that this is the right time for the Commission to present this proposal, given the on-going effects of the financial crisis? Does the proposal duplicate measures already taken by the Financial Services Authority?

The draft Directive contains two key ideas: first, that consumers should be guaranteed a high level of protection; and secondly, that the single market in mortgages should become much more integrated.

On the first point, the draft Directive aim to ensure that customers do not borrow beyond their means by putting in place stricter rules on advertising, pre-contractual information, advice, and creditworthiness assessment. Do the Government believe that the Directive strikes the right balance between the need to avoid reckless practices by mortgage lenders and the provision of credit? Will it be more difficult for EU consumers to get a mortgage? Is there a risk that with these rules the Commission is seeking to design a European solution to a US problem?
The Commission is also attempting to integrate mortgage markets in the EU by removing barriers and reducing the costs of engaging in cross-border lending. How achievable is the Commission’s ambition to create a single market given that very few customers are active across borders? To what extent will the UK be able to profit from the passporting provisions?

What are the risks that a greater single market in mortgages will increase the risks associated credit agreements denominated in foreign currency? Will the new provisions create further pressure for the UK banks who find themselves outside the euro area?

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

14 September 2011

Letter from Mark Hoban MP to the Chairman

Thank you for your Committee’s letter dated 14 September. I note that the proposal will be kept under scrutiny and I will write to your Committee to provide an update on progress in due course. Your Committee’s letter also raised a number of questions to which I provide the Government’s responses below:

DOES THE GOVERNMENT BELIEVE THAT THIS IS THE RIGHT TIME FOR THE COMMISSION TO PRESENT THIS PROPOSAL, GIVEN THE ON-GOING EFFECTS OF THE FINANCIAL CRISIS? DOES THE PROPOSAL DUPLICATE MEASURES ALREADY TAKEN BY THE FINANCIAL SERVICES AUTHORITY?

The Government accepts the Commission’s argument about the need for this proposal, provided we can achieve sufficient progress against our negotiating objectives. This will ensure that the benefits of this proposal outweigh the costs.

Both the Commission and the European Parliament are committed to taking action in this area to address “irresponsible lending and borrowing” in the EU. The Commission’s impact assessment notes:

“The financial crisis had a substantial impact on EU citizens. Although an important contributing factor was the growth in securitisation, which allowed creditors to pass the risk of their lending portfolios to investors, consumers have faced the consequences first hand. Many have lost confidence in the financial sector and certain lending practices that used to prevail are now having a direct impact. As borrowers have found their loans increasingly unaffordable, defaults and foreclosures have risen. Addressing irresponsible lending and borrowing is therefore an important element in financial reform efforts”.

The Government recognises the importance of responsible lending and borrowing, and a sustainable mortgage market for EU consumers to support a stable housing market.

The UK, like many EU Member States, already benefits from an existing high level of mortgage regulation. Many of the Directive’s more detailed proposals are consistent with the FSA’s current regulation of the UK mortgage market.

The FSA is currently conducting a comprehensive review of mortgage regulation in the UK, the ‘Mortgage Market Review’. The FSA has been heavily involved in discussions on the Mortgages Directive and will ensure that their Mortgage Market Review proposals are as aligned as possible.

DOES THE GOVERNMENT BELIEVE THAT THE DIRECTIVE STRIKES THE RIGHT BALANCE BETWEEN THE NEED TO AVOID RECKLESS PRACTICES BY MORTGAGE LENDERS AND THE PROVISION OF CREDIT? WILL IT BE MORE DIFFICULT FOR EU CONSUMERS TO GET A MORTGAGE? IS THERE A RISK THAT WITH THESE RULES THE COMMISSION IS SEEKING TO DESIGN A EUROPEAN SOLUTION TO A US PROBLEM?

The Commission’s impact assessment recognises that their proposal may lead to an overall reduction in mortgage lending across the EU. The UK is working with other Member States in Council to put forwards amendments that ensure the provisions within the Directive are proportionate. This will enable lenders to retain the ability to lend as appropriate on a commercial basis, while providing adequate protection for consumers.

The UK is seeking amendments to the Commission’s proposal in a number of other areas. This will ensure that the Directive provides an EU-wide framework for mortgage regulation, with more detailed rules provided for by regulators at a national level to ensure the right outcomes for consumers.
HOW ACHIEVABLE IS THE COMMISSION’S AMBITION TO CREATE A SINGLE MARKET GIVEN THAT VERY FEW CUSTOMERS ARE ACTIVE ACROSS BORDERS? TO WHAT EXTENT WILL THE UK BE ABLE TO PROFIT FROM THE PASSPORTING PROVISIONS?

