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 5 June 2014 - 30 March 2015

ECONOMIC AND FINANCIAL AFFAIRS

(SUB-COMMITTEE E A)

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A REFORMED FINANCIAL SECTOR FOR EUROPE (10197/14)

Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury

Thank you for EM 10197/14, dated 12 June 2014, on the Commission Communication A reformed financial sector for Europe. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 15 July 2014.

We note this overview of the regulatory reforms that have been agreed since the financial crisis erupted in 2008. We agree with your conclusions that the analysis lacks rigour due to the insufficient quantitative data available, coupled with the fact that certain reforms have not yet been implemented, and thus cannot be analysed in the review.

In that context we have chosen to focus a new inquiry into the EU financial sector regulatory framework. Our inquiry will draw attention to some of the areas where conflicting and overlapping regulation give cause for concern, and shall seek to build on the Commission’s work by identifying and highlighting any gaps or inconsistencies in the regulatory framework. We will focus on issues that have been identified by the Commission’s review such as: the resolution of interconnected and systemically large financial institutions as well as ensuring an effective and coordinated approach to supervision and implementation of the regulations. We will also gather evidence on the following areas:

— Which elements of the reforms have been most and least effective in addressing: consumer protection; market efficiency, transparency and integrity; and financial stability?

— How effective are individual pieces of legislation such as the Alternative Investment Fund Managers Directive? What will the impact be of such legislation on the UK?
— How effective has the legislative process been over the course of the financial crisis? Which EU institutions have been most or least effective?
— How can the ‘growth agenda’ and support of alternative financing sources best be promoted by the EU with respect to regulation?
— Are there any overlaps, contradictions or inconsistencies when assessing and comparing individual pieces of the regulatory agenda?
— How can it be ensured that there is an effective and coordinated approach to supervision and implementation of the regulatory agenda?
— Do areas of the regulatory agenda need immediate revision/reform? If so, how might the effectiveness of the review clauses which apply to the new measures be best ensured?
— Whether the Commission is correct in asserting that new and/or forthcoming proposals on Bank Structural Reform, Shadow Banking, Benchmark Regulation and Non-bank Resolution will complete the financial sector reform agenda, and if not, which policy gaps remain?
— Have the needs of consumers of financial services and products been appropriately addressed by the reform process? Do particular risks in relation to consumer protection arise from the reforms?
— Has the ‘too big to fail’ problem been addressed?
— How concerned should we be about the range of unintended consequences from such regulation – such as regulatory arbitrage and transferring risk off balance sheet?
— Is there now an effective balance between Member States and the EU in terms of regulation and supervision of the financial sector? If not, how can such an effective balance be struck?
— Is the EU process for adopting rules efficient and nimble enough to adjust and calibrate the new Single Rulebook? Which single element of the new Rulebook is in most acute need of careful monitoring and review?
— What is your assessment of the impact of the new Rulebook on third-country actor access to the EU and of the approach taken to ‘equivalence’?
— Is there a danger of ‘multiple jeopardy’ arising from the multiplicity of regulatory regimes across the EU and beyond?
— In light of the fact that some of the regulatory framework applies at EU-28 level, and other elements for the Eurozone only, is there a danger of a two-speed or inconsistent approach to regulation?
— What are the challenges of the regulatory reform agenda for non-eurozone Member States? In particular, which specific challenges does the UK face?
— Were financial regulatory proposals improved or weakened by the input of the Council and the European Parliament?
— How can it be ensured that there are mechanisms in place to fine-tune the regulatory system where necessary without disrupting financial stability and predictability for financial users? Should there be a period of calm before further reforms are introduced?
— How has the UK’s approach to the regulatory reform agenda compared with that of other non-eurozone Member States such as Poland and Sweden?
— Overall, do you believe that the UK’s interests have been compromised or enhanced by the programme of regulatory reforms? Has the UK done enough to protect its national interests?

Finally, the Commission document cites the forthcoming review of the European System of Financial Supervision. We are aware of media reports of a leaked draft of the report. Given that the report
was due to be published in late 2013, can you shed any light on why it has been delayed? When do you anticipate that it will be published?

The Call for Evidence for this inquiry has been launched today, and we invite HM Treasury to respond to that consultation. In the meantime we now clear the document from scrutiny.

16 July 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter dated 16 July 2014, on the Commission Communication A reformed financial sector for Europe, the Committee’s new inquiry into the EU financial sector regulatory framework and the Commission’s review of the European System of Financial Supervision.

We welcome your inquiry into the EU financial sector regulatory framework. Many of the areas that this will focus on were raised in the call for evidence to the HM Treasury-led report on financial services and the free movement of capital, which has just been published and forms part of the broader Government review of the Balance of Competences between the UK and the EU. We received around 70 pieces of evidence, including from banks, insurers and other financial services companies, industry groups, consumer organisations, and a number of individuals including MP/MEPs and academics.

The evidence base was also informed and extended through 15 engagement events with around 200 organisations and individuals in the UK and the rest of Europe. A copy of the final report is attached [not printed] to this letter and copies have been placed in the House. I hope that the report and all the evidence submitted, which has been published alongside, provide a useful source for the Committee’s inquiry. I would especially like to draw your attention to the volume of responses and evidence from stakeholders reflecting concerns about the quality and appropriateness of the EU policy-making process on financial services since the crisis. Concerns raised by stakeholders covered many aspects of the process and the HMT report sets out a number of possible ways to improve the standard of financial services regulation going forward.

You also raised some questions regarding the publication of the Commission’s review of the European System of Financial Supervision. It is not clear why this has been delayed, although the cross-cutting nature of the European Supervisory Authorities and the European Systemic Risk Board and the ongoing development of key pieces of financial services regulation in recent months may have contributed to the delay. As to the likely publication date, we expect this to be in July or August 2014.

18 July 2014

APPLICATION OF THE LAW ON CUSTOMS AND AGRICULTURAL MATTERS

(17110/13)

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

Further to your letters of 15 January 2014 and 4 February 2014, I am writing in response to your questions and to provide a general update on the state of play of negotiations on this dossier. I would also like to use this opportunity to inform the Committee of the presence of Justice and Home Affairs (JHA) content in the original Proposal that we have successfully removed.

Following lengthy Council working group negotiations, a text intended to form the basis of the next stage of informal negotiations with the European Parliament was presented by the Presidency to COREPER for endorsement on 24 September 2014. Unfortunately the speed at which this process was conducted by the Presidency, combined with the timings of Parliamentary recess, meant that I was unable to provide members of your Committee with an update before this discussion in COREPER. In addition, I regret that the need to resolve a number of complex legal issues following that discussion in late September has resulted in a further delay to providing you with an update which affords the necessary certainty in relation to the Government’s position on the text. This was a difficult and extended negotiation with conflicting demands and timetables, however I feel strongly that better communication between my officials and the Committee could and should have been maintained. I have taken steps to ensure that the importance of dialogue between Parliament and Government, especially when a scrutiny reserve is held, has a high priority in future matters.
Nonetheless, I would stress that negotiations are still ongoing and that no binding decisions have been reached in relation to the file, nor have ministers been formally consulted in the Council. I would like to assure you that I remain committed to the Parliamentary scrutiny processes, and as such would welcome any further observations from the Committee before the dossier is presented to Ministers.

DEVELOPMENTS IN THE COUNCIL WORKING GROUP

From the outset of negotiations a significant number of other Member States shared our concerns and objectives. Nonetheless, negotiations in the Council took much longer than expected due to the complex and technical nature of the proposal. Working closely with the other ‘like-minded’ Member States, the Greek and Italian Presidencies, and the European Commission, we are now close to securing a compromise text that I am satisfied meets the concerns of industry, fulfils the Government’s negotiating objectives and I hope reflects the Committee’s concerns.

UK NEGOTIATING OBJECTIVES

Although we supported many of the objectives of the proposal, we considered some of the provisions to be disproportionate and/or inappropriate. Our negotiating objectives therefore were to:

— Address our concerns about the unnecessary references to risk management;

— Limit the scope of the Container Status Management database to ease the burden on business, ensuring that reporting requirements did not overly burden private sector entities; and

— Block direct access by the Commission to UK economic entities.

I am pleased to report that all of those objectives are on track to be met.

Additionally, the European Court of Auditors’ (ECA) opinion was taken into consideration by the Council and successive Presidencies and has helped shape the Presidency compromise text on the use and limitations of data. The European Commission has undertaken to consult closely with business representatives when drafting the proposed implementing acts.

My officials have also engaged closely with the UK Chamber of Shipping throughout the Council working group negotiations and as a result secured provisions that satisfy the needs of industry.

On the basis of this Council position, trilogue discussions with the Parliament are now underway and feedback from the Italian Presidency indicates that it is likely a deal can be reached which very closely resembles the preferred Council version of the text. As such, it is probable that the Regulation will be presented to Ministers in the Council for adoption early in the New Year. In that event, the Government intends to support the adoption of the Regulation in Council, subject to the resolution of any outstanding concerns raised by either of the UK Parliamentary Scrutiny Committees.

JUSTICE AND HOME AFFAIRS CONTENT

I must also take this opportunity to inform the committee of developments on this file relating to the presence of a minor JHA provision which unfortunately only came to light at an advanced stage of negotiations. This was found in article 1(4)(a) amending Article 18(b). The text of the provision is reproduced below:

4. Article 18b is amended as follows:

(a) Paragraph 2 is replaced by the following:

‘2. The Commission may make expertise, technical or logistical assistance, training or communication activity or any other operational support available to the Member States both for the achievement of the objectives of this Regulation and in the performance of Member States’ duties in the framework of the implementation of the customs cooperation provided for by Article 87 of the Treaty on the Functioning of the European Union. For that purpose, the Commission shall establish appropriate technical systems.’

This was deemed to fall within Article 87 of the Treaty on the Functioning of the European Union, which covers measures concerning support for the training of staff regarding cooperation between Member State enforcement bodies in relation to the prevention, detection and investigation of criminal offences.
Following negotiations we have been able to secure the removal of the JHA component of this amendment to Article 18(b) from the Council's compromise text without adverse operational impact.

Whilst I am pleased to note that we have now reached a satisfactory outcome from a JHA perspective, I nonetheless regret that this content was not identified earlier and the Committees were not given an opportunity to express an opinion on the UK’s participation with regard to Protocol 21 (the “JHA Opt-in”) of the Treaties within the usual 3-month window.

Steps have now been taken within the department to ensure potential JHA content is identified sooner and I am confident that the new procedures will mean that we do not find ourselves in such a position again.

I hope this further information is useful to the Committee and that it provides sufficient clarification to enable the Committee to lift scrutiny at your earliest convenience.

11 December 2014

Letter from the Chairman to David Gauke MP


We begin by acknowledging that HMRC officials contacted my officials on 29 October 2014 to explain that this update letter would be delayed pending consultation with other Government departments with regard to the JHA issue that you raise. We also acknowledge that they have been in regular contact since then. While we are grateful for this contact, we regret to state that there have been a number of serious breaches of the scrutiny process with regard to this legislative file.

First, we were not informed of the likely COREPER agreement in advance of the 24 September meeting. Given that this document was held under scrutiny at the time, we regard this as a breach of the spirit of the scrutiny reserve resolution. You state that “negotiations are still ongoing and that no binding decisions have been reached in relation to the file, nor have ministers been formally consulted in the Council.” Yet your further statement that “on the basis of this Council position, trilogue discussions with the Parliament are now underway” makes clear that the Council has in fact reached a settled view. In such cases it is vital that the Committee is informed of discussions by COREPER with as much urgency as negotiations by Ministers in Council. It is regrettable that you did not give the Committee advance notice of the likelihood of agreement by COREPER and thus to have given the Committee an opportunity to complete its scrutiny. We also take issue with your justification for the failure to update the Committee. You state that negotiations moved quickly, yet you also state that “negotiations in the Council took much longer than expected due to the complex and technical nature of the proposal.” In such a case we would have expected an update much sooner, in particular given that the Government had not written to us since 28 January 2014. Neither is your reference to the timings of the parliamentary recess any justification. This Committee met on 9 September 2014 and would have stood ready to consider any update either at that meeting or on an expedited basis if clearance needed to be sought.

Unfortunately this was compounded by your failure to write sooner to update us on the outcome of the September COREPER meeting. We accept that you wanted to delay writing to us until the JHA issue had been resolved, and we acknowledge that your officials informed our officials as such. Nevertheless it would have been preferable from the Committee’s point of view to have received an update on negotiations straight away, coupled with a commitment to write again once the JHA issue had been resolved.

Finally, we regret that a JHA provision has again only been identified at a late stage in negotiations. You state that steps have been taken to ensure that JHA content is identified sooner and that you are confident that you will not find yourself in such a position again. However we have been given these reassurances by Ministers before, and the problem continues to occur. What specific steps have you taken to address this recurring problem?

You have kindly agreed to appear before the Committee on 27 January 2015 in relation to the EU budgetary process. We may wish to take the opportunity of your appearance before the Committee to discuss these issues further.
We would be grateful for a response to this letter, including any update on negotiations, by 16 January 2015. In the meantime, given that your negotiating objectives have been agreed, and in order to allow you to support the proposal in Council, we now clear the document from scrutiny. In so doing we wish to put on record our support for the proposal as a valuable means of tackling fraud.

17 December 2014

Letter from David Gauke MP to the Chairman

Further to your letter of 17 December 2014, I am writing in response to your comments and questions and to provide a further update on the dossier.

Firstly I reiterate my apology to the Committee concerning the length of time it took to update you of the outcome of the September COREPER meeting. The decision to delay writing to you was taken based upon the understanding that the outcome of internal deliberations on the JHA issue would have been reached much sooner than transpired. In the event, this understanding was incorrect and I agree that we could have written earlier. More generally, I accept that the handling of scrutiny procedures on this file has been far from ideal and undertake to ensure that a more productive dialogue with Parliament is maintained in future negotiations.

You raise specific concerns in relation to communication before and after the COREPER meeting on 24 September. Following the Government’s correspondence to the Committee on 27 January, there was little progress under the Greek Presidency and no clear indication from the Italian Presidency during the summer that rapid progress would be made. It was not until 9 September that the Italian Presidency made clear it would accelerate the work. It is a matter of regret that you were not updated ahead of the COREPER meeting on 24 September or provided with information as soon as you would have wished on the outcome of that meeting. I have instructed my officials to examine why this did not happen and put in place mechanisms to improve communications. This will include instructions emphasising the need to ensure that your Committee is properly updated in accordance with the relevant guidance. Please be assured that at no time did I or my officials intend to breach or bypass the spirit of the scrutiny reserve resolution.

Finally you have asked what specific steps I have taken to address the recurring problem of identifying JHA content sooner. My officials have engaged with the Cabinet Office team responsible for JHA matters to improve understanding and ensured that the appropriate policy staff and legal advisors have undergone training in JHA awareness. They have also taken steps to enhance communication and engagement between Government Departments with joint responsibility for decisions and instruments where JHA is likely to arise. This includes ongoing consultation with officials from the Home Office, Ministry of Justice and the Foreign & Commonwealth Office to deliver a more unified approach and ensure cross-Whitehall consultation is undertaken at an earlier stage in the development of EU legislation. You may also be aware that the importance of identifying JHA content is a regular issue for discussion amongst the Government’s scrutiny coordinators’ network who enjoy ongoing engagement with your Parliamentary officers. In addition, internally my officials have established a more robust process of checking for JHA content at a policy level in all EU dossiers.

UPDATE ON STATE OF PLAY

Since our last correspondence, we have been informed by the outgoing Italian Presidency that a basis for agreement by Ministers has been reached with the European Parliament at the informal trilogue discussion on 18 December. The resulting compromise text will meet all of the UK’s negotiating objectives as we hoped and is likely to be presented by the new Latvian Presidency to Ministers at the COMPET Council for consideration and adoption within the coming months. As both Parliamentary Committees have now released the document from scrutiny, I can confirm that the Government intends to support its adoption.

I hope this further information is useful and clarifies the process involved in these negotiations.

14 January 2015
Letter from David Gauke MP, Financial Secretary, HM Treasury, to the Chairman

With sincere apologies for the lateness of the hour I am writing to inform you about a unanimity dossier – the amending proposal to the Directive on Administrative Cooperation - that is on the agenda for political agreement at the ECOFIN meeting on 14 October. This Directive, which brings into EU law the new global standard for automatic exchange of tax information, is a political priority for the UK. The last time that your Committee was updated on the Directive was in September 2013. Little has happened on the Directive between then and the final agreement of the new global standard and its detailed commentaries in July of this year following the consensus of OECD countries. This was because the purpose of the Directive was simply to implement the global standard into EU law and until that standard was agreed no real progress could be made in EU negotiations. Since the agreement of the global standard the Italian Presidency has proceeded at great speed with the intention of adoption of the Directive by the end of this year in line with the mandate from the May European Council.

While this dossier has moved very quickly and there has been a limited window between the summer and conference recess, I fully acknowledge that we should have updated the Committee earlier based on our expectation for the final shape of the Directive. I apologise sincerely for that.

As said above, this is an important Directive for the UK. The UK has led on the development of the new global standard on automatic exchange of tax information, including through our G8 Presidency where this was the first of the ten commitments in the Lough Erne Declaration. Global implementation of this standard will largely put an end to offshore tax evasion except by the most determined criminals with important implications for revenue protection and for maintaining the confidence of honest taxpayers in the fairness and effectiveness of our tax system. The main features of the new standard are that it will require the reporting of account balances and account holder details of foreign tax residents, both individuals and entities, for both new accounts and for pre-existing accounts to the country in which the account holder is tax resident. It is largely based on US FATCA but contains important simplifications as a result of the reporting on the basis of tax residency rather than citizenship (which allows the account holder’s address to be the main indicator of tax residency). While we have yet to finalise the impact assessment for domestic implementation we expect the costs to industry to be a small proportion of the FATCA implementation costs. This is based on our experience with our bilateral agreements with the Crown Dependencies and the reduction in burden that will come from the repeal of the EU Savings Directive as explained below.

In addition to our G8 Presidency, the UK has been in the forefront of the development and implementation of this standard on multiple fronts. In April 2013, together with France, Germany, Italy and Spain we launched an initiative aimed at early adoption of the new standard once agreed. Many other countries and jurisdictions have joined this initiative over the past eighteen months. In February of this year we took the further step of announcing a concrete timetable for implementation which will see the standard implemented from the end of 2015 with the first exchange of information between the early adopter countries in 2017. A total of 48 countries and jurisdictions have agreed to implement to this timetable, including 26 EU Member States. The full list and the implementation timetable can be found at: http://www.oecd.org/tax/transparency/AEOI-early-adopters-statement.pdf

While not yet fully public, as a direct result of the lead shown by the early adopter group launched by the UK, almost all major financial centres have now signed up to this timetable or have agreed to exchange one year later. This includes all of the G20 countries which agreed at their September meeting to begin exchanging information automatically in 2017 or by 2018. Switzerland and Hong Kong have also recently publicly announced their intention to begin exchanging information under the new standard from 2018. Two years ago it was unthinkable that we would have made such progress.

The global standard is now being brought into EU law by amendments to the existing Directive on Administrative Cooperation (DAC) - 2011/16/EU. We are fully supportive of this, although our negotiating aim has always been to ensure full alignment of EU law with the global standard. This is something we have also pressed at European Council level and is reflected in the May 2014 Conclusions of the European Council. If we had a situation where there were different, competing standards then this could rapidly lead to fragmentation, increasing the difficulty of agreeing any further improvements over time on a global basis, and would lead to significant and unnecessary burdens on business. We have been successful in this aim and the Directive simply imports the standard into EU law. The one area where there has been some discussion of the standard with the industry is on a
provision in the global standard which exempts the reporting of certain insurance contracts in some situations where a sale is effectively prevented by law. Member States, the Commission and the Council Legal Services did not agree with the industry’s interpretation in the EU context and this is reflected in the final Directive text.

The Directive does not raise any issues of competence (although we had to work hard to remove a provision for comitology in the final meeting last week which had been pushed by the Presidency and supported by other Member States but which would have crossed UK red lines). The Directive is also fully in line with EU data protection law, something we have discussed at length with the Information Commissioner’s Office and which has been considered in depth by the relevant EU Committee.

Following political agreement of the Directive the intention is to give a mandate to the Commission to repeal the EU Savings Directive which overlaps with but is inferior to the new standard and relatively easy to avoid. Repeal of the EUSD and the removing of the unnecessary burdens it would occasion following agreement of the DAC will be welcomed by the UK financial services industry. While the Commission accept the need to repeal the EUSD, this is time critical as unless the DAC is agreed now and the EUSD switched off, we and the financial services industry will have to begin implementation of the amended EUSD which was agreed earlier this year but has not yet been implemented. This would lead to a significant wasted cost. Agreeing the Directive now is also important as regards ensuring implementation to the agreed timetable by all EU Member States. In order to give financial services firms sufficient time to make necessary administrative and IT system changes, they need the certainty of legislative requirements which the Directive brings. Agreement will also send a clear message globally of the need to move quickly from political commitments to legislative implementation.

The one outstanding issue on the Directive which we expect to agree at the ECOFIN is the date of implementation. The 26 Member States which have signed up to our early adopters initiative wish to exchange under the directive from 2017 in line with the early adopter timetable. However two member states which do not currently exchange under the EU Savings Directive (using an option of withholding tax instead) are arguing for an additional year for implementation. Discussions are ongoing but a compromise is very likely to be reached at the ECOFIN which may result in two different implementation dates, one year apart. While this is not our preference this is a unanimity dossier and this may be a necessary compromise to reach agreement. Different dates for two Member States will, however, make little difference to the impact of the Directive given the truly global take up of the standard which removes hiding places and therefore the incentive to move money between countries.

With apologies again for the lateness of this letter, I would be very grateful in the light of the explanation above if your Committee would be able to waive or clear this dossier from scrutiny in time for the 14th October ECOFIN. The officials who lead on this policy area in the Treasury stand ready to provide any further information which would be helpful in your consideration. If it is not possible to obtain clearance to that timetable then I hope that the Committee will understand the reasons why I believe it is important for UK objectives and for the UK’s reputation as the leader in tackling tax evasion for us to give support to political agreement on this dossier at the October ECOFIN.

13 October 2014

Letter from the Chairman to David Gauke MP


It is highly regrettable that this letter was only received immediately before political agreement was sought at the ECOFIN meeting on 14 October 2014. As you yourself state, this is an important Directive that seeks to implement the new global standard on automatic exchange of tax information. We acknowledge the leading role played by the UK in these global discussions, and well recognise why the file is, in your words, a political priority for the UK. Yet this fact makes your failure to update the Committee sooner all the more disappointing. For your obligations to a Committee of the House of Lords to be overlooked in such a high-profile case gives the impression that HM Treasury does not
take the parliamentary scrutiny process seriously. While we note your apology, what reassurance can you give us that all necessary steps are being taken to ensure that such an error is not repeated?

We understand that a General Approach was indeed reached at the 14 October ECOFIN. We would be grateful for a full account of the outcome of negotiations, as well as clarification of the following points.

You state that you have yet to finalise the impact assessment for domestic implementation but that you expect the costs to industry to be a small proportion of the FATCA implementation costs. Can you be more specific? When do you anticipate the full impact assessment to be finalised?

You state that two Member States were arguing for an additional year for implementation. We understand that Austria and Luxembourg are the two Member States in question. What was the reason for their reticence? We would be grateful for details on the outcome of the discussions at ECOFIN on the date of implementation. We understand that Luxembourg agreed to a 2017 implementation date, whereas Austria requested an extension to 2018 on the grounds that it needed to create a new reporting system. Can you confirm this? While we note your statement that this will make little difference to the impact of the Directive, can you be more specific about the practical implications of this discrepancy?

You state that the one area where there has been some discussion of the standard with the industry was on the provision in the global standard which exempts the reporting of certain insurance contracts in some situations where a sale is effectively prevented by law. Can you be more specific about the nature of the disagreement between the Commission and Member States on the one hand, and the industry on the other? Can you clarify if the final Directive text is in line with the global standard in this case?

You will be aware that the Sub-committee agreed on 13 October 2014 to grant a scrutiny waiver. Nevertheless we continue to hold the document under scrutiny pending your response to this letter. We would be grateful for a reply by 4 November 2014.

21 October 2014

Letter from David Gauke MP to the Chairman

May I begin by thanking you for the flexibility of the House of Lords EU Select Committee and its Sub-committee in giving such rapid consideration to my letter of 13 October seeking a waiver for the UK joining the political agreement at the 14 October ECOFIN on the proposed amendment to the Directive on Administrative Cooperation. As set out in my earlier letter these amendments bring the new single global standard on automatic exchange of taxpayer information into EU law and move us closer to the implementation of the new standard on a global basis.

I have attempted to address the further points you raise in your reply of 21 October below and hope the information provided will enable your Committee to clear the dossier from scrutiny which is now expected to be put on the agenda for adoption at the 9 December ECOFIN.

I am pleased to report that political agreement by all Member States was reached at the ECOFIN. In a very welcome development Luxembourg agreed in the final negotiations to the implementation of the amending Directive to the same timetable as had already been agreed by 26 other Member States, removing any need for delayed implementation in its case. This timetable will see the first exchange of information in 2017 in respect of accounts that are open at the end of 2015 and new accounts opened from 1 January 2016.

It was, however, agreed that Austria could have up to a year more for implementation. Austria argued that it needed additional time in order to create “links” between Austrian financial institutions and the Austrian Tax Authority since they do not currently exchange information under the Savings Directive (but have withholding arrangements instead). This is not something that we have ever understood and my officials have engaged with the Austrian Finance Ministry on this on a number of occasions. There is no need for new infrastructure. The information can pass in encrypted form through ordinary secure internet links as we would expect to be the case between Austrian financial institutions and the US tax authorities under FATCA. However, in order to reach agreement by the end of the year, as asked for by the Heads of State at the European Council in May, this compromise was agreed. As you may know, the Austrian Finance Minister stated at the ECOFIN that he would make all efforts to try and meet the 2017 exchange timetable and we are hopeful that as they examine implementation issues further that they will be able to do so.
As I said in my earlier letter, our view is that a difference of one year in implementation will make little practical difference. The main risk that we have been concerned with in our wider and highly successful diplomatic efforts to get all financial centres on a 2017 or 2018 first exchange timetable is the possibility of evaders simply moving their assets between jurisdictions that have announced implementation plans and those that have not. We judge this risk to be minimal where the difference in timetable is just one year. In the meantime, of course, Austria will continue to withhold under the EU Savings Directive in respect of UK taxpayers. (As regards the success of our wider efforts, I have attached an annex [not printed] which sets out the jurisdictions which have made commitments to implement the global standard to a 2017 or 2018 timetable. As you will see this includes virtually all financial centres.)

Finally as regards the ECOFIN, as foreseen in my letter Finance Ministers also agreed to give a mandate to the Commission to repeal the Savings Directive, subject to appropriate transitional arrangements to ensure there is no gap in coverage for Austria or the five EU third countries (Switzerland, Liechtenstein, Monaco, Andorra and San Marino). This will avoid any duplication which would result in increased and unnecessary burdens and costs for the financial services industry. Ministers also called for the existing Savings Agreements with the third countries to be brought into line with the new global standard. The Commission expressed optimism that such agreements would be reached in a very short time frame.

Turning to your other points, the draft impact assessment for domestic implementation will accompany draft legislation to give effect to the new Directive (which will be in line with our planned implementation of the global standard on which HMRC has been consulting). We are aiming to consult on draft legislation by the end of the year.

We expect the costs of implementation of the Directive to be a small proportion of the FATCA implementation costs based on our experience with the bilateral agreements that we reached with the Crown Dependencies and Gibraltar. These agreement were based on FATCA but with some changes to reflect the different circumstances, in particular taxation on the basis of residency. The impact assessment that we published with the regulations for the agreements can be found at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/358566/gib-crown-dep.pdf

As you will see, the estimate for costs on business were £50 million to £110 million. This contrasts with the estimated costs of FATCA implementation of between £1,100 million to £2,000 million: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/357543/itc-regps-2013.pdf

We would expect the implementation of the Directive to result in costs closer to the agreements with the Crown Dependencies and Gibraltar than the estimated FATCA costs. This is because industry will already have made many of the necessary IT and administrative changes in implementing FATCA and the CD/Gibraltar agreements and because of further simplifications to the due diligence process under the global standard. In addition, the switching off of the EU Savings Directive when the Directive comes into force will result in as yet unquantified savings. We will also continue working very closely with industry to minimise costs.

On the question of the discussion of the standard with representatives of the insurance industry I can confirm that the Directive is in line with the global standard. There was difference in interpretation of the commentary to the new standard (a form of guidance) between the Member States and representatives of the insurance industry. The global standard does not require reporting of insurance or annuity contracts where this is “effectively prohibited by law”. The commentary stated that “where the applicable law does not prohibit Reporting Financial Institutions from selling insurance or annuity contracts outright, but requires them to fulfil certain conditions prior to being able to sell such contracts to residents of the Reportable Jurisdiction (such as obtaining a license and registering the contracts), a Reporting Financial Institution that has not fulfilled the required conditions under the applicable law will be considered to be “effectively prevented by law” from selling such contracts to residents of such Reportable Jurisdictions”.

Representatives of the insurance industry had taken this to mean that where an insurance company had not undertaken the administrative steps required under European legislation (Directive 2002/83/EC) then they were effectively prevented by law. This was not an interpretation shared by the EU Member States which negotiated the commentaries in the OECD and which would not have agreed the commentary on the interpretation given to it by industry representatives. A number of
Member States have said that they experience significant numbers of sales to the residents of other EU Member States by insurance companies that have not undertaken the administrative steps and they wish this to be the subject of reporting (as it is in our agreements with the Crown Dependencies). The Commission and the Council Legal Service were also of the view in the negotiations that the administrative steps required by EU law did not amount to sales “effectively being prevented by law”.

I should be clear, though, that HMRC are working closely with all industry representatives on UK guidance on the Directive which should clear up what seem to be a number of misunderstandings about the due diligence required for pre-existing accounts which will hopefully reduce industry concerns about the burdens.

Finally, I apologise again for the delay in keeping the Committee informed and the urgency with which we sought scrutiny clearance. While not excusing it in any way, in this particular instance a number of factors came together which contributed to the oversight. As you kindly acknowledged in our recent meeting, HMT’s record on scrutiny has improved markedly over the last while, and I hope you would appreciate that this was an isolated incident. However, let me assure that we are putting in place further measures on top of our existing systems and guidance (which have held us in good stead for the last two years) to help ensure that this is an incident that is not repeated.

I hope the above answers your questions and that your Committee will be able to clear this dossier from scrutiny. As set out above, we are currently expecting formal agreement to be sought at the ECOFIN meeting on 9 December.

Thank you again for such quick consideration of my earlier request.

26 November 2014

Letter from the Chairman to David Gauke MP


We are grateful to you for this comprehensive response to our letter of 21 October 2014. Nevertheless there are two points on which we would be grateful for further details.

First, you state that the costs of implementation will be closer to that in respect to the Crown Dependencies/ Gibraltar bilateral agreement than the FATCA implementation costs. However this does not provide any useful estimate of the costs given the vast gulf between the costs that you cite. Can you be more precise about the broad range of costs that are expected? We note the draft impact assessment will be brought forward alongside draft legislation, and that you aim to consult on this by the end of the year. We would be grateful to you to keep us updated on the publication of the draft impact assessment and legislation and the launch of the consultation process.

Second, with regard to the problems with the scrutiny process in relation to this legislative file, you state that “we are putting in place further measures on top of our existing systems and guidance … to help ensure that this is an incident that is not repeated”. Can you give more details about the steps you are taking?

We would be grateful for a response to this letter by 16 December 2014. In the meantime we now clear the document from scrutiny.

2 December 2014

Letter from David Gauke MP to the Chairman

Thank you for your understanding in clearing this Directive through scrutiny, and for your letter dated 2 December 2014 requesting further details on Directive 2011/16/EU with regards to the mandatory automatic exchange of information in the field of taxation.

In your letter you ask for more detail on the implementation costs of the Directive and if we can be more precise at this stage on the cost range. Our discussions with industry to inform our assessment remain ongoing. However as these discussions progress officials are becoming more confident that the implementation cost will be closer to the Crown Dependencies figure of £110m.
The reason for this is that the requirements of the Directive have been designed to be very close to the requirements already placed upon them by FATCA and the Crown Dependency (CD) agreements. Whilst the scope of the Directive is wider than FATCA/CD agreements and more financial institutions will need to report, this is mitigated by the large number of institutions who have already implemented a very similar system for the FACTCA/CD reporting. This should reduce their implementation costs significantly.

As you request we will keep you updated on the publication of the consultation response, the draft legislation and the associated impact assessment. We expect the consultation response to be published alongside the draft legislation. Due to the constrained availability of legal resource we expect the legislation to be published in February at the latest.

In response to your request for details of the steps that have been taken on scrutiny process, in addition to our existing systems and guidance, we have put in place a new scrutiny tracking grid, refreshed scrutiny guidance and desk notes and will be providing additional training for officials working on EU business. I am confident that taken together these measures will help ensure that this incident is not repeated.

15 December 2014

BANK RECOVERY AND RESOLUTION (11066/12 12386/10)

Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury


We are grateful to you for your update on developments regarding your attempt to clarify the articles relating to the writedown of capital instruments at the point of non-viability. However we would be grateful for clarification on a number of points. First, why was the oversight not spotted until such a late stage in the negotiating process? What steps are you taking to ensure that such an oversight does not occur again in the future?

Media reports state that the Netherlands, Finland and the Czech Republic all formally objected the UK’s proposal, and that Germany also expressed concerns. What was the specific nature of these objections? Did those Member States share any concerns about the implications for mutual support for failing institutions, in particular in the context of the Single Currency?

Given that the Government’s proposed amendment was not accepted, are you working with the Bank of England to identify a solution to address the issue? What form will such a solution take?

We would be grateful for a response to this letter by 24 June 2014.

10 June 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter, dated 10 June 2014, on the Bank Recovery and Resolution Directive (BRRD).

As you will be aware, negotiations on European Directives can be extremely fast-moving, with new texts arriving on a regular basis. It is of course regrettable that this issue was not spotted until a late stage, making it difficult to address. Now that the Directive has been adopted and published, the Treasury will, in keeping with standard practice, be reviewing the file and assessing lessons learned. That process will include considering how this oversight occurred, and if necessary ensuring procedures are in place to prevent similar incidents in the future.

It is not appropriate to discuss the views which other Member States expressed during Council meetings, and I regret that it is not possible to provide detail beyond what has been suggested in media reports.

Following the agreement of the BRRD, we are now focused on transposition of the Directive. The Government is engaging with the Bank of England to consider any implications for the provision of
state-indemnified Emergency Liquidity Assistance and are optimistic that the issue will be effectively addressed as part of the transposition process.

In July, the Government intends to publish a consultation on transposition of the BRRD. I would be happy to update you at that point.

27 June 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 27 June 2014, on EM 11066/12, the Bank Recovery and Resolution Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 8 July 2014.

We welcome your statement that HM Treasury will be reviewing the lessons learned from this file in order to ensure that similar mistakes are not repeated in the future.

You state that it is not appropriate to discuss the views which other Member States expressed during Council meetings. However our question is justified given that media accounts suggest that the discussion in Council was more contentious than your letter of 11 May 2014 implied, when you stated that “the speed of the process, number of stakeholders and level of technicality and complexity meant that it was difficult to secure sufficient focus on the substance of our proposal”.

While we appreciate that the negotiating positions of other Member States remain confidential, we would be concerned if you were to rely on this principle to refuse to inform us of the different views within the Council on a proposal. As you will know from past experience, this can be done in general terms; it does not require disclosure of details which would compromise a Member State’s negotiating position or undermine the decision-making process of the Council. If the Government now refuses to do so, it will severely restrict our ability to scrutinise these policies effectively, and we will wish to pursue the matter further. So we ask you again to provide us with an outline of the different views in the Council on the amendment proposed by the UK.

We welcome your commitment to update the Committee when the Government publish their consultation on transposition of the BRRD. We would be grateful if this update could address in more detail how the provision of state-indemnified Emergency Liquidity Assistance will be addressed in the transposition process. We would be grateful for a response to this letter by 28 July 2014 at the latest.

9 July 2014

Letter from Andrea Leadsom MP to the Chairman


In my letter of 11 May I wrote to you about the Jurist Linguist process on the BRRD, to clarify the Government’s position in the context of media reports. You responded on 10 June asking questions on the specific positions expressed in private negotiations and on 9 July you asked for broader information on positions and asked again about the specifics of negotiations.

Let me first say that in my 11 May letter, I reflected on the use of state-indemnified Emergency Liquidity Assistance (ELA) across the EU and stated that our view had gained support in technical discussions. More broadly my letter made clear that the changes we requested merely sought alignment with the trigger conditions for bail-in that had already been agreed by Council and with the Basel 3 agreement which requires that capital instruments are written down or converted when a non-viable firm accesses public finances. Secondly, as a number of members of your Committee who have been involved in these types of negotiations are fully aware, the Jurist Linguist process is conducted at a rapid pace, with Member States putting forward technical suggestions and then being asked to take immediate positions on the suggestions of others. Amendments are only accepted when there is unanimous support for them. As stated in that letter, the reason the amendment was not accepted was due to the nature of the decision making process, including its speed, which prevented sufficient focus on the substance of our suggestion.

In your letter, you also ask for an update on how the provision of state-indemnified ELA will be addressed in the transposition process. The Government’s consultation on the transposition of the BRRD has now been published and is available at:
The section on Emergency Liquidity Assistance (ELA) is on p.47. Here, the Government sets out its interpretation of what the BRRD requires in relation to the provision of state-indemnified ELA. In our view, the requirement in the BRRD to write-down or convert relevant capital instruments following the provision of State aid only applies in circumstances where there are losses to absorb, since the BRRD requires that the instruments are written down “in proportion to the losses”. Therefore, when state-indemnified ELA is provided to a solvent bank that does not need to absorb losses or be recapitalised, then write-down is not required.

In cases where a bank is failing to meet its capital requirements, under the State aid guidelines, state-indemnified ELA may be provided for up to two months before burden sharing is required. During this time the bank could be attempting to recover its capital position for example by divesting assets or undertaking a liability management exercise. In such cases, ELA provides the bank with liquidity to enable it to keep operating while it attempts to recover its capital position. ELA does not provide additional capital to the bank. The Government considers that the BRRD should be interpreted similarly where a bank fails to meet its capital requirements but has a recovery plan underway and repays the ELA within two months. If the ELA is not repaid within two months, then burden sharing will be required.

The Government therefore does not consider that it is necessary to place any requirement in legislation for write-down to occur immediately upon the receipt of state-indemnified ELA, and the existing arrangements in the UK can be maintained.

The amendment we sought during the Jurist Linguist process would have made this position clearer. However, we believe that it is still the most reasonable interpretation of the text.

8 August 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 8 August 2014, on EM 11066/12 on the Bank Recovery and Resolution Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 September 2014.

While we note your explanation of the Jurist-Linguist process, we remain concerned that such a significant issue was not spotted until such a late stage when the likelihood of amendments being accepted is so slim. In reply to our query as to why the problem was not spotted earlier, you wrote on 27 June 2014 stating that negotiations can be fast-moving and expressing regret that the issue was not spotted until such a late stage. You also said that HM Treasury would “be reviewing the file and assessing lessons learned. That process will include considering how this oversight occurred, and if necessary ensuring procedures are in place to prevent similar incidents in the future.” Has this review now been conducted? What further details can you give us as to why this oversight occurred, and the steps you have taken to prevent similar incidents in the future?

We may seek to address this point at your appearance before the Sub-Committee on 4 November 2014. We would therefore be grateful for a response to this point by 13 October 2014.

10 September 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter, dated 10 September 2014, on the Bank Recovery and Resolution Directive (BRRD). You requested an update on the “lessons learned” review following the conclusion of the BRRD negotiations.

Our review of lessons learnt has concluded. The problems which occurred in this instance can be summarised as a mixture of human error – the issue was missed during the busy stages of a complex and fast moving process; and political sensitivities which meant that the issue became difficult to resolve due to the sensitive nature of the file, the late stage in the process, and the fact that the issue had been picked up by the media.
Sessions have been held with staff from all relevant parts of Treasury highlighting this example, and it is also reflected in the written guidance issued to staff in relation to managing EU legislative files, to help ensure issues of this nature are minimised in future.

As outlined in my previous letter, the Government believes that existing arrangements for the provision of emergency liquidity assistance can be maintained. Overall, the outcome of the BRRD negotiations was very positive for the UK.

20 October 2014

BROAD GUIDELINES FOR ECONOMIC POLICIES OF THE MEMBER STATES AND OF THE UNION (6813/15)

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


We welcome the four Broad Economic Policy Guidelines identified by the Commission, namely boosting investment, Member State implementation of structural reform, removing key barriers to jobs and growth at the EU level, and improving the sustainability and growth-friendliness of public finances. The text chimes with our own conclusions, set out in our April 2014 update report on the euro area crisis. In that report, we stressed that immense economic imbalances remained between core and periphery Member States. We called on EU leaders to promote growth-friendly policies, and to press on with structural reform and the completion of the Single Market. However we also stressed that creditor Member States had their own obligations to stimulate growth and demand. Does this point also need to be reflected in the Broad Guidelines? We also welcome the focus of the report on the importance of Capital Markets Union. We draw your attention to our new report, Capital Markets Union: a welcome start, published on 20 March 2015.

Notwithstanding this, we would stress that actions speak louder than words. How confident are you that the fine principles set out in this document will be translated into action? Do the Broad Economic Guidelines have any substantive effect on policy-making? For instance, how much heed has been paid over the past five years to the previous Council recommendation on broad economic policy guidelines, agreed in July 2010?

We note the Government's concerns over labour migration and the recommendations on taxation. What amendments to the text would you wish to see, whether in these areas or more broadly?

We note that the text is scheduled to be endorsed by ECOFIN in May, and then to be discussed at the June European Council. Will the Government formally support the text? What position will the Government take in these discussions, in particular if you are unable to secure amendments to the text?

We would be grateful for a response to this letter, together with an update on discussions in ECOFIN, by 26 May 2015. In the meantime, we now clear the document from scrutiny.

24 March 2015

CAPITAL REQUIREMENTS DIRECTIVE (CRD IV) (13284/11, 13285/11)

Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury, to the Chairman

I am writing to update you regarding the recent announcement by the Government to withdraw our legal challenge to various provisions contained within the Capital Requirements Directive (CRD) IV.

As you know, both CRD III and the original CRD IV proposals’ remuneration measures derived from the internationally agreed Financial Stability Board’s (FSB) Principles and Standards for Sound
Compensation Practices. They included policies such as strict limits on guaranteed bonuses and mandatory deferral periods for pay-outs. However, the European Parliament later added a mandatory, EU-wide, ‘cap’ on variable pay at 100% of fixed pay to CRD IV (the ‘bonus cap’). The final text enabled this provision to be increased to 200% subject to a shareholder vote.

The Government has consistently and strongly objected to the bonus cap, arguing that there was no evidence that it would be a disincentive to excessive risk-taking, and that it would instead backfire and lead to an increase in base salaries (and thus fixed costs) at banks. The Government has also argued that EU-based banks would be placed at a competitive disadvantage through being forced to apply these rules on pay globally, and that it would make it harder to claw back bankers’ pay when necessary.

However, despite the Government’s strong opposition, the bonus cap was adopted by the EU as part of CRD IV. Subsequently, and after receiving legal advice, in September 2013 the Government launched a legal challenge in the Court of Justice of the European Union (CJEU) against the bonus cap.

This legal challenge rested upon the following six grounds:

— The contested provisions have an inadequate treaty legal base;
— The contested provisions are disproportionate and/or fail to comply with the principle of subsidiarity;
— The contested provisions have been brought into effect in a manner which infringes the principle of legal certainty;
— The assignment of certain tasks to the EBA and conferral of certain powers on the Commission is ultra vires;
— The identified disclosure requirements in the Capital Requirements Regulation offend principles of data protection and privacy under EU law; and
— To the extent that Article 94(1)(g) is required to be applied to employees of institutions outside the EEA, it infringes Article 3(5) TEU and the principle of territoriality found in customary international law.

On 20 November, the Advocate General to the CJEU published his Opinion on the challenge. While such Opinions are non-binding they are followed in the majority of instances by the Court. Of the six grounds of challenge the Opinion found the first, on treaty base, to be the most cogent but stated that ultimately all six pleas should be dismissed.

While the Government continues to believe that its legal arguments had merits and that the cap could have a damaging effect on financial stability, following consideration of the Advocate General’s Opinion, it decided to withdraw its legal challenge.

This decision was taken on the basis that following the Advocate General’s Opinion it was unlikely that the legal challenge would succeed. By withdrawing the challenge a line has been clearly drawn under the issue and both the Government and the regulators may now focus on addressing issues that have arisen since the challenge was launched.

In particular, the Government will now work with the Bank of England and international standard setting bodies such as the FSB to consider any steps that can be taken to mitigate risks to financial stability arising from higher fixed costs at banks resulting from higher salaries.

In addition, you previously asked about the means of transposition of the remuneration provisions contained within CRD IV. These were transposed through rule changes by the regulators, particularly thorough amendments to the Prudential Regulation Authority (PRA) and Financial Conduct Authority’s (FCA’s) joint Remuneration Code. The final changes are set out in the PRA’s Policy Statement PS7/13 of December 2013.

8 December 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 8 December 2014, on EM 13284/11 & 13285/11, the Capital Requirements Regulation and Directive (CRD IV). The House of Lords European Union Sub-Committee considered this document at its meetings on 16 December 2014 and 13 January 2015.
We note that, following consideration of the advocate general’s Opinion, the UK decided to withdraw its legal challenge to the Court against the variable remuneration provisions in CRD IV. Can you tell us if there is a precedent for the Government withdrawing a legal challenge after the advocate general’s opinion has been delivered, which is the very last stage before judgment is given? What are the cost implications for the UK in withdrawing at this late stage?

You state that the Government and regulators will now focus on addressing issues that have arisen since the challenge was launched. In particular, you assert that “the Government will now work with the Bank of England and international standard setting bodies such as the FSB to consider any steps that can be taken to mitigate risks to financial stability arising from higher fixed costs at banks resulting from higher salaries.” How would you respond to arguments that the threat to stability lies not in the overall remuneration rate but rather in the relationship between variable and fixed pay? In the light of your decision to withdraw the legal challenge, what advice are you giving to UK banks on bonus levels as the bonus season approaches?

We would be grateful for a response to this letter by 28 January 2015.

14 January 2015

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter, dated 14 January 2015, on EM 13284/11 & 13285/11, the Capital Requirements Regulation and Directive (CRD IV).

You ask about precedents for withdrawing legal challenges; withdrawing a challenge rarely takes place, and there are no precedents in the recent past of the UK withdrawing a challenge, however this is fully permissible under the rules of the Court.

To your question on costs, the Treasury spent £43,063.22 on external legal fees relating to our legal challenge to some of the remuneration provisions of CRDIV, in particular the ‘bonus cap’, and we do not anticipate any further expenditure or any cost implications for the UK as a consequence of withdrawing this challenge.

You also ask the Government’s opinion of the argument that the threat to financial stability arises not from overall remuneration levels but from the relationship between fixed and variable pay. I agree that the structure of remuneration is of utmost importance, and this Government has worked to ensure that risk and reward are properly aligned in banking sector remuneration.

Under this Government, the regulators’ Remuneration Code has been strengthened: senior and highly paid bank staff must have at least 40% of their bonuses deferred over at least three years, and at least 50% must be paid in non-cash instruments. Firms must now also be able to reduce or cancel deferred bonus payments to account for poor performance, and from this year firms are now able to claw back bonuses for up to seven years after their award where sufficient information on misbehaviour comes to light.

The relationship between fixed and variable pay is one of the reasons the UK has serious doubts about the efficacy of the bonus cap: a cap on bonuses simply pushes up fixed pay, and in turn fixed costs at banks with implications for stability. Higher fixed pay also limits the amount that can be deferred and clawed back.

This is why the Chancellor wrote to Mark Carney asking the Financial Stability Board to look at how to mitigate the risks emanating from these higher fixed costs.

As to bonus levels at UK banks this year, I would expect banks to show appropriate restraint when setting their remuneration levels, particularly in light of recent conduct scandals and the fines levied by the Financial Conduct Authority as a result.

25 January 2015
Letter from David Gauke MP, Financial Secretary, HM Treasury, to the Chairman


As you are aware, a CCCTB would introduce a single set of harmonised rules for calculating the tax base for taxable profits of companies resident in EU Member States, and allow groups of companies to calculate their total EU-wide consolidated profit for tax purposes. Taxing rights on these profits would be allocated between Member States on the basis of an apportionment formula composed of labour, assets and sales.

The Government’s position on this dossier was expressed in a Reasoned Opinion to the Commission passed in a House of Commons motion on 11 May 2011. The Reasoned Opinion sets out Parliament’s view that the CCCTB proposal contravenes EU principles of proportionality and subsidiarity, and is therefore unlawful. In addition, the Government is not convinced by the economic arguments for a CCCTB. However, the UK will not stand in the way if other Member States want to push forward with the proposal and has committed to engaging constructively in negotiations.

Official-led technical discussion on the Commission’s proposed CCCTB Directive began in May 2011. Following an initial comprehensive read-through of the Directive in the Council Working Group, Member States agreed to set aside the articles dealing with consolidation and formulary apportionment for the time being, and focus on the detail for a common tax base. The Irish, Lithuanian and Greek Presidencies therefore concentrated on issues such as depreciation, intangibles, detailed definitions, and compatibility with the International Accounting Standards. In addition, they led discussions on anti-avoidance, including on a General Anti-Abuse Rule, and generally sought to achieve a common understanding so as to ensure a consistent implementation of the proposal.

Considering that the technical analysis of the tax base was sufficiently advanced to move on to issues related to consolidation, the Italian Presidency focused on international aspects, in particular on issues closely linked to Base Erosion and Profit Shifting (BEPS) such as mismatches, CFC rules and interest deductibility. The current Latvian Presidency intends to continue discussions on this basis.

Negotiations to date have been slow with little willingness among Member States to make substantial progress on the dossier whilst work on the G20/OECD BEPS project is still in progress. However, in light of the international focus on corporate tax avoidance, the CCCTB has received increased attention. In November 2014, the Economic and Finance Ministers of France, Italy and Germany wrote a letter to Commissioner Moscovici calling for tax harmonisation in the EU. The new Commission has interpreted this as a new-found appetite for a CCCTB and, keen to build momentum, has been promoting the proposal as the long-term solution to BEPS issues. Several Members of the European Parliament are echoing calls for progress on the dossier.

I do not believe that a CCCTB would contribute towards tackling BEPS. The proposal was not designed to prevent tax avoidance and it is unclear how it would do this. The system would only apply to the EU and companies could decide whether to opt in or not. This would risk creating mismatches both within and outside the EU, and hence even more opportunities for aggressive tax planning. On the other hand, Member States would be less inclined to sign up to a compulsory system because of the substantial concerns it would raise around tax sovereignty. Moreover, the Commission’s impact assessment suggests that the negative economic impacts of a CCCTB would be greater if optionality were removed. It is, instead, essential that we secure global agreement on the G20/OECD BEPS recommendations due to be published this year as this is the most efficient way to ensure that profits are taxed where they are generated.

The UK will continue to engage constructively in discussions at the technical Working Group level in order to help shape the Directive. Thus far, such engagement has helped to identify and mitigate certain risks to the UK’s competitiveness and tax code that would manifest if a version of the proposal were to be adopted, or if a smaller group of Member States pressed ahead under EU enhanced cooperation rules. For instance, officials have supported amendments to strengthen anti-abuse provisions in the Directive and, together with other Member States, have advocated a closer link to the International Accounting Standards. At the same time, the UK has maintained a scrutiny reservation and made clear that we retain overarching concerns on the proposal. For the reasons set
out in the previous paragraph, the UK will continue to challenge the assertion that a CCCTB would solve BEPS issues.

I hope that your Committee finds the information provided helpful.

16 March 2015

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 16 March 2015, on EM 7263/11: the Commission proposal for a Directive on a Common Consolidated Corporate Tax Base. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 24 March 2015.

While we are grateful for this update, and while we appreciate that progress on negotiations has been slow, we are disappointed that this is the first update we have received in over three years. We would be grateful for an update at the end of each Presidency term from now on. You state that the May 2011 Reasoned Opinion set out Parliament’s views on the proposal. We would remind you that the Reasoned Opinion set out the House of Commons’ view, rather than that of the UK Parliament as a whole, since the House of Lords did not issue a Reasoned Opinion.

Turning to the detail of the document, we note that agreement remains distant, in particular given that unanimity is required. You state that the Government is not convinced by the economic arguments for a CCCTB. Have you consulted UK businesses with pan-European operations on whether they would wish to adopt a CCCTB, if the option were available to them? You state that you would not stand in the way if other Member States want to push forward with the proposal. Does this indicate that the UK will oppose any EU-28 agreement, but will not oppose any decision by a smaller number of Member States to take forward the proposal under the enhanced cooperation procedure? How likely is it that supportive Member States will adopt such a course in the event that unanimity cannot be reached? Does the statement by the economic and finance ministers of France, Germany and Italy suggest that such a course of action is now more likely?

We note that the UK’s engagement in negotiations has helped to identify and mitigate risks to the UK’s competitiveness and tax code if a version was adopted or if a small group of Member States pressed ahead. What specific risks did you identify? Will you heed the arguments we have repeatedly made in relation to the Financial Transaction Tax, that the UK needs to be alive to the risks that a proposal pursued under enhanced cooperation could entail for the UK, and be ready to vote against authorisation of the enhanced cooperation procedure if necessary?

We note your arguments that a CCCTB would not solve Base Erosion and Profit Shifting (BEPS). However, would the greater inherent transparency not make them easier to tackle? How confident are you that global agreement on the G20/OECD BEPS recommendations can be reached, and that they would be implemented?

We would be grateful for a response to this letter, together with an update on negotiations, by 26 May 2015.

24 March 2015

CUSTOMS INFRINGEMENTS AND SANCTIONS (17949/13)

Letter from the Chairman to Nicky Morgan MP, Financial Secretary to the Treasury, HM Treasury


We are grateful to you for this update, and in particular for helpful sight of the joint letter from the UK, German and Dutch Finance Ministers to the Greek Presidency, expressing your concerns. Having previously exhorted the Government to maximise their efforts to work with other Member States in common cause, we congratulate you on this positive and innovative approach.

We note that the Greek Presidency has suspended article-by-article discussion of the proposal, but that the Commission is nevertheless seeking further discussion. We would be grateful for further
updates once the next steps become clear. In the meantime we will continue to hold the document under scrutiny.

10 June 2014

DRAFT AMENDING BUDGET NO.2 TO THE 2015 DRAFT BUDGET (5467/15, 5469/15)

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


We acknowledge that the Commission proposal for the amending Regulation laying down the MFF for 2014-2020 and DAB2 are necessary to enact Article 19 to allow approval and re-profiling of the programmes that could not be adopted in 2014. The Commission Communication states that some 300 programmes could not be adopted in 2014.

We understand that the Commission is proposing only to make adjustments to the cash flow of the 2015 General Budget and transfer any partial commitment appropriation sums to later years in the MFF. Since the overall ceiling commitments for the current MFF and the payments remain untouched, we note your support in Council for both DAB2 and the amending Regulation on the MFF.

Do you expect there to be any impact to investment, growth and jobs in the short term due to the 300 unapproved and thus non-adopted programmes in 2014? At the same time, will there be any likely negative effects arising from programme implementations due to the disruption in the timings of approvals? Lastly, are there any unintended consequences for Member States in agreeing to this transfer of commitment appropriations? Can you confirm whether this unfortunate delay in programme implementation will actually help to cool any recent backlog of increased payment appropriations that may have occurred, as was evident in 2014?

We would be grateful for a response to these questions by 17 February 2015. In the meantime, noting that the documents are shortly to be discussed at COREPER, we now clear the documents from scrutiny.

3 February 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter, dated 3 February 2014, on the above-mentioned documents.

In your letter, while clearing the documents from scrutiny, the Committee asked several questions concerning the expected impact of both the proposal to re-profile annual commitments ceilings and the accompanying Draft Amending Budget (DAB).

Your letter asked whether we expect there to be any impact to investment, growth and jobs in the short term due to the delays to the adoption process. Although programmes awaiting approval cannot be formally adopted until all Member States agree to the re-profiling of annual commitments ceilings, we do not anticipate the delay to the adoption process will impact on investment, growth and jobs in the short term. Under the 2007-2013 programming period, Member States had two years in which to spend annual Structural Funds allocations (the ‘de-commitment rule’). As a result, many 2007-2013 programmes across the EU will continue to spend remaining 2013 allocations until the end of 2015. Gaps in funding should therefore be avoided.

Your letter also asks whether there will be any likely negative effects on programme implementation due to the disruption to the adoption process. The Commission has stated that the majority of programmes that were not adopted in 2014 and did not qualify for the carry-over procedure would likely not have been adopted until March or April 2015 at the earliest. Article 19 sets a deadline of 1 May 2015 for Member States to agree to the re-profiling of annual commitments ceilings. Therefore, the majority of programmes will at most experience a one to two month delay. In addition, the Commission has stated that it is prepared to approve informally programmes which, in the coming
months, are deemed ready for adoption but must wait until the re-profiling of annual commitments is finalised before formal adoption. Once informally approved, Managing Authorities will be able to begin the tendering process, publishing and promoting the first calls for projects. For these reasons, the process of re-profiling annual commitments ceilings will have little impact on the implementation of outstanding programmes.

Your letter questions whether there are any unintended consequences for Member States in agreeing to the transfer of commitment appropriations. First and foremost, the re-profiling of annual commitments ceilings will not affect in any way the overall size of the MFF deal, both in terms of commitments and payments. As a practical solution, agreed as part of the MFF deal, to enable the timely adoption of programmes that were not approved in 2014, we do not anticipate any unintended consequences resulting from this procedure.

Lastly, your letter asks whether the delay in programme implementation will help to cool the recent backlog in payments. Whereas the backlog of payments experienced in 2014 related to payments for 2007-2013 programmes, the procedure proposed in the above-mentioned documents concerns commitments for 2014-2020 programmes. As we expect that the proposed re-profiling of annual commitments ceilings will have little impact on the implementation of outstanding programmes, we do not anticipate that the delay in programme implementation will affect the recent backlog in payments.

16 February 2015

EU BUDGET FOR 2014/2015 (DAB3/2014) (10340/14, 15444/14)

Letter from the Chairman to Nicky Morgan MP, Financial Secretary, HM Treasury

I am writing with regard to COM (2014) 329 FINAL, Draft Amending Budget No 3 (DAB 3) to the General Budget 2014. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 10 June 2014.

We understand that your EM on this proposal is shortly to be received. However, given the importance of the document we have taken the decision to write to you at the earliest opportunity.

The Commission defends this proposal on the grounds that budgetary pressures make recourse to further funds unavoidable. In light of the significant figures involved, we would be grateful for your detailed response to the Commission’s assertions, as follows.

What is the principal cause of such a large amendment being proposed? Is it the backlog of unpaid payments from the previous MFF period, the front-loading of the current MFF, unforeseen circumstances, or a combination of all three?

Given that the Contingency Margin is defined as “a last-resort instrument to react to unforeseen circumstances”, is the Commission’s proposal to resort to it as “the only available instrument to react to the budgetary impact of unforeseen circumstances” justified? Is it justified in seeking to mobilise the Contingency Margin for 2014 in full? Can you confirm reports that the UK and seven other Member States have written to assert that “a proposal for the mobilisation of the contingency margin in 2014 would not only be legally questionable but also unnecessary, premature and not a ‘last resort’ option”? What is the basis for this assessment, and in particular your argument that recourse to the contingency margin is legally questionable?

The Commission repeatedly cites a major shortage of payment appropriations as a justification for the proposal. It notes that shortages of payment appropriations are visible across all headings, and that there is a sizeable backlog of unpaid payment claims for 2007-13 programmes, amounting to €23.4 billion in Heading 1b (Economic, Social and Territorial Cohesion). Is the Commission correct to identify this as a problem? Why has it occurred on such a scale? What can be done to provide a long-term solution that would avoid recourse to such significant budgetary revisions as this? If funds have already been committed, for instance to ERDF recipients in Member States including the UK, where do the Government believe such funds should be drawn from, if not from the Contingency Margin?

The Commission notes six sets of unforeseen circumstances which it argues justifies calling on the Contingency Margin, including frontloading of various programmes; a top-up for the Fund for European Aid to the Most Deprived (FEAD); a large number of outstanding cohesion policy payment claims; rural development; European Fisheries Fund; and the financial package of support for Ukraine. While we accept that the ramifications of recent events in Ukraine could not have been anticipated,
do you share our scepticism that all the other circumstances cited by the Commission were entirely unforeseen? If our scepticism is justified, why were such problems not taken into account in previous budgetary negotiations?

The Commission states that it has taken into account the “extremely limited” possible sources for redeployment. However it appears only to have identified €65 million from the reserve for Sustainable Fisheries Partnerships Account that can be reallocated. Do you share our view that it is unlikely that all possibilities for redeployment have been exhausted? If so, which other areas would you identify as potential targets for redeployment?

Do you share our concern about the Commission’s warning that it may also have to propose the mobilisation of the Contingency Margin for 2015 at a later stage? Is the Commission’s warning that offsetting the Contingency Margin in 2016 “would be imprudent” a tacit admission that it will also need to be mobilised in 2016? In light of this, is it realistic, as the Commission asserts, to expect the offsetting to be distributed over the years 2018-2020, because such additional payment needs “are to a significant extent compensated by lower payment needs in later years of the 2014-2020 MFF”? What will happen if this does not prove to be the case?

In our letter to the former Financial Secretary to the Treasury, Rt Hon Greg Clark MP, on 24 July 2013, we asked if he could give any guarantee that the 2014 Draft Budget would not be subject to significant further amendment. We expressed concern about the effect on budgetary discipline of the decision to provide flexibility between years. We also warned that the relationship between payment and commitment appropriations had broken down. At his appearance before the Committee the previous day, we warned that in the deal secured on the MFF, there may be the potential for problems in the future in terms of front-end loading, which would increase the pressure on the budget. In our 15 October 2013 letter to his successor, Rt Hon Sajid Javid MP, we drew attention to the potential for, and consequences of, front-loading of annual budgets under the MFF, and suggested that the headline deal achieved in 2013 was therefore not as good as at first sight and had not addressed fundamental problems.

Noting that the Commission specifically cites front-loading as one of the “unforeseen circumstances” that have necessitated this budgetary amendment, do you agree that this proposal has borne out our predictions? What do such apparently intractable problems indicate about the efficacy of the EU budgetary process? Do they demonstrate that the mechanics of the process are no longer fit for purpose and need to be significantly overhauled? If so, how can the process be reformed to ensure that the budgetary process does not repeatedly and irretrievably break down?

We would be grateful for a response to these questions, as well as a full account of the timetable for negotiations on the proposal, by 24 June 2014. We also look forward to discussing these issues both with yourself and the Commission in the context of our forthcoming scrutiny of the Draft Annual Budget for 2015. In the meantime we will hold this document under scrutiny.

10 June 2014

Letter from Nicky Morgan MP to the Chairman

Thank you for your letter asking detailed questions on the Draft Amending Budget No.3 to the General Budget 2014 (DAB3/2014). As you acknowledge in your letter, you wrote in advance of receiving the Government’s Explanatory Memorandum on DAB3/2014 – and this EM, which has subsequently been sent, sets out the Government’s overall position.

The current timetable of negotiations has not changed since the submission of the EM. It remains unclear when the Presidency will return the proposal to Budget Committee for further discussion. The negotiation on DAB 3/2014 may be taken forward in parallel with the wider discussions on the draft annual budget for 2015, which will follow the usual timetable over the second half of 2014.

In your letter, you begin by asking the cause of the size of the Commission’s proposed amendment. The Commission’s argument is based on all the points you suggest in your letter. The Commission cite the unpaid payments from the previous MFF period and front-loading of the current MFF as reasons for why they need more money now. They also make the claim that both of these were “unforeseen” at the time of the agreement to the MFF ceilings. In addition, they present some other elements of the request as purely “unforeseen”, such as the funding for Ukraine.

You ask whether we accept the Commission’s rationale for requesting mobilisation of the Contingency Margin (“CM”), and also about the joint statement issued on the CM with other Member
The Government does not agree with the Commission that the CM is “the only available instrument to react to the budgetary impact of unforeseen circumstances”.

As set out in the Government’s EM on DAB3/2014, the Government’s view is that the Commission should always look first to reallocate funds from within existing agreed budgets to meet emerging in-year pressures, rather than coming to Member States with requests for additional money.

