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 November 2012 – 8 May 2013

### ECONOMIC AND FINANCIAL AFFAIRS

**(SUB-COMMITTEE A)**

#### CONTENTS

<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE (18038/12)</td>
<td>3</td>
</tr>
<tr>
<td>ANNUAL REPORT ON INTERNAL AUDITS IN 2011 (14431/12)</td>
<td>6</td>
</tr>
<tr>
<td>ASSISTANCE TO PORTUGAL AND EXCESSIVE DEFICIT IN GREECE (17455/12,</td>
<td>7</td>
</tr>
<tr>
<td>15645/12, 15646/12)</td>
<td></td>
</tr>
<tr>
<td>BANK RECOVERY AND RESOLUTION (11066/12)</td>
<td>7</td>
</tr>
<tr>
<td>BANKING UNION (13682/12, 13683/12, 13854/12)</td>
<td>13</td>
</tr>
<tr>
<td>COHESION POLICY (15243/11, 15247/1, 15249/11, 15250/11, 15251/11,</td>
<td>17</td>
</tr>
<tr>
<td>15253/11, 13730/12)</td>
<td></td>
</tr>
<tr>
<td>CREDIT RATING AGENCIES REGULATION-UPDATE (17308/11, 17329/11)</td>
<td>23</td>
</tr>
<tr>
<td>CUSTOMS 2020 (13265/12)</td>
<td>24</td>
</tr>
<tr>
<td>CUSTOMS RISK MANAGEMENT AND SECURITY OF THE SUPPLY CHAIN (5249/13)</td>
<td>25</td>
</tr>
<tr>
<td>DISCHARGE OF THE 2010 BUDGET (14652/12)</td>
<td>27</td>
</tr>
<tr>
<td>ECB OPINION: BANK RECOVERY AND RESOLUTION (17849/12)</td>
<td>29</td>
</tr>
<tr>
<td>ECB OPINION: ON FINANCIAL ASSISTANCE FOR NON-EURO AREA MEMBER STATES</td>
<td>30</td>
</tr>
<tr>
<td>(5477/13)</td>
<td></td>
</tr>
<tr>
<td>EURO AREA ECONOMIC GOVERNANCE: THE ‘TWO PACK’ (17230/11, 17231/11,</td>
<td>31</td>
</tr>
<tr>
<td>17323/11)...</td>
<td></td>
</tr>
<tr>
<td>EU BUDGET: 2013 DRAFT BUDGET AND 2012 DRAFT AMENDING BUDGET NO 6</td>
<td>31</td>
</tr>
<tr>
<td>(15272/12)</td>
<td></td>
</tr>
<tr>
<td>EU BUDGET 2012 AND DRAFT BUDGET 2013 (UNNUMBERED EM)</td>
<td>33</td>
</tr>
<tr>
<td>EUROPEAN COMMISSION COMMUNICATIONS ON GENUINE ECONOMIC AND MONETARY</td>
<td>36</td>
</tr>
<tr>
<td>UNION (6849/13, 7945/13)</td>
<td></td>
</tr>
<tr>
<td>EUROPEAN COURT OF AUDITORS ANNUAL REPORT 2011 (6984/13)</td>
<td>37</td>
</tr>
<tr>
<td>Title</td>
<td>Page</td>
</tr>
<tr>
<td>----------------------------------------------------------------------</td>
<td>------</td>
</tr>
<tr>
<td>EUROPEAN COURT OF AUDITORS ANNUAL REPORT 2011 (UNNUMBERED EM)</td>
<td>37</td>
</tr>
<tr>
<td>EUROPEAN GROUPING OF TERRITORIAL COOPERATION (EGTC) (15251/11)</td>
<td>39</td>
</tr>
<tr>
<td>EUROPEAN SEMESTER 2013: ALERT MECHANISM REPORT (16671/12, 16513/12)</td>
<td>39</td>
</tr>
<tr>
<td>AND 2013 EUROPEAN SEMESTER: ANNUAL GROWTH SURVEY (16669/12)</td>
<td>43</td>
</tr>
<tr>
<td>EUROPEAN SEMESTER 2013: ANNUAL GROWTH SURVEY (16669/12)</td>
<td>43</td>
</tr>
<tr>
<td>EUROPEAN STATISTICS: REPORT (14230/12)</td>
<td>45</td>
</tr>
<tr>
<td>EVALUATION OF THE UNION’S FINANCES (16850/12)</td>
<td>47</td>
</tr>
<tr>
<td>FINANCIAL ASSISTANCE FOR NON-EURO AREA MEMBER STATES (12201/12)</td>
<td>49</td>
</tr>
<tr>
<td>FINANCIAL REPORTING AND AUDITING FOR THE PERIOD 2014-2020 (5213/13)</td>
<td>50</td>
</tr>
<tr>
<td>FINANCIAL TRANSACTION TAX (14942/11)</td>
<td>51</td>
</tr>
<tr>
<td>FINANCIAL TRANSACTION TAX (6442/12, 15390/12)</td>
<td>61</td>
</tr>
<tr>
<td>FISCALIS 2020 (13346/12)</td>
<td>63</td>
</tr>
<tr>
<td>INSURANCE MEDIATION (12407/12)</td>
<td>67</td>
</tr>
<tr>
<td>INTERIM REPORT OF THE FOUR PRESIDENTS: TOWARDS A GENUINE ECONOMIC</td>
<td>68</td>
</tr>
<tr>
<td>AND MONETARY UNION</td>
<td></td>
</tr>
<tr>
<td>INVESTMENT PRODUCTS: KEY INFORMATION DOCUMENTS (12402/12)</td>
<td>69</td>
</tr>
<tr>
<td>MARKET ABUSE (16000/11, 16010/11)</td>
<td>71</td>
</tr>
<tr>
<td>MARKET ABUSE: AMENDED PROPOSAL (13023/12, 13037/12)</td>
<td>74</td>
</tr>
<tr>
<td>MIFID II (15938/11, 15939/11)</td>
<td>75</td>
</tr>
<tr>
<td>REQUIREMENTS FOR BUDGETARY FRAMEWORKS OF MEMBER STATES (17929/12)</td>
<td>76</td>
</tr>
<tr>
<td>SCRUTINY ISSUES AT HM TREASURY: YOUR EVIDENCE OF 5 FEBRUARY 2013</td>
<td>77</td>
</tr>
<tr>
<td>TAX FRAUD AND TAX EVASION (17617/12, 17637/12, 17669/12)</td>
<td>79</td>
</tr>
<tr>
<td>TOWARDS A GENUINE ECONOMIC AND MONETARY UNION (16988/1/12)</td>
<td>82</td>
</tr>
<tr>
<td>UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES</td>
<td>84</td>
</tr>
<tr>
<td>(UCITS V) (12397/12)</td>
<td></td>
</tr>
<tr>
<td>UPDATE ON CAPITAL REQUIREMENTS REGULATION AND DIRECTIVE 4 (13284/11,</td>
<td>85</td>
</tr>
<tr>
<td>13285/11)</td>
<td></td>
</tr>
<tr>
<td>VAT FRAUD: QUICK REACTION MECHANISM (13027/12)</td>
<td></td>
</tr>
</tbody>
</table>
Letter from Sajid Javid MP, Economic Secretary, HM Treasury to the Chairman

I wrote to the Committee on 24 January, providing the UK’s Explanatory Memorandum on the Delegated Regulation implementing the Alternative Investment Fund Managers Directive (AIFMD). I am now writing again to let the Committee know that the Government has decided not to object to the Regulation.

The Government is content with much of the Regulation and considers it is important that industry now has certainty over operational details ahead of the Directive’s implementation in July 2013. The Government is also determined that the UK take full advantage of the opportunities created by the Directive over this period to attract further funds business to the UK.

I identified in particular three areas of concern in the Explanatory Memorandum:

**The risk that application of the “Letterbox Entity” provisions could be interpreted to unduly restrict business models.**

As noted in the Explanatory Memorandum, the Government considers there to be scope for the Financial Conduct Authority to take a proportionate approach to application of the provisions.

The Financial Services Authority set out its general approach to delegation ahead of the provisions’ publication, as part of its first Consultation Paper on the implementation of AIFMD. The FCA noted its intention to “assess any delegation arrangements on a case-by-case basis in a robust and flexible way”. The FSA will be providing further guidance to industry in due course.

**The depositary provisions could impose a greater level of cost than necessary to provide effective investor safeguards.**

Asset managers and depositaries are currently determining how best to mitigate cost implications. For example, it is possible that co-location of some depositary and asset manager functions may help to minimise duplication of cash monitoring. It is too early, however, to determine which approaches will be adopted.

**The Government would have preferred the Regulation to permit the advanced method for calculating leverage, in order to provide fuller information to investors and regulators.**

The Government notes the opportunity for the Regulation to permit this in future upon further work by ESMA and will be encouraging this to happen in due course.

8 February 2013

Letter from the Chairman to Sajid Javid MP

Thank you for your Explanatory Memorandum, dated 24 January 2013, and your letter, dated 8 February 2013, on EM 18038/12 on the Commission delegated regulation supplementing Directive 2011/611/EU (the Alternative investment Fund Managers Directive) with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision. The House of Lords European Union Sub-Committee considered this document at its meeting on 12 February 2013.

The Committee has taken a close interest in the Alternative Investment Fund Managers Directive (AIFMD). Our 2010 report, Directive on Alternative Investment Fund Managers, considered the Directive in detail, and, whilst concluding that coordinated regulation and supervision of managers at EU level would be beneficial to the single market and the EU economy as a whole, expressed concern about the dangers of a one-size-fits-all approach to all non-UCITS funds. We also stressed the need for EU legislation to be in line with, and to complement, global arrangements, or else the Directive could seriously damage the EU and UK economies. We exchanged further correspondence with you as negotiations on the Directive continued.

We note this delegated legislation, and your support for much of the Regulation in allowing AIFMD to be implemented successfully, bringing the benefits of stronger investor protection, improved monitoring of systemic risk and opening up of the single market. Notwithstanding this, we note that the draft regulation diverges from ESMA advice in a number of areas. You express particular concern
that such divergence has the potential to impose unnecessary costs and restrict flexibility. We would be grateful for a number of points of clarification.

Your concerns centre on the letterbox entity test, depositary provisions and, of particular importance, the question of the calculation of leverage. Are there any other areas where the draft regulation differs from the ESMA draft? What is the Commission’s justification for adopting a different position? Is this variance unexpected? What is ESMA’s response? Is there any precedent for the Commission putting forward a proposal at variance with ESMA advice in this manner? On what grounds would you have preferred the Regulation to permit the advanced method for calculating leverage? What are the benefits of this method over the ‘gross’ method and the ‘commitment’ method?

Although you state that the Government believe that the draft Regulation has the potential to impose unnecessary costs and restrict flexibility, you make clear in your letter of 8 February that the Government have decided not to object to the Regulation. We are grateful for this confirmation. You state that you consider it important that industry now has certainty over operational details ahead of the Directive’s implementation in July 2013. Can you tell us what recent discussions you have had with industry representatives on this Directive? What is their view of recent developments? What is the position of other Member States? What update can you give us on the timetable for agreement of this delegated legislation?

Finally, you state that HM Treasury is transposing AIFMD ahead of the July 2013 deadline for implementation. What update can you give us on this process?

We would be grateful for a response to these questions by 28 February 2013. In the meantime we have agreed to clear the document from scrutiny.

13 February 2013

Letter from Sajid Javid MP to the Chairman

Thank you for your letter dated 13 February in which you confirm the European Union Committee has agreed to clear the AIFMD Delegated Regulation from scrutiny. You have asked for a number of points of clarification.

DIVERGENCE OF REGULATION FROM ESMA ADVICE

In addition to the letterbox entity test, depositary provisions and the calculation of leverage, the Commission’s delegated regulation diverges from ESMA’s advice in a number of other areas:

— Rejection of ESMA’s advice that a minimum threshold and cap on the requirements for Professional Indemnity be introduced. These were rejected by the Commission as they were regarded as giving an unjustified advantage to larger AIFMs. The Commission notes that the resulting coverage for average AIFMs differs little from that under the ESMA proposal.

— A lower threshold of Assets Under Management for which quarterly reporting to regulators is required. The threshold is 1bn Euros compared to 1.5bn Euros in ESMA’s advice. The Commission notes that the reporting frequency should be balanced between the need for competent authorities to prevent systemic risk and the avoidance of excessive administrative burden for authorities and AIFMs. They, however, give no detailed explanation as to why they consider ESMA had not struck the right balance.

— A fixed Net Asset Value threshold has been introduced, above which an AIF would be considered to be employing leverage on a substantial basis. ESMA recommended giving greater flexibility but the Commission justifies the fixed threshold arguing it gives greater legal certainty.

The Commission is not required to follow ESMA advice in adopting a delegated act and has considerable autonomy in how it does so, although it is required to consult Member States as part of the process. The process for adopting delegated acts is relatively new; it was introduced in article 290 of the Treaty of the Functioning of the European Union, in 2009. However, there are other early examples of where the Commission has adopted a different position to ESMA, for example in the Delegated Act on short selling.

However, the ESMA advice was developed by regulators with the help of other experts and was consulted on in a transparent process involving industry and investors. As a result, ESMA produced
advice that balanced competing considerations and is based on a sound understanding of the potential impact. The UK considers that the Commission will exceptionally need to depart from this advice. Where it does so, it needs to be in a position to explain and justify its rationale, provide confidence that alternatives have been considered using a similarly robust process, and demonstrate that the impact of its proposals is fully understood. Member States and the European Parliament should be fully involved through this process.

ESMA has not adopted an official position on the Commission Delegated Regulation.

**CALCULATION OF LEVERAGE**

The advanced method of calculating leverage allows for greater flexibility in netting off different positions. We would have preferred to give managers the option of reporting against the advanced method in addition to the gross and commitment methods for two reasons:

— Without the advanced method, regulators will be unable to receive directly from all AIFMs the information necessary to fulfil their Directive obligation to detect, monitor and respond to risks from AIFMs deploying leverage. This is particularly the case for AIFMs deploying specific strategies, such as in global macro funds; and

— Investors will also receive less relevant information on which to base their decisions on risk, with the potential for them to be misled about the comparative risk profiles of different funds. For example, a fund with a high leverage figure based on the commitment method might – as a result of offsetting arrangements that reduce risk but are not captured by the commitment method - actually have a lower exposure than another fund stating a lower “headline” figure based on the commitment method.

The Commission’s reasoning was that it was concerned that ESMA’s advanced method proposal could not be applied in a comparable manner across the EU and that methods of calculating leverage should be exhaustive.

**REACTIONS TO DELEGATED REGULATION AND NEXT STEPS**

The Treasury has engaged extensively with industry representatives throughout the process. These include the Investment Management Association (IMA), the Alternative Investment Management Association (AIMA), the British Venture Capital Association (BVCA) and the Association of Investment Companies (AIC). This has included discussions both prior to and following adoption of the Delegated Regulation.

We would characterise the views of the industry representatives in general as recognition of improvements achieved in the text, frustration where unnecessary costs and loss of flexibility remain and a shift in focus to ensuring effective implementation in the UK and elsewhere.

A number of other member states share the UK’s view in that they support much of the Regulation but have reservations around provisions including the Letterbox Entity Test. Along with the UK, they ensured that the Commission was aware of their concerns, and was able to adjust its proposed Regulation prior to adoption.

A number of other member states also share the UK’s concern that the process by which the Delegated Regulation has been developed lacks transparency. The UK is joining these Member States in formally minuting these concerns in Council. This document is attached.

The Council and Parliament have three months from the date of adoption in which to object to the Delegated Regulation, otherwise it will enter into force automatically. No Member State has objected and the Government considers it highly unlikely that the Parliament will do so, which means the Regulation will be published in the official journal shortly after 19 March 2013 and will enter into force 20 days later. It applies from 22nd July 2013, the implementation deadline for AIFMD.

**UK IMPLEMENTATION OF AIFMD**

The UK is on track to implement AIFMD by 22 July 2013. The Government’s main consultation, which set out the key policy decisions, closed on 27 February and may be found on the Treasury’s website. A short follow-up consultation will be published shortly, covering issues which it was not possible to cover in the main consultation. In parallel, the FSA is undertaking its own consultation.
20 November 2012

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

In response to the letter of the House of Lords Scrutiny Committee dated 20th November 2012, we are able to provide the following additional information in respect of the questions asked.

— Who are the key officials in the IAS?

The Director General of the IAS is Philippe Taverne. The European Commissioner responsible for the IAS is Algirdas Šemeta.

— How are decisions reached as to which aspects of the Commission’s activities will be audited and what is the rationale for such decisions?

The IAS works to a three-year audit plan based on considerations of risk, updated annually. The plan takes account of areas of risk/concern identified by Commission management, the European Audit Progress Committee (APC) and EU Directors-General/Heads of Service. The IAS reports to the APC, which endorses its plan. The IAS also presents its audit programme to the European Court of Auditors (ECA) annually. The IAS co-ordinates its work, as appropriate, with that of the ECA, who act as the Commission’s external auditors, in a similar manner to the operation of the National Audit Office in the UK.

— What role and involvement do Member States have in the work of the Service?

IAS work is focussed on European Commission Directorates-General and executive agencies. It co-ordinates its work with the Directorates-General own internal audit teams and the ECA as appropriate.

The involvement of Member States with the work of the IAS is therefore in relation to their engagement in the organisations audited by the IAS.

— What interaction have the UK Government had with the Service?

In addition to interactions in relation to the UK government’s engagement in the organisations audited by the IAS, the Treasury liaises with the IAS by providing an annual assurance report to the EU Commission on the management of funds under shared management with the EU - Structural Funds, Cohesion Fund and European Fisheries Fund. This feeds into the work of the IAS and involves liaison between the Treasury and the relevant UK Audit Authorities. This report is reviewed,
together with other returns provided by the UK Audit Authorities, at an annual meeting between the UK Audit Authorities and the Directorates-General who deal with Structural Funds. The Treasury also collates the annual summary report to Parliament on internal audits carried out by the IAS.

16 December 2012

ASSISTANCE TO PORTUGAL AND EXCESSIVE DEFICIT IN GREECE (17455/12, 15645/12, 15646/12)

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

I am writing with regard to EM 17455/12: a proposal for a Council Implementing Decision amending Implementing Decision 2011/344/EU on granting Union financial assistance to Portugal, and EMs 15645/12 and 15646/12: a recommendation for a Council Decision amending Decision 2011/734/EU addressed to Greece with a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit and a related Commission Communication. These documents were all cleared from scrutiny at the sift on 8 January 2013.

It appears that these documents were subject to an override. Can you confirm whether this is the case? Whilst we accept that, due to the time constraints, an override was justified in these cases, we would remind you that, in line with the spirit of the House of Lords Scrutiny Reserve Resolution, we expect you to inform us on each occasion that an override has occurred, and to explain the reasons why it did so.

22 January 2013

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

Thank you for your letter of 22 January, in response to Explanatory Memoranda 17455/12: Union financial assistance to Portugal and 15645/12 and 15656/12: Remedying the situation of excessive deficit in Greece.

In your letter you asked whether these documents were subject to an override. I am grateful for your acknowledgement that an override would have been justified in both cases, however I am pleased to inform you that in neither instance did an override take place.

With respect to EM 17455/12 and financial assistance to Portugal, I stated in the EM that the decision was likely to be adopted as an A-point by the Agricultural and Fisheries Council on 18 December, however in the end that did not happen and a decision was not taken by the Council until ECOFIN on 22 January, after your Committee had already cleared the document from scrutiny.

Regarding EMs 15645/12 and 15646/12 on excessive deficit procedures (EDP) in Greece, the Commission’s recommendations were adopted by the Council at ECOFIN on 5 December 2012, and procedure dictates that all EDP-related documents are subject to post-council scrutiny, as they are under limited circulation before any Council discussion. Nevertheless, no override took place as the UK does not have a vote on Commission recommendations related to the EDP for countries that are members of the euro area. For measures under Articles 126(9) and 136 TFEU, only members of the Council representing euro area Member States take part in the vote, which is by Qualified Majority Voting (QMV), without taking into account the vote of the member of the Council representing the Member State concerned.

6 February 2013

BANK RECOVERY AND RESOLUTION (11066/12)

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

We are writing to you with regard to Explanatory Memorandum 11066/12 on the Commission’s proposal for a Directive on Bank Recovery and Resolution (RRD). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 11 December 2012.

7
We have today published our report on Banking Union: Key Issues and Challenges. In that report, we conclude that: “The Recovery and Resolution Directive is a necessary step towards strengthening the single rulebook. However, the harmonisation model that it encapsulates is no longer sufficient to ensure the effective operation of the euro area banking sector. While there is a need for further steps towards effective banking union within the euro area in the form of a single resolution mechanism, it is vital that these steps do not risk a deepening split within the single market.”

Notwithstanding this, we acknowledge that the RRD proposal is an important one. We received a substantial amount of evidence on the RRD in relation to our inquiry into banking union, which can be summarised as follows.

OVERVIEW

Our witnesses recognised the necessity of the RRD. Commissioner Michel Barnier stressed that it was necessary to reduce the risk of moral hazard and of the taxpayer having to support failing banks, and Barclays stated that it was the most comprehensive attempt to establish such a framework. The Association for Financial Markets in Europe (AFME) stressed the industry’s view that the Directive was necessary regardless of the outcome of the banking union debate. They also pointed out that the RRD draws considerably on the UK’s Special Resolution Regime as set out in the Banking Act 2009. However, Professor Kern Alexander stated that it would require the UK to expand the scope of its resolution regime, in particular in relation to the depositor preference, intra-group support and cooperation agreement with third countries provisions.

We agree with our witnesses that the RRD proposal is a long-overdue and necessary tool to harmonise bank recovery and resolution mechanisms across the EU. We believe that this will help strengthen the EU banking sector and help break the vicious cycle between banks and sovereign states. We agree that all Member States should share a minimum common set of tools and powers to intervene quickly to avert or manage the failure of a financial institution, especially in a cross-border context. We acknowledge and welcome the fact that it broadly reflects the resolution framework as established in the UK. Nevertheless, we note the view of our witnesses that it will require adjustments to the UK’s resolution regime. Do you agree? Which adjustments need to be made, and how do you propose to achieve this?

BAIL-IN

The most significant element of the proposal is the bail-in tool, which would give resolution authorities the power to write down the claims of unsecured creditors of a failing institution and to convert debt claims to equity. This is designed to eliminate the need for recourse to public money in the event of a bank failure, since banks would be required to recapitalise from within, using private capital.

The majority of our witnesses welcomed the tool, although several emphasised the need for it to be well-designed. Barclays were opposed to any exclusion from the tool on the grounds of differentiating between liabilities of the same class based on maturity, as they argued that it would incentivise short-term funding and would create de facto depositor preference. On the other hand the Royal Bank of Scotland supported an exclusion of liabilities with maturities of under six months on the grounds that including short-term maturities could make a bank run more likely. The British Bankers’ Association asserted that the minimum requirement of bail-in liabilities that a firm should hold should be measured on the basis of Risk Weighted Assets rather than by reference to total liabilities. Barclays were also concerned about the proposal for a minimum requirement of bail-inable liabilities, since it would be at odds with the Basel III capital requirements. They were also unclear how bail-in would apply to deposit guarantee schemes.

We welcome the proposed bail-in tool, and believe that it would be a significant step towards ensuring that public money will not be required to bail out failing banks. Nevertheless the tool must be well-designed in order to ensure that it operates effectively. We particularly note the concerns of our witnesses regarding the exclusion of short-term maturities and the minimum requirement of bail-inable liabilities. What is the justification for these provisions, and how would you respond to the concerns that have been put to us? Do you anticipate that these provisions will be amended in the final version of the Directive? You have previously stated that you were seeking to clarify how national Deposit Guarantee Schemes would be affected by bail-in. What update can you give us?
RECOVERY AND RESOLUTION TOOLS

Although there was broad contentment with the other proposed recovery and resolution tools, several witnesses emphasised the need to distinguish between their use in recovery and resolution situations, stressing the importance of maintaining the Point of Non Viability (PONV) as the dividing line between the two. HSBC argued that use of bail-in or the ‘Special Manager’ tool (whereby a Special Manager could be appointed in place of the management of an institution for a limited time in order to restore the financial situation of the institution and the sound and prudent management of its business) before PONV would send a negative signal to markets about a bank’s credibility. The British Bankers’ Association stressed that the power to require an entity to plan for debt restructuring should not be used until PONV had been passed. They were also concerned about the impact of the proposal for the supervisor to contact potential purchasers to prepare for resolution of the institution, and expressed concern about the amount of discretion left to resolution authorities in deciding when to intervene. Others warned that the proposals for intra-group financial support could create a risk of contagion, although it was noted that the mechanism was optional.

We broadly welcome the proposed suite of recovery and resolution tools, although we recognise the concerns put to us about the use of certain tools before the Point of Non Viability has been reached. We share your fears that the Special Manager tool could undermine confidence in an already distressed institution. It is important to ensure that the use of such tools does not unnecessarily undermine the credibility of a financial institution whilst recovery remains a possibility. How would you respond to these concerns? Do you share the concerns of some of our witnesses concerning the amount of discretion left to resolution authorities when deciding when to intervene? What criteria should be used to determine when it is appropriate for a resolution authority to intervene? We note your concerns over the danger of contagion arising from the intra-group support mechanism. To what extent are such anxieties negated by the fact that it remains an optional mechanism?

THE ROLE OF THE EBA

The RRD proposes to give the EBA a binding mediation role in relation to cross-border group resolution and in reaching agreements with third countries. Barclays argued that a binding mediation role would provide an incentive for resolution colleges to reach a decision, but questioned why national resolution authorities were not given powers in relation to agreements with third country authorities. The British Bankers’ Association echoed the Government’s view that the timescales envisaged for EBA mediation could prove problematic when a decision was required urgently, and questioned whether it had the necessary expertise to take on the role. However, we note the view of Andrea Enria, Chairman of the EBA, that it makes sense to have a single entry point to establish agreements with third countries on how cross-border resolution can be managed.

We again stress the EBA’s importance as a rule-setting body. However, we note your concern at the proposed binding mediation powers for the EBA, stressing that decision-making should lie with national authorities. How would you respond to the argument that the EBA’s binding mediation role could provide an incentive to reach a decision? If the EBA does retain such a role in the final version of the Directive, do you envisage any way in which the timescale envisaged for its mediation role could be sped up? You have previously expressed concern at the implications of the proposed role for the EBA for Member States’ ability to establish cooperation arrangements with third country authorities. How would you respond to Mr Enria’s argument that a single entry point for such agreements would be advantageous?

RESOLUTION FINANCING MECHANISMS

You previously expressed concern that the proposal to create and maintain an ex ante resolution fund could generate moral hazard and undermine the credibility of resolution tools. What update can you give us on negotiations on this point?

THE TIMETABLE AND THE PROGRESS OF NEGOTIATIONS

Some of our witnesses expressed concern that the banking union proposals could delay the implementation of the Directive. We share these fears. What is your response? Now that it is clear that the Commission’s aim of implementation by the end of 2012 will not be met, what do you believe is a realistic timetable for agreement on the Directive?

You have not written to us on this proposal since 4 October, and we would be grateful for an update on negotiations, in particular in relation to the issues discussed above. In addition, your predecessor agreed, in his letter of 29 August, to keep us updated on negotiations around questions of subsidiarity.
and proportionality as they relate to the proposals. What update can you give us? We would also be grateful for information on the position of other Member States on these points.

We would be grateful for a response to these questions by Monday 7 January 2013. In the meantime we will retain the document under scrutiny.

12 December 2012

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

Thank you for your letters, dated 17 October and 12 December, on EM 11066/12 on the European Commission’s proposal for a Recovery and Resolution Directive (RRD). You requested to be kept updated on the progress of negotiations and any further consideration the Government has given on the proposed Directive.

You also requested to be kept informed of the Council Legal Services (CLS) opinion on the legal base of Title VII of the proposal (the European System of Financing Arrangements). We are yet to receive the CLS opinion, and will inform you when we do.

**RRD NEGOTIATIONS**

**RECOVERY AND RESOLUTION TOOLS (INCLUDING BAIL-IN)**

At the Council Working Groups, my officials have continued to support the recovery and resolution planning provisions, as well as the proposed preventative powers to remove identified impediments to resolution, as these are key foundations for any recovery and resolution framework. However, we have continued to question the need for some of the early intervention tools (intra group financial support and special manager).

Furthermore, the Government has broadly welcomed the proposed set of resolution tools in Working Groups, in particular the bail-in tool, to allow resolution authorities to manage failure of a systemic financial institution in an orderly manner. We have been working with our European partners to ensure that resolution tools are usable, based on our recent experience of resolving financial institutions, and that the design of the bail-in tool is credible.

**THE ROLE OF EUROPEAN BANKING AUTHORITY (EBA)**

On other specific aspects of the Directive, Member States, including the UK, have been carefully considering the proposed RRD provisions relating to the extension of EBA’s role in resolution, as well as whether the proposed EBA binding technical standards (BTSs) go beyond that necessary to enhance the single market (i.e. the principle of proportionality).

**RESOLUTION FINANCING MECHANISMS**

The Government remains concerned that there is a risk that a resolution fund could generate moral hazard and undermine the credibility of resolution tools, such as bail-in.

**TIMETABLING AND THE PROGRESS OF NEGOTIATIONS**

In its meeting on 13-14 December, the European Council urged the co-legislators to agree on the proposals for a Recovery and Resolution Directive before June 2013; the conclusions stated that the Council for its part should reach agreement by the end of March 2013, and that once adopted, it should be implemented by the Member States as a matter of priority.

28 December 2012

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


We are disappointed at the standard of your reply to our letter of 12 December 2012. That letter set out in some detail the important evidence received in relation to the Recovery and Resolution Directive in the context of our recent inquiry into European banking union. However your letter
does not provide any substantive response to this material, much of it received from experts and representatives of the financial sector. What discussions have you had with such experts and representatives in considering the UK’s position on this proposal?

Furthermore, our letter set out a series of issues where we asked for your response to the evidence we had received. We also asked for clarification and updates on a number of matters relating to this important proposal. Although your letter provides a brief response to some of these requests, you fail to engage with a number of our questions. We would emphasise your responsibility to reply to each of the Committee’s questions if we are to fulfil our scrutiny function effectively.

I would therefore invite you to provide a substantive response to the following questions as set out in our letter of 12 December 2012, a response to which was lacking in your letter:

— Would the RRD require adjustments to the UK’s resolution regime, and if so, what are they, and how will they be made?
— In terms of design of the bail-in tool, what is the justification for the provisions for the exclusion of short-term maturities and the minimum requirement of bail-inable liabilities? Do the Government anticipate that the provisions will be amended in the final version of the Directive?
— What update can the Government provide on their efforts to clarify how national Deposit Guarantee Schemes would be affected by bail-in?
— What criteria should be used to determine when it is appropriate for a resolution authority to intervene?

You also state that the Government and other Member States are carefully considering the proposed extension of the EBA’s role, as well as whether the proposed EBA binding technical standards go beyond that necessary to enhance the single market (i.e. the principle of proportionality). We would be grateful for further information on the conclusions that you have reached.

You set out the Council’s ambition to reach agreement by the end of March 2013, and for the co-legislators to agree on the proposals before the end of June 2013. How realistic is this timetable? What further update can you give us on negotiations on the proposal?

We would be grateful for a response to these questions by 30 January 2013. In anticipation of your response, we will continue to hold the document under scrutiny.

15 January 2013

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

Thank you for your letter, dated 15 January 2013, on EM 11066/12 on the European Commission’s proposal for a Bank Recovery and Resolution Directive (RRD). You asked for clarification and updates on a number of matters relating to this proposal.

RRD NEGOTIATIONS

Negotiations on this Directive are ongoing within the Council of Ministers and the European Parliament. Given the fluid state of negotiations, it is difficult for me to provide comment on some of these issues at the current time.

TIMETABLE

As set out in the December 2012 European Council conclusions, the European Council urged the co-legislators to agree on proposals for a Recovery and Resolution Directive before June 2013. The Irish Presidency has stated its objective to reach agreement in the second quarter of 2013, but as you imply this timetable is ambitious.

RRD RESOLUTION TOOLS AND THE UK’S RESOLUTION REGIME

The Government has broadly welcomed the proposed set of resolution tools, including the bail-in tool, to allow resolution authorities to manage failure of a systemic financial institution in an orderly manner. In the UK, the Banking Act 2009 already provides the Bank of England with the sale of business and bridge institution tools. In the 2012 Banking Reform White Paper, the Government outlined its preference for introducing the bail-in tool through the RRD.

11
We will assess whether any further adjustments to the UK’s resolution regime will be required on conclusion of the negotiations.

**Bail-in and Treatment of Deposit Guarantee Schemes**

As you are aware, the Government strongly supports the inclusion of the bail-in tool within the RRD. We consider that for the tool to be credible and effective across EU Member States, the RRD should ensure national authorities have statutory bail-in powers that cover a broad scope of liabilities and that this should be supplemented with a Minimum Requirement for Eligible Liabilities (which is similar to the Primary Loss Absorbency Capacity requirement recommended by the Independent Commission for Banking). The European Commission’s RRD proposals currently provide for this. We recognise the diversity of views expressed by experts and financial sector representatives in relation to bail-in design and our response to the specific issues you raise can be found in the Banking Reform White Paper.

At this stage of negotiations it is not possible to anticipate how the proposed bail-in provisions will be amended or how Deposit Guarantee Schemes will be affected.

**Criteria for Determining Resolution**

The Government believes that the conditions for entry into resolution must be carefully designed to ensure that they cover all possible causes of a financial institution’s failure and enable resolution authorities to use the resolution tools in a manner that meets the resolution objectives, whilst providing as much clarity to the market as possible.