The Government’s impact assessment acknowledges the national differences in culture, language and attitudes to housing. As a result, the Commission’s ambition of creating a single market for mortgages is expected to provide limited benefits in the short to medium term for UK lenders, intermediaries and consumers. The ability for intermediaries to passport may present opportunities for UK firms to expand into other Members States, although we expect these benefits to be limited in the short to medium term.

WHAT ARE THE RISKS THAT A GREATER SINGLE MARKET IN MORTGAGES WILL INCREASE THE RISKS ASSOCIATED WITH CREDIT AGREEMENTS DENOMINATED IN FOREIGN CURRENCY? WILL THE NEW PROVISIONS CREATE FURTHER PRESSURE FOR THE UK BANKS WHO FIND THEMSELVES OUTSIDE THE EURO AREA?

The volume of foreign currency denominated mortgages entered into by UK consumers represents a very small percentage of the overall volume of lending.

The provisions within the Commission’s proposal relating to foreign currency mortgages are intended to enhance the level of protection offered to consumers who wish to enter into these types of transactions.

12 October 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 12 October 2011, in relation to EM 8680/11 on the Commission proposal for a directive on credit agreements relating to residential property. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 22 November 2011. Our scrutiny of this proposal has been informed by an oral evidence session held on 1 November, at which the Committee heard evidence from Jackie Bennett, Head of Policy, Council of Mortgage Lenders, Nigel Terrington, Chief Executive, Paragon Group of Companies, Vera Cottrell, Principal Policy Advisor, Which?, and from Annik Lambert, Secretary General, European Mortgage Federation.

In the context of the ongoing financial crisis we believe that it is inappropriate for the Commission to bring forward this proposal at this time. While we recognise that the proposal may bring regulatory benefits in less developed mortgage markets, or where, unlike in the UK, there is significant cross-border mortgage lending, we believe that it is ill-suited to the particular characteristics of the UK’s largely autarkic market, such as its large buy-to-let sector.

Our witnesses shared their views on recent developments in relation to the Directive, including the publication of a Presidency Compromise Proposal on 20 October, the draft Report by Mr Sánchez Presedo MEP, Rapporteur to the European Parliament’s ECON Committee and subsequent reports by European Parliament Committees. We also understand that a new Presidency Compromise Proposal was published on 3 November. We were told by our witnesses that, whilst the October Presidency Compromise Proposal was a broad improvement, Mr Sánchez Presedo’s document went into an unnecessary level of detail. Ms Lambert also told us that the second report by the ECON Committee was “closer to the initial principle-based approach text from the Commission”. How would you summarise the various proposals that have been brought forward since the original proposal was published, and what is the Government’s view in relation to them? What is the current status of negotiations, and what changes do you expect to be made to the original proposal in the final text? Do you expect that a revised text may still lead to an overall reduction in mortgage lending across the EU? To what extent will the proposed changes meet the Government’s concerns, and what will be their impact on the UK mortgage market as a whole? What are the wider implications for the UK housing sector?

We agree with you that the Commission’s argument about the need for this proposal should be supported, so long as the benefits of the proposal outweigh the costs. What do you see as the principal benefits and costs of the Commission’s proposal as currently drafted? Are the Commission right to seek to address irresponsible lending and borrowing and to protect consumers? If so, how would you respond to Ms Lambert’s statement that, in the context of the crisis we are facing, “consumer protection is not what we should be dealing with right now”, and that “there is no business case” for action at the EU level? Do you agree with her that the proposal could lead to “an imbalance in the responsibility between the consumer and the lender”? 
Ms Bennett told us that, though responsible lending is well-established in the UK, the UK has not been without its own problems, while Ms Cottrell told us that there was a need to move away from the “feast or famine” nature of the mortgage market that has characterised the UK in recent years. Do you agree with these assessments? If so, how do you think that mortgage regulation can be improved in the UK? In what ways would the Commission’s proposal enhance regulation in the UK? Could it, for example, have helped to prevent the problems suffered by Northern Rock in 2007?

You state that the FSA will ensure that their Mortgage Market Review proposals are as aligned as possible with the Commission Directive. The FSA have confirmed this to us. We agree with this approach, and stress the need to ensure as far as possible that a dual regulatory burden is not created. What update can you give us on when the FSA’s proposals will be brought forward? Are there any areas where you anticipate that such alignment will be difficult to achieve? If so, what will be the implications of this?