The UK signed a joint statement along with seven other Member States – Germany, Sweden, Denmark, Netherlands, Finland, Austria and France – and it is included in an annex [not printed] which sets out the jurisdictions which have made commitments to implement the global to this letter for your information. This was prepared in advance of the publication of DAB3/2014, and as such addressed expectations (namely the mobilisation of the CM to meet commitments dating from before this MFF) rather than the actual content of DAB3/2014. Having said this, the sentence which you highlight in your letter is fully in line with the Government’s current position on DAB3/2014, as expressed in the EM, and is based on the same assessment – i.e. that the Commission should always look first to reallocate funds from within existing agreed budgets.

In terms of the specific point you make around the argument that the mobilisation is “legally questionable”, the Government does not have a definitive legal position on this issue. One potential argument could say that, given the CM may only be mobilized “as a last-resort instrument to react to unforeseen circumstances”, payments for pre-2014 commitments by definition cannot be considered as “unforeseen circumstances” and thereby are not a legitimate premise for mobilisation of the CM.

The inclusion of this argument in the joint statement reflects that this was one of several issues being considered by the signatory Member States in questioning whether the Commission should be mobilising the CM at this stage. The Government’s primary position on DAB3/2014 is not a legal one but the principled position set out in the EM and reiterated above.

You ask several questions about the backlog of unpaid payment claims under heading 1b, and what the Government feels should be done about this. First, the Government recognises that this is an issue that has to be addressed, insofar as it represents a pressure on the EU budget in this and in future years. The Commission states that it has arisen as a result of Member States submitting claims in 2013 around €10bn (£8bn) above those from 2012.

In terms of a long-term solution, the Government does not accept that significant budgetary revisions are required. These claims represent one pressure which has to be managed by the Commission alongside many other pressures. This should be done in a manner which sees real budgetary restraint, in this and in future years, and the solution need not be higher budgets. The Government has not given the Commission specific instructions as to where in the budget these funds should be drawn from, but in general feels that the Commission should look to areas which are under-implementing and which represent poor value for money if re-allocation is required.

You list several of the programmes which the Commission suggests represent examples of “unforeseen circumstances”, and voice scepticism over whether these, with the exception of payments relating to Ukraine, should be regarded as genuinely unforeseen. I agree that it is unclear why many of these pressures should not have been anticipated by the Commission.

You also ask why these problems were not taken into account in past budget negotiations. The Commission should have made better provision for them in compiling the detail of the 2014 budget, insofar as they were aware of these pressures. I do not think that the emergence of these pressures indicates that the Government should have taken a different approach to the budget negotiations, which were informed by our commitment to payment restraint.

You express scepticism that the Commission have exhausted all possibilities for redeployment as alternatives to bringing forward DAB3/2014. The Government shares this view, in particular given that, as you point out, the Commission have found only €65m in potential reallocations. In terms of where such funds should be found, as stated above, the Government has not given the Commission specific instructions, but in general feels that the Commission should look to areas which are under-implementing and which represent poor value for money.

The Government has put its views on DAB3/2014 clearly and repeatedly to the Commission and other Member States, initially via the joint statement and subsequently in the official-level Council Budget Committee and other meetings. In doing so, we have been supported by the other Member States which signed up to the joint statement.
You then express a longer-term concern that the Commission are planning to mobilise the CM repeatedly in future years, raising questions about whether these funds could be offset at the end of the MFF period. You refer to previous letters and comments made by the Committee raising concerns that the scope for “front-loading” annual budgets via the use of the CM rendered the MFF “not as good as at first sight”. Finally, you ask whether these issues demonstrate that the mechanics of the EU budget process are no longer “fit for purpose” and are therefore in need of significant reform.

I agree, in a general sense, that the Commission are likely to continue to come forward with significant requests for funds in future years – their recently published draft budget for 2015, an EM on which you will be receiving alongside this letter, is evidence of this trend. It is clear that significant front-loading into the first few years of the MFF (i.e. via multiple annual budgets at the payment ceilings and mobilisations of the CM) would impose pressure on later years of the deal.

The Government does not accept, however, that these recent developments have in any way demonstrated that the MFF is “not as good as at first sight”. The MFF agreed last year delivered the first ever real terms cut to the EU budget. The MFF deal included provision for the CM to operate as a mechanism to move expenditure between years but within the overall MFF ceiling. The fact that the Commission have chosen to request the mobilisation of the CM in the first year does not in itself indicate that the MFF and the mechanics of the EU budget specified within it are unfit for purpose.

The Government is very clear in its support for budgetary restraint in the EU, and is mindful of the importance of a continued strong position to ensure the successful delivery of the historic MFF deal. This is why the Government has taken a clear stance in the annual budget 2015 negotiations that there should be a significant margin between the budget and the annual ceiling, and more generally takes the view that, when in year pressures emerge such as the current DAB3/2014 request, the Commission should always look first to reallocate funds from within existing agreed budgets rather than coming to Member States with requests for additional money.

It is also worth recalling that Commission proposals can be blocked on a qualified majority vote basis, and that initial Commission proposals, such as draft annual budgets, are invariably reduced through negotiations with Members States ahead of final budgets being agreed.

The initial responses given to the Commission by the Government and by other Member States on the draft annual budget 2015, in addition to DAB3/2014, demonstrate that such large requests from the Commission are not something that will be accepted as usual practice. I intervened at Ecofin last Friday to set out the Government’s objections to the Commission’s annual budget proposal, and was supported by a number of other Member States including Germany, the Netherlands and Sweden.

25 June 2014

Letter from the Chairman to Nicky Morgan MP

Thank you for your EM, dated 25 June 2014, on the 2015 Draft Budget, EM 10340/14 & 10341/14, dated 16 June 2014, on Draft Amending Budget 3 (DAB3) to the 2014 Budget, and your letter, dated 25 June 2014, on the same. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 8 July 2014. In doing so we took account of the evidence heard on 24 June 2014 from Nadia Calviño, Director General, DG Budget (BUDG), and Silvano Presa, Director, DG Budget (BUDG), European Commission, and your own evidence before the Sub-Committee on 1 July 2014, for which we are grateful. We are also grateful to you for ensuring that the Committee had sight of the EM on the 2015 Draft Budget in advance of the evidence session.

The DRAFT 2015 BUDGET

The Commission states that it is proposing a 2.1% increase in commitments (to €145.6 billion) and a 1.4% increase in payments (to €142.1 billion) for 2015. We agree with you that, in doing so, the Commission is not comparing like with like, since its comparison assumes that DAB3 will be agreed as proposed. In comparison with the 2014 Budget as agreed, the Commission is, as you state, proposing a 4.9% increase in payment appropriations.

We also agree with you that in any sound budgetary process there should be a margin between the agreed budget and the annual ceiling. As you state, unforeseen pressures can and will emerge, and we note your view that past precedent suggests that the margin needs to be several billions of euros. As
we explore below, the absence of such a margin is one indicator of the immense strain that the budgetary process is now under.

Having said that, your observation that the proposed level of payments expenditure “is too high” over-simplifies the problem. You state that you do not intend to plan the Commission’s budget in detail for them. While we agree with you that the Commission has a responsibility to explain why such an increase is proposed, in making your assertions it is more convincing for the Government and the like-minded Member States (you cite Germany, the Netherlands and Sweden) to make concrete proposals as to how the 2015 Draft Budget can be trimmed. In your EM and in your evidence before us, you suggested that savings could be made under Heading 1a (Competitiveness for Growth and Jobs), Heading 1b (Economic, Social and Territorial Cohesion), Heading 2 (Sustainable Growth: Natural Resources), Heading 3 (Security and Citizenship) and Heading 5 (Administration). In your evidence before us, you identified the school fruit scheme under Heading 2, the Marco Polo II programme and cuts to the administration budget, but were unable to give precise details as to the amounts involved. In the absence of such information we remain doubtful as to the scale of the reduction in payments that such cuts would amount to. We would therefore be grateful for clarification as to the specific ways and amounts in which payment appropriations in the 2015 Draft Budget can be cut. Is your statement that savings can be made under Heading 1a compatible with your assertion that greater focus on this heading is a positive step? Overall, how much of the 4.9% increase can realistically be trimmed?

Nadia Calviño observed that the new MFF focuses “as much as possible [on] the headings that contribute more to growth and jobs: innovation, infrastructure and all the things to do with setting the basis for the future of Europe.” We agree with you that the increase in funding in Heading 1a (Competitiveness for Growth and Jobs) is a step in the right direction. It is regrettable that the constraints of the agreed Multiannual Financial Framework for 2014-2020 mean that it is only a small step. As we set out in our 2011 and 2012 reports on the MFF, reform of the Common Agricultural Policy (CAP) is imperative, and far greater efforts must be made to reduce the CAP’s budget and to begin phasing out direct payment to farmers. A further reduction in the CAP’s budget would allow the MFF to focus funding on areas that will support growth and encourage innovation. Notwithstanding the fall in CAP spending in the new MFF overall, we regret that Heading 2 (Sustainable Growth: Natural Resources) remains as much as 40% of the overall Budget. The size of the CAP budget means that the capacity for the EU to promote growth, jobs and competitiveness, which many would argue is more important, will continue to be hamstrung.

Taking into account the constraints of the MFF deal, in which specific ways do you believe that the EU Budget should be targeted in this and future years to ensure that economic recovery and growth is sustained in the years ahead? Is enough being done to focus spending on Heading 1a (Competitiveness for Growth and Jobs), or are we at the limit of what is realistically achievable under the current MFF deal?

**DRAFT AMENDING BUDGET 3 (DAB3) TO THE 2014 BUDGET**

In addition to the 2015 Draft Budget, the Commission has made a request for additional payments of €4.7 billion, albeit it argues that this will be offset to some extent by increased revenue and by transferring the remnants of last year’s budget. As such, the Commission argues that, in terms of its absolute size, it is a relatively small draft amending budget. For our part, we fear that the size of DAB3 calls into question the overall effectiveness of the budget-making process and that there is a significant cash flow problem. Do you share this analysis?

We note that the Commission justifies the request on three grounds: first (and most significantly), the backlog of bills for programmes and projects that have been pre-financed by Member States, including a backlog of cohesion policy payments amounting to €23 billion; second, the frontloading of programmes; and third, unexpected events such as the EU’s actions in Ukraine. Like you, we are sympathetic to the Commission’s actions in the latter case, although we note your observation that the Commission has already found the resources for disbursal of €250 million for Ukraine. However the key questions of the acceleration of payments and the frontloading of programmes deserve to be analysed in more detail.

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BACKLOG OF PAYMENTS

On the backlog of payments, the Commission states that the problem has arisen because of the speed of expenditure, and in particular because the rhythm with which bills have come in has been unexpected. Silvano Presa told us that “the forecast for Member States turned out to be much more accurate than before”, in part because Member States sought to spend money quickly because of the automatic decommitment of funds after two or three years. Nadia Calviño added that the UK Government had announced that €1.3 billion of bills would be coming from the UK to be paid. Does the Commission’s explanation tally with your own understanding of why such a massive backlog has built up? What is the explanation for such a large payment request being made by the UK? You state that it is unclear why the Commission did not anticipate many of these pressures and that the Commission should have made better provision for them in compiling the detail of the 2014 Budget, insofar as it was aware of them. To your knowledge, did anyone within the EU institutions or Member States anticipate these problems or urge the Commission to adjust the Budget at the time? Is the fact that the scale of this problem appeared not to have been anticipated an indictment not only of the Commission, but also of the Council and the European Parliament, as well as the budget-making process as a whole?

We welcome your statement that the growing backlog of payments is an issue that needs to be addressed. However, when we asked you to identify a long-term solution to the problem, you stated only that “the solution need not be higher budgets. The Government has not given the Commission specific instructions as to where in the budget these funds should be drawn from, but in general feels that the Commission should look to areas which are under-implementing and which represent poor value for money if re-allocation is required.” As set out below, we share your view that the Commission should look first to redeployment, and that further sources for redeployment other than the €65 million thus far pinpointed by the Commission need to be identified. However, the sheer scale of the problem cannot be tackled by redeployment alone. Is your own statement that the Commission should look first to redeployment to meet some of the commitments a tacit admission of this fact?

In light of this, is it not incumbent upon the UK and like-minded Member States to assist the Commission in identifying a long-term solution to the issue, not least given that €1.3 billion of bills pertaining to the UK remain outstanding? In seeking to identify solutions, will you need to move from generalities to specifics? Do you agree that the EU budgetary process is groaning under the weight of such seemingly intractable problems? In light of this, what assurances can you give us about the efforts that the UK and like-minded Member States are making to tackle this growing problem? Can the issue really be addressed without resort to significant budgetary revisions?

FRONTLOADING

On the frontloading of programmes, the Commission told us that there was a political decision to advance the payment of programmes that would boost growth and employment, and that this decision was supported by the UK. You confirmed that this was the case, and that the Government continue to support the frontloading of such programmes as Erasmus, the youth employment initiative, COSME and Horizon 2020 in the MFF as a reflection of the Government’s priorities in supporting growth and competitiveness. You state that “it is clear that significant front-loading into the first few years of the MFF … would impose pressure on later years of the deal”, and that the Prime Minister was well aware of the implications of the decision to frontload. Yet at the same time you point out that “when the Council negotiated the seven-year multi-annual financial framework it did not specify the detail of how it would work.” This was surely a mistake on the Council’s part, adding weight to our view that the UK and other Member States took insufficient account of the pressures that frontloading would create on the budgetary framework at the time the decision was made. Silvano Presa told us that if estimates do not prove as accurate as they should be between now and 2020, “the difficulties will lie with other programmes and adjustments will need to be made. The risk has, in a way, been transferred to other programmes within the general framework.” Are you confident that it will be possible to offset such spending in future years? Will it be possible to return to a more orthodox understanding of the purpose of a contingency margin in the future? What will be the outcome for the overall MFF if the pressure on the later years of the budgetary framework becomes untenable? Is there a danger that the overall MFF deal will unravel?
THE CONTINGENCY MARGIN

The Commission has asserted that it is proposing resort to the Contingency Margin only as a last resort, and that it will continue to seek opportunities for redeployment within the existing budget proposals. While we welcome the Commission’s commitment to “continue this effort for the remainder of the year”, we are disappointed that the message from the directors-general is that “it does not look as if there is going to be a big margin for other reallocations in the remainder of the year”. We urge the Commission to redouble its endeavours to locate further sources of redeployment, and welcome your efforts to encourage the Commission to do so. However, we reiterate that redeployment on its own will not deal with the magnitude of the problem. Thus the question of the Contingency Margin inevitably comes into play.

Nadia Calviño told us that “all the parties were aware of the challenges of these budgets, but the European Commission said at the time … that the budget can be implemented if we are able to use the margin of flexibility that has been embedded in it. If we are able to use the contingency margin and advance the payments, and if we are able to use the special instruments et cetera, then we can implement the tasks that are entrusted to the European budget. They knew the consequences. That is why the European Council also signed up to the need for flexibility when implementing the yearly budget within the ceilings of the multiannual financial framework.” Is this an accurate description of the MFF negotiations? If so, should the Council not have foreseen the inevitability of the Commission’s recourse to the Contingency Margin? Is this another example of a failure of the budgetary process?

The Joint Statement by eight Member States, including the UK, stated that “a proposal for the mobilisation of the Contingency Margin in 2014 would … be legally questionable”. However the Commission maintains that the proposal is legal, stating that “the existence of ‘unforeseen circumstances’ that may justify the mobilisation of the Contingency Margin to cover additional payment needs has … to be assessed against the state of play in February 2013 when the MFF payment ceilings were first established.” Your own letter of 25 June 2014 appears to cast doubt on the strength of the joint statement’s argument when you state that “the Government does not have a definitive legal position on this issue”, that “this was one of several issues being considered by the signatory Member States in questioning whether the Commission should be mobilising the CM at this stage”, and that “the Government’s primary position on DAB3/2014 is not a legal one but [a] principled position”. In your evidence to us, you went further, stating that “’legally questionable’ does not mean ‘illegal’; it means that there is a form of words in relation to ‘unforeseen’ and ‘as a last resort’, and we are not convinced that what is proposed meets that definition. That does not necessarily mean that it is ‘illegal’”.

In our view, to counter the Commission’s assertion that recourse to the Contingency Margin is a last resort because the Global Margin for Payments is not available, you would have to demonstrate the availability of a viable alternative to the Contingency Margin for the sum requested. Without this there is no basis on which the Court of Justice could impugn the Commission’s justification that using the Contingency Margin is a last resort. The argument employed in the Joint Statement, and repeated in your letter, that “payments for pre-2014 commitments … cannot by definition be considered as unforeseen circumstances” is not credible in our view. There is nothing in the term “unforeseen circumstances” in paragraph 1 of Article 13 of the MFF Regulation that could be construed to preclude such circumstances arising in the year before the additional appropriations need to be paid, so long as they were unforeseen. It is quite possible for pre-2014 commitments to lead to further expenditure than foreseen in 2014, such as the under-estimation of the backlog of payments under the Cohesion policy.

In light of this, do you stand by the Joint Statement’s assertion that resort to the Contingency Margin is a last resort because the Global Margin for Payments is not available, you would have to demonstrate the availability of a viable alternative to the Contingency Margin for the sum requested. Without this there is no basis on which the Court of Justice could impugn the Commission’s justification that using the Contingency Margin is a last resort. The argument employed in the Joint Statement, and repeated in your letter, that “payments for pre-2014 commitments … cannot by definition be considered as unforeseen circumstances” is not credible in our view. There is nothing in the term “unforeseen circumstances” in paragraph 1 of Article 13 of the MFF Regulation that could be construed to preclude such circumstances arising in the year before the additional appropriations need to be paid, so long as they were unforeseen. It is quite possible for pre-2014 commitments to lead to further expenditure than foreseen in 2014, such as the under-estimation of the backlog of payments under the Cohesion policy.

In light of this, do you stand by the Joint Statement’s assertion that resort to the Contingency Margin would be legally questionable? How would you respond to the suggestion made at the evidence session that a more effective approach would be to make sure that the inevitable increase in the budget is recognised as the result of a cash-flow problem, so that a clear statement is written into the minutes that reinforces the supremacy of the MFF and its seven-year numbers and makes clear that you expect compensating reductions in later years for the money that is brought forward to deal with the backlog of payments and frontloading of the MFF?

FUTURE YEARS

When we asked the Commission whether the scale of the problem meant that the Contingency Margin would be called upon in 2015 and 2016, Nadia Calviño told us that “we anticipate that by 2016
the payment appropriations situation should be eased … because we will have finished the payments of the past and the new programmes will be small in terms of pre-commitment by the European budget.” Nevertheless, she conceded that “it is almost impossible to say what is going to happen in 2016. If Member States are suddenly much more efficient, and launch the programmes much faster, we may have a problem in 2016. But … it would not be a responsible budgeting approach now to say that we are now going to activate the contingency margin in 2015 and 2016.”

In light of this uncertainty, we share your concern that the Commission is likely to continue to come forward with significant requests for funds in future years. While we urge you to continue your efforts to ensure that the Commission only turns to the Contingency Margin as a last resort once all opportunities for redeployment have been exhausted, the scale of the problem again illustrates the need to identify a long-term solution to the problem.

**THE BUDGETARY PROCESS**

All these issues feed into our broader concerns that the budgetary process itself is unsatisfactory. While we note your observation that the gap between payments and commitments has fallen from 7% to 5% and the Prime Minister has described that gap as perfectly safe, we repeat our view that a disjunction between the two has occurred. Is the Commission correct in stating that the underbudgeting of payments has arisen because of “the economic crisis and the obligations of budgetary restraint”? Is it therefore a temporary problem or has the disconnect in the relationship between payments and commitments become a permanent structural feature of the budgetary process? You state that part of the problem lies in adjusting to “a new budget era” of fiscal constraint. Can you elaborate on this? What in your view is the cause of this disjunction, and how can it be corrected?

Both you and Nadia Calviño deny that the budgetary process is no longer fit for purpose. We disagree. In our view the strains in the budgetary process that the 2015 Draft Budget and DAB3 have brought to light show that the budgetary process needs radical modernisation. It is a highly complex mechanism with insufficient flexibility to take account of the real world and how a budgeting process works in practice. Aside from the wider reforms to the MFF that we advocated in our past reports, we believe that the time has come to give serious thought to a review of the budgetary process itself. Ideally, this would complement the current review of Own Resources, as how the forward plans and budgets are set and managed and how they are funded are all part of the same system. To continue in the present vein risks bringing the entire exercise into disrepute. It is therefore incumbent on all sides urgently to identify a solution to these problems. You state that “there are question marks around the budgetary system, particularly on the balance between payments and commitments”, that “it is certainly fair to raise the issue of whether the budget should be calculated in a different way” than this “very unusual system”, and that “there may be broader scope to look at how the whole picture of the way the budget works”. However you also state that this is not your primary focus at the present time. While we appreciate the urgency of reaching a satisfactory deal on negotiations on the 2015 Budget and DAB3, this is a nettle that needs to be grasped. What reassurances can you give us that the Government are taking these issues seriously and are seeking to work alongside the Commission, the European Parliament and other Member States to address them? For our part, we stand ready to provide any assistance to your efforts that we can.

We note your statement that a formal position in Council is expected in early September. We would be grateful if you could ensure that we are able to undertake effective scrutiny of the proposals before Council adoption of its initial position. What further discussions do you anticipate taking place before the end of July? Is there any likelihood that Council will reach an initial position by then? In light of this, we would be grateful for a response to this letter by 22 July 2014, or sooner if significant progress is expected in Council in the meantime.

At your appearance before the Committee on 1 July, the Committee invited you to respond in writing to a number of points directly relevant to the issues raised in this letter, as follows:

- Further details of the programmes that you identified as candidates for cuts, and the amounts involved (Q20);
- Your response to the Committee’s questioning of the Joint Statement’s claim that resort to the Contingency Margin is “legally questionable” (Q22);
- Further information on the position of other Member States on the 2015 Draft Budget and DAB3 (Q25);
A response to the Committee’s question as to how the budgetary process can be improved (Q27);

— Providing information, ideally in tabular or graphic form, setting out the relationship between payments and commitments over the past ten years and explaining the reason why it has changed (Q29).

We would be grateful if your response to this letter could also respond to these points. Pending receipt of your reply we will continue to hold the documents under scrutiny.

9 July 2014

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

Thank you for the letter on these matters sent to my predecessor as Financial Secretary. First, I wanted to offer an update on progress in the budget negotiations since my predecessor appeared in front of the Committee on 1 July.

On 15 July, Coreper reached an agreed Council position on the 2015 budget, calling for a budget of €140.0bn (£112.2bn). This represents a €2.1bn (£1.7bn) cut to the Commission’s draft budget, and provides for a margin of €1.9bn (£1.5bn) between the budget and the 2015 annual ceiling set out in the MFF.

In Coreper, there was no formal vote as it was clear that a qualified majority was in place to support the Council position. Our Permanent Representative indicated that had there been a vote, the UK would have abstained on both Parliamentary scrutiny and substantive grounds, and regretted that greater cuts were not found. We do, however, welcome the fact that this position does support the overall delivery of the PM’s deal on the Multiannual Financial Framework.

As we suggested to you in the recent evidence session, we will have to vote formally via Council written procedure in early September. We will be abstaining in this vote. If the annual budget were to clear scrutiny by the time of the vote, we would still abstain on substantive grounds.

In terms of DAB3/2014, there has been no further progress since we last updated the Committee. We continue to expect that DAB3/2014 will be discussed alongside the negotiations on the 2015 annual budget in the autumn.

In your letter, you ask for our views on how the Commission’s draft budget could be cut. The press release from the Council, which sets out the revised breakdown by heading, is available at the following address:


As noted above, we felt that further cuts could have been found beyond these €2.1bn (£1.7bn). In particular, we would have been keen to see further cuts in administration, Heading 5 of the budget, where the Council proposal still represents a 2.1 per cent increase on the 2014 agreed budget.

You asked about how the budget could be targeted in 2015 and future years to ensure that growth and economic recovery is sustained across the EU. The MFF deal done by the Prime Minister secured a commitment to increase spending on high-value research and development, universities, and other pro-growth investment via Heading 1a of the budget. Pleasingly, we have seen the reorientation of expenditure to these areas, provided for by the MFF deal, play out in the 2015 annual budget negotiations. The agreed Council position ensures a 24.5 per cent increase in Heading 1a compared with the 2014 budget.

At the hearing with my predecessor, you asked for further details of how we plan to find sufficient cuts to the existing 2014 budget so as to avoid the need for additional expenditure on DAB3/2014.

I should re-iterate our overall approach to negotiations on the budget. We start from the fundamental principle of the importance of budgetary discipline, and this determines our stance in negotiations. As my predecessor made clear in her previous letter on DAB3/2014 and at the hearing, we do not provide a line-by-line breakdown of cuts or savings to the Commission. This is because we see the role of Member States as setting the overall parameters of spending, and the role of the Commission as managing the detail of the budget so as to ensure that the EU lives within its means.

You ask whether the Government stands by the assertion in the Joint Statement that the use of the contingency margin is “legally questionable”. On this, I do not have anything more to add to the
reasoning set out in our previous letter to the Committee. As we set out in this letter, the Government does not have a definitive legal position on this issue – this explains the use of the term “legally questionable”. The Government’s primary position on DAB3/2014 is not a legal one but the principled position set out in the original Explanatory Memorandum and reiterated in the letter sent and the hearing held since that EM was sent.

You ask several questions asking why scale of the problems caused by the pressures included in DAB3/2014 were not anticipated, and whether these represent an indictment of the budgetary process. As my predecessor made clear in the last letter on this subject, it is unclear why many of these pressures should not have been anticipated by the Commission. The Government does not agree, however, that this is an indictment of the budgetary process. In-year pressures of some sort will always emerge. The challenge is to ensure that there is sufficient flexibility built into budgets and in-year margins below the annual ceilings to allow resources to be re-allocated to meet genuinely unforeseen pressures.

You ask some more general questions about risks of the MFF becoming untenable as a result of the mobilisation of the contingency margin. As we said in our last letter to the Committee on this subject, it is clear that significant front-loading into the first few years of the MFF would impose pressure on later years of the deal. This is one of the reasons behind the Government’s view that the Commission should always look first to reallocate funds from within existing agreed budgets to meet emerging in-year pressures. Having said this, the MFF deal did include provision for the contingency margin to operate as a mechanism to move expenditure between years but within the overall MFF ceiling. The fact that the Commission have chosen to request the mobilisation of the contingency margin in the first year does not in itself indicate that the MFF is in some way untenable.

You ask several questions about the relationship between payments and commitments, and how it may have changed in recent years. As my predecessor made clear at the evidence session, the Government does not accept that the relationship has broken down. Indeed the gap between payment and commitment ceilings has fallen from 7 per cent during the last MFF to 5 per cent over the current MFF. The Prime Minister has described this gap as “perfectly safe”. The Government finds this downward trend encouraging as it contributes to mitigating the steady build-up of unpaid commitments.

You requested a table comparing payment and commitment appropriations over recent years. This is set out in an annex [not printed]. As it makes clear, the gap between payments and commitments is significantly tighter in 2014 than any of the previous four years. The gap between payments and commitments in the Council position represents a further tightening at just 3.6 per cent. This is evidence of the value of the 2014-20 MFF deal in bearing down upon the build-up of commitments, and should help to address the current backlog.

Finally, you ask for a response to the Committee’s questions as to how the budgetary process can be improved. As my predecessor said in giving evidence to the Committee, it is certainly fair to raise the issue of whether the budget should be calculated in a different way. She made it clear, however, that rather than focusing on potential reform of the system, the Government’s energies for now are fully focused on the amount of money that the UK is going to be expected to find in 2014 and 2015 – and more generally on the successful implementation of the 2014-20 MFF deal, where the Prime Minister delivered the first ever real-terms cut to the EU budget. This is where my focus too will be as Financial Secretary.

23 July 2014

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 23 July 2014, on the 2015 Draft Budget and on Draft Amending Budget 3 (DAB3) to the 2014 Budget. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 29 July 2014.

We are pleased to welcome you to your new post as Financial Secretary. However we regret to state that we are disappointed by the standard of this response to our detailed letter of 9 July 2014. The letter provides scant information beyond the position set out by your predecessor at her appearance before the Committee on 1 July 2014.

We are particularly disappointed by the lack of detail on the further cuts that the Government would have wished to have seen. You cite only further cuts in administration, and provide no further details.
You state that "we do not provide a line-by-line breakdown of cuts or savings to the Commission. This is because we see the role of Member States as setting the overall parameters of spending, and the role of the Commission as managing the detail of the budget so as to ensure that the EU lives within its means.” We find this attitude to be both complacent and counterproductive. The Government’s failure to pinpoint specific areas for cuts makes it all the harder for an effective case for reductions to be made. As we said in our 9 July 2014 letter, it is more convincing if the Government and like-minded Member States make concrete proposals as to how the Draft Budget can be trimmed. Your failure to do so tends to give weight to the Commission’s argument that there is little room for further cuts or for reallocation within the existing budgetary framework. The fact that Coreper has agreed a position not to the UK’s satisfaction suggests that you have been equally unable to convince other Member States of your case.

Likewise, we regret your failure to engage with our concerns about the efficacy of the budgetary process. You state that the fact that the Commission has chosen to request the mobilisation of the contingency margin does not in itself indicate that the MFF is in some way untenable. Yet you give us little cause for optimism that this will not ultimately prove to be the case. You do not agree that the fact that the scale of the problems lying behind DAB3 were not identified is an indictment of the budgetary process. Yet you give us little comfort that the underlying issues are being addressed in any systematic manner. You state that it is fair to raise the issue of whether the budget should be calculated in a different way, but that the Government will nevertheless not be focussing on such issues. Once again, wefind this to be a complacent attitude. If the UK and like-minded Member States do not lead the way in seeking sensible reforms to the budgetary process then it will not be surprising if the flaws in the system persist for years to come, to the detriment of all.

We note the table attached to the letter setting out the gap between commitments and payments since 2008. You state that the gap is significantly tighter in 2014. Can you clarify if the 2014 figure takes into account the DAB3 proposal? Given that payments exceed commitments in each of the years, and continue to do so for 2015 even if at a reduced level, we question your assertion that “this is evidence of the value of the 2014-2020 MFF deal in bearing down upon the build-up of commitments, and should help to address the current backlog.” Can you explain the rationale behind this claim? Is it true to say that the high gap in 2010-2013 was a temporary phenomenon arising from the financial crisis and EU-wide recession? Should we expect a small gap to persist in the future? Or should we expect a budget where commitments are lower than payments in the future? Is this not the only way in which the build-up of commitments can be reduced? You repeat that in the 2014-2020 MFF deal “the Prime Minister delivered the first ever real-terms cut to the EU budget.” Do you take as the basis for this claim the agreed level of payments or commitments?

Given that a general approach on the 2015 Draft Budget has now been reached, we now clear that document from scrutiny. However we will continue to hold DAB3 to the 2014 Budget under scrutiny pending the progress of negotiations. We would be grateful for an update on both when negotiations resume in the autumn, and by 30 September 2014 at the latest.

29 July 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter on the 2015 EU budget and DAB3/2014 sent just before the summer recess. You requested an update on progress on these matters by the end of September.

Regarding the 2015 budget, you will be aware the Budget Committee of the European Parliament (“BUDG”) are currently holding their hearings on the subject. This process will culminate in a vote on the European Parliament’s position on the 2015 budget at a plenary session. We expect this to occur around 22 October. Following this, a 21 day period of “conciliation” will begin for the Council’s and European Parliament’s positions to be reconciled. This will culminate at a Budget ECOFIN session on 14 November, where final agreement on the 2015 budget should be reached.

The Government’s position on the 2015 budget remains unchanged from the one I set out in my most recent letter to you. As I suggested in this letter, we abstained on the Council’s position on the 2015 budget in the Council written procedure that concluded at the beginning of September.

For DAB3/2014, there has been no progress. As was the case before the summer, DAB3/2014 remains on the table, but as yet the Presidency have not returned to the Council with either the original or an amended proposal. We continue to anticipate that it will be resolved as part of the wider negotiations this autumn on the 2015 budget, although we do not know the timetable over
which this will take place. As with the 2015 budget negotiations, the Government’s position on DAB3/2014 has not changed since we last communicated it to you.

You also asked some questions about the balance between payments and commitments in the EU budget.

In response to your first factual question, the figure for 2014 does not include DAB3/2014, as this has not been approved by the Council. Even without DAB3/2014, however, there is a marked narrowing of the gap between payments and commitments in 2014 compared with previous years – and this gap should be narrowed further in 2015 if the Council position is adopted. Annual budgets containing a smaller gap between payments and commitments should naturally be a key factor addressing the backlog of commitments that has been allowed to build up.

You ask whether this trend will persist in the future, and suggest that annual budgets where payments exceed commitments will be required to address the backlog. The Government does not consider that the latter situation will be necessary. The EU budget has always worked on the basis that not every commitment will be translated into a payment. This is why the Prime Minister was able to describe the gap of 5 per cent in this current MFF as “perfectly safe”.

In response to your final question, I can confirm that the Prime Minister’s 2014-20 MFF deal represents a real-terms cut to both payments and commitments compared to the previous MFF.

29 September 2014

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 29 September 2014, on the 2015 Draft Budget and on Draft Amending Budget 3 (DAB3) to the 2014 Budget. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 21 October 2014.

While we note your response to our specific questions, your letter did not respond to our criticisms of the lack of detail about the budgetary cuts you wish to see, and your failure to engage with our wider concerns about the efficacy of the budgetary process. We raised these and other points in evidence sessions that we held in Brussels with three prominent MEPs: Richard Ashworth MEP, UK Conservative/ECR member of the Committees on the Budget (BUDG) and on Budgetary Control (CONT); Jean Arthuis MEP, Chair of the BUDG Committee; and Dr Ingeborg Grässle MEP, Chair of the CONT Committee. We would be grateful for your reflections on the evidence they provided.

On the growing budgetary pressures which DAB3 bears witness to, Mr Ashworth told us that, while the budget had been cut, there had been no provision for a reduction in spending: “Consequently, we find ourselves continually squeezing 6.5 into 6 … and as a result any exceptional item is likely to result in a draft amending budget being submitted by the Commission. … Therefore, because there is no margin, draft amending budgets are going to be a feature we will have to live with.” Mr Arthuis noted that there was “substantial inertia” and “a lack of confidence” in the system that meant that it was not easy to respond to the current situation. Dr Grässle argued that “we should have the courage to redo the whole budgetary procedure, which will become more and more ridiculous.” Do you share this assessment? Do you agree with us that it is yet another indictment of the failures and weaknesses of the budgetary process, which, regrettably, no-one is taking the initiative to resolve? Mr Ashworth argued that the Commissioner for Budgets needs to undertake a mid-term strategic review within the budget to ensure that the EU keeps within fiscal limits. Mr Arthuis agreed that a review was necessary. Do you support the case for a mid-term review? Is it not essential that Member States are closely engaged with such a process if any positive outcome is to be delivered?

On the relationship between payments and commitments, Mr Arthuis said that new procedures for dealing with outstanding payments were needed. Mr Ashworth told us that the problem had “got out of control”, in particular since 2008: “Once the recession and the economic difficulties began to squeeze economies, member states realised that the money was there to be spent, that it is very often on a ‘use it or lose it’ basis and they had better start using it. That is when the problems really started to arise”. Dr Grässle agreed that “the commitments of today are the payments of tomorrow. There is always a gap of €50 billion in the MFF. Annually, every single euro that is foreseen but that we do not achieve in the negotiations for the annual budget means that the gap broadens.” This chimes with our own analysis in our letter to you of 29 July 2014, when we asked you if the growing gap between payments and commitments had arisen from the financial crisis, and whether payments
would need to exceed commitments in future budgets to address the issue. In response, you stated that a smaller gap between payments and commitments would naturally be a key factor in addressing the backlog of commitments that has built up. Nevertheless, the Government do not consider that annual budgets where payments exceed commitments will be required to address the backlog, since the EU budget has always worked on the basis that not every commitment will be translated into a payment. Given the scale of the problem, we do not believe that this will be sufficient to deal with the issue. Do you agree with us that drastic steps now need to be taken if the backlog is to be addressed and the relationship between payments and commitments is to be restored to an even keel?

With respect to the Commission’s decision to request resort to the Contingency Margin, Mr Ashworth told us that the Commission’s proposal to reduce payment ceilings in 2018, 2019 and 2020 may simply be “kicking the can up the road and storing up another problem”. We made the same point in our 9 July 2014 letter to your predecessor, when we asked what the outcome would be for the overall MFF if the pressure on the later years of the budgetary framework became untenable, and whether there was a danger that the overall MFF deal would unravel. In your reply of 23 July 2014, you stated that “the fact that the Commission have chosen to request the mobilisation of the contingency margin in the first year does not in itself indicate that the MFF is in some way untenable.” In light of Mr Ashworth’s observations, is there not a real and present danger that the MFF deal will unravel? If so, what steps need to be taken to address the problem before the situation becomes untenable?

On the budgetary process itself, our witnesses told us that a major weakness was the lack of an effective means of ensuring fiscal discipline. Mr Ashworth bemoaned the failure to appoint an office of budgetary control or Commissioner for budgetary control. The current flawed system was “the son of the original proposals from way back in 1957 with the Treaty of Rome and it has never changed because nobody ever thought to change it.” Mr Ashworth also told us that, while the European Parliament had a very active role in drawing up the expenditure budget, it had virtually no role in scrutinising outturn and delivery, for instance in questioning Commissioners or heads if departments on the effectiveness of delivery of the budget. It was therefore difficult for MEPs to form a judgment over the value for money and added value of EU spending. As a result, EU spending planning was determined by political considerations rather than fiscal or outturn considerations. Dr Grässle also said that there should be more effective cooperation between the European Parliament Committees on Budgets and Budgetary Control, and with those Committees responsible for spending, to ensure a more joined-up process of accountability.

Mr Ashworth was also critical of the generalised nature of European Court of Auditors’ reports, which failed to name and shame. Dr Grässle said that the delay in the start of the discharge procedure, marked by the publication of the ECA’s report, was a problem. She did point out that the ECA would, for the first time this year, provide country-specific error rates, making it possible to name and shame. However she bemoaned the lack of effective powers of sanction against countries with significant error rates because of Member State opposition to their introduction. She pointed out that the situation in the UK was getting worse in relation to regional policy and agriculture. Other Member States were suffering from similar problems. Mr Arthuis said that “Europe has created monstrous complexity and bureaucracy. We lose a lot of time on peanuts and nonsense. … We have to evaluate current expenditure, but we have to review our organisation and our bureaucracy. It is very expensive, and there is a lack of comprehension between the territorial actors and the European Union.”

Do you share such concerns about the system of budgetary control? If so, what steps can be taken to improve the scrutiny of the Budget within the EU institutions, whether it be the Commission, the European Parliament or the European Court of Auditors? What confidence do you have that Mr Juncker will seek to address these issues in his term as President of the Commission? Do you agree that there would be value in appointing a Commissioner for Budgetary Control? What steps will you take to ensure that positive examples from the UK system of budgetary control and scrutiny can be applied in the EU context? How would you respond to the assertion that the budgetary control situation in the UK is getting worse in relation to regional policy and agriculture? What steps is the Government taking to address these problems?

In our 29 July letter, we expressed disappointment at the lack of detail you provided on the further cuts that the Government would have wished to have seen. We also criticised as counterproductive and complacent the Government’s position that “we do not provide a line-by-line breakdown of cuts or savings to the Commission. This is because we see the role of Member States as setting the overall parameters of spending, and the role of the Commission as managing the detail of the budget so as to
ensure that the EU lives within its means.” Mr Ashworth told us that, “concerning the attitude of the United Kingdom Government and the Treasury, I find it very difficult to get them to become engaged at all. They will certainly get excited about the sort of headline that will make news in the Daily Mail or something like that, but it is hard to get them to drill down into the detail. I find it very difficult to get appointments at the Treasury. I find it very difficult to get them to take the subject seriously. … I feel I need to remind them that, ‘You, the member states, through the Council have input into the size of the budget’. To say, ‘We are hands-off on this’, is absolute nonsense. Unless or until we start to drill down into this and get people to accept responsibility, we will have the ongoing embarrassment of a qualified statement of assurance every year. That is never going to change unless the member states do something about it.” We wholeheartedly agree with Mr Ashworth’s assessment, and regret to say that his criticism of the Government mirrors our own experience. How would you respond? In light of Mr Ashworth’s comments, do you consider that a structural relationship between HM Treasury and UK MEPs on the Budgets and Budgetary Control Committees could be mutually beneficial?

In that regard, we also draw to your attention the views of Mr Ashworth in relation to the High-Level Group on Own Resources. He stated that “it is important that we maintain a position and attitude that we are open to proposals – we are not going to say a flat no to any … it is vital that if we are the only voice speaking out against a financial transaction tax and various Own resources we should have a seat at the table to say so and that we have the opportunity to say publicly what our position is. We may lose the argument, but if we do not engage in the battle, we know that we will lose.” This chimes with our own views expressed to you in previous correspondence about the importance of engaging in the debate on Own Resources. How would you respond?

We would be grateful for a response to these questions, as well as an update on negotiations on the 2015 Draft Budget and DAB3, by 4 November 2014 at the latest. We would however advise you that the Sub-Committee’s final meeting before the 14 November Budget ECOFIN session will take place on 4 November 2014. Any request for clearance of DAB3 ahead of Budget ECOFIN would therefore need to be received in advance of the 4 November meeting. In the meantime we will continue to hold DAB3 under scrutiny.

22 October 2014

Letter from the Chairman to David Gauke MP

I am writing to you to seek urgent clarification of reports on 24 October 2014 that the Commission has told the UK to pay an extra €2.1 billion into the EU Budget on 1 December 2014. We would be grateful for a full account of the Commission’s request, and in particular for clarification of the following points:

THE COMMISSION’S REQUEST:

— Can you provide a full account of the means by which this calculation has been arrived at and the statistics on which it is based? Can you confirm the legal basis for the request?

— Is it correct that the figure derives from a one-off recalculation of VAT and GNI figures undertaken by Eurostat dating back to 1995? Are we correct in our understanding that 1995 has been chosen because this was the year that the GNI/GNP resource came into operation?

— On what other occasions since 1995 did Eurostat also undertake recalculations of VAT and GNI figures? On what previous occasions in that period were Member States requested to provide payment or notified of reimbursements? Was 2010 one such occasion?

— When was the decision taken to recalculate VAT and GNI balances? In the event that this was more recent than 1995, what is the Commission’s justification for seeking retrospective readjustment as far back as this date rather than from the date of agreement?

— How does this one-off recalculation differ in form from the regular readjustments in the budgetary process?
— How does the question of VAT and GNI balances relate to Draft Amending Budget No 6/2014? When can we expect to receive an Explanatory Memorandum on the latter?

**THE REQUEST TO THE UK COMPARED TO OTHER MEMBER STATES**

— Why is the UK adjustment so much larger than for any other Member State?
— Can you confirm the figures for other Member States? Why are some required to make a payment while others will be reimbursed? Can you confirm that the amount, in total, to be reimbursed to some Member States outweighs that to be paid by others? What is the reason for this imbalance?
— How is the Commission dealing with Member States that acceded to the EU after 1995?

**THE GOVERNMENT’S POSITION:**

— Can you clarify when the Government were first made aware: a) of the likelihood of the UK being asked to make an additional payment; and b) the precise scale of the amounts involved? To what extent were you taking account of the full ramifications of the European System of National and Regional Accounts (ESA 2010)?
— What was the nature of the UK statistical authorities’ interaction with Eurostat in relation to this recalculation?
— What is the UK Government’s position on this request? Do you regard the request as justified or unjustified? If so, on what grounds? We note that the Prime Minister demanded a meeting of all EU finance ministers to discuss the issue. What update can you give us on these discussions? What discussions are you having with other Member States on the issue? Do you intend to make the payment? Will you ask for the date of payment to be put back or for payment to be staggered?
— Can you confirm the statement by the EU Budgetary Commissioner that the UK will be liable for interest if the payment is not made on time? What is the legal base for charging interest and has it always been rigorously applied?
— In December 2013 and February 2014, we wrote to the then Economic Secretary to the Treasury, Nicky Morgan MP in relation to the European Court of Auditors’ Annual Report on the Implementation of the EU Budget in 2012. That report had highlighted 11 GNI reservations outstanding in relation to the UK, the most of any Member State. We asked the Minister what was the nature of the problem, what had caused such a high number of reservations and how confident she was that the Commission would judge the UK to have sufficiently addressed these issues. In her reply of 11 March 2014, the then Minister stated that outstanding GNI reservations had been introduced over several years but that “the Government continues to give high priority to addressing these reservations in the National Accounts work plan. In addition, the ONS has agreed priorities with stakeholders and publicly set out commitments via the published plan.” How does this statement relate to the matter at hand?

We would be grateful for a response to this letter by 11 November 2014.

29 October 2014

**Letter from David Gauke MP to the Chairman**

Thank you for your letter dated 22 October on the draft EU budget for 2015 and the outstanding DABs proposed for 2014. In your letter the Committee sought the Government’s reflections on evidence provided by three MEPs on a series of issues and I have set out our response to the points raised below:
WEAKNESSES IN THE BUDGETARY PROCESS

The Committee raises fair questions regarding the EU budget process. The manner in which the EU budget is managed, including the use of payment and commitment appropriations, is an unusual system and not one applied here in the UK.

However, as set out by the then FST when she appeared before the Committee on 1 July 2014, the Government’s immediate focus remains delivering the tough but fair 2014-2020 MFF deal rather than reform of the budgetary system. Nevertheless, the Government would actively engage in the consideration of any formal proposals to improve EU budget processes.

MID-TERM REVIEW FOR ANNUAL BUDGETS

The Government notes Mr Ashworth MEP’s suggestion that a mid-term review, similar to the process provided for within the seven year MFF, be introduced for annual budgets. The Government is open to considering any formal proposals that seek to improve the Commission’s management of the EU budget and allow for better monitoring of annual budget expenditure.

Further, I agree with the Committee that the successful introduction of any reforms to EU budget processes would need the active engagement of Member States to ensure that they are representative and that funds are managed and implemented in a manner that offers the best possible outcome for taxpayers across Europe.

PAYMENTS AND COMMITMENTS

The Government recognises that the payments backlog represents an ongoing pressure on the EU budget that must be addressed. We have been consistently clear that effective and sustainable steps must be taken to mitigate the risk of this issue being replicated in future years.

The Government also remains of the view that the EU budget as a whole must reflect the prevailing fiscal circumstances across the EU. As such, we recognise that the budgetary restraint the UK seeks in the payment ceiling for the EU budget should be reflected in the accompanying commitment ceilings.

IMPACT OF THE CONTINGENCY MARGIN ON THE MFF

The Government notes the Committee’s concerns that the Commission’s proposed use of the Contingency Margin presents a risk to the MFF deal. It is important to be clear that the Contingency Margin was specifically designed to accommodate unforeseen spending pressures without breaching the overall MFF deal. In other words, although it is an emergency measure, it should not pose a threat to the overall MFF deal.

To ensure that the MFF deal is respected, we have joined other like-minded, budget-disciplinarian Member States in pushing for all proposals to access the Contingency Margin to be accompanied by clear and realistic assurances that this expenditure will be off-set in future MFF years. We are disappointed that the Commission offered no such plan when issuing their proposal to mobilise the Contingency Margin for 2014.

BUDGETARY CONTROL AND SCRUTINY

Your letter also highlights the Committees concerns in relation to scrutiny of the EU budget and the annual assessments conducted by the European Court of Auditors (“ECA”). Given the imminent arrival of the ECA’s report and the associated scrutiny considerations, I will commit to addressing these valid points in subsequent and associated correspondence.

HMG ENGAGEMENT

It is regrettable that Mr Ashworth MEP and the Committee feel that they have experienced difficulty in their engagement with the Government on the EU budget. I would like to reassure the Committee that the EU budget remains a priority for this Government and we take a very active approach to engaging on this important issue both at a domestic and EU level. This Government has adopted a
consistent and budget-disciplinarian stance on the EU budget maintaining that Governments across the EU have a responsibility to their taxpayers to ensure that the Commission effectively deploys EU budget funds.

The Government will therefore continue to press for savings in areas of expenditure which represent poor value for money, such as administration and the Common Agricultural Policy, and encourage the prioritisation of expenditure that offers high added value, such as research and development, and innovation. The Commission possess the detail on programme disbursement and must exercise financial discipline in reallocating between budget lines.

Further, the Government is open to taking appropriate steps to improve engagement on this key issue in all areas, including in our engagement with UK MEPs.

HIGH-LEVEL GROUP ON OWN RESOURCES

As set out in the then FST’s letter of 4 June, the High-Level Group on Own Resources has yet to publicly set out a specific plan on how it intends to conduct its work. It is not yet clear at this stage whether or how the Group will seek input from national governments. Once this becomes clearer, the Government will consider its engagement strategy with the Group.

It is important to note that the Group’s conclusions will not be legally binding. Any change to the current system requires the unanimous agreement of all Member States and approval by national parliaments. This means that the UK has a double-lock on any proposals to change to the EU’s financing system.

UPDATE ON NEGOTIATIONS FOR AB2015 AND DAB3

In your letter the Committee also sought an update on Draft Amending Budget no.3 ("DAB3") and negotiations on the annual budget for 2015. As we are now approaching the end of negotiations on both the 2015 budget and the outstanding Draft Amending Budgets for 2014, I have consolidated my responses to the questions posed in this and other letters on these issues into one comprehensive response.

As in previous years, the 2015 annual budget will be discussed and agreed at Budget ECOFIN which will be held on 14 October. The Presidency has presented its compromise proposal for the 2014 DABs, which includes a €350m reduction in DAB3 payment requests, and we expect this package to be discussed concurrently.

While I am unable to offer a definitive stance on these ongoing EU negotiations at this stage, I can confirm that at ECOFIN on 14 October, I intervened strongly to urge the Commission to pursue fiscal prudence in negotiations at November’s Budget ECOFIN stressing the importance of the EU budget reflecting the fiscal restraint demonstrated by domestic Governments across the EU. I also highlighted the disappointment shared by a number of Member States that the Commission had not done more to identify necessary savings and raised concerns over the consideration of MFF ceilings as being the 'minimum level of expenditure' which has contributed to the challenges the EU budget now faces.

Over the coming weeks, the UK will continue to work with like-minded Member States to pursue this budget-disciplinarian and sustainable approach to EU budget negotiations.

AMENDING LETTER 1 TO ANNUAL BUDGET 2015

Amending Letter No 1 ("AL1") was issued by the Commission on 15 October 2014. It amends the Commission’s draft budget proposal to account for the most recent developments in agricultural markets, recent forecasts of Member States on the execution of the 2014 budget and legislative changes since the Commission’s original proposal.

The net impact of these changes is a reduction of €448.5m in commitment appropriations with no overall change to the level of payment appropriations.

AL 1 provides two main adjustments to Draft Budget 2015. First, the redeployment of €448.5m of expenditure from Heading 2 and Heading 5 to Headings 1a, 2, 3 and 4 in 2015. This is made possible by: the €448m increase in assigned revenues available for the European Agricultural Guarantee Fund (EAGF) in 2015; and, a conversion of Commission posts which yields a saving of €0.5m.
Second, the use of the 'crisis reserve' in Heading 2 of Draft Budget 2015 to finance "temporary emergency measures" in response to the Russian ban on certain EU agricultural imports. The cost of these measures is currently estimated at €344m. This will not require additional appropriations as the Draft Budget 2015 already included €433 million appropriations for ‘crisis reserve’, intended to support the agricultural sector in crisis situations. Any mobilisation of the 'crisis reserve' would require a budget transfer to be agreed by Council after the adoption of the EU Budget 2015.

The Government welcomes that AL1 is budget neutral on payments and reduces commitments. We are also pleased to see that the Commission have identified savings in agricultural and administrative expenditure. However, we do not think that the Commission should seek to use the savings to increase expenditure in other headings on top of the draft budget 2015 proposed by the Commission. Instead, these savings should be used to help reach an agreement on the 2015 annual budget which is in line with the Council position.

We note that AL1 will be part of wider negotiations at ECOFIN where we will be clear in our objective to push for a 2015 annual budget which sets expenditure at a level that provides a significant margin below the MFF ceiling.

AMENDING LETTER 1 TO DRAFT AMENDING BUDGET NO.4 ("DAB4")

On 16 October, the Commission submitted Amending Letter 1 to DAB4. This Amending Letter includes additional fines and interest on late payments as well as interest on fines which adds to 'miscellaneous revenue'. As these changes serve to reduce Member State contributions, our position on DAB4 remains unchanged.

DRAFT AMENDING BUDGETS 6 & 7

EMs on DAB6 and DAB7 will be with the Committee shortly.

I would like to reassure the Committee that, taking into account ongoing EU negotiations and the fact that the UK’s final position will be dictated by the shape of negotiations, I have provided as much information as possible. I hope that I have now provided sufficient information to allow the Committee to clear these documents from scrutiny.

3 November 2014

Letter from David Gauke MP to the Chairman

I am writing to the Committee alongside the Explanatory Memorandum on Draft Amending Budget 6 2014 (DAB6) to request a waiver of Parliamentary Scrutiny in this instance. I believe this is necessary given the fast-moving pace of wider negotiations on the adjustment payment, on which DAB6 is entirely dependent. As the Prime Minister stated to the House in his post-Council statement the Government is seeking changes to these underlying adjustments. Therefore, the Government’s position on DAB6 will depend on the outcome of the negotiations.

If the negotiations reach an acceptable outcome, the Government will support DAB6 as a means of returning the additional contributions requested as a result of the data revisions. To retain flexibility for the negotiations, and in order to obtain the best overall outcome for the UK, the Government requests, exceptionally in this case, a waiver of Parliamentary Scrutiny. I will, of course, update committees following any further developments.

3 November 2014

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 3 November 2014, on the 2015 Draft Budget and on Draft Amending Budget 3 (DAB3) to the 2014 Budget. The House of Lords European Union Subcommittee on Economic and Financial Affairs considered this document at its meeting on 4 November 2014.

While we note your response to our specific questions, we regret the Government’s failure to take steps to respond to the concerns that we have raised. We highlight in particular your statement that “the payments backlog represents an ongoing pressure on the EU budget that must be addressed”
without setting out the means by which this pressure can be alleviated. It is not enough to be “open” to reforms – if the EU budget is, as you state, a priority for the Government, then it needs to take the initiative to promote reform where it is needed. Otherwise the problems that we have identified in this year’s process will inevitably recur in the future.

You state that the Presidency has presented a compromise proposal, including a €350 million reduction in DAB3 payment requests. Can you provide more details about the Presidency’s proposals? You state that you are unable to offer a definitive stance on these ongoing EU negotiations. Do you anticipate being able to inform the Committee of your stance ahead of Budget ECOFIN on 14 November? We would be grateful for a response to these questions before that meeting, as well as an update on the outcome of negotiations as soon as possible afterwards.

We would be grateful for a response to this letter by 11 November 2014. Pending a response to these questions we will continue to hold DAB3 under scrutiny.

4 November 2014

Letter from the Chairman to David Gauke MP

Thank you for your EM 14442/14 and accompanying letter, both dated 3 November 2014, on Draft Amending Budget 6 (DAB6) to the 2014 EU Budget, including reference to the adjustment to past VAT and GNI-based contributions. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 4 November 2014.

We note your explanation of why the payment adjustment has been requested at this time. We also note your statement that DAB6 is “a mechanistic procedure which is a direct consequence of and entirely dependent upon the gross adjustments”. Can you clarify what would happen in the event that DAB6 were not agreed on 15 November? Would the UK be required to pay the full adjustment of £2,873 million? Can you also clarify why the GNI and VAT changes date back to 2002 rather than 1995 in the UK’s case?

You state that the UK’s position on DAB6 is dependent on negotiations on the payment adjustments, and that the UK is seeking changes to these underlying adjustments. What is the basis of your argument for change in the underlying adjustments? We understand that the issue is scheduled to be discussed at the 7 November ECOFIN meeting. We would be grateful for an update on these negotiations.

You will be aware that we wrote to you in relation to these issues on 29 October 2014. We trust that your response to that letter, due on 11 November, will explore many of the issues raised in the EM in more detail. We would be grateful if responses to the questions contained in this letter could also be dealt with in that reply. In the meantime, we will continue to hold DAB6 under scrutiny.

4 November 2014

Letter from David Gauke MP to the Chairman

Thank you for your letters of 29 October and 4 November on the EU budget.

The ECOFIN meeting which the Chancellor attended in Brussels on Friday 7 November is relevant in the context of your questions regarding DAB6. On 10 November, the Chancellor updated Parliament on the discussions with the new Commission and at the ECOFIN meeting, and this was repeated by Lord Deighton in the House of Lords.

At the ECOFIN meeting, a deal was reached to make a permanent change to European law. As set out in the attached [not printed] Presidency conclusions, the Council agreed to invite the Commission to come forward with a proposal for an amendment to Council Regulation No 1150/2000 to take account of exceptional circumstances, to allow the Member State concerned to defer the required payment over a reasonable period of time. The Government will ensure that this proposal, when made, is submitted for Parliamentary scrutiny in the usual way.

Your letter of 4 November 2014 also sought an update on the Government’s approach to Draft Amending Budget no.3 (“DAB3”) and the draft annual budget for 2015. At Friday’s ECOFIN, the Council agreed to work constructively to adopt a position on DABs for 2014 in a timely manner,
while recalling Council’s position on the draft budget for 2015. As requested, I will provide the Committee with an update on the outcome of negotiations once they have concluded.

11 November 2014

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 11 November 2014, on the Draft EU Budget for 2015, Draft Amending Budgets 3 (DAB3) and 6 (DAB6) to the 2014 Budget, and the request to the UK for €2.1 Billion payment to the EU Budget. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 18 November 2014.

We note the deal reached at the 7 November ECOFIN on the request to the UK for a €2.1 billion payment. You refer the Committee to the Chancellor’s statement and the Presidency conclusions. Given the cursory nature of your letter, we look forward to a full account of the deal, together with details of the proposal to amend European law to take account of exceptional circumstances, in your reply. We also expect that this letter will provide a substantive response to the specific questions contained in our letters of 29 October and 4 November 2014.

We note that on 17 November 2014, Coreper agreed its position on a package covering the 2015 EU Budget and Draft Amending Budgets for 2014. Nevertheless agreement with the European Parliament was not reached before expiry of the conciliation deadline the same day. We would be grateful for a full account of these negotiations, as well as full details of the next steps as the Commission is required to propose a new draft budget. We would also be grateful for an account of the UK’s position on the 2015 Budget and the various Draft Amending Budgets for 2014, notably DAB3 and DAB6. Can you confirm that the UK abstained? What was the justification for abstention rather than voting against the proposals? We also seek clarification of the statement in the Council Press Release that "the Council’s position seeks to put the development of commitments and payments on a more sustainable path to avoid similar situations in the future." What are the practical implications of this statement?

DAB3 and DAB6 remain formally under scrutiny pending a response to this letter. We would be grateful for a reply by 25 November 2014.

18 November 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter of 18 November which seeks an update on discussions of the annual budgets for 2014 and 2015. I am sorry that you did not consider my letter of 11 November to be sufficiently detailed and hope that this letter provides the Committee with the information required.

As you note, my letter of 11 November and the accompanying Presidency conclusions set out the deal reached at ECOFIN on 7 November. This deal included agreement to a targeted amendment to Regulation (EC, Euratom) No. 1150/2000 to take account of exceptional circumstances and allow Member States to defer required payment over a reasonable period of time. Following the publication of a formal proposal for this amendment, I submitted EM no.15444/14 for the Committee’s consideration which sets out the detail of this proposal and the Government’s approach.

Your letter also sought an update on EU level discussions of the budgets for 2014 and 2015. Since last writing to you, I have attended two Budget ECOFIN meetings aimed at finalising the package of Draft Amending Budget (“DAB”) requests for the 2014 annual budget and the proposed annual budget for 2015. These discussions were, as you know, unsuccessful and we now expect the Commission to issue a new proposal in the coming days.

To explain in a bit more detail these developments, the Council had already, as you know, agreed in July a position on the annual budget for 2015 (a position which the UK had been unable to support). During Budget ECOFIN on Friday 14 November the Council was unable to agree a position on the package of DABs for 2014. The UK, alongside the majority of other Member States, was unable to support a compromise proposal from the Presidency resulting in no agreed Council position on the DABs package for 2014. As such, negotiations with the European Parliament (“EP”) could not take place.

Consequently, on Saturday 15 November and Monday 17 November COREPER met to discuss and ultimately agree a Council position. Conciliation with the EP then began on the afternoon of Monday
17 November, at a second Budget ECOFIN meeting which I attended. During this meeting, the Council and the EP were unable to agree a position ahead of the midnight deadline although there was no formal vote. The conciliation period therefore expired with no budget agreed.

In light of these developments, we now expect the Commission to release a new draft budget in the coming days with a view to discussing and securing agreement by mid-December. This proposal will be subject to the usual scrutiny procedure, and I will submit an EM for the Committee’s consideration once the new draft budget for 2015 is published.

Finally, your letter sought clarification of the practical implications of the reference in Council’s Press Release to achieving a more sustainable level of commitments and payments to avoid similar situations in the future. This statement recognises the issues presented by the historic gap between commitments and payments and Member States have taken this into consideration when adopting a position on proposed packages.

The gap between payments and commitments is significantly tighter in 2014 than in previous years and was tightened even further in the Council’s agreed position of July 2014. This is encouraging evidence of the value of the 2014-2020 Multiannual Financial Framework in bearing down upon the build-up of commitments and should help to address the current backlog. It is clear that the EU budget has to reflect the fiscal circumstances of Member States across the EU and the UK will continue to work with like-minded Member States to press for this type of budgetary restraint to be reflected across both the commitment and payments ceilings of the EU budget.

As you are aware, negotiations on the EU budget are live and developing quickly. As such, I will seek to keep you and the Committee up to date as discussions develop, and would be happy to speak by phone if helpful.

27 November 2014

Letter from the Chairman to David Gauke MP


We welcome this proposal as a simple yet sensible adjustment of the rules pertaining to the annual adjustment of Member States’ national contributions based on VAT and GNI. It is a pragmatic recognition that exceptional circumstances may from time to time arise where the figures involved are of such a high level as to, in the Commission’s words, “put Member States in a difficult budgetary situation and may even imply a significant risk for their economic or financial stability.” What are the implications of the agreement for Member States due to be reimbursed in 2014, and any given year in the future? In the event that one of the two conditions for delayed payment is met, will there be a consequential delay in reimbursing Member States whose national contribution has been revised downwards?

Given the unusual circumstances, we would be grateful for further clarification of your statement that “the proposal has been considered by the Council and opinions are being sought from the European Parliament and the European Court of Auditors.” It would be particularly helpful to know:

— Whether there has been, or whether there will be, any discussion in Council subsequent to the 7 November 2014 ECOFIN discussions and to the adoption of the document on 12 November;
— What is the timetable for formal agreement of the proposal by the Council;
— When the European Parliament and the European Court of Auditors are expected to present their views, and what sense, if any, there is of their likely positions;
— How the agreement will be applied in relation to agreement on the revised regulation on Own Resources, and whether you anticipate any difficulty in this regard;

27 November 2014
The meaning and basis for the Chancellor’s assertion before the House of Commons that “we can examine the numbers, and if there are errors we will get money repaid to us at the end of next year.”

You cite the Chancellor’s statement that the UK correction will apply in full. It is our view that the rebate was never in question, and thus the Chancellor’s assertion that “we have halved the bill” is factually questionable. We would therefore be grateful for a full account of negotiations and how they justify this assertion, as well as an explanation of the Chancellor’s statement that “it had not been clear that we would receive a rebate, let alone such a large one”. Can you also clarify his remarks that “it was agreed that a full rebate would apply to the British payment, that the rebate would be specific, that it would be in addition to any other rebate that we might expect next year, and that, for the first time ever, it would be paid at the same time as any money owed”? What will be the practical impact on the rebate process for 2014 and 2015?

We note your letter of 27 November 2014. While we acknowledge that a number of our questions on the Government’s position and the implications of a failure to reach agreement on the UK payment have been superseded by events, we are disappointed to have still not received a response to our questions of factual clarification on the original request, as set out in our letters of 29 October 2014 and 4 November 2014. We again invite you to address the following points:

THE COMMISSION’S REQUEST:

— Can you provide a full account of the means by which this calculation has been arrived at and the statistics on which it is based? Can you confirm the legal basis for the request?

— Is it correct that the figure derives from a one-off recalculation of VAT and GNI figures undertaken by Eurostat dating back to 1995? Are we correct in our understanding that 1995 has been chosen because this was the year that the GNI/GNP resource came into operation?

— On what other occasions since 1995 did Eurostat also undertake recalculations of VAT and GNI figures? On what previous occasions in that period were Member States requested to provide payment or notified of reimbursements? Was 2010 one such occasion?

— When was the decision taken to recalculate VAT and GNI balances? In the event that this was more recent than 1995, what is the Commission’s justification for seeking retrospective readjustment as far back as this date rather than from the date of agreement?