As you are aware, under the UK Special Resolution Regime, the conditions for the entry into resolution relate to a firm meeting its threshold conditions for authorisation, as well as a public interest test. Market participants are already familiar with these conditions. These conditions are broadly consistent with those proposed in the Commission’s proposed RRD.

**Role of European Banking Authority (EBA)**

Member States, including the UK, are carefully considering the proposed RRD provisions that extend EBA’s role into resolution, as well as whether the proposed EBA binding technical standards (BTSs) go beyond that necessary to enhance the single market (i.e. the principle of proportionality). Member States are also evaluating whether some of the proposed BTSs should be removed, or where the provision relates to firm specific action, whether EBA guidance might be more appropriate.

**Stakeholder Engagement**

The Government is continuing to engage closely with the Bank of England and the Financial Services Authority, as well as industry representatives and relevant experts to inform its position on these and other key policy issues within the proposal.

15 February 2013

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

Thank you for your letter, dated 15 February 2013, on EM 11066/12, the Bank Recovery and Resolution Directive (RRD). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 5 March 2013.

We note your response to our questions, as well as your statement that negotiations on the Directive are in a fluid state, making it difficult for you to provide comment on some of the issues that we raise. We would therefore be grateful if you could keep us updated as the Directive takes shape in the coming weeks, in particular in relation to such key elements of the proposal as the bail-in tool, the treatment of Deposit Guarantee Schemes, the role of the EBA, and the potential impact on the UK’s resolution regime.

We anticipate receiving the first update on this by the end of March and will continue to hold this under scrutiny in the meantime.

5 March 2013

12
Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for your letter, dated 26 October 2012, on EMs 13682/12, 13683/12 and 13854/12 on the Commission’s Single Supervisory Mechanism/ banking union proposals. The House of Lords Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 4 December 2012.

We expect to publish our report on A European Banking Union in time for the meeting of the European Council on 13-14 December. However, in light of your statement in your appearance before the Sub-Committee on 30 October that you would find it useful to gain a sense of the Committee’s views ahead of the report’s publication, we wanted to inform you of our emerging conclusions in the context of the current discussions in ECOFIN and as you prepare for the European Council meeting. The Sub-Committee Chairman, Lord Harrison, would be happy to meet with you to discuss these issues in more detail ahead of the European Council.

Like you, we believe that a European banking union is urgently required in order to restore credibility and stability to the euro area banking system, and to break the vicious cycle between banks and sovereign states. Although you have stated that the UK will not participate in a banking union, the consequences for this country may nevertheless be considerable. It appears to us to be inevitable that banking union participants will move towards common positions on issues pertaining to the EU financial sector, creating a significant risk of marginalisation of the UK. Such isolation will be accentuated if a large number of non-euro Member States choose to participate in banking union. In your letter of 3 October 2012 on the euro area crisis: an update, you wrote that “the UK financial services industry will remain an unparalleled global financial centre outside the banking union.” We fear that such confidence may prove to be misplaced. The Government must work hard to ensure that the City of London’s pre-eminence is retained, not assume that it will always remain. What are you doing to ensure that such marginalisation does not occur, and that the position of the UK financial services industry is retained?

We are also concerned that moves towards banking union could threaten the integrity of the single market, as the authority of EU-27 bodies such as the European Banking Authority and the European Systemic Risk Board comes under threat of a powerful European Central Bank. You have conceded that the level of integration in the euro area could have profound implications for the single market, but have stressed that the UK remains committed to maintaining the integrity and operation of the single market and to work to ensure that this is upheld as the banking union proposals are taken forward. We share your concerns over voting modalities within the EBA, and in particular the threat of non-participating Member States being systematically outvoted by those participating in the Mechanism. You welcome the agreement at the October European Council that an acceptable and balanced solution is needed, yet this is easier said than done, in particular if other non-euro area Member States choose to participate. How can this dilemma be resolved?

Nevertheless, we welcome the publication of the Single Supervisory Mechanism proposals as an important first step towards banking union. However, the implications of the proposal are significant. In taking on supervisory powers the ECB would become an extremely powerful institution, and it is imperative that equally powerful safeguards are put in place. In particular, there must be neither a conflict of interest nor a perception of a conflict of interest between the ECB’s supervisory and monetary policy tasks. The ECB needs to be fully accountable for the exercise of its supervisory powers, both to the European Parliament and to national parliaments. There must also be equality in the decision-making process between euro area and those non-euro area Member States who wish to participate. The proposal needs to be significantly strengthened in all these areas. What update can you give us on negotiations on these matters? Do you believe that it is possible to provide such safeguards without necessitating treaty change?

We regard the proposed timetable for agreement of the SSM to be wholly unrealistic. The Commission is determined to press ahead quickly. Adopting rushed and deficient legislation would be the worst of all outcomes.

The original banking union proposals, as set out in the June 2012 report Towards a Genuine Economic and Monetary Union, proposed a three-pronged approach, by which the Single Supervisory Mechanism would be complemented by a common resolution mechanism and a common deposit insurance scheme. We regret that this coherent model has already been undermined by political pressure, led by Germany. We agree with you that this position is unsustainable. Banking union
requires all three elements in order to be coherent. What steps will you take to ensure that further steps towards banking union remain on the policy agenda during 2013?

We would be grateful for a response to these questions, and for an update on the outcome of the December European Council, by 7 January 2012. The documents will be cleared from scrutiny upon publication of our final report. In the meantime, and in the context of current negotiations, we have agreed to grant a waiver from scrutiny.

4 December 2012

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

I am writing to you with regard to EMs 13682/12, 13683/12 and 13854/12 on the Commission’s Single Supervisory Mechanism/ banking union proposals. The House of Lords Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 18 December 2012.

Our report, European Banking Union: Key issues and challenges was published on 12 December 2012. Shortly afterwards we received news of agreement of a Council position on the Single Supervisory Mechanism proposals, which would constitute an important first step towards effective banking union. This has been confirmed in the 13/14 December European Council conclusions on completing EMU, published on 14 December.

We welcome the Council’s agreement on banking supervision. Our report stressed that a European banking union is urgently required in order to restore credibility and stability to the euro area banking system. However, the implications of these important steps, not least for the UK, are still to be determined. We will watch closely as events unfold over the coming months.

The Council have committed to undertaking work on an operational framework during as soon as possible during the first semester of 2013, with a view to the ECB taking on supervisory tasks by 1 March 2014 at the earliest. This detailed work needs to be undertaken as a matter of urgency in order to allow for the direct recapitalisation of banks to take place as quickly as possible.

Putting the Single Supervisory Mechanism in place is an important first step. But, as our report makes clear, banking union requires further steps, including a common resolution mechanism and a common deposit insurance scheme, in order to be effective. We therefore welcome the Council statement that the Commission will submit a proposal for a single resolution mechanism for participating Member States during 2013. However, we regret that the Council conclusions make no reference to a common deposit insurance scheme.

The Council agreement states that the ECB will be responsible for the overall functioning of the Single Supervisory Mechanism, with responsibility for all eurozone banks, albeit in a differentiated way. We understand that it is intended that the ECB will have direct supervisory responsibility for banks with assets of more than €30 billion, but with the power to intervene in relation to smaller institutions where necessary. This echoes our own conclusion that the ECB should focus on day-to-day supervision of only the largest cross-border and systemically important banks, but with the power to quickly assume responsibility for the supervision of smaller banks as required.

In our report we warned that there should be neither a conflict of interest, nor a perception of a conflict of interest, between the ECB’s supervisory and monetary policy tasks. We are therefore pleased to note the Council’s agreement that the ECB’s monetary policy tasks will be strictly separated from supervisory tasks to eliminate potential conflicts of interest. We wait to see if this agreement is sufficient to ensure that the strong firewall between the tasks that is necessary is constructed.

Our report also stated that the ECB needed to be fully accountable, both to the European Parliament and to national parliaments, in the exercise of its supervisory function. The Council conclusions do not make any reference to the accountability of the ECB. Was this issue discussed in negotiations, and has any agreement been reached to strengthen the weak accountability provisions as set out in the Commission’s original proposal?

Our report stressed that non-eurozone Member States that wished to participate in the Single Supervisory Mechanism enjoy equal voting rights with euro area Member States in the ECB decision-making process. We therefore welcome the Council’s conclusion that non-eurozone participating countries will have full and equal voting rights on the Supervisory Board. The Council state that the Supervisory Board’s draft decisions would be deemed adopted unless rejected by the ECB Governing Council. While this is undoubtedly an improvement on the original text of the proposals, it remains to be seen if it provides sufficient safeguards for non-eurozone Member States in order to encourage them to participate.
Our report expressed real concern about the impact of these proposals on the role of the EBA. The EBA Chairman, Andrea Enria, warned us that there was a risk of the EBA becoming an “overarching umbrella which had no teeth”. We welcome the Council’s assurance that the EBA continues to have an important role to play. However, our concerns that the EBA must have the necessary resources, capacity and authority in order hold effective sway over such powerful supervisory bodies as the ECB would be, must be addressed.

We stressed that the EBA’s voting arrangements must ensure that it is able to defend the interests of the single market as a whole. We therefore welcome the Council’s statement that EBA voting arrangements must ensure equitable and effective decision-making within the single market. However, the devil is in the detail. The Council agreement states that such amendments would ensure that the countries participating in the Single Supervisory Mechanism would not unduly dominate the EBA. We understand that voting decisions will not be approved unless a majority of both euro area and non-euro area Member States are content. Can you confirm this? How will this mechanism operate in practice? You have stressed that the new voting arrangements will provide a strong safeguard for the UK. How watertight do you believe the new arrangements will prove in practice? What will happen if the number of non-euro area Member States falls below four? The European Council conclusions also stress that the process of completing EMU “will be open and transparent towards Member States not using the single currency”, fully respecting the integrity of the Single Market, and ensuring a level playing field between Member States who participate in the SSM and those which do not. We welcome this, but, again, the devil is in the detail.

The significant developments that have taken place in recent days have momentous implications for the UK, even in spite of our decision not to participate in banking union. The Government appear satisfied with the safeguards that they have won. Along with the EBA voting provisions, you have particularly stressed the importance of the so-called non-discrimination clause, which states that the ECB should not discriminate against any Member State as a venue for the provision of banking or financial services in any currency. We would be grateful for further information on the safeguards that you believe these provisions will provide. The Government must continue to do everything necessary to ensure that London’s premier position is not imperilled by these first steps towards a banking union.

We intend to scrutinise these proposals closely as they take shape in the weeks and months ahead. We would therefore be grateful for a response to this letter, including a full account of the outcome of the Council meeting, by 9 January 2013. We will be inviting you to appear before the Sub-Committee to explore the implications of these developments on Tuesday 5 February 2013. In the meantime we confirm that these documents were cleared from scrutiny upon publication of our report on 12 December.

18 December 2012

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

Thank you for your letter of 4 December setting out the emerging findings of the Committee on the Commission’s proposals for a Single Supervisory Mechanism, the letter of 12 December accompanying the publication of the Committee’s report A European Banking Union and the letter of 18 December. I am writing to respond to the questions you have raised in this correspondence, and to update you on the progress of the negotiations.

As the Committee will be aware, an agreement on the proposals for a Single Supervisory Mechanism was reached in the Council of Ministers early on 13 December, after all-night talks between European finance ministers. The Chancellor represented the UK and, with likeminded allies, secured an agreement that will preserve the EU’s single market and protect the interests of those remaining outside the banking union. The European Parliament will now be consulted on the Regulation conferring specific supervisory tasks on the ECB (the “ECB Regulation”) and the trilogue process has commenced in relation to the EBA Amending Regulation.

The Council’s progress was endorsed by Heads of Government at the European Council meeting on 13-14 December. The European Council also concluded that it was imperative to break the vicious circle between banks and sovereigns, and committed that “further to the June 2012 euro area Summit statement and the October 2012 European Council conclusions, an operational framework, including the definition of legacy assets, should be agreed as soon as possible in the first semester of 2013, so that when an effective single supervisory mechanism is established, the European Stability Mechanism will, following a regular decision, have the possibility to recapitalise banks directly. This will be done in full compliance with the Single Market.”
The conclusions also noted the Commission’s intention to adopt a proposal for a Single Resolution Mechanism for Member States participating in the Single Supervisory Mechanism during the course of 2013. This high-level commitment will ensure that the remaining elements of banking union remain on the political agenda in 2013.

In your letter of 4 December, you raised concerns that the UK and other non-participating Member States risked marginalisation as a result of banking union, and asked how we can maintain the position of the UK’s financial services industry. I agree with the Committee that the Government must work hard to ensure that the City of London’s pre-eminence is maintained. This is why ministers have been very closely involved in these negotiations — including on technical details for provisions that could have a significant impact on UK financial services.

Consequently, as part of the Council agreement, we have secured a number of strong protections against potential discriminatory action against the UK’s financial services industry.

As the Committee has noted in its report and emerging conclusions, one of the most significant protections that the UK has secured is the principle of double majority voting in relation to key decisions taken by the Board of Supervisors of the EBA. This is a landmark agreement that demonstrates how greater integration between eurozone Member States need not mean the fragmentation of the single market in future.

This principle will be applied as follows: for key decisions, including those relating to binding technical standards that will apply to firms across the single market, current voting arrangements will be supplemented with a requirement that any necessary majority must include a simple majority of members of the Board of Supervisors representing participating Member States and a simple majority of members representing non-participating Member States. This protects against the risk that participating Member States will systematically impose a common view on other Member States by requiring a majority of those outside the banking union to approve decisions in the EBA.

There will therefore be a review of voting arrangements if and when there are four or fewer non-participating Member States. The report would be submitted to the Council of Ministers and European Parliament and the European Council for discussion.

The Committee asked for more detail on the other safeguards we secured as part of the Council agreement. We have secured a non-discrimination clause that will protect the single market. This requirement, stating that “no action, proposal or policy of the ECB shall, directly or indirectly, discriminate against any Member State or group of Member States as a venue for the provision of banking or financial services in any currency”, is a significant achievement and guards against any restriction of the UK’s role as a financial centre in the single market, including on euro-denominated banking services.

There is also an assurance that the scope of the new Single Supervisory Mechanism will only cover banking, and not other financial services institutions such as central counterparties, which are explicitly excluded.

We have secured agreement to the principle that there must be symmetry of treatment between the ECB and other supervisors, including the Prudential Regulation Authority. All competent authorities will be treated equally for the purposes of EBA mediation between supervisors, and all competent authorities will have the same powers of intervention within and beyond their jurisdictions. The independence of the EBA from the ECB has also been preserved as a result of the omission of the provision enabling the Chair of the EBA to participate as an observer on the ECB’s Supervisory Board, and there is agreement that appointments in the EBA (including its Chair and Vice-Chair) must be geographically balanced.

Finally, the agreement provides a statutory footing for a bilateral memorandum of understanding between the ECB and the Prudential Regulation Authority, which will secure coordination of supervision of cross-border banks and activities.

Our priority throughout these negotiations has been to ensure the unity and integrity of the single market is maintained, and consequently our focus has been on securing protections for those Member States, like the UK, which will remain outside the banking union. However, we have also been at the table for discussions on the ECB Regulation. We consider the deal reached is fair and balanced.

I agree with the Committee that it is important that there are governance arrangements within the ECB that clearly separate monetary and supervisory functions, as well as provide for equality in decision-making between euro area and non-euro area Member States that are participating.

The ECB Regulation aims to achieve this through an express requirement for the ECB to conduct its supervisory tasks separately to its other tasks, and through the establishment of a Supervisory Board,
with decisions of this board deemed adopted unless they are actively rejected by the ECB’s Governing Council. Membership of the Supervisory Board will consist of representatives from national competent authorities in each participating Member State, as well as a Chair, Vice-Chair and four representatives of the ECB, all of whom will have voting rights. There will also be a review panel to ensure the procedural and substantive legality of decisions taken by the ECB, and ultimately decisions of the ECB may be referred to the European Court of Justice under Article 263 TFEU.

The ECB will also have obligations towards national parliaments. Parliaments in participating Member States may invite the Chair or a representative of the Supervisory Board to participate in an exchange of views in relation to the supervision of credit institutions in that Member State together with a representative of the national competent authority. All these measures have been agreed without recourse to Treaty change.

These details, of course, remain subject to the outcome of discussions between the Council and European Parliament. The Council has agreed that the two regulations must be agreed together. This will maximise the UK’s ability to ensure the whole package represents a good deal for the eurozone and a good deal for the UK and the whole single market.

12 January 2013

COHESION POLICY (15243/11, 15247/1, 15249/11, 15250/11, 15251/11, 15253/11, 13730/12)

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

I am writing further to my letter of 8 October to update you on the outcome of the recent General Affairs Council.

At the General Affairs Council on 16 October 2012 the Presidency concluded that there was a partial general approach covering seven blocks: Information and communication; European territorial cooperation; territorial development; financial issues (not covered in the MFF negotiations); country-specific recommendations; management and control; and indicators. The agreement reached at the Council reflected the position as outlined in my letter to your Committee sent on 8 October.

I am attaching the texts of the partial general approach [not printed].

I will write separately to update both Houses on the Commission’s amended proposal for the Common Provisions Regulation (EM 13701/12).

13 November 2012

Letter from the Rt. Hon Michael Fallon MP to the Chairman

Your Committee has kept EM 13730/12 on the Common Strategic Framework under scrutiny. The other EMs, mentioned above, have been cleared by your Committee. The purpose of this letter is to inform you that the Cyprus Presidency has indicated that it intends to seek a partial general approach on the Common Strategic Framework and on the financial management bloc at the November General Affairs Council on 19-20 November 2012. I apologise that this letter is sent relatively late, we still do not know for definite what issues will be presented to the General Affairs Council (GAC).

I would have requested a waiver but understand that your Committee will not be meeting before the General Affairs Council on 19-20 November. I therefore may need to exercise an override of scrutiny on the Common Strategic Framework. During negotiations the Common Strategic Framework has been amended and is now satisfactory to the UK. In case we will need to exercise an override, I will ensure that the Minister present, likely to be the Minister for Europe, will state our concern that insufficient time was given to Parliamentary scrutiny of these matters. We will only accept the partial general approach on the basis that ‘nothing is agreed until everything is agreed’, including cross-cutting issues with other regulations, such as the overarching Multiannual Financial Framework.

This letter outlines what we do know ahead of the GAC. I hope you will accept that it has not been possible to provide the Committee with any earlier update.
We consider it important that the Common Strategic Framework is a strategic document which does not add additional requirements on Member States or weaken the existing requirements of the Common Provisions Regulation (CPR). We have ensured that the document is more strategic with a greater focus on growth.

We were concerned that the Commission’s draft text included additional requirements which went beyond the CPR, for example the requirement on Member States to track biodiversity related expenditure (Article 3.2), a demand for the gender balance of monitoring committees (Article 3.3), and an obligation to use CSF funds to develop tailor-made strategies to tackle demographic problems and to create growth linked to an ageing society (Article 3.5). We have been able to remove the requirements to track biodiversity related expenditure and the demand for the gender balance of monitoring committees. The wording on an obligation to use CSF funds to develop tailor-made strategies to tackle demographic problems and to create growth linked to an ageing society has been amended to only require CSF funds to be used in line with relevant national or regional strategies, where such strategies are in place.

FINANCIAL MANAGEMENT

The financial management bloc covers both the Common Provisions Regulations covering all four Common Strategic Framework Funds and two articles of the European Territorial Cooperation proposal. The only Article within the ETC proposal to be changed concerns the expenditure incurred in a currency other than the euro (Article 26). The new wording aligns it with the current system, which we consider has operated well. The other non-euro Member States are also content with this change.

The financial management bloc was kept back until the outcome of the discussions on the Financial Regulation was known and therefore could only be considered now.

There was a discussion on the financial management text at working group level yesterday. The Presidency decided that the text on the Common Strategic Framework did not require further discussion in the working group. Both these files have now been sent to COREPER for discussion on Wednesday 14 November with the Presidency’s intention to place them on the November General Affairs Council’s agenda. The Presidency’s desire to conclude a partial general approach at this stage is to allow this to inform the discussions on the partnership agreements.

As noted in my previous letter, we have and will continue to raise your concern about the accelerated timetable for the adoption of the Common Strategic Framework and emphasise the importance of allowing sufficient time for parliamentary scrutiny of proposals.

I will write again to update you post Council.

13 November 2012

Letter from the Rt. Hon Michael Fallon MP to the Chairman

Thank you for your letter of 17 October 2012, concerning EM 13730/12, in which you raise a number of important issues.

You questioned whether other Member States share our concern over the inclusion of indicative actions as a delegated act as well as the use of a delegated act to amend the annex. There is currently unanimous agreement within Council on this matter and the Council Legal Service has also provided a steer which supports this position.

We consider it important that the Common Strategic Framework is a strategic document which does not add additional requirements on Member States or weaken the existing requirements of the Common Provisions Regulation (CPR).

We are concerned that the Commission’s draft text does include additional requirements which go beyond the CPR, for example the requirement on Member States to track biodiversity related expenditure (Article 3.2), a demand for the gender balance of monitoring committees (Article 3.3), and an obligation to use CSF funds to develop tailor-made strategies to tackle demographic problems and to create growth linked to an ageing society (Article 3.5). We will work towards removing these requirements from the final text.

I note your concerns about the accelerated timetable being sought on this matter. My officials have raised concerns about the timeline for adopting this proposal in the working group and with the
Presidency. As a result of our raising this matter, the Council Legal Service has provided an opinion stating that as a partial general approach is not considered a final agreement in Council, a decision to adopt a partial general approach within the eight week period does not violate the Treaty.

The Presidency has placed this proposal on the draft agenda of the November General Affairs Council which will take place on 19/20 November 2012. I will ensure that should this item remain on the agenda for the adoption of a partial general approach at the November General Affairs Council, the UK Minister present will note our concern that national parliaments should have sufficient time for scrutiny and that a partial general approach should only be agreed after national parliaments have had eight weeks to scrutinise the proposal from the time it is published until it is first placed on the agenda of the Council.

I will ensure to keep your Committee informed on how the negotiations proceed and will update the Committee ahead of the November General Affairs Council, should these matters remain on the agenda.

14 November 2012

Letter from the Rt. Hon Michael Fallon MP to the Chairman

I am writing further to my letter of 13 November to update you on the outcome of the recent General Affairs Council.

At the General Affairs Council on 20 November the Presidency concluded that there was a partial general approach covering two blocks: Financial Management and the Common Strategic Framework. The agreement reached at the Council reflected the position as outlined in my letter to your Committee sent on 13 November.

I regret that it was necessary to override parliamentary scrutiny on the Common Strategic Framework (EM 13730/12) on this occasion. David Lidington MP, who attended the Council on behalf of the UK, raised our concern that sufficient time should be given for parliamentary scrutiny of the Common Strategic Framework block. We reiterated the UK position that we only accepted the partial general approach on the basis that ‘nothing is agreed until everything is agreed’, including cross-cutting issues with other regulations, such as the overarching Multiannual Financial Framework.

As mentioned in my previous letter we considered it important that the Common Strategic Framework was a strategic document which did not add additional requirements on Member States or weaken the existing requirements of the Common Provisions Regulation (CPR). We were able to ensure that the document was more strategic with a greater focus on growth. We were also successful in removing those elements of the Common Strategic Framework which included additional requirements which went beyond those requirements set out in the Common Provisions Regulation.

The overall rationale for agreeing to the proposal was that it is important to agree a broad consensus within the Council in order to start informal discussions with the European Parliament on these texts. As my predecessor noted in his letter of 18 June 2012, the funds are due to become operational from 1st January 2014, although of course this depends on the settlement of the Multiannual Financial Framework. We want to see effective and efficient spend of the significant sums devoted to cohesion policy across the EU. That means proper preparation and planning, with robust economic assessment of needs. That takes time and that works needs to start as soon as possible if the money is to be spent wisely. Agreeing elements through partial general approaches gives Member States some confidence of the shape of the final regulations to enable them to start planning.

He also noted the benefits of reaching partial general approaches in thematic blocks as this allows Ministers to focus on particular problems and issues within the blocks rather than being overwhelmed by having to consider everything at the same time. It means we can pocket gains without having to become involved in a large-scale trade of different objectives across different pieces of legislation.

All the Regulations this time round will be co-decided with the European Parliament. The European Parliament has adopted its negotiation mandate in the respective committees on most of the provisions and is due to vote on the final elements on 27 November. Agreeing partial general approaches gives the Presidency of the Council of Ministers scope to enter into discussions with the European Parliament. Timely implementation of the regulations is going to require the Parliament and the Council to work closely together. The partial general approaches will facilitate this.

The European Parliament voted to update its negotiation mandate on these files on 27 November 2012. I will write to you separately on the vote with an assessment of the European Parliament’s position.
I am attaching the texts of the partial general approach [not printed].

29 November 2012

Letter from the Chairman to the Rt. Hon Michael Fallon MP
Thank you for your letter, dated 14 November 2012, on EM 13730/12 on the amended proposal for more strategic use of Structural Funds and your letters, dated 13 and 29 November 2012, on the package of proposals related to Structural Funds (including EM 13730/12). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 11 December 2012.

We are grateful for your response to our queries as well as your detailed update on negotiations. We do, however, regret that a parliamentary override was necessary. Whilst proper preparation and planning are important to ensure money is spent effectively, this should not come at the expense of parliamentary scrutiny.

We would appreciate regular updates as negotiations proceed, in particular in relation to the appropriate use of delegated acts. In the meantime we are content to clear EM 13730/12 from scrutiny.

11 December 2012

Letter from the Rt. Hon Michael Fallon MP to the Chairman
As I indicated in previous correspondence, the European Parliament has voted in its Regional Development and Employment and Social Affairs Committees on the amendments it wishes to see to the above Regulations. It has not yet proceeded to a Plenary Vote and therefore has not established a formal First Reading position. Instead it intends to use the Committee votes as the basis to enter into informal discussions with the Irish Presidency and the European Commission, with a view to being able to moving quickly to a first reading deal if there is sufficient agreement between the positions of the three institutions, once a deal on the Multiannual Financial Framework has been reached by the European Council and subsequently agreed by the European Parliament. I promised to give the UK Government's assessment of the main changes the European Parliament is seeking. I have attached for information the complete set of amendments proposed by the European Parliament for each Regulation.

On the Common Provisions Regulation, the focus of the European Parliament has been on strengthening the requirements on partnership. It has proposed that in addition to a Partnership Contract between the Commission and the Member State, there should also be a formal Partnership Agreement between the Member State and local authorities on how the funds should be delivered. In the UK Government’s opinion, this fails to take sufficient account of the different institutional framework of the Member States and, in the case of England, the role we would like to give to Local Enterprise Partnerships as the founding blocks of our next programme.

The European Parliament also wants to keep the code of conduct on partnership as proposed by the European Commission, which would be introduced by means of a delegated act, and has proposed stringent requirement on what it should contain. The UK Government is not opposed to the principle of partnership enshrined in the code, but has been concerned that the code could not be introduced until after the Regulation was adopted, hence delaying the programming process and introducing new requirements after much preparatory work on the new programmes had already been done. Further, the UK Government would want assurance that the code did not cut across the principles of subsidiarity and proportionality, did not impose a one-size fits all model and was sufficiently flexible to take account of the different institutional and legal frameworks of the Member States.

The European Parliament’s strong focus on partnership is reflected in other provisions. For example, on community-led local development (Articles 31-34), the European Parliament wants the funding of local strategies to be agreed by the “partners” as well as the Managing Authority or Authorities. The European Parliament also wants a strong, clear role for partners in the monitoring committees (Article 42). In both cases, the UK Government does not object with the principle of partnership but the Managing Authority must retain the final say on some matters as it often will bear the financial risk for non-compliance with the Regulations in cases where it is not possible to recover costs from the recipient of the EU investment.

The European Parliament has proposed amendments to some provisions in the Regulations that the Member States are considering as part of the MFF deal. The European Parliament is strongly opposed
to the 5% performance reserve in Article 19 and macroeconomic conditionality in Article 21. The UK Government’s position on these was set out in its initial memorandum to the Committee. In terms of amendments on financial issues, the European Parliament has not taken a position on the level of funds (although it has made its views known on other occasions), beyond proposing that 7% of the global total should be allocated to European Territorial Development. It has proposed higher levels of initial pre-financing than proposed by the European Commission (Article 124), removed the lower levels of co-financing for less developed regions (Article 110) and altered the N plus 2 rule to an N plus 3 rule (article 127). The UK Government’s position is that the European Parliament’s changes weaken budgetary and financial disciplines.

The European Parliament has agreed with the UK Government and other Member States that the Common Strategic Framework should not be introduced by the European Commission by means of a delegated act but rather should be an annex to the Common Provisions Regulation which means that both Council and the Parliament would have greater say over its content. It has proposed detailed text as to what should be contained in the Common Strategic Framework. The UK Government welcomes the attempt by the European Parliament to set out the strategic framework, in particular its focus on how the structural and cohesion funds might be aligned with other EU funds, but is concerned that it is too prescriptive in areas, and the UK Government would want to see more recognition of the need to take account of the differences between Member States and regions in the EU.

Finally, the European Parliament has proposed three new activities. First, it wants the Commission to prepare a detailed practical guide on how to effectively access and use the Funds covered by the CPR, and how to exploit complementarities with other instruments of relevant Union policies. The difficulty here is the Funds are subject to shared management and it is not clear how the guide could cover what happens at regional level. Furthermore, annex V of the Commission’s proposal already contained an extensive list of information and communication measures. Second, the European Parliament wants Member States to nominate a one-stop agency for applications. If this can be done through a web-portal whilst recognising the diversity of activities supported by the funds which may require different procurement processes, this may not be problematic. Third, the European Parliament would like the Commission to produce a communication by the end of 2016 setting out the outcome of the negotiations on the Partnership Contract with each Member State. This again should not be problematic as the Contract will have been agreed by both the Commission and the Member State.

On the European Regional Development Fund, the European Parliament has proposed a weakening of the principle of thematic concentration by suggesting that, in addition to the three thematic objectives to which the Commission had suggested a minimum level of ERDF needed to be allocated (80% in the case of more developed and transition regions; 50% in the case of less developed regions), Member States should be free to select a fourth of their own choosing. The UK Government had welcomed the Commission’s original proposal as an attempt to create critical mass to focus the Funds on important drivers of growth and to avoid fragmentation. It believes that the European Parliament’s proposal would make concentration much less effective. The UK Government could accept a specified fourth objective, such as ICT. The European Parliament also wants at least 22% of ERDF to be spent on low carbon objective in more developed and transition regions; at least 12% in less developed, compared to 20% and 10% respectively that the Council has in its partial general approach.

On the European Social Fund, the European Parliament has again proposed a weakening of thematic concentration. Instead of at least 80% of ESF in each programme in more developed regions being spent on four investment priorities (70% in transition regions; 60% in less developed), the European Parliament has proposed the same minimum levels should be allocated to five priorities. In all cases, in response to specific needs, there could be up to six provided that investment priorities are identified after consulting the partners. Again, this seems to dilute thematic concentration too much and reduce the potential impact of the Fund.

The European Parliament also wants to bring a stronger social dimension to the European Social Fund that might conflict with its Treaty Base (Article 162 Treaty on the Functioning of the European Union) which requires a focus on employment opportunities and the labour market. The European Parliament has proposed increasing the number of available investment priorities from 18 to 23, introducing new ones under the social inclusion objective such as combating poverty, promoting children’s rights and well-being and promoting active ageing without poverty with particular regard to women. The Government will be making clear that, while Articles 8, 9 and 10 of Treaty on the Functioning of the European Union mean some general provisions such as equality and non-discrimination have to be taken into account in all EU activity, the focus of the European Social Fund should remain on improving employment opportunities.
On European Territorial Cooperation, the European Parliament wants to increase the number of objectives that programmes can focus on from four to five.

I hope this information is helpful to your consideration of these proposals.

31 January 2013

Letter from the Rt. Hon Michael Fallon MP to the Chairman

I am writing to update you on progress of negotiations on the above Regulations. The Irish Presidency would like to agree a partial general approach on outstanding negotiating blocks in March. Our understanding is this will be taken as an “A” point at a forthcoming Council meeting.

There are three elements to this partial general approach. The first covers the final provisions of each Regulation. The second covers some items which have been held back from previous partial general approaches because agreement between Member States was not possible at that time. The third covers the recitals to each Regulation. I have attached a list of the relevant articles.

The final provisions block covers the arrangements for the introduction of delegated and implementing acts, the committee procedure, transitional arrangements and review and repeal clauses. The main change proposed is to delete the power for the European Commission to bring forward a delegated act to amend annex VI of the Commons Provision Regulation (annex V of the original Commission proposal) that deals with information and communication requirements. The concern of member states, which the UK shared, was that the Commission would use this power to introduce new burdens. Deletion removes this risk. The other changes are technical and mainly standardise the wording across the different Regulations. Article 14 of the European Regional Development Fund Regulation has been deleted as there are no longer any delegated acts within the Regulation.

The provisions still pending from previous discussions included the definitions in Article 2 of the Common Provisions Regulation, Articles 1, 2 and 15 of the European Social Fund Regulation and articles covering the participation of the third countries in European Territorial Cooperation programmes and links with the European Neighbourhood Initiative (ENI) and the Instrument for Pre-accession (IPA).

Article 2 of the European Social Fund sets out its mission. The UK Government has successfully argued for language that brings out more clearly the need for the Fund to be used only for measures linked directly or indirectly to the labour market. Article 15 of the European Social Fund Regulation had proposed the creation of policy-based guarantees whereby Member States and regions could use the European Social Fund to guarantee funding from debt markets to support the delivery of social and labour market policies. The UK and other Member States were not satisfied that there were sufficient safeguards to the EU, or national or regional budgets, and have successfully argued for deletion of this provision.