We believe that it would be sensible for the Directive to be drafted in such a fashion as to provide greater protection for those EU markets that require it, without placing an unnecessary burden on already well-regulated markets, such as the UK. Does the Directive as currently drafted achieve this balance? Our witnesses were content with the principle of European legislation, so long as it remained at a principles-based level. We agree with this. Given that the proposal is a Directive, would it in any case give the UK sufficient discretion in the way that its mortgage market is regulated, or are you concerned that this proposal will create an unnecessary extra layer of regulation?

Our witnesses told us that it is unrealistic to create a single rulebook for Europe because of the differences in mortgage markets, and that there are dangers in a one size fits all approach. Does the Directive as drafted avoid these dangers? If not, how does it need to be improved? Do you share the scepticism of our witnesses about the potential for growth in cross-border activity? Do you agree with Ms Lambert that a fully integrated mortgage market should be pursued as a long-term objective?

If so, what steps need to be taken to bring it about? Whilst we acknowledge your statement that the Commission’s ambition of creating a single market for mortgages is expected to provide limited benefits for the UK in the short to medium term, what steps does the UK need to take to prepare for the possible development of a more developed single market for mortgages in the longer term?

Our witnesses also drew attention to specific concerns about the content of the Directive. They warned of the particular dangers of “imposing unnecessary and disproportionate regulations” on specific elements that characterise the UK mortgage market, such as the private rented sector, the buy-to-let sector, shared ownership and shared equity schemes and various niche products. We share these concerns. We were told that amendments had been proposed in relation to the provision of information and advice, Ms Bennett was concerned about pre-contractual information, and the proposal for a European standard information sheet. She stated that this document was inferior to the UK’s Key Facts Illustration, but that “we would not have any authority to move away from what the directive ... requires”. Ms Bennett and Ms Cottrell were concerned that the Directive would not allow lenders to give advice on their own products. Ms Bennett also wanted the provisions in relation to advertising to be simplified, and was concerned that the Directive as drafted would place creditors and intermediaries under an obligation to gauge the financial knowledge of the client. We were told that, though some progress had been made in relation to the provision of advice, little progress had been made in relation to pre-contractual information because “there is no real appetite amongst Member States “to follow the UK’s position”. Why is this? Which other Member States agree with the UK’s position? What amendments are you seeking to achieve in these areas, and what update can you give us on the progress you are making towards achieving the UK’s goals?

In terms of the provision of information and advice, Ms Bennett was concerned about pre-contractual information, and the proposal for a European standard information sheet. She stated that this document was inferior to the UK’s Key Facts Illustration, but that “we would not have any authority to move away from what the directive ... requires”. Ms Bennett and Ms Cottrell were concerned that the Directive would not allow lenders to give advice on their own products. Ms Bennett also wanted the provisions in relation to advertising to be simplified, and was concerned that the Directive as drafted would place creditors and intermediaries under an obligation to gauge the financial knowledge of the client. We were told that, though some progress had been made in relation to the provision of advice, little progress had been made in relation to pre-contractual information because “there is no real appetite amongst Member States “to follow the UK’s position”. Why is this? Which other Member States agree with the UK’s position? What amendments can you give us in terms of negotiations over the text of the document in relation to these specific concerns?

In relation to the provisions on passporting and the role of mortgage intermediaries, we were warned by Ms Cottrell that “there is a real risk that UK consumers will experience advice from mortgage intermediaries that are not being properly supervised.” She was particularly concerned that internet-based companies could bypass any regulatory provisions, including those currently being proposed by the Government. Mr Terrington told us that these provisions are a potential invitation to fraud. We agree that it is essential to ensure that such risks are removed. What update can you give us on the steps that the Government are taking to seek to ensure that such intermediaries are adequately supervised? In particular, how can it be ensured that internet-based companies are effectively supervised? You have stated that you would prefer such supervision to be undertaken by the host state supervisor rather than the home state. To what extent is this position compatible with the
Government’s support for the single market? To what extent have the Government’s concerns been met in ongoing negotiations on this matter?

We would be grateful for a response to these questions. In the meantime, we will continue to hold the document under scrutiny.

24 November 2011

ROADMAP TO STABILITY AND GROWTH ((15624/I1))

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

Thank you for your Explanatory Memorandum 15624/I1 on the Commission’s Communication “A Roadmap to Stability and Growth”. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 29 November.

We interpret this Communication as an attempt by the Commission to reassert its influence in dealing with the euro area crisis, in the context of observations that the key decisions during the crisis have been taken on the basis of intergovernmental deals between Member States.