— Can you also clarify why the GNI and VAT changes date back to 2002 rather than 1995 in the UK’s case?

THE GOVERNMENT’S POSITION:

— Can you clarify when the Government were first made aware: a) of the likelihood of the UK being asked to make an additional payment; and b) the precise scale of the amounts involved? To what extent were you taking account of the full ramifications of the European System of National and Regional Accounts (ESA 2010)?

— What was the nature of the UK statistical authorities’ interaction with Eurostat in relation to this recalculation?

— In December 2013 and February 2014, we wrote to the then Economic Secretary to the Treasury, Nicky Morgan MP in relation to the European Court of Auditors’ Annual Report on the Implementation of the EU Budget in 2012. That report had highlighted 11 GNI reservations outstanding in relation to the UK, the most of any Member State. We asked the Minister what was the nature of the problem, what had caused such a high number of reservations and how confident she was that the Commission would judge the UK to have sufficiently addressed these issues. In her reply of 11 March 2014, the then Minister stated that outstanding GNI reservations had been
introduced over several years but that “the Government continues to give high priority to addressing these reservations in the National Accounts work plan. In addition, the ONS has agreed priorities with stakeholders and publically set out commitments via the published plan.” How does this statement relate to the matter at hand?

Finally, we would point out that this episode demonstrates that reform of the budgetary process is possible when the Government and other Member States demonstrate the necessary political commitment.

We again draw your attention to our broader concerns about the budgetary process expressed in recent correspondence on the 2015 Draft Budget. You have repeatedly stated that “rather than focusing on potential reform of the system, the Government’s energies for now are fully focused on the amount of money that the UK is going to be expected to find in 2014 and 2015”. We once again call on you to reconsider this facile position.

In order to allow the Committee an opportunity to consider your response before the Christmas recess we would be grateful for a reply to this letter by 11 December 2014. In the meantime we will continue to hold the document under scrutiny.

We will write separately regarding the issues raised in your 27 November 2014 letter pertaining to the 2015 Draft Annual Budget and the 2014 Draft Amending Budgets.

3 December 2014

Letter from David Gauke MP to the Chairman

Further to my previous letter in response to your questions on the various Draft Amending Budgets (“DABs”) for the 2014 annual budget, I am writing to you to inform you that the Commission have issued an amending letter to Draft Amending Budget 6 for 2014 (AL to DAB6/2014).

This was published on the Commission website on 4 December, and I asked for the document to be deposited as soon as possible. I am writing to provide information on the content of the amending letter.

We provided an explanatory memorandum (EM) on the original DAB6/2014 proposal on 3 November 2014. The Prime Minister made it absolutely clear that it was completely unacceptable for the Commission to ‘suddenly present a bill like this for such a vast sum of money with so little time to pay it’, and said that the UK would not be paying this bill on that date. At ECOFIN on 7 November, the Chancellor secured an agreement to change the rules permanently.

The Commission have been working to translate that political agreement to a legal one by amending the relevant EU regulation (Regulation (EC, Euratom) No 1150/2000 implementing Decision 2007/436/EC, Euratom on the system of the European Communities’ own resources).

The Commission’s proposed AL to DAB6/2014 accurately reflects the Chancellor’s deal at the 7 November ECOFIN and the amending regulation. It confirms that, once adopted, the amended regulation will apply retroactively for the balances which had to be made available on the first working day of December 2014, and that, as a consequence of the flexibility on making payments the Commission revised the amounts entered initially in DAB6/2014. Therefore, the amended DAB6/2014 reflects only the amounts that some Member States effectively made available to the EU on the first working day of December 2014.

The AL to DAB6/2014 shows that the UK, Bulgaria, Cyprus, Malta and Slovenia have not paid anything on the first working day of December, France and Italy paid a small portion of their total amounts, with all other Member States paying their full amounts. As a result, the Commission now expects to collect approximately €4,095mn.

Separately, the AL to DAB6/2014 also withdraws the small increase in budgetary appropriations (€93,500 / £77,951) for the European Ombudsman initially requested in the original DAB6/2014, as the Ombudsman has identified further room for redeployment since then.

Since the amended DAB6/2014 will in due course reduce the UK contributions and confirm the Chancellor’s deal at the 7 November ECOFIN, the Government intends to support DAB6/2014.

10 December 2014
Thank you for your letter, dated 27 November 2014, on the 2015 Draft Budget and on Draft Amending Budget 3 (DAB3) and 6 (DAB6) to the 2014 Budget. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 December 2014. We wrote to you separately on 3 December 2014 in response to the content of your letter relevant to EM 15444/14 on the Proposal for a Council Regulation amending Regulation No 1150/2000 implementing decision 2007/436/EC, on the System of the European Communities’ Own Resources.

We note that a Council position on the revised 2015 Draft Budget and the 2014 Draft Amending Budgets was agreed by COREPER on 9 December 2014. We are disappointed not to have received the Government EM on the revised 2015 proposal ahead of consideration and agreement in Council. We are also disappointed not to have received notice from you of the imminent Council agreement in spite of your commitment to keep the Committee updated as discussions developed. What was the reason for delay in deposit of the document?

We would be grateful for clarification of a number of points relating to the Council deal and the issues raised in your letter.

The Commission adopted a revised 2015 Draft Budget on 28 November 2014, and proposed €145.2 billion in commitments (down from €145.6 billion in the original proposal) and €141.3 billion in payments (down from €142.1 billion in the original proposal). The Council compromise position was almost identical, setting commitments at €145.3 billion and payments at €141.2 billion. What position did the UK take in negotiations? What were the substantive differences, if any, between the Commission and Council positions? Does the agreement of figures so close to the Commission’s proposal indicate that the UK and like-minded Member States gave way in their efforts to secure greater budgetary restraint?

Vice-President Georgieva is reported (in an interview with Euractiv) to have said that the new proposal has taken into account the views of Council and the European Parliament, and more closely reflects the priorities of the new Commission to boost jobs, growth and investments. Pier Carlo Padoan, Italian Minister for Europe and President of the ECOFIN Council, said that the agreement squares the circle between the challenges of addressing the backlog of payments, not jeopardising Member States’ efforts to consolidate their public finance, and the need to stimulate growth and jobs. Do you agree with these claims? Former Budget Commissioner Jacek Dominik previously criticised the Council for seeking cuts in conflict with the Union’s main priorities, for instance under Heading 1a (Competitiveness for Growth and Jobs). How would you respond? Has the Commission reinstated the cuts that the Council was seeking to make? Is the 9 December Council agreement closer to the Commission’s position than the original Council position?

Does the new budget proposal contain any new proposals for redeployment within the existing budget figures? What further redeployment would you wish to see? Vice-President Georgieva stated that the proposal was constructed with the newly-announced Investment Plan for Europe in mind. We will write to you separately on the Investment Plan for Europe ahead of the 18-19 December European Council. In the meantime, how would you assess the relationship between the Investment Plan and the 2015 Draft Budget? Do you see any negative consequences to structural and cohesion funds, given the overlap between the investment plan and the European Structural and Investment Funds?

Turning to the earlier stages of negotiations, you stated that the UK, alongside a majority of other Member States, was unable to support a compromise proposal from the Presidency at the 14 November ECOFIN. On what grounds did you and other Member States object to the compromise proposal? What changed between then and Monday 17 November in order to allow COREPER to agree a Council position? You stated that you attended a second Budget ECOFIN meeting that afternoon, but you do not state what position you took. We again ask you to confirm if the UK abstained, and to explain what was the justification for doing so rather than voting against the proposal?

The Council and the European Parliament were unable to agree a position ahead of the 17 November deadline and that the conciliation period expired with no budget agreed. Can you explain the main points of difference between the Council and European Parliament positions at that stage? The Budget Commissioner, Vice-President Georgieva, is reported to have said that the sides had been close to an agreement, but that the issue of whether payments relating to special instruments such as the EU
Solidarity Fund should be above or below the ceiling had proved the breaking point. Can you confirm this was the case?

We note that the Council position on the Draft Amending Budgets for 2014 was also agreed on 9 December 2014, providing for an increase in payments by €3.5 billion to €139.0 billion “to tackle the unprecedented scale of unpaid bills”. The Council press release stated that “the additional amount is financed by mobilising the contingency margin for an amount of €3.2 billion and using €361 million below the MFF ceiling. The increase in payments is more than offset by additional revenue from fines, the financial surplus from 2013 and the revised forecast of own resources.” Can you elaborate on this statement? Can you also confirm and elaborate on the Euractiv report earlier in the negotiation process that “for 2014 the Commission has proposed an amending budget of €4.7 billion, at the same time indicating that almost the entire amount was in fact available, as a resource coming from fines imposed on companies under the EU’s competition rules. The Parliament agrees with this approach, but member states said they would prefer to channel the extra income back into their national budgets.” Why was the Commission’s proposal rejected? The Council Press Release states that the Council and the European Parliament have now agreed that “the amount mobilised via the contingency margin in this year’s budget includes €350 million from the ‘special instruments’ [including the emergency aid reserve, the EU Solidarity Fund, the flexibility instrument and the European Globalisation Adjustment Fund] for which they will decide at a later stage whether and to what extent their payments are financed within or above the MFF ceiling.” Can you elaborate on this agreement? When will this decision on whether payments fall within or above the ceiling be made?

The Council press release states that the deal also includes the European Parliament’s commitment to provide its opinion on the revised own resources regulation during its December plenary session, allowing the Council to adopt the regulation in a timely manner. How did negotiations on the revised own resources regulation impinge upon those on the 2015 Draft Budget and the 2014 Draft Amending Budgets, and vice versa?

Your letter states that the gap between payments and commitments is significantly tighter in 2014 than in previous years. However we stress that any comparison of the gap between budget years must take account of the final budget figures for each year as amended. In that context, we note that a series of significant Draft Amending Budgets for 2014 remain on the negotiating table. Given that commitments exceed payments in any given year, often by a substantial margin (meaning that the backlog continues to grow), we again dispute your assertion that the MFF deal is bearing down upon the build-up of commitments and should address the backlog. By contrast, we fear that a tidal wave of money owed in relation to the EU Budget is continuing to mount. To what extent do you anticipate that the level of commitments in the Draft Budget will be reflected in the level of payments forecast for future years? Is there any substance behind the Council’s statement that it is seeking to put the development of commitments and payments on a more sustainable footing?

Finally, in your letter of 3 November 2014, you said you would address our concerns regarding the system of budgetary control and the European Court of Auditors reports after the publication of the ECA report for 2013. Now that the report has been published, we would be grateful if you could provide a substantive response to our series of questions on the system for budgetary control set out in our letter of 22 October 2014.

Given the importance of these issues, we invite you to appear before the Committee at its meeting on 27 January 2014 to update us on the outcome of negotiations on the EU Budget, to discuss our concerns about the efficacy of the budgetary process and to explore in more detail the background to the UK payment to the EU Budget dealt with in our 3 December 2014 letter on EM 15444/14. We understand that the European Parliament Committee on Budgets is expected to confirm the agreement on 11 December, followed by formal Council agreement on 12 December and final European Parliament agreement on 17 December. In light of this we request a response to this letter by 6 January 2015. Pending this response, we continue to hold the revised 2015 Draft Budget, as well as DAB3 and DAB6, under scrutiny.

10 December 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter, dated 3 December, on the proposal for a Council Regulation Amending Regulation No. 1150/2000 implementing decision 2007/436/EC, on the System of European Communities’ Own Resources (The Amending Regulation). Thank you also for your letter, dated 10
December, regarding the Draft EU Budget 2015 and Draft Amending Budgets 3 (DAB3) and 6 (DAB6) for 2014. Following our phone call earlier today, I wanted to update you on the EU budget negotiations, which have developed rapidly in recent days and are now reaching a conclusion. I thought that it would be helpful to bring together developments into one place so the committee can see the full context. I will follow up early in the new year with a separate letter addressing the more detailed questions you pose in your correspondence.

The UK's approach to the EU budget is to deliver real budgetary restraint in the EU, in order to secure the best possible deal for UK taxpayers. Both the Chancellor's deal on halving and deferring the £1.7 billion surcharge and the outcome of the annual budget negotiations this week show that the UK is delivering on these objectives in Brussels.

This has been the first annual budget negotiation under the new Multiannual Financial Framework (MFF) deal secured by the Prime Minister in February 2013, which delivered an unprecedented real terms cut to the EU budget framework.

As a result of that deal, the proposed 2014 annual budget will be lower in cash and real terms than the final 2013 budget. This, and the protracted negotiations around that budget, is evidence that the MFF deal is delivering fiscal restraint in the EU.

The budgets for both 2014 and 2015 are consistent with the MFF and are within its ceiling. The proposed 2014 budget includes the mobilisation of the contingency margin, and both the 2014 and 2015 budgets include the use of special instruments. Both of these instruments are provided for within the MFF. The contingency margin enables expenditure from future years of the MFF to be drawn forward to 2014. This drawn forward expenditure must be offset by an equivalent reduction to the ceilings in future years of the MFF. This leaves the total MFF ceiling unchanged.

The EU budget was €144.5bn in 2013. It will be €139.0bn in 2014, including a €3.2 billion mobilisation of the contingency margin. The proposed budget for 2015 is €141.2 billion.

Looking at the individual headings within the budget for 2015, payment expenditure on Heading 1a (research, learning and innovation) will increase by 33% to €15.8bn in 2015 compared to the final 2014 budget (€11.9bn). Payment expenditure on Heading 1b (regional growth and employment) will decrease by 4.3% to €51.1bn in 2015 compared to 2014 (€53.4bn). Payment expenditure on Heading 2 (agricultural policy, rural development and fisheries) will decrease by 0.08% to €56.0bn in 2015 compared to 2014 (€56.4bn). Payment expenditure on Heading 3 (immigration, migration, security and justice) will increase by 1.3% to €1.9bn in 2015 compared to 2014 (€1.7bn). Payment expenditure on Heading 4 (EU foreign policy and international development) will increase by 8.5% to €7.4bn in 2015 compared to 2014 (€6.8bn). Payment expenditure on Heading 5 (administration) will increase by 3% to €8.7bn in 2015 compared to 2014 (€8.4bn).

A number of different amending budgets have been agreed as part of this deal. Whilst some include increases to expenditure in 2014, other amending budgets return revenue to Member States, reducing contributions from the UK. For this reason, taking into account all the amendments that comprise the 2014 annual budget, the fiscal impact on the UK is neutral.

Despite the fact that the EU budget is falling in real and cash terms in 2014, the Government continues to believe there should be maximum restraint on the EU budget with even lower levels of payments, and was therefore unable to support the annual budget package. This package will be voted on formally in the Council of Ministers expected on Friday 12 December.

Separate to the annual budget, at the ECOFIN meeting of EU Finance Ministers on 7 November, the Chancellor secured an agreement to change the EU budget rules permanently, following the demand of a surcharge bill for £1.7 billion on 1 December. As the Prime Minister said at the time, while annual adjustments to contributions were a regular part of EU membership, a sudden and unprecedented demand for a £1.7 billion payment on 1 December was unacceptable.

The new rules allow for payments to be delayed without interest penalties, up to September the following year. This is being achieved through an amendment to Regulation 1150/2000. In addition, following discussion with the new European Commission, it was agreed that a full rebate would apply to the British payment, and that, for the first time ever, it would be paid at the same time as any money owed.

As the Chancellor set out to the House on 10 November 2013, Britain’s payments have as a result been halved, from £1.7 billion to approximately £850 million. This comprises three elements: the £1.7 billion, which, as set out in the original publication, itself comprises a gross transfer of £2.9 billion
(€3.6 billion) and a resulting return transfer of £1.2 billion (€1.5 billion); and then the rebate, estimated by the Commission to be worth approximately €1 billion (£850 million). These collectively come to a net payment of around £850 million.

The agreement secured by the Chancellor is now being implemented. The Government has confirmed in correspondence to the European Commission that it will make its payments in instalments next year. As a result, the UK made no payment on 1 December this year, and the Commission have confirmed the UK will not incur any interest as a result. A number of other countries have also deferred their payments.

The payments next year will follow the standard procedure for administering the EU budget, with net payments incorporating transfers to and from the budget. There will be a series of transfers from the EU totalling £1.2 billion, plus the exceptional application of the rebate payment of approximately £850 million, and so totalling approximately £2 billion. There will be gross transfers to the EU budget of £435 million on 1 July 2015, which represents approximately half the estimated overall net payment; and a further gross transfer of £2.4 billion on 1 September 2015, which, when offset by the above payments from the EU of approximately £2 billion which we understand will be received on or before this date, represents approximately the other half of the net payment.

The agreement reached implies that the UK’s net transfer to the EU for these specific payments will not exceed £850 million at any one time. In practice, these different transfers will be administered with the other standard monthly EU budget transfers, and aggregated into net payments, including the application of the rebate.

The Government will formally vote in favour of the amended regulation enabling the agreement secured by the Chancellor in the Council of Ministers.

The overall impact on the fiscal position of the EU budget, including both the annual budget and the deferred and reduced surcharge, was estimated by the Office for Budget Responsibility (OBR) in its Autumn Statement forecast on 3 December 2014. That forecast made an assumption for the annual budget which is broadly in line with the actual outcome. Taking this and their other assumptions into account, the OBR forecasts that the UK’s net contribution to the EU budget will be lower over the forecast period (2014-15 to 2018-19) than assumed at the Budget in March 2014.

I realise that the Government voting in favour of the amendment to the Own Resources Regulation is a scrutiny override and regret that we were unable to secure clearance before voting. However, this was an amendment that the Government led the calls for in Brussels, and is one which we believe is firmly in the UK’s national economic interest – legislating, as it does, for the agreement secured by the Chancellor to ensure that the UK made no payment on 1 December this year, and that the UK will not incur any interest as a result. The UK will now pay half of the £1.7 billion bill we were originally presented and do so in instalments next year. This is the best possible deal for the UK.

Finally, as discussed in our call earlier, I am happy to appear before the Committee on 27 January. This will give you a further opportunity to ask questions of the Government on this matter.

11 December 2014

Letter from the Chairman to David Gauke MP

Thank you for your EM, dated 9 December 2014 on the revised 2015 Draft Budget; your letter dated 10 December 2014 on Amending Letter to the Draft Amending Budget 6 (DAB6) for 2014; and your letter dated 11 December 2014 on the outcome of EU Budget negotiations. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 16 December 2014.

We are grateful to you for supplementing these letters with a telephone call to Lord Harrison on 11 December 2014. We are also grateful to you for agreeing to meet with the Committee on 27 January 2015 to discuss these issues further.

On the other hand, we are disappointed that the EM on the revised draft budget for 2015 was not received until after COREPER agreement on 9 December 2014. While we acknowledge that the EM was not late, we stress the importance of providing EMs to us as swiftly as possible when they are due to be discussed on an expedited basis. This is necessary in order to allow the Committee to fulfil its scrutiny obligations. This is particularly so in a case as important as this. We also understand that there was a delay in deposit of this document. Why was this?
We acknowledge that an override has occurred in relation to DAB6 (and its associated Amending Letter) and in relation to EM 15444/14 on the amendment to the Own Resources Regulation. We note your account of the reasons why the Government felt it necessary to override scrutiny on this occasion.

We would be grateful if your next letter could update the Committee on the final outcome of negotiations on the various documents at the 12 December Council and the 18/19 plenary session of the European Parliament. We request that this includes a full account of the final agreement on each of the Draft Amending Budgets. We would also be grateful if you could state explicitly which elements of the package the Government supported, which it abstained from in voting and which it opposed outright.

You state that the payments margin under the MFF ceiling is now €800 million, amounting to only 0.6%. Is such a narrow margin really wise? You state that the €3.2 billion mobilisation of the Contingency Margin must be offset in future years of the MFF. How confident are you that it will be possible to hold to the ceilings in future years, in particular given the recent history of substantial in-year increases by Draft Amending Budgets? Do you already anticipate it being necessary to bring forward Draft Amending Budgets for 2015? We would be grateful if your letter could also address these points.

In light of the conclusion of negotiations we now clear from scrutiny the revised Draft Budget for 2015, Draft Amending Budget 3 (DAB3) to the 2014 Budget, Draft Amending Budget 6 (DAB6) to the 2014 Budget and its associated Amending Letter, and EM 15444/14 on the amendment to the Own Resources Regulation.

We look forward to receipt of your letter responding to the detailed questions set out in our 3 December and 10 December 2014 letters as early as possible in the new year. We will provide a further substantive response following receipt of that letter.

17 December 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter, dated 3 December, on the proposal for a Council Regulation Amending Regulation No. 1150/2000 implementing decision 2007/436/EC, on the System of European Communities’ Own Resources (The Amending Regulation). Thank you also for your letter, dated 10 December, regarding the Draft EU Budget 2015 and Draft Amending Budgets 3 (DAB3) and 6 (DAB6) for 2014. I hope that the Committee will have now received my letter of 11 December which updated you on the EU budget negotiations which developed rapidly. In that letter, I offered to provide further information once negotiations had formally concluded.

The 2015 EU Budget was agreed at the Council of Ministers on 12 December. The 2015 EU Budget was then formally adopted when the European Parliament gave its agreement on 17 December. A number of different Amending Budgets for 2014 were also agreed as part of this deal.

This delivered a final EU Budget of €139.0 billion for 2014, including a €3.2 billion mobilisation of the contingency margin, and an adopted EU Budget for 2015 of €141.2 billion. As a result, the final EU Budget for 2014 is lower in cash and real terms than the final EU Budget for 2013 (€144.5 billion). Both the 2014 and 2015 EU Budgets are consistent with the Multiannual Financial Framework (MFF) and are within its ceiling. This deal is evidence that the 2014-2020 MFF agreed by the Prime Minister is delivering fiscal restraint in the EU.

However, despite the fact that the EU Budget is falling in real and cash terms in 2014, the Government continues to believe there should be maximum restraint on the EU Budget with even lower levels of payments, and was therefore unable to support the annual EU Budget package.

Coming to your questions, you asked whether the Government agreed with Vice President Georgieva and Italian Finance Minister Padoans’ sentiments that the revised Draft EU Budget 2015 proposal reflects the need to boost jobs, growth and investment without jeopardising Member States’ efforts to consolidate their public finances. The revised Draft Budget and the adopted EU Budget for 2015 both set Heading 1a payments expenditure at €15.8 bilion. This is a 33% increase on the Heading 1a payments expenditure in the final EU Budget for 2014 (€11.9 billion). The Government welcomes this greater prioritisation of Heading 1a - which focuses on research, innovation and long term investment - within the overall budget; however, we felt that there also needed to be more significant reductions to the areas of the EU Budget which represent lower value for money to the taxpayer.
With regard to the negotiation process, there was no agreement on a Council position for the 2014 Draft Amending Budgets at Budget ECOFIN on 14 November. As a result, negotiations did not proceed with the European Parliament. On 17 November, a Council position was established at COREPER. Negotiations then began with the European Parliament on both the EU Budget for 2015 and the 2014 Draft Amending Budgets. However an agreement could not be found before the conciliation period expired at midnight on 17 November.

Following on from this you asked for an explanation of the Council press release, in particular the statement on the mobilisation of Special Instruments for €350 million expenditure. Special Instruments have always been part of the budget, and the Government’s focus, as with all aspects of the EU Budget is to keep costs controlled. The budget outcome assumes the Special Instruments as part of the Contingency Margin.

As set out in my previous letter, some of the 2014 Amending Budgets increased expenditure for the year, while others returned revenue to Member States. This returned revenue includes the fines, financial surplus from 2013 and revised own resources forecast which the Council press release presents as having offset the increase in payments. The Government believed that further expenditure reductions could be found in 2014 and 2015.

You also sought the Government’s view on the relationship between the Commission’s Investment Plan for Europe and the EU Budget for 2015. Within this Investment Plan, the Commission proposes the creation of the European Fund for Strategic Investment (EFSI), a new €21 billion fund which will aim to mobilise at least €315 billion of additional investment finance in the EU over 3 years (2015-17). The €21 billion will consist of a €16 billion EU guarantee, 50% of which will be ‘paid in’ from the EU Budget. The EIB will contribute €5 billion from its own resources. I am writing to you separately regarding the Investment Plan. Likewise, I have responded to you separately on the questions which you posed on the European Court of Auditors report for 2013.

With regard to scrutiny, you asked for an explanation of the delay in the deposit of the Commission’s revised Draft EU Budget 2015 proposal which was published on 27 November. On 10 December, we arranged for the deposit of the Commission’s document, within two weeks of its publication, having submitted an Explanatory Memorandum a day prior. This was ahead of the anticipated formal Council vote on EU Budget for 2015, which happened sooner than we had anticipated due to the speed in which an in-principle agreement was reached in trilogues. However, I accept that we could have been more proactive in depositing the Commission’s revised Draft EU Budget 2015 for your consideration ahead of receipt of the Explanatory Memorandum.

You also asked for further details on the Council’s consideration of the Amending Regulation proposal. Following the discussions at ECOFIN on 7 November, the proposal was discussed further in COREPER on 13 November ahead of formal adoption via Council written procedure on 18 December. The European Court of Auditors (ECA) published their opinion on the proposed Amending Regulation on 2 December. The European Parliament initially withheld their opinion on the proposal, before providing their consent on 17 December.

You also queried what the implications of the agreement of the Amending Regulation were for Member States due to be reimbursed in 2014. This amendment was to avoid unacceptable requests for such a vast sum of money with so little time to pay. As set out in my letter of 11 November, Member States unanimously supported this proposal at ECOFIN on 7 November.

Furthermore, you requested clarification of the Chancellor’s statement that, as a result of the Amending Regulation, the bill which the UK faced was halved and that it had not been clear whether we would receive a rebate. As set out by the Chancellor, confirmation of the UK rebate occurred following bilateral and constructive engagement with the Commission in the two weeks leading to the ECOFIN on 7 November. The application of the rebate was confirmed by the Commission on 6 November and resulted in the UK’s payment falling from £1.7 billion to approximately £850 million.

Your previous letters sought an explanation of the practical impact of this application of the rebate on the rebate process for 2014 and 2015. As set out in my letter of 11 December, following discussion with the new European Commission, it was agreed that, for the first time ever, the rebate would be paid at the same time as any money owed.

Further, as I also set out in my previous letter, the overall impact on the UK fiscal position of the EU Budget, including both the annual EU Budget and the deferred and reduced surcharge, was estimated by the Office for Budget Responsibility (OBR) in its Autumn Statement forecast on 3 December 2014. That forecast made an assumption for the annual budget which is broadly in line with the actual
outcome. Taking this and their other assumptions into account, the OBR forecasts that the UK’s net contribution to the EU Budget will be lower over the forecast period (2014-15 to 2018-19) than assumed at the Budget in March 2014.

With respect to the impact of the amending regulation on the negotiation of the 2015 EU Budget and the Draft Amending Budgets for 2014, as the Council press release sets out: the deal reached included the European Parliament’s commitment to provide its opinion on the amended regulation during its December plenary session. This allowed the Council to adopt the regulation in a timely manner.

Moreover, you asked a series of questions searching for a fuller explanation of the basis of the Commission’s requested payment adjustment from the UK and the means of calculation. On 31 October, the ONS, at the request of the Clerk Adviser, sent a note to the House of Commons European Scrutiny Committee. This explained UK GNI and the calculation of UK contributions to the EU Budget. As part of due process, I understand that the note was also shared with House of Lords Committee. I believe this note covers your questions on this subject comprehensively. However, the key point is that, while the UK authorities were aware of the GNI data being submitted for the UK well in advance of the Commission’s calculations, neither the ONS nor the Treasury had knowledge of other countries’ data, on which the calculations critically depended on – until 17 October. It was at this point that the Commission issued the Government with its unprecedented demand for a £1.7 billion payment on 1 December.

You also referred to a letter which my predecessor, Nicky Morgan, sent to you on 11 March 2014 regarding the European Court of Auditors’ Annual Report for 2012. This referred to the ONS’s priorities with regard to outstanding GNI revisions relating to the UK. Specifically, you asked how this related to the request from the Commission to the UK for an additional contribution of £1.7 billion. I reassert that until the data for all Member States was provided by the European Commission we could not have known how much the UK would be requested to pay. That information was first released on 17 October. This was confirmed by the European Commission in their press release of the 24 October, which stated “this year, Member States were informed of the budgetary impact of the new data on 17 October”.

Finally, I look forward to appearing before the Committee to discuss any further questions which you might have.

16 January 2015

Letter from David Gauke MP to the Chairman

Thank you for your letters dated 3 December, 10 December and 17 December. These letters covered: the EU Budget 2015; and, the Draft Amending Budgets 2014; and, the amendment to the Own Resources Regulation (The Amending Regulation). In my letter of 11 December, which updated you on the EU Budget negotiations which developed rapidly at that time, I offered to provide further information once negotiations had formally concluded. Allow me to provide that update now.

The 2015 EU Budget was agreed at the Council of Ministers on 12 December. The 2015 EU Budget was then formally adopted when the European Parliament gave its agreement on 17 December. A number of different Amending Budgets for 2014 were also agreed as part of this deal.

This delivered a final EU Budget of €139.0 billion for 2014, including a €3.2 billion mobilisation of the contingency margin, and an adopted EU Budget for 2015 of €141.2 billion. As a result, the final EU Budget for 2014 is lower in cash and real terms than the final EU Budget for 2013 (€144.5 billion). Both the 2014 and 2015 EU Budgets are consistent with the Multiannual Financial Framework (MFF) and are within its ceiling. This deal is evidence that the 2014-2020 MFF agreed by the Prime Minister is delivering fiscal restraint in the EU.

However, despite the fact that the EU Budget is falling in real and cash terms in 2014, the Government continues to believe there should be maximum restraint on the EU Budget with even lower levels of payments, and was therefore unable to support the annual EU Budget package.

Coming to your questions, you asked for a full account of how the Government voted on each of the elements of the package agreed on the EU Budget 2014, EU Budget 2015 and the Amendment to the Own Resources Regulation. The Government voted in favour of: the Amending Regulation; and, Draft Amending Budget No.4 for 2014. The Government abstained on: the EU Budget for 2015; 2014 Draft Amending Budget No.5 for 2014; Draft Amending Budget No.6 for 2014; Draft Amending Budget

You also asked whether the Government agreed with Vice President Georgieva and Italian Finance Minister Padoans’ sentiments that the revised Draft EU Budget 2015 proposal reflects the need to boost jobs, growth and investment without jeopardising Member States’ efforts to consolidate their public finances. The revised Draft Budget and the adopted EU Budget for 2015 both set Heading 1a payments expenditure at €15.8 billion. This is a 33% increase on the Heading 1a payments expenditure in the final EU Budget for 2014 (€11.9 billion). The Government welcomes this greater prioritisation of Heading 1a - which focuses on research, innovation and long term investment - within the overall budget; however, we felt that there also needed to be more significant reductions to the areas of the EU Budget which represent lower value for money to the taxpayer.

With regard to the negotiation process, there was no agreement on a Council position for the Draft Amending Budgets for 2014 at Budget ECOFIN on 14 November. As a result, negotiations did not proceed with the European Parliament. On 17 November, a Council position was established at COREPER. Negotiations then began with the European Parliament on both the EU Budget for 2015 and the 2014 Draft Amending Budgets. However, an agreement could not be found before the conciliation period expired at midnight on 17 November.

You also pointed out that the margin under the 2015 MFF ceiling was only €800 million and questioned whether such a narrow margin was wise. The Government believes that good budgetary management requires a significant margin - greater than which exists for 2015 - to account for in-year spending pressures which may arise. As such, the Government could not support the EU Budget 2015 which was agreed.

Following on from this you asked for an explanation of the Council press release, in particular the statement on the mobilisation of Special Instruments for €350 million expenditure. Special Instruments have always been part of the budget, and the Government’s focus, as with all aspects of the EU Budget is to keep costs controlled. The budget outcome assumes the Special Instruments as part of the Contingency Margin.

Related to this point, you noted that expenditure mobilised through the Contingency Margin must be offset in future years and asked whether the Government was confident that the MFF ceilings would remain intact. The requirement to offset expenditure mobilised by the Contingency Margin is set out in the MFF. The MFF was agreed unanimously by Member States and we expect it to be delivered as adopted. It is a government priority to ensure that annual EU Budgets agreed are within the ceilings set by the MFF.

As set out in my previous letter, some of the Amending Budgets for 2014 increased expenditure for the year, while others returned revenue to Member States. This returned revenue includes the fines, financial surplus from 2013 and revised own resources forecast which the Council press release presents as having offset the increase in payments. The Government believed that further expenditure reductions could be found in 2014 and 2015.

Another of your questions sought the Government’s view as to whether it would be necessary to bring forward Draft Amending Budgets for 2015. There have already been two Draft Amending Budgets for 2015 which I have written to you separately on.

You also sought the Government’s view on the relationship between the Commission’s Investment Plan for Europe and the EU Budget for 2015. Within this Investment Plan, the Commission proposes the creation of the European Fund for Strategic Investment (EFSI), a new €21 billion fund which will aim to mobilise at least €315 billion of additional investment finance in the EU over 3 years (2015-17). The €21 billion will consist of a €16 billion EU guarantee, 50% of which will be ‘paid in’ from the EU Budget. The EIB will contribute €5 billion from its own resources. I have written to you separately regarding the Investment Plan. Likewise, I have responded to you separately on the questions which you posed on the European Court of Auditors report for 2013.

With regard to scrutiny, let me reassure you that the Government takes its Parliamentary scrutiny obligations seriously. Specifically, you asked for an explanation of the delay in the deposit of the Commission’s revised Draft EU Budget 2015 proposal which was published on 27 November. On 10 December, we arranged for the deposit of the Commission’s document, within two weeks of its publication, having submitted an Explanatory Memorandum a day prior. This was ahead of the anticipated formal Council vote on EU Budget for 2015, which happened sooner than we had anticipated due to the speed in which an in-principle agreement was reached in trilogues. However, I
accept that officials could have been more proactive in depositing the Commission’s revised Draft EU Budget 2015 for your consideration ahead of receipt of the Explanatory Memorandum.

You also asked for further details on the Council’s consideration of the Amending Regulation proposal. Following the discussions at ECOFIN on 7 November, the proposal was discussed further in COREPER on 13 November ahead of formal adoption via Council written procedure on 18 December. The European Court of Auditors (ECA) published their opinion on the proposed Amending Regulation on 2 December. The European Parliament initially withheld their opinion on the proposal, before providing their consent on 17 December.

You also queried what the implications of the agreement of the Amending Regulation were for Member States due to be reimbursed in 2014. This amendment was to avoid unacceptable requests for such a vast sum of money with so little time to pay. As set out in my letter of 11 November, Member States unanimously supported this proposal at ECOFIN on 7 November.

Furthermore, you requested clarification of the Chancellor’s statement that, as a result of the Amending Regulation, the bill which the UK faced was halved and that it had not been clear whether we would receive a rebate. As set out by the Chancellor, confirmation of the UK rebate occurred following bilateral and constructive engagement with the Commission in the two weeks leading to the ECOFIN on 7 November. The application of the rebate was confirmed by the Commission on 6 November and resulted in the UK’s payment falling from £1.7 billion to approximately £850 million.

Your previous letters sought an explanation of the practical impact of this application of the rebate on the rebate process for 2014 and 2015. As set out in my letter of 11 December, following discussion with the new European Commission, it was agreed that, for the first time ever, the rebate would be paid at the same time as any money owed.

Further, as I also set out in my previous letter, the overall impact on the UK fiscal position of the EU Budget, including both the annual EU Budget and the deferred and reduced surcharge, was estimated by the Office for Budget Responsibility (OBR) in its Autumn Statement forecast on 3 December 2014. That forecast made an assumption for the annual budget which is broadly in line with the actual outcome. Taking this and their other assumptions into account, the OBR forecasts that the UK’s net contribution to the EU Budget will be lower over the forecast period (2014-15 to 2018-19) than assumed at the Budget in March 2014.

With respect to the impact of the Amending Regulation on the negotiation of the EU Budget for 2015 and the Draft Amending Budgets for 2014, as the Council press release sets out: the deal reached included the European Parliament’s commitment to provide its opinion on the Amending Regulation during its December plenary session. This allowed the Council to adopt the Regulation in a timely manner.

Moreover, you asked a series of questions searching for a fuller explanation of the basis of the Commission’s requested payment adjustment from the UK and the means of calculation. On 31 October, the Office for National Statistics (ONS), at the request of the Clerk Adviser, sent a note to the House of Commons European Scrutiny Committee. This explained UK GNI and the calculation of UK contributions to the EU Budget. As part of due process, I understand that the note was also shared with House of Lords Committee. I believe this note covers your questions on this subject comprehensively. However, the key point is that, while the UK authorities were aware of the GNI data being submitted for the UK well in advance of the Commission’s calculations, neither the ONS nor the Treasury had knowledge of other countries’ data, on which the calculations critically depended on – until 17 October. It was at this point that the Commission issued the Government with its unprecedented demand for a £1.7 billion payment on 1 December.

You also referred to a letter which my predecessor, Nicky Morgan, sent to you on 11 March 2014 regarding the European Court of Auditors’ Annual Report for 2012. This referred to the ONS’s priorities with regard to outstanding GNI revisions relating to the UK. Specifically, you asked how this related to the request from the Commission to the UK for an additional contribution of £1.7 billion. I reassert that until the data for all Member States was provided by the European Commission we could not have known how much the UK would be requested to pay. That information was first released on 17 October. This was confirmed by the European Commission in their press release of the 24 October, which stated “this year, Member States were informed of the budgetary impact of the new data on 17 October”.

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Finally, I look forward to appearing before the Committee to discuss any further questions which you might have.

9 February 2015

EUROPEAN COURT OF AUDITORS’ ANNUAL REPORT ON MAKING THE BEST USE OF EU MONEY: A LANDSCAPE REVIEW OF THE RISKS TO THE MANAGEMENT OF THE EU BUDGET (UNNUMBERED)

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

Thank you for your unnumbered EM, dated 22 January 2015, on the European Court of Auditors report, ‘Making the best use of EU money: A landscape review of the risks to the management of the EU budget’. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 10 February 2015.

We welcome this report as an important and valuable contribution to efforts to reform the EU budgetary process. As you know, we have argued for some time that the budgetary process is no longer fit for purpose and is in need of urgent reform. We note that the ECA report chimes with many of our own conclusions. We draw particular attention to its conclusion that “both the Commission and the Member States are responsible for ensuring that EU funds are spent well and wisely”. We agree that there has been an over-emphasis on spending the EU budget rather than on the results achieved by such spending. We also agree with the ECA’s conclusion existing commitments “may affect the Commission’s ability to meet all requests for payments in the year in which the requests are made”, and would welcome your comments on the problem of the RAL overhang, to which this Committee has long drawn attention, and how you believe it can best be addressed.

We also support the ECA’s recommendations. We share its call for spending to be focused on areas where there is European added value, and for systematic monitoring and evaluation of progress towards these objectives. We support its recommendation of the establishment of a robust performance management and reporting system. We also endorse its conclusion that the Commission needs to improve and publish its long term cash flow forecast, in order to better anticipate the monies required from Member States and to ensure that the necessary payments can be met from approved annual (payment) budgets. We also note its call for the mid-term review of the 2014-2020 MFF to provide opportunities to reflect on priorities for EU budget spending.

You also indicate broad support for the ECA’s recommendations. However we would be grateful for a more detailed response to each of its findings under the chapter heading ‘What are the opportunities and what needs to be done?’. Do you disagree with any of the ECA’s findings? In light of your commitment to “encourage the Commission to take steps to better assess and monitor the effectiveness and efficiency of EU budget funds”, what practical action will you take to press for the ECA’s recommendations to be taken forward? What timetable will you adopt to ensure the urgent consideration of such proposals? Such reforms need to be implemented if our support for the future allocation of EU funds is to be maintained.

We look forward to discussing these issues with you at your appearance before the Sub-Committee on 24 February 2015. In order to inform that discussion, we would be grateful for a response to this letter by 23 February 2015 at the latest. In the meantime we will continue to hold the document under scrutiny.

10 February 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter of 10 February concerning the European Court of Auditors (ECA) report, ‘Making the best use of EU money: A landscape review of the risks to the management of the EU budget’. In your letter, the Committee asks for a more detailed response to the findings outlined in the report.

The Government takes financial management of the EU budget very seriously and welcomes the ECA’s annual report on the implementation of the EU budget and its Landscape review of the risks to
financial management. The Government agrees that all those involved in the management of EU budget funds, including Member States, must do more to improve the way EU funds are implemented. Ensuring compliance with the rules and regulations governing EU budget expenditure remains a necessary means of ensuring that Member States manage EU funds effectively.

However, the Government has maintained that the complexity of some regulatory frameworks can result in inconsistent interpretations of the rules. We therefore join the ECA in pressing the Commission for genuine simplification. The Government also urges better engagement between the Commission and Member States to understand and address the reasons behind systemic and repeated errors which contribute to the overall standard of financial management. Further the Government supports the ECA’s drive for a greater focus on the performance of EU budget funds. Taxpayers need to have confidence that EU funds are deployed effectively and deliver maximum impact so the consideration of performance and the added value of EU budget expenditure remain key priorities for the Government.

The Government also welcomes the ECA’s recommendation that performance of EU budget funds should be better monitored and assessed to ensure that they deliver value for money. Taxpayers need to have confidence that EU funds are deployed effectively so the consideration of performance and the added value of EU budget expenditure remain key priorities for the Government.

The Government notes the Commission’s efforts in the areas of financial and performance management, including in the development of more coherent monitoring, evaluation and reporting on the performance of EU financial programmes for the 2014-2020 programme period. Nevertheless, as the ECA report makes clear, more can be done. The Government will therefore continue to work with like-minded Member States to ensure that the Commission makes further changes to achieve more in this area.

In addition, the Government agrees with the ECA’s assertion that the Mid-Term Review of the current MFF may provide opportunities to take forward the above-mentioned proposals. To this end, we strongly welcome Vice-President Georgieva’s announcement, communicated at ECOFIN on 17 February, to create an inter-institutional working group on ‘A Budget for Results’. Due to meet for the first time on 22 September this year, the working group will be composed of representatives from the European Parliament, the Commission and the Council. The Government is keen to ensure that the UK plays a leading role in this forum where, in line with the ECA report, we will push for steps to be taken to better assess and monitor the effectiveness and efficiency of EU budget funds.

I look forward to discussing these and other EU budget related issues with the Committee on 24 February.

23 February 2015

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 23 February 2015 on the unnumbered EM on the European Court of Auditors report, ‘Making the best use of EU money: A landscape review of the risks to the management of the EU budget’. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 2 March 2015.

We welcome your support for the ECA’s recommendations, and urge you to do all you can to ensure that its proposals are taken forward in the coming months, in particular in the context of the MFF Mid-Term Review. We repeat our view that such reforms need to be implemented if our support for the future allocation of EU funds is to be maintained.

We welcome Vice-President Georgieva’s announcement of an inter-institutional working group on ‘A Budget for Results’. We would be grateful for further information on the work and operation of this Working Group as it emerges.

In the meantime we are now content to clear the document from scrutiny.

2 March 2015
Letter from the Chairman to David Gauke MP, Financial Secretary, HM Treasury


We are glad to see that the ECA again conclude and indeed approve that the EU accounts are reliable and fairly represent the financial position of the EU, the results of its operations and its cash flows for the year. In noting that the ECA has granted a qualified Statement of Assurance for the twentieth year in a row, we observe that there has been next to no improvement in the headline estimated error rate. It is regrettable that this figure does not point to any significant improvements in control of the budgetary process. The ECA report does highlight however that had the Commission and Member States not applied corrective measures to transactions, the Court, based on its reviewed sample of transactions, would have estimated the level of error to be 1.6% higher than the current level, which is of course welcomed. We are concerned that new challenges in presenting reliable financial information of the EU budget will be increasingly burdensome in managing the EU budget. These challenges arise due to ongoing financial developments, particularly the growing use of net financial corrections and financial instruments. How is the UK Government intending to respond to the ECA’s recommendation that the Commission put in place sound procedures for Member States to work with the Commission to confirm timings, origins and amounts of corrective measures, in order to give greater assurance to the accuracy of the figures presented in the accounts?

Paragraph 58 of your Explanatory Memorandum implies that the governments of the Member States are not responsible for the problems to which the Court of Auditors draws attention. Yet it is clear that governments are, and indeed the Court of Auditors draw attention to failings in this country. Paragraph 59 of your EM implies resistance to Commission efforts to oblige the Member States to tackle such problems. As such you fail to address the persistent problems that exist at Member State level. You will find attached [not printed] to this letter an Annex produced by the European Court of Auditors detailing references to the UK in the Court’s Annual Report. We would be grateful for full details and explanations of the various reservations and weaknesses that have contributed to the error rate in the UK.

We are disappointed at the Government’s continued lack of initiative in suggesting improvements in the way the budget is run. While an increased focus on added value is welcomed, this does not alleviate the short and medium term persistent problems of inaccuracy of errors due to inadequate shared management processes at the Member State level. The information in the Evaluation Reports by the Commission are deemed inadequate to be used as a basis for discharge of the budget. The Court of Auditors also state that new performance arrangements may indeed encourage an increased focus on results, but the impact is likely to be marginal as there are still no financial incentive or sanctions in the 2014-2020 framework relating to the results achieved with EU funding. We ask again why sanctions should not be introduced. What specific proposals for sanctions have been proposed by the Commission? How would they be applied? What effective solutions are there to address the weak incentives in the management of the EU budget, other than performance measures? Which of the ECA’s recommendations do you find particularly helpful in restoring trust in operations of shared management?

In light of the mechanism of checks to assess the regularity, reliability and legality of transactions by the EU, we would be interested to know how the 4.7% error rate compares to the error rate for the UK budget. Can you estimate what this level would be? We note that in 2006, Sir John Bourn, the then Comptroller and Auditor General at the UK’s National Audit Office, told this Committee in the context of its report on ‘Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals’, that were he required to issue a single Statement of Assurance on the UK’s Government’s accounts in the same way as the Court of Auditors does for the European Union’s accounts, he, like the Court, would be unable to do so. This was because the previous year he issued a qualified opinion on 13 of the 500 accounts of the British Government which he audited. Does such a situation continue to hold true today?

Finally, we note that the Prime Minister has promoted a reform agenda for the EU. Why is reform of the budgetary system not a prominent part of this agenda?
We would be grateful for a response to this letter by 16 December 2014. In the meantime we will continue to hold the document under scrutiny.

2 December 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 2 December regarding the European Court of Auditors’ (“ECA”) report on the implementation of the EU budget in 2013. I note that the Committee shares the Government’s concerns regarding the continued qualification by the ECA of EU budget expenditure and the almost stable error rate which remains significantly above the ECA’s 2% materiality threshold.

Your letter asked how the Government intends to respond to the ECA’s recommendation that the Commission introduce sound procedures for Member States to work with the Commission to give greater assurance to the accuracy of figures in the EU budget accounts. The Government recognises the importance of ensuring that the EU budget accounts are accurate and reliable and will therefore engage with the Commission to discuss and agree proportionate and effective proposals capable of improving the quality and accuracy of the EU budget accounts.

As has been set out in previous correspondence and as discussed by Lord Newby when he appeared before the Committee on 11 December 2013, the Government recognises that all those involved in the management and implementation of EU budget funds must do better. This naturally includes Member States which share with the Commission responsibility for managing some 80% of EU budget expenditure.

I would therefore like to reassure the Committee that in paragraphs 58 and 59 of the unnumbered EM on the ECA’s report (dated 24 November 2014), I did not intend to indicate that Member States do not have any responsibility for the financial management of the EU budget. Paragraph 58 sought to explain why this Government continues to place such importance on effective financial management of the EU budget, while paragraph 59 confirmed the Government’s view of current and future systems and controls designed to improve financial management.

The Government remains open to considering proposals designed to improve the financial management of the EU budget but will continue to seek to ensure that any additional measures introduced are capable of delivering the required improvements and do not add significantly to the costs Member States already incur.

In your letter, the Committee requested an account of the references to the UK in the ECA’s report. I have provided this information in the attached annex.

It is regrettable that the Committee considers the Government’s approach to improving financial management to be lacking in initiative. As set out in the unnumbered EM number on the ECA’s report on the 2013 EU budget, the Government maintains that clear steps must be taken to ensure that the EU budget is spent appropriately and this should include the simplification of complex rules and regulations governing the use of EU budget funds, as well as improved and structured monitoring of the value of EU budget expenditure to ensure that funds are deployed and used effectively.

The Government supports the introduction of new measures and the proportionate use of existing corrective and punitive measures to incentivise Member States to better manage EU budget funds. However, as set out in my letters of 18 November and 9 December on EM 13681/14 (follow-up to the discharge for the 2012 financial year), the Government does not support the proposed introduction of progressively increasing payment reductions and administrative sanctions at this stage.

It is clear that Member States must continue to improve their control systems to better manage EU budget funds but the introduction of additional punitive incentives for errors which have no practical impact on EU budget funds and their use would not effectively address the errors.

Your letter asked which of the ECA’s recommendations are particularly helpful in restoring trust in operations of shared management. The ECA’s report contains a number of helpful recommendations to improve the financial management of EU budget funds but of particular note are the following. Recommendation 1 of chapter 4 (paragraph 4.37) calls on Member States’ paying agencies to carry out extensive administrative checks through utilising all relevant and available information to better detect and correct a greater number of errors. Further, recommendation 2 of chapter 8 (paragraph 8.36) calls on the Commission to make its control activities more risk driven, focusing checks on high-risk
beneficiaries, such as those with less experience of EU funding) and reducing the burden of checks on less risky beneficiaries.

Both recommendations encourage a targeted, proportionate and prevention based approach to financial management while recognising the role to be played by both the Commission and Member States in achieving necessary improvements.

Your letter also asked for details of the UK’s domestic error rate for expenditure of the UK budget. A comparable domestic error rate is not currently produced.

In your letter of 22 October (on The Draft EU Budget 2015 and Draft Amending Budget 3 for 2014), the Committee posed a series of questions in relation to the ECA report. As the ECA’s report on the 2013 EU budget had not been published at that point, I committed to responding to the Committee’s points. The report had been published.

The Government considers that the ECA’s annual reports do take steps to ‘name and shame’ those not effectively managing EU budget funds. The annual report contains numerous and specific examples of Member States and EU institutions’ weaknesses in the management of EU budget funds which ensures that all those dealing with EU budget funds are aware of and are held publicly accountable for identified shortcomings. This approach also fosters an open dialogue between the ECA, Commission and Member States.

Nevertheless, it is clear from the ECA’s findings that more must be done to improve the system of budgetary control. As set out in my EM on the ECA’s 2013 report, the Government welcomes the report’s consideration of performance and the added value of EU budget expenditure which remain key priorities for the Government.

In your letter of 22 October, the Committee also asks whether the Government believes that Mr Juncker will seek to address issues of budgetary control during his presidency. The Government anticipates that the Commission will reflect upon the ECA’s conclusions and Vice-President Georgieva has stated her commitment to budgetary management. Further, the UK will continue to work with like-minded Member States to engage with the Commission on this important issue.

The Government notes Mr Ashworth MEP’s proposal for appointing a Commissioner of budgetary control and remains open to considering and discussing any formal proposals for improving financial management of EU budget funds.

Finally, your letter of 22 October sought the Government’s views on the UK’s management of agricultural and regional funds, which has seen a decline. As set out in my letter dated 18 November on follow-up to the discharge for the 2012 financial year, the management and implementation of these funds continue to present a challenge for Member States and EU institutions alike. The UK has taken a leading role in pressing for the simplification of the complex rules and legislation governing these areas of the EU budget to secure rules that are both universally accessible and capable of being consistently applied by all.

5 January 2015

Letter from the Chairman to David Gauke MP


We are grateful for your helpful response addressing our concerns of persistent weak budgetary control systems that underpin inefficiencies in the management and implementation of EU budget expenditures. We acknowledge that you have reflected on the ECA’s recommendations and can support forthcoming measures which you consider as targeted, proportionate and preventative.

We note from your references to correspondence with the Committee that the Government takes the responsibilities of shared management seriously. However we regret that you have been unable to provide details of the UK error rate for expenditure from the UK budget. While you state that “a comparable domestic error rate is not currently produced”; as our 2 December 2014 letter pointed out, this has been provided in previous years. We therefore expect this figure to be communicated. How would you respond?
We recognise that the Government is committed to improvements in shared management, given they do not bear significant extra costs for Member States and are suitable for delivering required improvements. We note your support for simplified rules, consistent application of the legislation, opposition to sanctions or increasing payment reduction. It is disappointing that management of implementation of agricultural and regional funds continue to present a challenge. We encourage you to maintain a leading role in engaging on more innovative proposals in the future, particularly given your dissatisfaction with the error rate of EU budget expenditure.

We would be grateful for a response in relation to the UK error rate by 14 February 2015. In the meantime we now clear this document from scrutiny.

14 January 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter of 14 January in which the Committee cleared the above mentioned report from scrutiny. In your letter, the Committee also queried the lack of a comparable domestic error rate.

The European Court of Auditors’ (“ECA”) error rate includes the legality and regularity of the underlying transactions. The legality and regularity aspect accounts for the majority of the errors reported by the ECA, but is not considered under the old national audit requirements. As such, there is currently no comparable error rate for the UK.

However, under the new regulations, the National Audit Office (“NAO”) will provide error rates that include legality and regularity. These will be included in the NAO’s reports on the 2015 financial year.

11 February 2015

Letter from the Chairman to David Gauke MP


We are pleased to learn that the National Audit Office will provide error rates that include legality and regularity from the 2015 financial year onwards. We hope that this will make it easier in the future to compare error rates between the EU and the UK.

We do not require a response to this letter.

24 February 2015

EUROPEAN FINANCIAL REPORTING ADVISORY GROUP (EFRAG) (11690/14, 5213/14)

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

Following my letter of 15 March 2014, I am writing to confirm the final agreement.

I recently sent you EM 11690/14 covering a report from the Commission on the progress achieved in the implementation of the reform of the European Financial Reporting Advisory Group (EFRAG).

The Maystadt recommendations are an important element of the agreement of the funding programme for the international financial reporting and audit bodies.

Commitments to fund these bodies was related to these reforms, although the Commission’s proposal to provide funding support to three accounting and audit organisations was agreed on 3 April 2014 and published as Regulation (EU) No. 258/2014.

We had anticipated that the Commission’s report on progress with the reforms would be published early in April, but it did not take place until 8 July 2014. I am now following with details of the funding programme in the context of the satisfactory progress made on the reform of EFRAG, as described in the report.
The funding will be for the period 2014 – 2020. It will be provided in the form of operating grants awarded on an annual basis relating to:

— International Financial Reporting Standards Foundation (IFRS Foundation) EUR 31,632,000 (£25,002,408)
— The European Financial Reporting Advisory Group (EFRAG) EUR 9,303,000 (£7,354,213)
— The Public Interest Oversight Board (PIOB) EUR 2,241,000 (£1,771,417)

The UK supports the contribution these organisations make to a single and transparent set of global accounting standards.

31 July 2014

Letter from the Chairman to Jo Swinson MP

Thank you for EM 11690/14, dated 21 July 2014, on the Report from the Commission on the progress achieved in the implementation of the reform of EFRAG following the Maystadt report recommendations. Thank you also for your letter, dated 31 July 2014, on EM 5213/13, the Proposal for a Regulation 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 these documents at its meeting on 9 September 2014.

We welcome the progress in implementation of the Maystadt review recommendations. However we note that your EM does not comment on the departures from the Maystadt recommendations set out in the Commission document, including granting an additional seat to smaller Member States, the decision of the ESAs and the ECB to take only observer status, the addition of three additional seats to private stakeholders, and provision for a full-back mechanism of a qualified majority of two-thirds of Members to make a decision. What is the Government’s view of these adjustments?

You state that the UK will monitor progress with the reforms recommended by the Maystadt report. We also note that Philippe Maystadt will supervise the implementation of the reform of EFRAG. In that light we would be grateful for further updates on the progress of implementation in the months ahead.

We would be grateful for a response to our questions by 6 October 2014. In the meantime we now clear EM 11690/14 from scrutiny.

10 September 2014

Letter from Jo Swinson MP to the Chairman

I am writing in response to your letter of 10 September 2014 regarding a European Commission report on progress achieved in the implementation of the reform of the European Financial Reporting Advisory Group (EFRAG) that was summarised in EM 11690/14. Your letter welcomed the progress in the implementation of the Maystadt review recommendations and cleared the EM. You also noted a number of areas where the EFRAG’s reforms have departed from the Maystadt review recommendations and requested information on the Government’s view of these.

EFRAG plays an important role in the EU’s decision making processes in relation to the adoption of international accounting standards. As such it is essential that the body’s own governance arrangements provide confidence in the legitimacy of the advice it gives to the Commission. In this context, we are pleased with the decision to reform EFRAG and with the progress that has been made. The departures from the recommendations represent a pragmatic response to issues emerging during the implementation phase. Taking each of your points in turn:

— Granting of an additional seat to the smaller Member States - Although some smaller Member States do not have a national standard setter it is important that they have the opportunity to participate fully in the endorsement process. The granting of an additional seat to the smaller Member States recognises this and enhances EFRAG’s institutional legitimacy.
— Decision of the three European Supervisory Agencies (ESAs) and the European Central Bank (ECB) to take only observer status -The ESAs and
the ECB would have preferred a decision-making process centred around public authorities. As this is not the model proposed, they feel unable to participate as voting members of EFRAG's board. Both the ESAs and ECB have a strong interest in the accounting framework applied to companies listed on the EU's regulated exchanges. In view of this, we believe it is appropriate that they participate as observers.

Provision of three additional seats to private stakeholders - The increase in seats for private stakeholders is necessary to maintain the balance of EFRAG's board. This increase in seats should also ensure that concerns expressed after publication of Mr Maystadt's recommendations about the capacity of board members to reflect the wide spectrum of stakeholder interests can be addressed.

Qualified majority voting - It is essential that EFRAG is able to provide timely, high-quality advice to the Commission in support of the endorsement process. It would not be acceptable for the endorsement process to stall merely because consensus proved impossible to achieve. The proposal for advice to be agreed by a qualified majority, with the fall back of allowing the President to present his conclusions based on an indicative vote where a qualified majority view was not achievable, presents a practical way forward. We do not consider this undermines the Maystadt recommendation for consensus decision making.

Since the publication of the progress report the Commission has advertised for candidates for the role of President of EFRAG with a closing date of 15 September. The text of the notice was:

“The European Commission is looking for suitable candidates to fill in the post of President of the Board of the European Financial Reporting Advisory Group (EFRAG). The President of the EFRAG Board will be nominated by the European Commission after having heard the Council and the European Parliament and will be appointed by the EFRAG General Assembly.”

I will write again when I have news of the outcome from this exercise.

1 October 2014

EUROPEAN FUND FOR STRATEGIC INVESTMENT (5112/15)

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

Thank you for your EM 5112/15 dated 28 January 2015 on a Regulation on the European Fund for Strategic Investments (EFSI); EM 5317/15 on Draft Amending Budget No. 1 to the General Budget 2015, and your letter, dated 12 January 2015, on EM 16115/14, the Commission Communication on an Investment Plan for Europe. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 10 February 2015.

In our letter of 17 December 2014 we welcomed the Investment Plan for Europe but expressed some concern that the Fund may not have a large transformational impact due to its size and the imposition of regulatory and administrative barriers that may exist. We also asked you about the impact that the Guarantee Fund could have on the EU budget and thus the UK rebate, and whether a conflict of interest could arise. We also asked how HM Treasury would be applying the principle of non-additionality. We would be grateful for an answer to these questions. In addition we note that national contributions will be favoured in relation to the calculations under the Stability and Growth Pact. Are you concerned that Member States with weaker budgets, should they contribute to the fund, would still need to find and finance additional the borrowing?

Do you endorse the governance process as proposed for the Steering Board? Are you satisfied the Steering Board and Investment Committee will have sufficient accountability and independence? Furthermore, do you agree with the investment guidelines which determine the type of projects that the EFSI will support? In terms of growth and job creation priorities, is there sufficient emphasis on creating employment within the Investment Committee’s decision-making process? Should a clause be introduced to ensure that viable projects selected also need to ensure a sufficient level of job creation? The categories of potential investment listed in the document are of a very different
potential order of issue. More capital per euro of investment will therefore be required to support, for example, lending to SMEs or support for R&D spending than for classic infrastructure projects in transportation and energy. How is it therefore possible to state that there will be no sectoral pre-allocation of funds, and yet that the total sum available over the period will be precisely €315 billion? In light of this, how confident are you that the Investment Plan can fulfil its stated aims?

The proposal states that the participation of third parties, inside as well as outside the Union, will be subject to the consent of existing contributors. While third countries may contribute directly to the EFSI and take part in the governance procedure in a proportional way, the Commission and the EIB will not be able to be outvoted. What is your view of this arrangement?

More generally, what appetite there has been from private investors to co-finance potential projects chosen by the EFSI? Are any immediate operational challenges that need to be addressed? Lastly, while the Investment Plan hopes to involve SMEs in the circumstances they would be incentivised to co-invest, is there a danger that SMEs would be crowded out due to higher investment amounts co-invested from larger organisations?

We will seek to address these points with you at your appearance before the Committee on 24 February 2015, and in order to inform that discussion would be grateful for a response to this letter by 23 February at the latest. In the meantime, we now clear EM 5317/15 and EM 16115/14 from scrutiny. However, we will continue to hold EM 5112/15 under scrutiny.

10 February 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 10 February 2015 regarding the Investment Plan for Europe. You will be aware that the draft regulation that will underpin the European Fund for Strategic Investment (EFSI) was released by the Commission on 13 January and I submitted an Explanatory Memoranda on this proposal and the accompanying Draft Amending Budget No.1 2015 on 28 January. These proposals are now the subject of ongoing negotiations. I also note the questions in your letter of 17 December. Now the draft regulation has been released, I am able to provide more detailed responses to your questions.

You asked about the impact that the ESFI Guarantee Fund would have on the EU Budget. The EFSI Guarantee Fund will be capitalised to €8bn via reallocation from within the EU Budget. This capitalisation will take place over the course of the current Multiannual Financial Framework period to smooth the budgetary impact. Nonetheless, it is important that the Commission's annual budget proposals account for this expenditure as proposed. As you are aware, protection of the Multiannual Financial Framework secured by the Prime Minister is a well-established Government priority. The UK approach to negotiations on the EFSI will reflect this priority.

With regard to the reallocation, this will involve a transfer from existing Heading 1a expenditure - for which the UK is a net contributor - to the EFSI Guarantee Fund over 2015-2020. In the short term the money will be held in the EFSI Guarantee Fund, acting as a guarantee for additional European Investment Bank lending. Whilst there, it will not be classed as 'spent'.

The net financial impact, including the impact on the rebate, to the UK can only be judged in the long-term and it will be dependent on: success in accessing EFSI financing; success in bidding for Heading 1a expenditure; the extent to which the EFSI Guarantee Fund is called upon; the extent to which it is replenished by profits from EFSI lending; and, how much money is left in it once the EFSI comes to an end.

It is difficult to forecast how much additional European Investment Bank (EIB) lending the UK receives as a result of the EFSI Guarantee Fund. Yet, there is cause for cautious optimism: the UK achieved record levels of lending from the EIB in 2014. Equally, when the EFSI is wound up, there are a number of scenarios for the money left in the Guarantee Fund, it could be: transferred back to Heading 1a expenditure; sent back into the general EU Budget to meet other spending pressures; or, returned to Member States.

Following on from this you questioned whether HM Treasury would be applying the 'non-additionality' principle to EFSI financing. EFSI financing is provided by the EIB. On this basis, there will be no application of the 'non-additionality' principle. There is no incentive, as you suggested, to keep down the amount of financing which the UK accesses from the EFSI. Indeed, I actively encourage
bringing UK projects forward for the EFSI. I have made it clear that in order to maximise the UK benefit from the EFSI we will need strong cooperation across departments.

This is particularly the case for SMEs, where I am keen that we do all we can to deliver the benefits of the EFSI. We have reason to be positive. We expect the SME arm of the EFSI to be delivered through the EIB Group’s European Investment Fund, where the UK receives a high proportion of activity.

I am grateful for your assessment of the transformational impact of EFSI activity and I agree that we must be wary of unnecessarily burdensome regulatory and administrative barriers. I can assure that, in European discussions, the UK has emphasised the importance of taking forward necessary structural reforms in order to boost growth.

I also welcome the Hub for Technical Assistance the Commission seeks to establish through this regulation. The ambition for this is positive, as it seeks, over time, to build project expertise and therefore the capacity across Europe to bring successful projects to fruition, enriching the investment market.

On Governance, the exact structures of the EFSI are under negotiation. The current drafting of the regulation establishes an Expert Investment Committee underneath a Steering Board on which the EIB and Commission retain a veto. The Government does not object, in principle, to a Steering Board and Investment Committee, on the clear understanding that these structures do not become politicised, both in terms of membership and responsibilities. We do not want to see an imbalance in influence of the Steering Board, the structure of which the regulation outlines will be responsible for setting investment guidelines which will guide, at a strategic level, the project decisions of the Investment Committee. The central role of the EIB should also be welcomed, with the final responsibility for approval of all projects remaining with the EIB Board of Directors.