The changes to the European Territorial Cooperation have primarily dealt with specific concerns of those Member States who border third countries and take part in cooperation programmes under the ENI or IPA.

New definitions have been added over the course of the negotiation (for example on ex ante conditionality) and these have now been included in Article 2 of the Common Provisions Regulation. There are also now definitions of irregularity that reflects existing position under the 1995 Directive on protection of the Union’s financial interests and on beneficiary to take account of the fact that natural persons can be beneficiaries under the European Agricultural Fund for Rural Development, to which part II of the Common Provisions Regulation applies.

The recitals have been amended to reflect changes made in the substantive articles. The UK Government has particularly pushed for those on financial instruments to reflect the position in the Partial General Approach agreed in June 2012, which would enable JEREMIE and JESSICA to continue to operate on the same basis as in the current period, with strong private involvement. Each regulation has a recital on subsidiarity and proportionality, required following the Lisbon Treaty. These recitals are time-bound by the duration that the regulations will be in force - that is up to the end of 2020. The UK Government will make a declaration stating that this does not prejudge decisions on whether regulations governing the use of structural funds in future financial periods would meet tests of subsidiarity.

I am writing in similar terms to William Cash MP, Chair of the Commons European Scrutiny Committee, and copying this letter to the Minister for Europe, the Minister for Employment, the
Clerks of both committees, Marzena Bujalska, BIS departmental scrutiny co-ordinator and Meena Bhatti, DWP departmental scrutiny co-ordinator.

27 February 2013

CREDIT RATING AGENCIES REGULATION-UPDATE (17308/11, 17329/11)

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

My predecessor, Mark Hoban MP wrote in February 2012 to update the European Union Subcommittee on Economic and Financial Affairs and International Trade (the Committee) on progress on the CRA3 dossier. This was in response to the Committee’s letter on 7 February 2012 which raised concerns about the regulation of CRAs as well as requesting an update on the negotiations. Negotiations on this European regulation have now concluded and this letter provides a further update and a summary of the final agreement.

UPDATE

The European Council reached a General Approach agreement on CRA3 on 21 May 2012, and the Economics and Monetary Affairs (ECON) Committee of the European Parliament voted on a proposed package on 18 June. Trilogues took place during the second half of 2012 under the auspices of the Cypriot Presidency, resulting in a political agreement on 27 November which was approved by the Permanent Representative Committee of the European Council on 5 December and endorsed by the European Parliament on 16 January 2013.

THE AGREEMENT

The full text of the final package is available at:


The draft regulation introduces a mandatory rotation rule, aimed at fostering competition and addressing conflicts of interests between issuers and CRAs. The Committee’s letter to my predecessor cited concerns over the case for regular rotation in the use of CRAs. The Government has taken into account these concerns in our negotiation; as a result the mandatory rotation rule will now only apply to new re-securitisation products, as opposed to the original commission proposal applying the requirement to all securitisation instruments.

Moreover, mandatory rotation would not apply to small CRAs, or to issuers employing at least four CRAs each rating more than 10% of the total number of outstanding rated structured finance instruments.

In order to reduce over-reliance on credit ratings, the regulation requires the Commission to continue to review, firstly, whether references to credit ratings in Union law trigger or have the potential to trigger sole or mechanistic reliance on such credit ratings and, secondly, all references to credit ratings for regulatory purposes with a view to deleting them by 2020, provided that appropriate alternatives to credit risk assessment are identified and implemented.

In order to mitigate the conflict of interest within the credit ratings market, the regulation requires CRAs to publicly disclose if a shareholder with 5% or more of the capital or voting rights in that CRA holds 5% or more of shares in an entity it rates. The regulation further prohibits a shareholder of a CRA with 10% or more of the capital or voting rights in that CRA from holding 10% or more shares in an entity it rates. And to ensure the diversity and independence of credit ratings and opinions, the regulation prohibits ownership of 5% or more of the capital or the voting rights in more than one CRA, unless the agencies concerned belong to the same group.

As mentioned in the Committee’s letter in February 2012, CRAs should be held responsible for negligence or misconduct when producing ratings. Under the agreement, investors or issuers would be able to claim damages from a CRA if they suffered a loss due to an infringement committed by the agency intentionally or with gross negligence. Furthermore, the definition of key concepts within Civil Liability is now a matter of national law.
The Committee’s letter recognised the merit of requiring sovereigns to be rated every six months. The agreement states that sovereign ratings would have to be reviewed at least every six months (rather than every 12 months as currently applicable under general rules).

The regulation also requires CRAs to publish a list of two or three dates in a year during which they could publish ratings of member states. However, CRAs can deviate from this calendar to comply with their legal obligation to disclose any credit rating or rating outlook on a non-selective and timely basis.

Further to the Committee’s concerns on ensuring standards for third countries are not raised to an unrealistic level, the deadline for when CRA3 will apply for the purpose of endorsement assessments for third countries has been extended to 2018. Additionally, there are carve-outs from the endorsement regime for the mandatory rotation and shareholdings rule, the two areas where there are likely to be the greatest divergence in rules between the EU and other jurisdictions.

**NEXT STEPS**

Formal adoption will now take place in Council by qualified majority before the legislation is signed by the Presidents of the European Parliament and of the Council. We will define the key concepts within the Civil Liability regime in national law prior to the regulation being published in the Official Journal. The final CRA text will be published in the Official Journal in May/June 2013.

The draft regulation calls on the Commission to prepare a report by 1 July 2016, reviewing the situation in the credit rating market, and if necessary to follow it up with appropriate legislative proposals on some of the new provisions.

15 March 2013

**CUSTOMS 2020 (13265/12)**

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

Further to your letter of 23 October, I am writing in response to your questions and to update you on the progress of negotiations for Customs 2020. Your committee did not clear the document.

Negotiations on the proposal have progressed at a steady rate. In general Member States have noted their support for the continuation of the programme. Discussions have concentrated on a number of amendments to highlight more clearly the priorities and actions under the programme. For example the UK has secured an amendment which highlights the voluntary nature of the programme. Whilst the budget negotiations for the programme will take place in parallel as part of the Multi-annual Financial Framework (MFF) discussions; some Member States have noted their concern about the increase in the proposed financial envelope for the programme and this is likely to be the area which draws the most discussion.

We continue to press for a change in wording which removes the JHA obligations of the programme and this has met with general support. However the timetable of Council discussions means it is unlikely that we will be able to secure this by the opt-in deadline of 30 November. Therefore, as a contingency, we will be deciding whether to opt in to this proposal should the JHA obligations remain in the text at 30 November.

You requested further details on what activities could be reprioritised to ensure a freeze to the budget. The Customs 2020 proposal allows for the provision of funding for a number of cooperation activities. The UK would like to see funding concentrated on activities which fall under the priority of facilitating legitimate trade and reducing compliance costs and administrative burdens, ensuring that actions under the programme promote real benefits to UK business. Additionally, the UK would support the increased use of communication technology where appropriate; therefore protecting funds which would otherwise have been used to fund travel and subsistence of officials. We will make these views clear when discussions on the programme budget commence.

I will continue to keep you updated on the progress of negotiations.

13 November 2012
Letter from the Chairman to Sajid Javid MP

Thank you for your letter, dated 13 November 2012, on EM 13265/12: The Customs 2020 proposal. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 20 November 2012.

We are grateful for your response to our queries. We note that the UK will be deciding whether to opt in to this proposal should the JHA obligations remain in the text as of 30 November. We would request an update on this issue once a final decision has been made.

We also note that some Member States have expressed concern about the increase in the proposed financial envelope. We have previously expressed our concern about the proposed budget, and would be grateful for further updates as negotiations on the programme budget progress. You set out the ways in which you would wish to see activities reprioritised in order to ensure a freeze in the budget. Can you cite any examples of when the UK Government have successfully made the case for such reprioritisation? What changes have been made as a result?

We would be grateful for a response to these questions by 10 December 2012. In the meantime we are content to clear the document from scrutiny.

20 November 2012

Letter from Sajid Javid MP to the Chairman

Further to your letter of 20 November, I am writing in response to your questions. I apologise that this response has been slightly delayed: however I also wanted to be in a position to update you simultaneously on the progress of negotiations in Council.

Following my last letter a partial general approach on the text was approved at the Competitiveness Council on 5 December 2012. The agreed text will now go forward to trilogue discussions with the European Parliament later this month.

In your last letter you also asked for any examples of when the Government has successfully made the case for re-prioritisation and any changes that were made as a result. In negotiations for the predecessor Customs programmes the UK has consistently pressed for funds to be aligned to the current priorities. This has been achieved through limiting the percentage of the budget that can be used for administrative expenditure, such as travel and living costs incurred by participants, which allows the programme funds to be focused on areas such as the development and maintenance of EU information exchange networks which can assist with the detection of customs infringements, such as the Community Risk Management System.

I would also like to take this opportunity to inform you that since my last update the Government has opted in to the Customs 2020 proposal, which was confirmed in my Written Ministerial Statement on 5 December 2012.

31 January 2013

CUSTOMS RISK MANAGEMENT AND SECURITY OF THE SUPPLY CHAIN (5249/13)

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

Thank you for your Explanatory Memorandum, dated 28 January 2013, on EM 5249/13, a Communication on customs risk management and security of the supply chain. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 12 February 2013.

As the current horsemeat scandal demonstrates, questions of customs risk management and security of the supply chain are of fundamental importance. We will scrutinise legislative proposals closely as and when they emerge. What steps are the Government taking to prepare their response to such proposals?

Although you support many of the recommendations set out in the Commission document, you state that it contains a number of proposals and statements which the UK has challenged. We would be grateful for a more detailed response on this point. Which specific proposals do you have concerns about? What is the nature of those concerns? Which proposals are you concerned would not deliver an increase in sustainability commensurate with their cost? Which do you think would entail significant duplication? In terms of subsidiarity, you state that the Government are “mindful of
language which may seek to push the scope beyond the boundaries of EU competence.” Are there
any proposals contained in the document which you believe could breach the subsidiarity principle? Is
there a case for a system of financial sanctions as a means by which to ensure the security of the
supply chain?

You state that HMRC has formally written to TAXUD to set out the Government’s specific concerns.
We would be grateful to be sent a copy of that correspondence.

We would be grateful for a response to this letter by 1 March 2013. In the meantime we have agreed
to clear the document from scrutiny.

13 February 2013

Letter from Sajid Javid MP to the Chairman

Thank you for your letter of 13 February 2013 stating your Committee’s clearance of the above
document. My responses to your questions are set out below.

WHAT STEPS IS THE GOVERNMENT TAKING TO PREPARE THEIR RESPONSE TO THESE PROPOSALS?

The Commission Communication does not contain any concrete proposals but rather sets out the
Commission’s view on the direction of travel and areas of possible future action for customs risk
management and the security of the supply chain. The UK will continue to take an active role in
discussions on the future direction of work in this area.

WHAT SPECIFIC PROPOSALS DO YOU HAVE CONCERNS ABOUT AND WHAT IS THE NATURE OF THOSE
CONCERNS?

The Commission Communication introduces the concept of a centralised EU Risk team. In theory
such a team could undertake a range of activities, such as safety and security risk analysis for all
Member States as well as direct compliance and assurance activity for Member States to take. The UK
has particular concerns on competence and cost as well as the governance of a centralised team.
However without a concrete proposal at this stage we are unable to fully assess the range of
implications, including any possible operational impact.

WHICH PROPOSALS ARE YOU CONCERNED WOULD NOT DELIVER AN INCREASE IN SUSTAINABILITY
COMMENSURATE WITH THE COST?

The Commission Communication does not provide sufficient information with regards to the costs
and benefits of the proposals. As with all Commission proposals the UK will push for a formal impact
analysis and a cost benefit analysis.

WHICH DO YOU THINK WOULD ENTAIL SIGNIFICANT DUPLICATION?

The Communication contains ideas, which if developed further, could duplicate the electronic safety
and security declaration systems already operating in Member States. These systems cost Member
States a significant amount to develop and deploy, and we would wish to see a return on that
investment.

ARE THERE ANY PROPOSALS CONTAINED IN THE DOCUMENT WHICH YOU BELIEVE COULD BREACH THE
SUBSIDIARITY PRINCIPLE?

Proposals for a centralised risk team could push the boundaries of EU competence and, as such, have
the possibility to breach the subsidiarity principle.

IS THERE A CASE FOR A SYSTEM OF FINANCIAL SANCTIONS AS A MEANS BY WHICH TO ENSURE THE SECURITY
OF THE SUPPLY CHAIN?

In relation to breaches of customs procedures, the UK operates a system of civil penalties which can
be imposed for non-compliance with EU legislation, which includes safety and security declarations.

13 March 2013
Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum dated 24 October 2012, on a report from the Commission on the follow-up to the discharge for the 2010 financial year. The House of Lords European Union Economic and Financial Affairs Sub-Committee considered this document at its meeting on 27 November 2012.

We welcome many of the actions detailed by the Commission in this report and hope they improve the management of the EU budget. But we are particularly concerned by the fact that the European Court of Auditors (ECA) were, for the 17th year in a row, unable to sign off the 2010 EU budget due to an unacceptably high error rate. We would like to note that, since submitting your EM, it has come to light that the ECA was unable to sign off the 2011 EU budget. We note the Commission’s explanation as to why there are discrepancies. However we consider that this is an indication of consistently poor financial management and would like to see significant steps taken to resolve this. As such, we support your view that compulsory, rather than voluntary, disclosure of national management declarations will be an important step towards improving the accountability chain. However, more needs to be done. What are your views on the Commission’s proposals for strengthening sanctioning mechanisms? Do you think they go far enough?

We note your views on the increased use of pre-financing and would be grateful for further information on this matter. Specifically, what steps are you taking to ensure this message is passed on to the EU institutions? Do other Member States support you on this?

Do you accept that many of the problems with the budget discharge process can be attributed to Member States, including the UK? Do you and other national governments agree that Member States have an obligation to ensure that they play their full part in ensuring sound financial management at EU level?

Finally, as you are aware, the House of Lords has previously submitted two Reasoned Opinions in relation to the Food for Deprived Persons programme. We will carefully consider the proposed new fund for European aid for the most deprived to ensure consistency with the principle of subsidiarity.

We would be grateful for a response to these questions by 12 December 2012. In the meantime we are content to clear this document from scrutiny.

27 November 2012

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

Thank you for your letter, dated 27 November 2012, on Explanatory Memorandum 14652/12, concerning the Commission’s report for the follow-up to the discharge of the 2010 financial year.

The Government shares your concern that the European Court of Auditors once more identified serious shortcomings in the financial management of the EU Budget and has issued a negative statement of assurance for the 18th year in a row. We consider this to be completely unacceptable, particularly at a time when spending cuts are a key issue for Member States during this austere times and economic crisis across Europe. Improving EU-level financial management is a shared responsibility between the Commission and the Member States, and we will continue to press for urgent improvements to the way EU spending is managed.

The Government supports efforts by the Commission to ensure that sanctioning mechanisms are adequate and effective, and recognises the steps that have been taken to strengthen management and control of Structural and Cohesion Funds, through the use of mechanisms such as suspension and interruption to payments. However, it is not clear that further strengthening of the sanctions regime in isolation will lead to improved management of the current Structural Fund programmes. That is why the Government supports efforts to reduce the complexity of future programmes by stripping away bureaucracy and reducing the burdens on beneficiaries, as well as ensuring that the compliance regime and sanctioning mechanisms are sufficiently robust.

You asked for more information on pre-financing: It is a form of payment intended to provide the beneficiary with cash advance, i.e a float. It is paid, in some procurement contacts and in most agreements before the goods and services are delivered and before the occurrence of eligible costs by beneficiaries. The EU Financial Regulation introduced the concept and the implementing rules give a definition and determine the supporting documents required for it to be applied.
As one of the UK’s negotiating priorities for discharge of the 2010 EU Budget - it was encouraging that other Member States supported its inclusion in Council recommendations to the European Parliament. The Council and the European Parliament have called on the Commission to continue to improve the supervision of pre-financed amounts, to revisit the relevant accounting rules, and to systematically collect related data from Member States in a timely manner. The Commission responded that it updated the relevant accounting rule in January 2012 and will continue to improve its supervision of the use of the concept.

The Government accepts that many of the problems with discharge can be attributed to Member States but this is certainly not the case for the UK. As a major net-contributor to the EU budget, UK taxpayers are particularly vulnerable to the consequences of bad financial management in the EU. The UK has direct and legitimate interest in good, efficient management of EU funds. And so the Government takes the management of EU funds, and the findings of the European Court of Auditors, very seriously. Actions have been taken, and continue to be taken on corrective actions to eradicate errors and to improve EU financial management domestically.

The Government uses the discharge process to engage constructively with the Commission and Member States, and to push through its priorities for better financial management: for the Commission and Member States to pursue greater simplicity of rules, make payments and the use of EU money more transparent, and embed better management practices in programmes, such as SMART objectives.

The Government agrees that all Member States have an obligation to ensure that they play their full part in ensuring sound financial management at EU level. That is why, as part of a joint statement on the discharge of the EU accounts for 2010 issued by the UK, Sweden and the Netherlands, the UK called on the commission to toughen up its controls systems, and on Member States to take greater responsibility to drive down errors. Both the Commission and Member States have a role to play.

The Commission is however ultimately responsible for the proper implementation of the EU budget as a whole and it must impose greater order. It must work with Member States to ensure spending control rules are improved, simplified and properly enforced.

27 December 2012

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

Thank you for your letter, dated 27 December 2012, on EM 14652/12 on a report from the Commission on the follow-up to the discharge for the 2010 financial year. The House of Lords European Union Economic and Financial Affairs Sub-Committee considered this document at its meeting on 22 January 2013.

In this letter you stated that “the Government accepts that many of the problems with discharge can be attributed to Member States but this is certainly not the case for the UK”. We would however point out that the National Audit Office has been critical of the way UK Government departments have managed EU funds in the past. For example, the NAO has previously criticised DEFRA and the Rural Payments Agency (RPA) over their mismanagement of the Single Payment Scheme. Indeed, in the Explanatory Memorandum relating to the ECA’s Annual Report of 2010, your predecessor accepted that there were underlying issues in relation to the RPA and assuring us that the Government were taking steps to address these issues. In addition your predecessor admitted that there had been a mistake in calculating the definitive amount for the UK abatement. What steps are you taking to ensure that the UK is immune from such budgetary issues in the future?

We would be grateful for a response to this letter by 8 February 2013.

24 January 2013

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

Thank you for your letter, dated 24 January 2013, on EM 14652/12 on a report from the Commission on the follow-up to the discharge of the EU Budget for the 2010 financial year.

In your letter you asked what steps are being taken to address concerns over the management of EU funds in the UK. The Government takes all issues of mismanagement of EU funds extremely seriously and has taken a number of steps to deliver vast improvements.

Your letter refers to problems relating to the administration of the Single Payment Scheme (SPS). Whilst the resolution of historic problems with SPS is a long process, DEFRA is focussed on the actions needed to improve the timeliness, accuracy and efficiency of payments. As a result, the
number and value of payments made in the opening month of the payments window (December) have improved significantly year-on-year.

Lord Taylor of Holbeach made a statement in February 2012 to inform the House of Lords of the Rural Payments Agency’s (RPA) five-year strategic improvement plan. In his statement, he set out how the agency would be transformed so that it delivers both an improved service to its customers and better value for money for taxpayers. Phase one of the plan involves a series of 45 projects which run from 2012 to 2015 and will deliver a number of improvements, including better processes and controls, cleansed data, improved and maintained technology, fit-for-purpose structures and corporate services, better customer service tools and improved people capacity and capability. Phase two of the plan relates to the delivery of the CAP scheme changes post-2013.

The resulting improvements have been recognized by both the industry and the NAO. In its report on DEFRA’s accounts for 2011-12, the National Audit Office (NAO) acknowledged the steps that DEFRA and the RPA are taking to resolve the administration problems of the SPS.

In January 2013 Lord De Mauley made a statement informing the House of Lords that from 2014 DEFRA will introduce a single computer system for all CAP funding in England, irrespective of the delivery body. This will be launched in time for the 2015 scheme year and will provide a quicker and easier way to apply for CAP schemes going live from this date. This will affect four Defra delivery bodies: RPA, Natural England, Forestry Commission and the Rural Development Programme for England (RDPE) Delivery Team. As part of the drive to cut red tape in farming, it will mean that recipients will only have to enter their details once to a single point of contact rather than for each CAP scheme for which they apply. The new system will also improve the speed and accuracy of payments, improve targeting of farm inspections, reduce running costs, and allow the bodies to adapt easily to future policy or regulatory changes. DEFRA will be working closely with the Government Digital Service (part of the Cabinet Office) in procuring the new delivery solution.

In addition to annual audits by the NAO (under both domestic and EU legislation), RPA receives regular audit visits from the European Commission and ECA.

DEFRA is also seeking to ensure that implementation issues are taken fully into account when policy decisions are being made. However, the department faces on-going challenges to implement excessively complex regulations within very tight deadlines. It is subject to 'flat-rate' financial corrections (based on a percentage of total scheme expenditure) that are not linked to statistically-valid error rates in payments. As part of the negotiations on CAP reform, the UK is therefore arguing strongly for simplification of scheme rules, realistic timescales for implementation and a more proportionate and risk-based approach to controls, audit and financial corrections. As the ECA itself points out, it is likely that unacceptably high error rates will continue until such time as there is a fundamental simplification of the CAP. There is an opportunity through CAP reform, particularly in the auditing of legality and regularity at national level, to establish a more objective link between control weaknesses, error rates in payments and financial corrections. If this can be achieved, it will be easier for Member States to identify and address the real areas of weakness."

Finally, you also raise a concern about a previous mistake in calculating the UK abatement. The Commission, who are responsible for calculating the UK abatement, have now put in place a system of checks to ensure that such errors do not occur in the future. The ECA does of course also audit this calculation as part of their annual report on the overall EU budget.

15 February 2013

ECB OPINION: BANK RECOVERY AND RESOLUTION (17849/12)

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

Thank you for your Explanatory Memorandum 17849/12, on the ECB’s Opinion on the proposal for a Recovery and Resolution Directive (RRD). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 January 2013.

We welcome the ECB’s support for a Recovery and Resolution Directive. We agree that the RRD needs to be adopted rapidly, but that further steps towards the creation of a single resolution mechanism as part of the wider banking union proposals will also be required. We welcome the ECB’s support for a bail-in tool and share its view that the burden of resolution financing should be placed on an institution’s shareholders and creditors, although we note its concern that a European system of financing arrangements is ambitious.
We also note the ECB's concerns over intra-group support, minimum requirement of bail-in liabilities and the implications for Deposit Guarantee Schemes. We asked for further clarification of the Government's position in relation to these issues in our letter to you of 15 January 2013 on EM 11066/12, on the RRD proposals. We look forward to receiving your response to these questions, as well as the other matters raised in that letter. In the context of that letter, we would also be grateful for your analysis of the various amendments proposed by the ECB.

We will take the ECB's views into account in our continued scrutiny of the RRD proposals. In the meantime we now clear this document from scrutiny.

22 January 2013

ECB OPINION ON FINANCIAL ASSISTANCE FOR NON-EURO AREA MEMBER STATES
(5477/13)

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

Thank you for your Explanatory Memorandum, dated 24 February 2013, on EM 5477/13, an ECB Opinion on a Proposal for a Council Regulation establishing a facility for providing financial assistance for Member States whose currency is not the euro. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 12 March 2013.

We were disappointed that you did not provide a more detailed reaction to some of the issues raised by the ECB, in particular the concern regarding its proposed role vis-à-vis non-euro area Member States. We would be grateful for more details on this. Will it lead to changes to the proposed Regulation?

More generally, you stated that you were currently considering the implications of the proposed Regulation for the UK. We would be interested to learn what issues you are currently grappling with since this would allow us to put forward our own conclusions.

In addition, we are still waiting for a response from you regarding this proposal. We wrote on 15 January 2013 requesting further details on the Government's assessment of the proposal and have yet to receive a response. We find this particularly disappointing since you appeared before us on 5 February 2013 where you assured us that problems relating to the scrutiny process that we have recently experienced would be resolved. Please could you provide a response to the original letter as a matter of priority, incorporating answers to the queries set out in this letter.

In the meantime we will clear the ECB Opinion from scrutiny but will continue to hold the original proposal (EM 12201/12) under scrutiny.

12 March 2013

Letter from Rt. Hon Greg Clark MP to the Chairman

Thank you for your letter, dated 12 March, on EM 5477/13, which covers the ECB's Opinion on a Proposal for a Council Regulation establishing a facility for providing financial assistance for Member States whose currency is not the euro.

You ask about the ECB's Opinion in relation to its proposed role. The ECB argues that it should have less involvement than is currently being proposed, given that it is not the monetary authority of non-euro area Member States and therefore should be less involved in the preparation of the economic adjustment programme. In terms of the suggestion made in the proposed Regulation that the ECB may cooperate with the Commission on the assessment of debt sustainability, potential financing needs, the preparation and monitoring of macroeconomic adjustment programmes, the ECB writes that it will need to perform these roles within its mandate and with respect for its independence. The ECB provides specific drafting proposals in an Annex where it recommends that the proposed regulation is amended.

The ECB's proposed amendments will of course be considered by the Council and European Parliament once negotiations over the Proposal begin. Based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union, the ECB only has a consultative role in negotiations on areas falling within the ECB's fields of competence.
In your letter, you also request further details on the Government’s assessment of the implications for the UK of the proposed Regulation itself. As you will have seen, an update to that effect was included as part of the Euro Area Crisis update letter which was sent to your Committee on 19 March. That letter also provides an outline of when you should be provided with an assessment of the Proposal and the Government’s position.

27 March 2013

EURO AREA ECONOMIC GOVERNANCE: THE ‘TWO PACK’ (17230/11, 17231/11, 17323/11)

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

I wanted to update you on the latest situation concerning the ‘two pack’; the two proposed economic governance regulations for the euro area published on 23 November 2011. These cleared Parliamentary scrutiny in your Committee on 22 February 2012. While the proposals do not apply to the UK the Government takes an active interest in their development.

The European Parliament debated the proposals in plenary on 12 June 2012 and voted to adopt a number of amendments on 13 June 2012, but did not at that sitting adopt its legislative resolution, thereby not closing the first reading and leaving open the possibility of reaching an agreement in first reading.

During trilogue negotiations between the Council, Commission and European Parliament, the European Parliament was unwilling to agree the proposals without a commitment to further work by the Commission on debt mutualisation. Subsequently, an agreement was reached regarding this issue and, in a Commission Declaration, the Commission committed to establish an Expert Group “to deepen the analysis on the possible merits, risks, requirements and obstacles of partial substitution of national issuance of debt through joint issuance in the form of a redemption fund and eurobills”.

The Declaration also committed to present a proposal under Article 138(2) TFEU to establish a unified position to achieve an observer status of the euro area in the IMF executive board, and subsequently for a single seat and to put forward explicit ideas for Treaty changes in time for a debate before the next European Parliament elections in 2014.

This compromise agreement was presented to the European Parliament, and when it voted on 12 March 2013, the plenary adopted the compromise amendment to each proposal. The Council should now be in a position to approve the European Parliament position and adopt the proposals in the coming months.

In my letter of 17 July, I set out the amendments the European Parliament initially proposed to the Regulations, specifically: a European Debt Redemption Fund to group together all euro area members’ debt which exceeds 60% of their GDP; and a provision for legal protection for countries at risk of default. Neither of these amendments were included in the final Regulations. The Parliament also proposed an amendment for the Commission to be required to present a proposal for a growth instrument which would mobilise 1% of GDP per year, for infrastructure investments. The final Regulation did not include this amendment but did include a recital referring to the Compact for Growth and Jobs which was signed on 28-29 June 2012, after the European Parliament proposed its amendment. The recital states that “this Compact includes notably measures to boost the financing of the economy. EUR 120 billion (equivalent to around 1% of EU GNI) are being mobilised for fast-acting growth measures.”

5 April 2013

EU BUDGET: 2013 DRAFT BUDGET AND 2012 DRAFT AMENDING BUDGET NO 6 (15272/12)

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

We are writing to you concerning the draft budget for 2013 and the general budget for 2012, and also to express our concerns about a recent lapse in standards from HM Treasury in the parliamentary scrutiny process.
While we note the written statements to the House made on 12 and 20 November, you have not written to us with an update on negotiations on the 2013 draft budget since 25 September 2012. This is in spite of the request in our reply of 23 October 2012 for further updates as negotiations on the shape of the 2013 draft budget continue. Significant developments have taken place since your last letter to us. Most recently, it was reported in the Financial Times on 5 December that “a deal over the EU’s 2013 annual budget appeared to be at hand after key members of the European Parliament gave their political backing to a compromise offer endorsed by national governments”, calling for next year’s budget payments to rise by 2.9 per cent to €132.8bn. This was confirmed in a European Council notice, entitled “Council approved agreement on 2013 EU budget”, dated 6 December 2012. We therefore expect to receive an update letter from you on negotiations before the House rises on Wednesday 19 December. We also note that there was a delay in the deposit until 5 December 2012 of an Explanatory Memorandum on COM (2012) 716, an amendment to the earlier proposal on the Draft General Budget of the European Union for the financial year 2013. This was in spite of the fact that the Commission document was published on 23 November. We would be grateful if you could explain the reason for this delay. It is imperative that such delays do not recur in the future.

We are also aware that there have been significant developments in relation to the 2012 budget. The Financial Times also reported that, as part of the 4 December deal, “Member states were expected to approve a €6 billion ‘amending budget’ to cover a pile of unpaid bills. That is down from the €9 billion that MEPs and the Commission had requested.” This was also confirmed by the European Council on 6 December. The document in question, COM (2012) 632 on the Draft amending budget No 6 to the general budget 2012, was deposited on 26 October and an EM was due on 9 November. This EM was only received on 11 December. This is unacceptable. You have an obligation to keep this Committee informed of developments of such significance. We therefore expect you to provide us with an explanation of the delay.

Regrettably these are by no means isolated incidents. We have perceived a marked decline in the standards shown by HM Treasury in relation to the parliamentary scrutiny of EU documents. A number of EMs have been submitted late, often by a number of weeks, and in the vast majority of cases no explanation of the delay or request for an extension has been made. In addition, when EMs are received they are often of a poor quality: we are writing to you separately to express our concerns about the standard of EM 15390/12 on the Financial Transaction Tax. There have also been delays in responses to our correspondence on various scrutiny items, in spite of clear indications of our deadlines in the correspondence, and, once again, without any explanation for the delay in several cases. Again, this is unacceptable. We are unable to fulfil our scrutiny role if we do not receive documents on time and to a high standard. Whilst we understand that there may be delays from time to time, this should be the exception rather than the rule, and any problems should be communicated to my officials with as much advance notice as possible. This has patently not been the case in recent weeks.

This decline in standards needs to be addressed as a matter of urgency. As such we will be inviting you, accompanied by the Permanent Secretary, to appear before the Sub-Committee early in the New Year in order to explain how you intend to bring about an improvement in standards during 2013.

We expect to receive a response to this letter by Wednesday 19 December.

12 December 2012

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

I am writing to you with regard to EM 15272/12 on the Draft Amending Budget No.6 to the General Budget 2012. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 December 2012.

We are extremely disappointed at the unacceptable delay in receipt of this Explanatory Memorandum. The document was deposited on 26 October 2012, and an EM was due on 9 November. This document, dated 11 December 2012, was therefore received over a month late. Furthermore, it was not submitted until after a Council decision on the proposal had been reached. Neither does it make any apology for the delay, let alone provide any justification for it. This is unacceptable and in clear breach of the spirit of the House of Lords Scrutiny Reserve Resolution. We repeat the statement of our letter of 12 December 2012 that we will be inviting you, accompanied by the Permanent Secretary, HM Treasury, to appear before the Sub-Committee early in the new year in order to explain how you intend to bring about an improvement in standards during 2013.

We note that the Government voted against the Council’s proposal for a €6 billion increase in payment appropriations. We share your view that such a proposal is unacceptable (although we note
that the Commission points out that outstanding payments in relation to the European Social Fund –
regional competitiveness and employment pertained to the UK. What further information can you
give us on this? Yet your failure to provide this EM in advance of the Council meeting not only
deprived us of the opportunity to fulfill our parliamentary scrutiny function, but also deprived you of
the opportunity to make clear to Council colleagues that the House of Lords supported your
position. We do not expect this failure to recur.

As we state in our letter on the 2013 draft budget, it also appears to us that the relationship between
payment and commitment appropriations has become confused and is in danger of breaking down.
We would be grateful if you could provide us with clarity as to the relationship between the two, and
the impact of recent negotiations upon this relationship.

You state that the final size of the Draft Amending Budget had not been concluded at the time that
the EM was written. We therefore invite you to provide us with an update on any further
developments.

We expect a response to these questions by 7 January 2012. In the meantime, given that agreement in
Council has been reached, we now clear the document from scrutiny.

18 December 2012

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

Thank you for your letters of 18 December 2012 on the 2013 Draft Budget and the 2012 Draft
Amending Budget No 6 (DAB 6), and I look forward to discussing the issues you raised when I appear
before the Sub-Committee.

You raised three specific issues. Firstly, you asked for more detail on the relationship between
payment and commitment appropriations and the impact of recent negotiations upon this relationship.
Traditionally EU Member States have predominantly focused on commitments. We have introduced,
along with other budget disciplinarian Member States, an additional focus on payments, since this is
what directly impacts on the public finances. It is clear that the relationship between commitments
and payments can be unpredictable. The fact that Structural Funds are a significant part of the Budget
has increased this variability. We have made dealing with this unpredictability a key plank of our MFF
negotiating strategy by maintaining our focus on payment levels and by seeking to ensure that there is
a clear understanding of the rate at which commitments will transfer into payments in the next
period. It is also important to hold new commitments low in the next MFF, reflecting large payments
that will flow from commitments made in 2012 and 2013.