All the elements included in the Communication point towards the Commission’s determination to make progress with reforms that will, it hopes, lead to a stronger euro area, and may also result in further integration among euro area countries. We are examining many of the issues raised by the Communication in the context of our current inquiry into the euro area crisis, and we expect to publish our report soon. In the meantime we have agreed to clear this Communication from scrutiny.

29 November 2011

SHORT SELLING AND CREDIT DEFAULT SWAPS (13840/10)

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

Thank you for your letter of 24 May 2011, noting that the Commission’s proposal for a Regulation on Short Selling and certain aspects of Credit Default Swaps (CDS) proceeded to general approach at ECOFIN on 17 May 2011. You requested further detail regarding the passage of this proposal, in particular with respect to Articles 12 and 24.

Article 12 sets out restrictions applying to uncovered short sales of shares. The restrictions in relation to uncovered short sales of sovereign debt are now set out in Article 12A. The Government had particular concern surrounding the proposed restrictions on sovereign debt, and especially the prospect that uncovered short sales of sovereign CDS might be subject to restrictions.

Following negotiations in Council, the text agreed at general approach for Article 12A does not impose permanent restrictions on uncovered short sales of sovereign CDS. The restrictions in relation to uncovered short sales of sovereign debt remain. However, the impact of those restrictions is significantly reduced by the exemption given to market makers and authorised primary dealers in Article 15, In addition, a 'soft locate' rule for the borrowing of securities has been included, which ensures that where the person entering into a short sale has a reasonable expectation that settlement can be effected when it is due, the restrictions on uncovered short selling will not apply. This provision applies to both sovereign debt and equities.

On Article 24, the Government emphasised the importance of ensuring that the powers conferred on ESMA are legally robust.

We supported short selling proceeding to general approach, but only on the basis that the UK’s concerns in this area were acknowledged. Consequently, the Commission and Council produced a written statement as confirmation of their commitment to work during the trilogues with the European Parliament to find a solution taking into account the concerns expressed by Member States regarding the powers of ESMA in Article 24.

The trilogue process, which began on 23 May, will continue throughout June. I will, of course, provide a further update of our progress upon completion.

6 June 2011
Letter from Mark Hoban MP to the Chairman

The European Commission’s proposal for a Regulation on Short Selling and certain aspects of Credit Default Swaps (CDS) was discussed in Council working groups and a general approach was agreed at ECOFIN on 17 May 2011. You will recall that your committee granted a waiver for this as it was, and still is, under scrutiny. Trilogues between the Presidency, European Commission and European Parliament began on 23 May and have now concluded. Following the last Trilogue a text is expected to be agreed at COREPER on 10 November as an I point reflecting the general endorsement given by the European Council in its conclusions of 23 October.

In my letter of 6 June I updated you on the passage of this proposal, in particular with respect to Articles 12 and 24. During Trilogues there has been some movement in these articles which I have explained below.

ARTICLE 12 AND 12A

Article 12 and 12a set out restrictions applying to uncovered short sales of shares and sovereign debt, respectively. The text agreed at general approach for both articles included a ‘soft locate’ rule for the borrowing of securities, which ensures that where the person entering into a short sale has a reasonable expectation that settlement can be effected when it is due, the restrictions on uncovered short selling will not apply. The short selling of sovereign debt (Article 12a) retains the position agreed at general approach, however, during Trilogues the text for equities (Article 12) has lost some of this flexibility.

The text agreed at Trilogues for Article 12 (equities) now requires the short seller to enter into arrangements with a third party confirming that the share has been located, and to take other measures vis-a-vis third parties giving it a reasonable expectation that settlement can be effected when it is due. During Trilogue negotiations the European Parliament had pushed for a ‘hard locate’ where a short seller must have located and reserved the share he intends to short sell. This could have significantly impaired liquidity in the market tying up a large volume of securities that may never be borrowed. The text agreed provides more flexibility than the ‘hard locate’ because although the short seller will need to prove that he has ‘reasonable expectation’ of effecting settlement when it is due, he does not have to reserve the share.

ARTICLE 12B

The Government had particular concern surrounding the introduction of restrictions on sovereign CDS and the market detriment that this could cause. The text agreed at general approach did not impose restrictions on uncovered short sales of sovereign CDS. However, concerns were raised at ECOFIN by some Member States around the short selling of uncovered CDS on sovereign debt and it was agreed that this would be looked at during Trilogues. During Trilogue negotiations the European Parliament has strongly supported introducing restrictions around uncovered sovereign CDS. The text agreed at Trilogues proposes to put in place a ban, which will automatically apply to uncovered sovereign CDS unless a Member State suspends the ban. The Member State will only be able to do so where it can show that its sovereign debt market is not functioning properly, and that restrictions may have a negative impact on that market. The ban can be suspended initially for 12 months, and thereafter for six month periods.