The Government is clear that projects benefiting from the EFSI must be credible to private sector investors and decisions on applying the guarantee to projects, based on the Investment Guidelines that will be drawn up, should be based on rigorous criteria and merit. Political targets should not dictate investment decisions. Overall, EU policy will influence the direction of the EFSI’s priorities, including the focus on jobs and growth. More generally, the Government, learning from the UK experience with guarantee mechanisms, seeks to maintain flexibility in the operation of the EFSI, to allow the EIB to respond to protect availability, market demand and the respective priorities of all Member States, including the UK.

It is important to remember that the stated ambition of €315bn refers to the total investment Europe the EFSI will seek to unlock. Delivering the targeted €315bn total investment in the European economy will be dependent on mobilising significant levels of investment from other sources, including the private sector. We expect the actual portfolio of investment directly associated with the EFSI’s guarantee to be significantly smaller.

Finally, you asked about the treatment of national contributions to the EFSI under the Stability and Growth Pact (SGP), and whether this might encourage Member States with weaker budgetary positions to engage in additional borrowing. The Commission has confirmed that capital contributions to the EFSI will be treated as exceptional, one-off measures, and therefore will not affect the Commission’s assessment of Member States fiscal targets under the SGP. This removes a barrier which may otherwise have deterred some from borrowing. The Government is clear that a credible commitment to deficit reduction and fiscal sustainability is a critical foundation for economic recovery. We encourage those Member States confronting high deficits to consider this when determining their approach to EFSI contributions.

23 February 2015

Letter from David Gauke MP to the Chairman

At my hearing with the European Union Committee on Tuesday 24 February, we discussed the European Fund for Strategic Investments. Further to our correspondence earlier this month on this subject, negotiations on the draft regulation that will establish the EFSI are moving quickly and I want to keep the Committee updated on developments in the areas of greatest importance to the UK, and greatest interest to the Committee.

You will be aware the EFSI, a guarantee fund seeking to leverage high levels of total investment in the European economy, is a key part of the wider European Investment Plan. As of this week, we have made significant progress in positively shaping the EFSI draft regulation on core issues for the UK, and
we have achieved our key priorities for our priorities. The outcome is that I am now confident we will secure a regulation which has the potential to bring significant benefits to the UK.

As outlined in previous correspondence, the EFSI regulation seeks to establish a €21bn first loss guarantee, €16bn of which will come from the EU budget (€8bn of which will be paid in and €8bn of which will be callable). You asked about the impact that the ESFI Guarantee Fund would have on the EU Budget and I would like to now clarify, as we have secured language in the recital of the Presidency’s proposal for the Council position that this €16bn is a hard limit on payments from the EU budget for the guarantee, and, crucially, will be found from within the MFF ceilings secured by the Prime Minister. All payments to the Guarantee Fund and budget decisions otherwise associated with the operation of the EFSI will be fully consistent with the terms of the Multi-Annual Financial Framework and be authorised by the Council and European Parliament through the normal budgetary processes.

The Committee has previously expressed interest in the proposed governance structures for the EFSI. We have worked to ensure that the Steering Board and Investment Committee structure I have previously outlined, and which will determine the application of the EFSI guarantee, remains as free from politics as possible. It is absolutely critical that the Guarantee is credible to private investors – including from outside the EU – in order to achieve the envisaged leverage, and that means ensuring that projects are selected solely on merit. As a result, we have shaped the regulation to emphasise the importance of economic viability in project selection. This will put the EIB in the best position to repeat its success in delivering the 1:18 capital to investment leverage ratio committed to as part of the 2012 capital increase, and which the EIB is well on target to achieve this year.

Also important to the UK, is the maintenance of the EIB’s AAA rating. The financial robustness of the EIB is a high priority for the UK, as it is at the very core of the EIB’s business model and is the fundamental basis of its ability to lend at favourable conditions. In order to provide sufficient assurance that EIB Management can protect the EIB’s financial soundness, we have ensured that the governance structure for this Fund will fully respect the EIB decision making process – all projects will be approved by the EIB Board in the usual way. This will ensure that EIB Management can safeguard the EIB’s AAA rating.

On the potential benefit to the UK, we have successfully maintained a broad definition of the areas of potential investment, and the instruments which can benefit from the guarantee. We have prevented the Council constraining the areas that can benefit from the EFSI, and ensured therefore that priority areas for the UK have not been ruled out from seeking support from the EFSI. The focus on economic viability, which we have emphasised in the drafting of the regulation, should also benefit the robust UK project pipeline.

I am positive that the draft regulation represents a good opportunity to the UK. Figures released this week show the UK received a record level of EIB funding in 2014, an estimated €7bn in 2014, 11% of total EIB lending and an increase of 20% from the previous year’s share. The EFSI activity will be delivered through the EIB, and the European Investment Fund (EIF), where the UK received a higher share of activity than any other member state in 2014. The EFSI therefore gives us an opportunity to build on this success.

The UK is well-placed to benefit from the EFSI, thanks to the UK stable system of economic regulation which attracts investors, and has been judged one of the best in the world by Moody’s. We are prepared to be on the front-foot in approaching the EFSI, and we are aided in this by our commitment to showcasing opportunities to domestic and foreign investors through the work we have done to put together a clear pipeline of projects covering both the public and private sectors (£460bn) as part of a National Infrastructure Plan.

I now believe we have delivered a regulation that is beneficial to the UK and meets our key priorities. I would therefore like to be in a position to support the agreement of a General Approach at ECOFIN 10 March. It is in the UK’s interest to support the General Approach, as a failure to support risks damaging the UK’s ability to influence the Presidency in their negotiations with the European Parliament and Commission.

2 March 2015
Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 2 March 2015, on EM 5112/15 on a Regulation on the European Fund for Strategic Investments (EFSI). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 2 March 2015.

We are content to accede to your request to clear the document from scrutiny pending attempts to agree a General Approach at the 10 March ECOFIN. We will write again shortly with a more substantive response to your letter and your previous letter, dated 23 February 2015.

2 March 2015

Letter from the Chairman to David Gauke MP

Thank you for your letters, dated 23 February 2015 and 2 March 2015, on EM 5112/15: a Regulation on the European Fund for Strategic Investments (EFSI). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 10 March 2015. This followed the Committee’s decision to clear the Regulation from scrutiny at its meeting on 2 March 2015.

We understand that several scenarios exist for potential projects bidding for EFSI funding, depending on the arrangements of the project agreed at the Member State level. Additionality is referred to in the draft compromise text, seemingly in contrast to the comments made at your appearance before the Committee on 24 February 2015 when you stated that the principle of additionality does not apply because the financing will be provided by the EIB. We would be grateful if you could confirm the application of the wording of additionality in the current compromise text. While it is apparent that the EFSI will be flexible and complementary to existing EU financing programmes and activities by the EIB, we believe there may be a risk of duplication of effort. Do you draw firm distinctions between the financing of EFSI and existing EU financing programmes?

We note that you do not reflect on the EU’s goals of creating an energy and digital union through the use of EFSI. Given the Energy Union strategy that was recently proposed, do you agree with the general objectives in the draft Regulation that support these goals? We would be grateful for your assessment of how this initiative can work side by side with the Investment Plan. You note that the text has been amended so that EFSI is not constrained in making investments, adding that priority areas for the UK are not ruled out. Would you be able to provide more clarity on these priority areas and what this would mean in practice for the UK?

We note that there is strong opposition from the research community due to reallocation of their funding towards the EFSI. Do you believe the research and innovation objectives are well integrated into EFSI? Are there appropriate mechanisms to reinstate the financing arrangements and meet the loss of financing?

We welcome the inclusion of a provision for review of EFSI after three years. Looking forward, would you support a change in the target size of the Guarantee Fund, which can be changed via a delegated act from 2018? Can you also explain how flexibility is demonstrated within EFSI due to the amendments put forward by the UK? Lastly, what cooperation arrangements will be in place between UK Government departments in putting forward projects and bidding for EFSI guarantees and financing? Is the UK Government planning to contribute capital to the EFSI Guarantee Fund, or would the British Business Bank be more likely to contribute to the Fund?

In light of the forthcoming dissolution of Parliament we would be grateful for a response to this letter, together with an update on the outcome of negotiations at the 10 March ECOFIN, by 17 March 2015.

10 March 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 10 March, asking further questions on the European Fund for Strategic Investments. May I take this opportunity to thank the Committee for considering and clearing the draft regulation from scrutiny, which allowed the Government to support the Council approach at ECOFIN on the 10 March. This will allow us to positively and proactively work to secure the best possible outcome for the UK going forward and be on the front foot in ensuring the UK is well placed to benefit from the potential additional investment.

10 March 2015
Let me clarify the additionality point. In the context of the regulation, additionality refers to ensuring that activity undertaken using the EFSI guarantee represents additional activity which could not have been done without the EFSI. The Council agreed a definition of additionality to reinforce this, which stipulates that EFSI operations should address market failures and shall typically have a higher risk profile than projects supported under normal EIB operations.

The Council position was also clear that the EFSI will support projects which: are consistent with Union policies; are economically and technically viable; provide additionality; and maximise the mobilisation of private sector capital.

In this context, it is right that the EFSI is flexible, and can operate the guarantee alongside other existing EU programmes. However, I will note that the existing rules of the individual programmes concerned must be fully respected; the eligibility criteria of the EFSI must be met; and the goal of leveraging private sector finance must be achieved.

Energy union is not explicitly referenced in the proposal as a goal in itself. The initiative is new and not yet fully formulated. However, as outlined above, the first criteria is consistency with Union objectives – of which this is clearly one. Energy projects will be eligible for support from the EFSI.

Further, the Council acknowledged that the EFSI will support projects pursuant to the following general objectives: development of infrastructure; research and development and innovation; investment in education and training, health, information and communications technology; development of the energy sector; and the provision of financial support for companies as well as other entities (to incorporate charities and universities) having up to 3000 employees, with a particular focus on SMEs. The potential range of operations backed by the EFSI are therefore flexible, which was a priority for the Government in the negotiations, and I believe this is broad enough to avoid constraining Member State priorities.

The UK should therefore be well placed to use the opportunities of the EFSI to support domestic priorities. The UK’s National Infrastructure Pipeline sets out over £460 billion of planned public and private investment to the end of the decade and beyond. The bulk of this investment is in the transport and energy sectors. However, EFSI is potentially a relevant and important instrument for a broad range of sectors, including support for SMEs, research and innovation, as well as large infrastructure projects. Our objective is to maximise the potential for UK projects to benefit from EFSI whatever the sector. We will seek to ensure that the scope of sectors eligible for EFSI support remains broad, with the focus on criteria that ensure projects are economically viable, maximise private investment, and are additional.

On the reallocations, the current proposal, I believe, minimises the impact on those aspects of the Horizon 2020 programme that the UK values most. As noted above, research and innovation are explicitly identified as one of the areas covered by the instrument. The use of the EFSI is intended to be complementary to Horizon 2020 – one specific criterion of the reallocation was to transfer funds primarily from areas with the same or similar objectives in order to ensure that the transfer does not undermine overall EU budgetary support to that policy area.

I also would note that thanks to the multiannual financial framework deal that the Prime Minister secured, the Horizon 2020 budget will still increase by 38% over the period 2014-2020 even after the reallocation, when the EU Budget overall will see a real terms cut.

You mention explicitly the Commission proposal for a delegated act to vary the target level of the Guarantee Fund. The Government, and indeed Council, disagreed. We view the €8bn level of the guarantee as a fundamental component of the proposal and therefore not suitable for delegation. We believe the Commission should bring forward a proposal should it be necessary to vary the level of the paid in fund.

The key now is to get the practical details right, so that the EFSI can support credible, high quality projects that will have a demonstrable impact on long term growth. This will be the focus going forward and, as I noted in my previous letter, I am convinced that the UK is well placed to take advantage of this opportunity.

To this end the Government is proactively working to identify and promote projects that could be relevant for EFSI support, and is also exploring the creation of investment platforms to help secure EFSI resources to support projects and programmes in the UK. A number of institutions are involved
in this work – the UK Guarantee Scheme, the British Business Bank, the Green Investment Bank, as well as relevant government departments and the Devolved Administrations.

19 March 2015

Letter from the Chairman to David Gauke MP


You note that your letter states that support for research and innovation will not be undermined. We would like to draw your attention to the review of the Europe 2020 strategy in December 2014 that stated the target for increasing public and private investment in R&D to 3% of GDP is unlikely to be met. The reallocation of this funding in the EU budget thus further reverses the means by which Europe can meet its targets. You stated in your EM dated 28 January 2015 that “while grant funding from the Connecting Europe Facility and Horizon 2020 will be reduced, the multiplier effect generated by the EFSI will allow for a significant overall increase in investment in the policy areas covered by the two existing programmes.” We acknowledge that there would already have been a multiplier effect under such existing programmes.

We are disappointed that the changes affecting research and innovation funding have not been well communicated to the research community. This appears to be damaging confidence in Horizon 2020 and undermining the credibility of the EU budget. Given the loss of funding to research and innovation it is disconcerting that research and innovation projects may not be able to recuperate their loss of funding through EFSI should no pre-ration based on region nor sector be embedded within the text. We are also concerned that the projects that will lose funding will be unable to apply for EFSI funding via the European Investment Fund if the criteria and financing tools do not align with their preferences or profile. Can you explain how flexibility of the Fund interacts with the eligibility criteria that it will set? How will the criteria and financial instruments on offer through the EFSI affect research and innovation projects and their funding options, particularly those that were eligible under the existing Horizon 2020 and Connecting Europe Facility? For example, how would the new facility affect research and innovation projects that had planned to receive grants under the EU budget and would be expected to apply for a loan with Horizon 2020 and repay it?

We note that the recent non-binding Opinion from the European Court of Auditors on the European Fund for Strategic Investment raises relevant points on the risks to the EU budget. We note the Opinion makes the following suggestions:

— The Opinion states that the proposal does not explicitly exclude contingent liabilities for the EU budget beyond committed funds and does not set a ceiling for EIB expenses. The ECA thus support a general immunity and waiver against legal claims by EFSI beneficiaries so that the Commission is not liable for losses beyond the EU guarantee (funded by the EU budget).

— The ECA does not accept the flexibility of the SGP to allow Member States to contribute to the fund. It explains that Member States may have to borrow in order to contribute to the fund, and if providing counter-guarantees by EFSI, the risk of further debt is postponed. Additionally, EFSI may need additional public funding beyond the completion of a project.

— The ECA notes there is no provision protecting the overall MFF heading and budget lines in the circumstance that the liquidity cushion ratio is not sufficiently. (Currently the draft proposes a ratio of 50% between payments from the EU budget and the total EU guarantee.) While the Commission can adopt a delegated act to adjust the ratio by 10%, it does not protect the MFF and budget lines.

How do you respond to each of these risks that the Opinion has raised? Will the text be improved to take account of the risks posed to the EU budget further to the ECA’s Opinion?

We would be grateful for a response to this letter, together with an update on negotiations, by 26 May 2015.

24 March 2015
Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury, to the Chairman

Thank you for your letter of 10 December 2013 on the European Long Term Investment Fund Proposal (ELTIF), following our Explanatory Memorandum of 26 June.

The Council have met at working level to discuss this proposal on a number of occasions over the last few months, and the draft text is currently in a positive place. The Greek Presidency is planning on holding further meetings in June and has indicated that it hopes to reach a General Approach before the end of its term.

RETAIL PARTICIPATION

The major contentious issue has been whether or not such a long term product can be suitable for retail investors. The Commission’s rationale for creating a retail scheme is that there are many institutional investors whose investment mandate requires that they may only invest in retail suitable products, including many defined contribution pension funds. The Government broadly agrees with this view. A majority of Member States have argued, however, that a long term fund with no redemptions can never be suitable for retail investors. Whilst the compromise still allows marketing to retail investors, it is likely that future iterations will restrict this to certain semi-professional or high net worth investors defined by those able to make a minimum subscription of a certain amount, similar to European Venture Capital Funds (Regulation (EU) No 345/2013) or European Social Entrepreneurship Funds (Regulation (EU) No 346/2013).

We have spoken with UK firms that are interested in the opportunities that ELTIF could offer. They agree with the Commission’s proposition of a retail product with institutional investors in mind. Some believe that it would still be possible for them to make a workable product if the investor base were restricted by a minimum investment threshold though the benefits would be diminished as it would be a clear statement that it is not genuinely a retail suitable product.

In our view, the compromise that has been reached is acceptable due to the limited impact it would have in practice. A closed ended fund with no redemptions can be suitable for some retail investors as part of a diversified portfolio in the context of an advised sale – particularly where the fund is structured as an investment company admitted to trading on a regulated market. In this case funds will operate similarly to an investment trust or a venture capital trust where secondary trading can compensate for a lack of redemption, or where investment is being made as part of a self invested pension where there would be no redemptions in any case.

CROSS BORDER SUPERVISION AND ENFORCEMENT

With regard to cross border supervision and enforcement where an ELTIF is authorised in one jurisdiction and the manager in another, the Commission has stated that its intention is that this should follow the same model as exists for funds authorised under the Undertakings for Collective Investment in Transferable Securities Directive, as we had hoped. We expect to be added to the text.

ELIGIBLE INVESTMENTS

Eligible investment rules have changed little from the original proposal.

A number of Member States argued that ELTIFs should not be able to make loans, which they are permitted to do under the proposal and state that this represents shadow banking. The Government does not agree with this assessment. ELTIFs as they are envisaged are established for a fixed life with no redemption and may not make loans that exceed their lifecycle. Therefore there is no maturity transformation. Furthermore ELTIFs would be restricted from using leverage and would be lending their own capital. As such we do not agree that there would be any shadow banking risk. Restricting the ability of ELTIFs to lend would be very damaging as well as the majority of investment in infrastructure is made by way of loans. The text therefore currently still allows for an ELTIF to make 100% of investment by way of loans.

In order to ensure investment on infrastructure, whilst excluding certain speculative investments such as wine, art, or vintage cars, there is general agreement in the Council to include a suitable definition
of “real asset” as an eligible investment however the precise formulation of this definition is yet to be determined.

The text currently still does not allow for a fund of fund structure. Some firms interested in establishing ELTIFs have argued that it could be more efficient to structure themselves as a fund of funds when looking to invest in a range of assets across different markets, however on further discussion they agree that this is a secondary issue and the Government agrees.

UK TAX TREATMENT OF ELTIFS

In the UK tax rules operate independently of the Regulation or Directive under which a fund may be authorised. Therefore the vehicles which are used to facilitate investment in ELTIFs would continue to be subject to the tax rules that are currently in place. So if, for example, an ELTIF were to be set up as an investment company or as a limited Partnership then it would use the tax rules currently in place for such vehicles. Broadly, the Government does not hold any concerns and expects these rules to be effective as they stand.

As stated above, the Greek Presidency is looking to confirm the formal Council position on this dossier by the end of the month. The Government would look to support the Regulation as currently drafted, however if things move substantially I will write to you as a matter of urgency.

7 June 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 7 June 2014, on EM 12044/13: the Regulation on European long Term Investment Funds (ELTIFs). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 June 2014.

We are grateful for this useful update, and welcome the progress towards an acceptable compromise text. In light of our previous concerns, we note in particular that the proposal for a fund of fund structure looks unlikely to be pursued. We also note the sensible emerging compromise on retail participation, and support your position in relation to cross-border supervision and eligible investments. You state that firms and the Government agree that allowing for a fund of fund structure is a secondary issue. Does this mean that the idea has been dropped and will not feature in the final text of the proposal?

Noting that the Greek presidency is shortly expected to seek agreement to a General Approach, we are now content to clear the document from scrutiny. However we would be grateful for further update on the outcome of negotiations, in particular with regard to elements of the proposal yet to be determined. We would be grateful for receipt of such an update by 18 July 2014.

18 June 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 18 June on the European Long Term Investment Fund Regulation proposal. General Approach for this proposal was agreed by the Council in Coreper on 25 June. As requested I am writing to clarify the position on funds of funds and other items that were unresolved at the time of my previous letter.

FUNDS OF FUNDS

Regarding the possibility of a fund of funds, this is expressly prevented in the final Council text. A European Long Term Investment Fund (ELTIF) would not be able to invest more than 20% of its capital in other investment funds. In turn, those investee funds would not be able to invest more than 10% of their capital in other funds in order to prevent a proliferation of fees or dilution of investment.

Investee funds must also adhere to the same overall investment requirements as an ELTIF although they do not necessarily need to be authorised as an ELTIF themselves.

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RETAIL PARTICIPATION

Retail participation is still permitted in the final Council text with certain restrictions. Managers or agents acting on behalf of managers must sell to retail investors through an advised process that takes into account the suitability of the life cycle of the fund and its risk profile for the circumstances of the prospective investor. Retail investors must be able to commit to a minimum subscription of €10,000 and any investment must not exceed 10 per cent of their net investible assets.

These restrictions do not apply to retail investors with net investible assets exceeding €500,000.

DEFINITION OF REAL ASSETS

The final text defines a real asset as a physical or tangible asset that has value due to its substance and properties and can be expected to provide returns. The text is open as to whether this could be in the form of capital growth, an income stream, or a combination of the two. The text also provides a non-exhaustive list of examples.

16 July 2014

Letter from Andrea Leadsom MP to the Chairman

I am writing to update the Committee on the progress of this file following discussions at trilogues over the past few months. On 26 November political agreement was reached on the ELTIF regulation. The ELTIF regulation will introduce a new European authorised fund vehicle to support the real economy by investing in long term illiquid assets such as infrastructure, property, and SMEs.

The final agreement is a good outcome for the UK. I outline below the agreement reached in trilogue negotiations on the remaining contentious issues.

LOCATION OF INVESTMENTS

The Government had several concerns with the European Parliament’s proposal that at least 60% of an ELTIF’s investment must be in assets located in Member States. A protectionist restriction of this nature would damage the ELTIF brand and would discourage investment from non-European locations, thus limiting the flow of capital to European projects. Investments made outside of the EU can also have direct benefits to the European economy. Further, ELTIFs are also meant to benefit investors, and many of the infrastructure projects with the highest returns will be in emerging markets. The final agreement does not have a European investment quota, but clarifies that the purpose of the ELTIFs regulation is to support the European economy.

FISCAL RULES

The European Parliament proposal included a provision to prevent an ELTIF from investing in tax havens. The Government opposed this provision on the grounds that it would introduce tax legislation in financial services legislation. Furthermore the European Parliament definition of what counts as a tax haven would be open to subjective interpretation between jurisdictions and would have placed responsibility on the Financial Conduct Authority (FCA) to determine which countries are tax havens and which are not, a role that is beyond their remit.

The final agreement addressed this issue in a recital, which identified that the Commission will continue its assessment on potential barriers, including fiscal treatment of investments that might stand in the way of raising long term capital across borders. This is consistent with existing financial services legislation. Other provisions dealing with tax incentives and fiscal harmonisation were dropped.

ELIGIBLE ASSETS

The European Parliament had proposed restricting an ELTIF from investing in housing and commercial real estate assets in order to prevent property speculation by funds. The Government’s view is that this would be too restrictive and would exclude investment in assets that had clear social and economic benefits.
The final agreement does not include restrictions on real estate investment and instead addresses concerns over speculative investment through a recital that explains that an ELTIF may invest in property if the investment demonstrates a long term commitment.

REDEMPTION RULES

The European Parliament argued that a long term investment fund with no redemptions was not suitable for retail investors, while the Council view was that a closed-ended structure was more appropriate as it reflected the illiquid nature of the investments.

The Government's view is that a long term investment with no redemption may be suitable for some investors as part of a diversified portfolio in the context of an advised sale. The final agreement gives the fund manager the flexibility to design a redemption policy in line with their investment strategy, but limited to the liquid assets an ELTIF holds. In our view this compromise represents an acceptable middle ground.

Thank you for the interest you and your Committee colleagues have shown in the ELTIF regulation. I hope this letter is helpful, but please let me know if there are any other issues you would like addressed.

16 December 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 16 December 2014, on EM 12044/13: the Regulation on European long Term Investment Funds (ELTIFs). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 13 January 2015.

We are grateful for the update on negotiations in trilogues and furthermore welcome the political agreement reached on 26 November 2014. We take note of the contentious issues that were resolved and look forward to effective implementation of the Regulation and the positive impact it will make to long term investment and funding opportunities in the European economy.

14 January 2015

EUROPEAN SEMESTER: ALERT MECHANISM REPORT 2015 (15988/14, 15985/14, 15953/14)

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


We acknowledge that the Annual Growth Survey 2015 employs a similar narrative to the previous year. While the emphasis on structural reforms and fiscal consolidation remains strong, the AGS continues to prioritise complementing measures and initiatives for growth, namely the investment plan, and developing the energy, digital and services market. We agree with your assessment that efforts to enhance the Single Market and mobilising investment to support growth should be prioritised.

The AGS continues to state that political ownership, accountability and acceptance of the Semester is key to strengthening its credibility and comparability across Member states. Member States also need improve their implementation of country-specific recommendations. We do not feel that you have addressed this issue adequately. Underlying this, we note your negative or rather sceptical view that is expressed in HMT’s Balance of Competencies Economic and Monetary Policy paper published in December 2014. In the Paper, the Government states that it has little appetite for enhancing economic co-ordination, which the Government sees as suitable only for euro area Member States. Would you agree that your lack of support for enhanced policy co-ordination across all Member
States tends to discredit the European Semester in its entirety? Is the UK setting a bad example by
discrediting the process for other Member States that perhaps need more serious reforms to be put
in place? In the future, how does the Government intend to take ownership of the European
Semester and country-specific recommendations? Furthermore, how do you intend to support plans
to streamline and improve the economic governance process, including suggestions put forward by
the European Commission?

In the Draft Joint Employment Report, the European Commission recognises that a strong reversal is
needed to reach the targets set by the Europe 2020 strategy. How does the UK Government intend
to support and extend influence in this area at the EU level? While some positive signs of reform
implementation were seen in various Member States, we recognise that more important reforms
need to be undertaken. We find it worrying that trends on levels of poverty and divergences of
income levels within the EU are increasing. This will undoubtedly pose a long term risk to the
European economy. Do you believe the Commission has got the priorities and objectives right in
these areas of competence? What more can be done to reverse these trends?

We note your confidence that the UK has generated a strong economic performance over the past
year. However you seem less concerned about the content of the analysis presented by the
Commission. You will be aware that the IDR can be expected to replicate similar content to the
previous year, citing the growing risks of private sector indebtedness as a result of high mortgages
related to increasing house prices. How would you respond to analysis that structural challenges will
likely persist given the declining net export market and a current account deficit, and given the skill
shortages and deficiencies in infrastructure that remain alongside? Last year the Government did not
comply with country specific recommendations for correcting the excessive deficit set by the Council.
Do you expect this to be the case again this year? How do you respond to criticism that the similar
recommendations highlight that the Government has not addressed its macroeconomic imbalances?

We would be grateful for a response to these questions by 28 January 2015. In the meantime we will
continue to hold EM15985/14, EM15953/14 and EM15988/14 under scrutiny.

14 January 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter of 14 January 2015 on the European Semester documents.

You ask about the Government’s view on enhanced policy co-ordination and the credibility of the
European Semester. The Government believes that Europe urgently needs to address its growth
challenge, and that policy co-operation and co-ordination, appropriately done, can play an important
role in supporting reform. However, to be effective the Semester should be a partnership between
the Commission and Member States, with the Commission providing transparent and objective
analysis and Member States taking national ownership of necessary reforms, including through proper
scrutiny by National Parliaments. The Government will continue to press for improvements which
could increase its impact in encouraging growth-enhancing structural reform across the EU.

You also ask about the Government’s Review of the Balance of Competences in respect of Economic
and Monetary Policy. The Review is a reflection and analysis of the evidence submitted by experts,
non-governmental organisations, business people, and other interested parties, either in writing or
orally, as well as a literature review of relevant material. That evidence does however support the
importance of co-ordinating policy at the international level where appropriate. This happens in a
number of international fora and institutions, such as the IMF and OECD, but also the EU. The
evidence and economic literature also supports the view that the case for economic and monetary
co-ordination is stronger in the euro area than the rest of the EU.

You also ask about Commission plans to streamline and improve the economic governance process.
The Government broadly supports these proposals as a step in the right direction on the grounds
they increase the degree of early consultation with Member States and reduce the bureaucratic
burden.

In your letter you ask with respect to the Joint Employment Report whether we believe the
Commission has the right priorities and objectives. We agree with the emphasis on growth and
employment as key elements of recovery. The UK is among the strongest advocates of the
importance of structural reforms to Europe’s future prospects, and the Government believes that the
UK’s success in increasing employment in the face of the wider trend in Europe bolsters our message.
At the same time, it should be clear that the necessary reforms should be framed and implemented by the Member States themselves. The Government believes that achieving increased growth and employment in this manner offers the best route to reduced poverty and increased prosperity.

Your letter also raised various points on the Commission’s In Depth Review (IDR). As you note in your letter, the UK economy has performed strongly over the past year in comparison with the EU as a whole. The Government’s long term economic plan addresses historical challenges and imbalances the UK economy has faced over many years. The IDR highlights some of these challenges. We are making progress on addressing them. For example, the Office for Budget Responsibility forecasts that the Government will halve the deficit as a share of GDP over this Parliament. According to the IMF, between 2010 and 2013 the UK reduced its structural deficit by more than any other G7 country, and for the next 5 years (between 2014 and 2019) the IMF forecasts that the UK will reduce both headline and structural deficit levels by more than any other G7 economy. Household debt as a proportion of income has fallen from its pre-crisis peak and the saving ratio has gone up since its low point in 2008. Whilst exports have not risen as fast as anticipated overall, this mainly reflects weaker activity in the euro area, and exports to emerging economies have risen.

In terms of reporting on further progress, the Government will update Parliament on the performance of the economy and its policy plans at the Budget. This will be the basis of our submission to the Commission as part of this year’s Semester.

29 January 2015

Letter from the Chairman to David Gauke MP


You state that, in order to be effective, the Semester should be a partnership between the Commission and Member States, with the Commission providing transparent and objective analysis and Member States taking national ownership of necessary reforms. To what extent do you believe that the Semester is an effective partnership, judged in these terms? Does the process inspire the confidence of Member States? If not, what specific changes need to be made to ensure it does so in the future?

We agree with you that Member States need to take national ownership of necessary reforms and that the growth agenda needs to be prioritised. We draw your attention to the conclusions of our recently-published report on The post-crisis EU financial regulatory agenda, which stated that “the need for growth to be restored to the EU becomes more urgent by the day. Fears that the EU may slip yet again into recession have been exacerbated by the growing threat of a deflationary spiral. The Commission must do all it can to promote growth, in particular by promoting access to finance for SMEs … But primary responsibility for restoring growth and competitiveness remains with Member States, who much promote growth-friendly policies, and press on with structural reforms and the completion of the Single Market. Creditor Member States have their own obligations to stimulate growth and demand.” Do you share our analysis?

While you stress the importance of policy co-ordination and co-operation when “appropriately done”, you clarify this by stating that “the case for economic and monetary co-ordination is stronger in the euro area than the rest of the EU.” That being the case, how would you characterise the benefits of policy co-ordination encapsulated in the European Semester process for a non-eurozone Member State such as the UK?

We would be grateful for a response to these questions by 24 February 2015. In the meantime we now clear the documents from scrutiny.

10 February 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter of 10 February 2015 on the European Semester documents.
In your letter you ask for our views on the European Semester. We judge the European Semester has had some positive impact in co-ordinating fiscal policy among Member States, and the Government supports the spirit of partnership that characterises the Semester. We believe there is scope for improvement, and have outlined our proposals for reform of the European Semester in our public response to the consultation on the Europe 2020 review.

Your letter also asks if we share the analysis expressed in the conclusions to your report on The post-crisis EU financial regulatory agenda. The Government largely agrees with the conclusions you quote, particularly on the responsibility of Member States and the importance of structural reform and completing the Single Market.

Finally, in light of our clarification on the case for co-ordination being stronger in the euro area you ask us to characterise the benefits of policy co-ordination for a non-euro area Member State. As discussed in the Review of the Balance of Competences: Economic and Monetary Policy, there are benefits from the international co-ordination of economic policy. The OECD, for example, has argued that there is a potentially large payoff from collective action to tackle unsustainable public finances and from engaging pro-growth structural reform. The greater degree of economic integration between EU Member States compared to the extent of integration across the G20 or OECD, sharpens the risks around spillovers and therefore the case for economic co-ordination. Therefore, while the depth of co-ordination need not be as deep for non-euro area Member States, it is still of importance.

23 February 2015

Letter from the Chairman to David Gauke MP


You state that the Government has outlined proposals for reform of the European Semester in its public response to the consultation on the Europe 2020 review. We would be grateful for further details on the rationale behind your proposals, and what steps the Government is taking to promote such reforms with EU colleagues. Is there any likelihood of such reforms being agreed to? We also note the assertion of the former Chair of the European Parliament Economic and Monetary Affairs Committee, Sharon Bowles, that Member States often ignore the Commission’s Country-Specific Recommendations that form a key part of the Semester process. How would you respond? Do Country-Specific Recommendations form a useful element of the Semester process, in your view? Is there a case for a more robust deterrence and incentive structure? What are the implications of the recent Commission decision to extend France’s deadline for bringing its budget deficit under the threshold of 3% of economic output for two years for the credibility of the process? More broadly, you state that there are benefits of international co-operation, in particular in the EU, and including for non-eurozone Member States. What specific examples would you give? Your Europe 2020 consultation response stresses the importance of the Single Market. What specific examples of where the UK has taken active steps to deepen the Single Market over the past 12 months?

To enable the Committee to consider a reply before the end of the parliamentary session we would be grateful for a response to this letter by 10 March 2015.

2 March 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter of 2 March 2015 on the European Semester documents.

In your letter you ask for details on the rationale behind our proposals for the Europe 2020 review, as well as what steps the Government is taking to promote such reforms. The key principles behind the Government’s response were formulated in consultation with stakeholders and are: that the focus of Europe 2020 should remain firmly on jobs and growth; that Europe 2020 should seek to balance actions and policy levers by Member States with cost effective EU-level policy levers; and that there should be a partnership between the Commission and Member States. The Government has
advocated its position in various Council formations and Conclusions that have been adopted broadly reflect our views.

In relation to the wider European Semester process, you ask how the Government responds to the claim that Member States largely ignore the Commission’s Country-Specific Recommendations (CSRs). You also ask if CSRs form a key element of the Semester process and if there is a case for a more robust deterrence and incentive structure.

The Government encourages all Member States to push forward with essential structural reforms, as well as ensuring fiscal sustainability, in the interest of raising growth and stability across the EU. It believes that the Semester process, including the Country Specific Recommendations, can play a part in supporting those reform efforts. However, more needs to be done to encourage a spirit of transparency and partnership to allow Member States to implement and take national ownership of reform recommendations.

The UK’s progress on the structural reform areas covered by the 2014 CSRs compares favourably with other Member States and demonstrates the seriousness of this Government’s commitment to increasing the competitiveness of the UK economy.

With respect to a more robust deterrence and incentive structure: as outlined in the evidence collected as part of the Government’s Review of the Balance of Competences “Economic and Monetary Policy” report, the case for co-ordination is stronger for euro area Member States, and this is reflected in the stronger sanctions that already exist for those Member States under the Semester process.

You ask what the implications for the credibility of the process are of the Commission recommendation to extend France’s deadline for bringing its budget deficit under the 3% threshold. As you are aware, the Commission has recommended a two-year extension to France’s excessive deficit procedure (EDP) based on weaker than expected economic conditions and the French authorities’ commitment to a programme of structural reform. This recommendation was accepted by a vote of euro area Member States in ECOFIN on 10 March.

The Stability and Growth Pact (SGP), the pillar of the European Semester under which such fiscal targets are set, has undergone significant change in recent years, and its rules have been strengthened. It allows for flexible implementation in certain areas and under certain circumstances, as was recently clarified in the Commission’s communication of 13 January (see related EM 5375/15).

However, a balance needs to be struck between flexibility and predictability. The Government is clear that consistent and transparent enforcement of the rules will be an important part of maintaining the SGP’s credibility. Fiscal responsibility is necessary to provide a firm anchor for market confidence and sustainable long-term growth. The SGP has a clear role to play in this, and it is important that the EU’s institutions and Member States demonstrate a collective commitment to sound public finances and credible fiscal policy.

You also ask for specific examples of benefits of international co-operation. As highlighted in the Review of the Balance of Competences “Economic and Monetary Policy” report, during the recent crisis the G20 acted as a key forum in which to design, co-ordinate and implement economic measures that significantly expanded the global financial safety net. For example, in 2009, the G20 established a Framework for Strong, Sustainable and Balanced Growth as a compact that commits its members to work together to assess how domestic policies interact, to evaluate whether they are collectively consistent with more sustainable and balanced growth, and to act as necessary to meet common G20 objectives. The case for co-ordination is even stronger in the EU, and particularly in the euro area, where the level of integration is higher.

Finally, you ask for specific examples of where the UK has taken active steps to deepen the Single Market over the past 12 months. The UK has developed an ambitious set of Single Market proposals and has been working with the Commission and other Member States to make progress in our priority areas of the Digital Single Market, the Services Single Market and Capital Markets Union. I would note in particular the UK’s support for simple, transparent and standardised securitisation and private placements, both of which form part of the Commission’s Green Paper on Capital Markets Union.

12 March 2015
Letter from the Chairman to David Gauke MP, Financial Secretary, HM Treasury


We note and agree with the Commission’s assessment that macroeconomic imbalances such as large external liabilities, losses on price competitiveness, high current account surpluses, high levels of government and private debt, and high unemployment were considered as macro-economic imbalances that need to be corrected. We agree that restoration of demand in the eurozone is the key to a sustainable economic recovery. The persistent level of low inflation (and indeed the risk of a sustained period of deflation) also remains a concern, notwithstanding suggestions that falling oil prices may help to stimulate economic growth. It remains to be seen whether predictions of a mild recovery in 2015 and 2016 will come to pass.

Turning to the UK, we note the Commission’s assessment that risks posed by the UK housing market and the level of private indebtedness have subsided since 2014, but nevertheless the UK still faces low labour productivity, while the ‘at-risk-of-poverty’ and severe material deprivation rate has risen in recent years. We also note the Commission’s assessment of positive steps in the UK in relation to infrastructure and access to finance, although it notes that public and private R&D investment is behind other advanced economies. We note that you did not devote attention in your EM to the UK’s low labour productivity levels or its persistent Balance of Payments deficit. Equally you did not address the fact that the UK has failed to meet the EU’s debt and deficit to GDP targets. What steps are you taking to address these issues? How will the Government respond to the conclusions and recommendations that the Commission has set out?

How would you respond to suggestions that the tools used in the context of the European Semester to address macroeconomic imbalances are not effective? We noted in our April 2014 report “Euro area crisis: an update” that creditor countries have their own obligations to stimulate growth and demand across the euro area. At the present time however, such creditor and debtor imbalances continue to exist. How effective do you believe the European Semester has been in fixing these structural imbalances within the euro area and wider EU?

We would be grateful for a response to this letter, including an update on the ECOFIN discussions on country reports, by 26 May 2015. We will scrutinise the Commission’s Country-Specific Recommendations in due course. In the meantime we now clear these documents from scrutiny.

17 March 2015

Letter from Nicky Morgan MP, Financial Secretary, HM Treasury, to the Chairman

Thank you for your letter dated 13th May concerning Explanatory Memorandum 7413/14: European Semester: Prevention and correction of macroeconomic imbalances.

In your letter you welcome the Commission’s acknowledgment of the challenges that remain, and ask whether the EU Institutions have done enough to respond to the identified weaknesses. As you are aware, structural reform is ongoing across the EU, and much has already been achieved. The Government considers that this process needs to continue, notably by increasing the flexibility of
labour markets, and strengthening the single market, for instance by fully implementing the Services Directive.

Your letter also refers to a growing deflationary threat. You will be aware specific euro area monetary policy decisions are a matter for the ECB, which will continue to monitor developments in the euro area closely to ensure price stability as defined in its mandate. More broadly, the Government considers that all Member States need to comprehensively address Europe’s growth challenge and tackle overall low productivity, lack of economic dynamism and flexibility. The UK has long argued for a pro-business, pro-growth agenda completing the single market and fostering greater competition throughout Europe. There needs to be a step change in structural reforms across Europe, and high-deficit, low-competitiveness countries in the periphery must continue to tackle their problems.

In terms of the Commission’s assessment of the UK, the Government recognises that in accordance to the thresholds set out in the Macroeconomic Imbalances Procedure (MIP) scoreboard, the UK is in breach of the following three indicators: export market share, private sector debt and public sector debt. The Government’s long-term economy strategy, set out in the June 2010 Budget, was designed to address these imbalances from developing further. To date, the government has taken substantial steps to correct these imbalances. For instance, the household debt-to-income ratio has fallen by nearly 30 percentage points since its peak in 2008 and exports of goods and services grew by 1.9 per cent in 2013. Growth is expected to pick up to around 5 per cent a year from 2015 onwards according to the independent Office for Budgetary Responsibility. Moreover, the Government has introduced a new system of macro-prudential regulation, with the Financial Policy Committee (FPC) at the centre, to monitor risks and take action where appropriate.

You also ask about the practical effect of the UK’s participation in the European Semester process, given that the UK is not subject to sanctions under the MIP or at any point of the Semester. The Government supports the objectives of the Semester to share best practice on economic policies, to help strengthen the resolve of all Member States to move forward with structural reform and to support responsible fiscal policies.

4 June 2014

Letter from the Chairman to Nicky Morgan MP

Thank you for your letter, dated 4 June 2014, on EM 7413/14 on the European Semester: Prevention and Correction of Macroeconomic Imbalances. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 10 June 2014. At that meeting we also considered the Commission Recommendation, dated 2 June 2014, for a Council Recommendation on the United Kingdom’s 2014 National Reform Programme and delivering a Council Opinion on the United Kingdom’s 2014 convergence programme. We understand that the Government EMs on these documents and on the country-specific recommendations for other Member States are expected to be received shortly. However, given that the documents are due to be discussed in Council on 19/20 June, we took the decision to write to you at the earliest opportunity.

We would stress the responsibility of each Member State to take account of and respond appropriately to the Commission’s recommendations in each case, so as to encourage growth and economic prosperity across the EU. What more can the Government do to encourage this mutually beneficial process across the EU in order to secure the aims of the Single Market in securing enhanced growth and prosperity?

We note that the Commission has made a number of specific recommendations in relation to the UK. In light of the comment in your letter that “the Government supports the objectives of the Semester to share best practice on economic policies, to help strengthen the resolve of all Member States to move forward with structural reform and to support responsible fiscal policies”, what practical steps will the Government take in response to the Commission’s recommendations? What action will you take to ensure that best practice is indeed shared across the EU?

We look forward to receiving the EMs on these important documents, and in addition would be grateful for a response to this letter by 24 June 2014. In the meantime we will hold the country-specific recommendation documents under scrutiny.

10 June 2014
**Letter from Nicky Morgan MP to the Chairman**

Thank you for your letter dated 10 June concerning European Semester documents.

I refer to the Government’s recent Explanatory Memorandums on the Country Specific Recommendations addressed to the UK and to other Member States and the euro area.

You also asked specifically what steps could be taken to encourage a culture of mutual learning across the EU, and to ensure that best practice is shared. The Government considers that the Semester process is a constructive one, my officials and those of other interested departments are engaged in in-depth, open and frank discussions throughout the year in order to share best practice across the full range of policy areas. Key elements of the resulting analysis are considered at Council. However, the government notes that the policy areas covered by the Semester fall primarily within the competence of individual Member States, and considers that strong national ownership is essential for structural reform to be successful. In this context, the government does not formally comment on the economic policies of other Member States.

You also asked what steps the Government will take in response to the Commission’s recommendations. The European Commission addressed recommendations to the UK on 2nd June in the following areas: reducing the deficit, reforming the housing market, improving skills and tackling youth unemployment, combating worklessness, improving access to credit, and investing in infrastructure.

As set out in the Explanatory Memorandum, these areas are broadly in line with the government’s policies. We will take full account of the detailed analysis and recommendations in considering the most effective way for the government to meet our objectives on growth, as we do with the advice from other international institutions, such as the IMF or the OECD. The government nevertheless disagrees with the Commission’s assessment of the Help to Buy: mortgage guarantee scheme and notes that latest figures show that the scheme is having the desired effect. The government also disagrees with the Commission’s assessment that the Council Tax regime creates distortions in the wider housing market.

I look forward to participating fully in the Commission’s review of the Europe 2020 Strategy, and to exchanging ideas with you about how to further refine Member State implementation of growth-enhancing structural reforms.

16 June 2014

**Letter from the Chairman to Nicky Morgan MP**

Thank you for your composite EM 10502/14 et al, dated 9 June 2014, on various Recommendations for a Council Recommendation on Member States’ Stability Programme/Convergence Programme, and EM 10679/14 & 10522/14 on the Commission Communication European Semester: Country-specific recommendations building growth and a Recommendation for a Council Recommendation on the UK’s 2014 National Reform Programme and Council Opinion on the UK’s 2014 Convergence Programme. Thank you also for your letter, dated 16 June 2014, on EM 7413/14: European Semester – Country-Specific Recommendations and Prevention and Correction of Macroeconomic Imbalances. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 18 June 2014. You will also be aware that EM 10501/14 et al on recommendations for a Council Decision abrogating decisions on the existence of an excessive deficit in various Member States was cleared at the sift on the same day.

Further to our 10 June letter on the Semester, we are now content to clear these documents from scrutiny. However we would repeat our regret that, in the 9 April 2014 debate on the Convergence Programme, it again did not prove possible for the debate to also cover the National Reform Programme. We would also be grateful for further detail on your comment in EM 10679/14 and 10522/14 that “the devolved administrations have been consulted in the preparation of this EM”. What was the nature of this consultation?

We would be grateful for a response on these points by 2 July 2014.

18 June 2014
Letter from Nicky Morgan MP to the Chairman

Thank you for your letter of 18 June concerning the European Semester documents and in follow up to my letter of 16 June.

In your letter you asked about the nature of the consultations with the devolved administrations in the preparation of the Explanatory Memorandum 10679/14 & 10522/14 on the UK’s Country Specific Recommendations. It is standard practice for the Government to consult the Devolved Administrations when drafting EMs which concern either devolved functions or reserved functions with a particular impact on devolved functions, and to give careful consideration to any drafting proposals submitted by the Devolved Authorities. Given that the Country Specific Recommendations cover both reserved and devolved matters, the government consulted all Devolved Administrations in the preparation of this EM.

30 June 2014

EUROPEAN STATISTICS (9122/12)

Letter from Rob Wilson MP, Minister for Civil Society, Cabinet Office, to the Chairman

You may recall that the above proposal was cleared from Parliamentary scrutiny in the House of Commons following a debate in European Committee B on 20 January 2014.

The compromise text was rejected by COREPER in February 2014 because of concerns by a small number of Member States about the proposed relationship between the Director General of Eurostat and the European Parliament. No further information on developments had been communicated by either the Greek or Italian Presidencies since then.

However, the Italian Presidency informed Member States on 5 December that they had been discussing a new compromise with the European Parliament and Commission and this was presented to Member States for agreement at COREPER on 10 December. Following calls from the UK and other Member States, discussion of the new compromise was postponed until the COREPER meeting on 19 December to allow Member States to adequately scrutinise the amended text.

I apologise therefore for not being able to inform you, given the pace of events, at an earlier point before the new proposal is due for adoption by Council at COREPER.

After receiving legal advice from HM Government and Council legal experts, I do not consider most of the new amendments to the text as a cause for concern, particularly with respect to any of the concerns about subsidiarity shared by HMG and the European Scrutiny Committee regarding the original Commission proposal. The recent amendments may be summarised as follows:

— Relations between the European Statistical System (ESS) and the European System of Central Banks (ESCB) – Article 5 para 1.2: wording has been tidied-up to ensure clarity with respect to the principles of institutional autonomy of the actors involved and the appropriate cooperation between the two systems, including a clear indication that national arrangements for cooperation between NSIs and National Central Banks (NCBs) shall be respected

— The Head of the National Statistical Institute (NSI) – Article 5a – wording has been added that stipulates that when recruiting him/her Member States will ensure that there are equal opportunities, notably as regards gender

— Director-General of the Commission (Eurostat) – Article 6 – para 4 (new): the Commission has agreed that the Director General will appear before the European Parliament immediately after his/her appointment.

However, a new addition to the text emerged on Inspection visits in Member States – Article 12(3b) (new) following a proposal from the European Parliament. This refers to on-site inspections by the Commission to investigate whether or not a Member State should be subject to sanction for misrepresenting statistical data. It states that such sanctions and related inspection visits can only be envisaged when they are subject to, and conditional upon, sectoral legislation agreed by both the European Parliament and Council for specific circumstances.
However, advice from Treasury Solicitor’s Department indicates that if any relevant sectoral legislation made in reliance on Article 338 of the Treaty (governing European Statistics) seeks to create a power to impose fines, that power is unlawful, and any subsidiary power to investigate which is inseparably linked to it would also be impermissible under Article 338.

Although final arbitration of such matters in the future would be for the European Courts of Justice to decide upon, I am not prepared to accept that the illegality of such sanction regimes should be brought into question due to badly drafted law made under an unreasonable timeframe. This is particularly the case as the new provision presents a basis for future proposals that, should they become Regulations, would subject the UK to a sanctions regime based on no-notice on-site inspection visits by the Commission to the premises of UK Government Departments that produce official statistics. I consider this to represent an unacceptable risk of an unnecessary increase in the Commission’s competence, which the UK Government did not foresee in its signing of the Treaty. It would also risk unwelcome interference in the operation of normal Government business and would run against the principle of subsidiarity, particularly as I consider that the UK has strong legal framework to guard against the concerns this measure is designed to address.

Accordingly, I therefore instructed the Ambassador to vote against the regulation at the COREPER meeting of 19 December and to make a statement for the Minutes of COREPER to the effect that the UK Government considers the provisions of sanctions regimes that are not foreseen by the Treaty as illegal, as follows:

With reference to the proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) no. 223/2009 on European Statistics, the United Kingdom consider that while Article 338(1) TFEU is the legal basis for Regulation 223/2009 it does not constitute an appropriate legal basis for Article 12.3(b) of the proposed regulation. The latter Article provides for a competence of the European Commission to initiate and conduct an investigation, in case sectoral legislation provides for fines in cases where Member States misrepresent statistical data. The United Kingdom underline that Article 338 TFEU does not provide for the imposition of fines or other sanctions in the field of statistics in sectoral legislation, therefore article 12.3(b) is not considered as a legally permissible basis for future sectoral legislation.

Some other Member States presented a variety of objections to the compromise, while Finland, Hungary, and Lithuania all joined the minute statement proposed by the UK. However, the Presidency concluded that, despite these objections, there was sufficient support to proceed to a vote on the compromise text at a Council meeting (ECOFIN) early in 2015, but without a confirmed date. In order to provide further safeguard against future potential use of Article 12.3b to subject the UK and other Member States to a sanctions regime not anticipated by the Treaty, HMG intends to vote against the compromise text at the relevant ECOFIN meeting and lay a similar statement in the Minutes of that meeting. I would be happy to provide a further update on the outcome of that meeting should you require one.

6 January 2015

**Letter from the Chairman to Rob Wilson MP, Minister for Civil Society, Cabinet Office**

Thank you for your letter dated 6 January 2015 providing an update on EM 9122/12: A proposal for a Regulation of Revision of the Regulation 223/2009 on European Statistics. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 21 January 2015.

We note your decision to vote against the Regulation in light of the legal advice that you had received. However we are unconvinced by the legal arguments that you set out. We would therefore be grateful for further explanation of your legal position. Are we correct to assume that you will not be taking the case to the Court of Justice of the European Union? What is the justification for your assertion that the amended proposal would run against the principle of subsidiarity? We would be grateful for a response to these questions, as well any further update on the outcome of the ECOFIN meeting, by 21 February 2015 at the latest.

21 January 2015
Letter from Rob Wilson MP to the Chairman

Thank you for your letter of 21 January regarding the above Regulation.

You asked for further explanation of the legal arguments. The Treaties create an exhaustive system of remedies and sanctions against Member States for breach of Union law. The relevant provisions of the Treaties are Article 7 TEU (for serious breaches by a Member State of the values of the Union), Articles 258 to 260 TFEU (for breaches of Union law in general) and Article 126(11) TFEU (concerning the excessive deficit procedure). These relate to remedies and sanctions against Member States that cannot be amended through secondary legislation unless the Treaties themselves allow for it. Article 338 TFEU, on which the proposal in question is based, does not allow for such a possibility. Any system of sanctions similar to those foreseen in Article 12.3b of the proposal should therefore require an amendment to the Treaties before being legally permissible.

I can however confirm that the Government does not intend to challenge immediately the provision in the European Court of Justice. HMG’s view is that a challenge would not be an efficient use of resources at present, particularly as the Court is more likely to rule against a legal text if it has a practical rather than abstract effect.

You asked for justification that the proposal would run against the principle of subsidiarity. I consider that the overall proposal is now in accordance with subsidiarity except for the potential consequences of Article 12.3b. It should be welcomed that the new Regulation would place more obligations on all Member States to ensure that they have their own effective means in place to ensure the reliability of their official statistics. In the UK, we already have the Statistics and Registration Service Act 2007 (SRSA). Parliament has agreed this as the most effective way of ensuring reliable statistics according to the UK’s national circumstances.

The specific mechanisms for ensuring that statistics are produced free from political interference should be largely determined at Member State level. A one-size-fits-all approach cannot always be effective due to the significant differences in national constitutional and institutional environments. This has been a key overall negotiating objective of HMG and other Member States. Indeed, Article 5a (‘Heads of NSIs and statistical heads of other national authorities’) and Article 11.3 (‘Commitments on Confidence’) of the proposal now, rightly, put the means of ensuring that statistics are produced free from interference, according to a clear set of new legal criteria, largely in the hands of Member States.

I can now also update on you on the progress of the proposal in Council and the European Parliament. Following political approval at ECOFIN on 27 January, Council is now considering legal-linguistical revisions to the text. The Presidency intends for Council to finally adopt the new Regulation at first reading on 2 March, following its passage through COREPER again on 25 February. The Presidency then wishes to transmit the Council position to the European Parliament for its approval during its March plenary session.

22 February 2015

EUROPEAN SUPERVISORY AUTHORITIES AND THE EUROPEAN SYSTEMIC RISK BOARD (ESRB) (12446/14, 12447/14)

Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury

Thank you for EM 12446/14 on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS) and EM 12447/14 on the mission and organisation of the European Systemic Risk Board (ESRB), dated 1 September 2014. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 9 September 2014.

It is clear from the Commission report that the ESAs have focussed to a large extent on fulfilling more effectively their regulatory mandate than fulfilling their supervisory responsibilities. We understand that this is partly due to the demands of the intense regulatory climate which instructs the ESAs to draft rules. We agree with the short term amendments proposed in the Report that the ESAs should make more use of peer reviews. We would like you to explain in more detail your assessment of the
effectiveness of peer reviews and your suggestion that the peer reviews should provide second opinions on the discharge of supervisory responsibilities.

We agree with a number of the non-legislative amendments in the Commission Report. We particularly welcome the emphasis on enhancing the transparency process for preparing technical standards and advising the Commission. It is also clear from the Commission report that it will empower technical standards in future legislative proposals to have deadlines relative to the entry into force of the basic legal act. This will effectively allow the ESAs to have adequate time to produce and consult on level 2 rules, which we believe will make a significant difference to the experience of stakeholders in participating in consultations. However we are concerned that the ESAs have an insufficient ability to make quick and decisive changes to alter regulation. Evidence put to us in the context of our current inquiry into the EU financial regulatory framework has suggested that the vast volume and pace of agreed legislation has produced unintended drafting errors. Yet the ESAs lack the power to rectify legislation promptly, with potentially harmful consequences for European financial markets. How would you respond to this argument?

A number of suggestions were set out in the Report to enhance the internal governance of the ESAs and ESRB. You disagree with the Report’s assessment that the Board of Supervisors within the ESAs has not acted in the European interest. What are the reasons behind your belief that the Board of Supervisors has acted in the European interest?

You make clear that you believe no legislative changes are necessary at this point and that the ESAs are well equipped to fulfil their existing mandate. You may recall that our 2011 Report evaluating the EU Financial Supervisory Framework stressed that national supervisors should be responsible for micro-prudential regulation and information. It however remains clear that an ongoing tension exists as to how much information sharing should be permitted between the ESAs and individual financial institutions. Is there a danger of unnecessary and excessive bureaucracy being created if such competences are not transferred to ESAs? Given that it has been suggested that the ESAs could in future carry out roles such as stronger oversight of internal model valuations, shadow banking and IFRS enforcement, do you consider the medium term legislative changes in the level of information sharing appropriate? You state that transparency, efficiency and independence can be enhanced to improve the ESAs’ accountability using expertise from the national level. Can you provide more detail in terms of this suggestion, and in particular whether some level of direct access to data would help to improve transparency and the ESAs’ duty to carry out its economic analysis?

The recent decision by the European Court of Justice to dismiss the UK’s challenge in relation to the short selling regulation, handed down a judgment that could arguably encourage the EU to transfer further powers to EU bodies. How would you respond? What is the Government’s policy response to this judgment?

In light of the inauguration of the Single Supervisory Mechanism, you note that the ESRB will need to ensure it can manage any tensions that arise in terms of the ECB’s supervision of the SSM and the ESRB’s role in assessing risks across the whole of the EU. We take note of this concern and ask you to provide more details on the nature of the tension between the two institutional bodies and indeed any structural changes that may be necessary.

We take note of the expiration of the mandate of the first Chair of the ESRB in December 2015. Do you have any concerns on the Regulation that needs to be revised? Furthermore, in recognising the operations of the ESRB do you support the new function of a Managing Director, and whether the composition of the two advisory committees should be reviewed?

We would be grateful for a response to this letter by 6 October 2014. In the meantime we will continue to hold EMs 12446/14 and EM 12447/14 under scrutiny.

10 September 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter dated 10 September 2014 on the operation of the European Supervisory Authorities (ESAs), the European System of Financial Supervision (ESFS) and the European Systemic Risk Board (ESRB).

You asked for the Government’s view of ESA peer reviews. One of the core tasks of the ESAs in their role as strategic level regulators, as opposed to day-to-day supervision which remains a task for national competent authorities, is to help raise the standards of supervision across the EU. As you
noted, the UK Government considers this an area that has been relatively neglected since the inception of the ESAs due, in part, to the volume of rules that the ESAs have been required to draft. It is now important that the ESAs improve their ability to help raise supervisory standards, ensure that regulation is implemented consistently and share best practice across Member States. Peer review is one approach that has been demonstrated to be effective – for instance, in other international financial organisations such as the International Monetary Fund and the Financial Stability Board – in helping to enhance standards across member countries. To date, the ESAs have only conducted a limited number of peer reviews and so it is too early to provide a robust assessment of their impact and effectiveness. However, the UK Government is of the view that a greater future focus in the ESAs on peer review and a sufficiently clear and strategic approach, while still focusing on specific issues that support improved outcomes – for example, in the area of enforcement – would support higher standards of supervision.

You raised the issue as to whether the ESAs should have powers to rectify legislation promptly, in light of evidence to your inquiry that the volume and pace of agreed legislation has produced unintended drafting errors. The quality of the rule-making process on financial services issues, both at the legislative and “delegated” level, since the global financial crisis was also called into question by a large number of respondents to the Government’s Balance of Competences report on Financial Services and the Free Movement of Capital. However, any ex post powers to the ESAs to rectify errors would need to be considered carefully, not least as these could reduce the incentives for the quality of legislative drafting to be high from the outset and could impinge on the role of the co-legislature under the Treaty on the Functioning of the EU. It is arguable that there should instead be a stronger focus on preventing the creation of such errors in the first instance. In situations of urgency, the ESAs may already submit draft technical standards to the Commission for adoption without public consultation. For this reason, the UK Government is keen to see reforms to the quality of the policy-making process on financial services legislation, including through steps to improve the quality of the drafting of legislation in the first instance.

In your letter, you noted the Government’s disagreement with the contention in the Commission’s reports that the Boards of Supervisors of the ESAs do not act in the European interest. First, the National Competent Authorities (NCAs) that comprise the Board of Supervisors are very aware of their independence obligations under the ESA Regulations. The UK Government believes that the NCA representatives on the Boards of Supervisors generally act according to these obligations, seeking effective and practical outcomes that will improve EU markets and promote the interests of EU citizens and economic actors. Indeed, other NCAs are well-placed to identity when individual members are not acting in the European interest. It is also worth noting that NCAs are independent from national parliaments and finance ministries and that their objectives are aligned with the European interest. In addition, it is important to note the expertise and insights that the NCAs are able to provide which allow them collectively to identify the best course of action. They provide accountability, technical knowledge and understanding of domestic markets, all of which help to ensure that the ESAs’ actions are both legitimate and informed.

It is important for their functioning that the ESAs have adequate access, subject to legal limits, to firm-specific data via NCAs. It is equally important that the ESAs make effective use of data, in order to enhance their ability to conduct peer group analysis and both identify risks and enhance supervisory activity at a sectoral level. It is, however, necessary that the ESAs have sufficiently strengthened processes in order to demonstrate compliance with their confidentiality obligations and to ensure that they have adequate security systems in place. As you noted, the UK Government believes that any reforms to the ESAs should be based around supporting the ESAs so that they can perform their existing tasks and mandate and use their existing powers more fully. The Government, therefore, views the medium- to longer term options in this light. Furthermore, information sharing is not the key obstacle to achieving the goals of more transparent ESAs and a greater focus on economic analysis. The ESAs could improve their transparency by, for instance, being more open about communications with the Commission and decisions taken by the Board of Supervisors. A greater focus on economic analysis could be achieved through, for instance, a review of the prioritisation of work within the ESAs going forward.

With regard to the decision by the European Court of Justice on the short selling regulation, the UK Government has consistently stated that any powers conferred on EU agencies must be in conformity with EU Law to ensure legal certainty and institutional balance. The ECJ’s judgment in this case confirms that the Meroni principle continues to apply as to the nature of powers which may be vested with EU agencies and provides clarity as to how one is to apply the principle in the context of vesting
powers concerning financial services regulation in the ESAs. Any proposal to vest powers in the ESAs will need to ensure that it adheres to this judgement.

You concluded your letter with a number of questions regarding the European Systemic Risk Board (ESRB). The UK Government considers the ESRB to have performed well since its inception. Key factors in its performance include the authority and expertise it derives from its comprehensive membership of central bank governors and financial supervisors, its independence from Member States and EU institutions, and its macroprudential oversight across all financial services sectors and the EU as a whole. It is important that the benefits of these elements are retained. This includes ensuring that the European Central Bank’s supervision of banking union countries is subject to the ESRB’s macroprudential monitoring, in line with supervisors from non-banking union countries. To date, the ESRB has benefited from its close relationship with the ECB, including through the sharing of information and expertise. Such benefits should not be lost; but care should also be taken to ensure the ESRB’s independence is not undermined. You also refer to the Commission’s proposal for a Managing Director and the two advisory committees. The UK Government is prepared to explore options to improve the effectiveness, efficiency and visibility of the ESRB. Subject to its mandate, the creation of a Managing Director post could help to support these goals. Similarly, the composition of the advisory committees could be considered as part of the broader review. However, care should be taken to ensure that the benefits of the existing membership and separate groups are not lost.

6 October 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 6 October 2014, on EM 12446/14 on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS) and EM 12447/14 on the mission and organisation of the European Systemic Risk Board (ESRB). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 21 October 2014.

Your response provides a helpful level of detail on many of the points raised in our letter sent on 10 September 2014. Read in conjunction with your separate correspondence on the unnumbered EM on the European Court of Auditors’ report on the European Banking Authority, it is clear that you do not support extending the mandates to the ESAs at the current time, but will consider other non-legislative changes to improve their functioning. We agree with the Government’s support for measures to improve the functioning of the level 1 process and transparency of decision making in the level 2 process.

We are however still concerned that you show no concrete long term vision for the ESAs as they continue to evolve in the medium term. The recent legislative period has showed the weaknesses of the ESAs in operating with limited resources and powers, which has ultimately lead to sub-optimal outcomes especially in terms of supervisory consistency and convergence. Whilst it is important that the ESAs fulfil their existing mandate, we urge you to be proactive in engaging in the medium term and potential legislative changes that can improve the functioning of the ESAs’ regulatory and supervisory responsibilities.

We would be grateful for any update as to further discussions on the proposed amendments to the ESAs. In the meantime we now clear the document from scrutiny.