Secondly, as you state in your letter on DAB 6, the Commission’s argument for requesting additional
spending in the 2012 budget was based on its claim that there were outstanding payments in relation
to cohesion policy under heading 1b, including the European Social Fund (ESF). These pertained to
claims from the majority of Member States, including the UK.

Finally, I refer you to my letter dated 28 December for a final update on the 2012 and 2013 budget
negotiations.

30 January 2013
with the Permanent Secretary, to appear before the Sub-Committee early in the new year to explain how you propose to improve standards in 2013.

We have previously expressed our support for your efforts to secure a more appropriate budget figure as close to a real-terms freeze as possible. We therefore have sympathy with the position that you adopted at the Budget Council in opposing a 2.9% increase in payment appropriations, and regret that we did not have the opportunity to express our support in advance of the meeting. It also appears to us that the relationship between payment and commitment appropriations has become confused and is in danger of breaking down. We would be grateful if you could provide us with clarity as to the relationship between the two, and the impact of recent negotiations upon this relationship.

You state that the final deal on the 2013 budget had not been concluded at the time of writing. We would therefore be grateful for an update on further developments. In particular, we would be grateful for clarity of the implications for the UK’s contribution to the EU budget. In the meantime we now clear the document from scrutiny.

18 December 2012

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

Thank you for your letter of 23 October on the Draft EU Budget 2013, in which you asked to be updated on the negotiations as they continue.

I am writing to update you on the outcome of annual budget negotiations on the 2012 and 2013 budgets. You will recall that I laid a Written Ministerial Statement on the 12 November, which updated both Houses on the suspension of the Conciliation Committee with the European Parliament following discussions at Budget ECOFIN on the 9 November. Formal negotiations reconvened on Tuesday 13 November. No agreement was reached on the overall package. As such, the 21-day Conciliation period for the 2013 budget expired, and the Commission was asked to reissue a new proposal for 2013 and Draft Amending Budget 6 for 2012.

THE 2012 DRAFT AMENDING BUDGET 5 (DAB 5)

As you know, the Commission requested EUR 670 million of additional payments in a DAB 5 following a request for EU Solidarity Fund support from Italy after a series of earthquakes in May 2012. You received EMs 13960/12 and 13963/12 on this request. Following discussions on the overall 2012 and 2013 budget package, the Council agreed to additional payments to support Italy's Solidarity Fund request. The Government made clear that we supported Italy's application, but still believed this should be financed through redeployments in the 2012 budget. The UK, Sweden, Austria and the Netherlands voted against. However, the proposal was approved by a qualified majority of Member States.

THE 2012 DRAFT AMENDING BUDGET 6 (DAB 6)

You will recall I submitted EM 15272/12, dated 11 December 2012, on the Commission proposal for additional EU spending for 2012 of approximately EUR 9 billion (DAB 6). As set out in the EM, the Government stated from the start that, at a time when taxpayers are having to cut back their own spending and with tight constraints on domestic public spending, any increase in the 2012 budget was completely unacceptable. The Government took this position throughout the negotiations.

During Conciliation, Council formally rejected the Commission’s original proposal. Negotiations between the Council, Presidency and European Parliament started again following the end of Conciliation. On the 7 December, Council formally adopted a compromise proposal of EUR 6 billion for DAB 6.

The Government, alongside Sweden, the Netherlands and Denmark refused to support this position and voted against the proposal. This was not sufficient to block the proposal and the Council position on DAB 6 was approved by a qualified majority of Member States.

THE 2013 BUDGET

Following the end of the Conciliation period, the Commission reissued its proposal for the 2013 budget on the 23 November. You received an unnumbered EM (COM(2012) 716) on the new proposal, dated the 11 December. The new Draft Budget was based very closely on the Commission’s original Draft Budget proposal of a 6.8% increase in the 2013 budget. As set out in the EM, the Government was clear throughout negotiations that there should be real budgetary restraint
in the EU to avoid unaffordably high costs to the UK and the UK taxpayers. You will recall that in line with this position, the Government voted against the original Council position of a 2.79% increase in the overall budget in July.

Council remained close to this original position. On the 7 December, Council formally adopted a proposal of a 2.9% increase in the 2013 budget, an increase of around EUR 100 million on its original position.

The Government, alongside Sweden, the Netherlands and Austria did not support this position and voted against the proposal. As with DAB 6, this was not sufficient to block the proposal and the Council position on the 2013 budget was approved by a qualified majority of Member States.

**FINAL APPROVAL BY THE EUROPEAN PARLIAMENT**

On the 12 December, the Council’s position on DAB 6 and the 2013 budget were formally approved by the European Parliament. 

28 December 2012

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

Thank you for your letter, dated 28 December 2012 (but not received until 10 January 2013), on the outcome of negotiations on the 2012 and 2013 budget. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on Tuesday 22 January 2013. This relates to EM 15272/12 on the 2012 Draft Amending Budget No 6 and the unnumbered EM (COM (2012) 716) on the amended 2013 draft budget, which were both considered and cleared by the Sub-Committee on 18 December 2012.

Your letter states that it is written in response to our letter of 23 October 2012. However, you will know that we have written three letters to you since then on the various issues relating to the 2012 and 2013 budgets – once on 12 December and twice on 18 December. We are grateful to you for your update on negotiations on the 2012 and 2013 budgets, and we note that the Council’s position on both documents has now been formally approved by the European Parliament. However, given the significant developments that had taken place since your last update on 25 September 2012 we are disappointed that this update was not provided sooner.

Furthermore, your letter fails to address two points raised in our letters of 18 December. In those letters, the Committee noted that the relationship between payments and commitment appropriations had become confused and was in danger of breaking down, and asked for clarity as to the relationship between the two, and the impact of recent negotiations on this relationship. We also asked for clarity on the implications for the UK’s contribution to the EU budget. We again emphasise the importance of responding to each of the Committee’s queries. We would be grateful for a written response to these questions as soon as possible to enable us to draw our correspondence on these documents to a close.

Whilst you have previously expressed regret that, due to an administrative error, the EM on the amended 2013 draft budget was not deposited earlier, you now appear to be justifying this on the grounds that the amended budget was based closely on the original budget, which had already been comprehensively discussed by the Committee, and in respect of which the Committee had indicated its support for the Government’s position. This is not a justification for the delay – to enable us to fulfil our scrutiny function effectively deposit and production of EMs must occur on time, and certainly before decisions in Council are reached. A failure to do so, as in this case, marks a breach of the spirit of the House of Lords Scrutiny Reserve Resolution.

You have also failed to respond to the request in our letter of 12 December 2012 for an explanation of the delay of over one month in receipt of EM 15272/12 on the 2012 draft Amending Budget No 6. We expect you to provide an explanation for this delay in your response to this letter.

We will pursue both these matters in our meeting with you on 5 February 2013.

22 January 2013
Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum, dated 5 April 2013, on EM 7945/13, a Communication from the Commission on ex-ante coordination of plans for Major Economic Policy Reforms, and for your Explanatory Memorandum, also dated 5 April 2013, on EM 6849/13, a Communication from the Commission on the introduction of a Convergence and Competitiveness Instrument. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 23 April 2013.

You stated that there remain some unresolved issues in relation to these proposals. Can you detail what these unresolved issues are? How will the contractual arrangements that would form part of the Convergence and Competitiveness Instrument be enforced? What are the implications for the role and authority of national governments?

We note that the UK’s position in relation to these proposals is similar to that in relation to the Banking Union proposals, seeing these elements as only being relevant to addressing the problems of the euro area. Do the Government perceive any risks in such a detached approach? What do you perceive as the implications of these proposals for non-participating Member States, such as the UK? Are there any implications in terms of UK national sovereignty? Have you considered alternative, more constructive, ways to engage with this process? What will be the voting arrangements for such proposals, and what influence will non-participating Member States be able to exert on the shape of the proposals?

We are aware of reports that the Economic and Financial Committee (EFC), composed of national and central bank officials, showed little enthusiasm for the Convergence and Competitiveness Instrument when it met on 4 April. It is predicted that the June 2013 European Council, where this is due to be discussed, is unlikely to make progress on this. How quickly do you expect progress to be made on these proposals?

We have launched an inquiry into the proposals for Genuine Economic and Monetary Union and the implications for the UK, in the context of which these proposals will be considered in more detail. We are, therefore, content to clear these documents from scrutiny. However, we would be grateful to receive regular updates on the progress of negotiations as well as a response to our specific queries by 9 May 2013.

24 April 2013

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

Thank you for your letter of 24 April regarding HM Treasury Explanatory Memoranda on the European Commission Communications on the Genuine Economic and Monetary Union. It raised a number of interesting points and questions.

You asked the Government to detail the unresolved issues surrounding these proposals. Discussions of these measures are at a very early stage. No legislative proposals have yet been put forward by the Commission and as such, there are many details that are yet to be determined. These include, the precise legal bases on which these measures will be put forward, how they will interact with the existing EU surveillance and coordination mechanisms and which specific reforms should be subject to ex ante coordination. Furthermore, very little progress has been made on the financing mechanism of the Convergence and Competitiveness Instrument (CCI).

You asked how the contractual arrangements of the CCI would be enforced. This is also currently unclear. Early indications envisage that these ‘contracts’ would be binding politically rather than legally. Discussions also envisage significant Government involvement when agreeing upon a ‘contract’ with the EU to ensure the necessary national ownership of required structural reforms.

You asked whether the Government sees any risk in taking a ‘detached’ approach to these proposals similar to that taken to the Banking Union. I assure you that the Government will not be taking a ‘detached’ approach. Rather, as was the case with negotiations on Banking Union, the Government will be fully involved in negotiations in order to protect the UK interest. These measures will be taken forward through the EU Semester, in which the UK is involved. At the same time, the Government considers that this strengthened level of economic coordination is necessary only for the smooth...
functioning of the economic and monetary union. As such, it is right that they predominantly be aimed at those using the single currency. If those currently outside the single currency but intending to join in future wish also to take part in these measures, it should be possible for them to do so.

You asked what the voting arrangements for these proposals will be and what influence non-participating Member States will be able to exert on the shape of the proposals. The voting arrangements of each proposal will depend upon the legal base used, which is still to be determined. As regards Member State influence, all 27 Member States, including the UK, are fully involved in the discussions on the Economic and Monetary Union reform process and we will keep the Committee informed of major developments.

6 May 2013

EUROPEAN COURT OF AUDITORS ANNUAL REPORT 2011 (6984/13)

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

Thank you for your Explanatory Memorandum, dated 15 March 2013, on EM 6984/13, a Report from the Commission on Member States’ replies to the Court of Auditors’ 2011 Annual Report. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 16 April 2013.

We welcome the process of informing Member States of findings in the European Court of Auditors (ECA) annual report that relate to areas under their management. The fact that the ECA was not able to give the 2011 EU budget a positive Statement of Assurance was unacceptable and we have previously stated that responsibility for identifying improvements to these problems lies primarily with Member States. This exercise is a welcome step in addressing this. What we note your call for simplification of regulations and guidelines, what concrete examples can you give us of where this is happening?

A number of Member States appeared to be in agreement that simplification of the complicated rules and regulations currently in place would help resolve some of these problems and the Commission’s report indicated that steps were being taken to address this. We hope to see tangible improvements in the management of EU funds as a result of this.

We are content to clear this document from scrutiny.

16 April 2013

EUROPEAN COURT OF AUDITORS ANNUAL REPORT 2011 (UNNUMBERED EM)

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

Thank you for your Explanatory Memorandum, dated 30 November 2012, on the European Court of Auditors Annual Report on the implementation of the Budget concerning the financial year 2011. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 December 2012.

We are once again disappointed by the fact that the European Court of Auditors was not able to give the 2011 EU budget a positive Statement of Assurance. This is an ongoing issue which we have expressed concern about on a number of previous occasions. We did not find your Explanatory Memorandum particularly enlightening. Given the detailed nature of this report, it warranted a much more considered response. Can you tell us what an error rate of 3.9% equates to in monetary terms? Whilst we welcome your assurances that you will press for urgent improvements to the way EU spending is managed we are keen to learn exactly what measures you are pressing for that would lead to improvements. What has been the response to these ideas?

As we have previously stated, responsibility for identifying improvements to the problems that this report has revealed lies primarily with Member States, including the UK. Which other Member States are you working with to seek improvements? What steps are the UK, and other Member States, taking to address these issues? It may be that an improvement will only arise if financial sanctions are put in place. Do you agree?
We would be grateful for a detailed response to these queries by Tuesday 15 January 2012. In the meantime we will clear this document from scrutiny.

18 December 2012

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

Thank you for your letter dated 18 December, on the European Court of Auditors (ECA) Annual Report 2011, in which you asked a number of questions.

I apologise for the delay in sending you a response, however I wanted to ensure that I had sought the ECA’s advice on your first question regarding the monetary value of the 3.9% error rate reported by the ECA. You may be aware that the ECA itself does not provide a monetary value of its error rate. I understand that a figure of around EUR 5.2 billion has been reported in the media, based on the calculation of 3.9% of EUR 129.4 billion (the figure given in the report for total payments made in 2011 in table 1.1, page 16). However, the ECA itself does not encourage such calculations. A particular concern they note with this type of calculation is based on the timing of payments and expenditure. The issue is that a significant share of the errors found in 2011 is based on Member States’ expenditure in that reporting year, whereas the corresponding payments will not all be captured in the EUR 129.4 figure for total payments in the same year. For example, some of the expenditure audited could have been received in a previous year in the form of pre-financing payments. Moreover, the ECA have expressed concerns at extrapolating a monetary value from an error rate which results from a specific sample of EU spending. For these reasons, the ECA believes such a calculation can be misleading.

Secondly, you asked what measures the Government has called for in order to improve the financial management of the EU budget. The Government takes the management of EU funds, and the findings of the ECA, very seriously. Improved management and control over EU funds are essential to budget discipline and value for money in EU spending. This is why this Government took the unprecedented decision, for the UK, to vote against the 2010 discharge process, supported by the Netherlands and Sweden. We also issued a joint statement calling for immediate improvements to EU financial management. These improvements include:

— further simplification of regulations and guidelines, in particular those relating to structural funds, rural development, agricultural and environmental measures;
— more robust management of programmes, with annual and mid-term reviews and disclosure of programme performance assessed against SMART objectives; and
— greater recognition of Member State responsibility over funds under shared management arrangements, as these account for around 80% of the EU budget.

A number of improvements have been achieved over the last year. The outcome of the new Financial Regulations agreed by the Commission, Council and European Parliament provide an overarching and consistent set of rules informing all financial activity across the EU. This shows a significant step forward for simplification of the regulatory landscape and greater consistency of rules of implementation for joint management with Member States. The UK is also working constructively with the Commission on further simplification of the EU budget regulations for the next MFF.

Looking ahead, the UK will continue to use the discharge process for the 2011 accounts to engage constructively with the Commission and with like-minded Member States - including the Netherlands, Sweden, Denmark and Finland - to seek further improvements.

The Government agrees with your view that responsibility for identifying improvements in relation to the issues highlighted by the ECA report lies primarily with the Member States. The UK continues to press for the Commission and the Member States to improve their management and control systems, with the aim of achieving rigorous and effective controls in the new financial perspective period.

Improvements to the management of EU funds in the UK are pursued on an ongoing basis, with operational and audit systems constantly assessed to ensure their effectiveness. The Commission’s use of interruption to payments as soon as deficiencies are detected has encouraged Member States to remedy deficiencies more quickly and to ensure irregular expenditure is identified sooner and recovered more quickly.
Finally, you raised the idea of financial sanctions as a way of improving financial management in the EU budget. In our 2010 discharge joint statement with Sweden and the Netherlands the Government encouraged the Commission to continue to drive better financial management by all Member States, including through stricter application of sanctions such as suspensions and interruptions. However, this must be well targeted to achieve its aim of protecting EU funds and encouraging better financial management.

6 February 2013

EUROPEAN GROUPING OF TERRITORIAL COOPERATION (EGTC) (15251/11)

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

Your Committee has cleared the above EM from scrutiny on 19 June 2012. The purpose of this letter is to update you on the latest negotiations of this regulation and inform you that the Irish Presidency has indicated that it intends to seek a general approach on the above regulation concerning a European Grouping of Territorial Cooperation (EGTC) as an “A point” at a forthcoming Council.

As outlined in the EM, the objective of this proposal is to make changes to the existing rules for the formation of EGTCs. The changes proposed should maintain the existing nature of EGTCs so no current EGTC need change its way of operating; should provide clarity on areas that have caused confusion and make EGTCs more visible; and provide flexibility by providing third countries to participate. There are no EGTCs in the UK at present.

The Government considers that the proposed General Approach is acceptable. The revised regulation ensures that the decision to form an EGTC remains optional, and is not compulsory in order to benefit from funds allocated for territorial cooperation.

We consider that the amendment to the regulation will clarify the rules on liability. In a case where a member of an EGTC has limited liability, any Member State concerned may require that the EGTC shall take appropriate insurance, or that it shall be subject to a guarantee provided by a bank or other financial institution established in a Member State, or be covered by a facility provided as a guarantee by a public entity or by the Member State, to cover the risks specific to the activities of the EGTC.

Some Member States raised constitutional concerns about the inclusion of a tacit agreement procedure within the regulation which means that if a member notifies a Member State of its intention to join an EGTC the Member State has six months in which to raise any concerns or explain why it has decided not to approve the request. If the Member State does not respond to such a request within the six month period the Member State is deemed to have given its approval. The UK does not have the same constitutional concern but did agree that a clarification of the procedure would be helpful. Therefore the UK supported the inclusion of a requirement for the Member State, where the registered office the EGTC is located, to have to give a formal approval to the formation of the EGTC. We have also ensured that the UK Government will have to be notified if a new member intends to join an existing EGTC. We consider that the proposed text meets the requirement of simplifying the proposal whilst meeting the Member States need to be informed and have the right to approve EGTCs, especially in the cases where the registered office is located in that Member State.

27 February 2013

EUROPEAN SEMESTER 2013: ALERT MECHANISM REPORT (16671/12, 16513/12) AND 2013 EUROPEAN SEMESTER: ANNUAL GROWTH SURVEY (16669/12)

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

Thank you for your Explanatory Memorandum, dated 16 December 2012, on EMs 16671/12 and 16513/12, on the Alert Mechanism Report 2013 and related documents. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 January 2013.

You state that the Government support the Macroeconomic Imbalances Procedure (MIP) as a means of strengthening European economic governance. In your predecessor’s letter of 23 March 2012, on the 2012 Alert Mechanism Report, he noted the relative novelty of the Macroeconomic Imbalances
Procedure. What is your assessment of the Procedure after the past year’s experience? You welcomed the inclusion of an indicator in the 2013 scoreboard to monitor developments in the financial sector? Are you now satisfied with the 11 macroeconomic indicators? Are there any ways in which you believe it can be improved? What tangible benefit has it brought about in terms of strengthening economic governance in the EU? What is your assessment of the effectiveness of the Semester process, taken as a whole? What impact does it have on policy-making in the UK?

The Commission concludes that the 2013 MIP takes place against the backdrop of continued financial tensions, uncertainty and low growth prospects. We agree. Yet whilst the MIP provides a useful diagnosis of the EU’s economic ills, do you believe that the Semester process does enough to identify a cure by setting out practical steps to improve growth and competitiveness? What are the Government doing to promote the growth and competitiveness agenda across the EU as a whole that is so desperately needed?

The UK breached four thresholds in the 2012 report, and it breaches three of these, on public sector debt, private sector debt and the change in export market shares, once more in 2013. The UK will therefore be subject to an In-Depth Review (IDR) for the second year in a row. You state that exceeding the threshold values for one or more indicators does not mean that an imbalance is present. However, we note that in 2012 imbalances were confirmed in all 12 Member States subject to an IDR. Are you concerned that the UK has been subject to an IDR for the second year in a row? What steps have you taken to address the concerns raised by the Commission in 2012? What is the likelihood that these thresholds will continue to be breached for some time to come? What steps need to be taken to ensure that imbalances in public and private debt, and export market shares are corrected?

We also stress the importance of providing full accountability to national parliaments in the context of country-specific recommendations. It is therefore essential that an opportunity is provided for debate of the European Semester in the House of Lords. What steps will you take to ensure that such a debate takes place as a matter of priority?

What is your assessment of the attitude of other Member States (and their national parliaments) to the Alert Mechanism Report? What impact do the country-specific assessments have on policy-making in other Member States? What is their assessment of the Semester process, taken as a whole?

We note that ECOFIN is scheduled to agree conclusions to formally endorse the report in February 2013. We are therefore content to clear the documents from scrutiny. However we wish to receive a response to our questions, as well as an update on discussions at ECOFIN, immediately after that meeting takes place.

22 January 2013

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

Thank you for your letters, dated 22 January 2013, on Explanatory Memorandums 16671/12 and 16513/12 covering the Alert Mechanism Report and on Explanatory Memorandum 16669/12 covering the Annual Growth Survey. Since both of these letters relate to the European Semester process, I shall address both sets of questions below.

ANNUAL GROWTH SURVEY

You asked whether the Government shares the optimism of the European Commission that the worst of the crisis is over. The Government recognises that Member States and the EU Institutions have already taken unprecedented steps to tackle the crisis. However, much more remains to be done to restore public finances and market confidence and to put the EU back on a sustainable growth path. The 0.6% contraction in euro area GDP in 2012Q4 demonstrates the continued chilling effect the crisis is having on the European economy, including the UK.

You asked for the Government’s assessment of whether it is a cause for concern that the priority areas identified by the Annual Growth Survey (AGS) are the same as last year, and whether this points to a lack of progress. You also asked how the Commission’s aspirations could be translated into actions to bring about growth.

The Government welcomes the five priority areas set out in the AGS, and considers that a focus on continuity of reform messages and implementation of existing commitments is paramount. In terms of achieving the Commission’s objectives on growth and competitiveness across the EU, it should be pointed out that the Commission already holds many of the policy levers required to achieve this. Achieving a genuine European Single Market in services and digital content could add up to €800bn to
the EU economy, while completing the EU Free Trade Agreement deals that are underway or in the pipeline could add €250bn to the EU economy.

Regarding your request for specific examples of where “growth-friendly fiscal consolidation” had been achieved in practice, for the UK there are strong commonalities between the policy reform priorities set out in the AGS and domestic reforms to promote growth. As the Commission point out, “sound and sustainable public finances are an essential prerequisite for macroeconomic stability and hence growth”. The Government is therefore equipping the UK to compete in the global race by switching current spending to capital investment in science, roads and education, offering support for business and enterprise, as well as reforming the civil service and clamping down on wasteful expenditure.

MACROECONOMIC IMBALANCES PROCEDURE

You asked about the Government’s general assessment of the Macroeconomic Imbalances Procedure (MIP) one year after its inception. You also asked specifically about the design of the scoreboard, potential improvements, and what tangible benefits the MIP had brought about.

The Government continues to support the MIP as a necessary means to strengthen European economic governance. With the inclusion of a new financial sector indicator for 2013, the Government considers that the scoreboard now broadly captures the potential imbalances that need to be monitored.

Despite being a relatively new procedure, the MIP has proved a useful addition to the European Semester, by highlighting economic policy challenges that Member States across Europe need to address. For instance, it highlights that a majority of Member States are experiencing high levels of private sector indebtedness, while the 2012 procedure identified both Spain and Cyprus as being Member States in need of particularly urgent reforms.

IN DEPTH REVIEW OF THE UK

You asked whether the Government is concerned about the UK being subject to an in-depth review (IDR) for the second year running and what steps have been taken following the 2012 IDR. You also asked whether the UK would continue to exceed threshold values in the future and what steps need to be taken to rebalance the economy.

The Government has always been clear that rebalancing the economy is a priority. The Government recognises that the imbalances inherited from the pre-crisis period take time to unwind and is therefore not concerned at being subject to an IDR in 2013. However, it is important to recall that the Alert Mechanism Report (AMR) is a screening device and that being placed in an IDR should not be taken to mean that the UK will be found to have an imbalance. The Government awaits the Commission’s assessment, which is due to issue in March.

In terms of specific steps taken to address these issues, the Government has clear and credible fiscal consolidation plans which are essential for maintaining stability in the face of an uncertain global outlook. The plan is working: the deficit is down, private sector jobs are up by over a million and debt interest payments have fallen relative to previous forecasts, while a radical programme of supply-side reforms is expected to rebalance the economy towards investment and exports in the medium term.

The Government’s plans for rebalancing are reflected in the independent Office for Budget Responsibility’s forecasts, which are forecasting private and government consumption to decline as a share of GDP through the forecast period.

EUROPEAN SEMESTER

You asked about the Government’s broad assessment of the effectiveness of the European Semester process, and its impact on policy-making in the UK. The Government considers that the European Semester is an effective means for aligning reporting cycles of EU-level economic instruments, and for providing mechanisms to ensure adequate surveillance of Member States’ macro-economic, micro-economic and employment reforms.

The reforms envisaged under the European Semester are broadly in line with the Government’s own efforts to rebalance the economy and create the conditions for employment and growth.

You asked about other Member States’ attitude towards the AMR and the European Semester more broadly. The Government considers that other Member States take their responsibilities under the European Semester process seriously. A number of other Member States, particularly Germany and
Sweden, support the UK’s position that national ownership and the involvement of national parliaments are crucial to ensuring a successful process.

We will of course consider further parliamentary steps in due course, as the Commission’s timing becomes clear.

UPDATE ON DISCUSSIONS AT ECOFIN

ECOFIN agreed conclusions on the AMR and the AGS on 12 February. The AGS conclusions will serve to prepare discussions of Heads of State or Government at the European Council on 14-15 March.

15 February 2013

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

Thank you for your letter, dated 15 February 2013, on EMs 16669/12 on the Annual Growth Survey, and EMs 16671/12 and 16513/12 on the Alert Mechanism Report, in relation to the 2013 European Semester. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 5 March 2013.

We are grateful to you for your response to the queries set out in our letters of 22 January 2013. We note the Government’s support for the Semester process, and we particularly welcome your assertion that national ownership of the Semester and the involvement of national parliaments are crucial to ensuring a successful process. We welcomed the opportunity to represent the House of Lords at the European Parliamentary Week on the European Semester from 28-30 January 2013. The European Parliamentary Week is just one possible model for the oversight of the Semester: national parliaments and the European Parliament will have a wider discussion about what the appropriate forum in April at the next Conference of EU Speakers. We note that the Annual Growth Survey and the Alert Mechanism Report from the first part of the 2013 Semester process, and we will continue to remain closely engaged in the Semester process as it takes shape over the coming months.

5 March 2013

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

I am writing to give you notice of the Government’s intention to publish the above document and explain its relevance to the debate that is planned to take place on 25 April, subject to the progress of Parliamentary business.

Article 121 of the Treaty on the Functioning of the European Union requires the UK to submit an annual Convergence Programme to the European Commission reporting upon its fiscal situation and policies. The UK’s Convergence Programme will be submitted to the European Commission by 30 April. This deadline was set in accordance with the new European Semester combined timetable for both Convergence and National Reform Programmes. The Government supports the European Semester which plays important role in EU surveillance of economic and fiscal policy.

Section 5 of the European Communities (Amendment) Act 1993 requires that the content of the Convergence Programme must be drawn from an assessment of the UK’s economic and budgetary position which has been presented to Parliament by the Government for its approval. This assessment is comprised of the Budget report and the Office for Budget Responsibility’s Economic and fiscal outlook and it is therefore this content, not the Convergence Programme itself, which requires the approval of the House for the purposes of the Act. The Government is holding this debate to obtain the required approval before the 30 April deadline to submit the Convergence Programme to the European Commission.

Early copies of the Convergence Programme will be provided to Parliament prior to the debate. The document will also be available electronically via HM Treasury’s website when submitted to the Commission.

18 April 2013
Letter from the Chairman to the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury

Thank you for your Explanatory Memorandum, dated 18 December 2012, on EM 16669/12 on the Annual Growth Survey 2013. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 January 2013.

We welcome the publication of the Annual Growth Survey as the first stage in the 2013 European Semester. The Commission is cautiously optimistic about the year ahead, stating that the EU economy is slowly emerging from the deepest financial and economic crisis in decades, and that there are signs that in the course of 2013 we will see a recovery. Such optimism has been echoed in recent statements by the Managing Director of the IMF, Christine Lagarde, the President of the European Commission, José Manuel Barroso and the ECB President, Mario Draghi. Do you share this optimism that the worst of the crisis is over?

Nevertheless, the sobering statistics set out in the report make clear the scale of the challenge if sustainable growth and competitiveness is to be restored to the EU economy. There was an expected contraction of 0.3% in the EU economy last year (0.4% in the euro area). Unemployment has risen by 2 million in the past six months to 25 million, with nearly one in two out of work for over a year. Youth unemployment is more than 50% in some countries.

The Commission states that “the EU needs to be able to show that our policies are working, that they will deliver results over time and that they will be implemented fairly in terms of the impact on our societies. Correcting the problems of the past and putting the EU on a more sustainable development path for the future is a shared responsibility of the Member States and the EU Institutions.” We agree with this, yet it is much easier to make a diagnosis of the EU economy’s ills than to identify an effective cure. What is your assessment of the Commission’s proposals? How can the Commission’s aspirations be translated into action in order to deliver the improvements in growth and competitiveness that are so desperately needed?

The Commission states that it will take time to move towards a sustainable recovery, and that the crisis is having severe consequences. Is it not a concern that the 2013 AGS sets out the same reform priorities as the 2012 AGS? Does this demonstrate how little progress has been made to meeting such challenges? You welcome the Commission’s five priority areas, including the focus on “growth-friendly fiscal consolidation”. What examples can you give us of when growth-friendly fiscal consolidation has actually been achieved?

We note that the Semester will be taken forward in the context of National Reform Programmes, to be submitted in April 2013, and Stability and Convergence Programmes, followed by the endorsement of country-specific recommendations at the June 2013 European Council. We stress again the importance of ensuring full accountability to national parliaments in the context of the European Semester. It is therefore essential that an opportunity is provided for debate of the European Semester in the House of Lords. What steps will you take to ensure that such a debate takes place as a matter of priority?

We note that ECOFIN and other Council groupings are scheduled to discuss this document shortly, ahead of endorsement at the 14-15 March 2013 European Council. In light of this we have agreed to clear this document from scrutiny. However, we would be grateful for a response to the questions in this letter by 6 February 2013.

22 January 2013

European Statistics: Report (14230/12)

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

Thank you for your Explanatory Memorandum, dated 19 October 2012, on EM 14230/12 on a special report of the European Court of Auditors (ECA) entitled “Did the Commission and Eurostat improve the process for producing reliable and credible European statistics?” The House of Lords European Union Economic and Financial Affairs Sub-Committee considered this document at its meeting on 20 November 2012.
We are concerned by the report’s assessment in relation to the partial implementation of the European Statistics Code of Practice at both European level and within Member States. The importance of good quality European statistics cannot be overstated, and we would stress the distinction between setting rules and overseeing their implementation. We note your preference for a model of compliance with the Code of Practice based on self-assessment and independent accreditation. Recent experience, in particular in relation to Greece, has demonstrated the problems of a laissez-faire approach to statistical oversight. We do not believe that a system based on mutual trust is sufficient to ensure the production of good quality statistics throughout the EU. In light of this, how would you justify your support for a system of self-assessment?

The report also calls for greater legal clarity in relation to the Code of Practice, which was not addressed in your original EM. It is our view that this should be adopted as part of the proposed Amendment to the Regulation on European Statistics. Do you agree?

You state that the report recommends giving Eurostat a direct supervisory and investigatory role. Our analysis of the report is that it recommends extending the remit of the European Statistical Governance Advisory Board (ESGAB). We would wish to receive clarity on this matter, and on whether you would support extending the remit of the ESGAB, before we would be willing to clear the document from scrutiny.

We would be grateful for a response to these questions by 5 December 2012. In the meantime we will continue to hold this document under scrutiny.

20 November 2012

Letter from the Rt. Hon Francis Maude MP to the Chairman

Thank you for your letter of 20 November. The Government shares your concern about the partial compliance by Member States with the European Statistics Code of Practice described in the Special Report of the European Court of Auditors (ECA). We agree that assurance of compliance and good quality cannot be achieved if producers of statistics are also responsible for the oversight of compliance. The statistical system of a Member State should be structured to provide scrutiny and oversight that is independent from production. The UK has created such a structure through the establishment of the UK Statistics Authority. It is self assessment of this sort that will help ensure compliance with the European Statistics Code and robust quality management.

The adequacy of the independent assessment of compliance for European statistics within Member States must itself be scrutinised and assured. The Commission proposals for amending Regulation 223/2009 on European statistics include a requirement for Member States to issue a ‘Commitment of Confidence’, which we support. This Commitment would include any improvement actions necessary for full compliance with the Code. The onus would be on Member States to establish robust assurance systems akin to those we have already established in the UK. A report on the Commitments of Confidence of Member States would be presented by the Commission to the European Parliament (EP) and the Council. The current role of the European Statistics Governance Advisory Board (ESGAB) would extend to scrutiny of these published national Commitments, and ESGAB’s own report on compliance would be submitted to EP and the Council. The Government’s support for self assessment and peer review is of course dependent upon the proper implementation of these, or equivalent, structures. But the Government would also wish to avoid establishing legal structures at the European level that would imply changes to UK law with respect to official statistics.

Member States have asked the Council Legal Service for a written opinion on the effect of the Commission’s proposals for Commitments on Confidence on the status of the Code of Practice. Their opinion was received on 3 December. It sets out that the effect of the proposal would be to “harden” the Code, making compliance with its statements an obligation of European law.