We have worked to ensure that the proposed restrictions on uncovered sovereign CDS are workable and do not unduly impede the proper use of sovereign CDS as an instrument to hedge many types of risk. In particular, the impact of the ban is limited by Article 4 (1) of the regulation, which defines uncovered sovereign CDS. The effect of this article is that the restrictions would not apply in most circumstances. These include:

— hedging against the risk of default of the sovereign issuer where a natural or legal person has a long position in the sovereign debt of that issuer; or
— hedging against the risk of a decline in the value of the sovereign debt where the natural or legal person holds assets the value of which are correlated to the value of the sovereign debt.

ARTICLE 24 AND 24A

We supported the short selling proceeding to general approach, but only on the basis that the UK’s concerns that powers conferred on ESMA in Article 24 should be legally robust were acknowledged.
Consequently, we achieved a Council-COMMITMENT in the form of a statement at May ECOFIN that the concerns expressed by Member States regarding the lawfulness of the powers conferred on European Securities and Markets Authority (ESMA) in Article 24 would be taken into account during Trilogues. Despite this commitment our concerns regarding the lawfulness of Article 24 have not been addressed. Therefore the Government will not be able to support this part of the text to be agreed at Coreper on 10 November.

As explained in my letter of 7 February, we have significant concerns that as drafted, Article 24 - which confers powers on ESMA to choose between a range of measures which would ban or restrict short selling when ESMA considers that it is necessary to do so - would be unlawful and contravene the principle set out in the judgment of the Court of Justice of the European Union in the case of Meroni. Consequently, the Government will be considering how best to ensure legal certainty is provided.

Some progress has been made in that a new Article 24a has been introduced that provides a proper legal basis for ESMA to temporarily ban short selling of sovereign debt under Article 18 of the ESMA regulation. As a result, Article 24 now only applies to financial instruments other than sovereign debt. However, a consequence of the new Article 24a is that the Member State consent clause for a ban on short selling of their own sovereign debt was removed. Instead Member States will rely on the protections under Article 18 of the ESMA regulation. Article 18 of the ESMA Regulation limits ESMA’s intervention powers to a situation where the Council, in consultation with the Commission, the European Systemic Risk Board (and, where appropriate, the European Supervisory Authorities), has declared an emergency. There are also a number of safeguards inherent in Article 18. For example, ESMA may only address decisions to competent authorities where coordinated action by national authorities is necessary and the decisions may only direct the authorities to act in accordance with existing legislation so as to ensure that the requirements of that legislation are satisfied. Finally, the fiscal safeguard set out in Article 38 of ESMA Regulation applies to decisions taken under Article 18 and means that ESMA cannot take decisions that has a material or significant impact on the fiscal responsibilities of Member States.

I hope that this further information is helpful. Following agreement at COREPER, the European Parliament is expected to vote on the text at Plenary in November.

31 October 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letters dated 6 June and 31 October 2011, in relation to EM 13840/10 on the Commission’s Proposed Regulation on short selling and certain aspects of credit default swaps. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 8 November.

We welcome the fact that the agreed text seeks to differentiate between investors who use short sales as a legitimate tool to hedge or insure potential losses on shares or bonds and harmful speculators who may be trying to make a profit by influencing market moves. However, we continue to believe that it would be necessary to assess the possible effects of any restrictions of naked CDS trading on sovereign borrowing.

We also would like to repeat our view that restrictions on CDS and uncovered short sales in the EU would be meaningless if they could be circumvented by operating outside the EU.

On a final point, it is significant that you do not intend to support the part of the agreement which confers powers on ESMA to ban or restrict short selling under certain circumstances on the grounds that they are in contravention of the Meroni principle. You state that the Government will not be able to support this part of the text and that you will be considering how best to ensure legal certainty is provided. We would be grateful for further clarification of the Government’s position and the stance that you intend to take at Coreper on 10 November.

We did not find the Government’s argument convincing. Our view is that due to the highly cross-border nature of the CDS trade, giving ESMA such intervention powers might be necessary to preserve financial stability in the EU. In our update report on The EU Financial Supervisory Framework, we urged the Government to review their objection to these provisions, and instead acknowledge their necessity while ensuring that adequate safeguards are put in place.