21 October 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your two recent letters on the operation of the European Supervisory Authorities (ESAs) and the European Court of Auditors’ report on the European banking Authority (EBA), and for clearing the relevant documents from scrutiny. I am responding to some of your further comments, as I want to ensure you are fully appraised of the government’s position on the ESAs review and will update you as the agenda progresses.

First of all, I wanted to clarify that the Government has a clear, long-term vision for the ESAs, which we have elaborated since their inception and most notably at some length in our response to the European Commission’s consultation last year. The Government wants to see each of the ESAs develop into strong and expert organisations that sit at the heart of financial supervision in the EU. Our vision is of the ESAs as strategic organisations that manage the overall system of supervision,
ensuring there is a uniformly high standard of outcomes across the EU, which in turn will help to ensure a safe and stable single financial market as well as a level playing field that is fair and prevents arbitrage between different countries. The ESAs have a critical role in helping to design regulations, especially the detailed technical standards, raising standards of supervision across all 28 Member States and undertaking financial market analysis to help safeguard financial stability, as well as underpin the quality of regulation and supervision. I strongly believe that the key added value of the ESAs is that they provide a unique and strategic EU-level approach that helps to enhance standards of supervision and regulation.

For this reason, I feel it is undesirable for the ESAs to take on more direct supervision. To date, they have only directly supervised entities (credit ratings agencies and trade repositories) that are ancillary to financial markets. However, if they undertake more supervision, which is best left to national regulators with their expertise and proximity to local markets, then the benefit of that second, additional EU layer of protection will begin to disappear.

Indeed, there is a conflict of interest between the ESAs’ mandated role as a second layer of supervisory authorities that shares best practice and highlights inadequacy in national-level approaches, while also undertaking national level supervision themselves. For example, who will undertake a peer review of how the ESAs are supervising credit ratings agencies and trade repositories? Who would hold them to account in the same way that they are meant to hold national supervisors to account? The question of direct supervision also raises important questions of subsidiarity and ensuring that national regulators are able to meet their financial stability mandates and mitigate the risk to taxpayers posed by financial sector failure.

To date, the ESAs have only partially delivered on their mandate, primarily on the single rulebook aspect, and so they have much further to go if they are to deliver in full. To some extent, the ESAs could be considered to be approaching the end of their first development phase, which has been on writing new rules, and to now be entering the next phase, which is to help ensure rules are implemented and enforced appropriately.

The Government wants to see the ESAs succeed in taking forward the various tasks and activities they are already being asked to deliver. In this regard, the Government is engaging proactively in Council discussions to help improve the functioning and efficiency of the ESAs. For instance, we support the majority of the short-term improvements proposed in the Commission’s report from August 2014, including better use of peer reviews, greater transparency in drafting technical standards, and enhancements to internal governance within the existing Regulations. We should work to enhance ESA functioning within the existing Regulations, where much can be achieved, before considering more challenging options that would entail legislative change. I do not agree that they will become more efficient by being given more tasks or responsibilities – these may serve only to distract them from their core focus. Nor do I agree that they should be given additional powers when they have not exercised in full those they already have today. There would need to be clear evidence that there are obstacles or uncertainties in delivering their current mandate before changes and additional powers could be proposed.

You specifically raised the issues of binding mediation and supervisory convergence. On the first of these, Article 17 in the ESA founding Regulations sets out the instances and process whereby the ESA can adopt binding decisions on competent authorities in the event of disagreements between competent authorities in cross-border situations. The ESAs have not yet availed themselves of these powers. This is due, in part, to the successful use of non-binding tools and the threat of binding action which has helped to secure resolution of such issues when they have emerged. As such, it is not clear that the lack of use of binding mediation means that there is any need to strengthen these powers.

In principle, I am not opposed to clarifications or modifications, however there is as yet no clear evidence that this is necessary. Furthermore, I do not believe that the current system of switching on binding powers on a case by case basis will lead to a piecemeal and disjointed approach to powers. Rather, I consider this to be an appropriately tailored approach that ensures the accountability, transparency and due process through the co-legislature that is necessary for the application of such significant powers.
As noted above, I believe the ESAs should focus more on supervisory convergence in the next few years and I welcome the steps they are beginning to take to deliver on this important part of their mandate. However, again there is little, if any, evidence that there is a need for enhanced powers, given that they have not yet fully used their existing peer review powers. Indeed, up until the end of 2013, the ESAs had collectively conducted only 11 reviews between them in the three years since their inception, and the EBA alone had conducted just one. Therefore, there is a clear need for the ESAs to use these existing powers much further – and the Government is keen to see them do this – before any consideration is given to the need for greater powers. As with binding mediation, I am not opposed in principle to clarifications or modifications to support supervisory convergence if needed, but there is no evidence as of yet that this is the case. In large part, this lack of focus on supervisory convergence is due to the ESAs focusing on drafting technical standards in the last few years. But this points to a change in focus and reallocation of resources, and not to any new powers, as the ESAs’ work on Level 2 issues begins to ease.

You also made reference in your correspondence to the possible greater involvement of the EBA in Level 1. Overall, the Government believes that there should be benefits in involving the ESAs more closely across various parts of the legislative process, on the basis that their expertise and understanding of the impact of rules on firms should help to improve the quality and coherence of the rules that emerge from the process. Steps to improve their engagement could include: ensuring the Commission consults with the ESAs at the start of Level 1 on their ability to deliver, the timing of review clauses, and the mandates and priority order of Level 2; a requirement for the ESAs to publish an assessment of all new proposals, covering the quality of evidence and analysis in Commission impact assessments, the implementation timetable, and any issues with Level 2 delegating provisions; requiring the ESAs to publish ex post assessments of the extent to which legislation is meeting its regulatory objectives; and ensuring the ESAs have adequate time to produce and consult on Level 2 rules. However, significant care will need to be taken to ensure that any change in the roles of the ESAs is appropriate and commensurate with their roles as set out in their governing Regulations and is not an unnecessary distraction from other aspects of their existing mandate.

I hope that the above information is useful and I will keep you informed on developments regarding the ESAs review.

27 November 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 27 November 2014, on EM 12446/14 on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS) and EM 12447/14 on the mission and organisation of the European Systemic Risk Board (ESRB). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 16 December 2014.

We share your vision to develop the ESAs into strong and expert organisations that sit at the heart of financial supervision in the EU. In addition, we welcome the steps you are considering, to improve the functioning and effectiveness of the ESAs at the level 1 process. We agree that the addition of any roles should be commensurate with those established in the founding regulations, but would highlight that additional resourcing should be considered in these plans, given that the ESAs seem to be running to full capacity.

We understand that as long as you see the ESAs as ’system organisers’, not overstepping lines of subsidiarity as far as direct supervision is employed, there is no immediate appetite for the Government to delegate further powers to the ESAs until it is clear that they are unable to function effectively under their current mandate. We hope that the short term non-legislative changes that are being considered will lead to positive improvements to the legislative process and the quality of rulemaking. Since the ESAs have not fulfilled their mandate on supervisory convergence, it should become clearer how the use of non-binding and binding powers continue to function.

While we do not require a formal response to this letter, we would be grateful for any update as to further discussions on the proposed amendments to the ESAs.

17 December 2014
Letter from the Chairman to David Gauke MP, Financial Secretary, HM Treasury
Thank you for EM 11473/14, dated 21 July 2014 on the European Commission’s Communication on Long-Term Financing of the European Economy. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 September 2014.
We agree with you that the report does not provide adequate evidence of the extent to which the EU’s objectives have been achieved. Do you agree with us that it suffers from an overemphasis on how money was spent as opposed to what the end result of such spending was? What steps do you believe can be taken to further improve the quality of the report in the future, and what will the Government do to help ensure that such improvements are made?
We note that you provide little analysis of the policy implications of the Commission document. While you comment that the report itself is essential in ensuring accountability and transparency of the EU budget and welcome the improvement to the quality of the reports since the previous year, we nevertheless wish to stress the importance of a number of the interim conclusions, particularly where programmes have fallen behind or achieved early on their targets. Given the Government’s position and watchful eye on all areas of the expenditure under the new Multiannual Financial Framework, we would be grateful if you could expand your analysis further to account for example on areas of poor performance such as the Cohesion Fund and ERDF Infrastructure investments to date, or the early evaluation success of FP7 programmes designed to meet research needs of businesses.
We note that this document also follows up on key recommendations that the Commission has made further to the request of the Court of Auditors. Do you believe that enough has been done to address the ECA’s recommendations?
We would therefore request that you provide us with deeper analysis of the areas of evaluation. We would be grateful for a response to this letter by 6 October 2014. In the meantime we will continue to hold EM 11473/14 under scrutiny.
10 September 2014

Letter from David Gauke MP to the Chairman
Thank you for your letter of 10 September on the above named explanatory memorandum. Your letter seeks further information on several issues which are considered below.

Focus of the report
Your letters sought HMG’s views on the quality and focus of the Commission’s report. The Government believes that monitoring the way in which EU budget funds are spent and managed should remain a priority. However, we support the Committee’s view that the Commission’s report should seek to place greater focus on the end result of such expenditure. For example, in this year’s joint counter-statement on the discharge of the EU budget for 2012, the UK (joined by Sweden and the Netherlands) called for further steps to be taken to monitor and enhance the European added value of interventions financed from EU funds.
Adjusting the focus of this report would support this and other calls from the European Court of Auditors (ECA) and the European Parliament for EU budget expenditure to be considered and assessed in light of its value for money. The Government will continue to engage closely with like-minded Member States in Council and the Commission to encourage all institutions to begin to incorporate value for money in their consideration of the use of EU budget funds, including in this report.

Report’s conclusions
Your letter also asked for further analysis of poor and positive performance in specific areas.
It is encouraging that the Commission has acted reactivity to improve poor performance in areas such as the Cohesion Fund and ERDF infrastructure investment.

The Government is pleased to note the successful implementation of FP7 and particularly welcomes the steps taken to improve business participation, including the introduction of public-private partnerships which has been successful in generating increased business investment in associated R&D and innovation.

For less successful programmes, such as Cohesion Funds and the ERDF, the Government recognises that the slow start up of the 2007-2013 programmes was exacerbated by the economic crisis. As a result, many programmes have found their results and outputs falling behind their original profiled targets. With regard to infrastructure projects in particular, the report indicates that the below target outputs relate mainly to the EU12 which suffered more from the impact of the economic and financial crisis than the EU15.

Further, the results and impact of Cohesion fund and ERDF projects are often best reported after the projects have been completed. We expect the development of performance frameworks for the 2014-2020 programmes, and a more results oriented approach to outputs and indicators, to produce more transparent and efficient monitoring of implementation in the future.

EUROPEAN COURT OF AUDITORS’ (ECA) RECOMMENDATIONS

Finally, your letter asked for the Government’s views on the follow up to the ECA’s recommendations. The Government welcomes the ECA’s Special Reports and recommendations which encourage the Commission and Member States to continue to improve their management and financial controls systems to optimise the value for money of investments.

The Government considers that the Commission has made a good start in addressing the shortcomings identified by the ECA, however, it is clear that more needs to be done to maintain the progress made and tackle outstanding issues.

It is worth noting that the Government continues to oppose the use of coupled payments which distort the market and require additional layers of bureaucracy. However, the Government supports the ECA’s recommendation that there should be improved monitoring of Member States’ use of coupled support and we therefore welcome the Commission’s commitment to make improvements in this regard for the new CAP period.

The Commission emphasised that they will apply some of the ECA’s key recommendations to the 2014-2020 programmes. These include a stronger results oriented focus, partnership agreements that include an analysis of disparities and development needs, ex ante conditionalities and annual reporting of output indicators based on a common set of indicators.

3 October 2014

Letter from the Chairman to David Gauke MP

Thank you for your letter dated 3 October 2014 on EM 11473/14, 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 18 November 2014.

We are grateful for your short analysis of the performance of the programme implementations, addressing in particular the problems seen in relation to the Cohesion Fund and the ERDF Infrastructure investments to date. We note that the Government has been active in vocalising the need to strengthen the focus of the report on Union finances to incorporate European added value. Do you believe there is any momentum behind persuading the Commission to incorporate such focus to the reports? Are there further obstructions to achieve such arrangements?

You note that you are dissatisfied with the coupled payment system currently in operation, which adds an additional layer of bureaucracy to the process. We note that this system has largely been phased out in the CAP reform in 2013, and should no longer pose additional burdens in the future. In raising this issue, do you believe that these reforms will not effectively achieve their goals?

We would be grateful for a response to this letter by 2 December 2014. In the meantime we now clear EM 11473/14 under scrutiny.

18 November 2014
Letter from David Gauke MP to the Chairman

Thank you for your letter, dated 18 November 2014 and received on 13 January 2015, on the above mentioned document.

In your letter the Committee queried the feasibility of focusing on added value in future reports.

The UK has joined like-minded Member States to support the European Court of Auditors’ (“ECA”) consideration of performance of EU budget funds in its annual report. The Government also supports the ECA’s landscape review on risks to financial management of the EU budget for which an EM was submitted on 22 January 2015. The Government will continue to encourage the Commission to pursue the monitoring and assessment of the added value of EU budget expenditure and is encouraged that the Commission has made some effort to incorporate the assessment of performance in the 2014-2020 programme period.

Your letter also asked whether reforms to the coupled payment system as part of the CAP reform of 2013 will effectively achieve its goals. The Government is pleased that most of the former coupled direct payment schemes have been phased out and integrated into the Single Payment Scheme and, as part of the 2013 CAP Reform, its successor the Basic Payment Scheme.

This decoupling process has removed some administrative burdens for Member States and farmers. However, there remains the option for Member States to use some of their direct payments budget for voluntary coupled support measures. As these are voluntary measures there are no associated administrative burdens for those Member States, or regions of Member States, who do not make use of this option. Within the UK coupled support is only being operated in Scotland. The Government continues to have concerns about the market-distorting effects of coupled support and will be pushing the Commission to make available details of Member States’ use of coupled support to help monitor its impact.

29 January 2015

FINANCIAL MANAGEMENT - INTERNAL AUDITS CARRIED OUT IN 2013 (13921/14)

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

Thank you for EM 13921/14, dated 27 October 2014, an Annual Report to the Discharge Authority on the Internal Audits carried out in 2012 and accompanying Commission Staff Working Document. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 November 2014. I apologise for the delay in sending you this letter.

You note that you found the Annual report useful and take the management of Union funds very seriously. However, you provide little analysis of the report’s findings. We would therefore be grateful for further elaboration on how you see the internal control systems developing from previous years across the DGs?

Overall, the story emerging from the IAS mirrors that of EM 13681/14: Follow up to discharge of the 2012 EU Budget. Both reports raise concern over the control and audit strategies for DG REGIO and DG AGRI. Again, we understand that the problem lies in the fact that the Commission relies heavily on the control statistics reported by Member States which the IAS assess to be unreliable. While the recommendations go some way to reinforce the work of the Certifying Body and strengthen the assessment of the Paying Agency, further improvements or re-design will not take place quickly. The fact that there is a weakness in the sanctioning system, as well as the need to respect the principles of shared management means there will inevitably be a continued level of inertia in ensuring reliability of statistics. What confidence do you have that the problems in these DGs will be rectified, taking into account best practice from other DGs?

While the European Social Fund represents 8% of the EU Budget, and efforts have been made by DG EMPL to reduce the error rates, the audit concludes there are significant issues regarding the effective functioning of management and control systems for 27 Operational Programmes in a number of Member States, of which the UK is one. Can you provide any clarity on the nature of these issues and how they are being resolved, with particular reference to the UK?
Although we have raised issues of internal controls and systems in relation to the EU Budget, the IAS recommendations underscore the fact that ‘critical’ and ‘very important’ recommendations across the Commission warrant significant attention.

We would be grateful for a response to this letter by 16 December 2014. In the meantime we will continue to hold the document under scrutiny.

2 December 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter of 2 December on the Annual Report on Internal Audits conducted by European Commission’s Internal Audit Service (IAS) and the three questions raised therein.

INTERNAL CONTROL SYSTEMS DEVELOPMENT IN COMPARISON TO PREVIOUS YEARS

You asked for information on how Directorate Generals’ (DG) internal control systems have developed over recent years. The information provided in the annual report indicates that not only have DGs been responsive to internal audit and its recommendations, but the reduction in the number of key recommendations may indicate improvements in controls. In addition, 2013 saw the audit delivery improvements made in 2012 over 2011 sustained. 100% of the planned audit engagements have been undertaken (100% in 2012; 88% in 2011). The level of internal audit work in the Commission is being maintained with 87 individual assignment reports issued (89 in 2012; 77 in 2011). 134 improvement recommendations were made (191 in 2012; 158 in 2011). All recommendations made have been accepted by management and all related remedial action plans were reviewed and approved by IAS. 79% of cumulative recommendations made during the period 2009-2013 have now been implemented. As last year, IAS follow-up work concluded that recommendations are being implemented satisfactorily and 96% were closed as a consequence (88% in 2012). If one accepts that the work leading to the recommendations is focussed on the most critical issues and the conclusions are valid, then the overall reduction in the number of recommendations made indicates an improving situation.

CONFIDENCE THAT THE PROBLEMS IN DG AGRI / DG REGIO WILL BE RESOLVED

The IAS audit the measures taken by the Commission to supervise and check Member States and other bodies which are responsible for disbursing EU funds. The IAS are the Commission’s own internal auditors and the annual programme of work undertaken is agreed between the IAS and the Commission. The Treasury is not involved in this process, but does monitor IAS activity and DGs responses via the annual report.

The audit assignment summaries provided in the annual report do give some confidence that the remedial work specified will bring about the desired improvements. The report acknowledges improvements already achieved by DGs AGRI and REGIO that IAS’ advice builds upon:

— Considerable improvements in the 2012 and 2013 Annual Activity Reports (AARs) and the on-going efforts made by DG AGRI to reduce error rates and protect the budget
— And the efforts made by DG REGIO to improve the quality of data reported by Member States and the DG itself.

EUROPEAN SOCIAL FUND: FUNCTIONAL EFFECTIVENESS OF MANAGEMENT AND CONTROL SYSTEMS IN MEMBER STATES (IN PARTICULAR THE UK)

The IAS audit is confined to the Commission and does not cover Member States’ systems of control over payments to final beneficiaries; such audits are carried out by member states’ own internal auditors, the Commission DGs and the European Court of Auditors. As this query is asking for information beyond the scope of IAS’ annual audit, further investigation would be required. If the Committee would find it helpful, I can ask the individual UK Audit Authorities for the relevant information. Please let me know if you would find this useful.

15 December 2014
Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 15 December 2014, on EM 13921/14, an Annual Report to the Discharge Authority on the Internal Audits carried out in 2013 and accompanying Commission Staff Working Document. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 21 January 2015.

We are grateful for your assessment of how the internal control systems have made efforts to improve over recent years. However we consider that your reply is rather backward looking and does not adequately take into account the various divergences between DG controls of EU fund disbursement, as well as the fact that there are differences in the levels of recommendations as 'critical' and 'very important' that require more serious attention.

As established previously, the Commission relies heavily on the control statistic reported by Member States which the IAS assess to be unreliable. The fact that you do not seem to make this connection in your reply implies that you underestimate the importance of Member States' control systems in the Commission’s audit figures. We have previously stressed the importance of shared management in managing the EU budget. We wish to emphasise the importance of strengthening the control of payments to final beneficiaries and its impact on the Commission’s annual audits. In light of this, we are grateful for your helpful offer to request information from the UK authorities on the problems associated with the disbursement of the European Social Fund.

We would be grateful for a response to this letter by 21 February 2015. In the meantime we now clear the document under scrutiny.

21 January 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter of 21 January confirming that the Annual Report on Internal Audits conducted by the European Commission’s Internal Audit Service (IAS), which was under scrutiny, has now been cleared.

EUROPEAN SOCIAL FUND (ESF): FUNCTIONAL EFFECTIVENESS OF MANAGEMENT AND CONTROL SYSTEMS IN MEMBER STATES (IN PARTICULAR THE UK)

You also asked that I request more details from the UK Audit Authorities (AAs) concerning the problems with Managing Authorities’ (MAs) control systems identified by audits undertaken by the NI Audit Authority (in respect of Northern Ireland ESF), the European Court of Auditors (in respect of England and Gibraltar ESF) and DG EMPL (in respect of Scotland Highlands & Islands ESF) that are mentioned in the 2012 Annual Activity Report: Employment, Social Affairs and Inclusion (page 66 – 69 http://ec.europa.eu/atwork/synthesis/aar/doc/empl_aar_2012.pdf) and which in turn was referenced by the IAS in their Annual Report of Audits in 2013 EM 13921/14, in the section dealing with the planning for their 2013 Audit of DG EMPL – Implementation of ESF 2007-13.

The position for the relevant UK Audit Authorities is summarised at Annex A. In each case the deficiencies identified have been addressed and the original assurance levels provided have been revised to category 2, which acknowledges residual low risk deficiencies that have a moderate impact on systems’ functionality.

The EC’s Assurance Category Definitions are at Annex B.

23 February 2015

FINANCIAL TRANSACTION TAX (6442/13)

Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury, to the Chairman

Thank you for your letter of 13 May, responding to mine of 11 May about the recent ruling by the ECJ on the UK’s precautionary legal challenge and the 6 May ECOFIN meeting.

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You ask what more I can tell you about the implications of the ECJ’s ruling for negotiations, and for any future challenge against an FTT directive. Negotiations will proceed as usual until a compromise text is adopted by the participating Member States. It would be at that stage that the Government would look to lodge a new legal challenge, if necessary. In the meantime we continue to participate in discussions, ensuring that UK concerns are heard.

I note the 10 April response by the Commission to your report Financial Transaction Tax: Alive and deadly. The arguments in that letter are similar to those contained in a paper circulated by the Commission to the FTT working group last November. The Government’s position on these points, as set out in the paper accompanying my predecessor’s letter of 25 May 2013, remains unchanged: in particular, we continue to consider that the counterparty principle in its current form breaches Article 327 TFEU and is inconsistent with established international tax law. It would in due course be for the Court to consider the views of the litigating parties and decide whose interpretation is correct, should the Government decide to challenge any final FTT directive.

You ask about the level of information provided to Member States about the draft FTT proposal in advance of the Authorising Decision. On 26 November 2012, in response to requests for more detail from the UK and others, the Commission delivered a presentation at a Council Working group. The slides briefly set out potential options for amending the original proposal, and included a bullet point relating to the possible extension of the residence principle to guard against relocation. The Commission explained at the meeting that they were considering introducing the issuance principle. The UK welcomed this information but continued to call on the Commission to make available the full draft proposal, accompanied by a full impact assessment, before Council was asked to authorise enhanced cooperation on an FTT. A further note was circulated by the Commission prior to a meeting of fiscal attaches on 7 January 2013, providing some additional detail on possible changes to the original proposal, including on the possible introduction of the issuance principle, but no draft proposal was made available. I take full note of the Committee’s views on the Government’s approach to the Authorising Decision. However, I believe the decision to abstain from the Authorising Decision was appropriate and I refer you to previous correspondence with my predecessors on this.

You also mention the joint statement by ministers of the participating Member States at ECOFIN on 6 May, and ask about its implications and the next step in negotiations. Since my last letter, there has been one further Council working group, on 28 May. At that meeting, Member States had a preliminary discussion about how to tax derivatives under the FTT, including whether in principle to seek to adopt a custom list of in-scope instruments, or instead to refer to financial instruments contained in the annex to the Markets in Financial Instruments Directive (MiFID); and whether in principle to select derivatives by instrument type (e.g. futures, options) or instead by type of “underlying” (e.g. shares, interest rates). The UK emphasised that before any process of selecting which derivatives to tax could be started, clarity was needed on the territorial limits of the proposal. The discussion did not cover in any detail which particular derivatives or classes of derivatives should be covered. Officials also discussed legislative options for structuring any “step by step” approach.

At the meeting, UK officials highlighted the concerns expressed at the 6 May ECOFIN by the Chancellor and other non-participating countries’ finance ministers about process and transparency. I am pleased to note that at the working group there was an open discussion involving both participating and non-participating Member States. This was in contrast to recent experience. We understand there will be no more meetings under the current presidency, but expect Council working groups to resume in July.

On whether the UK could accept a UK-style stamp duty, the answer is yes, in principle. The UK tax is, broadly, limited to UK shares (ensuring a proper territorial link is established) and contains suitable exemptions to preserve market liquidity. Something designed along these lines and put into effect in the FTT area should not adversely affect the UK, though further analysis to confirm this position would be needed if such an approach is proposed. However, the statement issued by the participating countries indicates that they intend to capture certain derivatives. We share your concerns about the lack of detail in this statement and believe it reflects a current lack of consensus among the 11 about which derivatives to tax and on what basis.

You ask about Slovenia’s position given that they did not sign the joint statement from the participating Member States at May ECOFIN. The reasons for this are unclear at this time. Slovenia remains a participating Member State in the enhanced cooperation group.

The UK continues to raise its concerns around the proposal at Council working groups and through a variety of other channels. A key priority is to ensure the territorial basis of any compromise
addresses our legal concerns. The Chancellor has been clear that we will not hesitate to launch a further legal challenge to any final implementing directive, if required. However, there is still much to be discussed before any final FTT can be agreed, and we stand ready to engage with other Member States on any emerging compromise.

6 June 2014

Letter from the Chairman to Andrea Leadsom MP


We are grateful to you for this informative response. We welcome the fact that in the most recent Council working group there was an open discussion involving participating and non-participating Member States. We note the lack of consensus among the 11 participants about which derivatives to tax and on what basis, and would be grateful for further updates on the scope of the tax and more generally as negotiations progress. We also welcome the clarity you provide on the UK’s likely approach to a stamp duty-type model. However we are surprised to learn that a Stamp Duty model may be deemed unacceptable to the UK if it applies to derivatives as this could create a competitive advantage for the City of London.

We note your account of the information provided to Member States on the draft FTT proposal in advance of the Authorising Decision in late 2012 and early 2013. However, we regret that this information has only come to light now. We also find it odd that we only became aware of this following receipt of the Commission’s response to our December 2013 report, rather than being told as much by the Government at the time. While we wholly accept that it was unacceptable on the Commission’s part not to publish the draft proposal in full before the authorising decision was made, we are disappointed that the then Financial Secretary did not share with us the information that had been revealed on 26 November 2012 and 7 January 2013. We wrote to the then Minister on three separate occasions between October and December 2012 asking him to provide the Committee with information on the proposed scope of the revised proposal. The Minister’s reply, written one month after the 26 November 2012 briefing took place, stated 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.” The Government’s failure to keep us apprised of such information on the scope of the proposal as was available inhibited this Committee’s ability to scrutinise the proposals and the proposed authorising decision. Now that we know what the Government knew at the time about the likely scope of the proposal under enhanced cooperation, we are even more puzzled that the Government made no attempt to muster a blocking minority against the Authorising Decision.

You will also recall that our December 2013 report concluded that there was no Treaty impediment to the Commission bringing forward at the same time its proposal for a Decision authorising enhanced cooperation and its proposal for the substantive legislation implementing enhanced cooperation. The Government’s response to our report expressed sympathy with the Committee’s conclusions, and stated that “it is crucial that the right precedents are set at the early stages of [the use of the enhanced cooperation procedure] in order to provide all Member States with confidence if the procedure is to be used effectively in future.” In light of this, we would be grateful if you could inform us as to the efforts you are making to gain support amongst EU colleagues for ensuring that the precedent is adopted and followed of ensuring that a substantive proposal is brought forward at the same time as any proposal for an Authorising Decision for enhanced cooperation.

We note the Government’s willingness to launch a further legal challenge if necessary. We would be grateful for the Government’s assessment of the strength of the safeguard contained in Article 20(4) TEU that enhanced cooperation should not bind non-participating Member States, and the extent to which you would seek to rely on it in any legal challenge. At the same time we welcome your commitment to engage with other Member States on any emerging compromise.

You would be grateful for response to this letter, including an update on negotiations in the Council working groups scheduled for July, by 21 July 2014 at the latest, and sooner should there be any significant developments in the meantime. We continue to hold the document under scrutiny.

18 June 2014
Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 18 June.

Since then, there has been one Council working group, on 15 July. This mainly focused on how to define the scope of the commitment by participating Member States to apply the tax (in its first phase) to "shares and some derivatives".

On shares, the discussion centred on which types of instruments to include beyond ordinary shares (such as preference shares, rights and warrants, and depositary receipts). On derivatives – the more controversial element, where the negotiation remains wide open – various approaches to selecting which instruments to cover were discussed. One option proposed was to tax derivatives which are linked to equities, another idea was to tax derivatives most closely associated with speculation, another was to target those derivatives whose taxation would be expected to raise substantial revenue, and the final option was to tax derivatives according to which could successfully be captured by the issuance principle.

These options have very different implications and the discussion was inconclusive. Our prior judgement, that there is considerable work to do before any revised proposal begins to take shape, remains unchanged – and we do not currently expect another working group before September.

In your letter you proposed that a tax on equity-linked derivatives could benefit the UK through relocation effects. We agree that, in certain scenarios, this might create a competitive advantage for the City of London. However, it is also possible that the participants would seek to design the tax in a way which prevents the migration of trading activity to London and financial centres in non-participating countries as much as possible. This could possibly be done by recourse to extraterritorial provisions to which we may have objections of principle. We continue to ensure that our legal and other concerns are taken on board in discussions of the options.

In relation to the provision of information to the Committee in the lead up to the authorising decision, I would note that until 7 January 2013, we had received nothing in writing about the potential inclusion of the issuance principle other than the single bullet point in the Commission’s informal presentation. Indeed, when a draft paper was circulated on 7 January, after the correspondence with the Committee to which you refer, it was described as an indication of thinking rather than a definitive proposal. It was only when the Commission published its draft implementing proposal on 14 February 2013 that the inclusion of the issuance principle was formally confirmed. My predecessor outlined the scope of the proposal in his explanatory memorandum of 19 March 2013. I note also that the potential inclusion or combined use of the issuance principle was, for us, not the offensive element of the tax as such. As you know, UK stamp duty takes this approach and we do not object to it in principle. Our main concern was general – that in order to properly analyse the impacts of a tax, which would inevitably be very sensitive to the details of the proposal, we would need to see its detailed provisions. My predecessor made this point very strongly at the ECOFIN meeting in December 2012.

On the enhanced cooperation procedure, the Treasury will continue to work to ensure that appropriate precedents are established during this negotiation. We will also ensure that any appropriate lessons from the use of enhanced cooperation on the FTT are used to inform wider work in Government on the future of Europe.

On Article 20(4) TEU, this says that acts adopted under enhanced cooperation do not bind non-participating Member States. In the case of FTT, however, our concern has not been with acts which would bind the UK directly. Rather, it has been with acts which would apply ostensibly only to the participating Member States but which nevertheless have indirect or extraterritorial effects on entities in non-participating Member States, as well as third countries. Article 20(4) does not address this situation in terms, and was not referred to in the UK’s legal challenge to the Council’s decision authorising enhanced cooperation. We will of course keep it in mind should it be relevant for any future proceedings.

18 July 2014

Letter from the Chairman to Andrea Leadsom MP

European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 29 July 2014.

We are grateful to you for your update on discussions at the 15 July 2014 working group. You state that four options for taxation of derivatives were discussed at that meeting. Although we note that the discussion was inconclusive, can you provide any further details? Were any of these options deemed preferable compared to the others? What were the views of their relative strengths and weaknesses? Were any ruled out as unviable, or do they all remain on the table for future discussion? Is there momentum behind any of the proposals? You state that each of the options have very different implications. Can you provide a more detailed analysis of each of them? Which of these options is most and least preferable from the UK’s point of view, and why?

On the enhanced cooperation procedure, you state that “the Treasury will continue to work to ensure that appropriate precedents are established during this negotiation. We will also ensure that any appropriate lessons from the use of enhanced cooperation on the FTT are used to inform wider work in Government on the future of Europe.” However, you do not provide a specific response to our question as to the efforts that you are making to gain support among EU colleagues to ensure that a substantive proposal is brought forward at the same time as any proposal for an Authorising Decision for enhanced cooperation at the very latest. Are you taking practical steps to make the case to fellow Member States that there is no Treaty impediment to such practice being followed in the future?

We note your statement that there is considerable work to do before any revised proposal begins to take shape. We also note that no further Working Groups are expected until September. We would therefore be grateful for a response to this letter, together with an update on discussions at the next working group, by 30 September 2014, or sooner if significant progress is made before then. In the meantime we will continue to hold the document under scrutiny.

29 July 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 29 July.

You asked for an update on discussions following any further working group meetings, of which there has been one since my last letter, on 7 October.

Discussions at the meeting focused on three room documents issued by the Presidency.

The first proposed which instruments should come under the definition of “shares”. Discussion focused mainly on whether to provide options for participants to exempt shares in smaller and unlisted companies from the scope of the tax, and on whether to tax secondary trading (as opposed to redemptions and subscriptions, which were proposed to be exempt) of shares and units in funds. While there was widespread support for optionality on smaller and unlisted companies, there was no agreement on details such as the design of any size threshold or the definition of “unlisted”. Several Member States opposed the inclusion of fund units and some called for special treatment for pension funds. It was clear from the meeting that there was no consensus on the drafting, and that more work needed to be done on specifying the range and definitions of shares to be covered. Some Member States pointed out that it was difficult to consider these issues before agreement had been reached on the territorial basis of the tax.

The second document highlighted various risks associated with the residence principle, including potential relocation effects and the difficulties of identifying counterparties to a transaction when a trade was centrally cleared. The Commission was invited to comment on these risks, and argued that on the limited data available it did not expect widespread relocation of activity outside the FTT-zone. It was for participating Member States to develop a solution for the identification of counterparties and they could, if necessary, make use of the joint and several liability provision in Article 10 of the Commission’s proposal.

The third document outlined potential options for the allocation of FTT revenues among the participating Member States in the event that an issuance principle was adopted as the sole determinant of liability for the tax. In most options, the residence of the counterparties to a transaction would partially determine to which Member States the FTT revenue associated with that transaction was distributed. Some options foresaw revenue being allocated to relevant Member States on an immediate transaction-by-transaction basis, and others assumed a periodic disbursement based
on a formula. While certain participating Member States appeared to welcome the paper as a step towards a potential compromise, it was clear that several smaller participating Member States were sceptical about the proposals.

There was no further discussion of the approach to taxing derivatives which had been discussed at the previous working group. The Presidency indicated that this would be raised again at a future working group. The UK position on derivatives will largely depend on the basis on which these derivative instruments are proposed to be taxed – i.e. the residence or issuance principle. We have consistently expressed our preference for the Commission’s version of the issuance principle as the exclusive territorial basis for the tax, recognising this would substantially limit the application of the tax to derivatives traded in the UK.

Thank you for your further thoughts on the process around the enhanced cooperation procedure. We share a number of your concerns about how the FTT enhanced cooperation procedure has been handled, which has not always given non-participating Member States the certainty they need, and lessons need to be learned. However, the enhanced cooperation procedure has rarely been used, each case has been different, and there is unlikely to be a single solution that fits all future cases well. We are therefore continuing to discuss with other Member States, and with the EU institutions, how the process might be improved, respecting the framework set out in the Treaties, particularly with an eye to any future proceedings where the approach you set out may be an appropriate course of action to pursue.

At the time of writing there are no further working groups scheduled.

14 October 2014

Letter from the Chairman to Andrea Leadsom MP


We are grateful to you for your update on discussions at the 7 October 2014 working group. We would invite you to provide the Committee with further updates on future working groups as soon as practicable after they take place. In light of the evident disagreements between participating Member States, do you still consider it likely that they will reach agreement on the form of the tax by their end-2014 deadline? How satisfied are you with the extent to which non-participating Member States are being kept informed of the progress of discussions?

We note that no further working groups are currently scheduled. Accordingly we would be grateful for a response to this letter by 21 November 2014 at the latest, and sooner should a further working group be held in the meantime. In the meantime we will continue to hold the document under scrutiny.

28 October 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter dated 28 October.

You asked whether it is likely that the participants will reach agreement on the form of the tax by their end-2014 deadline. Since my last letter, no consensus has been formed on the territorial scope of the tax, how it would be collected and distributed between participants, or how it would apply (in particular) to derivatives. It therefore currently appears unlikely that a substantive agreement will be reached this year.

You also asked for an update following any further working group meetings, of which there has been one since my last letter, on 2 December.

Discussions at the meeting focused on two room documents issued by the Presidency.

The first covered options for setting the tax rate for derivative transactions. This included a proposal to vary the tax rate according to the maturity profile of a derivatives contract, and discussion of the most appropriate way to tax options and similar contracts.
No consensus was reached on these ideas, and the UK representative argued that it was premature to be discussing technical approaches for taxing specific types of derivatives when there was no agreement among participating Member States on which instruments to tax and on what territorial basis.

The second room document was a set of largely technical questions the Presidency had received from Member States relating to a report by consultants EY, published on the Commission website in October. The report considers potential collection mechanisms which might be used to collect an FTT in the form proposed by the Commission. It was clear from the report and the discussion that considerable challenges would arise, particularly in relation to the collection of any FTT on derivatives.

Finally, you asked about the extent to which non-participating Member States are being kept informed of the progress of discussions. The participating Member States have participated openly in recent council working groups, although we and other non-participating member states continue to press the importance of transparency during these negotiations.

No further working groups are currently scheduled.

5 December 2014

Letter from the Chairman to Andrea Leadsom MP


We are grateful to you for your update on discussions at the 2 December 2014 working group. We note that the lack of consensus on the scope and form of the tax means that substantive agreement this year is now unlikely. Does this suggest that such momentum as there was behind the proposal is diminishing? Is there any sign that the participants are likely to reach agreement on core principles during 2015? Do all 11 participants remain committed to introducing the FTT?

We would be grateful for further updates as negotiations progress. We invite a further update by 30 January 2015. In the meantime we will continue to hold the document under scrutiny.

17 December 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 17 December following my letter of 5 December.

You asked whether momentum behind the FTT proposal was diminishing and whether there was any sign that the participants would reach agreement on core principles this year.

In my last letter I explained that the participants had not reached consensus on the territorial scope of the tax, how it would be collected and distributed between participants, or how it would apply to derivatives. This situation has not changed.

However, Ministers of the participating Member States released a joint statement on 27 January expressing a renewed commitment to reach agreement and implement the tax by 1 January 2016. They said that “we decided that the tax should be based on the principle of the widest possible base and low rates, while taking full consideration of the impacts on the real economy and the risk of relocation of the financial sector”.

Further, you asked whether all 11 participants remained committed to introducing the FTT. There is currently no sign that any participant is considering leaving the enhanced cooperation negotiations.

There has not been an FTT working group since my last letter and the next is scheduled for 24 February. Following this, I will write to you again with a further update on the progress of negotiations.

I will continue to pay close attention to the progress of negotiations to ensure that our rights as a non-participating Member State, which are contained in the Treaty on the Functioning of the European Union, are respected. The government has been clear that if our legal concerns, particularly
relating to extraterritorial aspects of the proposal, are not addressed we will not hesitate to challenge the FTT at the Court of Justice of the European Union.

29 January 2015

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 29 January 2015, on EM 6442/13, the 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 3 February 2015.

We are grateful to you for your update on negotiations. We note the joint statement by Ministers of participating Member States to seek to apply the tax “on the principle of the widest possible base and low rates”. What does this mean in practice? Does this indicate any substantive progress from the inconclusive discussions that have thus far taken place? Can you confirm Bloomberg News reports\(^1\) that the Austrian Finance Minister had said that there had been real progress towards including derivatives in the tax’s scope? Can you confirm media reports that the Member States are seeking technical advice from the Commission, that Austria will co-ordinate political work and that Portugal will lead on technical issues? We note that Greece was not a signatory to the joint statement. Was this because of the Greek election process? Do you expect Greece to remain a participant in the discussions?

We welcome your offer to write again after the 24 February 2015 Working Group. We would accordingly be grateful for a reply by 2 March 2015. In the meantime we will continue to hold the document under scrutiny.

3 February 2015

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 3 February on the FTT, following my letter of 29 January.

A Council working group, the first since 2 December, was held on 24 February. Two issues were discussed and no substantive agreement was reached on either.

Firstly, technical issues surrounding possible collection mechanisms were examined. Little progress appears to have been made on this, and some participating Member States questioned the use of discussing collection at such length before the scope and territorial basis of the tax has been agreed. The UK representative had expressed similar doubts at the previous working group.

Secondly, the possibility of including a market making exemption, analogous to the UK’s intermediary relief for stamp taxes on shares, was discussed. Again there was no clear consensus among participants, and several voiced their concern over the potential economic impact of the current proposals, which lack a broad exemption.

After recently learning that the Commission would be attending informal meetings of the 11 participants, the UK representative raised the Government’s concerns that Commission involvement in such meetings would not result in enhanced cooperation progressing with the transparency guaranteed in the Treaties. The Council Legal Service said that the Treaties do not prevent the 11 participants meeting informally with the Commission. However, the Commission confirmed that any documents provided to the participants would be circulated to all Member States and offered to meet the non-participating Member States if requested.

The Latvian Presidency announced that the FTT had been removed from their draft agenda for the March ECOFIN and would not return to the agenda until progress had been made. No further working groups have yet been arranged.

You asked whether the joint statement made by the participants at the January ECOFIN and comments made to the media by the Austrian Finance Minister indicated that substantive progress had been made in talks. This is not the understanding of UK officials present at the working group, where it appears that little has changed in practice since December, and no new agreement has been reached by the participants.

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You mentioned media reports indicating that Austria would provide political coordination for the participants and that Portugal would lead on technical issues with advice from the Commission. My understanding is that this is indeed the case.

Finally, in reply to your question concerning Greek participation, there is no indication that the Greek position on the FTT has changed. You were correct to suggest that the absence of Greece as a signatory to the joint statement was due to their election process.

28 February 2015

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 28 February 2015, on EM 6442/13, the 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 10 March 2015.

We are grateful to you for your update on negotiations. With regard to the Commission’s involvement in negotiations, we urge you to continue to stress the need for full transparency in the process.

We note your observation that there has been little progress in negotiations. We would be grateful for a further update on negotiations by 26 May 2015 at the latest, or sooner if there are significant developments before then. In anticipation of being kept informed of such further negotiations, we will continue to hold the document under scrutiny.

10 March 2015

FOLLOW-UP TO THE DISCHARGE FOR THE 2012 FINANCIAL YEAR (13681/14)

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

Thank you for EM 13681/14, dated 15 October 2014, a Report from the Commission on the follow-up to the discharge for the 2012 financial year. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 28 October 2014.

You state that “the Government welcomes the Commission’s report which highlights efforts to address the concerns raised by Council in their discharge recommendations”. However the rest of the EM tends to undermine this assertion. For instance we detect little detailed analysis of the Commission’s responses, and in particular whether its rationale for disagreeing with 40 of the recommendations of the European Parliament or the Council is justified. We also note that, while the report is presented to the Council and the European Parliament for consideration, no ministerial discussion is anticipated. That being the case, can you illuminate us as to the practical purpose that this report serves? Is it an effective means by which the Commission and Member States alike can improve management of the EU Budget? Given that the document appears to respond to a greater extent to recommendations from the European Parliament than the Council, what reassurance can you give us that the Council’s recommendations are taken seriously by the Commission, and that the Commission’s response is taken seriously by Member States? In support of your arguments, can you clarify what mechanisms are in place to take forward discussions with the Commission in order to, in your words, “satisfy the recommendations put forward by the EP and Council”?

We also wish to highlight a number of specific points which arise from the report.

In relation to addressing problems raised in the DGs’ Annual Activity Reports, how would you respond to the Commission’s assertion that the Parliament’s request to audit all operational programmes at least once in the course of the programming period is not in line with the single audit approach proposed by the ECA, and also conflicts with the EP’s request to enhance cost-efficiency? Do you agree that DG AGRI and DG REGIO are in particular need of stronger control and audit strategies? Why is this? What systemic issues affect those two DGs? Would you highlight any DGs in terms of best practice of effective management of EU resources, from which others can learn?

We note your statement that, in relation to stronger control and audit strategies for 2014-2020, the Commission assessed that the EP’s recommendations fell outside the Commission’s remit, being the responsibility of Member States. We note in particular the Commission’s arguments that “it is the MS
that has to assume the primary responsibility for ensuring that actions financed by the budget are implemented correctly in accordance with the rules. The role of the Commission consists rather in an overall supervision by verifying the effective functioning of MS’s management and control systems”. Do you share this perception of the division of responsibility between Commission and Member State? In previous correspondence we have criticised your predecessors for not doing enough to acknowledge Member State responsibility for effective management of EU spending. In our view, effective management is a shared responsibility between Commission and Member State, and the two must work together. It is therefore regrettable to perceive a tendency by both parties to seek to place the primary onus on the other. This appears to us to be symptomatic of a wider problem, that no-one is willing to grasp the nettle and seek to effect meaningful reform of a budgetary process that is patently no longer fit for purpose. How would you respond?

With regard to the European Parliament’s request for the application of progressively increasing payment reductions and administrative sanctions where eligibility criteria have not been respected, the Commission states that the current regulatory framework already provides for such a system when there is sufficient evidence that the persistence of the deficiencies is increasing the financial risk to the EU Budget. However, in recent evidence to us, Dr Ingeborg Grässle MEP, Chair of the European Parliament Budgetary Control Committee, argued that it had not proved possible to implement an effective sanctions regime because of the unwillingness of Member States to countenance such a paradigm shift. How would you respond? Do you agree that an effective sanctions regime is urgently needed to ensure effective management of EU funds?

In his recent evidence to us, Richard Ashworth MEP told us that the use of RAL (reste à liquider) was getting out of hand. Yet the Commission defends it on the grounds that “the pre-financing is a tool meant to provide the beneficiaries with a float and to enable them to run the projects they have committed to. If the period covered by pre-financing were to be shorter than the period of the project, then the beneficiary would sooner or later run out of resources and the project in question could eventually fail.” How would you respond? What practical steps need to be taken to bring RAL under control?

We would be grateful for a response to this letter by 11 November 2014. In the meantime we will continue to hold the document under scrutiny.

28 October 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter of 28 October on the above named EM.

Your letter queries the purpose of the Commission’s report which the Committee notes is not subject to ministerial discussion. As part of the discharge process for the 2013 budget Council will consider the Commission’s actions as set out in this and other reports to assess whether sufficient progress has been made on management of the EU budget and where further improvements are required.

As the Committee is aware, this Government has adopted a consistently robust approach to discharge of the EU budget as a process for holding the Commission to account. For the past three years, we have joined Sweden and the Netherlands in voting against discharge and issued a joint counter-statement calling on the Commission to do better. The findings of this report will feed into the UK and other Member States’ approach to discharge of the 2013 EU budget.

With regard to the Annual Activity Reports (“AARs”) from Directorates-General, Member States now carry out an annual audit of the legality and regularity of programme expenditure. The Government believes that the Commission and the European Court of Auditors (“ECA”) should, in line with the single audit approach, rely on the information provided by Member States. Further, they should seek to reduce the number of audits conducted which will reduce duplication of effort and the overall cost of financial controls.

The control regime for the 2014-2020 programme period already includes annual control reports, management declarations, annual clearance of accounts, certification of expenditure and annual summaries of audits. As such, the Government does not support the European Parliament’s proposal which undermines the current single audit approach.

Your letter asked about the performance of two Directorates-General. The management and implementation of Agricultural and Cohesion Funds, which fall within the remit of DGs AGRI and
REGIO, continues to present a challenge for both Member States and EU institutions. The UK has taken a leading role in pressing for the simplification of the complex rules and legislation governing these areas of the EU budget to secure rules that are universally both accessible and capable of being consistently applied by all.

Your letter also raises questions regarding the division of responsibility for the implementation of EU budget funds. It is clear that, as 80 percent of the EU budget is spent under the system of shared management, Member States must put in place effective and efficient control mechanisms for the receipt and management of EU budget funds.

However, as evidenced by the discharge process, the Commission is accountable for the implementation of the EU budget as a whole. I agree that Member States and the Commission must work together to address systematic concerns and ensure that EU budget expenditure is effective and represents value for money for taxpayers. This must include working to simplify the regulatory framework to enhance compliance and facilitate a universal interpretation of the rules and legislation governing EU budget expenditure - a key UK objective.

The Government does not support the idea that Member States should accept the implementation of progressively increasing payment reductions and administrative sanctions at this stage. Before this can be considered, eligibility criteria and control requirements must be significantly simplified and the application of financial corrections adjusted to better reflect the actual risk to EU budget funds.

On the overall budgetary system and the management of EU budget funds, the Government believes that the clearest route for addressing the issues you raise is to narrow the gap between payments and commitments. This gap was significantly tightened in 2014 compared with previous years, which is evidence of the value of the 2014-2020 MFF deal in bearing down on commitments.

17 November 2014

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 17 November 2014, on the Report from the Commission on the follow-up to the discharge for the 2012 financial year. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 25 November 2014.

You state that the Government has adopted a consistently robust approach to discharge of the EU budget as a process for holding the Commission to account. Notwithstanding this, we repeat the concerns expressed in our 29 July and 22 October 2014 letters to you on the Draft Budget for 2015, when we criticised the Government’s complacent and counterproductive attitude to efforts to reform the EU budgetary process. We would point out that administrative sanctions and payment reductions would be one means of making the process more effective.

We would be grateful for further clarification of the Government’s position with regard to these issues. You state that you do not support proposals for sanctions and payment reductions at this stage, and that eligibility criteria and control requirements must be significantly simplified before they can be considered. By what criteria will you judge whether eligibility criteria and control mechanisms have been “significantly simplified”? How much progress has been made to this end at this stage? In the event that you are satisfied that such simplification has been achieved, would you then support the introduction of a sanctions regime? We would also be grateful for clarification of the third criterion that you cite, that the application of financial corrections needs to be adjusted to better reflect the actual risk to EU budget funds. We note the explanation of the issue contained in your 18 November 2014 letter on EM 13781/14: the Communication on protection of the EU Budget to end 2013. In addition, can you give some specific examples of the sorts of problems that are arising and need to be addressed?

We would be grateful for a response to this letter by 9 December 2014. In the meantime we now clear the document from scrutiny.

25 November 2014
Letter from David Gauke MP to the Chairman

Thank you for your letter of 25 November on the Commission’s discharge report for the 2012 budget in which the Committee clears this document from scrutiny but seeks further information on several points raised.

In your letter the Committee seeks clarity on the criteria the Government will use to assess whether the eligibility criteria and control mechanisms in place for EU budget funds have been significantly simplified.

It is a real concern that the high costs of control coupled with the risk of error and financial corrections are constraining Member States from introducing schemes that would deliver beneficial outcomes. In this context, a yet higher level of payment reductions at the current time would be counter-productive. Whilst recognizing that Member States need to continue to improve their controls, it is essential that EU scheme and control requirements are simplified and the Government considers that the criteria for judging whether simplification has been achieved should be whether error rates can be kept below the European Court of Auditors’ 2% materiality threshold at an acceptable cost of control.

Taking the CAP as an example, the 28 Member States incur €4 billion p.a. (nearly 7% of scheme expenditure) on administration costs, not including the compliance costs incurred by claimants. Despite these very high costs of control, the EU error rate established by the ECA for 2013 was 3.6% for CAP Pillar 1 and 6.7% for CAP Pillar 2, well above the 2% materiality threshold. During the current programming period the Commission has so far imposed financial corrections of €8 billion (2% of scheme expenditure) on CAP expenditure incurred by the Member States. The level of financial corrections may increase in the future. The UK, in conjunction with other Member States, is therefore asking the Commission to take a pragmatic approach to the implementation of the new and complex CAP rules in 2015. The UK is also arguing, as this Committee recommended in 2006, that there is a need to differentiate between irregularities on the basis of seriousness and provide more analysis of error rates.

While the Government does not support the introduction of progressively increasing payment reductions and administrative sanctions at this stage, we will continue to assess and engage constructively with any future Commission proposals to address this ongoing issue.

Your letter also seeks examples of when financial corrections should better reflect the actual risk to EU budget funds. The financial corrections imposed by the Commission in respect of CAP expenditure are often flat-rate corrections (of 2%, 5% etc) applied to large schemes. They are applied on the basis of risk-based audits that look at very small samples.

As there is often little relation between financial corrections and actual irregularities, it is not possible for paying agencies to recover the amounts from claimants. The financial corrections often relate to differences in the interpretation of regulations and guidelines and on subjective judgements, for example regarding the eligibility of rough grazing land. However, from the current financial year (year ending 15 October 2015) certification bodies in Member States are now required to audit the legality and regularity of expenditure on an annual basis. The results of these audits should in future provide a more accurate assessment of the level of error and inform the actual risk to EU funds.

9 December 2015

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 9 December, on the Report from the Commission on the follow-up to the discharge for the 2012 financial year. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 16 December 2014.

We note the Government’s position on the relationship between the error risk and the use of financial corrections. You continue to state you do not believe sanctions are the way forward. Instead greater engagement with the Commission is preferred. We are disappointed that you do not provide more concrete suggestions as to how discussions should develop. Nevertheless we recognise that new audit requirements on expenditure at the level of the certifying bodies will help in assessing more accurately the level of error and actual risk to EU funds.

We do not require a response to this letter.

17 December 2014
Letter from the Chairman to Rob Wilson MP, Minister for Civil Society, Cabinet Office

Thank you for EM 16612/14, dated 7 January 2015 on the Regulation on harmonised indices of consumer prices and repealing regulation (EC) no 2494/95. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 21 January 2015.

We welcome this Regulation that aims to streamline the implementing regulations and introduces new provisions. The new measures will benefit the ECB and other Central Banks in their monetary policy decisions, as well as economic policy makers. This Regulation has significance for economic policy coordination as enhanced by the introduction of the European Semester in the EU and euro area.

We acknowledge your concerns regarding Commission Delegated Acts. Do you therefore consider the areas where the Commission wish to adopt Delegated Acts to be essential, rather than non-essential as currently proposed? Do you expect that other Member States will also share this view? In light of the areas in which Delegated Acts are being proposed, do you already have an indication of what the threshold below which there will not be an obligation to provide sub-indices will be? Are there any other proposed Delegated Acts that you object to?

The Commission explains that it would, when preparing and drawing up Delegated Acts, ensure simultaneous, timely and appropriate transmission of relevant documents to both the European Parliament and Council. How do you propose to engage with this process?

We would be grateful for a response to these questions, together with an update on negotiations, by 6 February 2015. In the meantime we will continue to hold EM 16612/14 document under scrutiny.

21 January 2015

Letter from Rob Wilson MP to the Chairman

Thank you for your letter of 21 January concerning the above Regulation. I apologise for not being able to meet your original deadline for a response of 6 February.

The Delegated Acts proposed mainly relate to statistical methodological issues. Decisions about such matters are generally not suitable for prolonged political negotiations between the Council and European Parliament according to the Ordinary Legislative Procedure. The delegation of powers in these areas should result in the methodology for the harmonised indices of consumer prices (HICP) being more speedily adapted, rightly without political influence on the detail, to either the changing policy environment or overall improvements in statistical methodology. This should be of significant benefit to the EU policymaking to which you refer.

However, the risk with Delegated Acts in these areas is that the Commission may be successful in its proposals in spite of the expert advice available across the European Statistical System (ESS) and/or leading to unnecessary costs incurred on all or some Member States. Our aim is therefore to ensure that the Commission is legally obliged to take the fullest account possible of the national-level expert advice already available within the ESS, including advice on cost-effectiveness, and to ensure thereafter a legal barrier to the Delegated Act introducing excessive burdens on Member States. A qualified majority of Member States have already supported this position across all recent negotiations on statistical regulatory proposals.

Due to the nature of the EU’s competence in statistics, the ESS comprises an extensive system of consultative committees of Member States’ official statisticians, who are professionally independent under the law. The UK’s engagement with any consultative process should initially be through the three layer system of working groups already operated by Eurostat (the Commission’s statistical office) in Luxembourg, whose apex is a committee of the heads of Member States’ National Statistical Institutes (NSIs), the European Statistical System Committee (ESSC). This should allow for an important level of Member State influence over the detail of a Delegated Act proposal on the HICP before its deposition in Council.

The current threshold below which there is no obligation to provide sub-indices is one part per thousand of the relevant area of household expenditure. This is not problematic for the UK. The expectation is that the Commission would use its delegation of powers in this area to respond to a
future change in policy needs by EU policymakers. No such need has yet been expressed by the Commission through the ESS.


10 February 2015

Letter from the Chairman to Rob Wilson MP

Thank you for your letter, dated 10 February 2015, on EM 16612/14: the Regulation on harmonised indices of consumer prices and repealing regulation (EC) no 2494/95. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 24 February 2015.

We are grateful to you for your response and are now content to clear the document from scrutiny. However we would be grateful for further updates as negotiations progress, and stress the need to be kept informed as to when a General Approach is likely to be agreed.

We would be grateful for a response to these questions by 10 March 2015. In the meantime we now clear the document from scrutiny.

24 February 2015

HIGH LEVEL GROUP ON OWN RESOURCES

Letter from Nicky Morgan MP, Financial Secretary, HM Treasury, to the Chairman

I am writing in response to your letter dated 13 May. As the Committee knows, the High Level Group held its first meeting in Brussels on 3 April 2014, following the announcement by the European Parliament, Council and Commission in Strasbourg on 25 February 2014 of Mario Monti as the Group’s Chair. The Group, the establishment of which was agreed as part of the 2014-2020 Multiannual Financial Framework, will undertake a general review of the current Own Resources system, and issue a first assessment by the end of 2014.

We understand that the Group will take into account all existing and forthcoming input from the three European institutions and national parliaments, and that the intention is for national parliaments to be provided an opportunity to assess the outcome of the work through an inter-parliamentary conference in 2016. The UK was instrumental in securing a voice for national parliaments in this process. This Government is committed to ensuring that Parliament has its say and we will keep you updated as further details become available.

The Group is still in its infancy and it has yet to set out a specific plan on how it intends to conduct its work, either before the first assessment is made at the end of this year or ahead of its final assessment. One aspect of the Group’s work that is not yet clear is whether and how they may seek input from national governments. Once that becomes clearer the Government will consider its engagement strategy with the Group.

You ask in your letter about HM Treasury’s current thinking on the future of Own Resources. The Government’s view on the system of Own Resources is clear. As set out in Explanatory Memoranda and correspondence relating to the MFF and the Own Resources legislative proposals over recent years, the Government’s overriding, and continuing, priorities have been to protect the UK abatement, and to oppose any new EU-wide taxes to finance the EU budget. This means the Government opposes any new own resources, and in particular any new EU taxes or changes to the existing Own Resources system that increase UK’s contributions or pose a threat to our position in the long term.

The Joint Declaration on Own Resources states that the Council shall unanimously adopt a decision on the system of Own Resources and that the Council may establish new categories of Own Resources or abolish an existing category. This makes it clear that the UK retains a veto on any Own Resources proposals. Moreover, Article 311 of the Treaty on the Functioning of the European Union confirms that any Council decision on own resources shall not enter into force until it is approved by
the Member States in accordance with their respective constitutional requirements. This means that the UK Parliament will be asked to approve any Own Resources decision of the Council.

4 June 2014

Letter from the Chairman to Nicky Morgan MP

Thank you for your letter, dated 4 June 2014, on the High-Level Group on Own Resources. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 June 2014. We note that the Group is still in its infancy and has yet to set out a specific plan for how it intends to conduct its work. It is imperative that Parliament is kept updated on these important issues, and we are therefore grateful to you for committing to keep the Committee updated as further details become available, and in particular as it becomes clear how the input of national parliaments and national governments will be sought.

While we note the Government’s clear position on Own Resources, nevertheless this should not rule out the Government undertaking contingency planning in case circumstances change. In our 2012 report on The Multiannual Financial Framework 2014-2020, we concluded that “the complexity of the VAT-based own resource, and the Commission’s own statement that it offers no European Added Value over the GNI-based resource, may make it preferable for it to be removed entirely, which could bring relatively small, although welcome, savings by reducing the administrative costs of collection. This need not necessarily prejudice the UK abatement, although we acknowledge that determining a new base for calculating the abatement might require a difficult negotiation. We nevertheless urge the Government to give further thought to this possibility as part of their response to the own resources proposals.” We may seek to bring this proposal to the attention of the High-Level Group when it begins its engagement with national parliaments, and would therefore be grateful for your own view. We would also be grateful for your assessment of the most appropriate effect on the level of Own Resources of the expansion of the EU in recent years.

Once the Group makes clear how it will engage with national governments, we would be grateful for greater clarity on how you intend to engage with its work.

We look forward to discussing these issues with you at your forthcoming appearance before the Committee to discuss the 2015 Draft Annual Budget on 1 July. We would therefore be particularly grateful to receive any updates before then.

18 June 2014

Letter from the Chairman to David Gauke MP

I am writing to you to seek the Government’s response to the First Assessment Report by the High Level Group on Own Resources, published on 17 December 2014, and to seek an update on the High Level Group’s work. We were grateful to have the opportunity to discuss these issues at your appearance before the Committee on 24 February 2015, and have a number of further questions of clarification.

We understand that the document was discussed at ECOFIN on 17 February 2015. Should the document therefore have been deposited in Parliament? Will you commit to depositing future reports by the High Level Group so that they can be subject to the process of parliamentary scrutiny?

What is the Government’s view of the First Assessment Report? Does it form a suitable basis for the Group’s work in the months to come? What is your view of the general and EU-specific assessment criteria that the report sets out?

We understand that the report has been discussed in recent weeks both in the European Parliament, and, at the 17 February 2015 ECOFIN. What update can you give us on these discussions? What is Council’s view of the work of the Group and its future plans? What points did the UK Government make in these discussions?

The High Level Group calls for a “positive and rallying argument that can create a concerted ambition for reform and merge national interests with a higher European interest. The High Level Group invites all actors – especially the European Parliament, the European Commission, the Council and the national parliaments of Member States to embrace ambitious objectives and to work in a spirit of cooperation and good will to devise a viable way forward. The group’s upcoming work in 2015/2016 and its outreach activities will be conducted with these goals in mind.” Is this a realistic goal? Can you
see any basis for agreement for future reform of the system of Own Resources? Does the Government’s position remain a reactive, blocking approach, rather than our preferred position of making constructive suggestions for reform? How will the Group engage with Member State governments, and with national parliaments of Member States? What steps will you take to encourage the Group to engage with national parliaments in its future deliberations? Has the Group given any indication of the timetable for its next steps?

We would be grateful for a response to this letter by 10 March 2015.

24 February 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 24 February 2015 regarding the High Level Group on Own Resources. Following my appearance before the Committee on 24 February at which we discussed the Group’s First Assessment Report, you asked a number of follow-up questions, which I will deal with in this letter.

You asked in your letter for the Government’s view of the First Assessment Report. The report is primarily a review of the current Own Resources system, setting out past reform proposals, along with a discussion of its own criteria for assessing the system. It also makes it clear that the Group will engage with all actors over the course of the next year, especially the European Parliament, the European Commission, the Council, and national parliaments of Member States.

Although the Group is not yet clear on the process or detail, the Government welcomes the Group’s desire to engage with national Parliaments and looks forward to welcoming it to the UK. This was something the Government insisted on. You asked about the Government’s view of the criteria for assessing the system. In its report, the Group makes it clear that its assessment criteria can be difficult to define precisely and are open to different interpretations. Indeed, the report identifies as a question for further work of the High Level Group, whether there is a common perception of what the eventual criteria on which reform of Own Resources should be based, and whether these criteria can be defined objectively. As such, since they are not in fact fixed in the First Assessment Report, it would be peremptory to comment on the criteria at this stage, particularly in the absence of any recommendations that flow out of those criteria. As the report does not contain any new proposals or recommendations, the Government will consider the detail of the Group’s final report, which will contain the Group’s recommendations, once it is published. But suffice to say that the Government has always placed emphasis on budget discipline and fairness and would view these issues as the highest priority in any future discussion of reform. We will keep the Committee updated on the Government’s thinking.

You asked for an update on recent discussions on the First Assessment Report held at the European Parliament and ECOFIN. A summary of the discussion following Mario Monti’s presentation to the European Parliament is available publicly. Since there were no proposals or recommendations in the Group’s first report, the discussion at ECOFIN was very brief and limited, with all Member States broadly welcoming the Group’s future plans. At ECOFIN, the Chancellor intervened by highlighting the importance of budget discipline and accountability, as well as welcoming the High Level Group to the UK for discussions with Parliament.

You asked whether the group’s first report should have been deposited in Parliament. Given the non-institutional status of the High Level Group and, consequently, of the First Assessment Report, this type of document would not routinely be deposited in Parliament. It is worth noting that this particular report contains no new proposals or recommendations. However, given that national Parliaments will be asked to engage with the High Level Group, and that any future reports are likely to make recommendations, I am happy to instruct my officials to deposit these when they are published.