The government’s policy remains that European statistics should be produced in full compliance with the European Statistics Code of Practice, with independent oversight of compliance and transparent reporting on breaches of the Code.

14 December 2012

Letter from the Chairman to the Rt. Hon Francis Maude MP

Thank you for your letter, dated 14 December 2012, on EM 14230/12 on a special report of the European Court of Auditors (ECA) entitled “Did the Commission and Eurostat improve the process for producing reliable and credible European statistics?” The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 January 2013.
We would like to thank you for your response to our queries and we are now content to clear this document from scrutiny.

22 January 2013

EVALUATION OF THE UNION’S FINANCES (16850/12)

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

I am writing with regard to your Explanatory Memorandum, dated 25 January 2013, on EM 16850/12, a report from the Commission on the evaluation of the Union’s finances based on the results achieved. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 12 February 2013.

This EM is unacceptable on a number of grounds. First, the document is dated 26 January 2013 and was not received until 28 January, over six weeks after the due date of 12 December 2012. As a result, the Committee was not able to examine the document before it was discussed at Budget Council on 11 January 2013. Yet the EM fails even to acknowledge that the EM was so late, let alone apologise for or explain the delay. Although this was not a legislative proposal and was therefore not subject to a formal override, your failure to provide the EM in advance of the Budget Council is a clear breach of the spirit of the House of Lords scrutiny reserve resolution.

Second, the EM itself is of an extremely poor quality. The Commission report contains nearly 20 pages of detailed assessment of a large number of budgetary programmes. The EM provides no substantive analysis of this material, simply stating that “the Report summarises evaluation results of the financial programmes for each budget heading, highlighting EU added value, focus and coherence, effectiveness and efficiency as well as organisational issues.” We therefore request that you provide us with the Government’s analysis of the Commission’s assessment under each of the following headings:

**HEADING 1A – COMPETITIVENESS FOR GROWTH AND EMPLOYMENT**

— Enterprise.
— Economic and Financial Affairs.
— Mobility and Transport.
— Information Society and Media.
— Energy.
— Research.
— Education and Culture.
— Heading 1b – Cohesion for Growth and Employment
— Employment and Social Affairs.
— Regional Policy.

**HEADING 2 – PRESERVATION AND MANAGEMENT OF NATURAL RESOURCES**

— Agriculture and Rural Development.
— Maritime Affairs and Fisheries.
— Heading 3a – Freedom, Security and Justice
— Home.
— Justice.

**HEADING 3B – CITIZENSHIP**

— Communication.
— Health and Consumer Protection.
In your appearance before the Sub-Committee on 5 February 2013, alongside Sir Nicholas Macpherson, Permanent Secretary, HM Treasury, we told you that we had perceived a marked decline in standards at HM Treasury in recent months. This EM is a case in point. We would invite you to compare the quality of this EM with EM 6736/12 (signed by your predecessor, Mark Hoban MP) on the equivalent report from a year ago. In that document, the “Policy Implications” section, which sets out the Government’s assessment of the document, runs to 11 paragraphs over two pages. By contrast, the equivalent section in this document amounts to four sentences. You state that it is essential that EU expenditure is closely scrutinised. We agree. Yet we cannot undertake such scrutiny if you fail to provide us with EMs on time and to a high standard.

At the evidence session on 5 February, Sir Nicholas Macpherson acknowledged that there had been problems with the scrutiny process within HM Treasury during October and November 2012, but stressed that these issues were now being addressed. Yet this EM was signed by you on 26 January 2013. We expect you to write for us to explain the delay in receipt of this EM and its poor quality.

We welcome the commitment given by Sir Nicholas Macpherson that the problems with the scrutiny process are being addressed. In light of this commitment and your acknowledgement of the importance and value of the system of parliamentary scrutiny of EU documents, we are confident that you will ensure that such failures do not recur in the future.

Turning to the document itself, we agree with you that it is essential that EU expenditure is closely scrutinised. We also agree that the production of such a report is important in the context of accountability and transparency of the EU budget. Yet we acknowledge your concerns that the Commission may not thus far have identified the most effective means by which to make such a report. We agree with you that multiannual programmes should be evaluated at set milestones and against planned results. We welcome the Commission’s review of the structure and content of the report, and we would request that you keep us updated on the outcome of this review. What is your view as to the most appropriate format and timing of such a report? Do you consider the format of this year’s report to be an improvement on last year’s, which focussed on only two policy areas, Education and Culture and Research programmes?

We also have on specific query. Under Heading 1a, and in relation to enterprise, the Commission states that “the growth and Innovative SME Facility (GIF) and SMEG loan and micro credit facility were confirmed as relevant to the needs of small and medium-sized businesses (SMEs) and, in terms of EU added-value, fulfil a demand for finance which otherwise would not have been met.” Can you advise us of how the mechanism for such support for SMEs operates in practice?

We expect a response to this letter by 4 March 2013. Given that the document has already been considered by the Council’s Budget Committee we now clear it from scrutiny.

13 February 2013

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

Thank you for your letter of 13 February 2013 on the evaluation of the Union’s finances based on the results achieved.

You asked for further detail on the Government’s analysis of the Commission’s evaluation report by heading. I have set this out in Annex A to this letter, and I look forward to hearing the Committee’s assessment of this in due course.

On a point of clarification, this document was not (and is unlikely to be) discussed by Ministers in any Council formation. It has simply been presented by the Commission to, and discussed by, officials at Budget Committee.

We consider the format and content for the Commission’s latest report to be a clear improvement on the previous report, with a much wider ranging focus on substantive policy areas. However, the
Government’s view is that more can and should be done as part of the Commission’s review to build on this. As your letter notes, the Government would like to see the Commission’s evaluation assessing the full impact of multiannual programmes. In order to do this, the Commission will need to consider the most appropriate evaluation milestones. The reports would also benefit from a greater focus on how such analysis could be used to inform the annual discharge process for the EU’s accounts. Future reports should also include analysis of the impact of programmes on economic growth.

The Government notes the other existing reports on EU spending published by the Commission, including Impact Assessments, Annual Activity Reports, the Synthesis Report of Management Achievements, the Activity Statements, and the reports related to the discharge of the EU budget. The Government considers that this new reporting series should complement these other reports, in terms of content, value-added and timing.

You asked how the small and medium-sized businesses guarantee facility (SMEG) mechanism works in practice. SMEG provides loan guarantees to banks. By reducing the banks’ exposure to risk they encourage them to make more debt finance available to SMEs, including microcredit and mezzanine finance. It is worth noting that the Government does not know of any UK financial intermediaries to have used the existing EU loan guarantee scheme (SMEG), due to the existence of the UK’s own guarantee scheme (the Enterprise Finance Guarantee).

21 March 2013

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

Thank you for your letter, dated 21 March 2013, on EM 16850/12: Evaluation of the Union’s finances based on the results achieved. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 16 April 2013.

We are grateful to you for your response to our request for clarification. We note the Government’s analysis of the programmes under the various Budget headings in Annex A of your letter, and support you in your efforts to ensure that EU funding is simplified and focussed on economic growth and EU added-value. The material that you provide at Annex A is precisely what we would have expected to have been included in the original EM, and we invite you to use it as a template for EMs on the equivalent report in future years. We are also grateful for the helpful response to our questions on the structure and content of the report, and repeat our request that you keep us updated on the Commission’s review.

16 April 2013

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

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

Following my letter to you of 1 October 2012 regarding the above Explanatory Memorandum, I am writing to update you on the Proposal’s status.

Since I last wrote to you, there has been no indication that this dossier will be progressed in the near future, and the Presidency is yet to issue a timetable for the Proposal. Our best assessment is that, since the Proposal includes provisions which relate to monitoring the implementation of financial sector conditionality, the Proposal is unlikely to be progressed until the detail of the Single Supervisory Mechanism, for credit institutions in Member States who participate in Banking Union, has been agreed.

In the meantime, the Government is formulating its view on the issues and the Proposal as a whole, and will respond in more detail once the dossier progresses.

However, in your letter you also asked some questions that I am happy to address at this juncture.

You asked about precedents regarding the exchanging of views between the European Parliament, the Commission and national Parliaments. Voluntary exchanges of views between the competent committee of the European Parliament and the Member State have previously been agreed by Member States in November 2011 in the context of the so-called “6-pack of economic governance “, in the event that Member States are subject to Council Decisions and Recommendations which identify amongst other things, excessive deficits, actions for correcting excessive deficits and non-
compliance with recommended corrective action for excessive macro imbalances. Further, voluntary communications across a range of issues take place between the Commission and national Parliaments, as summarised in an annual report on the subject (please refer to EM 12676/12 as submitted by the Minister for Europe on 8 August 2012).

You also asked about what criteria would be applied under this Proposal to assess eligibility for access to a Precautionary Conditioned Credit Line (PCCL). As stated in Article 4 of the Proposal:

Access to a PCCL shall be limited to Member States whose economic and financial situation is still fundamentally sound. A global assessment shall be made on whether a Member State qualifies for a PCCL, using as a basis the following eligibility criteria:

— The respect of the Council recommendations and Council decisions adopted on the basis of Articles 121 and 126 of the Treaty. Member States under excessive deficit procedure may still access a PCCL, provided they fully abide by the Council recommendations under Article 126(7) of the Treaty.

— A sustainable general Government debt.

— The respect of their commitments under the excessive imbalance procedure (EIP). Countries under EIP could still access PCCL it is established that they are committed to addressing the imbalances identified by the Council.

— A track record of access to capital markets on reasonable terms.

— A sustainable external position.

— The absence of bank solvency problems that would pose systemic threats to the banking system stability.

Finally, with respect to simplifying and codifying existing activation procedures, the Proposal seeks to codify, for example, the content of assessments made by the Commission at each point in the activation process, in more detail than is currently provided for in the existing Regulation. Furthermore, under the existing activation procedures, the requesting Member State must formally submit a draft macro-economic adjustment programme to the Economic and Financial Committee prior to its inclusion in any recommendation to provide EUBOP financial assistance by the Commission. The Proposal, as drafted, seeks to remove this step.

16 December 2012

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

Thank you for your letter, dated 16 December 2012, on EM 12201/12: Proposal for a Council Regulation establishing a facility for providing financial assistance for Member States whose currency is not the euro. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 15 January 2013.

We are grateful to you for your response to our requests for factual clarification as set out in our letter of 18 September 2012. However, in response to our question as to your assessment of the proposal, you state that the Government are continuing to formulate your view on the issues and the proposal as a whole, and will respond in more detail once the dossier progresses. Whilst we understand that there may remain some uncertainty about the proposal given that a timetable has yet to be issued, and given its interrelationship (highlighted in your letter) with the Single Supervisory Mechanism proposals, we find it inconceivable that you have not made at least a preliminary assessment of the proposals in the six months since they were published. What is the reason for your reticence? In order to allow us to fulfil our scrutiny role effectively, please provide us with your assessment of the proposals as they stand, and the issues that need to be considered in order to allow you to reach a settled view on the dossier.

You state that, since the proposal includes provisions which relate to monitoring the implementation of financial sector conditionality, the proposal is unlikely to make progress until the detail of the Single Supervisory Mechanisms for credit institutions in Member States who participate in Banking Union has been agreed. You will know that our report, European Banking Union: Key issues and challenges, which considered the Single Supervisory Mechanism proposals in detail, was published on 12 December 2012, and will be debated in the House of Lords on 24 January 2013. We look forward to receiving your response to the report. What further details can you give us on the interrelationship between this proposal and the SSM proposals? What do you anticipate will be the impact of the agreement reached on SSM at Council in December 2012 on the content of this proposal, and the timetable for it to be taken forward?
We would be grateful for a response to these questions by 30 January 2013. In the meantime, and in recognition of the continued uncertainty over the proposal, we will continue to retain the document under scrutiny.

15 January 2013

FINANCIAL REPORTING AND AUDITING FOR THE PERIOD 2014-2020 (5213/13)

Letter from the Chairman to Jo Swinson MP, Parliamentary Under Secretary for Employment Relations, Consumer Affairs, Department for Business, Innovation and Skills

Thank you for your Explanatory Memorandum, dated 25 January 2013, on EM 5213/13, a proposal for a regulation establishing a Union programme to support specific activities in the field of financial reporting and auditing for the period 2014-2020. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 12 February 2013.

We are grateful to you for this useful summary of the work of the beneficiary bodies. However, we would be grateful for clarification of a number of matters. You state that the Government support the continued funding of these organisations in principle, but question the justification for a blanket increase in the current financial climate. How would you respond to recent criticisms by IFRS by the Bank of England and the House of Lords Economic Affairs Committee? How has the Commission responded to such criticism? Whilst we support your efforts to ask the Commission to explain what consideration it has given to linking funding to its policy priorities, we would be grateful for the Government’s view of how such funding can be prioritised. Should such funding be concentrated on Member States encountering most difficulty in relation to accounting standards? We would also be grateful if you could clarify if you support the proposed funding for PIOB.

You state that the Government will consider if the use of delegated powers is an appropriate mechanism. Whilst we support you in asking the Commission to explain how it will assess whether successor bodies merit continued funding, we would be grateful for your own views of how such an assessment should be conducted. Can you give us any update on your consideration of the use of delegated powers? When do you expect to reach a conclusion on this question? What is the view of other Member States?

You state that the EU Accounting Regulatory Committee (ARC) may be more suited to presenting Member States’ views on standards than EFRAG. What more can you tell us about the work and operation of EFRAG, in particular in terms of its basis as a private organisation? What benefits do you believe would accrue from ARC taking on this role? What is the response of the Commission and other Member States to this suggestion? Can you give us a practical illustration of the sorts of problems you believe would ensue if EFRAG took on this role? Can you give any examples of problems that have arisen up to now? You state that this is a live issue in discussions with the Commission. Which other Member States share the UK’s concerns?

We would also be grateful for further details of the funding arrangements for each of the beneficiaries. What is the source of their non-EU funding? What other sources are being targeted by the IFRS Foundation? What is the source of EFRAG’s own resources? What update can you give us on efforts to diversify PIOB’s funding and to reinforce its independence vis-à-vis the audit profession?

Finally, the Explanatory Memorandum presents a complex picture of the responsibilities of and links between a large number of organisations. We would be grateful for further clarification of the work of and interrelationship between the various organisations that you mention, for instance in the form of a detailed glossary or an organogram/diagram.

We would be grateful for a response to these questions, as well as an update on the timetable for negotiations, by 4 March 2013. In the meantime we will continue to hold the document under scrutiny.

13 February 2013
FINANCIAL TRANSACTION TAX (14942/11)

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

Thank you for your further letter dated 17 October regarding the Explanatory Memorandum 14942/11, which related to the EU Commission's proposal for a Financial Transaction Tax (FTT). I know Mark Hoban wrote to you previously to explain discussions at ECOFIN earlier this year on FTTs.

In advance of the 9 October ECOFIN, the Finance Ministers of France and Germany wrote to all Member States calling for agreement to pursue the introduction of a FTT through an enhanced cooperation procedure. Subsequent to this, nine member states (Austria, Belgium, Estonia, Greece, Italy, Portugal, Slovakia, Slovenia, Spain) have joined France and Germany in writing to the Commission requesting the introduction of a FTT using the enhanced cooperation procedures. On 23 October, the Commission issued an Authorising Decision proposal, having assessed that the introduction of a FTT under Enhanced Cooperation is consistent with the provisions of the Treaties. This will be subject to scrutiny in the usual way.

There is no formal timetable beyond this point. However, the June European Council conclusions noted the desire among participating states to agree the use of enhanced cooperation before the end of the year. We would therefore anticipate that FTTs will once again be discussed in at least one ECOFIN this year.

If the Council does approve the use of enhanced cooperation, the FTT proposal will then be discussed in Council meetings. The UK, along with all non-participating member states, is entitled to attend and contribute to these meetings. The participating member states have not yet given any indication of how quickly they expect these discussions to last.

The Commission has stated that a proposal for specific measures implementing such enhanced cooperation – i.e., on substance, for a Directive on a common system of FTT – will be submitted in due course. This proposal will be largely based on the original Commission proposal, in terms of scope and objectives. However, participating member states may seek to change the detail before reaching agreement, so for example it is possible that different rates will be agreed to those proposed.

The Chancellor restated the UK's position at the October ECOFIN. We will not participate in a FTT unless other major financial centres outside Europe also participate. In addition, although we are not minded to block others, this is contingent on the proper process, as set out in the Treaties, being followed, and the safeguards being met. As well as the provisions you note on the internal market, Article 327 TFEU additionally sets safeguards regarding the rights and competences of non-participating member states. We are currently assessing the Commission's Authorising Proposal.

We share the Committee's concerns over the impacts a sub-EU27 FTT may have on all Member States, including those that do not participate. We believe that it will still have damaging impacts on growth, jobs and financial activity in the EU, and that it would increase costs for pensions and for manufacturers. We will continue to make these arguments in discussions with our European partners.

The Government will submit an Explanatory Memorandum to Parliament in mid-November on the Commission's Authorising Proposal, and we will provide further analysis at this stage. Furthermore, we will of course continue to update you on progress on this issue going forward.

4 November 2012

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

Thank you for your letter, dated 4 November 2012, on EM 14942/11 on the Commission’s proposal for a Financial Transaction Tax. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 20 November 2012.

We are grateful for the update that you provide on recent developments in relation to the introduction of a Financial Transaction Tax under the Enhanced Cooperation Procedure. You stated that an Explanatory Memorandum on the Commission’s Authorising Decision proposal would be deposited in mid-November. However we have yet to receive this EM. This document must be deposited as a matter of urgency in order to allow us to scrutinise the proposals and their likely impact in detail.
You repeat the UK’s position in relation to this proposal. Although you state that you are not minded to block others, we observe that, since Council’s decision as to whether an enhanced cooperation proposal is consistent with the Treaty is made under qualified majority voting, the UK would not on its own have the power to block the proposal in any case. You also state that the UK will not participate in an FTT unless other major financial centres outside Europe also participate. We repeat the conclusions of our March 2012 report, that, given that the Government’s support for a global tax has been lukewarm at best, such a position is unconvincing. If the Government do support the introduction of a global tax then you should make the case for it. If, however, your true position is that you oppose a Financial Transaction Tax outright, then you should say so.

You state that you share our concerns over the impact of a sub-EU 27 FTT on all Member States, and that it will have a damaging impact on growth, jobs and financial activity in the EU. In view of the damaging impact that you concede it will have, we find your analysis of the likely effect of such a tax on the UK, both in your initial response to our report and in your subsequent exchange in correspondence, wholly insufficient. We fear that this proposal will damage EU capital markets, including the UK. Yet the UK, in choosing not to participate, will not benefit from any tax receipts that accrue. On the contrary, such a tax would mean that UK financial institutions would still be liable for the FTT, which could be collected through EU mutual assistance for the recovery of tax or as a result of the provisions of joint and several liability. What work are you undertaking to ascertain the impact on the UK of an FTT taken forward under the enhanced cooperation procedure? What is your assessment of the impact of such a tax in terms of relocation of financial transactions? What will be the subsequent impact of such relocation on the City of London and other world markets? What will be the consequences in the trading of European bonds, for example, where much trading activity is conducted by institutions in the US?

We would be grateful for a response to these questions in the context of the EM, now overdue, on the Commission’s authorising proposal. In the meantime, and in recognition of the fact that an EU-27 Financial Transaction Tax will not now be pursued, we clear EM 14942/11 from scrutiny.

20 November 2012

FINANCIAL TRANSACTION TAX (6442/12, 15390/12)

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

I am writing with regard to EM 15390/12, dated 29 November 2012, on the proposal for a Council Decision authorising enhanced cooperation in the area of Financial Transaction Tax. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 11 December 2012.

We are extremely disappointed with the quality of this Explanatory Memorandum. The letter provides no substantive analysis of the document in question, provides no detail on how the enhanced cooperation procedure operates, and adds nothing of value to the information that you have previously provided to the Committee.

You state that “the implications of an enhanced cooperation FTT cannot be assessed until the detail of the proposal itself is published.” Whilst we accept that a full analysis may only be possible once the proposal is published, you yourself point out that the Commission has stated that the substantive proposal will be largely based on the original Commission proposal (EM 14942/11) for an FTT in terms of scope and objectives. The EM also flies in the face of the commitment made in your letter to us of 4 November 2012 (on EM 14942/11), that “the Government will submit an Explanatory Memorandum to Parliament in mid-November on the Commission’s Authorising Proposal, and we [will] provide further analysis at this stage.” Not only was the EM overdue, but it fails completely to provide the analysis promised.

In particular, the EM entirely fails to address the five pages of detailed assessment of the proposal’s compliance with the legal conditions for enhanced cooperation contained in the Commission document. Indeed the EM fails even to mention the existence of such an assessment. This is unacceptable.

Furthermore, the EM fails to take into account, nor even make reference to, the points raised in our letter to you of 20 November 2012 (on EM 14942/11). This is in spite of our specific request that you provide a response to these questions “in the context of the EM, now overdue, on the Commission’s authorising proposal.” Again, this is unacceptable. We would in particular point out the concern
expressed in that letter that the Government’s assessment of the impact of an FTT on the UK has been wholly insufficient. The fact that your statement of the policy implications of this document runs to no more than two sentences does nothing to alleviate our anxieties.

We therefore anticipate receipt of a detailed letter from you addressing these failures. In particular, you should:

— Provide a detailed assessment of the Government’s response to the Commission’s assessment of the proposal’s compliance with the legal conditions for enhanced cooperation, and your overall response to the proposal for a Council Decision authorising enhanced cooperation;

— Provide a full response to all of the points raised in our letter of 20 November 2012 on EM 14942/11, and in particular our queries as to the work that the Government are undertaking to assess the impact of such an FTT on the UK;

— Provide us with an update on the timetable, including the outcome of discussions at the December ECOFIN, the likely timetable for a Council Decision on enhanced cooperation, as well as any indication of when a policy proposal can be expected to be brought forward under enhanced cooperation.

We expect to receive such a letter at the earliest opportunity, and by Monday 7 January 2013 at the latest. In the meantime we will retain the document under scrutiny. We also draw to your attention our separate letter on the EU budget, which expresses our complaints about recent problems with the scrutiny process more broadly.

The Financial Transaction Tax is an exceptionally important proposal with significant implications for the UK. Either the Government are failing to take it seriously and analyse it properly, or else you are undertaking this work but are failing to report it to Parliament. Either case is unacceptable.

12 December 2012

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

Thank you for your letters of the 12 December.

I can assure you that the Treasury takes its obligations regarding parliamentary scrutiny of EU documents very seriously, and that I and Sir Nicholas Macpherson would be happy to accept your invitation to appear before the sub-committee in the new year to discuss this further.

Concerning your separate letter, also of the 12th, regarding the proposals for a Council Decision authorising enhanced cooperation in the area of the Financial Transactions Tax, as you are aware I discussed this issue with Lord Harrison on the 11th December and would reiterate that in the absence of a substantive proposal by the Commission, my officials are unable to provide the analysis or the information that the Committees have requested. I and others expressed our concerns about precisely this absence of a tangible proposal at the 5th December ECOFIN, and I reiterated the need to have full and careful consideration to ensure the relevant procedures for enhanced co-operation are met. I would also be happy to discuss this issue further with the Committee if it is so wished when we meet in the new year.

28 December 2012

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

I am writing to update you on recent developments on the EU financial transaction tax (FTT) dossier.

At the January ECOFIN meeting, the Council adopted a proposal for a Council Decision authorising enhanced cooperation for a FTT. This therefore means that the enhanced cooperation procedure can begin.

As you are aware, the UK will not participate in an enhanced cooperation FTT.

We were one of a number of Member States who raised concerns that the European Commission has not provided any analysis of the impacts an enhanced cooperation FTT would have on individual Member States, both participants and non-participants.
In addition, we tabled a minute statement at the meeting stating that we could not support the proposal as it was not possible to take the view that the conditions set out in the Treaty on the Functioning of the European Union and the Treaty on European Union are fulfilled.

These conditions include the following: any such cooperation shall not undermine the internal market or economic, social and territorial cohesion; such cooperation shall not constitute a barrier to or discrimination in trade between Member States, nor distort competition between them; and any enhanced cooperation shall respect the competences, rights and obligations of those Member States which do not participate in it.

We have now received the European Commission’s full proposal for an enhanced cooperation FTT, and we will provide a further Explanatory Memorandum to Parliament on it forthwith.

Finally, please be assured that we will continue to press the European Commission to provide an impact analysis of what their proposal would mean for both participating and non-participating Member States.

24 February 2013

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

Thank you for your Explanatory Memorandum 6442/13, dated 19 March 2013, on the proposal for a Council Directive implementing Enhanced Cooperation in the area of Financial Transaction Tax, and for your letter, dated 24 February 2013, on EM 15390/12: a proposal for a Council Decision authorising Enhanced Cooperation in the area of Financial Transaction Tax. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 26 March 2013. This followed an oral evidence session with Manfred Bergmann, Director of Indirect Taxation and Tax Administration, DG TAXUD, European Commission; John Vella, Senior Research Fellow, Oxford University Centre for Business Taxation; and Richard Woolhouse, Head of Tax and Fiscal Policy, CBI, held on 19 March 2013, and your own appearance before the EU Select Committee at its meeting on 13 March. We also received written evidence from Rebecca Healey, Senior Analyst, TABB Group.

THE SCRUTINY PROCESS

We regret that we have to complain once again about failures in the scrutiny process in relation to this important proposal. The Commission proposal was published on 14 February and an EM was due on 4 March 2013. Yet it was not received until 19 March, over two weeks late. This meant that we were not able to take it into account in our evidence session on 19 March, and, given the paucity of information you provide in relation to your concerns on subsidiarity, means that it will not be possible for us to give due consideration to the use of the Reasoned Opinion procedure before the deadline of 16 April. In your appearance before the Select Committee you argued that it was not possible to provide the EM until “we have sufficient clarity from the Commission as to what is proposed and we have made our assessment of the likely implications”. This does not justify your failure to produce an EM on time in relation to a proposal of such magnitude. As the Cabinet Office Guidance for Departments on Parliamentary Scrutiny of European Documents states, the nature of the document is not an acceptable reason for the late production of EMs, and if the UK policy has not been agreed or there are other areas of uncertainty, the EM should say so while giving as much information as is available at the time. You have failed to provide such information on time, in spite of our having made clear to you our frustration about previous shortcomings in relation to your handling of the Financial Transaction Tax proposals, both in our letter of 11 December 2012 and at your appearance before the Sub-Committee on 5 February 2013. We are disappointed that the anticipated improvement in standards at HM Treasury that we were told at that meeting was now taking place has not been borne out by subsequent events. So long as these shortcomings persist you are failing in your duty to this House under the Scrutiny Reserve Resolution.

Notwithstanding these difficulties, we have heard important evidence on the proposal for a Financial Transaction Tax under the Enhanced Cooperation procedure, in particular in terms of the serious implications for the UK and other non-participating Member States, which we would be grateful for your views on.

THE DETAIL OF THE PROPOSAL

We share your concerns that “there has been insufficient clarity as to what the proposal is and what its impacts might be”. Both the CBI and Mr Vella complained about the lack of detail in the
Commission’s proposal. Mr Vella told us that there remained significant gaps in knowledge in terms of the effect of the tax. In his view, some of the calculations in the Impact Assessment gave the impression of having been written “on the back of an envelope”. Our March 2012 report, Towards a Financial Transaction Tax?, drew attention to the poor quality of the Impact Assessment pertaining to the original proposals, and we are disappointed to find that the situation has not improved.

Mr Woolhouse drew particular attention to the lack of detail on the means by which the tax would be collected. In his view, the broad range of assets that would be brought under the scope of the proposal meant that it would be difficult effectively to monitor collection of the tax. He pointed to the massive system changes that would need to be made to collect the tax if it was to become operational by January 2014, as the Commission envisages. The Commission conceded that the proposal was silent on the question of collection as well as the costs that might accrue, because it had not at this stage been deemed necessary to seek to harmonise systems of collection. However, Mr Bergmann suggested that the collection model as used in relation to the UK Stamp Duty, for instance making use of trading platforms and electronic transactions, was being examined closely.

In defending the lack of detail, the Commission told us that there was a three stage process: first, the design of the tax; second, how to collect it; and third, how to spend it. Mr Bergmann told us that discussions on the second and third stages would follow in due course, and it would be a choice for Member States whether revenue collected was used as an Own Resource for the EU budget. You confirm that the Commission has proposed separately that a portion of the revenue could constitute a new Own Resource for the EU budget, resulting in a corresponding reduction of the national contributions of participating Member States, although agreement to this proposal will not of itself establish the new Own Resource. As we explain below, this raises the deeply unpalatable prospect that an FTT imposed on a financial institution resident in a non-participating Member State such as the UK would reduce the national contribution of a participating Member State.

We are astonished by the paucity of thinking exhibited by the Commission. Detailed assessment of all aspects of such a tax, including the method of collection and the use of potential revenue, must be undertaken as a matter of urgency before further steps towards its implementation are taken. We urge you to make this point as negotiations progress.

The proposal is particularly weak in relation to two other issues: the impact of the new issuance principle, and the impact on non-participating Member States, including the UK.

THE ISSUANCE PRINCIPLE

The Commission has proposed to supplement the existing residence principle with a new issuance principle, whereby financial instruments issued in a participating Member State will be taxed when traded, even if those conducting the transaction are outside the FTT zone. The Commission told us that the issuance principle was a key element of the enhanced cooperation proposal, and constituted the main change from the original proposal. Mr Bergmann explained that it had been introduced after the European Parliament made clear that the safeguards against relocation needed to be strengthened. He estimated that the addition of the issuance principle would bring a further 3-4% of trades within the scope of the tax – the other 95% would already be covered by other criteria. He also noted that the newly-enacted FTTs in France and Italy were based on the issuance principle, and said that it bore similarities with the way in which the UK Stamp Duty operated. He suggested that the order of criteria might be adjusted during negotiations, with the issuance principle gaining precedence.

Mr Vella agreed that the issuance principle was intended as an anti-avoidance measure, but feared that it went far beyond what was justified to meet this aim. He gave the illustration of the tax applying when a UK pension fund purchased German shares from a US bank. He agreed that the UK Stamp Duty was based on the issuance principle but pointed out that it affected a much narrower set of financial institutions. In his view, the use of the issuance principle in this way was unprecedented and risked being non-compliant with customary international law, under which a genuine link with the transaction being taxed needed to be demonstrated. The key determinant of compliance, in his view, was the objective that lay behind the tax. He also argued that the Impact Assessment should have provided more accurate data on the potential impact of the issuance principle.

How would you respond to the concerns about the issuance principle that have been raised? Do you agree that it goes beyond what it necessary to deter avoidance measures?

THE IMPACT ON NON-PARTICIPATING MEMBER STATES

We are particularly alarmed at the lack of detail about the implications of the proposal for non-participating Member States. The Commission told us that the implications for non-participating
Member States would be minimal, and that in any case it did not perceive any negative effects for non-participants, including the City of London. We share your concerns that the Commission Impact Assessment provides only very limited detail on how the proposal will impact on non-participating Member States. We note in particular your concern about the lack of detail on the contribution to the tax expected from non-participating Member States, the economic impacts on non-participants, and the impact on the existing tax base of non-participants. We share yours and Mr Vella’s disappointment that there was no detailed analysis of the impact on non-participants in the Impact Assessment. We find this to be an unacceptable omission, suggesting that the Commission has failed in its duty to the 16 Member States who have thus far chosen not to participate in the tax, yet may be significantly affected by it. We welcome your assurance that this is “an issue that the UK will proactively raise in future discussions”. What steps are you taking to ensure this failure is remedied as a matter of urgency?

The Impact on the UK

You confirm that the UK will not participate in the enhanced cooperation FTT. Yet we have consistently pointed that the implications of such an FTT for the UK could still be significant. Mr Vella agreed, and told us that there would be both negative and positive effects. There could be a negative effect on the financial activity and profitability of UK-based firms, but on the other hand the UK might benefit from some relocation, both of entities and capital. The Commission has expressed the hope that, since financial operators would only be able to avoid the FTT if they were prepared to relocate and relinquish their clients and businesses in the 11 participating Member States, and given the relatively low headline rates of taxation, relocation could be limited. However, Mr Vella perceived clear advantages for financial institutions within a participating Member State operating in the UK. We find that considerable uncertainty remains about the impact of the FTT on the UK. In the absence of such an assessment by the Commission, what analysis have the Government undertaken on the impact of this tax on the UK?

We also sought clarification in terms of the obligation on UK authorities to collect the tax. Our March 2012 report stated that, in relation to the original proposal, UK financial institutions entering into financial transactions with financial institutions in participating Member States would still be liable for the FTT, which could be collected through EU mutual assistance for the recovery of tax or as a result of provisions of joint and several liability. We found that, in the event of a transaction between a bank in a participating Member State and a bank in the UK, tax authorities in participating Member States could request the UK tax authorities to collect the FTT from the UK institution: the legal basis for the request would be the EU regime for mutual assistance on tax matters, and such requests would have to be met. More likely the participating tax authorities would rely on the provisions of the proposal imposing joint and several liability on the bank in the participating Member State. Knowing this, the bank in the participating Member State would be likely to ensure, through its contractual relations with the UK bank, that it would be indemnified by the UK bank.

When we put this to the Commission, Mr Bergmann told us that there would be no legal obligation on UK tax authorities to collect the tax. He made the comparison with arrangements in relation to the UK Stamp Duty, where non-UK financial institutions such as a German bank or Japanese investment firm pay the tax when they purchase a UK share, but where their authorities are not obliged to collect the Duty. He said that tax authorities in the UK or the US, for example, might be invited to collect the tax, but it would be entirely voluntary. Mr Bergmann stated that, in theory, the financial institution in the participating Member State could be required to pay the tax twice. The likely effect of this burden on such an institution might be taken into account in any transaction activity, but there would nevertheless be no obligation for UK firms.