We have agreed to clear the proposal from scrutiny in anticipation of the agreement to be reached at Coreper on 10 November.
Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 8 November 2011, regarding the European Commission’s proposal on short selling and certain aspects of credit default swaps (CDS). You requested further clarification of the Government’s position on Article 24 and the stance it would take at Coreper on 10 November.

The Government’s primary concern with Article 24 is that it does not comply with the principle set out in the judgment of the Court of Justice of the European Union (“CJEU”) in the case of Meroni. That principle states that “a discretionary power, implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy” cannot be conferred on an EU agency. Such a conferral of power would not be consistent with general legal rules limiting the delegation of powers or with the institutional balance enshrined in the Treaty on the Functioning of the EU. The CJEU has sought to protect the roles of the different institutions under successive Treaties, and allowing a wide discretion to an EU agency would trespass on the territory of both the institutions that are supposed to make policy (in this case, principally the Commission and arguably the Council and Parliament as the legislature), and of the CJEU, as it is well-established that “the rights and duties of Member States may be determined and their conduct appraised only by a judgment of the Court of Justice”.

The Government notes your view that it is necessary for ESMA to have intervention powers due to the highly cross-border nature of the CDS trade. However, the Government would like to stress that its concerns over Meroni refer not only to Article 24 as currently drafted, but also exclude any other workable means by which ESMA could be delegated such a banning power. In order to comply with Meroni, Article 24 would have to be redrafted in such a way as to remove any discretion from ESMA. The Government considers that this could only be done by writing into the Regulation an exhaustive list of specific and objective criteria to determine when a ban could be effected; such a rules-based regime would be unlikely to capture all circumstances in which a ban would be necessary, and would not be an effective means of addressing the risks to financial stability for which a short selling ban is designed.

The issues raised in the short selling dossier are not unique. The same issues are likely to arise whenever it is proposed that the enabling power in Article 9(5) of the ESA regulations, which permits the ESAs to be given a power in sectoral legislation temporarily to prohibit or restrict certain financial activities, be used. Moreover, the principle established in Meroni is not limited to financial services, but is important across Whitehall as it applies to all EU agencies. The ESAs are at the forefront of developments in relation to powers given to EU agencies and thus will set a precedent that will affect all EU agencies in all spheres. It is crucial to give ESAs legal certainty and as set out in my letter of 31 October 2011, the Government will be considering how best to ensure legal certainty is provided.

Although there were some improvements in the text during the Trilogue negotiations, our concerns regarding the lawfulness of Article 24 were not addressed. Given the seriousness of the legal concerns regarding Article 24 that I have set out in this letter, the Government decided it could not support the package at Coreper on 10 November and therefore chose to abstain.

The European Parliament voted in favour of the text at Plenary on 15 November. The text will now go through the Jurist Linguist process before being adopted.

21 November 2011

TRADE AGREEMENT BETWEEN THE EU AND COLOMBIA AND PERU (14757/11, 14760/11)

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

Thank you for your Explanatory Memoranda EM 14757/11 and 14760/11, dated 20 October 2011, on a proposal for a Decision on the signing of, and the conclusion of, the Trade Agreement between the EU and Colombia and Peru. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 15 November 2011.
We should be grateful for clarification as to which specific provisions of the agreement are considered by the Government as falling within Member State competence. If the Agreement is to be changed to show Member States as separate parties then there ought to be provision in it for a declaration of competence to make it clear, as between the EU and its Member States, which will be benefiting from the rights conferred by the Andean states and which are assuming the obligations to those states.

You indicate that the Government are likely to assert that the UK opt-in applies in respect of provisions in the agreement concerning mode 4 services. In line with our approach to the earlier FTA with Korea, we have doubts that this is justified. You also assert that the UK opt-in applies despite the fact that the proposed decisions do not have a Title V legal basis. As you know, our approach is that the UK opt-in is only engaged in respect of legislation which does have an express Title V legal basis. This is, however, a matter being pursued in separate correspondence.

Nevertheless, we do accept that the practical significance of these issues is affected by whether the UK becomes a separate party to the FTA or opts in. We should therefore be grateful for an early update on progress on these points.

We note that, in relation to human rights concerns, the Government believe that Colombia is keen to show progress in this area. We would be grateful for further information on the steps that Colombia is taking to address these concerns. We also note the Government’s commitment to “continue to have a frank dialogue with Colombia and Peru on human rights”. What steps are the UK, and the EU as a whole, taking to encourage such a dialogue?

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

15 November 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

The EU Economic and Financial Affairs and International Trade Sub-Committee considered your Explanatory Memorandum 16183/10 on a Commission Communication on Trade, Growth and World Affairs at its meeting on 4 October.