Your letter questions whether the High Level Group’s goal is realistic. It is, of course, logical that if the Group makes any recommendations, it would wish to see them implemented. Beyond that, however, it is difficult to know whether reform is realistic at this stage because we have not yet seen any new proposals. The UK’s position on the system of Own Resources and the role of the Council as exclusive arbiter is well understood. However, the Government is happy to consider ways in which

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2 https://www.theparliamentmagazine.eu/articles/eu-monitoring/reforming-own-resources-eu-feasible-or-unrealistic
the process could be made to work more simply and efficiently – this is a point that the Chancellor made in the meeting.

You asked about the Group’s engagement with national Parliaments. The Group has not yet set out its plans for this, other than that it will begin in 2015. The UK looks forward to welcoming the Group to the UK for discussions with Parliament and to engaging in a spirit of goodwill and cooperation. The Government will work to ensure that the UK Parliament’s views are fed into the process and will work to facilitate this, including providing analysis of the Group’s eventual recommendations.

9 March 2015

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 9 March 2015, on the First Assessment Report by the High Level Group on Own Resources. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 17 March 2015.

We note this update on the work of the Group and on Council discussions on the First Assessment Report. We welcome the Chancellor’s invitation to the Working Group to visit the UK, and look forward to the opportunity of meeting with the Group to discuss these issues further. We note that the Group’s plans for consultation with national parliaments have yet to be set out. We would therefore be grateful to be kept informed as and when further details of the consultation process emerge.

We are also grateful to you for acceding to our request that future reports by the High-Level Group be deposited in Parliament.

However we continue to regret the Government’s apparent intention to make no input into this exercise until the Group’s final report, which will contain its recommendations, has been published. We would have preferred a more positive approach, with the Government seeking to influence the recommendations, as we shall try to do.

We note that the work of the Group is at an early stage, and would be grateful to be kept informed of its progress, and of Council discussions on this important subject, in the coming months. We would be grateful for an update by 26 June 2015, or sooner should there be any developments in the meantime.

17 March 2015

INDICES USED AS BENCHMARKS (13985/13)

Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury, to the Chairman

Following the end of the Greek Presidency, I thought it timely to provide an update on the negotiations of the European Commission proposal for a Regulation on indices used as benchmarks in financial instruments and contracts (Benchmarks Regulation).

The Greek Presidency held five Council working group meetings to discuss the benchmarks proposal. These focused predominantly on the scope of the proposal, as without knowing how broad the scope will be, it is not possible to effectively develop rules and provisions that will apply. Given the range of views amongst delegations on the question of scope, progress has been relatively slow.

Council discussions have also focused on how best to ensure appropriate proportionality in the proposal. During discussions delegations have considered a range of options. Some were based on sector specific approaches, others potentially considering the usage of the benchmark as a threshold, whilst some support an approach that considers the vulnerability of a benchmark. Council has yet to settle on a specific approach and discussions continue.

The Government favours an approach in which regulatory intensity is calibrated according to the significance of benchmarks and the potential impacts of their failure on markets across the EU. Under this approach, the focus of regulatory intensity would be on critical benchmarks. However there would be appropriate proportionality introduced for non-critical benchmarks to ensure proper
The incoming Italian Presidency hopes to make significant progress with this file. However they are aware that a number of major issues remain outstanding and the nature of discussions on these issues will determine how much progress is made.

15 August 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 15 August 2014, on EM 13985/14, the proposal for a regulation on Indices used as Benchmarks in Financial Instruments and Financial Contracts. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 September 2014.

We are grateful for this update. We note that negotiations have yet to proceed beyond first principles, although the Italian Presidency will seek to make progress in the weeks and months ahead. That being the case, we would be grateful to be kept updated as negotiations progress, and in particular to learn whether there is any support among other Member States for the UK’s preferred approach of focussing the most intensive regulation on critical benchmarks while ensuring a proportionate and yet not unduly burdensome approach to non-critical benchmarks. In anticipation of such an update we will continue to hold the document under scrutiny.

10 September 2014

Letter from Andrea Leadsom MP to the Chairman

I am writing to update you with regard to negotiations on the European Commission proposal for a Regulation on indices used as benchmarks in financial instruments and contracts (Benchmarks Regulation).

The Italian Presidency has made good progress over the last few months, including circulating two Presidency compromise texts. The Government has been satisfied with the direction of travel in some of the amendments made by the Presidency, which introduces a more relative and proportionate approach. This considers the specific characteristics of benchmarks when determining the regulatory regime to be applied to them, with some administrators required to be authorised and some just having to register with their regulator. We are seeking to expand upon this approach in negotiations, in order to ensure that regulators are able to concentrate their resources on the administrators of more important benchmarks.

Also discussed in some detail is the issue of benchmarks from outside the EU, and whether firms in the EU will be able to utilise them once the Regulation is in force. We have argued in favour of finding a solution that allows use within the EU for benchmarks that can prove they are administered in line with internationally agreed International Organization of Securities Commissions (IOSCO) standards. This line of argument has been well received amongst other delegations and the general view now appears to be that the regime proposed by the European Commission is not appropriate and needs to be amended so that it is fit for purpose. Council is now in the process of discussing what an acceptable regime for non-EU benchmarks would look like.

In addition, the European Parliament began their consideration of the proposal in November. In public statements key Member of the European Parliament working on this proposal have highlighted they are keen to ensure proportionality in the text and identified the regime for non EU benchmarks as an area that needs to be improved as the Commission proposal in this area is not appropriate.

The Italian Presidency has expressed a desire to secure a General Approach by the end of the year. Whilst this is not impossible, there are serious issues remaining where progress is necessary before an agreement can be made.

15 November 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 15 November 2014, on EM 13985/14, the proposal for a regulation on Indices used as Benchmarks in Financial Instruments and Financial Contracts. The House of Lords
European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 25 November 2014.

We are grateful for this update and for highlighting the key areas of continued concern. The international element of the proposal is one that was considered most controversial given the widespread use of international benchmarks. It is good that the European Parliament too finds the Commission’s treatment of the international dimension inappropriate. You will be aware that we favour methods to align non-EU benchmarks with the international standards set by IOSCO. You will be aware that a number of Benchmarks are already adhering to these standards since they were announced by IOSCO in 2013. Given the upcoming EU-US Financial Market Regulatory Dialogue in January 2015, can we expect any further outcome of these discussions? We understand from the last meeting that the US is not likely to bring forward any legislative proposal on benchmarks.

We would be grateful for further updates as negotiations progress, and in particular if a General Approach is expected to be reached. In anticipation of such updates we will continue to hold the document under scrutiny.

25 November 2014

Letter from Andrea Leadsom MP to the Chairman

I am writing to update you with regard to negotiations on the European Commission proposal for a Regulation on indices used as benchmarks in financial instruments and contracts (Benchmarks Regulation).

On 1 December the Italian Presidency circulated a new compromise text. I believe that the latest text contains important improvements in several areas. Firstly, it allows for a transitional period in which significant discretion is given to national competent authorities to decide whether benchmark administrators should be authorised or registered by their regulator. Institutions who are already supervised will also only have to register rather than go through a full authorisation. This goes towards our objective of ensuring regulators can focus their resources on bringing large and economically important benchmark administrators under supervisory focus.

Furthermore, the proposal now contains many appropriate delegations which will allow many of the requirements to be suitability calibrated according to the specific characteristics of benchmark administrators such as their size or the sector they cover.

It is also welcome that benchmarks based on regulated data (such as data from trading venues) are now exempted from some of the Regulation’s requirements. This is appropriate and proportionate since such regulated data is already subject to strict regulatory requirements.

The treatment of non-EU benchmarks remains an areas where the text could be improved, although the Italian Presidency, inspired by regimes in other EU legislation, has put forward alternative approaches for recognising non EU administrators. These are welcome and I believe the Presidency’s approach represents a sensible basis for a suitable regime, though we will continue to take opportunities as the negotiation progresses, including in trilogues, to secure clarifications and improvements to ensure the regime will work in practice. This is an important issue and ensuring we have a workable regime that is based on IOSCO remains a key objective.

We also continue to press for national competent authorities to have the final say on the authorisation and supervision of benchmark administrators.

The Government will continue to seek improvements further to those outlined above before we are able to agree a General Approach on this Regulation, but I believe that negotiations under the Italian Presidency have brought us close to an acceptable text.

On your specific question on the US approach to benchmarks, it is correct that the US is not likely to bring forwards any legislative proposal on benchmarks. However, in recent weeks the chairman of the US Commodities Futures Trading Commission has expressed his concerns about lack of equivalence between jurisdictions but also noted that his organisation stands ready to work with its regulatory counterparts in the US to address the issue further.

16 December 2015
Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 16 December 2014, on EM 13985/14, the proposal for a regulation on Indices used as Benchmarks in Financial Instruments and Financial Contracts. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 13 January 2015.

We are grateful for this update and welcome the improvements that align with IOSCO principles and key objectives. You will be aware there is much debate on the requirements applicable to commodity benchmarks versus financial benchmarks. Would you be able to explain why you assess the text to be appropriate and proportionate for the size and category of the benchmarks that will be regulated? Furthermore, what is your view on the latest discussions surrounding “critical benchmarks”?

We note that you prefer supervisory discretion to be exercised at the national level. Do you envisage any implications towards reaching a ‘level-playing field’ should a benchmark administrator be supervised differently in the EU due to discretion being mandated with respect to transitional periods? Can you explain why these requirements are being put in place, and how these rules work towards the EU’s goals of upholding high levels of supervision?

The restricted use of non-EU benchmarks in Europe is still a concern. The US has stated that there could be adverse consequences for financial markets should legislation be approved with strict requirements. You do not expand nor point to the preferable “alternative approaches” at hand. In your view, what viable options are preferred to the Commission’s strict third country equivalence regime?

We would be grateful for a response to these questions by 14 February 2015, as well as further updates as negotiations progress, and in particular if and when a General Approach is expected to be reached. In anticipation of such updates we will continue to hold the document under scrutiny.

14 January 2015

Letter from Andrea Leadsom MP to the Chairman

I am writing to update you with regard to negotiations on the European Commission proposal for a Regulation on indices used as benchmarks in financial instruments and contracts (Benchmarks Regulation).

The Latvian Presidency of the Council of the European Union has proposed a new compromise text on the EU Benchmarks Regulation. This text contains significant improvements over the previous version.

Most importantly, the text changes the balance between national competent authorities and the European Securities and Markets Authority (ESMA) in favour of the former. The circumstances in which ESMA can take binding decisions in relation to the regulation of benchmarks has been very tightly constrained, and the ability of supervisors to retain control of supervision of benchmarks in their jurisdictions is maintained.

You ask about the category of critical benchmarks in your letter. We have consistently argued in negotiations for critical benchmarks to be a small and clearly defined category. The present Council text achieves this objective, with a benchmark only able to be defined as ‘critical’ on an EU-wide basis if they meet a high quantitative criteria, alongside a slightly lower quantitative threshold for benchmarks that can meet a set of cumulative qualitative criteria.

In terms of proportionality more generally, our position has been that the requirements should be aligned as closely as possible with the internationally agreed IOSCO Principles on benchmarks. The current text has been significantly amended since the original Commission proposal to bring it more closely in line with the relevant principles, and how the rules are to apply to different types of benchmarks and sizes of benchmark administrator in accordance with the principle of proportionality will be clarified by further ESMA work.

You also ask about regulatory discretion during transitional periods. This is in order to enable a proportionate treatment of smaller administrators: for the first two years of the Regulation, competent authorities have discretion to allow benchmark administrators to simply ‘register’ information to be brought under supervision rather than go through a full authorisation process. I do not envisage this causing any level playing field concerns, since under the Council proposal all
benchmarks must comply fully with the requirements of the Regulation, and ESMA are to review the registration discretion after two years to ensure that there have been no negative consequences.

On the alternatives to a strict third-country equivalence regime as proposed by the Commission, Council has created two alternative routes for non-EU benchmarks to be utilised within the EU. One is ‘endorsement’, whereby a benchmark administrator may ‘endorse’ the benchmarks produced by another part of the same group in a different jurisdiction and thereby allowing their use. The other is ‘recognition’, where a third country benchmark administrator can have its benchmarks approved for use within the EU by appointing a legal representative who will submit information demonstrating compliance with EU standards. On this basis such benchmarks would be permitted to be used within the EU.

Overall, the Council text has significantly improved over its several iterations and on the issues of greatest interest to the UK in this negotiation. Therefore, the Government is prepared to support a General Approach on the basis of the current proposed text and I hope that on the basis of the information provided, the Committee will able to clear or waive scrutiny on this document.

2 February 2015

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 2 February 2015, on EM 13985/14, the proposal for a regulation on Indices used as Benchmarks in Financial Instruments and Financial Contracts. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 10 February 2015.

We are grateful for this update and welcome the fact that the new compromise text marks a significant improvement over the previous version. We would be grateful for clarification of two points raised in your letter. First, you state that the circumstances in which ESMA can take binding decisions in relation to the regulation of benchmarks has been very tightly constrained. Can you provide more detail as to the circumstances in which ESMA will be able to take binding decisions?

Second, you state that a benchmark can only be defined as critical on an EU-wide basis if a high quantitative criteria is met. Can you provide further details on this criteria?

We would be grateful for a response to these questions, as well as an update on negotiations, by 24 February 2015. In the meantime, and in anticipation of the Latvian Presidency’s attempt to secure a General Approach, we now clear the document from scrutiny.

10 February 2015

Letter from Andrea Leadsom MP to the Chairman

I am writing to update you with regard to negotiations on the European Commission proposal for a Regulation on indices used as benchmarks in financial instruments and contracts (Benchmarks Regulation).

Firstly, many thanks for providing clearance from scrutiny by your committee. I can update that the proposed Latvian General Approach was recently passed by a meeting of Permanent Representatives to the EU and will soon be formally adopted by the Council of the European Union.

As to your questions, you asked for clarification as to the circumstances in which ESMA can take binding decisions in the proposed General Approach from the Latvian Presidency. In this text, there is only one such circumstance; where a competent authority uses its power to require mandatory contribution of a critical benchmark administered in its jurisdiction. Here a decision of a competent authority to require mandatory contribution may be referred to ESMA for binding mediation where there is disagreement within the ‘College’ of regulators that the Regulation mandates be formed in regards to each critical benchmark. In all other circumstances of disagreement within the College, the competent authority of the relevant benchmark administrator is the final decision-maker.

On the criteria for defining a benchmark as critical on an ‘EU-wide basis’, the General Approach put forward by the Latvian Presidency proposes two mechanisms for becoming critical. The first is if the benchmark is referenced by financial contracts, instruments, and used for measurement of the performance of investment funds with a cumulative value of €500 billion. The second is if by the same criteria a lower threshold of €400 billion is met, along a set of qualitative criteria including the
existence of few market-led substitutes for the benchmark and a negative impact on the real economy or financial stability if the benchmark ceased to exist. We consider both of these thresholds suitably high to ensure that the ‘EU-wide’ category of critical benchmarks - the only benchmarks subject to the formation of Colleges of supervisors and ESMA binding mediation of mandatory contribution decisions – is kept suitably narrow and well defined.

24 February 2015

INVESTMENT PLAN FOR EUROPE (16115/14)

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


We welcome the ‘Juncker investment plan’ as the Commission’s latest attempt to revive economic growth and create jobs. We agree with your initial assessment that it is difficult to come to any solid conclusions without concrete details on how the financing arrangements will precisely work. We are encouraged that the EIB is placed at the centre of the investment plan, complementing Europe’s goals to create an energy union for Europe. The expertise of the EIB should add value to the financing and development experience of longer term investment projects in the EU. Do you believe that the proposed 1:15 multiplier effect is a realistic aim?

At his appearance before the House of Lords EU Select Committee on 9 December 2014, we asked the Minister for Europe, Rt Hon David Lidington MP, whether, as long as HM Treasury is responsible for the UK rebate, it has an incentive to keep down the amount of EU funding that comes to the UK, since the rebate is a proportion of the net contribution of EU funding. How would you respond to this apparent conflict of interest? In that context, how will HM Treasury be applying the ‘non-additionality principle’ to funds from the EU budget in this investment plan as it seeks to participate in the promotion of projects and apply for investment funding? Do you have initial indications as to how the UK rebate could or would apply to funds from the European Strategic Investment Fund?

Looking closer at the projects, which investment opportunities are at the top of the lists from the UK energy and climate, and transport departments, in relation to the Special Task Force’s project lists from Member States and the Commission? Is there a risk that the optimum moment for projects to be taken forward will have passed by the time that agreement is reached on where investment should be targeted? How confident are you that there will be a steady stream of ‘ripe and ready investments’ ready to be taken forward? In exploring the investment impact further, do you believe there is a risk that high risk projects will go only so far as to correct existing market failures and not actually have a transformative impact on growth and jobs? How will the EIB measure its success? Is the creation of 1.3 million jobs a realistic target to reach?

We understand that investments made under the EFSI will need the support of independent and transparent assessments that can confirm whether a project is economically viable and if it satisfies relevant regulatory and administrative requirements. We support this ‘certification’ or database which, if successfully operated, could become the most worthy and sensible element of the investment plan. For markets to function effectively, simple regulatory environments and adequate information for end investors is fundamentally essential.

However, we remain sceptical as whether this sum of initial investment is large enough to support the task at hand. Reaching €315 billion in investment adds only 2% over three years to GDP, a level which the EU could reach under moderate business conditions. Real success will be difficult to evaluate. Reflecting on the EU’s past and failed attempts to leverage the European Financial Stability Facility in 2011, why do you believe the current plan will be more likely to succeed? What lessons have been learnt from previous experience? How much would the UK consider in co-financing the Fund, to leverage private investment? Rather than focussing on cash-strapped Member States, do you agree that the EU should be looking to private investment and sovereign wealth funds in non-EU countries that have surplus funds to invest? What efforts is the Commission making to secure such investment?

We also stress that reforms need to be implemented to remove barriers to entry including regulatory and administrative burdens, to make this investment plan truly successful. What is the risk that countries that do inhibit complex and administratively burdensome regulations will be unsuccessful in
receiving project certifications because they are deemed economically unviable? Will the investment plan instead favour those projects in countries where the regulatory environment is already simpler and administratively lighter?

We also understand that contributions to the Fund from Member States are excluded from the Stability and Growth Pact calculations of deficit. Would this be extended to all national and regional co-financing in the context of the European Structural and Investment Funds, and indeed other areas of Cohesion funding?

Lastly, on the use of the budget funds, uncertainties persist as to how €8 billion in funds from the EU budget will be accounted for in the margin of flexibility which exists. We would be grateful for your explanation of how the €8 billion from the EU Budget will be funded in future financial perspectives. Do you envisage an early DAB being necessary in 2015?

We would be grateful for a response to these questions, as well as an account of discussions at the 18/19 European Council, by 16 January 2015. In the meantime we will continue to hold the document under scrutiny.

17 December 2014

Letter from David Gauke MP to the Chairman

I am writing in response to your letter of 17 December, in response to my EM of 10 December. As you note in your letter, this was discussed at the December European Council, and the Prime Minister gave an account of these discussions to Parliament in his statement of 05 January. This can be found:

http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2015-01-05/HCWS167/

As the Prime Minister has made clear at the December European Council, at a time of low growth in Europe, the Government supports a focus on ways to encourage investment. It is important that the approach is comprehensive. While use of EIB lending backed by a guarantee will feature as part of that, more important is structural reform to improve the environment for investment and deliver the necessary focus on drawing in private investment. The Government is clear that this will not be delivered if greater investment is not supported by, among other factors, urgent structural reform.

As you are aware, many details of the Investment Plan remain unclear and we expect more clarification when the Commission publish a proposal shortly which will be deposited in the House and we will subject to scrutiny in the usual way.

You pose a number of questions about the operation of the European Fund for Strategic Investment (EFSI) which the Commission has suggested will underpin the Investment Plan. We expect further detail from the Commission in due course but, as you imply, will be backed by a €16bn EU guarantee, 50% of which will be ‘paid in’ from the EU Budget. The Commission has yet to set out the proposed composition and profile of the EU budget contributions to be made to the fund, so it is not possible to provide further detail at this stage.

You ask about the pipeline of investment projects to make use of the Fund. Delivery of the proposed overall investment target of €315bn will be highly dependent on the ready availability of robust, investment-worthy projects which can make use of the Fund-backed EIB lending and attract other sources of investment. We cannot at this stage speculate on the likelihood on delivering the suggested 1:15 leverage ratio, however, it can be noted that the EIB’s 2012 capital increase targeted €180bn total investment, leveraging 1:18 capital to total investment. The EIB expects to reach this target during the course of 2015.

On specific projects, as part of the work of the Investment Task Force, and informing their eventual report, the lists submitted by the UK and other member states are indicative, illustrating the types of investments in the specified sectors that could benefit from EU support in the 2015-17 period, and do not represent a comprehensive, prioritised list of all possible projects. This is well understood by the Commission, the EIB, and Member States. The criteria for project selection has not yet been agreed, but we will want to see rigorous selection criteria, focussed on project viability, value for money, and demonstrable long-term demand. The UK’s experience in managing the National Infrastructure Plan highlights to us the need or proper governance arrangements.
The UK has submitted a strong list of pipeline projects, linked to the National Infrastructure plan published by the government annually setting out plans for delivery of UK infrastructure, with a clear pipeline of planned investment. The UK’s National Infrastructure Plan (NIP) enabled us to be on the front foot in proposing over £60 billion of investment that could be eligible for support from the proposed new European Fund. The EIB and Commission Task Force Report highlights the UK’s National Infrastructure Plan and approach of producing a clear, rigorous pipeline across all infrastructure sectors as an exemplar.

You ask about the interaction between Member State contributions to the Fund and the Stability and Growth Pact. The Commission has said that ‘in the context of the assessment of public finances under the Stability and Growth Pact, the Commission will take a favourable position towards [such] capital contributions to the Fund.’ You also ask about parallels between the EFSI and the EFSF which was established in 2010 to support financial stability in the euro area by providing temporary financial assistance rather than to guarantee project investments. Therefore, I do not believe that the EFSF and the EFSI are comparable in this regard.

Finally, on the wider regulatory and business environment, as the Prime Minister made clear in his statement to Parliament, the Government believes that urgent structural reforms and appropriate monetary policy are key to delivering long-term growth. The Prime Minister secured ambitious commitments at the December European Council to pursue these priority areas.

12 January 2015

INVESTOR COMPENSATION SCHEMES (12346/10)

Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury, to the Chairman

Further to the previous letter of Mark Hoban dated 5 December 2011, I am writing to inform the Committee that the Commission has decided to withdraw its proposal for an amendment to the Investor Compensation Scheme Directive (ICSD) through its Regulatory Fitness and Performance (REFIT) programme.

As noted in previous correspondence, a General Approach was reached in the Council on 23 November 2011 during the Polish Presidency. The Government secured all of its negotiating priorities in this agreement.

The European Parliament adopted its report in a plenary vote in July 2011. This retained many of the Commission’s original proposals that caused us concern, including on pre-funding, and mutual borrowing between national schemes. The Parliament text also retained a maximum harmonising compensation level, although it raised it to €20,000.

Since the General Approach, there has been no further activity on this proposal. No Presidency has instigated trilogues, in likelihood because many Member States would strongly oppose concessions to the European Parliament, making any negotiations difficult.

Given the position of the European Parliament and Commission on certain aspects of the Directive, there was a clear risk that the existing standards in the UK’s Financial Services Compensation Scheme (FSCS) would have been watered down. For example, the FSCS, which implements the original ICSD proposals, provides significantly greater compensation levels than the level set out in the European Parliament text of €20,000. Moreover, although the updated ICSD could have raised compensation scheme cover for UK investors investing in non-UK funds, it remains the case that the level of cover has to be disclosed at the point of sale so that investors are able to make informed choices.

In addition, the position of the European Parliament and the Commission would have led to considerable pressure to introduce pre-funding, which would reduce investor returns without providing increased protection.

Due to the lack of progress, the Commission has decided to withdraw the proposal through the European Union’s REFIT programme. There may be further work in the future to consider alternative methods of reforming national compensation schemes. However, we are not aware of any plans at the present time.
Therefore existing arrangements under the original Directive 97/9 EC as implemented in the UK through the Financial Services Compensation Scheme will remain unchanged.

16 December 2014

Letter from the Chairman to Andrea Leadsom MP


We note that the Commission has decided to withdraw the proposal through the REFIT programme. While we are in principle supportive of moves to withdraw proposals that are either unlikely to be beneficial or where political agreement is unlikely, we would be grateful for further clarification of the circumstances in this particular case. You state that no Presidency has instigated trilogues because many Member States would strongly oppose concessions to the European Parliament. Your letter makes clear that this includes the UK. Did the UK lead such opposition or were other Member States equally as vocal in their concerns? In light of the UK’s concerns about the European Parliament’s position and the Commission’s original proposal, do you support the Commission’s decision to withdraw the proposal? What concerns, if any, have been raised about the potential negative effect of withdrawing the proposal?

We would be grateful for a response to this letter by 14 February 2015.

14 January 2015

Letter from Andrea Leadsom MP to the Chairman


As you are aware, trilogue negotiations on the proposed amendments to the Investment Compensation Scheme Directive stalled after a Council General Approach was agreed in 2011. The lack of progress is likely to have been a result of the strong opposition expressed by a large number of Member States towards the position taken by the European Parliament, making a political agreement unlikely.

The United Kingdom had significant concerns with the European Parliament’s proposals, which would have resulted in the level of protection for investors provided by the Financial Services Compensation Scheme being significantly reduced from a maximum of £50,000 to a maximum of €20,000. The European Parliament also supported pre-funding of the scheme by industry, which would have reduced investment returns without providing additional protection for investors. The United Kingdom therefore opposed making concessions towards the European Parliament and welcomes the Commission’s decision to withdraw the proposals as part of its REFIT programme. A number of other Member States shared similar concerns about the European Parliament’s proposals and were similarly vocal in opposing concessions.

You asked about the possible negative effects of withdrawing the proposal. The withdrawal of the proposal means that investor compensation rules in some Member States may not have been updated to ensure claims are paid in a reasonable timeframe or so rules reflect current market practices, such as ensuring payment when funds are held by a third party custodian. This could have a detrimental impact on investor protection for investors, including UK investors, in funds domiciled in those jurisdictions. Investors in funds regulated in the United Kingdom will, however, continue to be protected to a high standard through the Financial Services Compensation Scheme.

9 February 2015
Letter from David Gauke MP, Financial Secretary, HM Treasury, to the Chairman

I want to update the Committee on developments regarding the international financial assistance programme for Ireland, and provide further detail on the announcement made by the Chancellor in his Written Ministerial Statement regarding the UK's bilateral loan to Ireland laid in both Houses on the 13 October.

As you will recall, the UK provided a £3.2 billion bilateral loan to Ireland as part of a €67.5 billion international assistance package with contributions from the IMF (€22.5bn), the European Union (€22.5bn), euro area Member States (€17.7bn) and other bilateral lenders; Sweden (€0.6bn) and Denmark (€0.4bn).

On 27 August 2014 the Irish Finance Minister Michael Noonan wrote to all EU Finance Ministers, setting out his intention to repay early up to €18.3 billion of loans obtained from the IMF. The IMF loans carry a significantly higher interest rate than other elements of the programme.

Where Ireland chooses to make early repayments to one of the lenders under the programme, the loan agreements of all other assistance providers, including the UK and EU, contain a clause requiring that Ireland make proportional early repayments to all the other assistance providers.

On 19 September 2014 Ireland formally requested a waiver of this clause from the UK alongside similar requests to the EU, euro-area Member States, Sweden and Denmark. Ireland have published these documents online at:


The Chancellor has today issued a waiver under clause 19.3 of UK Credit Facility Agreement (Amended 4 October 2012) enabling Ireland to repay up to £18.3 billion of outstanding IMF loans. The waiver that has been agreed is conditional upon all other assistance providers, besides the IMF, issuing similar waivers. This decision does not amend the amount or timing of interest and principle repayments originally foreseen in the Amended Credit Facility Agreement.

The benefits of providing a waiver were set out in a note by the ‘troika’ (European Commission, IMF and European Central Bank) published online on the website outlined above. In their view, early repayments of €18.3 billion to the IMF could generate net fiscal savings of up to €2.1 billion in the period 2015-2020.

The Government believes that the significant benefits to Ireland’s fiscal position and debt sustainability in the coming years are not exclusive to Ireland. Improvements to Irish debt sustainability in the years leading up to repayment of the UK’s bilateral loan enhance the likelihood of repayment of the UK’s loan.

For the loans provided by the EU under the European Financial Stabilisation Mechanism (EFSM), the European Commission is empowered by the loan agreement to provide a waiver by mutual agreement with Ireland. However, the Commission initiated a written consultation to the European Financial Committee (EFC) on 3 October 2014, concluding on 10 October 2014. A consultation for the loans provided by the euro area occurred simultaneously. The UK’s waiver remains contingent on all other assistance providers issuing similar waivers.

I can confirm that all Member States have agreed to provide a waiver to Ireland on the outstanding loans. Nonetheless, UK’s waiver remains contingent on all other assistance providers issuing similar waivers.

Since there was no Council Decision to be taken and given the expedited timetable of this decision during recess I did not consider it possible nor necessary to consult the European Scrutiny Committees. Furthermore, I supported the provision of a waiver and therefore did not wish to hold up the process which I believe was in the UK’s national interest. Attempting to block the provision of a waiver on these grounds would not have been in line with the Chancellor’s decision to provide a waiver on the UK’s bilateral loan.

13 October 2014
Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, to the Chairman

My predecessor last wrote to you regarding the recast Insurance Mediation Directive (to be renamed the Insurance Distribution Directive) in February 2013, and in turn you confirmed that the European Union Committee had cleared this document from scrutiny.

Progress of the directive was put on hold in 2013 and this has largely stayed dormant until negotiations restarted in earnest under the Italian Presidency. Things have since developed quickly to the extent that I think it would be useful to provide an update for the Committee.

A compromise text was tabled at the working group meeting on 21 October which meets most of the UK’s negotiating asks, and similarly has the backing of the Presidency and broad support of other Member States. In the days following this meeting discussions have suggested that the Presidency will look to table a General Approach in the very near future. Although there are some issues still to be finalised, including the alignment of the directive with MiFID/PRIPs, if the General Approach text tabled is in line with our wider negotiating aims, we would look to support it.

In our EM and subsequent correspondence, we highlighted a number of policy issues where there has subsequently been positive progress.

We were concerned that the directive included a provision on Alternative Dispute Resolution as there was a question as to whether this properly related to the internal market. Further, we viewed that this provision would change the nature of the existing UK Financial Ombudsman Service with out-of-court disputes and would reduce consumer protection. These concerns have been alleviated as our successful negotiations have resulted in the deletion of the original provision in the Council text.

The draft of the directive previously prohibited tying insurance products with ancillary services whereas we were of the view that there was no strong evidence suggesting this was needed. This prohibition has now been removed in favour of firms informing customers whether the components of a package are available to be bought separately.

Also, the UK government view has been that sanctions provisions in the directive should be minimum harmonising and we have achieved this in the current Council text.

Finally, the UK was previously concerned that full mandatory disclosure of commission for all insurance sales would not benefit customers as this would serve to overload them with information. The UK supports the position of the current Council text on requirements for disclosure of commission as elements which the UK did not support have been removed from the text.

I trust this information will serve as a suitable update for the Committee. I will of course write to you as a matter of urgency if there is any significant movement ahead of General Approach.

27 October 2014

Letter from the Chairman to Andrea Leadsom MP


We are grateful to you for this update on negotiations. However we would be grateful for clarification of two points. First, which specific issues in terms of alignment with MiFID and PRIIPs remain to be finalised? Are you confident that the legislative files will be consistent with one another? Second, you state that you support the current Council text on requirements for disclosure of information as elements which the UK did not support have been removed from the text. Which elements have been removed, and which requirements remain in the current Council text?

We would be grateful for a response to these questions, as well as an update on the Italian Presidency’s attempt to reach a General Approach, by 18 November 2014.

4 November 2014
Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter dated 4 November 2014 regarding the recast Insurance Mediation Directive (which has been renamed the Insurance Distribution Directive). You asked for more information on how the text aligns with other directives and on the nature of changes to disclosure requirements. I provide some additional detail below as well as confirmation that the Italian Presidency were able to secure an agreement to a General Approach.

Since I last wrote to the Committee a further text was tabled which the Government found represented an improvement in terms of the UK’s negotiating asks and which was in line with our wider negotiating aims. Therefore on 10 November 2014 Council unanimously agreed a General Approach on IDD.

This text included substantial progress in aligning sanctions provisions with MiFID and PRIIPS so that the text of IDD allows an effective and proportionate sanctions regime which does not conflict with UK law. The sanctions provisions improved include those on the protection of personal data and on the powers available to regulatory bodies.

The significant improvements on sanctions provisions represent an increased alignment of the IDD with other related directives to the extent that we are satisfied that sanction powers can be consistently applied and that IDD overall is more greatly aligned with MiFID and PRIIPS.

We have highlighted during negotiations differences that exist between IDD and related directives regarding inducements for investment products. The text addresses these concerns in the UK market as it explicitly allows Member States to go beyond IDD in order to put in place consumer protection measures on inducements that are consistent with MiFID.

I would also like to address your question on disclosures required of insurance distributors and provide additional detail on UK negotiating successes in this area of the text. As background, we had not seen evidence of commission bias in non-investment insurance products and therefore did not see any justification in requiring mandatory disclosure by insurance distributors of granular information on the level and structure of commission received. We believed this would serve to overload customers with information that would not likely be understood.

Following negotiations, elements in the text have been removed which previously mandated that insurance distributors provide a detailed breakdown of how commission is calculated, the proportion of the commission which is based on agreed targets, and additionally details of the targets in place.

These elements have been replaced by less onerous requirements which state that the distributor should disclose the type of remuneration it receives. The Government believes this solution is more flexible for firms distributing insurance and will result in customers receiving more comprehensible information. The directive still includes requirements for a firm distributing insurance to disclose among other things its identity and address, details of its complaints procedures and details of its registration with the financial regulator.

I hope that you find our responses to your questions on specific negotiating issues and also our update on the progress of these negotiations to be of value to your Committee.

17 November 2014

Letter from the Chairman to Andrea Leadsom MP


We are grateful to you for this update on the outcome of negotiations. You state that information disclosure requirements have been amended so that the distributor is required to disclose the type of remuneration it receives. Can you confirm whether there is any requirement to disclose the amount of remuneration received?

We would be grateful for a response to this letter by 9 December 2014.

25 November 2014
Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter dated 25 November 2014 regarding the Insurance Distribution Directive. You asked whether there is any requirement for firms to disclose the amount of remuneration received in the draft text of the directive.

The answer depends on the type of insurance being distributed. I previously wrote to you regarding the distribution of non-investment insurance products, whereby in the draft text there is no requirement for firms to disclose the amount of commission, but the amount of fees to be paid by customers must be disclosed. However, with respect to insurance-based investment products, the amount of any remuneration (such as commission) must be disclosed to the customer.

I hope this provides the information you need and you find it to be of use to your Committee.

2 December 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 2 December 2014, on EM 12407/12: Draft Directive on Insurance Mediation (Recast), to be renamed the Insurance Distribution Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 16 December 2014.

You state that with regard to non-investment products, while there is no requirement to disclose the amount of commission, the amount of fees to be paid by customers must be disclosed. Do you agree with us that costs are likely to devolve to customers in any case either in the form of an inflation of commission premiums or an increase in the price of the product?

We would be grateful for a response to this letter by 16 January 2015.

17 December 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter dated 17 December on EM 12407/14: Draft Directive on Insurance Mediation (recast), to be renamed the Insurance Distribution Directive.

As stated in my previous letter, there is no requirement in the draft text of the directive for the amount of commission to be disclosed in sales of standard (non-investment) insurance products, though insurance intermediaries must disclose the amount of fees to be paid directly by customers. I agree that in either case, the cost is likely to be borne by the customer.

I hope that the Committee finds this response helpful.

10 January 2015

MANDATORY AUTOMATIC EXCHANGE OF INFORMATION IN THE FIELD OF TAXATION (7374/15)

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


We share your support for this proposal as an important means of ensuring that Member States receive necessary information about tax rulings that could have an impact on their tax base. Nevertheless we have a number of questions. The Commission makes clear that the proposal is designed to combat aggressive tax planning, cross-border tax avoidance and harmful tax competition. It states that “at a time when citizens are making huge efforts and many small business are struggling to remain afloat, the ability of certain – mostly multinational – companies to minimise their taxes through aggressive tax planning is intolerable.” Do you share the Commission’s view? Does it mark a
shift in focus of the Directive on mandatory exchange of information in the field of taxation from a system of checks on individuals to an emphasis on tackling structured avoidance? Will it be successful in its aim of increasing transparency? What further measures beyond this proposal are required to ensure that there is an effective EU approach to combating these issues? Is there a case for a turnover tax, as proposed by the OECD?

Can you elaborate on your concerns that the proposed two-stage system for disclosure of information on advance cross-border rulings and Advance Transfer Pricing Agreements might entail disclosure “without foreseeable relevance” and undermine the principle of proportionality? Can you give some examples of the problems in terms of administrative burdens and infringing on HMRC’s legal duty to preserve taxpayer confidentiality that may arise? Are you seeking to amend the Directive to meet these concerns?

We note that the Commission last year launched investigations into whether decisions by tax authorities in Ireland, the Netherlands, Luxembourg and Belgium complied with EU rules on state aid. We also note that the European Parliament in February 2015 established a special parliamentary committee to look into EU Member States’ “tax rulings and other measures similar in nature or effect” and make recommendations for the future. What further information and update can you give us on these investigations? What are the implications in terms of the application of state aid rules in this area? How will these investigations inform discussion on this proposal and the other measures set out in the Commission’s Tax Transparency package?

The Financial Times reports that the new proposal falls short of demands in some quarters for full public disclosure of tax rulings, opting instead for sharing of confidential information among tax authorities. The Commission argued that a new regime allowing for public disclosure would take too long to implement because of the need to set up safeguards to protect corporate information that was market sensitive. Do you share the Commission’s arguments?

More broadly, you state that the Government welcomes the Tax Transparency Package. The package sets out six specific aims: establishing strict transparency for tax rulings; streamlining legislation on the automatic exchange of information; assessing potential further transparency initiatives; reviewing the Code of Conduct on Business Taxation; Working towards better quantification of the tax gap; and promoting greater tax transparency internationally. You state that you look forward to receiving more detail on these initiatives, and we note that the Commission intends to publish an Action Plan on corporate taxation before the summer. Beyond the information contained in your EM, are you able to share any further detail on the Commission’s proposals, and the Government’s views on them, at this stage? In particular, how do you respond to the Commission’s intention to “assess whether additional public disclosure of certain corporate tax information should be introduced, in a way which goes beyond administrative cooperation and provides public access to a limited set of tax information of multinational companies”? What proposals does it have in mind? In addition, in what specific ways can it be ensured that the EU’s efforts in this area complement the development of global standards? What update can you give us on the OECD/BEPS project to tackle corporate tax avoidance internationally? How would you assess the attitude of global partners to the issues at hand?

We note that the timetable for agreement remains uncertain. We will therefore continue to hold the document under scrutiny. We would be grateful for a response to our questions, and an update on negotiations, by 26 May 2015.

24 March 2015

MARKET ABUSE DIRECTIVE (16010/11)

Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury, to the Chairman

I am writing to provide an update on the Criminal Sanctions Market Abuse Directive (CSMAD).

As you may recall, the Government decided to not opt-in to CSMAD at the outset of negotiations because it was not possible to assess the implications of CSMAD while the broader market abuse framework set out in the Market Abuse Regulation (MAR), on which CSMAD is contingent, was at an early stage of negotiations, as was the MiFID Review, which sets out the wider regulatory framework.

Political agreement was reached on CSMAD on 20 December 2013. As a result of the decision not to opt-in, the UK did not have a vote on (and will not be bound by) the Directive. The final text covers market abuse in at least serious and intentional cases for both insider dealing and market manipulation, including the manipulation of benchmarks, and the unlawful disclosure of inside information. The text also sets out minimum-maximum levels of sanctions for these offences.

In previous correspondence, the Government committed to reviewing its decision and after considering the regime set out in the final agreed text on CSMAD, the Government does not believe that the UK would be well served by changing the decision to opt-in to CSMAD.

The UK has led the way in the EU on tackling market abuse. Under the present regime, our custodial terms for insider dealing are higher than 19 other EU Member States, and for market manipulation, higher than 17 other EU Member States. We are able to achieve the objectives of the CSMAD without opting into the Directive. Furthermore, not opting-in provides us with increased flexibility in how we make provision for criminal sanctions in the UK, both now and in the future.

The Government welcomes the fact that the EU has raised the minimum standards for criminal sanctions for market abuse, however it is important to note the unique nature of the UK financial market as a global financial centre. The depth and complexity of our financial market is unmatched in the EU. Rules that work for other Member States will need refinement and amendments to ensure that they are appropriately designed to give regulators the tools required to properly police UK financial markets, whilst also working in an international context.

The Government is committed to updating the UK criminal regime to reflect recent substantial changes in EU the regulatory framework, introduced as part of MiFID2 and MAR, and we will also consider whether any further changes are appropriate to the UK market. The Treasury therefore plans to launch a consultation on new UK legislation for criminal offences in relation to market abuse. The Treasury will work to have the relevant domestic legislation in place by the CSMAD transposition deadline at the latest – this is expected to be at some point in summer 2016. This will guarantee that the UK remains at the forefront of tackling market abuse.

3 July 2014

**MONEY MARKET FUNDS (12713/14, 13449/13)**

*Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury*

Thank you for your letter, dated 13 May 2014, on EMs 13426/13, 13449/13 and 6020/14, on Shadow Banking, and for your letter, dated 1 June 2014, on JHA issues pertaining to EM 6020/14. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 10 June 2014.

We are pleased to welcome you to your new post. We are also grateful to you for this comprehensive and thoughtful response to our letter of 1 April 2014. We note in particular your helpful response on defining shadow banking and its benefits and risks. We agree with you that there is an extremely complex web of interconnections between the shadow banking and the regular banking sector. However, given the rapid growth of Shadow Banking, not least in China, we would be grateful for further information on the nature of the global risk arising from its growth in such countries. We concur with your assessment that, while understanding of the sector has increased, more needs to be done. We therefore welcome international regulatory efforts to increase transparency and understanding of the working of the sector.

In that light, we are grateful for your useful explanation of the work of the FSB. We would be grateful for further updates on the FSB’s work as the five workstreams are taken forward. It is particularly important to increase awareness of new risks as they develop, and to ensure that policies are implemented in an internationally consistent manner. On its annual global shadow banking monitoring report, what can be done to ensure that the risks arising from off-shore centres are captured, and that more jurisdictions collect more detailed data so as to allow the FSB’s narrowing down of the data to be effective?

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Turning to the Commission’s two legislative proposals, you state that the policy response is at an early stage and it is therefore not possible to provide an assessment of the Commission’s approach at this point. However, we ask you to bear this question in mind in the coming months and to keep us updated as the legislative proposals are taken forward. On the proposal for a regulation on Money Market Funds (EM 13449/13), what is the view of other Member States on the proposal?

On the proposal for a regulation on Securities Financing Transactions (EM 6020/14), you state that other stakeholders, and the European Parliament in particular, “may seek to include additional provisions that detract from those measures agreed at the international level.” Can you be more specific about your concerns? In what particular ways do you anticipate that the European Parliament may seek to amend the proposal? In relation to the delegation of technical provisions to ESMA, you state that the Government will seek “to ensure important matters relevant to the UK interests are properly addressed in the negotiation”. Again, can you be more specific about the UK interests that you are seeking to protect? We also note your assertion that the UK’s JHA opt-in protocol is triggered in relation to this proposal. As you know, the Committee’s consistent position is that the opt-in is engaged only if the proposal cites a Treaty base within Title V TFEU. Given that the deadline to notify the Commission of the UK’s decision was 19 May, we regret that this was not brought to the Committee’s attention until now. Whilst we are grateful for your apology for the delay, we note that this is the second time in a matter of weeks that a JHA opt-in issue has been identified at a late stage. On 31 March 2014, the then Economic Secretary to the Treasury, Nicky Morgan MP, wrote to us in a similar vein in relation to EM 17949/13: Proposal for a Directive on the Union Legal Framework for Customs Infringements and Sanctions. What steps are you taking to improve the Government’s internal processes to ensure that JHA issues are identified and brought to the Committee’s attention at an early stage?

While we note that negotiations on the legislative proposals are at an early stage, we would be grateful for an initial response to these questions by 24 June 2014, followed by further updates as negotiations progress. In the meantime we will continue to hold EMs 13449/13 (Money Market Funds regulation) and 6020/14 (Securities Financing Transactions regulation) under scrutiny.

10 June 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 10 June on shadow banking, and your follow up questions.

I am glad that you found my previous letter helpful and comprehensive, and hope this response addresses your outstanding questions.

THE NATURE OF GLOBAL RISK ARISING FROM THE GROWTH OF SHADOW BANKING

In the Financial Stability Board’s (FSB) shadow banking monitoring report of 2013, ten jurisdictions were identified that experienced growth in their shadow banking sectors of over 10% - China, Argentina, India, South Africa, Russia, Brazil, Mexico, Turkey, Korea and Indonesia. Emerging markets, particularly in Asia, have experienced rapid credit growth and a shift in intermediation frameworks towards a more market based model, marked by an increase in the use of corporate bonds (for example, S&P estimates that China overtook the US in the issuance of non-financial corporate debt in 2013).

China’s shadow banking sector growth is noteworthy, although this growth does come from a low base, banks still dominate lending and, as with many emerging markets, there is a need to deepen financial markets to broaden access to finance. The measurement of the sector in China was made possible by the publication of a new statistical measure by the People’s Bank of China, “Total Social Financing (TSF), in 2011. This is not strictly comparable with the sectoral balance sheet data used by the FSB, but gives a much more accurate picture than was possible previously.

Shadow banking growth in China is driven by demand for loans by local governments and property developers which is met indirectly by investors seeking higher yield products, but there is still a good deal of uncertainty around the risks that this growth could give rise to and the inter-connectedness of the shadow banking and traditional banking systems. At worst, failures in the shadow banking system could have spill-over effects, leading to losses in the traditional banking sector.
Recent stresses have strained parts of China's shadow banking sector but the authorities are aware of concerns and are taking steps to address the issue, although stress could increase in the interim if growth were to slow more than expected.

At the IMF Spring meetings this year, the annual early warning exercise conducted jointly with the FSB noted the potential risks from the growth in shadow banking, recommending that jurisdictions should improve their data collection so as to capture the size of the sector more effectively and the particular risks being taken. By improving monitoring, authorities will be better able to apply macro and micro prudential tools to address excessive leverage, maturity transformation and imperfect credit-risk transfer; and to improve transparency of more complex transactions such as securitised products and Over-the-Counter derivatives.

CAPTURING RISKS FROM OFF-SHORE CENTRES

You raise the quality of information gathered by the FSB's annual global shadow banking monitoring report and how it might be improved to capture risks from off-shore centres. As mentioned in my previous response, this information is not perfect and it is improved every year. The FSB actively encourages all jurisdictions to improve the data that they collect so as to make the report more accurate; individual actions are essential for creating a common good.

Recently, the FSB's Regional Consultative Group for the Americas (comprising FSB members and non-members) produced a report on the shadow banking monitoring exercise which sought to design a monitoring exercise specifically for jurisdictions in the region (but compatible with the global study) which mapped the connections of shadow banking to the rest of the financial sector and the potential risks of these connections. A template was developed to capture offshore shadow banking activities in international financial centres (IFCs) and their relationship with the onshore financial system. This will be assessed by the FSB’s Analytical Group on Vulnerabilities and it is hoped that it will provide a starting point from which the global monitoring exercise can be improved to include IFCs in the future.

CURRENT NEGOTIATIONS ON THE PROPOSED REGULATIONS REGARDING MONEY MARKET FUNDS AND SECURITIES FINANCING TRANSACTIONS

You also asked about other Member States views regarding the proposed Regulation on Money Market Funds. No working level meetings have taken place at EU level, and Member States have not yet publicly shared their views on the proposal. It would not be appropriate to discuss the views shared by other Member States in confidence.

In terms of the direction the securities financing transactions (SFTs) may take, the Government is, as always, vigilant to the risk that the Regulation may be diverted away from its core purpose. In this case, to address the financial stability risks arising from shadow banking. Whilst the Government has no specific concerns at the moment, negotiations are inherently fluid.

The Government believes strongly that the Regulation should maintain its current purpose as an element of the international initiative to improve the supervision and transparency of shadow banking. As I stated in my previous letter on this subject, the Government favours a step-by-step approach which carefully implements internationally consistent supervision measures as they are finalised to minimise the potential for gaps in supervision or regulatory arbitrage.

Moving to the matters the UK will seek to clarify on the face of the Regulation, the Government will be seeking to agree a text which will work as planned and will allow for unintended consequences dependant on subsequent decisions from the European Supervisory Authority (ESA) or the Commission. As much of this proposal is highly technical, there are several areas where a European Supervisory Authority or the Commission will be empowered to act, such as in specifying financial instruments of ‘equivalent economic effect’ to those named in the text, and the data templates to be used by firms to report their SFT data to supervisors. Where an ESA or the Commission are empowered to specify the rules further in secondary legislation such as delegated acts, or technical standards, the Government will work to ensure sufficient controls are in place to ensure they do not diverge from the agreed purpose of the legislation.

I will keep your Committee and the House of Commons European Scrutiny Committee informed as negotiations progress on both dossiers.
The Government takes very seriously the concerns you express in your letters on Shadow Banking, on Bank Structural Reform, and most recently to my colleague, the Commercial Secretary to the Treasury Lord Deighton, on Anti-Money Laundering. This Government is focused on ensuring we meet our scrutiny commitments to Parliament.

To ensure the opt-in is identified at an early stage, the Home Office and Ministry of Justice have recently reissued guidance across Whitehall on the opt-in protocol. In addition, specific training on the application of the opt-in, especially in relation to identifying JHA content and understanding the process for asserting the opt-in is being provided to Departments.

24 June 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 24 June 2014 on EMs 13426/13, 13449/13 and 6020/14, on Shadow Banking. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 8 July 2014.

You provide helpful and insightful information on the growing risks of shadow banking in emerging markets and in response to our concerns on risks from off-shore centres. It is reassuring that you continue to devote sufficient resources into developing the Money Market Funds and Securities Financing Transaction Regulations by placing due importance on international initiatives designed to improve the supervision and transparency of shadow banking. We are well aware of the difficulties in collecting data on shadow banking activities. We would be grateful if you could keep us informed on the current status of data collection provisions, since this has been a challenging task for many financial centres, and one still being considered by the FSB.

As part of your general approach to negotiations, we recommended that agreement of the text should allow the ESAs to supervise the activities of Shadow Banks with sufficient flexibility, providing them with the ability to shift targets as the financial system changes. Similarly, while institutions such as the Bank of England have demonstrated a flexible approach to non-financial institutions, providing liquidity backstops to broker dealers and central counterparties in an effort to prevent instability if the financial markets seize up, perhaps comparable efforts could be taken forward by the European Central Bank to ease similar pressure should it build. In this context we note media reports of a leaked draft European Commission report on the European System of Financial Supervision that examines the merit of extending the reach and power of the ESAs to encompass these new areas. Can you shed any light on this matter, and on when the Commission’s report, initially expected to be brought forward at the end of 2013, can be expected to be published?

In answer to our query about the views of other Member States regarding the proposed Money Market Funds regulation, you state that “it would not be appropriate to discuss the views shared by other Member States in confidence.” While we appreciate that the negotiating positions of other Member States remain confidential, our desire is simply to gain a broader understanding of the debate in hand. We would be concerned if you were to rely on the principle of confidentiality to refuse to inform us of the different views within the Council on a proposal. We do not accept that this automatically means that we cannot be informed about the views of other Member States. This can be done in general terms; it does not require disclosure of details which would compromise a Member State’s negotiating position or undermine the decision-making process of the Council. If the Government now refuses to do so, it will severely restrict our ability to scrutinise these policies effectively. So, while bearing in mind that negotiations are at an early stage, we ask you again to provide us with an outline of the different views in the Council on the proposed Money Market Funds Regulation.

We welcome the fact that the belated recognition and enactment of JHA issues has resulted in training course being taken forward.

We would be grateful for a response to these questions by 23 July 2014, and thereafter to be kept updated on EMs 13449/13 and 6020/14 as negotiations progress. In the meantime we will hold both documents under scrutiny.

9 July 2014
Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 9 July on shadow banking, and your follow up questions.

Since I last wrote to you, working level Council discussions on the Securities Financing Transactions Regulation have continued. The Government has continued to press for the regulation to be technically rigorous and consistent with the FSB recommendations in this area. This has been undertaken in co-operation with the UK financial services regulators and in consultation with Industry.

You also asked the Government to shed light on media reports of a leaked draft and when the Commission will publish its proposal for a European System of Financial Supervision. We are aware that a draft of the report was leaked, however it is our understanding that this is unlikely to be the finalised version. A proposal is expected to be published in the coming weeks, more specifically between the end of July and the beginning of September.

As regards whether the European Supervisory Authorities (ESAs) should play a role in the supervision of shadow banks, there are a range of challenging issues that will need to be considered. This ranges from the definition of shadow banks, the expertise required to undertake such supervision to whether national or regional supervisors are better placed to supervise and monitor risks, as well as the need to balance the existing responsibilities of the ESAs with new duties.

In that regard, we are conscious that the ESAs have yet to fulfil their existing mandate.

The ESAs have focused on rule-making in recent years, given the high volume of legislation since the crisis, and we are keen to see the ESAs strengthen their focus on raising standards of supervision across the EU and identifying and mitigating risks through greater analysis of financial markets – two other key aspects of their mandate. These issues will be considered further in light of the forthcoming report from the Commission on the review of the European System of Financial Supervision (ESFS).

You also asked about other views in Council on the proposed Regulation on Money Market Funds. While it would clearly be inappropriate to comment on positions, following an early working group on 3 July, we are in a position to provide more information on the views that have emerged. A number of Member States were supportive of our position, with some raising concerns that it may not be possible to avoid causing serious disruption to short term financing of the real economy if the Union moves from the existing framework which allows both Constant Net Asset Value (CNAV) and Variable Net Asset Value (VNAV) funds, to either requiring a capital buffer or prohibiting CNAVs outright.

Some expressed concerns about CNAV funds, with calls for them to be banned. The important role played by money market funds gives rise to prudential concerns that under stressed market conditions they could pose a source of systemic risk. Some concerned about CNAVs suggested they might tolerate them marketing to investors in their country from other jurisdictions, but they were not happy that the Regulation would require them to lift national prohibitions on the establishment of CNAV funds within their territory.

Overall, there does not appear to be any open support for the capital buffer at this early stage, but this working group was only an initial discussion and therefore many of the views expressed are very preliminary.

24 July 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 24 July 2014 on EMs 13426/13, 13449/13 and 6020/14, on Shadow Banking. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 29 July 2014.

We are grateful to you for the update on the exchange of views at Council working group on 3 July. We note that there was some level of support for the UK’s concerns that the proposals may have damaging consequences for short term money markets and thus the real economy. While there is limited support for a capital buffer, we would benefit from being updated on whether other mechanisms are currently being proposed by way of capital or liquidity management in the future.
The details concerning the marketing of CNAVs in Member States and the requirement for national prohibitions to be lifted is one that we note for future consideration as this Regulation is discussed. We would thus be grateful for further updates as and when progress is being made.

In the meantime we continue to hold EM 13449/13 and 6020/14 under scrutiny.

29 July 2014

**Letter from the Chairman to Andrea Leadsom MP**

Thank you for your EM 12713/14, dated 29 September 2014, on the ECB’s opinion on the European Commission’s proposal for a Regulation on Money Market Funds. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 14 October 2014.

We support the helpful comments raised by the ECB, in particular those that add weight to concerns on the wider implications on bank intermediation, short term and securitisation markets, as well as MMF concentration.

We take note of the efforts by the ECB to ensure consistency and harmonisation with other connecting regulations, particularly in light of our inquiry into the EU financial sector regulatory framework, which aims to establish the gaps and inconsistencies between regulations. We are alert to the interconnections raised in the ECB opinion. For example, the ECB supports clarity on how the proposal interacts with the national provisions transposing UCITS and AIFM Directives. In addition the ECB also raises the potential implications to bank funding arrangements in conjunction with the Basel III Liquidity Cover Ratio, effectively incentivising banks to raise funding through corporates instead of through asset managers. We also take note of the ECB’s caution with respect to the development of rules on net stable funding, impacting the link between banks and MMFs.

We note the Regulation’s proposed eligibility requirements for short term securitised assets. Given a framework for high quality securitisation that may be developed by European institutions and authorities in the new European Commission, we believe it is important that the incentives for such short term securitised assets are matched for both buyers and sellers, given potential capital requirements. We are following the wider debate on the definition of high quality securitisation and its potential variance with other regulatory approaches. Are there particular divergences or inconsistencies in other EU regulations or Directives that could risk causing fragmentation in the market should these eligibility requirements be agreed?

On the subject of convergence, we note that it may be indeed tougher for the EU to reach convergence with the reform of Money Market Funds in the US. We note that the ECB supports convergence with the US given that a very large share of the world’s MMF industry is established there. We note that the ECB’s support for a capital buffer (albeit one taking into account the risk profile of the MMF) contradicts the SEC’s earlier decision to reject this type of reform measure. Furthermore the SEC’s decision in July 2014 effectively allows the majority of CNAVs to remain (mandating conversion to variable NAV for only a minority of CNAVs) can be read as another sign that both regimes are moving in different directions. While the US decision is seen to reflect the feature of the US CNAV market, do you have an opinion on this ruling and whether it supports the argument against the controversial 3% capital buffer in the EU? Furthermore the SEC has opted to impose fees and gates for most money market funds. Do you believe this is a solution that is also workable in the EU for all CNAV funds? We note your opposition to a 3% buffer. Can you please expand your view as to the reasons behind this opinion, whether you oppose the buffer as a principle or whether you disagree with its calibration? Would you be able to provide more clarity on the potential harmful effects of introducing such a measure?

We would be grateful for a response to this letter by 28 October 2014. In the meantime we now clear EM 12713/14 from scrutiny, while continuing to hold EM 13449/14 under scrutiny.

15 October 2014

**Letter from Andrea Leadsom MP to the Chairman**

Thank you for your letter concerning EM 12713/14 dated 15 October 2014 regarding the European Central Bank’s (ECB) opinion on the European Commission’s proposal for a Regulation on Money Market Funds.
You enquire as to whether there are any particular divergences or inconsistencies between this proposed Regulation and other EU Regulations or Directives as to the eligibility requirements for short term securitised assets that might give rise to market fragmentation if not reconciled.

As currently proposed the text is likely to be inconsistent with the approach taken elsewhere and it is true that a divergent approach might give rise to market fragmentation although ultimately this will depend on the final nature of any divergences.

As you will be aware, reviving securitisation markets is an important step to improving financing of the economy. Discussions around this issue are already underway within the context of a number of Commission delegated acts. As such the EU’s Economic and Financial Committee has already stressed the importance of ensuring a consistent and coherent framework.

In addition an international working group has been jointly established by the International Organisation of Securities Commissions (IOSCO) and the Basel Committee on Banking Supervision (BCBS) to develop criteria to identify “simple, transparent and consistent” securitisations. This working group is due to provide its final report in 2015 which will help ensure a common framework within which to develop appropriate regulatory and prudential approaches.

You also ask for my view on the ruling by the Securities and Exchange Commission (SEC) on US money market funds (MMFs) and the extent to which I believe it supports arguments against capital buffers in the EU. In so far as it concerns the suitability of capital buffers I agree that the SEC’s conclusions support the argument against the introduction of capital buffers in the EU. Specifically, a buffer sizeable enough to absorb large security defaults as seen during the crisis would almost certainly be unaffordable and reduce yields to investors to such an extent that most Constant Net Asset Value (CNAV) funds as currently exist would cease to be attractive or viable investment vehicles.

You also ask whether the SEC proposals on fee and gates would be a workable solution in the EU for all CNAV funds. Fees and gates are an effective tool for stopping runs once in action although there are questions as to whether the introduction of fees and gates in one fund could trigger redemptions elsewhere.

The US has tried to mitigate this through the use of structured discretion, whereby MMF managers retain some discretion as to whether to introduce either tool. In principal such a solution is workable in the EU although differences between the EU and US markets make a direct transfer of the SEC proposals problematic. In particular the SEC proposals require prime institutional funds to float the NAV. While this is expected to affect only a small minority of investors in the US, in the EU it would affect virtually all existing CNAV funds.

Connected to this you ask whether the Government’s opposition to capital buffers is one of calibration or principle and ask if I could expand on the reasons for this opposition and what the harmful effects of such a measure may be.

While the proposed application of bank-like regulation to investment funds raises points of principle, in this case my opposition is primarily one of practicality. As noted above, it is hard to see how a capital buffer could be calibrated so as to be affordable while being sufficiently large to absorb losses and provide comfort to investors.

There are further complications around how such a buffer is replenished and whether the need to replenish it simply becomes a channel by which risk is transmitted to banks or other entities who act as sponsors.

To the extent that some CNAV MMFs were to continue operating under a regime which required capital buffers then there is a risk of a significant increase in market concentration. This would exacerbate, not reduce, systemic risks within the financial system.

It is hard to quantify precisely the likely effects of such proposals. This is largely because we cannot be certain of the behavioural response of investors. However, according to one survey 38% of European investors in CNAV MMFs stated that they would reduce their CNAV allocation if the NAV was moved to a floating structure and 36% would disinvest entirely. Given the important role MMFs play in financing the real economy this could have serious repercussions for the European economy, something this Government is rightfully seeking to avoid.

2 November 2014
Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 2 November 2014, on EM 12713/14: the ECB’s opinion on the European Commission’s proposal for a Regulation Money Market Funds. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 25 November 2014.

We are grateful for your helpful comments and views on the nature of the impact of the proposed capital buffer. Your reference to JPMorgan’s evidence of the potential decline in use of CNAV funds is noted, however we caution that it should not be read in isolation given there are clearly many factors affecting the reasons why an investor may withdraw funds from an MMF. We also agree that investor behaviour remains uncertain.

With reference to the latest Presidency Compromise text that emerged on 10 November 2014, we note that all mention to the proposed capital buffer has been removed. Can you update us on the Council’s latest compromise text not to support the capital buffer proposed for CNAV funds? What is the justification for the Council’s position on the decision? What do you see as the implications for CNAVs of this compromise? Should the capital buffer continue to attract views from each side, would there be benefit in conducting another impact assessment in light of the current Basel capital and funding requirements that have yet to be finalised?

The Presidency compromise also brings retail and small professional CNAV fund requirements into focus. Can you explain the reasoning behind Article 29? Can you explain how alternatives to a capital buffer such as redemption gates and fees would be aligned to what is currently in place for AIFMD and UCITS? Should short term and standard MMFs expect similar treatment instead of a capital buffer? On a broader point, how large is the retail and small professional CNAV fund market?

Article 13a of the Presidency Compromise details some requirements which limit the MMFs from investing more than 10% in another single MMF units or shares. The text says that Member States have the discretion to lift this limit to 20%. We are concerned that the ability for Member States to vary the limit up to 20% runs counter to the principle of creating a single market with a single set of rules. Do you believe this amendment, if adopted, would create divergences in the eligible level of investment of another single MMF between Member States? Is this a concern?

Lastly, can you outline with any specificity the potential legal inconsistencies that apply to the eligibility of short term securitised assets? It would be a failure if the market that is trying to become ‘revitalised’ becomes fragmented due to eligibility requirements. Is there any room for flexibility at the Level 1 level so as to reduce any future adverse consequences to this market? In light of the latest compromise text, why was the Article on securitisation not revised? How would you intend to improve the text so as to ensure that future international developments can be taken into account?

We would be grateful for a response to this letter, together with an update on negotiations, by 9 December 2014. While we cleared EM 12713/14 from scrutiny on 14 October 2014 we continue to hold EM 13449/14 under scrutiny.

25 November 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 25 November 2015, on EM 13449/13: Regulation on Money Market Funds (MMFs) and EM12719/14: ECB opinion on the Money Market Funds Regulation, following our letter of 2 November.

The majority of your letter relates to the Presidency Compromise text that emerged on 10 November 2014. Since then, the Presidency has circulated two further compromise texts, which include significant changes to the text proposed on 10 November. Where appropriate, I have referenced changes made to the most recent compromise text of 27 November.

Both the Presidency Compromise text of 10 November and the most recent compromise text do not include a capital buffer for constant net-asset value (CNAV) funds. You ask for a justification of the Council’s position on the decision. However, there is no single ‘Council position’ as no agreement has yet been reached in Council on the treatment of CNAV MMFs. As with all compromise proposals, the text is an attempt by the Presidency to balance the differing views of Member States.

You enquire as to the impact of removing the capital buffer. The buffer is intended to increase the resilience of CNAV MMFs to withstand significant redemptions. However, CNAV MMFs are a low
margin business and so a requirement to hold 3% in cash as a capital buffer would likely be a de facto ban on CNAV MMFs. So, in isolation, removing the capital buffer will preserve the possibility of providing CNAV MMFs within the EU, while taking away the additional resilience that a capital buffer would provide.