Notwithstanding the Commission’s evidence, it remains our understanding that UK financial institutions which are counterparties to financial transactions with an EU established financial institution would have to pay the tax, and it could be collected either from the EU financial institution on the basis of joint and several liability or through the mutual assistance regime. Similar procedures would apply in relation to tax which is imposed on the basis of the issuance principle. Indeed there may be far-reaching adverse consequences for UK resident financial institutions. This is illustrated by the case of a financial transaction involving German shares between a US and a UK financial institution. Under the issuance principle this would give rise to FTT upon both parties payable to the German tax authorities. Given that collection of this tax from the US financial institution may be difficult, the proposal would enable the German tax authorities to impose joint and several liability for both instances of the FTT upon the UK financial institution and recover the whole amount using the EU mutual assistance regime. This would undermine Mr Bergmann’s evidence that there would be no difference in the effect of the tax on London as compared to New York and Hong Kong. The
consequences of this would be serious indeed and must be resisted. Do you share our understanding of the obligation that would be placed on UK authorities to collect the tax? If so, what steps are you taking to resist the proposal? We urge you to do all you can to resist this measure in Council, and, if necessary, at the European Court of Justice.

Further, as we outline above, the proposal that a portion of the revenue could constitute a new Own Resource for the EU budget raises the spectre that an FTT imposed on a financial institution resident in a non-participating Member State such as the UK would reduce the national contribution of a participating Member State. Do you agree that UK businesses will, in effect, be subsidising the budgetary contribution of participating Member States? If so, what steps are you taking to resist the proposal, both in Council negotiations, and, if necessary, at the European Court of Justice?

In the light of such important issues, we are alarmed at the complacency shown by the Government in relation to this proposal. You are aware that we have repeatedly raised concerns about the quality of the Government’s analysis of the FTT and your responses to our concerns, since our original report was published a year ago. We warn against any perception that, because the UK will not participate, the reverberations of an FTT would not be felt here. We are perplexed by your repeated failure to provide any detailed analysis of a proposal that holds such serious implications for the UK, and we urge you to undertake such analysis, and share it with this Committee, as a matter of urgency.

Neither is the UK alone in choosing not to participate in the FTT – at present, 16 Member States have chosen not to do so, from both inside and outside the euro area. Many of these Member States have historically been sympathetic to the UK’s position in relation to financial sector legislation. What discussions have you had on these questions with other non-participating Member States? What steps are you taking to work alongside like-minded Member States to give voice to our concerns? Such close cooperation is urgently needed if the worst consequences of this proposal are to be avoided.

We are equally alarmed that the UK financial sector has not taken the likelihood of an FTT being implemented seriously. The CBI conceded that the political will amongst many in the EU in support of the proposal had been underestimated. They also stressed the importance of the Government remaining engaged in the debate on the FTT in the weeks ahead. Mr Bergmann told us that the UK would remain involved in the negotiations until the vote was cast by participating Member States, and we welcome your own statement that the UK will exercise its right under the Treaty to fully and proactively participate in discussions on the design of the enhanced cooperation FTT going forward. What steps are you taking to ensure that the UK is able to exert a positive influence on these discussions?

THE IMPACT ON SUBSIDIARIES

We also asked about the impact on London-based subsidiaries of financial institutions with headquarters in a participating Member State. Mr Bergmann told us that “it depends on what their business is”, but that if the subsidiary was undertaking business which had no economic link to the territory of participating Member States, then no tax would be due. However, other witnesses suggested that there was some uncertainty about the impact on subsidiaries. You state that an FTT zone financial institution’s branches worldwide will be subject to an FTT on all their securities and derivatives businesses. Is it your view that the proposal as drafted is clear in terms of the effect on subsidiaries based outside the FTT zone?

THE IMPACT ON ECONOMIC GROWTH

One of the concerns in our original report was the potential deleterious effect on economic growth. Your EM states that the Commission’s most recent analysis suggests that the FTT will not lead to any job losses, whereas the original proposal predicted the loss of 500,000 jobs, and that this proposal is estimated to have a -0.28% impact on EU GDP, compared to -1.76% in relation to the original proposal. You state that the difference stems mainly from revised economic modelling, and that the Commission estimates that spending FTT revenues on growth-enhancing public investment could have a positive impact on GDP of between 0.2 and 0.4%. The Commission also estimates that revenue of €31 billion a year will be generated.

When we asked our witnesses about the potential impact on economic growth, Mr Vella said that a negative impact on growth was inevitable – the question was rather by how much. He was concerned that the modelling used by the Commission contained significant flaws, and that, whilst the Commission had acknowledged criticisms of its original modelling, it did not appear to have addressed
the concerns that had been raised. For instance, it only made calculations on the basis of a tax on securities but not derivatives, and it assumed a closed economic model (and therefore did not take account of potential relocation effects).

We note the TABB Group’s analysis that the FTT introduced in France had a negative impact on trading in the shares of smaller firms. We also note recent reports that trading in Italian stocks through the desks of major banks dropped sharply amid a wider fall in volumes after Italy introduced its own FTT. Mr Woolhouse argued that an FTT would be bad for growth, and suggested that SMEs could be disproportionately affected because of the impact on liquidity. On the other hand, Mr Bergmann argued that only 10,000 out of 20 million EU-wide SMEs were involved in the kinds of transactions that would be caught by the tax.

In our last report, we expressed alarm at the degree of criticism to which the Commission’s Impact Assessment was subjected. We also concluded that, at a time of ongoing financial crisis and at best fragile economic growth across the entire EU, a new tax which could have a substantial detrimental impact on EU GDP should be resisted. Notwithstanding the Commission’s revised figures, we remain concerned that an FTT will inevitably have a negative impact on economic growth. We are equally sceptical about its claims that spending FTT revenues on growth-enhancing public investment could have a significant positive effect on GDP. We remain alarmed at the degree of criticism to which the Commission’s modelling has been subject. Assessment of the impact of proposals of such importance as this must be based on rigorous analysis, or else all assumptions that follow will be flawed. What assessment have you made of the potential impact on economic growth of the proposal, and in particular on SMEs?

THE IMPACT ON “IRRESPONSIBLE TRADING”

One of the Commission’s aims, both in its original proposal and in the enhanced cooperation proposal, was to “temper irresponsible trading” and create “appropriate disincentives for transactions that do not enhance the efficiency of financial markets”. Mr Bergmann told us that this was a secondary aim of the proposal compared to the need to harmonise tax arrangements and to ensure that the financial sector made a contribution to the costs of the financial crisis. However, Mr Woolhouse objected to what he saw as the philosophy underpinning the proposal that some financial activity, such as trading in derivatives, had no economic utility. Mr Vella told us that the Impact Assessment was unclear as to the impact of the proposal on High Frequency Trading.

The impact of High Frequency Trading on financial markets remains contentious. The desirability of seeking to discourage such activity is a matter of considerable debate, and the potential impact of the FTT proposal on such activity is less certain still. In the context of this debate we welcome the publication of the recent Foresight project. What update can you give us on the Government’s own thinking on HFT and its effect on financial markets? What analysis have you undertaken of the potential impact of the FTT proposal on such activity, and by extension on financial markets as a whole?

THE POTENTIAL FOR A GLOBAL TAX

One of the stated aims of the original proposal was “to contribute to the ongoing international debate on financial sector taxation and in particular to the development of an FTT at global level.” The Commission once again expressed the hope that an enhanced cooperation FTT could pave the way for a tax at global level if it was able to show that the model worked. In Mr Bergmann’s view, the 11 Member States represented a ‘critical mass’, including the four largest economies in the euro area, representing 90 per cent of the euro area economy and one-sixth of the global economy. In his view, it would be difficult for other global financial centres to avoid the tax. However Mr Woolhouse was certain that the US would never introduce such a tax, and indeed would view it with hostility as an extraterritorial tax, even more so than in relation to the original proposal for an EU-27 FTT. He cited a letter from American trade bodies stating that “these novel and unilateral theories of tax jurisdiction are both unprecedented and inconsistent with existing norms of international tax law and long-standing treaty commitments”, and warned that it could have potential negative consequences for the US-EU trade deal. Furthermore, Mr Vella argued that there would be a positive incentive for such countries as the US not to introduce such a tax, in order to benefit from the potential relocation of economic activity.

In our last report, we concluded that, given the palpable lack of appetite for the introduction of a tax amongst other nations, most notably the USA, the Commission’s argument that an EU-wide FTT would pave the way for the introduction of a global tax was wholly unrealistic. Given that the continued opposition to this tax in the US shows no sign of abating, this remains our view. Indeed,
given that the enhanced cooperation procedure will at present involve only 11 Member States, the uphill battle that the Commission faces has got even steeper. Given potential US hostility to the proposal, we also fear the potential implications for the EU-US trade negotiations. What discussions have you had with US counterparts about the potential impact of the tax, in particular in terms of the implications of the issuance principle? What urgent steps are you taking to alert our partners in the US to the concerns and implications shared between our two nations regarding the FTT proposal? What is the position of the US Government on the proposal?

THE ENHANCED COOPERATION CRITERIA

Taking all of this into account, we also sought to consider whether the proposal met the criteria for use of the enhanced cooperation procedure. The Treaty on the Functioning of the European Union requires that enhanced cooperation “shall not undermine the internal market or economic, social and territorial cohesion. It shall not constitute a barrier to or discrimination in trade between Member States, nor shall it distort competition between them.” Enhanced cooperation must also “respect the competences, rights and obligations of those Member States which do not participate in it”.

Mr Vella stated that a full analysis of the impact of the proposal on non-participating Member States should have been made available before the vote on the enhanced cooperation procedure took place. You state that the Government made clear at the January 2013 ECOFIN that you would abstain in any vote on the use of enhanced cooperation because the UK was not assured that the proposal would respect the single market and respect the competences of non-participating Member States. We also note that the Government tabled a Minute Statement stating that they could not support the proposal as it was not possible to take the view that the conditions set out in TFEU were fulfilled. Did you discuss your negotiating position with other non-participating Member States? Did they share your position? In light of your concerns (which we share), why did you decide not to vote against the proposal? We also observe that the 14-15 March 2013 European Council Conclusions note that “the work on the enhanced cooperation on a financial transaction tax is advancing.” What part did the Prime Minister play in these discussions? Did you advise him on the serious implications of the proposal for the UK and its financial sector?

Mr Vella also expressed doubt as to whether the proposal met the criteria for the enhanced cooperation procedure to be used. He argued that it would create distortion of competition: for instance in the case of a German and a UK bank competing for a UK customer, the German bank would be placed at a competitive disadvantage. He conceded that distortions would be reduced amongst the participating Member States, but stressed that they would be increased in terms of the single market as a whole. Mr Vella also pointed out that the Commission conceded that some double taxation was bound to occur, although its Impact Assessment did not go into much detail. Having said that, he was uncertain how the European Court of Justice would respond to any legal action concerning the use of the enhanced cooperation procedure. He pointed out that enhanced cooperation had only been used twice before and had only been challenged once (by Italy and Spain in relation to patents). In that case, only the opinion of the Advocate General had been set out – the Court itself had not yet reached a decision.

Mr Bergmann told us that the Commission did not believe that an enhanced cooperation FTT would create any significant degree of distortion. He stressed the distinction between introducing a new tax and seeking to harmonise existing taxes. He argued (in contrast to Commissioner Šemeta, who, in his appearance before us in relation to the original proposal made clear that it was not the Commission’s primary aim) that the primary purpose of the proposal was to harmonise the operation of a Financial Transaction Tax across the 11 participating Member States. The alternative would be the operation of 11 separate FTTs. In his view, therefore, the proposal would enhance the single market. He also stressed that some double taxation was inevitable so long as the tax did not operate at EU-27 level, because non-participating Member States would be free to introduce their own FTT. However, he emphasised that the risk of double taxation was limited, given, for example, that only the UK currently operated a Stamp Duty. However, Mr Woolhouse was sceptical about the Commission’s argument that this was not a new tax, because the national FTTs in France, Italy and Spain would not have arisen had the Commission not been considering implementing such a tax.

In your evidence to the Select Committee, you stated that the Government were reserving their position on whether they would contemplate taking legal action. However we note that you said that “it would be unwise to rule it out”. You state that the UK will continue to raise concerns in terms of compliance with EU law and the Single Market, and whether the extraterritorial effects prejudice non-participating Member States, and potential problems over double taxation and enforceability. What further details can you provide us of your concerns? What further consideration have you given to the case for a legal challenge?
Taking the evidence that we have heard into account, we believe that the proposal fails to meet the criteria for enhanced cooperation, and in particular the requirement to respect the competences, rights and obligations of those Member States which do not participate in it. It is particularly unacceptable that a full analysis of the impact of the proposal on non-participating Member States was not made available before the vote on enhanced cooperation took place. We exhort you to take urgent legal advice on the case for a legal challenge at the European Court of Justice.

SUBSIDIARITY

Your EM also states that the Government have concerns that introducing an FTT through enhanced cooperation does not meet the conditions of subsidiarity. However you provide no further detail of your concerns. Our initial analysis is that there is a stronger case for arguing that the proposal fails to meet the criteria for enhanced cooperation than that it does not meet the subsidiarity principle. However, we require clarification from you of the Government’s concerns in order to reach a considered position. In what ways do you believe that the proposal fails to meet the principle of subsidiarity?

We invite a response to this letter by 16 April 2013. In the meantime we will hold EM 6442/13 under scrutiny and clear EM 15390/12 from scrutiny.

26 March 2013

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

I am writing to inform you that yesterday, 18 April, the UK Government made an application to the European Court of Justice for the annulment of Council decision 22 January, authorising enhanced cooperation in the area of financial transaction tax. This decision has naturally been taken only after discussions between the Chancellor, the Prime Minister, and other key Cabinet colleagues.

We have taken this step following legal advice that there is a risk that, in the event that we need to challenge the directive, currently under negotiation, that would implement the FTT, our case could be rejected by the Court as being too late. We therefore concluded we had no alternative but to challenge the authorising decision now.

The application focuses on the extraterritorial elements of the tax. In our view, if the FTT directive were adopted in its current draft form, the tax would infringe the rights and competences of non-participating member states, and would depart from accepted international tax norms. Specifically, we have concerns about the proposed “deemed establishment rule” under which financial institutions in non-participating EU Member States would be deemed to be established in the FTT area (and hence liable for the tax) when dealing with counterparties based in the FTT area. We consider this is likely to breach Article 327 TFEU (respect for Member States’ Competences) and be in conflict with international tax law and customary international law.

In addition, the tax in the form proposed by the EU Commission could oblige UK tax authorities to collect the FTT under existing EU agreements on mutual assistance. However, this raises fundamental concerns, as Article 332 TFEU provides that expenditure resulting from implementation of enhanced cooperation shall be borne by the participating Member States. As a result, we are also challenging the directive on this ground.

Outside of this legal challenge, we continue to contribute proactively to Council discussions on the FTT, and are working hard to ensure that the UK view is fully considered and reflected in the final design of any tax agreed by the participating Member States. Participating member states are now focusing more on the possible adverse economic implications of the tax, as well as the operational challenges that remain unresolved.

We therefore remain hopeful that these discussions can lead to changes to the design of the tax to address our main concerns and reduce the economic damage of the tax. If negotiations in Council result in a final design which addresses our concerns, we will reconsider our legal challenge.

I am conscious I owe you a response to your questions on explanatory memorandum (6442/13), and I plan to provide a full response next week on the points you raised. I hope you will appreciate that our efforts of late have been focused on finalising this legal challenge.

18 April 2013
Letter from the Chairman to Rt. Hon Greg Clark MP

Thank you for your letter, dated 18 April 2013, on EM 6442/13: a proposal for a Council Directive implementing enhanced cooperation in the area of Financial Transaction Tax. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 23 April 2013. I would also like to thank you for taking the time to contact Lord Harrison to apprise him of the content of this letter in advance of its receipt.

In our letter to you of 27 March 2013, we stated that “we believe that the proposal fails to meet the criteria for enhanced cooperation, and in particular to respect the competences, rights and obligations of those Member States which do not participate in it. It is particularly unacceptable that a full analysis of the impact of the proposal on non-participating Member States was not made available before the vote on enhanced cooperation took place. We exhort you to take urgent legal advice on the case for a legal challenge at the European Court of Justice.”

In light of this, we welcome and support the Government’s decision to make an application to the European Court of Justice for the annulment of the Council decision of 22 January 2013, authorising enhanced cooperation in the area of Financial Transaction Tax. We would be grateful for your response to our observation that the grounds for a legal challenge that you cite echo the concerns consistently raised by this Committee in our correspondence with you over the past year.

The Committee have repeatedly argued, most recently in our letter of 27 March 2013, that UK tax authorities would be required to collect the tax under EU mutual assistance agreements. You now state that you share this view. The Committee have also previously expressed concern that the proposal risked being non-compliant with customary international law. We cited the evidence put to us by John Vella, Senior Research Fellow, Oxford University Centre for Business Taxation, that the proposed use of the issuance principle is unprecedented and risks being non-compliant with customary international law, under which a genuine link with the transaction being taxed needs to be demonstrated. You cite concerns over the “deemed establishment rule”, of which we would be grateful for further details. However, do you also share our conclusion that the proposed use of the issuance principle, which was set out in the substantive proposal only after the decision authorising enhanced cooperation, is unprecedented and risks being non-compliant with customary international law? More broadly, what further details can you provide us in relation to the Government’s legal challenge? What will happen now?

The Committee have also repeatedly cited the potential negative effect on economic growth. We are therefore pleased to note your statement that participating Member States are now focussing more on the possible adverse economic implications of the tax.

You acknowledge that a full response to our letter of 27 March is outstanding. We appreciate that the Government’s efforts have been focussed on finalising this legal challenge, and we look forward to receiving your response to our letter shortly. In addition, we would draw your attention to the 26 March House of Lords debate on the Committee’s report on MiFID II. As well as the MiFID II proposals, the debate touched on a range of issues of interest to the Committee, including the Financial Transaction Tax. A number of questions were put to the Minister, and we would be grateful for a detailed response to these, as well as to a number of questions arising from your letter, as follows:

Will the proposal by 11 Member States to take forward an FTT under enhanced cooperation damage the European Union? Will the proposal, if implemented, have a damaging impact on the UK financial sector?

Why did the Government only abstain from the vote on the use of the enhanced cooperation procedure at the January 2013 ECOFIN meeting? Why did you choose not to oppose the proposed use of the enhanced co-operation procedure at that point?

Had the Government at that point, and have you since, sought to work in alliance with other non-participating Member States, including the Netherlands, Denmark, Sweden, Poland, Finland, Ireland and Luxembourg? What is the position of the other non-participating Member States in relation to the decision to use the enhanced cooperation procedure, and of the likely impact of the proposal itself, both on non-participating Member States as well as the EU as a whole? Have any other Member States initiated a legal challenge, or indicated that they will intervene to support the UK? Whilst we welcome the Government’s decision to initiate proceedings at the European Court of Justice, it is our view that it would have been better to have acted in concert with others among the 16 Member States not party to the proposed enhanced co-operation, having first blocked agreement, on a precautionary basis, to the use of the enhanced co-operation procedure, at least until the Commission had produced its substantive proposal. We would be grateful for your comments on this,
and on whether proceedings initiated now can prevent the 11 participating Member States proceeding on the basis of the Commission proposal of 14 February.

You state that the decision to make an application for a legal challenge has been taken only after discussions with the Prime Minister. Given that the Conclusions of the March 2013 European Council state that the Council took note of the proposal, what briefing did the Prime Minister receive at that stage on the likely impact of this proposal on the UK and on the EU as a whole?

We note the view of London Economics, in its paper on The Impact of a Financial Transaction Tax on Corporate and Sovereign Debt, that behavioural change will result from implementation of the FTT in the long run. Do you share our concern that the Commission has not undertaken an effective assessment of the likely impact of the FTT upon the behaviour of market participants? What such analysis have you undertaken?

We would be grateful for a combined response to our letter of 27 March, and to this letter, including an update on the Government’s legal challenge, as soon as possible, and by 7 May at the latest. In the meantime we will continue to hold EM 6442/13 under scrutiny.

24 April 2013

FISCALIS 2020 (13346/12)

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

Further to your letter of 23 October, I am writing in response to your questions and to update you on the progress of negotiations for Fiscalis 2020. Your committee did not clear the document.

Negotiations have progressed favourably for the UK. Our proposals to have a clear reference to the voluntary nature of the programme and to remove the JHA obligations have been accepted and included in a revised text. However the proposal remains under negotiation and is subject to co-decision and QMV. Therefore, as a contingency, we will be deciding whether to opt in to this proposal, should the JHA obligations remain in the text at 30 November.

We have also gained additional text which highlights the remit of the programme, and with some further minor amendments, which we are optimistic of achieving, we feel this would guard against the possibility of the programme’s remit extending further into the area of direct tax. The current programme funds administrative cooperation activities in areas of indirect tax and some direct tax areas where there is already an administrative cooperation agreement, agreed under unanimity, in place. If the remit was extended to cover all taxes falling within the scope of Article 2(1) (a) of the Mutual Assistance and Recovery of Claim Directive, this would essentially broaden the programme’s remit to cover all direct taxes. This could potentially open the door to cooperation activities in areas where there is no administrative cooperation agreement.

The financial envelope for the proposal is yet to be discussed: however, we are aware that a number of other Member States share our concerns about the increase in the programme budget. You requested further details on what activities could be reprioritised to ensure a freeze to the budget. The UK would like to see funding concentrated on activities which fall under the priority of reducing administrative burdens and compliance costs for tax payers and also to support the successful multilateral control work which can assist with the detection of tax fraud.

The proposed legal bases are yet to be discussed in detail; however we remain concerned about the appropriateness of the articles cited for the proposal. You asked for more information on how Article 212 could be used – we are concerned that the inclusion of this article could indicate that the UK supports the conclusion of agreements with non-participating countries for technical cooperation. Such technical cooperation could include setting up access to European Information Systems that are funded and managed by the Fiscalis programme. We believe this goes beyond administrative cooperation into technical cooperation, which is not the intended purpose of the programme.

I will continue to keep you updated on the progress of negotiations.

13 November 2012
Letter from the Chairman to Sajid Javid MP

Thank you for your letter, dated 13 November 2012, on EM 13346/12: The Fiscalis 2020 proposal. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 20 November 2012.

We are grateful for your response to our queries. We note that the UK will be deciding whether to opt in to this proposal should the JHA obligations remain in the text as of 30 November. We would request an update on this issue once a final decision has been made.

We also note that some Member States have expressed concern about the increase in the proposed financial envelope. We have previously expressed our concern about the proposed budget, and would be grateful for further updates as negotiations on the programme budget progress. You set out the ways in which you would wish to see activities reprioritised in order to ensure a freeze in the budget. Can you cite any examples of when the UK Government have successfully made the case for such reprioritisation? What changes have been made as a result?

We also note that the proposed legal base has yet to be discussed. Whilst we note your concerns about the potential extension of the Fiscalis programme into areas of technical cooperation, why should this be regarded as a problem? Is there not a case in favour of such coordination if it would contribute to a reduction in inefficiencies? Do any other Member States share your concerns? We would also be grateful for updates as negotiations on the legal base progress.

We would be grateful for a response to these questions by 10 December 2012. In the meantime we are content to clear the document from scrutiny.

20 November 2012

Letter from Sajid Javid MP to the Chairman

Further to your letter of 20 November, I am writing in response to your questions. I apologise that this response has been slightly delayed; however, I also wanted to be in a position to update you simultaneously on the progress of negotiations in Council.

The Fiscalis 2020 negotiations have progressed rapidly following my last update, with the incoming Irish Presidency tabling a compromise text. I am satisfied that the latest text clarifies that participation in programme activities remains voluntary; removes the Justice and Home Affairs content and sufficiently clarifies the scope of the programme, protecting against the extension of activities further into direct tax matters.

I previously informed you of the UK concerns on the legal bases cited for Fiscalis 2020. Legal advice has since confirmed that the UK can accept the use of Article 114 and 197 for the proposal, although ideally a single article would be preferred. However the UK remains concerned about the appropriateness of Article 212, which has the potential to extend the remit of the programme into new areas, such as concluding agreements on technical cooperation with third countries. In your letter, you asked why this was an issue for the Government. Fiscalis is essentially an administrative cooperation programme which aims to share best practice and increase cooperation between Member States and candidate countries, their administrations and officials. Enabling technical cooperation activities with third countries would fundamentally change the nature of the programme. We do not support a budget increase for the programme, and believe that extending the remit into new areas would have a detrimental impact on the funds available for priority activities.

In your last letter, you also asked for any examples of when the Government has successfully made the case for re-prioritisation and any changes that were made as a result. In negotiations for the predecessor Fiscalis programmes, the UK has consistently pressed for funds to be aligned to current priorities. This has been achieved through limiting the percentage of the budget that can be used for administrative expenditure, such as travel and living costs incurred by participants, which allows the programme funds to be focused on areas such as the development and maintenance of EU information exchange networks which can assist with the detection of tax fraud.

The Presidency placed the file on the agenda for the Coreper meeting on 24 January for the agreement of a partial general approach. Coreper was not asked to agree the budget for the programme, which will be determined as part of the Multi-annual Financial Framework negotiations. Coreper was also not asked to agree the use of Article 212 as a legal base for the proposal. The text was subsequently approved at Coreper it will now be taken forward to discussions with the European Parliament in the coming weeks.
I would also like to take this opportunity to inform you that since my last update the Government has opted in to the Fiscalis 2020 proposal, which was confirmed in my Written Ministerial Statement on 5 December 2012.

31 January 2013

INSURANCE MEDIATION (12407/12)

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


Whilst the Committee notes your concerns regarding mandatory commission disclosure and the proposed ban on the tying of insurance products with one or more ancillary services, we see justification for them on consumer protection grounds. We believe there is a risk that your proposed compromise on the tying together of products may not appease the proponents of a ban. The practice of tying products together means that they are not available separately so your suggestion that firms could instead be required to inform customers “whether” the components of a package can be purchased separately is not much of a concession. We would appreciate updates on these issues as negotiations progress.

With regards to the issue relating to the Alternative Dispute Resolution (ADR) procedure, you will be aware that we have previously expressed, as part of our scrutiny of the PRIIPs proposal, concern over the reduction in consumer protection that some of these additional requirements imply. We continue to maintain this position and welcome the Government’s efforts to seek amendments that would offer adequate consumer protection.

Related to this, the Committee would like to highlight the link between this proposal and the proposal for a General Directive on ADR published on 31 May 2012. This includes a provision designed to protect the rights in the General Directive from being overridden by sector specific legislation. We would be keen to understand exactly how these two proposals interact.

You state that the Government have established a stakeholder group to give consumer and industry representatives in the UK an opportunity to share views on the proposals. Can you provide further information on the outcome of these discussions, and the views of both consumer and industry representatives more broadly?

Finally, we note the Government’s view that the provisions on ADR may require a Title V legal base. The Committee’s position on this remains that unless and until a specific Title V legal base is included in the proposal the UK’s opt in protocol does not apply, and neither does the timetable for parliament to consider the merits of the decision. We understand that if you are successful in convincing the other Member States that a Title V legal base is necessary the timetable for consideration of the issue could potentially be very tight. In view of this, we wish to be swiftly informed of any developments in relation to the legal base issue.

We would be grateful for a response to these queries by 21 November 2012. In the meantime we will continue to hold the document under scrutiny.

6 November 2012

Letter from Sajid Javid MP to the Chairman


The Treasury appreciates the original deadline for a response to your letter was 21 November, but in discussion with the Clerk to the European Union Sub-Committee (A), it was agreed that a short delay was advisable so that we could give you a more complete update on the progress of negotiations.

You have asked for further clarity on how the proposal for a general Directive on Alternative Dispute Resolution (‘ADR Directive’) interacts with the Insurance Mediation Directive (IMD), in light of
provisions designed to protect the rights provided by the ADR Directive from being overridden by sector-specific legislation.

Under the ADR Directive as currently drafted, out-of-court redress provisions contained in sector specific EU legislation will only prevail if they provide equal or better consumer protection than is provided for in the ADR Directive. Where sector-specific provisions are weaker in terms of consumer protection, the ADR Directive will prevail over sector specific EU legislation.

You also asked for further information on the views of consumer and industry representatives. The Treasury held a stakeholder working group meeting, in confidence, with insurers, intermediaries, trade bodies and consumer group representatives. Officials have also held a range of bilateral meetings to further gather stakeholder views on the revision of IMD. There is general consensus amongst stakeholders about the need to seek clarity on definitions used in IMD and the practicalities of how provisions will work in practice.

27 November 2012

Letter from the Chairman to Sajid Javid MP


We were disappointed not to learn more from your letter with regard to the timetable and progress of negotiations, in spite of the fact that the letter was delayed to provide just such an update. Would you be able to provide us with an update?

We would also be grateful for more clarity on the relationship between the general Directive on Alternative Dispute Resolution (‘ADR Directive’) and the Insurance Mediation Directive (IMD). At the heart of our question was the desire to understand exactly how these two Directives interact. However, we find your reply that “where sector specific provisions are weaker in terms of consumer protection” unhelpful, since we fear that the word “weaker” lacks precision. We would appreciate an explanation from you as to its precise meaning in this context. Perhaps you could provide the Committee with specific examples illustrating the interaction of the two proposals in this regard. As you know, we have previously expressed concern over the reduction in consumer protection that the additional ADR requirements in the IMD might imply. Can you provide an indication of whether consumer protection will be maintained by the ADR Directive?

We would be grateful for a response in relation to these matters by 19 December 2012. In the meantime we will continue to retain this document under scrutiny.

4 December 2012

Letter from Sajid Javid MP to the Chairman


You have asked for further information with regard to the timetable and progress of negotiations. There have been three working group discussions to date covering Articles 1-14 of the Directive. Further Council discussions will be scheduled under the Irish Presidency. A first exchange of views in the European Parliament took place on 6 November. The rapporteur, Werner Langen, is expected to publish a draft of his report between 17-18 December. The European Parliament’s ECON committee will take a vote on 26 March followed by a plenary vote in the European Parliament on 21 May.


Negotiations are drawing to a close on the ADR Directive. A consolidated text for the ADR Directive was agreed at a recent informal trilogue meeting between the Presidency, European Parliament and European Commission. We expect this text will be adopted early next year, and it has this to say about the relationship between the ADR Directive and other Union legislation:
ARTICLE 3

1. Save as otherwise provided by this Directive, if any provision of this Directive conflicts with a provision laid down in another Union act and relating to alternative dispute resolution procedures initiated by a consumer against a trader, the provision of this Directive will prevail.

The UK’s initial interpretation of this is that the provisions of the ADR Directive will prevail if there are requirements in other Directives which attempt to impose provisions relating to ADR, which are mutually exclusive with the provisions found in the ADR Directive. For example, the ADR Directive provides that in the case of an ADR entity where the natural person in charge of the dispute resolution is remunerated exclusively by the individual trader, that person must be granted a period of office of more than three years. If another Directive provided that in such circumstances the person must be granted a period of office of a maximum of two years, the provision of the ADR Directive is the one that prevails.

However, other Directives may impose separate, additional ADR requirements that are not covered by the ADR Directive. For example, other Directives may require the use of ADR to be mandatory in the sectors which they cover (the ADR Directive does not have any provision making the use of ADR mandatory).

A major objective of the ADR Directive is to achieve a high level of consumer protection across the internal market, by ensuring that each Member State has dispute resolution entities and procedures of high quality that can deal with consumer to business disputes.

The Department for Business, Innovation and Skills (BIS) leads on the UK’s negotiations on the ADR Directive and would be happy to field any further queries you might have on its interpretation.

18 December 2012

Letter from Sajid Javid MP to the Chairman

On 6th November 2012 the European Scrutiny Committee considered the proposal to amend the EU Directive of the Parliament and the Council on insurance mediation (IMD 2). On this date the Committee also considered the proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products. I am now writing to let you know that the UK formally opted in to this Directive and Regulation in accordance with Article 3 of Protocol 21 to the Treaty on the Functioning of the European Union (TFEU) on 16 October.

Both files contain proposals on Alternative Dispute Resolution (ADR) procedures which are out-of-court procedures for resolving disputes. Common forms of ADR are conciliation, mediation, adjudication and arbitration. The Financial Ombudsman Service is one of the largest consumer ADR providers in the UK.

The provisions in question oblige firms to participate in national ADR procedures, provided the procedure conforms to certain criteria. Although we support the obligation to participate, we do not agree with the specific criteria imposed.

In addition, some of the criteria required in order to make participation by firms in ADR procedures mandatory—namely restrictions on the operation of limitation periods and the requirements for the availability of interim measures—give rise to questions about the legal base of the provisions. These criteria require that any limitation or prescription period for bringing a civil claim will need to be suspended until the ADR is completed and consumers must be able to apply for interim measures to preserve their position in exceptional cases. Because these criteria would impose requirements on the operation of the UK’s Civil Justice system, we believe they should be brought forward pursuant to Title V, and more specifically Article 81, TFEU.

The UK’s policy is to insist on a Title V legal base for any measure containing JHA obligations, but if we are unsuccessful, to record our position by means of a minute statement. The UK’s preferred legal outcome is either to negotiate the JHA obligations out of the instrument, or to split it so that the JHA obligations are contained in a separate measure with an Article 81 legal base, to which the opt-in would clearly apply. Many other Member States have supported the UK in arguing for the removal of the criteria that raise JHA issues, and at this stage of the negotiations my officials are optimistic that we will succeed in doing so.