We wrote to you in January setting out some of our initial thoughts on this proposal. We recently took evidence from EU Trade Commission Karel de Gucht on this topic and a letter to the Commissioner, setting out some further thoughts, is attached to this letter.

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

5 October 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 24 May with the comments on this Proposed Regulation from the EU Economic and Financial Affairs and International Trade Sub-Committee.

I want to both answer your specific questions in turn (my answers have been held back as these have been overtaken by events in Brussels) but also to explain to you in detail the latest state of play. These discussions progressed at a rapid pace in recent weeks as the Presidency seized the opportunity to conclude discussions on this dossier and chalk it up as a success. I regret that, because of the fast moving situation, that this is the first opportunity to alert you to this situation. “Trilogue” discussions with the Commission and European Parliament have now been successful in achieving a First Reading deal despite a lot of points of substance being unclear at the outset of these recent discussions. This was then taken to COREPER on the 29th June where it was adopted as an item without discussion. The UK maintained our Parliamentary Scrutiny reserve. This will now go to the ECOFIN Council on 12 July. The final discussions on this dossier took place right up to the COREPER
I hope that the following information in answer to your specific questions contained in your letter (which proved helpful in guiding my officials in the negotiations) may go some way in helping your Committees in their Scrutiny considerations alongside the further information and impact assessment that I will need to send to you shortly.

You are right to point out that Article 10 of the UN Firearms Protocol (UNFP) covers import licensing but the proposed Regulation has never addressed imports, concentrating solely on the export of firearms. The requirement in Article 10 UNFP is that Member States “shall establish or maintain an effective system of export and import licensing or authorization”. I am confident that Council Directive 91/477/EC – the “Weapons Directive” – provides an adequate set of measures for Member States to meet this requirement. However, I think it is clear that while this Directive represents a minimum standard in most Member States, many like the UK have stringent national import controls in place that entirely meet the requirements of Article 10 UNFP.

On your point about applying the Regulation to countries that have not signed up to the Protocol, I think it is clear that it is the intention to do this. However, as these countries in many cases will clearly lack the requisite administrative structures and procedures in areas such as transit and import controls it is possible that a number of problems will be created for manufacturers and traders trying to obtain clearance from these countries. On this basis, my officials have been attempting to introduce text into the discussions (for example on widening the transit exemptions) to limit the impact wherever possible on business and private individuals. This will be a factor to be covered in our Impact Assessment.

On Article 3 of the proposed Regulation, relating to “State to State transactions or State transfers”, this is something my officials tried to raise in the Council Working Group for clarification but unfortunately there was not any opportunity for this to be discussed before the Working Group ended with the Presidency entirely focused on resolving issues connected to Article 7. This remains unchanged in the final text.

I disagree that the phrasing in Article 3(b) exempting firearms if they are “specially designed for military use” would seem to exempt nearly all firearms. The proposed Regulation is meant to apply uniform export controls on firearms not intended for military purposes, but it does apply to firearms for civilian uses such as hunting and sports shooting - that is specifically those firearms that are not “specially designed for military use”. The provisions of Directive 2009/43/EC and Council Common Position 2008/944/CFSP will continue to apply to those firearms specified in the EU Common Military List, which includes firearms specially designed for military use.

On Article 3, I can confirm that the exemption for collectors and bodies concerned with cultural and historical aspects of firearms was deleted as a result of discussions in the Council Working Group. Member States had concerns that museums (and other similar bodies that had not been properly defined in the Regulation) would be exempt from export licensing requirements for firearms under this Regulation. However, this was re-instated following the first “Trilogue” meeting and remains in the final text but includes an amendment that these collectors and bodies have to be recognised by each Member State for the purpose of this Regulation. This looks to provide sufficient reassurance on this issue.


On the “tacit consent” procedures, you are right to highlight that this system of approval is not consistent with the UN Firearms Protocol. Furthermore, the practicalities surrounding the operation and enforcement of these arrangements look extremely difficult. For both of these reasons, some optional language has been included in the latest text that allows both tacit and written procedures to be operated by Member States depending on their viewpoint on this issue. The UK position (supported by UK industry representatives) is to support the option of requiring written approval for transit. Several Member States are however, squarely behind the tacit option and have persuaded the Commission to support it. The optional language remains in the final version of the text.
Article 7 of the Regulation was the subject of intensive discussion in the Council Working Group over the past month or so. A final text was only recently agreed in the Council Working Group on 22 June. On your specific question, on how we would verify a lawful purpose, the starting point will be to produce some guidance that sets out exactly what constitutes a verifiable lawful purpose as the UN Firearms Protocol only lists hunting, sport shooting, evaluation, exhibitions or repairs. Once that has been established, it would be for the exporter to demonstrate through the usual export licensing requirements that his export falls within these export scenarios.