To strengthen the resilience of CNAV MMFs against significant redemptions, the Presidency has also proposed introducing liquidity fees and redemption gates as part of their Compromise text. Liquidity fees require funds to impose a fee on redemptions once liquidity within the fund has reduced below a certain threshold.

In effect, this fee would ensure that those redeeming during a period of stress were unable to benefit from the CNAV to exit at a higher unit price than the underlying asset value, thus removing first mover advantage. If redemption pressure continued then a redemption gate would be imposed locking investors into the fund. This would give managers a chance to increase available liquidity or more likely begin an orderly wind down of the fund. Alternative Investment Funds Managers Directive (AIFMD) and Undertakings for the Collective Investment of Transferable Securities (UCITS) do not specifically mandate the introduction of fees and gates but redemption gates are permissible.

The Presidency Compromise text also limits the marketing of CNAV MMFs to retail and small professional investors only. The precise definition of both has not yet been defined but the Commission estimate this represents around 20% of the CNAV MMF market.

You enquire whether short term and standard MMFs should expect similar treatment, instead of a capital buffer. The Presidency’s Compromise proposals on fees and gates would only apply to retail and small professional CNAV funds, so would not apply equally across short term and standard MMFs.

You ask about the benefit of conducting another impact assessment in light of the current Basel capital and funding requirements that have not yet been finalised. I am afraid I am not clear which requirements you are referring to in this instance but would be happy to provide my views if you were willing to clarify your request.

The 10 November Presidency compromise text limits the amount an MMF can invest in another MMF at 10%, but allows Member States the flexibility to increase the limit to 20%. You ask whether the ability for Member States to increase this limit will create divergences between Member States. You may wish to note that the most recent Presidency compromise text decreases the initial limit to 5%, with the flexibility for Member States to increase this to 10%. I agree that creating a single market for MMFs, with a single set of rules, should be a priority. Member State options are not generally helpful in this regard. However, in this instance, the functional impact of the flexibility is limited, as investment is ultimately capped at 10%.

You ask why the Presidency Compromise text on eligible securitisations of 10 November was not revised. The latest Presidency Compromise text of 27 November includes several amendments to the article on eligible securitisations. These changes provide further flexibility regarding which securitisations will be considered eligible. In addition, a Commission delegated act has been proposed, which give powers to further define eligibility in line with ongoing work to set similar criteria in Solvency II.

8 December 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 8 December 2014, on EM 12713/14: the ECB’s opinion on the European Commission’s proposal for a Regulation Money Market Funds and EM 13449/13: Regulation on Money Market Funds. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 16 December 2014.

We are grateful for your helpful comments and views on the latest Presidency Compromise. We would be grateful if you could elaborate on why liquidity fees and redemption gate tools seem to be more appropriate for retail and small professional funds, and what should be in place for the remaining CNAV funds to make them more resilient. Whilst acknowledging that a trade-off exists in the application of a capital buffer, it seems that the tools are not applicable for the remaining 80% of the CNAVs that are neither small nor retail. Do you believe that standard and short term MMFs should also be subject to similar requirements?
We note that the 10-20% threshold was reduced to 5-10%, in relation to the eligibility for MMFs to invest in other MMFs in the latest Presidency Compromise. Do you know what the average or current percentage level is, that a typical MMF will invest in another MMF? Is the 5-10% level indicative of what is currently replicated in the interconnections between MMF markets? As mentioned in our previous letter, we consider the level of discretion that could be left to Member States to be wholly unnecessary. We fear that this could impinge upon the principle of the Single Market and leave MMFs in EU Member States subject to risks of regulatory arbitrage.

We have noted the latest Draft Report from the European Parliament Rapporteur, Neena Gill MEP. Whereas the Council Presidency Compromise opposes CNAVs having a capital buffer, while Neena Gill proposes this only for a new category called ‘EU Public Debt CNAV Funds’. Do you have an initial opinion on this proposal?

There also appears to be a difference of opinion on the use of derivatives by an MMF. The current Draft Report from the European Parliament wishes to ban the use of OTC or ‘over-the-counter’ derivatives as an eligible investment. The Rapporteur also supports stronger oversight of an MMF’s internal rating system and suggests that ESMA and the Competent Authority approve an MMF’s assessment procedures in advance. Do you have a view on the risks to an MMF using OTC derivatives as an eligible investment, and indeed whether internal rating systems should be strengthened?

In providing clarification over possible engagement in a further impact assessment, we highlight that factors such as an expected low investment return due to continued low interest rates persisting in the EU, as well as Basel III capital requirements on banks, may reduce an MMF’s incentive to hold short-term wholesale deposits, and may actually encourage MMF investors to see benefit in transferring to VNAV funds. Do you believe that this investment and regulatory environment has been factored in to the current discussions?

We are aware that the text of the proposal has changed substantially from that originally adopted by the Commission in September 2013. In line with paragraph 3.4.1 of the Cabinet Office Guidance for Government Departments on Parliamentary Scrutiny of European Union Documents, we accordingly request deposit of a supplementary EM on the text of the Regulation as it currently stands.

We would be grateful for a response to this letter, together with an update on negotiations, by 16 January 2014. We continue to hold EM 13449/14 under scrutiny.

17 December 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 17 December, on EM 13449/13: Regulation on Money Market Funds, following our letter of 8 December.

Supplementary Explanatory Memorandum (EM) and Update on Negotiations

You note that the most recent Italian Presidency compromise text has changed substantially from that originally adopted by the Commission and requested deposit of a supplementary EM on the text of the Regulation as it currently stands. A copy of the supplementary EM is enclosed.

It should be noted that the Italian Presidency was unable to gain sufficient support in Council for their proposed compromise text. Therefore, the text on which you have requested a supplementary EM, and asked a number of questions, holds no formal status, does not have the support of Council and is therefore potentially subject to further change. The incoming Latvian Presidency must now decide whether to take forward negotiations based on the Italian Presidency’s proposals, or seek to restart discussions based on a different text. At present, the Latvian Presidency has not given an indication of when MMF discussions will resume.

Treatment of Constant Net Asset Value (CNAV) MMFs

You ask why liquidity fees and redemption gate tools seem more appropriate for retail and small professional funds and whether they should be applied to all MMFs. As noted in my letter of 8 December, liquidity fees and redemption gates strengthen the resilience of CNAV MMFs against significant redemptions by limiting the ability of investors to redeem at a higher unit price than the underlying asset value. It would therefore be appropriate for all CNAV MMFs permitted under this
regulation to be able to impose liquidity fees and redemption gates if necessary to ensure financial stability.

The Italian Presidency’s latest compromise text only introduces liquidity fees and redemption gates for small professional CNAV MMFs. In its progress report of 17 December, the Italian Presidency notes the need for further discussion on the treatment of the remainder of the CNAV market. Depending on the approach taken, which should seek to preserve some of the utility of CNAV MMFs while appropriately addressing financial stability concerns, the introduction of liquidity fees and redemption gates may be appropriate.

**THRESHOLDS FOR ELIGIBLE INVESTMENT**

You highlight concerns regarding the discretion given to Member States to set different thresholds in relation to the eligibility of MMFs to invest in other MMFs. The discretion was removed from the most recent Italian Presidency compromise text. The latest thresholds proposed by the Italian Presidency are in line with those set out in the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive.

You asked what the average or current percentage level is, that a typical MMF will invest in another MMF. The amount that an MMF invests in another MMF varies by type of MMF and no central record is kept. However, the Institutional Money Market Fund Association estimates that CNAV MMFs invest, on average, less than 1% in other MMFs but that variable net asset value (VNAV) MMFs may invest substantially more.

**EUROPEAN PARLIAMENT PROPOSALS**

You ask a number of questions regarding the proposed text of the European Parliament. Around 800 amendments to the Commission’s original proposals have been put forward by MEPs, including by the Rapporteur and Shadow Rapporteurs. No clear consensus has yet emerged on the treatment of CNAVs, the use of derivatives, or on the internal rating systems used by MMFs.

**IMPACT OF BASEL III CAPITAL REQUIREMENTS AND LOW INTEREST RATES**

You highlight that factors such as an expected low investment return due to continued low interest rates persisting in the EU, as well as Basel III capital requirements on banks, may reduce an MMF’s incentive to hold short-term wholesale deposits, and may actually encourage MMF investors to see benefit in transferring to VNAV funds. The impact of Basel III capital requirements and low investment returns has indeed been factored into discussions, particularly the treatment of CNAV MMFs. For example, investment and regulatory conditions have driven opposition to capital buffers for CNAVs, which are considered to be uneconomic (and therefore a de facto ban) in the current environment. The continued use of CNAV MMFs by investors, and changes to fund structures that reflect the current climate, are considered when exploring compromise proposals.

**23 January 2015**

**Letter from the Chairman to Andrea Leadsom MP**

Thank you for your supplementary EM 13449/13, dated 23 January 2015 for a Regulation on Money Market Funds, and letter dated 23 January 2015. The House of Lords European Union Sub- Committee on Economic and Financial Affairs considered these documents at its meeting on 10 February 2015.

We welcome the fact that provisions that would enable a Member State to apply discretion to the level that an MMF is able to invest in shares or units of another MMF has been withdrawn. We note that you draw attention to the potential damaging effects of restricting eligible assets the MMF may use or hold because of strict liquidity and maturity requirements in the proposed regulation. We agree that overly restrictive requirements could unduly impact the wider economic environment, but we recognise that the regulation seeks to ensure that any assets or instruments used by the MFF do not increase unnecessarily the liquidity risk and overall risk profile of the fund. You explain that many securitisations include both corporate and consumer debt. Do other asset classes need to be included within the text so as to ensure that certain high quality securitisations are not banned for purchase by MMFs? While we welcome alignment of the eligibility requirements with other EU regulatory files, do
you believe the proposal should provide more clarity on how the proposal interacts with the national provisions transposing UCITS and AIFM Directives, as noted by the ECB in its Opinion?

We acknowledge that the 3% capital buffer for CNAV funds has met opposition and it is clear that liquidity and redemption fee mechanisms used to prevent runs on MMFs are gaining support. We note that tensions still remain over the definition, scope and treatment of CNAV funds. Do you envisage any harmful implications in introducing different requirements for different segments of the CNAV MMF market, for end users as well as MMF providers? You state that redemption gates and liquidity fee mechanisms would be in place for 20% of the CNAV market in the form of small professional CNAV funds. Is it correct to assume this leaves 80% of the CNAV market subject to no requirements preventing a run risk? If this is the case, is it important to apply these requirements to ‘impatient’ and less reactive investors? We welcome the engagement with investors and MMF providers in seeking to estimate the cost of switching from CNAV to VNAV funds. We would be grateful to be kept updated with respect to these preliminary conclusions.

We would be grateful for a response to these questions, as well as an update on negotiations, by 24 February 2015. In the meantime we continue to hold EM 13449/13 under scrutiny.

10 February 2015

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 10 February, on EM 13449/13: Regulation on Money Market Funds, following our letter of 23 January.

You ask whether, in addition to securitisation containing corporate and consumer debt, certain asset classes should be eligible for investment by Money Market Funds (MMFs). Asset backed securities are an important method of financing the economy and so any asset backed security that is of sufficient quality, transparency and liquidity should be eligible for investment. This includes, for example, so called Asset Backed Commercial Paper. It is important, however, that a consistent approach across EU legislation is taken to defining the necessary quality, transparency and liquidity of securitisations. I therefore welcome proposals in the Italian Presidency’s compromise text to align those definitions with ongoing work in other areas of European legislation, including Solvency II.

You ask whether I believe the MMF proposal should provide more clarity on how it interacts with the national provisions transposing the Undertakings in Collective Transferable Securities (UCITS) Directive and the Alternative Investment Fund Manager Directive (AIFMD), as noted by the ECB in its Opinion. I support the ECB’s views that more should be done to ensure alignment with existing legislation and will be exploring possible changes to be made in the final compromise.

You ask whether I envisage any harmful implications in introducing different requirements for different segments of the Constant Net Asset Value (CNAV) MMF market, for end users as well as MMF providers. I believe it is crucial to find a balanced response to the risks of CNAV MMFs that deals appropriately with financial stability concerns, while preserving the utility of CNAV’s for investors. The difference in treatment of certain segments of the CNAV MMF market in the Italian Presidency’s final compromise text is intended to reflect the different risks posed. For example, liquidity fees and redemption gates have been introduced for ‘small professional CNAV MMFs’, which are made up of investors that are considered less prone to significant redemptions and is therefore considered by the majority in Council to be a sufficient safeguard.

It is not the case that no requirements to manage the risk of significant redemptions will be placed on the remaining 80% of the CNAV MMF market. As noted in the Italian Presidency’s progress report of 17 December, no agreement was reached in Council over the appropriate treatment for that portion of the market and further discussion will be needed to agree what measures may be necessary. Ensuring a compromise is found that deals adequately with financial stability concerns for this part of the CNAV MMF market, while ensuring that the utility of CNAV MMFs for investors is maintained as far as possible, is a priority.

24 February 2015
Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 24 February 2015, on the Regulation on Money Market Funds. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 10 March 2015.

You letter is a helpful response to our questions. We note that you continue to support a differentiated approach to managing the risk of CNAV funds and it seems that little progress has been made by way of ensuring that requirements on the majority of the CNAV MMF market are not overly damaging to their overall utility and function. At the same time, we recognise pressures to ensure that institutional investors including corporate treasurers will not be adversely impacted by the changes.

We acknowledge your efforts to ensure consistency between the current MMF regulation and existing elements within UCITS and AIFMD. Defining securitisation as eligible investment for purposes of inclusion in both the MMF Regulation and Solvency II is a good example of ensuring consistency between current legislative files.

We are aware that the European Parliament will be voting on the draft text on 23 March 2015. Noting the recent vote by ECON in February, do you have any views on the proposed categorisation of CNAV funds within the compromised draft document?

In light of the forthcoming dissolution of Parliament, we would be grateful for a response to this letter, including an update on negotiations, by 26 May 2015. In the meantime we continue to hold EM 13449/13 under scrutiny.

10 March 2015

PRE-DISSOLUTION UPDATE ON REMAINING HM TREASURY SCRUTINY BUSINESS

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

Ahead of the dissolution of Parliament, I am writing to provide you with an update on live files still under scrutiny, or on which the Committee has asked to be kept updated.

EM 8633/14: PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON THE AC AND SUPERVISION OF INSTITUTIONS FOR OCCUPATIONAL RETIREMENT PROVISION (RECAST)

The timetable for negotiations remains the same as stated in my previous letter of 26 February: the European Parliament’s Economic and Monetary Affairs (ECON) and Employment and Social Affairs (EMPL) committees are expected to have their first exchange of views in March. Consideration of first draft reports are expected in July, with final consideration by the committees expected in October and possible first reading votes in November or December. If this timetable works out, we can expect trilogue negotiations to begin in December 2015 or January 2016.

EM 13449/13: PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON MONEY MARKET FUNDS; AND EM 12713/14: OPINION OF THE EUROPEAN CENTRAL BANK OF 22 MAY 2014 ON A PROPOSAL FOR A REGULATION ON MONEY MARKET FUNDS

Negotiations on the Money Market Funds (MMF) Regulation have not progressed under the Latvian Presidency. However, the European Parliament is due to vote in Plenary on the text proposed by the ECON Committee in April, which may put pressure on the Latvian Presidency to restart discussions. If discussions do resume, it is likely that the Presidency will seek views on the ECON Committee’s proposed compromise, which deletes the Commission’s proposed capital buffer for Constant Net Asset Value (CNAV) MMFs and replaces it with a regime that seeks to preserve some of the utility of CNAV MMFs while dealing with financial stability risks. The ECON Committee’s proposals are consistent with the opinion of the ECB, for example on clarifying when sponsor support can be given, the impact on securities markets and market concentration and in refining the internal ratings system, which I welcome.

It is not yet clear whether Member States will support a compromise which builds on the ECON Committee’s proposals. If progress is made in this direction, however, there is a chance that discussions could progress quickly, especially since the European Parliament are likely to be in a position to begin trilogue discussion by April.

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On the Banking Structural Reform Regulation proposal, the Latvian Presidency has held two Council working groups on 19 January and 13 February, at which it presented and elaborated on a concept paper on the separation process. Member States discussed the principles that should be incorporated into such a process, including predictability, following a risk-based approach to assessment and applicability and enforceability. The Commission has also presented analytical work on how certain metrics on assets and trading activities could be used to categorise banks in terms of their potential systemic risk. A further working group is scheduled for 13 March. The Presidency has indicated that it is aiming to reach a General Approach in Council at the May ECOFIN, which would form the basis for trilogue negotiations with the European Parliament. However, on the basis of current negotiations, our assessment is that reaching a broad compromise in the Council currently looks unlikely.

Your Committee asked how the ECB Opinion on the Commission proposal was playing into the Council negotiation. This Opinion remains to be cleared from Parliamentary scrutiny (EM 15924/14). The ECB’s criticism of the Commission’s proposed derogation (principally aimed at accommodating the UK in its application of the Banking Reform Act (BRA)) in Article 21 is primarily based on concerns about the effectiveness of the SSM and its own ability to apply legislation in a consistent manner. The ECB is also concerned about precedent. However, the ECB’s concerns have been tempered in the wider discussions by the clear willingness of the majority of Member States to seek an accommodation for the UK, as set out in the Italian Presidency’s progress report on the dossier). Several ECON Committee MEPs across political groups also recognise that the regime the UK has established is clear and robust. How that accommodation can best be framed in the Regulation is the subject of many ongoing discussions we are having with the Commission, the Presidency and other Member States, and we remain committed to achieving a satisfactory outcome.

The ECON Committee rapporteur for the dossier, Gunnar Hökmark, published his report on the Commission proposal on 6 January with an amendment deadline set for 30 January. Over 800 amendments were submitted. The report diverges from the original proposal by making separation optional (supervisors may instead enhance supervision or apply increased capital requirements if they wish), but it also reformulates the proposed derogation into an exemption aimed at achieving the same effect. The ECON Committee had an exchange of views on the proposal on 21 January and then on 23 February. MEPs will now consider and discuss the raft of amendments with a view to voting on them in late March.

Given the divisions in both the Council and the Parliament on some of the fundamental elements of the Commission proposal such as the separation process, it currently looks unlikely that there will be a Council General Approach or trilogues by May, although we can expect the Latvian Presidency to continue to push for this.

In regard to the Payment Services Directive (PSD II), I last wrote to you on 26 November with an update on negotiations. In that letter, I reported that the final compromise text reflected the Government’s key priorities. General Approach was agreed in December.

In your letter of 2 December, you waived scrutiny and asked for a further update. The Directive is now in trilogues and therefore subject to further negotiations between the Presidency, the Commission and the European Parliament. So far, the European Parliament is aligned on our key issues, including that:

— Third Party Payment Service Providers (TPPs) should remain within scope of PSD II so that consumers will be protected when using these services;
— Security requirements should be balanced against the need to encourage new technological services into the payments market; and

— Charitable donations should not be negatively impacted.

On the exemption for independent ATMs providers, the European Parliament is concerned about consumer protection, given that consumers in Europe do not benefit in the same way from the 'LINK' (the network which connects all ATMs together in the UK) Scheme Rules. However, we are confident that a satisfactory compromise can be found.

This process is due to continue into dissolution, but we do not expect any significant further changes to the text as the European Parliament and European Council texts are fairly closely aligned. I hope that based on the information provided in this letter, the Committee finds itself in a position to clear PSD II from scrutiny.

EM 12683/12: PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON THE FIGHT AGAINST FRAUD TO THE UNION’S FINANCIAL INTERESTS BY MEANS OF CRIMINAL LAW

There have been no substantive developments on the ‘PIF’ Directive since my last update. Trilogues with the European Parliament continue, and there has been no substantive agreement as yet on a compromise text. UK Government officials regularly attend working group meetings following trilogues to shape the Presidency’s negotiating position. Agreement between the Council and the European Parliament does not seem imminent, and the likely timeframe for adoption will be clearer once the Latvian Presidency has concluded at the end of June this year.


Regarding the European Union Solidarity Fund (EUSF) and the Flexibility Instrument, expenditure for these was agreed as part of the deal reached on the 2015 EU Budget. €11m of payments expenditure were agreed for the Flexibility Instrument and €176m of payments expenditure were agreed for the EUSF. Special Instruments have always been part of the budget, and the Government’s focus, as with all aspects of the EU Budget is to keep costs controlled. The Government abstained in the vote on the 2015 EU Budget and therefore abstained on the mobilisation of these instruments.


With respect to the Controller Procedural Guarantee, this has not been discussed in Council since the last update which I provided on 23 September. As previously set out, the Government is encouraged by the Committee’s endorsement of our views on the Commission’s proposal to introduce a Controller of Procedural Guarantees and will continue to work with other Member States in Council to prevent the Commission from pursuing this unhelpful proposal.

EM 6442/13: PROPOSAL FOR A COUNCIL DIRECTIVE IMPLEMENTING ENHANCED COOPERATION IN THE AREA OF FINANCIAL TRANSACTION TAX

We are not anticipating that agreement will be reached on the Financial Transaction Tax (FTT) Proposal before September. There is still disagreement amongst the 11 participating Member States over the scope, territorial basis and collection mechanism of the tax, despite the public statement made by the participants in January 2015 renewing their commitment to reaching agreement.

There are no Council working groups currently scheduled, and the Latvian Presidency said at a working group meeting on 24 February that it would not be put on to the ECOFIN agenda until further progress had been made. The 11 participants may meet informally before September, with the Commission attending the meetings. The Commission has confirmed that any documents provided to the participants would be circulated to all Member States.
EM 12201/12: PROPOSAL FOR A COUNCIL REGULATION ESTABLISHING A FACILITY FOR PROVIDING FINANCIAL ASSISTANCE FOR MEMBER STATES WHOSE CURRENCY IS NOT THE EURO; AND EM 5477/13: 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 (CON/2013/2)

Since ECOFIN in December 2013, there have been no further discussions on the reform of the EU Balance of Payments facility. Whether negotiations recommence is a matter for upcoming Presidencies, and there is currently no indication that this is the case.


I am corresponding separately on this proposal, which was cleared from scrutiny by your Committee on 2 March 2015, and will respond shortly to your most recent letter.

EM 6020/14: PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON REPORTING AND TRANSPARENCY OF SECURITIES FINANCING TRANSACTIONS

This file was cleared from scrutiny by your Committee on 5 November 2014, and General Approach was reached in Council shortly thereafter. The European Parliament’s consideration of the Securities Financing Transactions Regulation is ongoing. There are limited points of divergence in the ECON committee, and discussions so far have been broadly in line with the final Council agreement that we supported. It is currently expected that trilogues will commence in April and it may be possible for political agreement to be achieved under the Latvian Presidency.


On you 20 January letter, your Committee cleared this file from scrutiny asking for a further update after political agreement on 21 January. Political agreement has now been reached following the trilogue process, and, as expected, the final text reflects the Government’s priorities. The file is currently going through the necessary translation processes, and we expect it to go to ECOFIN in May for final agreement.

EM 12407/12 – PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON INSURANCE MEDIATION (RECAST)

As you know, a General Approach was agreed in Council in November 2014 for the recast Insurance Mediation Directive (which has been renamed the Insurance Distribution Directive). The Latvian Presidency originally intended to conclude trilogues negotiations by April-May 2015, however trilogues were delayed and began in late February 2015, and the subsequent trilogue has been pushed back to the end of March. A further trilogue is scheduled in April, two more trilogues are scheduled in May, and the last scheduled trilogue is in June, however these may also be subject to delay as other directives are prioritised. It is therefore less certain that negotiations will conclude under the Latvian Presidency. In any case, we will work closely with stakeholders during trilogues to protect the numerous successes we achieve in the Council text. I note that this file has been cleared from scrutiny by your Committee on 7 February 2012.

EM 9270/11: PROPOSAL FOR A DIRECTIVE AMENDING DIRECTIVE 2003/96/EC RESTRUCTURING THE COMMUNITY FRAMEWORK FOR THE TAXATION OF ENERGY PRODUCTS AND ELECTRICITY

The Commission has indicated it intends to withdraw the proposal as set out in their 2015 Work Programme.
With regard to VAT and vouchers discussions, there have been no further meetings since we last updated the Committee in February 2015. The possibility remains that this file will be put to ECOFIN in the coming months, although this is looking doubtful at this stage.

EMS15337/13: STANDARD VAT RETURN AND 7263-11: COMMON CONSOLIDATED CORPORATE TAX BASE
Update letters on the current state of play with these proposals will be sent by separate cover.

EM 17637/12 & 17617/12: COMMUNICATION ON TAX FRAUD AND EVASION
Following my letter of 23 May 2013, you asked to be informed of the technical details of the Commission’s proposals. I have done this as the Commission’s plans for specific proposals have become clearer – for example, on the amendments to the Parent Subsidiary Directive (letter of 16 January 2015), the amended Directive for Administrative Cooperation (15 December 2014) and the Commission’s proposed mandate for negotiating a VAT Administrative Cooperation Agreement with Norway (8 January 2015). Looking forward the Commission will publish in June a Report on Member States’ progress on implementing the two Recommendations in their 2012 Action Plan. As you know, our objective throughout to tackle tax fraud and evasion internationally has been through automatic exchange of tax information (AEoI), on which we have rapidly secured agreement to implement in the EU through the Directive on Administrative Cooperation (DAC). The UK has previously said it will not adopt the Recommendations as they stand. We continue to do that on the basis that the UK believes it has met the objectives in the two Recommendations, but does not agree with the specific methods and actions that the Commission proposed.

I hope the Committee finds this information helpful.

9 March 2015

Letter from the Chairman to David Gauke MP
Thank you for your letter, dated 9 March 2015, providing the Committee with a pre-dissolution update on remaining scrutiny business in relation to Explanatory Memoranda for which HM Treasury has departmental responsibility. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 17 March 2015. This letter deals with the documents you cite that fall under that Sub-Committee’s remit. Some of the documents you refer to fall under the remit of the Sub-Committees on the Internal Market, Infrastructure and Employment, and on Justice, Institutions and Consumer Protection. They will consider the update you provide separately.

EM 13449/13: PROPOSAL FOR A REGULATION ON MONEY MARKET FUNDS
We wrote to you on 10 March 2015, holding the document under scrutiny and asking for a response to a number of questions and an update on negotiations, by 26 May 2015. We look forward to receipt of your reply.

EM 6022/14: PROPOSAL FOR A REGULATION ON STRUCTURAL MEASURES IMPROVING THE RESILIENCE OF EU CREDIT INSTITUTIONS
We wrote to you on 2 March 2015, holding the document under scrutiny and asking for a response to a number of questions and an update on negotiations, by 26 May 2015. We look forward to receipt of your reply. Your letter states that the ECB Opinion on the proposal (EM 15924/14) is still held under scrutiny. I can confirm that in fact my letter dated 14 January 2015 stated that it was cleared from scrutiny.

EM 10946/14: PROPOSAL FOR A DECISION ON THE EU SOLIDARITY FUND AND EM 10947/14: PROPOSAL FOR A DECISION ON THE MOBILISATION OF THE FLEXIBILITY INSTRUMENT
I can confirm that these documents should be considered as having been cleared by the Sub-Committee, along with all the other documents pertaining to the 2014 and 2015 draft Budgets, as of
my letter to you on the Budget, dated 17 December 2014. We note that the proposals have now been agreed and require no further response.

EM 6442/13: PROPOSAL FOR A DIRECTIVE IMPLEMENTING ENHANCED COOPERATION IN THE AREA OF FINANCIAL TRANSACTION TAX
We wrote to you on 10 March 2015, holding the document under scrutiny and asking for an update on negotiations by 26 May 2015. We look forward to receipt of your reply.

EM 12201/12: PROPOSAL FOR A REGULATION ESTABLISHING A FACILITY FOR PROVIDING FINANCIAL ASSISTANCE FOR MEMBER STATES WHOSE CURRENCY IS NOT THE EURO
We note that there have been no further discussions since December 2013 and that there is currently no indication that negotiations will recommence. Accordingly we will continue to hold the document under scrutiny. We would be grateful to receive a further update as and when negotiations recommence.

EM 5112/15: PROPOSAL FOR A REGULATION ON THE EUROPEAN FUND FOR STRATEGIC INVESTMENTS
We wrote to you on 10 March 2015, asking for a response to a number of questions and an update on negotiations. We look forward to receipt of your reply.

EM 6020/14: PROPOSAL FOR A REGULATION ON REPORTING AND TRANSPARENCY OF SECURITIES FINANCING TRANSACTIONS
We note the possibility of political agreement being reached under the Latvian Presidency. We would be grateful for further updates as negotiations progress.

EM 12407/12: PROPOSAL FOR A DIRECTIVE ON INSURANCE MEDIATION (RECAST)
We note that trilogue discussions have been delayed. We would be grateful for further updates as negotiations progress.

EM 9270/11: PROPOSAL FOR A DIRECTIVE RESTRUCTURING THE COMMUNITY FRAMEWORK FOR THE TAXATION OF ENERGY PRODUCTS AND ELECTRICITY
We note that the Commission has indicated that it intends to withdraw the proposal. What is the rationale for this decision? What is the view of the Government and other Member States of this decision? When do you expect withdrawal to be confirmed? We would be grateful for a letter on EM 9270/11, responding to these points, by 26 May 2015.

EM 9926/12: PROPOSAL TO AMEND THE PRINCIPAL VAT DIRECTIVE TO PROVIDE A UNIFORM TREATMENT OF VOUCHERS ACROSS THE EU
We note that there is a possibility that the file will be put to ECOFIN in the coming months, although this looks doubtful at this stage. We wrote to you on 24 February 2015, holding the document under scrutiny and asking for an update on negotiations by 26 May 2015. We look forward to receipt of your reply.

EM 15337/13: PROPOSAL FOR A DIRECTIVE ON THE COMMON SYSTEM OF VALUE ADDED TAX AS REGARDS A STANDARD VAT RETURN
We have written to you separately on this legislative file.

EM 7263/11: PROPOSAL FOR A COUNCIL DIRECTIVE ON A COMMON CONSOLIDATED CORPORATE TAX BASE
We note your letter, dated 16 March 2015, and will respond shortly.
EM 17637/12 & 17617/12: COMMUNICATION ON AN ACTION PLAN TO STRENGTHEN THE FIGHT AGAINST TAX FRAUD AND TAX EVASION

We note that the UK has said that it will not adopt the Recommendations as they stand. We look forward to considering these issues further when the Commission’s progress report is published in June 2015.

17 March 2015

PARENT SUBSIDY DIRECTIVE (16918/13)

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

I would like to further update your Committee on progress made in the EU negotiations concerning the Council Directive to amend the Parent Subsidiary Directive (PSD), about which I last wrote to you in February.

As you are aware, the main purpose of the PSD is to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes, and to eliminate double taxation of such income at the level of the parent company.

When I last wrote to you in February, I updated you on the progress of discussions and the link with the G20/OECD Base Erosion and Profit Sharing (BEPS) work, following which your Committee cleared the file.

In April, the Greek Presidency split the dossier to focus only on reaching agreement as regards the amendment to Article 4. The House of Commons Committee dropped its reservation on the anti-hybrid file relating to Article 4 of the PSD, which was subsequently agreed at ECOFIN in June. The remaining file aimed to amend Article 1 by introducing a general anti-abuse rule, which would require Member States to withdraw the benefits of PSD in respect of tax arrangements that have been put into place for the essential purpose of obtaining an improper tax advantage. This amendment to Article 1 went out for technical discussion in the Council Working Groups under the Italian Presidency.

Rather than split out the general anti-abuse rule into a new proposal, the Italian Presidency reframed the rule as a minimum standard requirement, which would not prevent Member States from applying domestic or agreement-based anti-abuse measures. While initial assessment had suggested that the proposal was too general, after further analysis we concluded that:

— Risks to tax sovereignty were low
— The measure would only require minimal amendment to UK law with negligible business impact; and
— It supports our overall objectives in relation to preventing corporate tax avoidance, including through the BEPS negotiations.

Following further work, we were successful in securing the incorporation of further amendments proposed by the UK. The Italian Presidency then tabled the anti-abuse compromise proposal for discussion at the November ECOFIN. While Member States expressed broad support, unanimity was not reached. The Dutch abstained citing Parliamentary Scrutiny and outlining substantive concerns with the compromise text. The UK intervened to express general support for principle of the proposal and stated that, following further consideration by national parliaments, we looked forward in the hope that agreement could be reached during the Italian Presidency. At its meeting on 26 November, the House of Commons Committee cleared the remaining PSD file.

Following the November ECOFIN, the dossier was further examined at the meeting of the Council Working Group of 13 November where, in order to address the remaining Dutch concerns, the Presidency proposed the following:

— A modification to recital 8 of the Presidency compromise text to include one example of the application of the “to the extent” approach, which was championed by the UK and introduced an element of proportionality to the
withdrawal of benefits with respect to the extent to which tax arrangements are not genuine; and

That political agreement would be accompanied by two following Council statements:

1. In applying the anti-abuse provision in Directive 2011/96/EU, Member States will endeavour to inform each other, under existing EU legal instruments, when information may be useful to the other Member State.

2. "The Council will take into consideration the anti-abuse provision in Directive 2011/96/EU in its future work on a possible anti-abuse provision to be included in Directive 2003/49/EC."

Delegations agreed to the above proposals and the Netherlands lifted their reservation following the meeting of the Committee of Permanent Representatives of 3 December. At the December ECOFIN, all Member States expressed formal political support for the compromise text, including the amendment to recital 8. In addition to the above Council Statements, the following Commission statement was entered into the meeting minutes:

The Commission confirms that the proposed amendments to Article 1, paragraph 2 of the Parent Subsidiary Directive are not intended to affect national participation exemption systems in so far as these are compatible with the Treaty provisions.

16 January 2015

Letter from the Chairman to David Gauke MP


We are grateful to you for this comprehensive account of the progress of negotiations. We support the formal political support expressed by Member States in December 2014. We acknowledge that the amendment for binding minimum anti-abuse rules in the PSD will enable Member States to better fight aggressive tax planning by groups of companies, ensuring fairer corporate taxation in the EU.

28 January 2015

PROTECTION OF THE EU BUDGET TO END 2013 (13781/14)

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

Thank you for EM 13781/14, dated 15 October 2014, a Report from the Commission on the follow-up to the discharge for the 2012 financial year. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 28 October 2014.

We note the Commission’s assertion that "the figures presented in this Communication demonstrate the positive results of the multi-annual preventive and corrective activities undertaken by both the Commission and Member States. … Moreover, the significance of the amounts reported concerning financial corrections and recoveries should be viewed as an affirmation of the commitment of both parties to ensuring that European taxpayers’ money is being used in accordance with legal requirements.” Do you agree? Is an alternative reading to suggest that the large amounts involve indicate the scale of the problems with illegal and irregular expenditure that exist?

We are disappointed at the lack of detail in the EM about cases pertaining to the UK. You state only that 214 out of 2495 financial corrections related to the UK. Can you be more specific about the reasons for the financial corrections that related to the UK? The Communication states that shared management financial corrections confirmed and implemented in 2013 as compared to payments received from the EU budget was the fourth highest figure in the EU. What is the reason for such a high figure?

We would be grateful for further explanation of a number of assertions in the EM. Can you elaborate on the problems that have been identified in the way in which financial corrections are currently
applied? What steps has the Commission taken to address these? In relation to the conformity procedure, can you explain in more detail your argument that the Commission should apply by the same deadlines for issuing responses as apply to Member States? We welcome your support for close collaboration between Commission and Member States’ paying agencies as well as efforts to simplify complex rules and legislation governing the use of EU budget funds. As we have made clear in previous correspondence, it is imperative that the Commission and Member States work together if the EU budgetary process is to work effectively.

We would be grateful for a response to this letter by 11 November 2014. In the meantime we will continue to hold the document under scrutiny.

28 October 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter of 28 October on the above mentioned EM. The Committee is correct that the figures in the Commission’s document can be interpreted as indicative of the scale of illegal and irregular expenditure. The Government believes that an important step in robustly tackling fraud against the EU budget has to be improved detection and the fraud figures reflect improvements in this area. The true scale of the problem must be exposed if it is to be dealt with appropriately.

The Committee also sought further detail on the 214 financial corrections for the UK referred to in the report. As set out in table 3.1 of the report, the majority of financial corrections in place across the EU continue to concern agriculture and cohesion funds and this is also true for the UK.

Given the ongoing and universal nature of issues concerning the implementation of agriculture and cohesion funds in accordance with existing regulations, the Government continues to work with other Member States to encourage close collaboration with the Commission and press for the simplification of the complex rules and legislation governing expenditure in this area.

In your letter, the Committee requests further detail of the problems with the Commission’s application of financial corrections. The Government remains of the view that financial corrections are an important means of addressing and rectifying errors.

However, the application of such corrective measures should take into consideration and reflect the actual risk to EU budget funds. Errors identified do not always present a risk to EU budget funds and yet can lead to a financial correction. This is because the approach taken does not reflect the true impact of the error and can lead to both the imposition of unnecessarily complex control requirements and unduly high costs of control.

Further, the Commission now has new powers to increase the level of flat-rate financial corrections where it identifies multiple issues. It is important that the Commission applies financial corrections in a proportional manner. The Government will continue to engage with the Commission and work with other Member States in Council to improve proportionality in the application of financial corrections.

The Government supports the principle of completing conformity audit enquiries within two years but notes the challenges that this will present. To achieve this aim, the Commission should adhere to the same deadlines as Member States for issuing responses as this will contribute to reducing the length of the overall process.

18 November 2014

Letter from the Chairman to David Gauke MP to the Chairman

Thank you for your letter, dated 18 November 2014, on a Report from the Commission on the follow-up to the discharge for the 2012 financial year. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 28 October 2014.

The scale of the problems with illegal and irregular expenditure remains a matter of great concern. We pursue the issue of the need for corrective measures to take into account the actual risk to EU budget funds in our continued correspondence on EM 13681/I4: follow-up to discharge of the EU
RESIDENTIAL PROPERTY DIRECTIVE (8680/11, 13450/13)

Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury, to the Chairman

I’m writing to you as I wanted to update you on the Government’s approach to the implementation of the EU Mortgage Credit Directive (MCD), also known as CARRP (Credit Agreements Relating to Residential Property) Directive.

I know your committee showed significant interest in this Directive in the past, and my predecessor last wrote to you in June 2013, following political agreement on the Directive, setting out the final position negotiated on a number of key UK priorities. As you may remember, we were satisfied to have achieved an outcome that meant that the Directive was broadly consistent with existing UK mortgage regulation, and to have negotiated a five year transitional provision for the introduction of the standardised customer disclosure document (the European Standardised Information Sheet or ESIS).

On the inclusion of buy-to-let lending we were pleased to have secured an exemption from the detailed requirements of the Directive. This was agreed in the final stages of trilogue negotiations, and represented a significant negotiating win for the UK.

As HM Treasury officials have worked through the details of implementation of this Directive, it has become apparent that the wording, although it provides the UK much more flexibility than it would have had otherwise, does require Member States availing themselves of this exemption to ensure that an appropriate domestic framework is applied to buy-to-let lending. Regulation will only be required for the minority of buy-to-let lending that is to consumers, given that the Directive does not apply to borrowing for the purposes of someone’s trade, business or profession and one of the key reasons that we have in the past decided not to bring buy-to-let within the scope of FCA regulation is precisely because of the business characteristics of the vast majority of this borrowing. We therefore expect that the regulations would only apply to a small minority of transactions, where the individual is a buy-to-let borrower due to circumstance more than choice and therefore has the characteristics of a consumer rather than a business. This could, for example, include instances where a borrower has previously lived in a property, but is unable to sell it so must resort to letting the property.

This is still a good outcome for the UK and I am confident that the UK will secure an approach that minimises the Directive’s impact on the domestic market, and we are engaging closely with stakeholders in our efforts to achieve this.

Given your committee’s long-standing interest in this Directive, I wanted to write to you to make you aware of how this issue had progressed in advance of the publication of the HM Treasury consultation. This consultation sets out all the proposed legislative changes, and will be published on the HM Treasury website on 5 September.

1 September 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 1 September 2014, on EM 8680/11, the Residential property Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 14 October 2014.

We are concerned at your statement that “as HM Treasury officials have worked through the details of implementation of this Directive, it has become apparent that the wording … does require Member States availing themselves of this [buy-to-let] exemption to ensure that an appropriate domestic framework is applied to buy-to-let lending.” Why were the implications of the final agreement not grasped at the time? Could more have been done to do so?

You state that you are confident that the Directive’s impact on the domestic market will be minimised. However we are concerned that the effect will be greater than you are suggesting. How
many do you anticipate will be affected by a new domestic framework? What special help will HM Treasury be providing to support those affected? What further information can you give us on the HM Treasury consultation? What further steps will follow the close of the consultation period?

You state that you are engaging closely with stakeholders in your efforts to minimise the Directive’s impact on the domestic market. What further details can you give us on such consultation? What is the view of stakeholders on this requirement and the burden it will place on the domestic market? How would you respond to the reported view of the Council of Mortgage Lenders that the proposal “is based not on any evidence of a need for additional consumer protection, but purely on ensuring that the European legal requirements are met”? How would you respond to their concerns that it may be difficult for lenders to distinguish between consumer landlords and those who went into buy-to-let deliberately, and that this uncertainty might discourage lending?

We would be grateful for a response to this letter by 28 October 2014.

15 October 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter, dated 15 October, responding to my previous update on the implementation of the EU Mortgage Credit Directive (MCD), also known as the CARRP (Credit Agreements Relating to Residential Property) Directive.

In your letter you set out a number of concerns the Committee has around the Government’s proposed approach to implementing the Directive’s requirements around buy-to-let mortgage lending.

Your first question is why the full implications of the final agreement were not appreciated at the time the Directive was finalised. As you will recall, the focus at the time of finalising this agreement was to maintain policy support for the broadest possible exemption for buy-to-let lending. As the UK is almost alone in having a developed buy-to-let market, this was a difficult position to defend. The eventual agreement was that member states wishing to utilise the exemption that the UK fought so hard to win, needed to ensure an appropriate framework for buy-to-let lending for consumers. As you would expect, we tested and worked through the wording in detail to determine our full obligations, with legal analysis of the final wording concluding that a small proportion of current buy-to-let lending needs to be brought into regulation in order to meet this requirement. However, I remain confident that given the circumstances, the final wording represents a positive outcome for the UK.

The Treasury is continuing to review the processes it has in place to ensure important details such as this are identified during the negotiating stages of future directives, including recent work I highlighted in my letter to you on 20 October 2014 regarding the Bank Recovery and Resolution Directive.

Your additional comments relate primarily to the impact of HM Treasury’s proposed approach to the implementation of the Directive’s requirements with respect to buy-to-let and our efforts to deal with stakeholder concerns.

As I explained in my previous letter, while the Directive exempts buy-to-let lending from the detailed provisions that will apply to the mainstream mortgage market, it does require us to ensure that an appropriate domestic framework is applied to buy-to-let lending. However, given that the Directive does not apply to borrowing for the purposes of someone’s trade, business, or profession, this framework only needs to apply to buy-to-let mortgage lending to consumers. In most circumstances, buy-to-let borrowers will be using the mortgage to acquire assets for the purposes of running a property letting business. However, we have identified some situations where the borrower does not appear to be acting in a business capacity. Examples of this may be where the property has been inherited or where a borrower has previously lived in the property, but is unable to sell it so resorts to a buy-to-let arrangement. In such cases, the borrower may well be a landlord as a result of circumstance rather than through their own active business decision, and as such looks to be acting as a consumer. However, government’s initial view, informed by discussions with stakeholders, is that such circumstances represent a relatively small proportion of the buy-to-let market.

The proportion of the market that will be subject to these regulations is therefore one factor that Treasury expect will limit the impact of the Directive on buy-to-let mortgage lending. The other factor is the work we are doing to ensure the regime minimises the burdens on lenders while meeting
the UK's legal obligations. This has included working closely with lenders, including through the Council of Mortgage Lenders (CML), to ensure that our rules will make compliance as straightforward as possible.

You ask in your letter for the Government's response to the CML's view that the proposed approach is driven by requirement to comply with the MCD rather than analysis about the need for greater protections. As explained in the government consultation document, published on 5 September, the Government agrees that the case has not been made for the conduct regulation of buy-to-let mortgage lending, which is why we are seeking to do the minimum in order to meet the UK's legal obligations.

The Government is consulting closely with industry and their representatives as the proposals are finalised. Alongside the consultation document itself, this has included a wide range of meetings and a survey of affected firms to find out more about the likely impact.

The consultation closed on October 30 and HM Treasury is now considering what amendments maybe needed to our legislation, taking into account the responses received both formally and informally. A response document will be published in due course, at which I will of course write to update your committee on the implementation process.

6 November 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 6 November 2014, on EM 8680/11, the Residential Property Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 November 2014.

We appreciate that the unique nature of the UK's buy-to-let market placed the UK in a difficult negotiating position. However we regret that your letter has failed to meet our concerns about the potential impact of the requirement for an appropriate domestic framework to be put in place. This is particularly so given that you fail to provide any figures on the numbers who are likely to be affected, not least in those examples of inheritance of a property or an inability to sell, that you identify. What figures can you give us on the numbers that you and the industry estimate will be affected? What further specific details can you give us on the views of such stakeholders as the Council for Mortgage Lenders?

In light of your statement that “the UK is almost alone in having a developed buy-to-let market”, do you know of any other Member State that wishes to utilise the exemption that the UK secured?

We note that HM Treasury is continuing to review the processes it has in place to ensure important details such as this are identified during the negotiating stages of future directives. You highlight recent work in the context of similar issues with the Bank Recovery and Resolution Directive. Does it concern you that there have been such oversights in quick succession in relation to two legislative files of such core importance to the UK and its domestic interests?

We are grateful to you for offering to update the Committee on the implementation process. We would also be grateful for an update when the response document is published.

We also note EM 13450/14 on Commission Delegated Regulation on the Minimum Monetary Amount of the Professional Indemnity Insurance or Comparable Guarantee to be held by Credit Intermediaries. This will increase the level of PI required to be held from the current minimum levels required in the UK. While we note your assessment, based on discussions with the industry and taking into account cost-benefit analyses by the EBA and FCA, that the effect on UK mortgage intermediaries will be negligible, we would be grateful for further clarification. Can you give more details of the consultation you have held with industry groups? Have any of them raised concerns about the change? You state that the EBA chose the second lowest option following engagement from the UK Government. What is the EBA's rationale for recommending a higher level in the first place? Is it, as you suggest, in order to provide a small increase in consumer protection? You also state that the FCA has not put a monetary figure on the expected costs. Has there been any estimation of the costs likely to pertain to the UK?

We would be grateful for a response to this letter by 2 December 2014.

18 November 2014
Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 18 November, setting out your outstanding concerns about the impact of the Mortgage Credit Directive (MCD) on the buy-to-let mortgage market and on the level of professional indemnity insurance (PII) held by UK mortgage credit intermediaries. I am sorry that my previous letter did not address your concerns.

On the impact of the Government's proposed approach to meeting the Directive's requirements for buy-to-let, as explained in my previous letter, you pose a specific question about how many mortgages will be affected. The Treasury has been consulting widely to improve our understanding of the likely impact. This will be reflected in full in the final stage impact assessment, but our current best estimate is that around 10 per cent of buy-to-let transactions could be subject to the new framework.

In terms of the views of stakeholders such as the Council of Mortgage Lenders, their response to the HM Treasury consultation welcomed the Government's efforts to minimise the impact on industry, including limiting the application to those who are consumers. As a result of this, they thought the impact was likely to be minimal overall, although they recognised that there could be a more significant impact at the margins, for example if only a limited number of lenders chose to participate in lending to buy-to-let consumers, and during the period of transition to the new regime.

You also ask whether the Government is aware of any other Member States that would look to use the exemption secured by the UK. I can confirm that we are not aware that any other Member States are seeking to use this exemption, although it should be added that most Member States seem to be less advanced than the UK in working through the details of implementation.

In terms of the handling of negotiations on this and other dossiers, my previous letter refers to the difficulties associated with the fast-paced nature of EU negotiations and the very large volume of technical detail. HM Treasury will, of course, continue to learn lessons and review and improve processes to ensure that the UK is as effective as possible in meeting our objectives in such negotiations. While both the MCD and the Bank Resolution and Recovery Directive (BRRD) include some elements where HM Treasury could have done more to identify issues with specific elements of the text sooner, I think it is worth noting that the wider aims on both dossiers were achieved with outcomes that were positive for the UK.

You also requested further clarification on a number of issues in relation to EM 13450/14. The first was about consultation with industry. The European Banking Authority (EBA) consulted openly on the proposed level of PII cover. The Financial Conduct Authority (FCA) highlighted this consultation to UK industry bodies such as the Association of Mortgage Intermediaries. From discussions with the industry at the time of the EBA consultation, the FCA came to understand that the increase in PII requirements for intermediaries, while unwelcome, was unlikely to prove highly significant.

You also ask about the other options considered by the European Banking Authority (EBA). These are set out in more detail in their consultation on this issue. The different options were based on different potential methodologies for calculating the appropriate levels. The EBA concluded that their preferred methodological approach, to arrive at a level through a detailed analysis of the costs and benefits, was not feasible with the data available. This left 3 potential options, the most expensive of which was to align the levels with those set out for insurance intermediaries in the Insurance Mediation Directive. However, the EBA concluded that this approach was not appropriate as the risks, in terms of the number of compensation claims and the compensatable loss of the types of claim to which the activities could give rise, was lower for mortgage intermediaries than insurance intermediaries.

In terms of assessing the cost of this change to the UK, the change is being made through FCA rules, and so is included in their cost benefit analysis of the changes required to implement to MCD. This gives a high level cost benefit analysis which concludes that they 'do not expect incremental compliance costs to be very large' but that they also 'do not expect significant benefits'. However, this analysis does not include a monetary estimate of the incremental cost of this change. The FCA judged that this would be disproportionate because it would have required extensive data to be gathered from industry about their current levels of PII, imposing costs on industry, and the UK would not be in a position to change its approach in response to this estimate.

I hope that this letter addresses your questions. As I previously explained, I will certainly write again to update you when the Government's response document is published.

2 December 2014
Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 2 December 2014, on EM 8680/11, the Residential Property Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 December 2014.

We are grateful to you for this detailed response to the Committee’s questions. We look forward to a further update when the Government’s response document is published.

9 December 2014

Letter from Andrea Leadsom MP to the Chairman

I am writing to provide a further update to you ahead of the publication of the final draft UK legislation to implement the EU Directive on credit agreements for consumers relating to residential immovable property, more commonly known as the Mortgage Credit Directive (MCD).

We have exchanged a number of letters on this Directive in recent months, so I was keen to make you aware of this publication, which is accompanied by a final stage impact assessment as well as a document summarising responses to the consultation. These documents will all be available on the HM Treasury website when they are published early next week.

The Government’s objective in the implementation of the MCD, as with its negotiation, has been to minimise the impact on the UK market as far as possible. The Government does not believe that the MCD offers many benefits to UK consumers beyond those already provided by the high level of protection offered by the existing Financial Conduct Authority regime for mortgages. However, it does add a number of costs to UK industry. The Government has therefore been determined to avoid gold-plating, whilst also preserving the existing framework for mortgage regulation. The final stage impact assessment, validated by the independent Regulatory Policy Committee, sets out in detail how the Government has sought to achieve this.

Your primary concern in our recent exchanges has been on the impact of the changes on the buy-to-let market. In previous correspondence you asked for our estimate of the proportion of buy-to-let transactions that would be subject to the new framework put in place by this legislation. I explained that we expected this to be around 10 per cent, and this is confirmed in the final stage impact assessment, which uses an estimate of 11 per cent.

Overall, the impact assessment provides a best estimate of the cost of £16.7m over 10 years for the cost of the buy-to-let changes. The Committee may, however, be interested to know that the Government expects this cost to be offset by some deregulatory steps that the Government has identified for intermediary firms broking on buy-to-let mortgages.

I hope this letter is helpful in keeping you and the Committee up to date with the developments around the implementation of this Directive. Of course, the UK does not need to comply with the MCD until 21 March 2016. But by confirming our approach at an early stage, the Government hopes to give industry the clarity it needs to prepare for this change ahead of that deadline.

23 January 2015

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 23 January 2015, on EM 8680/11, the Residential Property Directive. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 3 February 2015.

We are grateful to you for this update. You state that the Government expects the estimated cost of £16.7 million to be offset by some deregulatory steps that you have identified for intermediary firms broking on buy-to-let mortgages. Can you provide more detail on the deregulatory steps that you have in mind, and the timetable for action being taken?

We would be grateful for a response to this letter by 17 February 2015.

3 February 2015
Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter, dated 3 February, responding to my previous update on the implementation of the EU Mortgage Credit Directive (MCD), also known as the Directive on credit agreements relating to residential property (CARRP).

In your letter, you ask for further details on the deregulatory steps the Government has identified for intermediary firms broking on buy-to-let mortgages.

As you know, the implementation of the MCD requires the Government to introduce a framework for the regulation of buy-to-let lending and broking to consumers. The details of this new regulatory regime were initially set out in the consultation document published by the Government on 5 September 2014.

The draft legislation published alongside the consultation document included some provisions on the regulation of buy-to-let broking to consumers. However, the Government acknowledged that the regulatory status of these brokers was not the same as buy-to-let lenders and invited views on how best to accommodate buy-to-let brokers in this regime before the legislation was finalised. This was in recognition of the fact that there are existing regulations which include broking on buy-to-let mortgages within the scope of ‘credit broking’. The Financial Conduct Authority (FCA) has had responsibility for the regulation of ‘credit broking’ since April 2014 as part of their regulatory regime for consumer credit lending.

The impact of the changes required by the MCD would therefore be to create two regimes that apply to buy-to-let brokers. Where their activity is related to buy-to-let lending to consumers, they would need to be subject to the new MCD-compliant requirements. However, where the activity is related to buy-to-let lending to business, their activity would remain within the definition of ‘credit broking’, and therefore subject to any relevant requirements under the FCA’s consumer credit regulatory regime.

In feedback the Government received from respondents to the consultation, respondents made the point that the introduction of a consumer buy-to-let regime on top of the existing consumer credit regime would lead to confusion. The Government considered this case further and concluded that there was a strong case for removing buy-to-let from the definition of ‘credit-broking’.

Making this change will remove the requirement for firms conducting broking on business buy-to-let loans to become authorised by the FCA and comply with the rules applicable to this activity under their consumer credit regulatory regime. This will simplify the regulatory framework and reduce costs to business who will no longer have to pay FCA fees or ensure compliance with the consumer credit regime. Furthermore, there is no evidence that consumers will be negatively affected by this change.

The Government submitted its preliminary evidence to the Regulatory Policy Committee in December 2014, who confirmed that this measure was deregulatory and therefore suitable for fast-track. A validation stage impact assessment containing the final estimate of the benefit of this policy will be submitted to the Regulatory Policy Committee in due course. The Government expects this to confirm the offsetting effect that this policy will have on the overall cost of the changes to the buy-to-let regime being proposed to implement the MCD.

Your letter also requested details on the timetable for action on this proposal. The Government announced its intention to pursue this policy in the consultation response published on 26 January 2015. These can be found at: www.gov.uk/government/consultations/implementation-of-the-eu-mortgage-credit-directive

The policy will be implemented within the same legislation that makes the changes need to meet the MCD, the Mortgage Credit Directive Order 2015, which was laid before Parliament on 26 January 2015 and can be found at: www.legislation.gov.uk/ukdsi/2015/9780111127742/contents

I hope that this letter addresses your questions. If there are any further developments in relation to this Directive, I will of course write to update you further.

11 February 2015
Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury

Thank you for your letter, dated 13 May 2014, on EMs 13426/13, 13449/13 and 6020/14, on Shadow Banking, and for your letter, dated 1 June 2014, on JHA issues pertaining to EM 6020/14. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 10 June 2014.

We are pleased to welcome you to your new post. We are also grateful to you for this comprehensive and thoughtful response to our letter of 1 April 2014. We note in particular your helpful response on defining shadow banking and its benefits and risks. We agree with you that there is an extremely complex web of interconnections between the shadow banking and the regular banking sector. However, given the rapid growth of Shadow Banking, not least in China, we would be grateful for further information on the nature of the global risk arising from its growth in such countries. We concur with your assessment that, while understanding of the sector has increased, more needs to be done. We therefore welcome international regulatory efforts to increase transparency and understanding of the working of the sector.

In that light, we are grateful for your useful explanation of the work of the FSB. We would be grateful for further updates on the FSB’s work as the five workstreams are taken forward. It is particularly important to increase awareness of new risks as they develop, and to ensure that policies are implemented in an internationally consistent manner. On its annual global shadow banking monitoring report, what can be done to ensure that the risks arising from off-shore centres are captured, and that more jurisdictions collect more detailed data so as to allow the FSB’s narrowing down of the data to be effective?

Turning to the Commission’s two legislative proposals, you state that the policy response is at an early stage and it is therefore not possible to provide an assessment of the Commission’s approach at this point. However, we ask you to bear this question in mind in the coming months and to keep us updated as the legislative proposals are taken forward. On the proposal for a regulation on Money Market Funds (EM 13449/13), what is the view of other Member States on the proposal?

On the proposal for a regulation on Securities Financing Transactions (EM 6020/14), you state that other stakeholders, and the European Parliament in particular, “may seek to include additional provisions that detract from those measures agreed at the international level.” Can you be more specific about your concerns? In what particular ways do you anticipate that the European Parliament may seek to amend the proposal? In relation to the delegation of technical provisions to ESMA, you state that the Government will seek “to ensure important matters relevant to the UK interests are properly addressed in the negotiation”. Again, can you be more specific about the UK interests that you are seeking to protect? We also note your assertion that the UK’s JHA opt-in protocol is triggered in relation to this proposal. As you know, the Committee’s consistent position is that the opt-in is engaged only if the proposal cites a Treaty base within Title V TFEU. Given that the deadline to notify the Commission of the UK’s decision was 19 May, we regret that this was not brought to the Committee’s attention until now. Whilst we are grateful for your apology for the delay, we note that this is the second time in a matter of weeks that a JHA opt-in issue has been identified at a late stage. On 31 March 2014, the then Economic Secretary to the Treasury, Nicky Morgan MP, wrote to us in a similar vein in relation to EM 17949/13: Proposal for a Directive on the Union Legal Framework for Customs Infringements and Sanctions. What steps are you taking to improve the Government’s internal processes to ensure that JHA issues are identified and brought to the Committee’s attention at an early stage?

While we note that negotiations on the legislative proposals are at an early stage, we would be grateful for an initial response to these questions by 24 June 2014, followed by further updates as negotiations progress. In the meantime we will continue to hold EMs 13449/13 (Money Market Funds regulation) and 6020/14 (Securities Financing Transactions regulation) under scrutiny.

10 June 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 10 June on shadow banking, and your follow up questions.
I am glad that you found my previous letter helpful and comprehensive, and hope this response addresses your outstanding questions.

THE NATURE OF GLOBAL RISK ARISING FROM THE GROWTH OF SHADOW BANKING

In the Financial Stability Board’s (FSB) shadow banking monitoring report of 2013, ten jurisdictions were identified that experienced growth in their shadow banking sectors of over 10% - China, Argentina, India, South Africa, Russia, Brazil, Mexico, Turkey, Korea and Indonesia. Emerging markets, particularly in Asia, have experienced rapid credit growth and a shift in intermediation frameworks towards a more market based model, marked by an increase in the use of corporate bonds (for example, S&P estimates that China overtook the US in the issuance of non-financial corporate debt in 2013).

China’s shadow banking sector growth is noteworthy, although this growth does come from a low base, banks still dominate lending and, as with many emerging markets, there is a need to deepen financial markets to broaden access to finance. The measurement of the sector in China was made possible by the publication of a new statistical measure by the People’s Bank of China, “Total Social Financing (TSF), in 2011. This is not strictly comparable with the sectoral balance sheet data used by the FSB, but gives a much more accurate picture than was possible previously.

Shadow banking growth in China is driven by demand for loans by local governments and property developers which is met indirectly by investors seeking higher yield products, but there is still a good deal of uncertainty around the risks that this growth could give rise to and the inter-connectedness of the shadow banking and traditional banking systems. At worst, failures in the shadow banking system could have spill-over effects, leading to losses in the traditional banking sector.

Recent stresses have strained parts of China’s shadow banking sector but the authorities are aware of concerns and are taking steps to address the issue, although stress could increase in the interim if growth were to slow more than expected.

At the IMF Spring meetings this year, the annual early warning exercise conducted jointly with the FSB noted the potential risks from the growth in shadow banking, recommending that jurisdictions should improve their data collection so as to capture the size of the sector more effectively and the particular risks being taken. By improving monitoring, authorities will be better able to apply macro and micro prudential tools to address excessive leverage, maturity transformation and imperfect credit-risk transfer; and to improve transparency of more complex transactions such as securitised products and Over-the-Counter derivatives.

CAPTURING RISKS FROM OFF-SHORE CENTRES

You raise the quality of information gathered by the FSB’s annual global shadow banking monitoring report and how it might be improved to capture risks from off-shore centres. As mentioned in my previous response, this information is not perfect and it is improved every year. The FSB actively encourages all jurisdictions to improve the data that they collect so as to make the report more accurate; individual actions are essential for creating a common good.

Recently, the FSB’s Regional Consultative Group for the Americas (comprising FSB members and non-members) produced a report on the shadow banking monitoring exercise which sought to design a monitoring exercise specifically for jurisdictions in the region (but compatible with the global study) which mapped the connections of shadow banking to the rest of the financial sector and the potential risks of these connections. A template was developed to capture offshore shadow banking activities in international financial centres (IFCs) and their relationship with the onshore financial system. This will be assessed by the FSB’s Analytical Group on Vulnerabilities and it is hoped that it will provide a starting point from which the global monitoring exercise can be improved to include IFCs in the future.

CURRENT NEGOTIATIONS ON THE PROPOSED REGULATIONS REGARDING MONEY MARKET FUNDS AND SECURITIES FINANCING TRANSACTIONS

You also asked about other Member States views regarding the proposed Regulation on Money Market Funds. No working level meetings have taken place at EU level, and Member States have not yet publicly shared their views on the proposal. It would not be appropriate to discuss the views shared by other Member States in confidence.
In terms of the direction the securities financing transactions (SFTs) may take, the Government is, as always, vigilant to the risk that the Regulation may be diverted away from its core purpose. In this case, to address the financial stability risks arising from shadow banking. Whilst the Government has no specific concerns at the moment, negotiations are inherently fluid.

The Government believes strongly that the Regulation should maintain its current purpose as an element of the international initiative to improve the supervision and transparency of shadow banking. As I stated in my previous letter on this subject, the Government favours a step-by-step approach which carefully implements internationally consistent supervision measures as they are finalised to minimise the potential for gaps in supervision or regulatory arbitrage.

Moving to the matters the UK will seek to clarify on the face of the Regulation, the Government will be seeking to agree a text which will work as planned and will allow for unintended consequences dependant on subsequent decisions from the European Supervisory Authority (ESA) or the Commission. As much of this proposal is highly technical, there are several areas where a European Supervisory Authority or the Commission will be empowered to act, such as in specifying financial instruments of ‘equivalent economic effect’ to those named in the text, and the data templates to be used by firms to report their SFT data to supervisors. Where an ESA or the Commission are empowered to specify the rules further in secondary legislation such as delegated acts, or technical standards, the Government will work to ensure sufficient controls are in place to ensure they do not diverge from the agreed purpose of the legislation.

I will keep your Committee and the House of Commons European Scrutiny Committee informed as negotiations progress on both dossiers.

**Improving the Government’s Internal Processes for Handling JHA Issues**

The Government takes very seriously the concerns you express in your letters on Shadow Banking, on Bank Structural Reform, and most recently to my colleague, the Commercial Secretary to the Treasury Lord Deighton, on Anti-Money Laundering. This Government is focused on ensuring we meet our scrutiny commitments to Parliament.

To ensure the opt-in is identified at an early stage, the Home Office and Ministry of Justice have recently reissued guidance across Whitehall on the opt-in protocol. In addition, specific training on the application of the opt-in, especially in relation to identifying JHA content and understanding the process for asserting the opt-in is being provided to Departments.

24 June 2014

**Letter from the Chairman to Andrea Leadsom MP**

Thank you for your letter dated 24 June 2014 on EMs 13426/13, 13449/13 and 6020/14, on Shadow Banking. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 8 July 2014.

You provide helpful and insightful information on the growing risks of shadow banking in emerging markets and in response to our concerns on risks from off-shore centres. It is reassuring that you continue to devote sufficient resources into developing the Money Market Funds and Securities Financing Transaction Regulations by placing due importance on international initiatives designed to improve the supervision and transparency of shadow banking. We are well aware of the difficulties in collecting data on shadow banking activities. We would be grateful if you could keep us informed on the current status of data collection provisions, since this has been a challenging task for many financial centres, and one still being considered by the FSB.