11 January 2013
Letter from the Chairman to Sajid Javid MP


We are grateful for your response to our queries. You stated that your initial interpretation of the ADR Directive was that, where there is a provision relating to alternative dispute resolution procedures in other Directives, the provisions set out in the ADR Directive would prevail. However, in your letter of 27 November 2012 you stated that “under the ADR Directive as currently drafted, out-of-court redress provisions contained in sector specific EU legislation will only prevail if they provide equal or better consumer protection than is provided for in the ADR Directive”. Can you clarify which of these two interpretations will apply? If it is the latter, what is your interpretation of “equal or better consumer protection”? We would wish to stress the significant implications of this for consumers. We would also be grateful for clarity as to whether the ADR Directive would override the ADR provisions set out in the Insurance Mediation Directive.

We would appreciate a response to this by 6 February 2013. In the meantime we will continue to hold this document under scrutiny.

22 January 2013

Letter from Sajid Javid MP to the Chairman


Your letter requests clarity on the interpretations of the interaction between the Alternative Dispute Resolution (ADR) Directive and IMD.

As you may have noted from my last letter of 18 December, negotiations have effectively drawn to a close on the ADR Directive. A compromise text was agreed by the European Commission, European Parliament (EP) and European Council at trilogue negotiations in December.

The European Parliament has now set a date of 12 March for their plenary vote on these proposals and Council is expected to vote on these proposals soon after. Due to the successful conclusion of the trilogue negotiations and both IMCO and COREPER voting in favour of the proposals, the forthcoming EP and Council votes are expected to vote in favour too.

As a result, the original proposals by the Commission regarding the interaction between the ADR Directive and sector specific legislation has been replaced with the following text:

Article 3

Save as otherwise provided by this Directive, if any provision of this Directive conflicts with a provision laid down in another Union act and relating to alternative dispute resolution procedures initiated by a consumer against a trader, the provision of this Directive will prevail.

The requirements under this revised text suggests that Member States no longer have to determine whether there is weaker or greater consumer protection in sector specific legislation.

Our interpretation of Article 3 is that the ADR Directive will prevail over sector specific legislation where there are ‘mutually exclusive’ i.e. conflicting provisions. For example, the ADR Directive provides that in the case of an ADR entity where the natural person in charge of the dispute resolution is remunerated exclusively by the individual trader, that person must be granted a period of office of more than three years. If another Directive provided that in such circumstances the person must be granted a period of office of a maximum of two years, the provision of the ADR Directive is the one that prevails. There are no provisions in the current draft of IMD that are conflicting with those in the ADR Directive.

Other Directives may impose separate requirements that do not feature in the ADR Directive. For example, IMD imposes a mandatory requirement for firms to participate in ADR initiated by a consumer, provided that the ADR procedure meets certain criteria. I believe this provision strengthens consumer protection by giving the consumer the right to redress without taking costly legal action.

5 February 2013
Letter from the Chairman to Sajid Javid MP

Thank you for your letter, dated 5 February 2013, on EM 12407/12 on the Insurance Mediation Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 12 February 2013.

We are grateful to you for your clarification of the interaction between the Alternative dispute Resolution Directive and the Insurance Mediation Directive. On the basis of this clarification we are now content to clear the document from scrutiny.

13 February 2013

INTERIM REPORT OF THE FOUR PRESIDENTS: TOWARDS A GENUINE ECONOMIC AND MONETARY UNION

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

Thank you for your Explanatory Memorandum, dated 16 October 2012, on the Interim Report of the Four Presidents: Towards a Genuine Economic and Monetary Union. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 20 November 2012.

We repeat our satisfaction, expressed in my letter of 17 October 2012, that this document was deposited for scrutiny. We would take this opportunity to emphasise the importance of ensuring that documents of this significance are in future deposited for scrutiny, and in particular that the final report of the Four Presidents, expected to be published before the December 2012 European Council, is deposited for scrutiny.

The report sets out “four essential building blocks” to economic and monetary union, namely: i) an Integrated Financial Framework; ii) An Integrated Budgetary Framework; iii) An Integrated Economic Policy Framework; and iv) Democratic Legitimacy and Accountability. We are considering the first of these building blocks, including the proposals for a Single Supervisory Mechanism and further steps towards “banking union”, in the context of our current inquiry into Reform of the EU Banking Sector.

We expect to publish our final report before the end of the year.

On the fourth building block of democratic legitimacy and accountability, we reiterate the point made in my letter of 17 October, that it must be for the parliaments of the European Union to take the lead in determining how any new structures and frameworks should be scrutinised and controlled. Whilst it is important for Member States to liaise with the European Parliament in this regard, it would be highly inappropriate for the European Council to put forward specific proposals, especially when the great majority of parliaments and their scrutiny committees have not yet had any opportunity to consider the matter. It is our view that the best way for such discussions to take place would be through the annual European Speakers’ Conferences, the next of which will be held in Cyprus in April 2013.

We have a number of observations on the document as a whole. Some argue that Economic and Monetary Union needs a framework for transfer payments in order to succeed. Do you agree? How likely is it that such a framework can be agreed? What would you perceive to be the “destination point” of this package of proposals, and what is a realistic timetable for such reforms to be achieved? Is it now necessary to adopt a fully integrated economic approach for EMU’s viability to be ensured? Do you envisage that any of these proposals will require treaty change?

The document makes no reference to the economic difficulties currently facing Spain. To what extent do you believe that these proposals are driven by Spain’s difficulties? Will they be sufficient to deal with the problem, and what is your current assessment of Spain’s position?

The UK has made it clear that it does not intend to participate in the banking union proposals. Taking the proposals in the Interim Report as a whole, what is your assessment of the impact of these proposals upon the UK? What will be their impact upon the single market in financial services? Do you perceive any danger of a fragmentation of the single market as a result of moves towards closer Economic and Monetary Union? How will this impact upon the UK’s position in relation to these proposals?

We would be grateful for a response to these questions by 4 December 2012. In the meantime we have agreed to clear the document from scrutiny.

67
INVESTMENT PRODUCTS: KEY INFORMATION DOCUMENTS (12402/12)

Letter from the Chairman to Sajid Javid MP, Economic Secretary, HM Treasury
Thank you for your letter, dated 16 October 2012, on Explanatory Memorandum 12402/12 on a Commission proposal on Key information Documents for Investment Products. The House of Lords European Union Economic and Financial Affairs Sub-Committee considered this document at its meeting on 6 November 2012.

We are grateful for your useful update on the progress of negotiations, although we would welcome further information on the views of other Member States, and in particular which Member States are supportive of the Government’s position in relation to the exclusion of pensions, and which have been critical of the ADR proposals. We are content to clear this document from scrutiny. However, since there are still a number of outstanding issues in relation to this proposal, and negotiations are still in the early stages, we would be grateful to receive further updates on negotiations in due course.

6 November 2012

MARKET ABUSE (16000/11, 16010/11)

Letter from the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury, to the Chairman
I am writing to provide an update on the broader negotiations of MAR and Criminal Sanctions and Market Abuse Directive (CSMAD). In terms of the timetable, the European Parliament voted on amendments to both of the Commission’s proposals on 9 October. The Presidency is aiming for the Council to agree on both the Regulation and Directive in the Autumn – the precise date is not certain, due to the interaction with the Markets in Financial Instruments Directive (MiFID) negotiation, but it could be as soon as late November. After this point, Trialogues will commence.

Broadly speaking, the UK is satisfied with the Council’s position on MAR. The Commission’s proposal, which was a constructive starting point, has been improved in several areas - the powers for Competent Authorities have been maintained; the offences are much broader in scope (now encompassing, for example, tips on the basis of inside information and benchmark manipulation): and legal certainty has been enhanced.

The Government’s position on CSMAD is unchanged. The UK supports the Commission’s proposal in principle but has taken the view that it was not possible to assess the implications of CSMAD while the broader market abuse framework in MAR (on which CSMAD is contingent) is not yet agreed (as well as the wider regulatory framework in MiFID). You will recall that the Government decided in spring this year not to opt-in to CSMAD for this very reason.

In light of this decision not to opt-in to CSMAD at the outset, the UK does not have a vote on (and would not be bound by) CSMAD, however we remain an active participant in negotiations.

I trust that this further information is helpful to the Committee and, in view of the fact that the Council negotiations are now reaching their conclusion, will enable the Committee to complete its scrutiny.

27 November 2012

Letter from the Chairman to the Rt. Hon Greg Clark MP
Thank you for your letter, dated 27 November 2012, on EMs 16000/11 and 16010/11, on Market Abuse. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 4 December 2012.

We are grateful for the update in negotiations. Noting that Council negotiations are now reaching a conclusion, we now clear the documents from scrutiny. However we would be grateful to be kept updated on developments as Trialogues commence.

4 December 2012
Letter from the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury, to the Chairman

Thank you for your letter of 10 October regarding the European Commission’s proposed amendments to its proposals for a Market Abuse Regulation and Directive. You requested an update on the negotiations and how the Wheatley Review will inform the Government’s position on the proposals.

The Commission’s proposals have been discussed at European Council working groups where Member States are broadly supportive of the proposals and the need to ensure all possible scenarios of misconduct are clearly captured.

You asked what the consequence of the Commission not amending the scope of the Directive to bring market manipulation of benchmarks themselves within reach of the market abuse regime would be. This question relates to a wider point, namely that the Commission’s proposed Directive does not fully clarify its scope. We think it should. The UK has raised the issue of scope in negotiations, including the manipulation of benchmarks, and the Presidency has now accepted that the scope of the Directive should be directly aligned with the scope of the Regulation, and benchmarks will therefore expressly be within scope.

Despite this it is important to note that the Commission’s proposals amending the Directive were sufficient to ensure that the direct manipulation of benchmarks would have been brought within scope of the Market Abuse Directive.

The Government announced its response to the Wheatley Review of LIBOR on the 17 October, with a written ministerial statement to Parliament. The Wheatley Review makes a series of recommendations to the Government and to the wider market. The Government has accepted the recommendations of the review in full, and is acting swiftly to implement the necessary legislative changes, through the Financial Services Bill, which is currently before Parliament. Specifically, the Government is making the following legislative amendments:

— to bring LIBOR activities within the scope of statutory regulation, including the submission and administration of LIBOR;
— to create a new criminal offence for misleading statements in relation to benchmarks such as LIBOR, as well as amending the language of existing offences; and
— to provide the new Financial Conduct Authority (FCA) with a specific power to make rules requiring banks to submit to LIBOR, with reference to a Code of Practice produced by the rate administrator.

These reforms will ensure that LIBOR is brought into the UK regulatory purview, that any attempt to manipulate LIBOR can be sufficiently punished under criminal law, and that LIBOR is a stable benchmark rate. Together they will provide comprehensive regulatory oversight of the rate, and give confidence to both the market and the wider public that LIBOR is credible and trustworthy.

The Government response to the Wheatley Review published this week will feed into our negotiating position on Market Abuse going forward. Specifically, the Wheatley Review points out the importance of ensuring that the Regulation is sufficiently wide that it covers all benchmarks, including in particular any benchmarks which may not be based on the underlying value of assets or prices, or which may not use a formula to calculate the level of the benchmark. It also recommends consideration of whether it should be a necessary element of market abuse that the calculation of a benchmark is affected, or whether making a false or misleading statement is sufficient, as the former may inadvertently exclude certain scenarios from the regime.

Finally it highlights the importance of sufficiently serious sanctions in order to provide sufficient behavioural deterrent, and advocates the UK continuing to oppose any weakening of the sanctions regime proposed by the European Commission.

Accordingly, the Government will consider these recommendations as part of its negotiating strategy moving forward.

As the proposed Regulation and Directive are still subject to negotiation, the date at which they will come into effect is dependent on when agreement is reached and the final detail of proposals. It is currently envisaged that both the Regulation and the Directive will apply from 24 months after their
entry into force, with the latter applying in the UK only if the UK chooses to opt in to the Directive on or after its adoption.

The European Parliament voted on amendments to the Commission’s proposals for a Directive and a Regulation on 9 October. The Cypriot Presidency is planning for agreement in November, after which we expect Trilogues will commence.

I hope that this further information assists the Committee in its consideration of the European Commission’s proposals.

13 November 2012

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

Thank you for your letter, dated 13 November, on EMs 13023/12 and 13037/12, on proposed amendments to the Market Abuse Regulation and Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 27 November 2012.

We are grateful for your response to our queries, particularly your helpful outline of the Wheatley Review findings. We would however be keen for more detail on exactly how these findings will influence your negotiating strategy. In particular, the Review encourages the Government to oppose any proposal by the European Commission to weaken the sanctions regime. It cites the financial penalty of £85 million imposed on Barclays (reduced to £59.5 million for agreeing to settle at an early stage) for its failings in respect of its submissions to LIBOR and EURIBOR as representing a serious disincentive in relation to this type of behaviour. We stress the fundamental importance of such financial penalties in discouraging such behaviour, and are anxious not to see any weakening of this disincentive. Can you provide us with more details of exactly what the Commission is proposing in relation to sanctions? Do you plan to oppose this and, if so, what steps are you taking to retain a strong sanctions regime?

We would appreciate a response on this issue by 12 December 2012. In the meantime, and in recognition that the Cypriot Presidency is seeking to reach agreement shortly we have agreed to clear the documents from scrutiny.

27 November 2012

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

Thank you for your letter dated 27 November 2012 where you requested an update on the sanctions regime in the Market Abuse proposals.

The UK supports the Commission’s proposal to set minimum sanctions levels in the draft regulation. This approach has been maintained in negotiations and the minimum sanctions levels remain. Attempts by some member states for lower minimum sanctions levels were successfully resisted. It is also clear in the draft regulation that these are minimum sanctions levels - ie that Member States can go beyond this and set higher sanctions levels in their domestic law. The draft regulation also clarifies that sanctions will apply to both actual and attempted market abuse. The regulation as drafted would prohibit activity such as attempted manipulation of benchmarks such as EURIBOR and LIBOR. In addition, the European Parliament has suggested introducing higher minimum levels of penalty, which the UK could support given our existing robust regime.

These provisions are consistent with the UK’s sanctioning regime and do not affect the capacity of the FSA to impose robust penalties against misconduct.

I hope that this further information is helpful to the Committee.

16 December 2012

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

Thank you for your letter, dated 16 December 2012, on EMs 13023/12 and 13037/12, on Market Abuse. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 15 January 2013.

We are grateful to you for your response to the queries in our letter of 27 November 2012. We are pleased to note your view that the provisions in the proposal are consistent with the UK’s sanctioning regime and do not affect the capacity of the FSA to impose robust penalties against misconduct. We
are also pleased to hear that attempts to reduce the minimum sanctions levels were resisted. Like you, we would support the European Parliament’s suggestion of higher minimum levels, and to that end we would be grateful if you could keep us updated on negotiations as trilogues commence.

15 January 2013

MIFID II (15938/11, 15939/11)

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

Thank you for your letter, dated 24 October 2012, on EM 15938/11: Proposal for a regulation on markets in financial instruments and amending Regulation (EMIR) on OTC derivatives, central counterparties and trade repositories, and EM 15939/11: Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC (recast), known as MiFID II. Thank you also for your response to the Committee’s July 2012 report, MiFID II: Getting it Right for the City and EU Financial Services Industry. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 6 November 2012.

We are grateful to you for your detailed response to the Committee’s report, and we are pleased to note that you express agreement or sympathy with the majority of the Committee’s findings. We are also grateful for the update on the progress of negotiations. What is your overall assessment of the progress of negotiations, and the extent to which the Government’s negotiating aims have been met? You appear to have made good progress in meeting your objectives in a number of areas, and the changes to the Council text have gone some way to address several of our own concerns. Nevertheless, we note that the Government’s objectives have not been fully met in such areas as commodity derivatives, high-frequency trading and, in particular, the role of ESMA. We would be particularly grateful for an update on negotiations on these areas, and in particular in relation to any legal challenge in relation to the role of ESMA. We reassert our view that ESMA has a vital role to play in coordinating regulation of financial markets across the EU, although an EU regulator should only have the power to intervene in the supervision of financial institutions in exceptional circumstances.

On high-frequency trading, you indicate that a definition of high-frequency trading is likely to be included in the legislation. What is the nature of this definition, and what do you think the repercussions will be of seeking to define it in such a way? You state in your response to the Committee report that the Government have taken into account the interim findings of the Foresight project. The final report was published in October. What is the Government’s assessment of its findings, and what further steps do you propose to take in light of its findings? We will continue to examine the impact of high-frequency trading over the coming months.

Notwithstanding the changes that look likely to be agreed in Council, we note with concern that there remains considerable distance between the Council and the European Parliament on a number of key aspects of the proposals. What is your assessment of the implications of the October vote of the European Parliament? What do you anticipate to be the likely outcome of negotiations as they progress? What assurance can you give us that the concerns that we have expressed in our report will be reflected as trilogue negotiations progress?

We note that negotiations in Council are moving towards a conclusion, with a General Approach expected to be agreed before the end of the year. Nevertheless we would seek further reassurance about the prospects for this important package, in particular in light of the European Parliament’s position, before we will be content to lift the scrutiny reserve. As such we have decided to retain the documents under scrutiny, in anticipation of a further update from you responding to these concerns.

In order to allow the Sub-Committee to consider this document at its meeting on 20 November we would need to receive a response to this letter by Tuesday 13 November 2012.

7 November 2012

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

Thank you for your letter, dated 7 November 2012, on EM 15938/11: Proposal for a Regulation on markets in financial instruments and amending Regulation (EMIR) on OTC derivatives, central

Since I last wrote to you, our expectations for the Council timetable have changed, with MiFID not discussed at ECOFIN in November as we had previously expected.

Alongside negotiations in Council, the Government has kept closely engaged with developments in the European Parliament. As negotiations progress, the UK will continue to argue strongly for our negotiating priorities, including the particular issues you touch on in your letter, namely, commodity derivatives, ESMA powers and high-frequency trading, where the Government welcomes the work of the Foresight project and agrees with many of its recommendations.

16 December 2012

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

I am writing in relation to your letter dated 16 December 2012 on EMs 15938/11 and 15939/11, on MiFID II. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 15 January 2013.

We are disappointed that your letter did not provide a substantive response to a number of the questions set out in our letter of 7 November 2012. In particular, whilst we note that the proposals were not discussed at ECOFIN on 27 November as originally envisaged, you do not provide any further information. What is the expected timeframe for agreement of the package? What is your assessment of the implications of the October vote of the European Parliament, which set out a position at variance from that emerging from Council negotiations in a number of areas? What update can you give us on negotiations in relation to commodity derivatives, high frequency trading and the role of ESMA? How likely is it that progress can be made in these areas, where, thus far, the UK’s negotiating priorities do not appear to have been met?

On high-frequency trading (HFT), you have not answered our question as to the nature of the definition of HFT likely to be included in the legislation, and your assessment of the repercussions of seeking to define it in such a way. We would be grateful for a response to this query. We also asked for your assessment of the findings of the Foresight project, and the further steps that you propose to take in light of its findings. Your letter states only that you welcome the project and agree with many of its recommendations. We would be grateful for a more considered response to this question.

We will retain the documents under scrutiny pending a response to these questions. We would be grateful for a response by 30 January 2013.

15 January 2013

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

Thank you for your letter of 15 January 2013, on EMs 15938/11 and 15939/11, on MiFID II. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 15 January 2013.

The Irish Presidency have provisionally planned for General Approach at ECOFIN on 5 March, but this could slip back. Trilogue discussions would follow, and it might be reasonable to anticipate agreement of the full package by the end of 2013.

I am now also able to provide further information on the more specific questions you ask.

EUROPEAN PARLIAMENT AND TRILOGUES

The Government has kept closely engaged with developments in the European Parliament, and is aware that the vote in October will have implications for the outcome of negotiations as a whole. Although we agree with the Committee’s observation that as would be expected there are some areas of difference between the positions of the European Parliament and the Council, in many areas views are broadly aligned. For example, we expect the outcomes on the payment of inducements, on the Organised Trading Facility and on commodity derivatives to be broadly similar in the Council and Parliament versions of the text. One area where there may be a difference is on the third country provisions, which will be a subject for discussion during the trilogues. We have negotiated hard to reach a sensible compromise in Council, but at the same time many of the developments in the
European Parliament text have been in a positive direction, and both texts are an improvement on the Commission’s proposal.

COMMODITY DERIVATIVES
On commodity derivatives, Member States seem to be agreed on the current compromise position which combines a framework of position limits with a broad position management regime.

HIGH-FREQUENCY TRADING
As mentioned in my earlier letter, we expect to see a definition of high-frequency trading in the legislation. This would be a subdivision of algorithmic trading characterised by infrastructure designed to minimise network latency, and high intraday message rates. The sole purpose of the definition would be to ensure that certain high-frequency firms are within the scope of MiFID and subject to MiFID authorisation requirements. We are comfortable with this compromise, and do not see any wider repercussions.

The Government welcomes the work of the Foresight project. It is a strong piece of work, which provides a very solid body of evidence for the implementation of the Directive. Calibration of minimum tick sizes and the design of circuit breakers are two examples of issues that will need to be carefully considered at level two, where Foresight may be helpful.

THE ROLE OF ESMA
The EU financial supervisory framework remains a key priority for the UK. We agree that ESMA has a role to play in coordinating national supervisors, but an EU agency’s powers must at the same time be within the legal boundaries of the Treaties and of European case law. In particular, it is vital to ensure that ESMA decisions are not subject to legal uncertainty. In negotiations, we continue to raise our concerns that MiFID confers powers on ESMA which go beyond what is lawful. The outcome of the current legal challenge of the powers conferred in the Regulation on short selling and certain aspects of credit default swaps (Regulation (EU) No 236/2012) will inform our long-term approach on this issue.

Overall, the Government’s views and negotiating priorities are strongly aligned with those of the Committee, and we can provide assurances that we will continue to pursue these objectives vigorously.

11 February 2013

Letter from the Chairman to the Rt. Hon Greg Clark MP
Thank you for your letter, dated 11 February 2013, on EMs 15938/11 and 15939/11 on MiFID II. The House of Lords European Union Economic and Financial Affairs Sub-Committee considered this document at its meeting on 26 February 2013.

We are grateful to you for your response to our questions, although we note that the letter was not sent until 11 February, nearly two weeks after our requested response date of 30 January. Following your appearance before the Sub-Committee on 5 February where we discussed problems with the scrutiny process, we would remind you of the need to get in touch with my officials in advance if you expect any difficulties in meeting a deadline.

We would be grateful for further updates in relation to some of the issues mentioned in your letter. First, you state that a compromise position has been agreed on commodity derivatives. Are the Government content with this compromise? Second, you state that the Government continue to raise their concerns in relation to powers conferred on ESMA, and that the outcome of the current legal challenge of the powers conferred in the Regulation on short selling and certain aspects of credit default swaps will inform your long-term approach. We would be grateful for further updates on the Government’s position on this issue, including progress on the legal challenge, as your approach evolves. Third, you state that the Irish Presidency have provisionally planned for General Approach at ECOFIN on 5 March, but this could slip back. We would be grateful for an update on negotiations, and in particular whether a General Approach was adopted on 5 March, and what was agreed, once this meeting has taken place.

We would be grateful for such an update by 18 March 2013. In the meantime we are content to clear the documents from scrutiny.
Letter from the Rt. Hon Greg Clark MP to the Chairman


You requested further updates in relation to some of the issues mentioned in my previous letter.

First, regarding the Council compromise on commodity derivatives, the Government is satisfied that the current text provides for a suite of position management tools that will ensure that commodity derivatives markets are properly regulated throughout the EU. While the compromise text appears stable, however, the Council’s position on this issue will only be formally agreed at General Approach.

In relation to the Government’s position on the powers conferred on ESMA, I have no further updates at this time. The legal challenge concerning certain powers conferred in the Regulation on Short Selling and certain aspects of Credit Default Swaps is ongoing before the European Court of Justice.

Finally, the Irish Presidency decided not to take MiFID to General Approach at ECOFIN on 5 March as a number of issues remained open in Council. They have not yet presented a revised schedule.

15 March 2013

REQUIREMENTS FOR BUDGETARY FRAMEWORKS OF MEMBER STATES (17929/12)

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


We agree with you that the Budgetary Frameworks Directive is an important element of the “six pack” on the strengthening of economic governance within the EU, and that it should, in theory, help to ensure better budgetary forecasting and responsible budgetary policy by Member States. However, what assessment would you make of the practical effect that the Directive is having in the current climate?

We welcome your assessment that the UK has already achieved the level of implementation required by the end of the transposition period, and we note the report’s assessment of the UK’s compliance with the directive.

Nevertheless, it is important to avoid complacency. The report considers at length the role of the Office for Budgetary Responsibility (OBR). What is the Government’s assessment of the role of the OBR, nearly three years after its formation? How, if at all, do you think that its work can be improved? How would you respond to the criticism levelled at the OBR in terms of its methodology and the accuracy of its forecasting models? Does this demonstrate, as the OBR chairman, Robert Chote, told the House of Commons Treasury Committee in December 2012, the limitations of economic forecasting?

You have called on other Member States to implement the Directive in a timely manner. Which other Member States have an independent body performing similar functions as the OBR? Which Member States have, in your judgement, complied with the Directive’s requirements, and which have not yet done so?

We would be grateful for a response to these questions by 28 February 2013. In the meantime we have agreed to clear the document from scrutiny.

13 February 2013
Letter from the Rt. Hon Greg Clark MP to the Chairman


You asked the Government for its assessment of the practical effect that the Directive is having in the current climate. While the Government believes that the Directive is an important aspect of the strengthened economic governance framework, it also believes it is too early to fully assess the Directive’s effects as the deadline for implementation has not yet been reached. Notwithstanding the euro area’s commitment to implement the Directive by the end of 2012, before a proper assessment could be made it is important to allow Member States the time to fully implement the Directive’s measures and for the measures themselves to be given time to become established.

You asked for an assessment of the OBR. The establishment of the OBR has placed the UK at the forefront of institutional reform internationally. It has significantly enhanced the credibility of the UK’s fiscal framework by ensuring that the Government’s fiscal policy decisions are based on independent forecasts for the economy and the public finances. As the OBR has highlighted, all forecasts are subject to a high degree of uncertainty in this period of global instability. The Budget Responsibility and National Audit Act places a statutory requirement on the OBR to publish an annual assessment of the accuracy of its previous fiscal and economic forecasts. It also requires the OBR’s Non Executive directors to appoint a person or body to review the OBR’s reports at least once every five years.

You asked which other Member States have an independent body performing similar functions as the OBR. The Commission’s interim report states that a third of Member States reported having structured processes in place involving several institutions or bodies to ensure transparency and accountability of forecasts. These include Belgium, Germany, Denmark, Estonia, Poland, Romania, Sweden, Slovenia, Slovakia and the UK.

Furthermore, under the two pack regulation for monitoring draft budgetary plans, the euro area Member States have committed to introduce independent bodies, with “functional autonomy vis-à-vis the budgetary authorities of the Member State” for monitoring compliance with numerical fiscal rules. These may also play a role in the budgetary forecasting of euro area Member States.

1 March 2013

SCUTINITY ISSUES AT HM TREASURY: YOUR EVIDENCE OF 5 FEBRUARY 2013

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

I am writing following your appearance, alongside Sir Nicholas Macpherson, Permanent Secretary, HM Treasury, before the House of Lords European Union Sub-Committee on Economic and Financial Affairs at its meeting on 5 February 2013, to discuss the recent problems at HM Treasury in supporting parliamentary scrutiny of EU documents. I am writing in response to your suggestion that we might explore alternative avenues of communication between the Committee and HM Treasury.

We welcome your acknowledgement of the value and importance of the Committee’s scrutiny work. We note Sir Nicholas’s admission that HM Treasury’s record was “not impressive” during the autumn of 2012, and we welcome the steps that have been taken to address these problems, including strengthening the unit that deals with scrutiny, and his commitment to continue to monitor performance. Sir Nicholas argued that performance improved in December and January. However, you will be aware that we have since January 2013 had cause to write to you a number of times expressing concerns about various aspects of the scrutiny process.

We would remind you of the well-established, long-standing, bicameral principles set out in the Cabinet Office Guidance for Departments on Parliamentary Scrutiny of European Documents. The Guidance states that deposit should take place within two working days of receipt of documents, that EMs must normally be provided no later than 10 working days from the date of deposit, and that if an EM is likely to be delayed, the Committee officials should be informed as early as possible of the reasons. It also states that staff shortages, lack of time, pressure of other work, the likelihood of further amendments, or the nature of the document are not acceptable reasons for the late production of EMs. If the UK policy has not been agreed or there are other areas of uncertainty, the EM should say so while giving as much information as possible as is available at the time. On written correspondence, the Cabinet Office Guidance points out that the Government have given the
Committee a commitment that they will aim to reply to correspondence from the Committee within 10 days but will provide a holding reply if the issues that need addressing are complex.

We expect these standards to be complied with, and will keep the situation under review in the expectation that standards will improve in light of your appearance before the Committee. We will keep in mind Sir Nicholas’s commitment to appear before the Committee again should standards not improve.

You raised concerns about the Explanatory Memorandum mechanism in relation to proposals where developments are fast-moving or where the policy implications are uncertain. You suggested, in such cases, “a more informal means of communicating and perhaps even meeting to discuss things as they are happening ... so not all our engagement is retrospective.”

It is important to emphasise that the Explanatory Memorandum mechanism must not be undermined. It is the established mechanism by which Parliament is able to hold both the Government and the EU institutions to account in relation to the consideration of EU documents. Notwithstanding any issues with the speed or uncertainty of negotiations, EMs must be produced on time (and certainly before any agreement takes place at Council) and to a high standard, providing, as the Cabinet Office Guidance states, as much information as is available at the time. Other means of communication must therefore supplement, rather than substitute for, Explanatory Memoranda.

We would also stress that we are well aware of the need to respond promptly to fast-moving proposals, and we have already taken steps to enhance the effectiveness of the scrutiny process in such cases. In relation to the banking union proposals, we met with President Van Rompuy and Commissioner Barnier to discuss the proposals well in advance of receipt of the Government EM. You will also be aware that we wrote to you, and that Lord Harrison spoke to you, about the Committee’s emerging conclusions on banking union, ahead of publication of our final report, so as to aid you in Council negotiations. Likewise, our Brussels contacts enabled us to anticipate the publication of the Van Rompuy reports on Towards a Genuine Economic and Monetary Union, which resulted in our request to you that the documents be deposited and an EM produced on an expedited timetable. We have on numerous occasions sought to stress to you the considerable implications for the UK of the proposal to take forward a Financial Transaction Tax under enhanced cooperation. Indeed, our concern in relation to such examples is that the standard of your response has not reflected the urgency or the gravity of the proposals in question.

In his 23 January speech on the future of Europe, the Prime Minister said that one of the principles for a new European Union was democratic accountability, and in particular “a bigger and more significant role for national parliaments”, because “it is national parliaments, which are, and will remain, the true source of real democratic legitimacy and accountability in the EU.” In that spirit, we very much welcome any mechanisms by which the Committee’s ability to influence negotiations can be enhanced. There are various potential methods, some of which we discussed with you on 5 February, such as a letter from the Minister accompanying the EM providing further details on the issues in question, an informal meeting of Committee members with the Minister and/or officials, and communications between HM Treasury officials and the Committee Clerk. We would encourage you and your officials to use such tools on a proactive basis, whenever you anticipate any issues or difficulties arising. However, I must emphasise again that they must supplement, rather than substitute for, Explanatory Memoranda.

We also stress the importance of effective communications with HM Government representatives in Brussels. We therefore welcome Sir Nicholas’s commitment to speak to the Permanent Representative to the European Union about the House of Lords engaging with negotiations in Brussels at an early stage. We note with concern his view that the British Civil Service has disengaged from Brussels in recent years. We agree with him that this issue needs to be considered as a matter of urgency.

I would be more than willing to continue our dialogue on these issues either via correspondence or in person.

26 February 2013

TAX FRAUD AND TAX EVASION (17617/12, 17637/12, 17669/12)

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

Thank you for your Explanatory Memorandum, dated 14 January 2013, on EMs 17617/12, 17637/12 and 17669/12 on Communications from the European Commission relating to tax fraud and tax
evasion. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 5 February 2013.

We would be grateful for more detail of your view of the Action Plan and Recommendations, and in particular in terms of your response to the individual initiatives proposed. You stated that you would consider the initiatives set out in the Action Plan. Whilst recognising that these initiatives are at an early stage, we would be grateful for more information on your emerging view.

In particular, you indicated that the Action Plan was not binding. We would be interested to learn which of these initiatives the Government intend to sign up to. We would also be interested to learn whether there will be a critical mass of Member States signing up to these proposals since co-ordinated EU-wide action seems to be the only way to fully tackle the problems of tax fraud and evasion.

In his speech at the World Economic Forum in Davos, the Prime Minister indicated that one of the main priorities of the UK’s G8 Presidency would be ensuring tax compliance. How will this G8 initiative relate to the EU initiatives outlined in this Action Plan?

We have some other, more specific, questions. We understand that the OECD has its own ‘blacklist’ of countries that do not meet appropriate standards of business taxation. Do you see this EU initiative as an unnecessary duplication? The Action Plan recommends medium term actions including the creation of an EU Tax Identification Number (TIN). What is the purpose of this? One new initiative is to “extend the common approach to denatured alcohol to partly denatured alcohol”. What does this refer to?

You stated that the Action Plan was presented to ECOFIN on 22 January. What update can you provide on these discussions?

On 5 February the Sub-Committee heard evidence from the Financial Secretary to the Treasury, Rt Hon Greg Clark MP, and the Permanent Secretary, HM Treasury, Sir Nicholas MacPherson, on recent problems with the scrutiny process within HM Treasury. This is a further example of a poor standard of Explanatory Memorandum produced by HM Treasury, in particular in comparison with EM 17817/12 on an Action Plan relating to European company law and corporate governance produced by the Department for Business, Innovation and Skills, which, whilst dealing with a similar nature of document provides far more useful detail, particularly in terms of the document’s policy implications for the UK.