I will need to write to you again shortly to provide your Committee with our final analysis on the outcome on the negotiations when we have had time to look at this in more detail and to provide you with an impact assessment to inform your scrutiny decision.

4 July 2011

Letter from the Chairman to Mark Prisk MP

Thank you for your letter, dated 4 July, on EM 10963/10 on a proposed Regulation implementing the UN Firearms Protocol. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 13 September.

We welcome your full response to the questions raised in our previous letter. We understand, however, that it is expected that this proposal will be agreed at Competitiveness Council on the 29 September. Given the fast pace of negotiations over the past few months, we have yet to be informed of the final outcome of negotiations, or receive a UK-specific impact assessment.

We cannot see any urgent need for this proposal to be agreed on the 29 September when parliamentary scrutiny has yet to be completed. Under the circumstances, we have decided to maintain the scrutiny reserve on this proposal at the present time.

14 September 2011

Letter from Mark Prisk MP to the Chairman

Thank you for your letter of 14 September with the outcome of your Committee meeting on 13 September.

I fully understand your position on parliamentary scrutiny and the maintenance of your scrutiny reserve. I can report that this proposal was not on the agenda of the Competitiveness Council on 29 September and it is now anticipated to be placed on the agenda for a forthcoming Council agenda early next month.

I have enclosed with this letter the Impact Assessment Checklist [not printed] which I hope will enable your Committee to reach a decision on your scrutiny position at a forthcoming meeting in time for the vote in Council at the start of next month.

21 October 2011

Letter from the Chairman to Mark Prisk MP

Thank you for your letter, dated 21 October 2011, on EM 10963/10 on a Proposed Regulation implementing the UN Firearms Protocol. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 1 November.

Thank you for providing us with the Impact Assessment Checklist. We also asked to be informed of the final outcome of negotiations. We note that the proposal is now anticipated to be placed on the agenda for a forthcoming Competitiveness Council agenda early this month. We would be grateful if you could provide us with further details of your analysis of the outcome of negotiations, as promised in your letter of 4 July 2011.

In the meantime we have agreed to clear this document from scrutiny.

1 November 2011
Letter from David Gauke MP, Exchequer Secretary to the Treasury, to the Chairman

I would like to update you on developments relating to the application of VAT to postal services since the Committee was last updated on 2 July 2009. There are three elements to this: a European Commission proposal; a judicial review; and, European Commission infraction proceedings.

As you know, the European Commission on the VAT treatment of postal services proposal has a long history; it was issued in 2003. A year of discussions between Member States followed. However, after this period, talks stalled. Discussions started up again under the Swedish Presidency in the latter half of 2009 and continued under the Belgian Presidency in 2010. The UK, with support from Germany, remained firm in its objections to the proposals. Continued deadlock under the Belgian Presidency resulted in a December 2010 ECOFIN meeting concluding that although there was some interest in agreeing changes to the VAT treatment of postal services, given strong Member State positions, there was no prospect of unanimous agreement and therefore the exemption will remain in place. The proposal however remains on the table but we understand that the Commission is considering withdrawing it.

At the time of the last update, the European Court of Justice had recently released its decision in the case of TNT Post (C-357/07). The ECJ decided that the VAT exemption for Royal Mail was required under the Principle VAT Directive, but only in respect of services provided in its capacity as the public postal service provider. Individually negotiated contracts therefore fell outside the exemption. Parliament agreed changes to UK VAT legislation (effective from January 2011) to take account of the decision. TNT recently lodged a second application for judicial review on the basis that the UK legislative changes did not go far enough. However, HMRC contests the challenge and is defending its position.

Following the changes made to the UK’s treatment of postal services, the Commission’s infraction proceedings against the UK have now been closed. This was agreed in a College of EU Commissioners meeting on 16 June this year.

I hope you find this information helpful and I will update you again if there are material developments.

19 July 2011

Letter from the Chairman to David Gauke MP

Thank you for your letter dated 24 May on a Green Paper on the future of VAT (Explanatory Memorandum 17491/10). The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 18 October 2011.

We are content to clear the Green Paper from scrutiny. We will defer any further consideration of this subject as we expect a Communication by the end of the year which will set out the future legislative and non-legislative actions in relation to VAT.

18 October 2011