We would be grateful for a response by 20 February 2013. In the meantime, we are content to clear this document from scrutiny.

5 February 2013

Letter from David Gauke MP to the Chairman

Thank you for your letter of 5 February regarding the EU Communications about tax fraud and tax evasion.

The Government is fully committed to clamping down on those who evade paying their tax and welcomes the Commission’s consideration of further possible actions to help address tax fraud and evasion. The Government is currently considering the proposals in the Commission’s Action Plan in further detail, including the fit between wider international actions, EU-level actions and Member State actions. We will also want to ensure that there is effective prioritisation. In assessing the Commission’s proposals, we will be taking fully into account the subsidiarity principle and the importance of respecting the balance of competences in this area.

At this stage we would broadly categorise the actions into the following groups:

— Existing EU actions which we would wish to be taken forward as a priority. These are the first six actions set out in the Action Plan and include full implementation of administrative co-operation agreements, adoption of the VAT fraud Quick Reaction Mechanism and agreeing the amended Savings Directive.

— Initiatives that ultimately require action at the global level and where it is important that the EU considers how its actions can support the international work. For example, the work that the OECD is taking forward on base erosion and profit shifting and the work on extending automatic exchange of information.
Recommendations where coordinated actions might have added value but where the responsibility for action remains with Member States. Here we will want to look carefully at the relative priorities and the details of proposals. The suggestions for an EU Taxpayers Charter and proposals to expand the work of the Code of Conduct Group fall into this category.

Initiatives that would, if done through legislation, increase EU competence on tax and which we would not support, for example a common EU general anti-avoidance rule.

We are currently considering the various proposals in more detail in preparation for working groups that the Irish Presidency is convening, with a view to producing Council conclusions by June. These conclusions will need to be agreed by consensus. We hope to be able to give you a more detailed response to your question as to our views on the individual measures shortly.

Making progress on tax evasion will be an important part of the G8 Presidency as well as being taken forward by the OECD. The Commission’s Action Plan contributes to the debate, but we need to ensure that these proposals do not duplicate existing work at international level.

Turning to the specific points raised in your letter:

— On the EU proposed blacklist we do see that this could result in unnecessary duplication and we will wish to emphasise this point in discussions.

— We are not convinced at this stage of the merits of an EU Taxpayer Identification Number (TIN). This could add complexity, may raise issues with taxpayer confidentiality and could impact on Member States’ ability to design their tax systems.

— Extending the common approach of completely denatured alcohol (methylated spirits) to partly denatured alcohol could potentially help to reduce administrative burdens for the movement of these goods. However, it would be necessary to consult with industry on the cost and benefits of this proposal before taking a firm view.

— The 22 January ECOFIN discussion showed that further work and clarity would be needed on the proposals and that the Council preparatory bodies would examine these in detail. This was not discussed at the February ECOFIN.

19 February 2013

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 19 February 2013 relating to EMs 17617/12, 17637/12 and 17669/12 on Communications from the European Commission relating to tax fraud and tax evasion. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 5 March 2013.

We found this a helpful indication of your emerging views in relation to the proposals set out in the Action Plan. It does, however, concern us that the discourse in relation to this issue often confuses tax evasion and tax avoidance. As you know well, tax evasion relates to illegal activities whereas tax avoidance is the legal use of the tax regime to reduce the amount of tax that is payable by means that are within the law. For example, capital allowances are a form of tax relief and are set at national level to reflect national priorities. As such, they provide the incentive to avoid tax. It concerns us that the action plan regards the fight against tax fraud and tax evasion (illegal activities) whilst the recommendation which falls within the action plan relates to “aggressive tax planning”. This recommendation thus concerns a form of tax avoidance. What steps are you taking to ensure the separation of treatment of these two conceptually different areas?

In addition, you stated that there were a group of initiatives that, you believed, ultimately required action at the global level and where it was important that the EU considered how its actions could support the international work. You cited the OECD as an example of an organisation undertaking work at this level. We would be grateful if you could provide us with details of other organisations operating at different levels that are engaged in this work.

We would also like to clarify the intended scope of the proposal relating to the EU Tax Identification Number (TIN). We understand that this would relate to all taxpayers engaged in cross border
operations. Do you anticipate that this proposal would therefore be relevant to all cross border operations?

We would be grateful for a response to these questions by 20 March 2013. We also expect more detailed updates as you consider the proposals in more detail during the course of the Irish Presidency, and as working group discussions proceed.

5 March 2013

Letter from David Gauke MP to the Chairman

Thank you for your further letter of 5 March regarding the EU Communications about tax fraud and tax evasion. Given the broad scope of this dossier, I appreciate there may be further questions and I would like to reassure you that we are carefully considering each of the actions in detail and whether EU-level action is appropriate.

In discussions so far, the UK, and a number of other Member States, have called for better prioritisation of measures to focus on implementing existing agreed initiatives. We have also been clear that any EU-level action must be focussed on measures that are effective, achievable under unanimity, in line with the current balance of competences and complement existing work at both the national and international level.

I agree with you that the conflation of tax avoidance and tax evasion is a common problem and can dilute the message that tax evasion is an illegal activity. As part of our approach, we have stressed the importance of being clear what is tax avoidance and what is tax evasion.

As regards the EU recommendation on aggressive tax planning, this was discussed at the last EU Working Party on Tax Questions held on 27 February. There was general agreement with the UK’s view that fairness and effectiveness is crucial to the tax system and that Member States should be allowed to develop their own anti-avoidance rules. In response, the Commission reaffirmed that the recommendation is non-binding.

You asked about other organisations engaged in international efforts to tackle tax fraud and tax evasion. This includes the Financial Action Task Force (FATF), which sets standards and promotes effective implementation of measures to combat money laundering; the G20, which is committed to strengthen transparency and exchange of information; and the G8, where the UK - as the Presidency - is keen to develop approaches to tackle cross-border tax evasion.

Turning to your question on the proposal related to an EU Tax Identification Number (TIN), you will be aware that on 25 February, the Commission launched a public consultation on this proposal. The link to this consultation can be found at


The aim is to help identify and match taxpayers from information exchanged between Revenue Authorities to help avoid double non-taxation arising from cross-border operations. The scope of the proposal is subject to consultation, but the Commission intends for the EU TIN in the first instance to be for cross-border operations subject to automatic exchange of information and then extended to all other cross-border operations.

We have doubts as to whether an EU TIN will help improve tax collection or compliance overall and will be considering how best to provide our views on this proposal. For example, this proposal overlaps existing domestic taxpayer identification systems and could increase administrative and IT burdens to Member States. A better solution may be to focus on more effective use of national TINs and improving existing systems of information exchange.

18 March 2013

TOWARDS A GENUINE ECONOMIC AND MONETARY UNION (16988/1/12)

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

I am writing with regard to your EMs, both dated 10 December 2012, on EM 16988/1/12, a Commission Communication on A Blueprint for a Deep and Genuine Economic and Monetary Union, and an unnumbered EM on the Van Rompuy/Four Presidents final report Towards a Genuine
Economic and Monetary Union. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 11 December 2012.

We note that these documents were written in preparation for the 13 December 2012 European Council. We therefore regret that the EMs on these important documents were only received the day before our final meeting before the Council, meaning that we were unable to take the EMs into account in our scrutiny work. We are particularly disappointed that the EM on 16988/1/12 (the Commission Blueprint) was not received earlier, given that it was published on 29 November. We stress the importance of providing EMs as soon as possible on documents of such urgency. We also ask you to pass on to the Commission and Council our view of the importance of publishing such documents in enough time to allow all national parliaments to undertake the scrutiny process effectively.

Given their relevance to the forthcoming European Council, we have decided to grant a scrutiny waiver in relation to both documents. We will return to them in the context of our consideration of the Council conclusions.

11 December 2012

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

Thank you for your Explanatory Memorandum 16988/1/12, dated 10 December 2012, on the Commission’s report ‘A Blueprint for a deep and genuine Economic and Monetary Union’ and your Unnumbered Explanatory Memorandum, dated 10 December 2012, on the Four Presidents’ report ‘Towards a Genuine Economic and Monetary Union’. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 18 December 2012.

We repeat our disappointment, expressed in our letter of 11 December 2012, that the EMs on these important documents were only received on 10 December, meaning that we were unable to take them into account ahead of the 13/14 December European Council. We are particularly disappointed that the EM on 16988/1/12 (the Commission Blueprint) was not received earlier, given that it was published on 29 November. We stress the importance of providing EMs as soon as possible on documents of such urgency. We also repeat our request that you pass on to the Commission and Council our view of the importance of publishing such documents in enough time to allow all national parliaments to undertake the scrutiny process effectively.

We are disappointed at the level of information you provide in these EMs on the Government’s position on these documents. We expect far more detailed analysis of the implications of proposals of such importance for the future direction of the EU. We would therefore be grateful for a considered and early assessment of the implications of paragraphs 1–17 of the Conclusions of the 13/14 December 2012 European Council. In particular, what are the implications of these proposals for the UK? You stated in your response to these reports that you intend to protect the UK’s specific interests, especially in relation to the single market. We commend this ambition but would be grateful for more detail on exactly how you propose to do this, as well as on your views of the proposals more generally. Also, how would you compare the conclusions of the Summit with the proposals as set out in the Commission Blueprint and Van Rompuy Report? What is your assessment of the likely prospects for the medium and long-term steps towards Economic and Monetary Union, which, whilst detailed in the Commission blueprint, are not referred to in any detail in the Council Conclusions.

We note that the Commission’s Blueprint focused heavily on how to achieve greater fiscal integration. The report contains some ambitious proposals which would have major implications not only for the euro area but for the European Union as a whole. We acknowledge the arguments for greater fiscal integration amongst euro area members but would like to highlight that there remain a number of well-respected voices arguing that greater fiscal integration is not necessary to resolve the problems of the euro area. Are you convinced by the need for greater fiscal integration? Have you considered alternative options? Whilst the 13/14 December European Council conclusions do not go as far as the proposals in the Blueprint, there still remains a sense of inevitability in relation to steps towards fiscal integration.

We note that both reports consider questions of democratic legitimacy and accountability. We note that the European Council conclusions state that the European Parliament and national parliaments will determine together these new structures. We reiterate our view as expressed in our letter of 17 October 2012 on the Van Rompuy/ Four Presidents Interim Report, that “it must be for the parliaments of the European Union to take the lead in determining how any new structures and
frameworks should be scrutinised and controlled. It would be entirely inappropriate for the
European Council to put forward specific proposals, especially when the great majority of parliaments
and their scrutiny committees have not yet had any opportunity to consider the matter.” We also
stress the importance of each national parliament holding their own national government to account.

We welcome the fact that both reports as well as the European Council Conclusions commit
to a proposal for a Single Resolution Mechanism following the adoption of the Single Supervisory
Mechanism. Our recently published report European Banking Union: Key issues and challenges
discussed the need for a Single Resolution Mechanism to accompany the Single Supervisory
Mechanism. We would, however, also like to see proposals for a Single Deposit Scheme brought
forward, since only then will the euro area achieve a truly effective banking union.

We would be grateful for a response to these queries by Wednesday 9 January 2013. In the meantime
we are content to clear these documents from scrutiny.

18 December 2012

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

Thank you for your letter of 18 December regarding the reports published by Presidents Van Rompuy
and Barroso in the run up to December European Council.

You requested an assessment of the implications of the December European Council Conclusions for
the UK. The Conclusions were a good outcome for the UK. They welcomed the approach to the
Single Supervisory Mechanism and they confirm that the Single Market is protected for all Member
States (see below for further information). They also set out a number of other areas where the euro
area wants to make progress in the coming months.

Your letter asked how the Government intended to protect the Single Market. At the December
European Council the Prime Minister secured in the Council Conclusions, robust language on
protecting the Single Market in its entirety but also more significantly, language agreeing specific
safeguards to protect the Single Market in financial services and protect the interests of the UK’s
financial sector. I discussed these in detail in my letter of 12 January.

On protecting the integrity of the Single Market in general, the Conclusions outline clearly that
“throughout the process the integrity of the Single Market will be fully respected, including in the
different legislative proposals which will be made”. This makes clear that the integrity of the Single
Market must be respected in all aspects of further integration.

The agreement at European Council of the Regulations on the single supervisory mechanism and
changes to the European Banking Authority provides a good example of how the Government can
secure important changes to safeguard its interests. As the Prime Minister made clear in his Post-
Council Statement:

“A single currency needs a single system for supervising banks, so Britain supported the first steps
agreed towards a banking union, but in return we and others demanded proper safeguards for
countries that stay outside the new arrangements. The European Council therefore agreed a new
voting system that means that the eurozone cannot impose rules on the countries outside the euro
area, such as Britain, without our agreement. There is also an explicit clause that says that no action
by the European Central Bank should directly or indirectly discriminate against those countries
outside a banking union. That is vital for our financial services industry, which must continue to be
able to provide financial products in any currency.”

Your letter also asked the Government whether it is convinced by the need for greater fiscal
integration. As the Prime Minister stated in his post Council Statement, “there have been calls from
some for greater solidarity and burden sharing, and calls from others for tough rules for fiscal
discipline. These arguments raise far-reaching questions of national sovereignty, and it is yet to be
determined how far or fast the changes will go, but it seems likely that we will see a process of
further integration for members of the eurozone.”

In your letter, you reiterate your view that “it must be for the parliaments of the European Union to
take the lead in determining how any new structures and frameworks should be scrutinised and
controlled”. On the role of national parliaments and the European Parliament, as the Prime Minister
made clear in his reply to the Chairman of the European Scrutiny Committee during his Post-Council
statement debate on Monday 17th December, while the European Parliament has the role given to it
as set out in the treaties this Government believes that national parliaments are the institutions
closest to the peoples of Europe and that is why they should be at the heart of providing democratic
legitimacy within the European Union.
The Conclusions outline that, in the process of greater eurozone integration, national parliaments and the European Parliament both have a part to play; they suggest that new mechanisms to increase the level of cooperation between national parliaments and the European Parliament could contribute to this process, but that the exact modalities of a conference of their representatives to discuss EMU related issues is for the Parliaments to determine themselves. The Government shares that view.

26 January 2013

UNDEAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES
(UCITS V) (12397/12)

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

Thank you for your letter, dated 20 October 2012, on EM 12397/12 on a Draft Directive amending the Directive on the coordination of laws, regulations and administrative provisions relating to Undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 6 November 2012.

We are grateful to you for your response to our questions. We note in particular your view, and those of industry and other Member States, regarding the Commission’s proposal to prevent unsuitable institutions from acting as depositaries. You state that the depositary sector’s proposal for a grandfathering provision, whilst protecting existing firms, would create an uneven playing field and barrier to entry for new depositary firms. You also state that any grandfathering could permit unsuitable institutions to continue to operate as depositaries. What is the basis for your position? In particular, should the national authorisation schemes which you defend, if they are operating effectively, not be in a position to prevent such unsuitable institutions from operating as depositaries? You state that Member States that currently operate national regimes for depositaries have all voiced their concern at this proposal. How many Member States operate national regimes, and who are they? How do they compare with the UK’s scheme?

In our view it is also important that the risks pertaining to the use of depositaries need to be fully assessed. What assessment have the Government undertaken of such risks? Does such an assessment form a part of the Commission’s current consultation on the UCITS Directive?

We would be grateful for a response to these questions, as well as an update on negotiations, as discussions on this proposal progress. In the meantime we have agreed to clear the document from scrutiny.

6 November 2012

Letter from Sajid Javid MP to the Chairman

The European Union Committee has requested further information regarding a number of points regarding these proposals.

The UCITS Directive currently gives Member States very wide discretion to determine the categories of institution that may act as a depositary to UCITS funds authorised within their jurisdiction. While many depositaries are already credit institutions or MiFID investment companies, Poland, Ireland, Malta, and the Netherlands all have national regimes.

Depositaries operating under the national regime of the United Kingdom must be authorised by the Financial Services Authority which subjects them to a very robust prudential regulation and ongoing supervision. They are also required to hold a minimum capital of £4,000,000. Depositaries in the Netherlands and Ireland are authorised under similar regimes though are only required to hold capital of €112,500 and €125,000 plus three months operational costs respectively. Poland operates the National Depositary for Securities, the KDPW, which is a central securities depositary and jointly and equally owned by the Warsaw Stock Exchange, the National Bank of Poland, and the Polish Treasury. Maltese UCITS depositaries must hold an investment services licence from the Maltese Financial Services Authority.

As UCITS funds may be marketed in any jurisdiction, a blanket grandfathering of all national regimes would allow UCITS funds with depositaries of widely divergent standards to be marketed to investors in the United Kingdom. Therefore I agree that if national regimes are to be permitted to continue then there should be key minimum harmonising requirements that national regimes should include.
The European Commission undertook a public consultation in 2009 covering a number of issues and risks relating to depositaries including effective prudential regulation, minimum capital requirements and supervision. The findings of this consultation have been incorporated into the Commission’s impact assessment. Further questions on depositaries, particularly relating to the possible risks posed if a depositary passport is introduced in the future, were also asked in a further consultation that closed in October.

The Government and Financial Services Authority are currently considering a number of issues relating to depositaries as part of the implementation of the Alternative Investment Fund Managers Directive and discuss depositaries risks with industry stakeholders on a regular basis.

The Committee has asked about the progress of the proposals. The Council met again briefly on 17 October. The Presidency indicated that as sanctions are a horizontal issue across a number of proposals, they would wait until sanctions provisions are agreed on files where discussion is more advanced, particularly the Markets Abuse Regulation and Transparency Directive, then the relevant provisions will be copied into the text of the UCITS proposal and then Member States would consider whether any refinement is necessary in the context of UCITS. We agree that this approach is sensible. A number of technical suggestions were also made in respect of remuneration. The Commission conceded that the text had been copied exactly from the Alternative Investment Fund Managers Directive and that they would consider a number of minor amendments to remove certain anachronisms that had been copied across. The issue of eligible depositaries was also raised briefly though no new points were made. The Presidency indicated that they hoped to hold another meeting in late November, though no date has been set yet, and that they hoped to circulate a new compromise text ahead of this meeting.

14 November 2012

Letter from the Chairman to Sajid Javid MP

Thank you for your letter, dated 14 November 2012, on EM 12397/12 on a Draft Directive amending the Directive on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 27 November 2012.

We appreciate your response to our questions. We have since become aware that the rapporteur in relation to this dossier in the European Parliament, Sven Giegold, is seeking a ban on performance fees for UCITS funds.

We would be grateful for the Government’s views on this as well as further updates on negotiations in due course. In the meantime we are content to clear the document from scrutiny.

27 November 2012

Letter from Sajid Javid MP to the Chairman

The committee has requested an update in light of new remuneration proposals for UCITS managers being considered by the European Parliament.

Last month, the Economic and Monetary Affairs Committee of the European Parliament endorsed an amendment to the Commission’s proposals that would cap any variable remuneration paid to key staff at a UCITS manager at 100 per cent of their basic salary.

The Council has not yet reached General Approach and no working groups have been held since December. The Presidency have not scheduled any further meetings or set out any plans to progress this dossier. The current Council text does not include any cap on variable remuneration.

28 April 2013
Letter from the Rt. Hon Greg Clark MP, Financial Secretary, HM Treasury to the Chairman

This letter provides an update on CRR/CRD 4 negotiations and an explanation of our position on the agreement that has been reached.

The objective of CRR/CRD 4 is to implement the Basel 3 recommendations for a more resilient banking system in the European Union. It was adopted by the European Commission in July 2011 through a Regulation and a Directive and a General Approach was reached at the May 2012 ECOFIN.

CRR/CRD 4 amends and replaces the existing CRD and is intended to better safeguard financial stability through steps such as strengthening banks’ capital requirements, introducing new requirements for liquidity and leverage, and strengthening governance and supervision requirements.

The Irish Presidency and the European Parliament reached an agreement on CRR/CRD 4 in Trilogues on 20th March 2013. The Government indicated that it could not accept this agreement at Coreper on 27th March 2013. However, other Member States were able to accept the agreement and the Presidency concluded that there was sufficient support to agree CRR/CRD 4 by a Qualified Majority Vote. CRR/CRD 4 will now go through the jurist-linguist process before being put to a formal vote at Council in May or June.

We are satisfied with a number of important elements of the agreement but are unable to vote in favour of the agreement for two main reasons.

COMPLIANCE WITH BASEL 3

First, the UK has pushed for full and consistent implementation of Basel III standards throughout negotiations. The UK made a commitment in the G20 to faithfully implement Basel 3 which was taken up by other Member States as well as the European Commission. Unfortunately, the Government is concerned that the legislation is not compliant with the Basel 3 agreement for internationally active banks in certain significant areas, including definition of capital and options for a more lenient treatment of significant investments in insurers.

REMUERATION PROVISIONS

Second, the agreement includes a 1:1 cap between fixed and variable remuneration, rising to 1:2 upon approval by a shareholder majority. The Government is concerned that this proposal will undermine rather than improve financial stability by driving up fixed pay (which, unlike variable pay, is not discretionary and cannot be clawed back). There has been no impact assessment in relation to these measures.

Other areas of the agreement are far more satisfactory to the UK, most notably in the area of Member State flexibility to set higher requirements.

MEMBER STATE FLEXIBILITY

As you are aware, the Commission’s original proposals for CRR/CRD 4 were maximum harmonised, meaning the UK would have been unable to implement the recommendations of the Independent Commission on Banking (ICB) or give the Financial Policy Committee (FPC) the tools to conduct macro-prudential policy.

However, the UK was successful in ensuring that the final agreement allows the UK scope to apply a 3% Common Equity Tier (CET) 1 buffer to the ring fenced part of a bank with no control by any EU institution.

The agreement also enables macro-prudential authorities to use a wide number of tools to address financial stability risks. In order to implement an extra prudential measure, the FPC must submit relevant quantitative and qualitative evidence justifying its decision to the Commission. Following this notification process, the FPC could only be prevented from taking a measure if the Commission found that there was robust, strong and detailed evidence that the measure will have a negative impact on the single market that outweighs the financial stability benefits resulting from a reduction in the systemic risks identified and if a qualified majority of Member States in Council agreed that the measure should be blocked.
TREATMENT OF SMALL INVESTMENT FIRMS

The Commission’s proposals also included overly onerous requirements for small investment firms, the majority of which are located in the UK. The Government was concerned that these requirements were not subject to any impact assessment and would have had a very damaging impact on the sector (one which poses very limited systemic risk and plays an important role in ensuring diversity in the UK’s financial system). The final agreement removes some of the very smallest investment firms from the scope of CRR/CRD 4 and ensures that the standards applied to those still within scope are appropriate.

OTHER PRUDENTIAL ISSUES

Despite the weakening of Basel 3 in a number of areas the UK was successful in securing consistency with Basel 3 in other important areas. For example, banks will be required to disclose their leverage ratio to the market from 2015, something which will enhance market discipline. The Basel 1 floor (which ensures that the risk weights assigned to assets do not fall to an inappropriately low level) will be retained until 2017. Also, in the important area of the treatment of banks’ exposures to central counterparties (CCP) default funds the agreement reflects Basel 3. This area of the agreement is particularly important to the UK in light of the size of the CCPs located in London.

NEXT STEPS

CRD4 will formally be adopted by qualified majority in Council during May or June. The agreement states that the package needs to be implemented by the 1st January 2014 if the legislation is published in the Official Journal by the 1st July 2013, otherwise it must be implemented by 1st July 2014.

15 April 2013

VAT FRAUD: QUICK REACTION MECHANISM (13027/12)

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

Thank you for your letter, dated 23 October 2012, on Explanatory Memorandum 13027/12 on a Commission proposal to amend Directive 2006/112/EC on the common system of Value Added Tax as regards a Quick Reaction Mechanism against VAT fraud. The House of Lords European Union Economic and Financial Affairs Sub-Committee considered this document at its meeting on 6 November 2012.

We are grateful for the further details you have provided in relation to this proposal. You state that the Commission has opposed all three alternative approaches being explored in Council. Can you provide details of the grounds on which the Commission has ruled these approaches out? In particular, can you provide us with further information on the proposal to streamline the current arrangements? Since the exact form that this amendment will eventually take is still very uncertain, we will continue to retain this document under scrutiny. We are keen to receive further updates on negotiations in due course.

6 November 2012

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 6 November on the proposal for a Quick Reaction Mechanism against VAT Fraud.

You asked for further details about the grounds on which the Commission ruled out the suggested alternative approaches presented to the Council. The Commission’s view was that the alternatives either fell foul for legal reasons or would not deliver the time-savings needed. However, despite being pressed in the meeting and subsequently, they have not so far clarified what they described as their practical and legal objections to the alternatives.

In relation to the streamlining of the current system, our approach has been to examine the steps of the existing system and test whether they need to take the time they do. Ideas include: whether faster internal Commission procedures can be engaged; the use of standardised forms and texts to ensure the appropriate information is provided initially and translation times minimised; and a revision of handling within the Council.
Since your letter, this dossier has been discussed at the ECOFIN on 4 December. The discussion focused on whether implementing powers under the Directive should be conferred on the Commission or the Council. In the debate, the UK made it clear that we supported the idea of a quick, effective mechanism to combat fraud and that we were looking for speedy agreement. The stumbling block was the use of Qualified Majority Voting in the Commission’s proposal. There are alternatives which preserve unanimity voting which have yet to be properly explored but should be. The UK’s position was vocally supported by Germany, Luxembourg, Malta, Sweden and Portugal. The Council agreed that further work should be undertaken, which would explore both approaches, with a view to reaching an agreement as soon as possible.

17 December 2012

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 17 December 2012, on EM 13027/12: VAT Fraud: Quick Reaction Mechanism. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 15 January 2013.

We are grateful to you for your response to the questions in our letter of 6 November 2012, and for the useful update on negotiations, including the position of other Member States. We agree with you that a quick, effective mechanism to combat fraud is needed, and have previously expressed our sympathy with your view over the proposed increased role for the Commission. We would be grateful for further detail of your concerns over the proposed use of Qualified Majority Voting. We note that the Council has agreed to undertake further work, and agree with you that such work should be undertaken speedily.

We also note that the Commission has not clarified its objections to the alternative models that you have suggested, and we urge you to continue to press the Commission for such clarification.

We would be grateful for further information as negotiations progress. In the meantime, and in light of the continued uncertainty of the final shape of the proposals, we will continue to hold the document under scrutiny.

15 January 2013

Letter from David Gauke MP to the Chairman

Thank you for your letter of 15 January regarding EM 13027/12 VAT Fraud: Quick Reaction Mechanism (QRM).

The QRM dossier was most recently on the agenda for the 5 March ECOFIN. This followed discussion by officials in response to the ECOFIN conclusions from 4 December which required further work to be conducted on both the Commission’s proposed QRM, and on alternatives which respect the principle of unanimity in taxation matters. These discussions did not resolve the fundamental difference in approach between the Member States. The Presidency conclusion was that progress on this dossier would be best served by a further Ministerial discussion.

Accordingly, the Irish Presidency asked the Council to consider political guidelines on the future direction of work on the QRM, based on a package of anti-fraud measures. This package left unchanged the approach to the QRM taken by the Commission, but time limited its application to the end of 2018. Any renewal would require legislation subject to unanimity. The other elements of the package were:

— an optional reverse charge subject to a longer list of supplies and also valid until 2018;
— an undertaking by the Commission to speed up the existing derogation procedure for non urgent cases;
— clarification of the arrangements for any transition between a QRM derogation and a normal derogation;
— the facilitation of best practice in relation to the fight against fraud;
— and a request that the Commission address the weaknesses in the current VAT system to deliver a robust and resilient system which will to a great extent negate the need for derogations to counter fraud. The target time for this would be 2018.
At the 5 March ECOFIN meeting there was consensus that a quick and effective QRM was needed. However, the UK opposed the use of Qualified Majority Voting (QMV) in the proposal. In this we supported Germany, and in turn received support from Sweden, Portugal and Luxembourg. The Council reached conclusions in May last year that unanimity should be one of the principles and legal considerations which should be taken into account in furtherance of any future action under the VAT strategy. The QRM forms a part of that strategy. This Government thinks that an effective and efficient alternative approach to the Commission’s proposal which honours those conclusions is still attainable.

Successive Governments have taken the view that agreement on substantive tax matters should be subject to a unanimous decision taken in the Council. Indeed the current derogation system operates in such a way. Although attractive in terms of making use of a system that is already available in the Treaty on the Functioning of the European Union, our view is that there is no requirement to make use of delegated powers, especially when it could cause a precedent in the tax sphere. The Council should therefore concentrate its efforts on finding an alternative solution which is similar in speed to the proposed mechanism but which does not rely on delegating powers to the Commission and the associated use of QMV.

As in previous discussions, other Member States were prepared to accept the use of QMV in the QRM. More widely, there was broad support for the Irish package, although there were differences on significant points such as the value and impact of the optional reverse charge; the composition of the list; and the need for a package in the first instance.

The Irish Presidency, in summing up the March ECOFIN discussion, concluded that more technical level work was required on the proposal. Although they were open to detailed suggestions of alternative approaches from Member States, their intention was to continue work at the technical level on the basis of their package.

13 March 2013

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 13 March 2013, on EM 13027/12: VAT: Quick Reaction Mechanism. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 26 March 2013.

We are grateful for your update on the progress of negotiations in relation to this dossier and response to our query relating to your opposition to the use of Qualified Majority Voting (QMV). Is there any legal basis for your opposition to the use of QMV in relation to these matters? We note that the most recent proposal presented by the Irish Presidency attempted to address your concerns relating to QMV by time limiting the application of the Quick Reaction Mechanism to the end of 2018, since any renewal of its application would needed to be adopted unanimously by Member States in the Council. Is this sufficient to address your concerns? If not, can you explain why?

We would also be grateful for clarify on the support you have from other Member States in relation to your opposition to the use of QMV. At one point in the letter you indicated that you had support from Germany, Sweden, Portugal and Luxembourg but at another point you indicated that Member States were prepared to accept the use of QMV. Can you clarify this and also indicate if there is a risk that you might be isolated in your opposition? You also discussed some further objections that Member States had in relation to the proposal. Can you tell us which Member States held these objections?

Finally, we would be interested to know if the threshold for registration of VAT has any implications for this proposal. What are the registration thresholds in other Member States?

We would be grateful for responses to these queries by 16 April 2013, as well as further updates on negotiations in due course. In the meantime, and in light of the continued uncertainty of the final shape of the proposals, we will continue to hold the document under scrutiny.

26 March 2013

Letter from David Gauke MP to the Chairman

Thank you for your letter of 26 March regarding EM 13027/12 VAT Fraud Quick Reaction Mechanism (QRM).

You ask about the legal basis for the Government’s opposition to the use of Qualified Majority Voting (QMV) in tax matters. The Government does not question the Commission’s right to bring forward
a proposal which confers implementing powers and allows for QMV in a tax dossier. We do, however, strongly oppose such a move, believing that tax must remain primarily a Member State competence and that legislative decisions at the EU level must be taken on the basis of unanimity voting. The Commission argues that because the Lisbon Treaty allows for Commission implementing powers in this area, they must be used. That is not the view of the Government or like-minded Member States – Germany, Portugal, Sweden and Luxembourg. Nor is it the view of the Council Legal Service which has noted that it is the Council that already exercises implementing powers by unanimity to agree VAT anti-fraud measures.

You also asked whether the Irish compromise suggestion of applying a sunset clause to the current proposal and then replacing it in 2018 with a proposal based on unanimity voting would meet the Government’s concerns. I am afraid it would not. There are two problems with the Irish suggestion. First, agreeing to the current proposal would mean agreeing to QMV voting on an EU tax issue, which would breach a fundamental red line for the UK. Even if this was only a temporary measure, as the idea of a sunset clause suggests, this would set a dangerous and unacceptable precedent. Secondly, it is not at all clear what the “unanimity envelope” mentioned by the Presidency amounts to. If it means the unanimous agreement of a QRM which still involves QMV, then it offers no advance on the current position. If it means the unanimous agreement of a QRM which involves no QMV, this would be more promising, but then we would question the delay until 2018.

On the question of support from other Member States, I see little risk of the UK being isolated in its opposition to the current proposal. We continue to work closely with Germany, and have seen support for our position growing rather than shrink over recent months. The UK submitted a joint note with Germany, Portugal and Luxembourg to the Irish Presidency outlining our objections to the Commission proposal and confirming our willingness to examine together a solution and mechanism based on unanimity. Other Member States - Sweden, Austria and the Netherlands – have expressed frustration at Commission inflexibility and the lack of movement, and have also suggested alternatives that could be explored.

You also asked about the difficulties which other delegations had with the QRM proposal. Italy has objections to the use of the reverse charge as the only anti-fraud measure to be included in the scope of the mechanism. Italy also has strong principled objections, which are shared by Belgium, to the Commission’s Reverse Charge proposal of 2009 for an optional time-limited reverse charge for specified supplies (as modified by the Presidency) and the fact that the Presidency and Commission have linked it to the QRM proposal in a broader package. Spain shares our and Germany’s view that greater consideration must be given to standardised application forms, and it is particularly concerned about maintaining all the Union languages for such applications and subsequent information requests.

Your final question was about the implication of the QRM proposals for the VAT registration threshold (and the level of the threshold across the EU). Given that the QRM proposal involves derogations from the normal VAT rules to allow the use of the reverse charge where there is massive and sudden fraud, it will have implications for VAT registered businesses in the affected sectors, but not for the VAT registration threshold itself. A list of the registration thresholds applying across the EU can be found at:


The attached table [not printed] from the European Commission summarises the thresholds applying across the EU at March 2012, though I note that the figures here are inaccurate for the UK, as its threshold in March 2012 was £73,000. The current UK registration threshold is £79,000.

15 April 2013