As part of your general approach to negotiations, we recommended that agreement of the text should allow the ESAs to supervise the activities of Shadow Banks with sufficient flexibility, providing them with the ability to shift targets as the financial system changes. Similarly, while institutions such as the Bank of England have demonstrated a flexible approach to non-financial institutions, providing liquidity backstops to broker dealers and central counterparties in an effort to prevent instability if the financial markets seize up, perhaps comparable efforts could be taken forward by the European Central Bank to ease similar pressure should it build. In this context we note media reports of a leaked draft European Commission report on the European System of Financial Supervision that examines the merit of extending the reach and power of the ESAs to encompass these new areas.
Can you shed any light on this matter, and on when the Commission’s report, initially expected to be brought forward at the end of 2013, can be expected to be published?

In answer to our query about the views of other Member States regarding the proposed Money Market Funds regulation, you state that "it would not be appropriate to discuss the views shared by other Member States in confidence." While we appreciate that the negotiating positions of other Member States remain confidential, our desire is simply to gain a broader understanding of the debate in hand. We would be concerned if you were to rely on the principle of confidentiality to refuse to inform us of the different views within the Council on a proposal. We do not accept that this automatically means that we cannot be informed about the views of other Member States. This can be done in general terms; it does not require disclosure of details which would compromise a Member State’s negotiating position or undermine the decision-making process of the Council. If the Government now refuses to do so, it will severely restrict our ability to scrutinise these policies effectively. So, while bearing in mind that negotiations are at an early stage, we ask you again to provide us with an outline of the different views in the Council on the proposed Money Market Funds Regulation.

We welcome the fact that the belated recognition and enactment of JHA issues has resulted in training course being taken forward.

We would be grateful for a response to these questions by 23 July 2014, and thereafter to be kept updated on EMs 13449/13 and 6020/14 as negotiations progress. In the meantime we will hold both documents under scrutiny.

9 July 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 9 July on shadow banking, and your follow up questions.

Since I last wrote to you, working level Council discussions on the Securities Financing Transactions Regulation have continued. The Government has continued to press for the regulation to be technically rigorous and consistent with the FSB recommendations in this area. This has been undertaken in co-operation with the UK financial services regulators and in consultation with Industry.

You also asked the Government to shed light on media reports of a leaked draft and when the Commission will publish its proposal for a European System of Financial Supervision. We are aware that a draft of the report was leaked, however it is our understanding that this is unlikely to be the finalised version. A proposal is expected to be published in the coming weeks, more specifically between the end of July and the beginning of September.

As regards whether the European Supervisory Authorities (ESAs) should play a role in the supervision of shadow banks, there are a range of challenging issues that will need to be considered. This ranges from the definition of shadow banks, the expertise required to undertake such supervision to whether national or regional supervisors are better placed to supervise and monitor risks, as well as the need to balance the existing responsibilities of the ESAs with new duties.

In that regard, we are conscious that the ESAs have yet to fulfil their existing mandate.

The ESAs have focused on rule-making in recent years, given the high volume of legislation since the crisis, and we are keen to see the ESAs strengthen their focus on raising standards of supervision across the EU and identifying and mitigating risks through greater analysis of financial markets – two other key aspects of their mandate. These issues will be considered further in light of the forthcoming report from the Commission on the review of the European System of Financial Supervision (ESFS).

You also asked about other views in Council on the proposed Regulation on Money Market Funds. While it would clearly be inappropriate to comment on positions, following an early working group on 3 July, we are in a position to provide more information on the views that have emerged. A number of Member States were supportive of our position, with some raising concerns that it may not be possible to avoid causing serious disruption to short term financing of the real economy if the Union moves from the existing framework which allows both Constant Net Asset Value (CNAV) and Variable Net Asset Value (VNAV) funds, to either requiring a capital buffer or prohibiting CNAVs outright.
Some expressed concerns about CNAV funds, with calls for them to be banned. The important role played by money market funds gives rise to prudential concerns that under stressed market conditions they could pose a source of systemic risk. Some concerned about CNAVs suggested they might tolerate them marketing to investors in their country from other jurisdictions, but they were not happy that the Regulation would require them to lift national prohibitions on the establishment of CNAV funds within their territory.

Overall, there does not appear to be any open support for the capital buffer at this early stage, but this working group was only an initial discussion and therefore many of the views expressed are very preliminary.

24 July 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 24 July 2014 on EMs 13426/13, 13449/13 and 6020/14, on Shadow Banking. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 29 July 2014.

We are grateful to you for the update on the exchange of views at Council working group on 3 July. We note that there was some level of support for the UK’s concerns that the proposals may have damaging consequences for short term money markets and thus the real economy. While there is limited support for a capital buffer, we would benefit from being updated on whether other mechanisms are currently being proposed by way of capital or liquidity management in the future.

The details concerning the marketing of CNAVs in Member States and the requirement for national prohibitions to be lifted is one that we note for future consideration as this Regulation is discussed. We would thus be grateful for further updates as and when progress is being made.

In the meantime we continue to hold EM 13449/13 and 6020/14 under scrutiny.

29 July 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your EM 11921/14, dated 29 August 2014, on the ECB’s opinion on the European Commission’s proposal for a Regulation on reporting and transparency of securities financing transactions (SFTs). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 14 October 2014.

We agree with the main issues that the ECB see as particularly important in the development of this regulation. We also support the suggestions made by the ECB that the framework of the regulation should be able to adapt to key developments and recommendations from the FSB data experts group as they arise.

You are right to point to the fact that the ECB have expert knowledge and advice, and we agree with you in showing support for the ECB’s expertise in contributing to technical standards by ESMA. We would be interested to know the process and means through which the ECB would formally be able to help in preparing technical standards entrusted to ESMA.

We note that you do not respond to the potential policy implications of the ECB’s suggestion that the Commission propose extending the scope and requirements of the measures within the regulation, such as introducing limits on the re-hypothecation of client assets for the purpose of financing the intermediary’s own-account activities; and the entities allowed to engage in the re-hypothecation of client assets. Would you support including such limits in the regulation to enhance financial stability? Are these measures that the FSB are already looking at introducing, and would they gain support from other Member States? Furthermore, is there a danger that introducing limits could lead to an increase in financing costs?

We support strongly the ECB’s suggestion that terminology in the regulation be aligned with the FSB recommendations, and provide legal certainty to market participants. The ECB also makes a sensible suggestion concerning drafting clarity with reference to ‘title transfer financial collateral arrangement’ and ‘security financial collateral arrangement’. Will you support these drafting suggestions?

Finally, we ask you to reflect on the practical issues surrounding trade repositories taking into account the lessons learnt in the implementation of EMIR. There have been some suggestions that double
sided reporting has proved troublesome in practice whereby the Unique Trade Identifier (UTI), which is produced by a counterparty, is not being matched at the Trade Repository with the UTI of the counterparty which was traded with. As a result, barely any over-the-counter (OTC) derivatives and exchange traded derivatives that are being reported to trade repositories have been paired. This has hindered the ability of regulators to assess systemic risks effectively. Is the Government aware of these blockages from conversations with the FCA? Is there likely to be any discussion on lessons learnt from EMIR in the current negotiations on the regulation on SFT reporting and transparency?

We would be grateful for a response to this letter by 28 October 2014. In the meantime we clear EM11921/14 from scrutiny, while we continue to hold EM 6020/14 under scrutiny.

15 October 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 2 November 2014 on the Commission’s proposal for a Regulation on reporting and transparency of securities financing transactions (SFTs). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 4 November 2014.

Given the technical nature of the file, we welcome the Council taking into consideration drafting suggestions by the FSB, National Supervisory Agencies, and the ECB. On sight of the latest Council text, we agree that the Council has tried in various Articles to introduce consistency with existing reporting regulations already in force. We welcome the efforts introduced which allow ESMA to respond flexibly to revised standards at the international level, as well as measures that allow the Commission, assisted by ESMA, to introduce mechanisms to avoid duplicative or conflicting transparency and reporting rules. We welcome for example the re-drafting of ‘re-hypothecation’ to ‘reuse’, which ensures legal certainty of the financial transaction.

Thank you for notifying to us that Renato Soru, an Italian S&D MEP, has been appointed rapporteur for this dossier. We will be following the developments closely in the European Parliament. We would appreciate any update you may be able to provide if there are significant changes to the text, particularly should there be further discussions on additional restrictions on SFTs.

In light of the forthcoming vote in Council, we clear 6020/14 under scrutiny.

We would be grateful for a response to these questions, as well as an update on the Italian Presidency’s attempt to reach a General Approach, by 18 November 2014.

4 November 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter dated 4 November 2014 regarding the Securities Financing Transaction Regulation and your decision to clear the proposal from scrutiny.

I am pleased to report that the Italian Presidency was able to secure a unanimous General Approach on the Securities Financing Transaction Regulation (SFTR). This agreed Council position met the UK’s negotiating objectives as outlined in my previous update.

The agreed text is consistent with the Financial Stability Board (FSB) Recommendations published 29 August 2013, showing a high degree of alignment with FSB principles. As such, the text is both proportionate and workable, and provides clarity as to the types of securities financing transactions within scope of the Regulation. In this regard, the re-drafting of ‘re-hypothecation’ to ‘re-use’ is helpful and has improved legal certainty.

During negotiations, we have ensured that overlaps with existing provisions, such as the European Market Infrastructure Regulation (EMIR), have been taken into account as far as possible. Due to the highly technical and complex nature of some of the provisions, this has in part been achieved by providing scope in certain limited cases for the European Securities and Markets Authority (ESMA) to develop relevant technical standards.

More broadly, the text that has been agreed meets the Government’s objective of increasing transparency within the shadow banking sector, without unduly restricting the use of such transactions. As requested, a further update on the file shall be provided as deliberations within the
European Parliament develop, especially in the event that there is discussion of potential further restrictions on security financing transactions.

28 November 2014

**Letter from the Chairman to Andrea Leadsom MP**

Thank you for your letter, dated 28 November 2014, on EM 6020/14: the Commission’s proposal for a Regulation on reporting and transparency of securities financing transactions (SFTs). The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 16 December 2014.

We take note of the General Approach reached by Council on 14 November 2014. We welcome the text provides alignment with FSB recommendations, creates consistency between EMIR, gives further legal clarity on SFTs and provides scope for ESMA to draft technical standards. Portugal has expressed regret that the General Approach did not go further with respect to competent authorities’ access to data from trade repositories. Can you explain whether this is an issue specific to Portugal, or whether this reflects constraints on other National Competent Authorities for example in the UK?

We would also welcome any further updates as negotiations continue with the European Parliament.

We would be grateful for a response to this letter by 30 January 2015.

17 December 2014

**Letter from Andrea Leadsom MP to the Chairman**

Thank you for your letter of 17 December on the Securities Financing Transactions Regulation (SFTR).

The UK is not affected by the issue Portugal raised in their ‘Declaration for the minutes’ accompanying the General Approach on SFTR. Portugal’s concern lies with references to the European Markets Infrastructure Regulation (EMIR), not with SFTR itself, as under Article 81(3) of EMIR, insurance supervisors are not specifically listed as authorities who are able to access trade repositories data. The Portuguese independent insurance authority oversees compliance around reporting to trade repositories, and as a result their government believes that the relevant authority may not have access to full data.

The Government believes that SFTR as constructed actually improves competent authorities’ access to data from EMIR. Competent authorities identified under SFTR, including the Financial Conduct Authority and the Prudential Regulation Authority (which regulates insurance companies in the UK), will gain access to all trade repositories data, allowing them to view a holistic picture and better discharge their obligations, whereas currently they are only guaranteed access to data specific to their role.

Discussions in the European Parliament are ongoing. The European Parliament Committee began their consideration of the file after the General Approach had been agreed, so we do not expect trilogues to start until late April at the earliest. We will update you as these discussions develop.

31 January 2015

**SHADOW BANKING (13426/13)**

**Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury**

Thank you for your letter, dated 13 May 2014, on EMs 13426/13, 13449/13 and 6020/14, on Shadow Banking, and for your letter, dated 1 June 2014, on JHA issues pertaining to EM 6020/14. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 10 June 2014.

We are pleased to welcome you to your new post. We are also grateful to you for this comprehensive and thoughtful response to our letter of 1 April 2014. We note in particular your helpful response on defining shadow banking and its benefits and risks. We agree with you that there
is an extremely complex web of interconnections between the shadow banking and the regular banking sector. However, given the rapid growth of Shadow Banking, not least in China, we would be grateful for further information on the nature of the global risk arising from its growth in such countries. We concur with your assessment that, while understanding of the sector has increased, more needs to be done. We therefore welcome international regulatory efforts to increase transparency and understanding of the working of the sector.

In that light, we are grateful for your useful explanation of the work of the FSB. We would be grateful for further updates on the FSB’s work as the five workstreams are taken forward. It is particularly important to increase awareness of new risks as they develop, and to ensure that policies are implemented in an internationally consistent manner. On its annual global shadow banking monitoring report, what can be done to ensure that the risks arising from off-shore centres are captured, and that more jurisdictions collect more detailed data so as to allow the FSB’s narrowing down of the data to be effective?

Turning to the Commission’s two legislative proposals, you state that the policy response is at an early stage and it is therefore not possible to provide an assessment of the Commission’s approach at this point. However, we ask you to bear this question in mind in the coming months and to keep us updated as the legislative proposals are taken forward. On the proposal for a regulation on Money Market Funds (EM 13449/13), what is the view of other Member States on the proposal?

On the proposal for a regulation on Securities Financing Transactions (EM 6020/14), you state that other stakeholders, and the European Parliament in particular, “may seek to include additional provisions that detract from those measures agreed at the international level.” Can you be more specific about your concerns? In what particular ways do you anticipate that the European Parliament may seek to amend the proposal? In relation to the delegation of technical provisions to ESMA, you state that the Government will seek “to ensure important matters relevant to the UK interests are properly addressed in the negotiation”. Again, can you be more specific about the UK interests that you are seeking to protect? We also note your assertion that the UK’s JHA opt-in protocol is triggered in relation to this proposal. As you know, the Committee’s consistent position is that the opt-in is engaged only if the proposal cites a Treaty base within Title V TFEU. Given that the deadline to notify the Commission of the UK’s decision was 19 May, we regret that this was not brought to the Committee’s attention until now. Whilst we are grateful for your apology for the delay, we note that this is the second time in a matter of weeks that a JHA opt-in issue has been identified at a late stage. On 31 March 2014, the then Economic Secretary to the Treasury, Nicky Morgan MP, wrote to us in a similar vein in relation to EM 17949/13: Proposal for a Directive on the Union Legal Framework for Customs Infringements and Sanctions. What steps are you taking to improve the Government’s internal processes to ensure that JHA issues are identified and brought to the Committee’s attention at an early stage?

While we note that negotiations on the legislative proposals are at an early stage, we would be grateful for an initial response to these questions by 24 June 2014, followed by further updates as negotiations progress. In the meantime we will continue to hold EMs 13449/13 (Money Market Funds regulation) and 6020/14 (Securities Financing Transactions regulation) under scrutiny.

10 June 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 10 June on shadow banking, and your follow up questions.

I am glad that you found my previous letter helpful and comprehensive, and hope this response addresses your outstanding questions.

THE NATURE OF GLOBAL RISK ARISING FROM THE GROWTH OF SHADOW BANKING

In the Financial Stability Board’s (FSB) shadow banking monitoring report of 2013, ten jurisdictions were identified that experienced growth in their shadow banking sectors of over 10% - China, Argentina, India, South Africa, Russia, Brazil, Mexico, Turkey, Korea and Indonesia. Emerging markets, particularly in Asia, have experienced rapid credit growth and a shift in intermediation frameworks towards a more market based model, marked by an increase in the use of corporate bonds (for example, S&P estimates that China overtook the US in the issuance of non-financial corporate debt in 2013).
China’s shadow banking sector growth is noteworthy, although this growth does come from a low base, banks still dominate lending and, as with many emerging markets, there is a need to deepen financial markets to broaden access to finance. The measurement of the sector in China was made possible by the publication of a new statistical measure by the People's Bank of China, "Total Social Financing (TSF)," in 2011. This is not strictly comparable with the sectoral balance sheet data used by the FSB, but gives a much more accurate picture than was possible previously.

Shadow banking growth in China is driven by demand for loans by local governments and property developers which is met indirectly by investors seeking higher yield products, but there is still a good deal of uncertainty around the risks that this growth could give rise to and the inter-connectedness of the shadow banking and traditional banking systems. At worst, failures in the shadow banking system could have spillover effects, leading to losses in the traditional banking sector.

Recent stresses have strained parts of China’s shadow banking sector but the authorities are aware of concerns and are taking steps to address the issue, although stress could increase in the interim if growth were to slow more than expected.

At the IMF Spring meetings this year, the annual early warning exercise conducted jointly with the FSB noted the potential risks from the growth in shadow banking, recommending that jurisdictions should improve their data collection so as to capture the size of the sector more effectively and the particular risks being taken. By improving monitoring, authorities will be better able to apply macro and micro prudential tools to address excessive leverage, maturity transformation and imperfect credit-risk transfer; and to improve transparency of more complex transactions such as securitised products and Over-the-Counter derivatives.

CAPTURING RISKS FROM OFF-SHORE CENTRES

You raise the quality of information gathered by the FSB’s annual global shadow banking monitoring report and how it might be improved to capture risks from off-shore centres. As mentioned in my previous response, this information is not perfect and it is improved every year. The FSB actively encourages all jurisdictions to improve the data that they collect so as to make the report more accurate; individual actions are essential for creating a common good.

Recently, the FSB’s Regional Consultative Group for the Americas (comprising FSB members and non-members) produced a report on the shadow banking monitoring exercise which sought to design a monitoring exercise specifically for jurisdictions in the region (but compatible with the global study) which mapped the connections of shadow banking to the rest of the financial sector and the potential risks of these connections. A template was developed to capture offshore shadow banking activities in international financial centres (IFCs) and their relationship with the onshore financial system. This will be assessed by the FSB’s Analytical Group on Vulnerabilities and it is hoped that it will provide a starting point from which the global monitoring exercise can be improved to include IFCs in the future.

CURRENT NEGOTIATIONS ON THE PROPOSED REGULATIONS REGARDING MONEY MARKET FUNDS AND SECURITIES FINANCING TRANSACTIONS

You also asked about other Member States views regarding the proposed Regulation on Money Market Funds. No working level meetings have taken place at EU level, and Member States have not yet publicly shared their views on the proposal. It would not be appropriate to discuss the views shared by other Member States in confidence.

In terms of the direction the securities financing transactions (SFTs) may take, the Government is, as always, vigilant to the risk that the Regulation may be diverted away from its core purpose. In this case, to address the financial stability risks arising from shadow banking. Whilst the Government has no specific concerns at the moment, negotiations are inherently fluid.

The Government believes strongly that the Regulation should maintain its current purpose as an element of the international initiative to improve the supervision and transparency of shadow banking. As I stated in my previous letter on this subject, the Government favours a step-by-step approach which carefully implements internationally consistent supervision measures as they are finalised to minimise the potential for gaps in supervision or regulatory arbitrage.

Moving to the matters the UK will seek to clarify on the face of the Regulation, the Government will be seeking to agree a text which will work as planned and will allow for unintended consequences.
dependant on subsequent decisions from the European Supervisory Authority (ESA) or the Commission. As much of this proposal is highly technical, there are several areas where a European Supervisory Authority or the Commission will be empowered to act, such as in specifying financial instruments of ‘equivalent economic effect’ to those named in the text, and the data templates to be used by firms to report their SFT data to supervisors. Where an ESA or the Commission are empowered to specify the rules further in secondary legislation such as delegated acts, or technical standards, the Government will work to ensure sufficient controls are in place to ensure they do not diverge from the agreed purpose of the legislation.

I will keep your Committee and the House of Commons European Scrutiny Committee informed as negotiations progress on both dossiers.

IMPROVING THE GOVERNMENT’S INTERNAL PROCESSES FOR HANDLING JHA ISSUES

The Government takes very seriously the concerns you express in your letters on Shadow Banking, on Bank Structural Reform, and most recently to my colleague, the Commercial Secretary to the Treasury Lord Deighton, on Anti-Money Laundering. This Government is focused on ensuring we meet our scrutiny commitments to Parliament.

To ensure the opt-in is identified at an early stage, the Home Office and Ministry of Justice have recently reissued guidance across Whitehall on the opt-in protocol. In addition, specific training on the application of the opt-in, especially in relation to identifying JHA content and understanding the process for asserting the opt-in is being provided to Departments.

24 June 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 24 June 2014 on EMs 13426/13, 13449/13 and 6020/14, on Shadow Banking. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 8 July 2014.

You provide helpful and insightful information on the growing risks of shadow banking in emerging markets and in response to our concerns on risks from off-shore centres. It is reassuring that you continue to devote sufficient resources into developing the Money Market Funds and Securities Financing Transaction Regulations by placing due importance on international initiatives designed to improve the supervision and transparency of shadow banking. We are well aware of the difficulties in collecting data on shadow banking activities. We would be grateful if you could keep us informed on the current status of data collection provisions, since this has been a challenging task for many financial centres, and one still being considered by the FSB.

As part of your general approach to negotiations, we recommended that agreement of the text should allow the ESAs to supervise the activities of Shadow Banks with sufficient flexibility, providing them with the ability to shift targets as the financial system changes. Similarly, while institutions such as the Bank of England have demonstrated a flexible approach to non-financial institutions, providing liquidity backstops to broker dealers and central counterparties in an effort to prevent instability if the financial markets seize up, perhaps comparable efforts could be taken forward by the European Central Bank to ease similar pressure should it build. In this context we note media reports of a leaked draft European Commission report on the European System of Financial Supervision that examines the merit of extending the reach and power of the ESAs to encompass these new areas. Can you shed any light on this matter, and on when the Commission’s report, initially expected to be brought forward at the end of 2013, can be expected to be published?

In answer to our query about the views of other Member States regarding the proposed Money Market Funds regulation, you state that “it would not be appropriate to discuss the views shared by other Member States in confidence.” While we appreciate that the negotiating positions of other Member States remain confidential, our desire is simply to gain a broader understanding of the debate in hand. We would be concerned if you were to rely on the principle of confidentiality to refuse to inform us of the different views within the Council on a proposal. We do not accept that this automatically means that we cannot be informed about the views of other Member States. This can be done in general terms; it does not require disclosure of details which would compromise a Member State’s negotiating position or undermine the decision-making process of the Council. If the Government now refuses to do so, it will severely restrict our ability to scrutinise these policies
effectively. So, while bearing in mind that negotiations are at an early stage, we ask you again to provide us with an outline of the different views in the Council on the proposed Money Market Funds Regulation.

We welcome the fact that the belated recognition and enactment of JHA issues has resulted in training course being taken forward.

We would be grateful for a response to these questions by 23 July 2014, and thereafter to be kept updated on EMs 13449/13 and 6020/14 as negotiations progress. In the meantime we will hold both documents under scrutiny.

9 July 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 9 July on shadow banking, and your follow up questions.

Since I last wrote to you, working level Council discussions on the Securities Financing Transactions Regulation have continued. The Government has continued to press for the regulation to be technically rigorous and consistent with the FSB recommendations in this area. This has been undertaken in co-operation with the UK financial services regulators and in consultation with Industry.

You also asked the Government to shed light on media reports of a leaked draft and when the Commission will publish its proposal for a European System of Financial Supervision. We are aware that a draft of the report was leaked, however it is our understanding that this is unlikely to be the finalised version. A proposal is expected to be published in the coming weeks, more specifically between the end of July and the beginning of September.

As regards whether the European Supervisory Authorities (ESAs) should play a role in the supervision of shadow banks, there are a range of challenging issues that will need to be considered. This ranges from the definition of shadow banks, the expertise required to undertake such supervision to whether national or regional supervisors are better placed to supervise and monitor risks, as well as the need to balance the existing responsibilities of the ESAs with new duties.

In that regard, we are conscious that the ESAs have yet to fulfil their existing mandate.

The ESAs have focused on rule-making in recent years, given the high volume of legislation since the crisis, and we are keen to see the ESAs strengthen their focus on raising standards of supervision across the EU and identifying and mitigating risks through greater analysis of financial markets – two other key aspects of their mandate. These issues will be considered further in light of the forthcoming report from the Commission on the review of the European System of Financial Supervision (ESFS).

You also asked about other views in Council on the proposed Regulation on Money Market Funds. While it would clearly be inappropriate to comment on positions, following an early working group on 3 July, we are in a position to provide more information on the views that have emerged. A number of Member States were supportive of our position, with some raising concerns that it may not be possible to avoid causing serious disruption to short term financing of the real economy if the Union moves from the existing framework which allows both Constant Net Asset Value (CNAV) and Variable Net Asset Value (VNAV) funds, to either requiring a capital buffer or prohibiting CNAVs outright.

Some expressed concerns about CNAV funds, with calls for them to be banned. The important role played by money market funds gives rise to prudential concerns that under stressed market conditions they could pose a source of systemic risk. Some concerned about CNAVs suggested they might tolerate them marketing to investors in their country from other jurisdictions, but they were not happy that the Regulation would require them to lift national prohibitions on the establishment of CNAV funds within their territory.

Overall, there does not appear to be any open support for the capital buffer at this early stage, but this working group was only an initial discussion and therefore many of the views expressed are very preliminary.

24 July 2014
Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter dated 24 July 2014 on EMs 13426/13, 13449/13 and 6020/14, on Shadow Banking. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 29 July 2014.

We are grateful to you for the update on the exchange of views at Council working group on 3 July. We note that there was some level of support for the UK’s concerns that the proposals may have damaging consequences for short term money markets and thus the real economy. While there is limited support for a capital buffer, we would benefit from being updated on whether other mechanisms are currently being proposed by way of capital or liquidity management in the future.

The details concerning the marketing of CNAVs in Member States and the requirement for national prohibitions to be lifted is one that we note for future consideration as this Regulation is discussed. We would thus be grateful for further updates as and when progress is being made.

In the meantime we continue to hold EM 13449/13 and 6020/14 under scrutiny.

29 July 2014

SMALLER CREDIT RATING AGENCIES (9586/14)

Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury

Thank you for EM 9586/14, dated 3 June 2014, a Report on the Feasibility of a network of smaller Credit Rating Agencies. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 June 2014.

We welcome this Report and agree that it comes to sensible conclusions, namely to encourage regulatory dialogue with stakeholders and conduct an impact assessment once the full effects of CRA3 has been digested by smaller CRAs. We acknowledge the previous and current market obstacles that have inhibited smaller CRAs from gaining market share and also prevent them from seeing the benefit in forming a network of CRAs.

We are nonetheless concerned that cross-border access for smaller EU CRAs has not been sufficiently addressed. We would welcome your views on whether these barriers are likely to be reduced by ESMA’s engagement with non-EU competent authorities, and whether more measures should be taken.

International efforts have concentrated on measures to reduce references to external ratings in legislation while at the same time ensuring investors carry out their own additional due diligence on a well-informed basis. In light of this, it would be helpful to understand your views on whether a balance can be achieved in stimulating competition with smaller and larger CRAs without relying on the ‘issuer-pays’ model for profitability. Furthermore it is a concern that the size of the three larger and dominant CRAs continues to inhibit the market from becoming truly competitive. It is clear that the incentives of smaller CRAs need to be aligned with the larger CRAs so that they are encouraged to exist and gain more market share without relying on the ‘issuer-pays’ remuneration model. In seeking to shape the conflict of interest debate, we therefore encourage the Government to assess the issues closely connected to smaller CRAs within the European Commission’s reassessment by 2016 of the risks of conflicts of interest due to the ‘issuer pays’ remuneration model.

We would be grateful for a response to this letter by 18 July 2014, as well as updates as and when there are any further developments in this field. In the meantime we are content to clear the document from scrutiny.

18 June 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 18 June 2014 on the report on the feasibility of a network of smaller Credit Rating Agencies (CRA), following our Explanatory Memorandum of 3 June 2014.

With regards to barriers for small EU CRAs, the pan-European rules agreed for the credit ratings market have substantively improved their ability to operate and compete in a much larger market. All
CRAs that operate within the EU are required to register with the European Securities and Markets Authority (ESMA). The registration process is also duly robust, to ensure that end investors are protected.

Cross-border, I would also refer you to the EU’s equivalence and endorsement processes. Once a third-country’s CRA framework has been deemed equivalent to the EU by the European Commission, EU financial institutions can, subject to various conditions, rely upon credit ratings issued by CRAs in that jurisdiction. The process should also facilitate non-EU financial institutions’ use of credit ratings issued by EU CRAs. To date, the European Commission has completed equivalence assessments for nine jurisdictions.

Increasing competition in the credit ratings market has been a key element of the approach taken by the EU. The most recent CRA Regulations (CRA3) include the requirement that where an issuer, or a related third party, intends to appoint at least two CRAs for the credit rating of the same issuance or entity, the issuer or a related third party, shall consider appointing at least one CRA with a market share of no greater than 10 per cent (depending upon availability and relevance). If at least one small CRA is not appointed, the issuer must document that fact. The CRA3 Regulation has also introduced rules on re-securitisation that require CRAs to rotate. This should facilitate new entrants to the market and offer existing CRAs the opportunity to extend their business into new areas.

In addition, we note that CRA3 requires the public disclosure of information on structured finance instruments. Doing so is likely to reinforce the competition between CRAs in an important market sub-sector, because it could lead to an increase in the number of unsolicited credit ratings, especially from those smaller CRAs not reliant on the ‘issuer pays’ model which previously were not privy to receipt of the information necessary to generate credit ratings. This is welcome in helping to create a level playing field.

15 July 2014

Letter from the Chairman to Andrea Leadsom MP


We acknowledge the responses you give in relation to the Committee’s query on stimulating competition more generally for smaller CRAs, while reducing reliance on the ‘issuer pays’ model. We recognise that a number of the requirements laid out in CRA3 will need time to take effect and thus it is too early to advocate specific policy action. The Committee will in future assess the European Commission’s reassessment by 2016 of the risks of conflicts of interest due to the ‘issuer pays’ remuneration model.

Given the report’s recommendation not to establish a network of smaller CRAs but rather to continue with informal stakeholder conversation, we would be interested to receive information on relevant developments that would be a useful indicator to how the current CRA3 regulation is being implemented.

29 July 2014

SOLVENCY II: DELEGATED REGULATION (14263/14)

Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury


We note that the Solvency II file has undergone a long legislative journey in the EU and has led to some difficult compromises for particular Member States over the years. While we are confident that the Directive will deepen the single market in Insurance and increase the level of policy holder
protection across the EU we have some reservations on the fragmentation at the retail end of the market. In a speech on 18 November 2014, Commissioner Hill referred to the different levels of pricing and services levels across Member States, for example when buying car or travel insurance. Will Solvency II, which is intended to deepen the Single Market, address and indeed close the pricing gap seen between Member States? Which pricing anomalies continue to exist in the wholesale market?

We agree and believe that the Government should stick by its commitment to review by December 2018 the capital requirements including methods, assumptions and parameters used by insurers. Furthermore we favour methods to incorporate new developments in standards on securitisation from both BCBS and IOSCO into this Directive, which will be key to ensuring harmonisation and international consistency of measures designed to advance the securitisation market. We will continue to follow industry developments in the insurance market in light of the new Directive which also seeks to develop long-term investment finance in the EU.

We are pleased to note that the Government has taken a very active role in the development of this Directive. This is a good example of what HM Treasury should be doing across all legislative files. We are pleased to note efforts to share the UK’s expertise through participation in expert working groups, and trust that this demonstrates the Government’s commitment to deepening the single market in the insurance sector. Can you furthermore expand on how Solvency II will deepen the Single Market in insurance? It is indeed favourable for the UK market that the Directive adopts the UK model of risk-based, market consistent regulation. Whilst it is encouraging that this file and the technical standards alongside, nears completion, do you believe that the right level of proportionality for small insurers has been adequately incorporated into the Directive? It has been mentioned that costs will fall to insurers in the form of regulatory and reporting. Will small insurers be disproportionately and adversely affected? How will the industry be adapting more generally to the new rules, if the main areas of attention that include capital requirement, will not be expected to increase for insurance firms in the UK? What barriers remain in the single market to insurance, which Solvency II does not attempt to break down? What do you expect by way of any negative or positive short term consequences to the new technical requirements?

We would be grateful for a response to this letter by 9 December 2014. In the meantime we now clear EM 14263/14 from scrutiny.

25 November 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 25 November on the Solvency II Directive and its implementing measures. I entirely agree that the Solvency II Directive will deepen the EU’s single market for insurance and strengthen policy holder protection. It is for these reasons that the UK has been a supporter of the Solvency II project and we have worked hard to shape the Solvency II regime so that it will result in a much improved regulatory environment for European insurers. Your letter posed a number of questions and I hope that the answers below will prove helpful.

HOW WILL SOLVENCY II DEEPEN THE SINGLE MARKET IN INSURANCE AND ADDRESS PRICING ANOMALIES BETWEEN MEMBER STATES?

The single market already operates freedom of establishment, which allows UK insurers to compete in other EEA insurance markets without the need for separate authorisation. However, the current prudential regimes for insurers differ considerably between Member States, as the current EU regime (Solvency I) is minimum-harmonising. Insurers subject to less stringent prudential rules in their home jurisdiction may be able to offer insurance products at lower prices in other jurisdictions as they will not need to hold as much capital for the protection of policyholders.

Solvency II replaces the different capital standards across the EU with a maximum-harmonising, risk-based solvency calculation. Capital requirements will instead differ between insurers depending on how effectively they manage their risk, but all insurers will be held to the same solvency standard. While some national differences may exist regarding national tax regimes or differences in statutory accounting rules, Solvency II is expected to contribute significantly to a level playing field across the EU, enabling increased competition between UK and non-UK insurers.
Prudential rules, including the level of capital that an insurer must hold and the ways in which an insurer can seek investment returns in order to meet insurance claims, can have a significant impact on the pricing of insurance products. Under Solvency II, all EEA insurers will be held to the same prudential standard, ensuring that prudential factors which influence insurance pricing affect all insurers in the same way.

**WHAT BARRIERS REMAIN IN THE SINGLE MARKET TO INSURANCE, WHICH SOVENCY II DOES NOT ATTEMPT TO BREAK DOWN?**

By creating a single prudential rulebook, Solvency II will ensure that insurers compete on a level playing field. There will of course continue to be different rules across Member States about the design and sale of insurance products offered to consumers, but all insurers will be able to compete on the same basis to offer insurance products within a particular market. To harmonise rules around the design and sale of insurance products would represent a very significant increase in EU competence and I do not see any great demand from Member States for this kind of harmonisation.

**DOES SOVENCY II ADOPT A PROPORTIONATE APPROACH FOR SMALLER INSURERS?**

Supervisors are required to apply a proportionality test in their approach to supervision, and this is already captured in the Prudential Regulation Authority’s (PRA’s) current application of supervision rules. Smaller insurers can expect to be less intensively supervised than a larger insurer with a similar risk profile. The burden of reporting requirements on smaller insurers was considered explicitly as part of Solvency II and the legislation now allows supervisors to give reporting exemptions to small insurers, applicable for up to 20% of national markets. The exemptions include reduced quarterly reporting and reduced narrative reporting from annual to three yearly. Transitional provisions that phase in the capital calculations over sixteen years will also assist smaller insurers with limited resources in their preparation for Solvency II.

**HOW WILL THE INDUSTRY BE ADAPTING MORE GENERALLY TO SOVENCY II?**

While aggregate capital requirements for the UK insurance industry are not expected to increase, capital requirements are likely to be reallocated among UK insurers to some extent, with low risk-profile insurers holding less capital and those with a higher risk-profile holding more. The risk-based capital calculation incentivises insurers to more effectively manage their risks. For example, the Matching Adjustment for annuity products provides a capital benefit to insurers that effectively manage their maturity mismatch risk by matching long-term assets with long-term liabilities. Insurers will also be able to lower their capital requirements through diversification (both in their choice of assets and liabilities).

**WHAT DO YOU EXPECT BY WAY OF ANY NEGATIVE OR POSITIVE SHORT TERM CONSEQUENCES TO THE NEW TECHNICAL REQUIREMENTS?**

With any major regulatory reform there are likely to be some one-off costs to industry in complying with the new regime. Solvency II is no exception to this and the cost in adapting compliance systems to the new rules will not be insignificant. Unfortunately, these costs have been exacerbated by the significant delay in reaching political agreement over the final Solvency II package. The UK’s contribution to negotiations has prioritised regulatory certainty for the insurance business so that these costs can be kept to a minimum. It is clear that what industry now wants above all else is for the implementation of Solvency II to be completed on time. The UK is, however, better placed than other Member States to meet the implementation challenge. Solvency II is based on an approach to insurance supervision which UK firms and regulators are already familiar with. The UK has also found ways to push ahead with Solvency II preparations even while political negotiations for the Directive were stalled. UK implementation is certainly well advanced compared to that in many other Member States.

**REVIEW OF SOVENCY II AND IMPLEMENTING MEASURES**

I entirely agree that we should carefully monitor the operation of Solvency II and review its impact to ensure that the regime is doing what it should to ensure a sound, stable, thriving insurance sector. In particular, it is important to ensure we have a regulatory regime which supports insurers as providers.
of long-term finance for the wider economy. For this reason, we pushed for both the Directive and its Delegated Acts to contain review requirements. The Commission is due to review the key Solvency II implementing measures that deal with the Solvency Capital Requirement and investment risk-charges by the end of 2018. The Commission must also review the framework provisions around the Solvency Capital Requirement in the Directive itself by the end of 2020. The UK will make a full contribution to these reviews. As the evidence base develops around the appropriate regulatory approach to non-standard investments, such as securitisations, we will urge the Commission to reflect this evidence in Solvency II provisions, including the analysis currently being carried out by the Basel Committee on Banking Supervision (BCBS) and the International Organisation of Securities Commissions (IOSCO).

Once again, thank you for the interest you and your Committee colleagues have shown in Solvency II. I hope this letter is helpful, but please let me know if there are any other issues you would like addressed.

2 December 2014

Letter from the Chairman to Andrea Leadsom MP


We are grateful for your response explaining how Solvency II will affect insurers, particularly small insurers, and whether barriers to entry will continue to exist in the single market. We take note of the points you raise on how proportionality is being applied by the PRA and recognise how important the upcoming reviews will be for the insurance industry. While we acknowledge that there is limited appetite for the EU to harmonise specific design and sale of products, we remain concerned that Solvency II does not contribute to the elimination of these barriers between Member States, limiting the progress of the Single Market in insurance. We welcome the sharing of the UK’s expertise at the European level, and support the level of commitment you have shown to the negotiations and forthcoming reviews.

We take note of the main adaptations that will take place in industry in the short term and how insurers will be incentivised to calculate solvency risks going forwards. You helpfully outline the resistance that has been met in explaining that there is no appetite for the EU to take on competencies of designing rules concerning the sale of insurance products. It is hoped that Solvency II and its current prudential requirements will positively contribute to deepening the Single Market in insurance.

While we do not require a formal response to this letter we would be grateful for any updates on these issues as they are taken forward.

16 December 2014

SPECIAL REPORT BY THE EUROPEAN COURT OF AUDITORS ON EUROPEAN BANKING SUPERVISION AND THE EUROPEAN BANKING AUTHORITY (UNNUMBERED)

Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury

Thank you for your EM, dated 13 July 2014, on the unnumbered EM on the Special Report by the European Court of Auditors on European Banking Supervision and the European Banking Authority, together with the Authority’s reply. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 29 July 2014.

We have taken a longstanding interest in the work of the ESAs, for instance in our 2011 report on the EU Financial Supervisory Framework. Given this, and in light of the Committee’s new inquiry on the EU financial regulatory framework, the report provides some important insights into the set-up of the EBA and its role in improving the functioning of the internal market, in particular by ensuring high,
effective and consistent level of regulation and supervision. Taking the ECA’s recommendations in turn, we would draw your attention to the following issues.

RECOMMENDATION 1: SUFFICIENT TIME SHOULD BE ALLOWED FOR DRAFTING AND FOR CONSULTATION AND A CROSS-SECTORAL IMPACT ANALYSIS SHOULD BE CONSIDERED

While the EBA has met its procedural deadlines with respect to public consultations, there have been instances where consultation periods were unnecessarily squeezed in order for the EBA to meet deadlines set externally by the legislators. The ECA recommend that the EBA be given observer status in the legislative process. The EBA outline in their reply how this could be achieved in practice. Do you agree with what they have proposed? What do you believe is the best way forwards to include the EBA in the legislative process so that it can better deliver on its mandates and ensure stakeholders are consulted with the time period allocated to them? Would these be changes that could be included in relation to the Commission’s review of the European System of Financial Supervision?

RECOMMENDATION 2: THE EBA SHOULD CONTINUE TO PROMOTE THE EFFECTIVENESS OF THE COLLEGES OF SUPERVISORS

The ECA report highlights that the supervisory colleges that exist for cross-border banking groups have tended to be used for more procedural conversations rather than those dedicated to enhancing information sharing and discussing risk. While we note that significant progress has been made to improve the functioning of the colleges despite these limitations, the EBA maintain that for significant improvements in the supervisory convergence in the EU to take place, a change in mandate in primary legislation is required. Do you believe that this is ultimately the best way to respond to the limitations that the EBA currently embodies? Furthermore, what steps is the UK taking to enhance information exchange before November 2014 when the ECB’s supervisory responsibilities come into force?

RECOMMENDATION 3: A CLEAR AND WIDE-RANGING MANDATE AND SUFFICIENT EXPERIENCED STAFF ARE NEEDED FOR THE RELIABILITY OF BANK STRESS TESTS. EU-WIDE RESOLUTION MECHANISMS SHOULD BE DESIGNED TO WORK EFFICIENTLY.

We note the ECA statement that the EBA had been under-resourced and operated with a limited mandate, which led the EBA’s role in facilitating and coordinating the stress tests in 2011 to be unreliable. While the mandate for the EBA remains to facilitate and coordinate future stress testing, the EBA however raises the important point that the legal responsibility for the conduct of the stress testing remains with the competent supervisors. The EBA thus has no control on the results. Do you agree that the EBA’s mandate should be strengthened enabling the EBA to deal directly with banks, in order to conduct peer analyses, challenge the banks’ results on the stress testing and publishing data accordingly? Where do you think the responsibility for the results of the stress testing should lie?

RECOMMENDATION 4: STRENGTHENED MEASURES ARE NEEDED FOR CONSUMER PROTECTION IN THE EU FINANCIAL SECTOR

A number of the shortcomings set out in the ECA’s report on legislation dealing with consumer protection have been addressed in additional directives in 2011, 2012 and 2013. However the EBA still has limited scope to take legally binding decisions. The EBA has managed to respond to urgent situations through identifying and addressing issues through non-binding legal instruments, but there is no mandate for it to act with binding decisions in emergency situations. Do you believe there is scope to extend the mandate for the EBA to make binding decisions by way of consumer protection? How effective has the Joint Committee structure been in addressing problems of overlap between the three supervisory agencies?

RECOMMENDATION 5: ESTABLISHMENT OF A PERFORMANCE MEASUREMENT SYSTEM

We also agree with the measures to track the EBA’s core activities in order to assess their achievements and objectives as an organisation.
RECOMMENDATION 6: CLARIFICATION OF ROLES AND RESPONSIBILITIES IS NECESSARY FOR A SUCCESSFUL BANKING UNION AND EFFECTIVE BANKING SUPERVISION.

One of the most serious shortcomings set out in the report is the further clarification of the role and responsibilities between the ECB, NSAs and EBA in terms of EU-wide supervisory tasks. The EBA notes in its reply to the ECA report that it does not consider the MoU as an appropriate instrument for clarification of roles and responsibilities between the EBA, the ECB and NSAs, and considers any such changes can only be taken at the level of primary legislation. Do you believe the MoU is indeed appropriate as a means for clarification of supervisory responsibilities between all parties?

Given that the ECA visited the EBA in 2012 and early 2013, why were these issues not raised at the same time as the ongoing proposals for Banking Union were being discussed in early 2013? What is the UK Government currently doing to ensure that an effective system of supervisory cooperation will be up and running in November, when the ECB takes up its supervisory responsibilities?

29 July 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter dated 29 July 2014 on the unnumbered Explanatory Memorandum on the Special Report by the European Court of Auditors (ECA) on European Banking Supervision and the European Banking Authority (EBA), together with the EBA's replies. We welcome your interest on the reports and the implications aspects of these will have on the Commission's review of the European System of Financial Supervision (ESFS).

RECOMMENDATION 1: SUFFICIENT TIME SHOULD BE ALLOWED FOR DRAFTING AND FOR CONSULTATION AND A CROSS-SECTORAL IMPACT ANALYSIS SHOULD BE CONSIDERED

In your letter, you raised a number of questions regarding the ability of the EBA to contribute to the legislative process. We share the broad thrust of the EBA's response to the ECA and favour clarifying the roles of the ESAs in the legislative process, in the interests of transparency and accountability. For instance, we believe the ESAs should be consulted by the Commission at the start of the Level 1 process, including on their ability to deliver, the timing of review clauses, and the mandates and priority order of Level 2. We also believe that each of the ESAs should be required to publish an assessment of any new proposal, covering: the strengths of the evidence and analysis presented by the Commission in its impact assessment; the implementation timetable; the effect on SMEs and how the approach will be proportionate; and any issues with level 2 delegating provisions. Your response referred to the possibility of the EBA having observer status during the legislative process, which could be one approach to achieve the above. In addition, we strongly support the ECA's overarching recommendation that the ESAs should have adequate time to produce and consult on Level 2 rules, which could be addressed by having deadlines relative to the entry into force of the basic legal act. Each element of this should be considered as part of the Commission’s review of the ESFS.

RECOMMENDATION 2: THE EBA SHOULD CONTINUE TO PROMOTE THE EFFECTIVENESS OF THE COLLEGES OF SUPERVISORS

In your letter, you asked whether legislative change was required to support the EBA’s ability to promote the effectiveness of the colleges. Our objective is for the EU to achieve consistently high standards of supervision; however, it is not to achieve supervisory harmonisation whereby the same tool is used with the same intensity to address the same risk in all Member States, as this would lead to a mechanistic approach to supervision and run counter to judgement based supervision – the need for which is one of the lessons of the crisis. Therefore, while we agree with the ECA that the EBA should continue to support the effectiveness of the colleges, we do not see any need for the EBA’s mandate to require legislative change.

You also asked what steps the UK is taking to enhance information exchange before November 2014 when the ECB’s supervisory responsibilities come into force. The Bank of England has been engaging with the ECB at all levels to establish and foster a strong supervisory relationship.
RECOMMENDATION 3: A CLEAR AND WIDE-RANGING MANDATE AND SUFFICIENT EXPERIENCED STAFF ARE NEEDED FOR THE RELIABILITY OF BANK STRESS TESTS. EU-WIDE RESOLUTION MECHANISMS SHOULD BE DESIGNED TO WORK EFFICIENTLY

You raised the question as to whether the EBA should deal directly with banks with regard to stress tests. It is important to recognise that the EBA is a system manager – it is not a day-to-day supervisor. For the EBA to have a direct supervisory relationship with a firm would present a conflict of interest with its role as a system manager. On this basis, the EBA’s role in stress tests is to organise and oversee, provide quality control and comparability, and not to deal directly with banks.

RECOMMENDATION 4: STRENGTHENED MEASURES ARE NEEDED FOR CONSUMER PROTECTION IN THE EU FINANCIAL SECTOR

There are two situations in which the EBA is potentially able to exercise binding powers on supervisory authorities in emergency situations. The first is when the Council has declared an emergency in accordance with Article 18 of the EBA Regulation where there is a need to address serious risks to the orderly functioning and integrity of financial markets, or the stability of the financial system. The second is where binding powers are vested with the EBA in accordance with Article 9(5) of the EBA Regulation, which in addition to being to ensure the order and integrity of the markets or financial system stability, may be for the purpose of consumer protection. In such cases, where there is an emergency the EBA may be empowered to take decisions binding on supervisory authorities and market participants to impose restrictions on financial activities. However, this role has to be switched on in a specific provision in a Directive or Regulation (such as has happened in relation to ESMA and the EBA in the recently made Markets in Financial Instruments Regulation (see Articles 40 and 41 of that Regulation)).

You asked how effective the Joint Committee (JC) structure has been in addressing problems of overlap between the three ESAs. First, it is worth noting that the JC only really became operational in 2012, sometime after the ESAs were introduced, and so it remains relatively early to fully assess how it is functioning. However, it has an important role to play in ensuring coordination at across the ESAs and examining issues that are relevant across the markets that the ESAs monitor, considering the ESFS system as a whole. In this regard, the function and remit of the JC as set out in the Regulations is appropriate and should be maintained. The ESAs should focus on continuing to develop the efficiency and capacity of the JC and ensuring that the ESAs are encouraged to work collaboratively on issues of shared interest.

RECOMMENDATION 5: ESTABLISHMENT OF A PERFORMANCE MEASUREMENT SYSTEM

We share the views of the ECA, EBA and Committee that the EBA should establish a performance measurement system to assess their achievement and objectives as an organisation.

RECOMMENDATION 6: CLARIFICATION OF ROLES AND RESPONSIBILITIES IS NECESSARY FOR A SUCCESSFUL BANKING UNION AND EFFECTIVE BANKING SUPERVISION.

You raised the issue of the Memorandum of Understanding (MoU) between the EBA, ECB and NSAs. The SSM Regulation specifies the conditions for cooperation with other authorities, including the requirements for an MoU between the ECB and other competent authorities from non-participating member states, alongside cooperation with the EBA. An MoU between the ECB and Bank of England will therefore need to be implemented prior to the SSM taking up its supervisory responsibilities. The UK Government has argued throughout banking union discussions that it is important to clarify the roles and responsibilities of various bodies and that it considers an MoU to be appropriate for the Bank of England, ECB and other regulators. This view was shared by the co-legislators. It is, however, a matter for the EBA as to why it did not raise its concerns during 2012 and 2013 when this issue was under discussion.

A number of the issues you raise are being taken forward by the Bank of England, including the UK’s ongoing engagement with the ECB on supervision of banking union and the formulation of the MoU, and they may be best placed to provide you further information on these technical areas.

31 August 2014
Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 31 August 2014, on the unnumbered EM on the Special Report by the European Court of Auditors on European Banking Supervision and the European Banking Authority, together with the Authority’s reply. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 September 2014.

We are grateful to you for this helpful response. Your reply suggests that the UK Government is broadly satisfied with the level of powers of the EBA enshrined to it under its founding regulations. Is this correct? Although you have acknowledged that the UK Government supports clarification of roles and responsibilities between the European Supervisory Agencies, National Supervisory Authorities and the operations of the Single Supervisory Mechanism, we would be grateful for any further information or concerns that you have on this issue, while we consider these uncertainties.

We welcome your suggestion for ways in which the ESAs can be more involved in the Level 1 process. It is hoped that the changes introduced through the review of the ESAs by the Commission will lead to improvements in the Level 2 process. Can you clarify what is currently impeding the opportunity for each of the ESAs to be able to publish an assessment of any proposal, covering for example the strengths of the evidence and analysis presented by the Commission in its impact assessment?

You state that any enhanced level of information exchange would cause a conflict of interest between the Authority and the financial institutions that it does not directly supervise. We note that issues concerning increasing data exchange were picked up as a proposed medium term legislative change in the context of the Commission’s recently-published review of the ESAs. How much support is there from other Member States for this proposed legislative change? In terms of strengthened measures for binding powers for the ESAs, you note that this has to be ‘switched on’ in a specific provision in a Directive or Regulation. Do you support this method going forwards in other important dossiers?

We would be grateful for a response to this letter by 6 October 2014. In the meantime we now clear the document from scrutiny.

10 September 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter dated 10 September 2014 on the unnumbered Explanatory Memorandum on the Special Report by the European Court of Auditors (ECA) on European Banking Supervision and the European Banking Authority (EBA), together with the EBA’s replies.

With regard to your further questions, the UK Government is broadly satisfied with the level and nature of the powers that the EBA Regulation provides to the EBA. Indeed, one concern we have with the existing review of the European System of Financial Supervision is that there are proposals for all three ESAs, and not just the EBA, to have more powers before they are delivering in full on their existing mandate or utilising their full powers as strategic level regulators. For instance, we would welcome a stronger focus by the ESAs on their mandate to conduct economic analysis of markets in order to prevent financial instability.

At present, it is possible for the ESAs to issue own initiative opinions on Commission legislative proposals, to the extent that they relate to issues within their respective areas of competence, although the potential use of this ability is not as clear or as proactive as it could be. To date, they have not done so. Given the expertise of the ESAs, we believe that having them provide published technical assessments of legislative proposals, either soon after Commission publication or at some other stage in their development, would contribute to better legislative proposals and that their broader engagement, in an appropriate fashion, in the legislative process would help ensure a higher standard of final legislation. There may be merit in making any ESA role in this regard clearer and with defined parameters to ensure that the role of the co-legislature is not inadvertently infringed in any way.

You asked about the degree of support from other Member States for the Commission’s proposal for increasing data exchange. There has only been a preliminary exchange of views between Member States on the Commission’s review of the ESAs, and so the various positions of other Member States on this issue are not yet clear.
Finally, you referred to the use of specific provisions for “switching on” binding powers in Directives and Regulations. The UK Government supports this mechanism for ESA powers being used in specific legislation as it means that the co-legislature have to give specific consideration and explicit direction as to how these powers ought to be used in any one policy area, how such powers sit within the wider legislation and how the overall policy is best delivered.

6 October 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 6 October 2014, on the unnumbered EM on the Special Report by the European Court of Auditors on European Banking Supervision and the European Banking Authority, together with the Authority’s reply. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 21 October 2014.

We are grateful to you for this helpful response. You state clearly that the UK Government is satisfied with the level of powers of the EBA enshrined to it under its founding regulations. We note that you encourage the ESAs to fulfil their responsibility in economic analyses within their area of competence. We are supportive of your willingness to find ways to include the EBA, and its technical skills, early on in the legislative process. While you mention that there has only been an initial exchange of views at this stage, we would like to be kept up to date on any progress, which would allow the EBA and ESAs generally to be more involved in the level 1 process.

However, we remain concerned that the UK Government is opposed to considering extending the mandate of the ESAs to include more powers on supervisory convergence and mediation. We understand that the objective of the EBA is to promote convergence of supervisory practice at a high supervisory standards across the EU. However it is difficult to see how the EBA, and ESAs overall, can otherwise evolve in ways that best suit the goals and objectives set out for them in the European financial system given their limited powers to make or enforce decisions on supervisory convergence and to resolve disputes with National Supervisory Authorities.

In response to our query concerning the ‘switching on’ of binding powers for the ESAs, you state that you are content to pursue this method on a case-by-case basis. We are concerned that over time some ESAs may end up with binding powers in some areas and not others, making their powers piecemeal and disjointed. Do you recognise this as a concern?

Given your clear intentions not to promote the ESAs with greater powers, we remain concerned that the effectiveness of the EBA may become compromised. We would be grateful for updates as to the progress of the short term and medium term legislative changes. In the meantime we now clear the document from scrutiny.

21 October 2014

STABILITY AND GROWTH PACT (5375/15)

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

Thank you for your EM 5375/15, dated 30 January 2015, on the Commission Communication on Making the best use of the flexibility within the existing rules of the Stability and Growth Pact. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 24 February 2015.

We agree with you that this Communication is a helpful clarification of the Commission’s approach to applying the Stability and Growth Pact. It also appears to us that the changes in guidance are sensible adjustments, notwithstanding your concern, which we share, that the flexibility allowed for under the SGP is not used in a manner or to a degree that undermines the Pact’s credibility as a tool of responsible fiscal policy. In light of the contentious discussions over the past months, what assessment would you make of the credibility of the SGP? Is it an effective mechanism for restoring stability and growth to the EU?

You state that the Commission will give “due consideration” to planned structural reforms when deciding on the existence of an excessive deficit, will “closely monitor” the implementation of the reforms, and will take “the necessary action” in the case of a failure to implement. Is the amount of...
discretion granted to the Commission in making these judgments appropriate and sufficient, or can
the process be made yet more transparent? In terms of the efficacy of the European Semester
process overall, how would you respond to the assertion of the former Chair of the European
Parliament Economic and Monetary Affairs Committee (ECON), Sharon Bowles, that Member States
largely ignore the Commission’s Country-Specific Recommendations? What account does the UK
take of such recommendations?

You state that “those countries confronting problems of high deficits need to continue the work of
fiscal consolidation”. In that context, what is your assessment of the Greek crisis? In the context of
recent discussions, what does the UK Government believe is the appropriate solution to such a
seemingly intractable problem? What role has the UK Government played in negotiations to identify a
resolution to the crisis?

We would be grateful for a response to these questions by 10 March 2015. In the meantime we now
clear the document from scrutiny.

24 February 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter of 24 February on the subjects raised in the above mentioned explanatory
memorandum.

In your letter you ask, in the light of recent discussions, what assessment the Government makes of
the credibility of the Stability and Growth Pact (SGP), and whether it is an effective mechanism for
restoring stability and growth to the EU. The Government supports the goals of the SGP as laid out in
Council Regulations (EC) No 1466/97 and 1467/67, i.e. to promote “sound government finances as a
means of strengthening the conditions for price stability and for strong sustainable growth conducive
to employment”. The Pact has undergone significant change in recent years, and its rules have been
substantially strengthened, including through the introduction of the “six pack” and “two pack”
legislative reforms in 2011 and 2013 respectively.

Given the recent nature of these reforms, and the fact that reinforced SGP has yet to be properly
tested under normal economic circumstances, the Government believes that it is too early to draw
conclusions with regards to its overall effectiveness. However, the Government is clear that
consistent and transparent enforcement of the rules will be an important part of establishing and
maintaining the SGP’s credibility.

In relation to the Commission’s statement that it will give “due consideration” to planned structural
reforms when deciding on the existence of excessive deficits, will “closely monitor” the
implementation of reforms, and will take “effective action” in the case of a failure to implement, you
ask whether the amount of discretion granted to the Commission in making these judgements is
sufficient, or whether the process can be made more transparent.

In its communication on SGP flexibility, the Commission states that, in order to qualify for
consideration, planned structural reform programmes must be “major” and be expected to produce
“direct long-term positive budgetary effects”. The Government considers that ambitious structural
reform is vital to promote growth and jobs in the EU, and supports measures that encourage Member
States to undertake such programmes. Given the difficulties in defining what constitutes a “major”
structural reform, or accurately determining the direct impact of planned measures, the exercise of
judgement and discretion on the part of the Commission is a necessary component of efforts to make
this happen.

However, a balance needs to be struck between flexibility and predictability in the enforcement of
these rules. Transparency is essential to underpin the credibility, and that is what we have argued in
discussions. The Government has been clear that a transparent and consistent approach on behalf of
the Commission and Council – both in the assessment of planned reforms and the enforcement of
existing commitments – will be an important factor in maintaining the SGP’s overall credibility.

In relation to the wider European Semester process, you ask how the Government responds to the
claim by Sharon Bowles (former Chair of the European Parliament’s Economic and Monetary Affairs
Committee), that Member States largely ignore the Commission’s Country-Specific Recommendations
(CSRs). You also ask what account the UK takes of such recommendations. The Government
encourages all Member States to push forward with essential structural reforms, as well as ensuring
fiscal sustainability, in the interest of raising growth and stability across the EU. It believes that the
Semester process, including the Country Specific Recommendations, can play a part in supporting those reform efforts. However, more needs to be done to encourage a spirit of transparency and partnership to allow Member States to implement and take national ownership of reform recommendations.

The UK’s progress on the structural reform areas covered by the 2014 CSRs compares favourably with other Member States and demonstrates the seriousness of this Government’s commitment to increasing the competitiveness of the UK economy.

In relation to the need for some countries to continue the work of fiscal consolidation, you ask what the Government’s assessment is of the Greek crisis, what the Government believes is the appropriate solution to “such a seemingly intractable problem”, and what role the UK Government has played in negotiations to identify a resolution. After the recent Greek elections, the Prime Minister spoke with the new Greek Prime Minister. He welcomed Prime Minister Tsipras’ intention to tackle corruption and increase tax transparency across Greece and noted that, as a key advocate of these issues, the UK is keen to work closely with the Greek government. The Chancellor subsequently met with the Greek Finance Minister at Downing Street, where they discussed a range of issues relating to the current situation in Greece and the euro area.

While the future of Greece’s support programme is a matter for Greece and the euro area to decide, it is in Britain’s interest to see a stable euro area. The Government therefore welcomes the agreement, reached at the end of February, to extend Greece’s existing financial assistance for a further four months. This is the beginning of a discussion between both sides, and the Government urges Greece and the euro area to continue to work together to ensure economic and financial stability.

As the Chancellor has stated, the recent stand-off between Greece and the euro area posed a great risk not just to Greece, but to the global economy. The best way to insulate the UK’s economy from such instability is to stick to our long-term economic plan.

12 March 2015

STRUCTURAL REFORMS OF EU CREDIT INSTITUTIONS (6022/14, 15924/14)

Letter from the Chairman to Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury

Thank you for the letter from the former Financial Secretary to the Treasury, dated 4 April 2014, on EM 6022/14, the Commission’s proposal for a Regulation on structural measures improving the resilience of EU credit institutions, and for your letter, dated 1 June 2014, on JHA issues pertaining to the proposal. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 10 June 2014. In doing so we took account of evidence heard on the proposal on 8 April 2014 from Martin Spolc, Deputy Head of Unit, Banks and Financial Conglomerates II, DG Internal Market, European Commission, and on 6 May 2014 from Sir Win Bischoff, former Chairman, Lloyds Banking Group, Dominic Morris, Director, Group Public Affairs, Lloyds Banking Group, and Anthony Browne, Chief Executive, British Bankers Association (BBA). We set out the evidence heard, and our own views and questions, under a number of headings below.

The Rationale Behind the Proposal

Martin Spolc described the proposal as the “final cog in the wheel to complete the regulatory overhaul of the EU banking system”. He said that the proposal was justified on the grounds that the size and complexity of a small number of the largest and most complex institutions remained a concern: “these banks remain too big to fail, too costly to save and too complex to resolve”, which meant that they “enjoyed special privilege” in the form of an implicit public subsidy: “they believe, and there is a perception, that if these banks get into difficulties the Governments will step in to bail them out rather than let them fall.” This in turn leads to “moral hazard, excessive risk-taking and weaker market discipline.” Martin Spolc stressed the Commission’s view that risky trading activity had shifted some banks’ focus from customer-oriented service, and that such activity should not benefit from implicit government support.
Do you agree with this analysis of the problem? Is the Commission’s proposal the right way to seek to address it, or is there a case for a simpler model of separation between commercial and investment banking? Overall, is the Commission’s proposal an improvement, or a step back, from the Liikanen proposals? Do you agree with Martin Spolc that this is the final cog in the wheel to complete the regulatory overhaul of the EU banking system? Or does more need to be done?

WHICH INSTITUTIONS?

Martin Spolc told us that a “too big to fail” bank is defined as one whose failure would have systemic implications, but that such a judgment should not only be based on an institution’s size, but should also take account of the riskiness of its trading activity. Nevertheless, the proposal was likely to capture “only a very small number of the largest and most complex banks”, perhaps 30 to 35 in total. Individual Member States would be able to impose structural measures on small banks not captured by the proposal. Is this the right approach to ensure that all systemically-important banks are included within the proposal’s scope? Given that only a limited number of institutions will be affected, is there a case for a uniform approach to smaller institutions?

A REGULATION OR A DIRECTIVE?

Martin Spolc told us that the Commission had opted to propose a regulation rather than a directive because of the importance of a single rulebook for systemically important banks with significant cross-border activity. In terms of the regulatory burden, he noted that it would be easier for a bank if the rules were applied consistently across the EU. A regulation was also proposed to make it easier for the rules to be applied in the context of Banking Union, since the ECB would only be required to implement one set of rules rather than numerous national laws.

Anthony Browne thought it an unusual piece of legislation as a regulation with derogation and discretion for national authorities. However, he said that the Commission had to adopt a more flexible approach because of the work that had already been undertaken by different Member States. Would there have been any advantages for the proposal to have been brought forward in the form of a directive? Does it set any kind of (unhelpful) precedent, in particular given the suggestion that a regulation was adopted to suit the demands of the ECB in its role as single supervisor within Banking Union? What are the likely future implications of such a preference for regulations for non-participants in Banking Union/ non-members of the Eurozone, such as the UK?

THE BAN ON PROPRIETARY TRADING

Martin Spolc said that the Commission recognised the difficulty of disentangling proprietary trading from market-making, which is why it proposed a narrow definition of “trading that is carried out with the exclusive purpose of making a profit for the bank itself without any actual close relationship with the customer”. In the Commission’s view, “proprietary trading activities not linked to clients’ activity should simply not be permissible.” Martin Spolc acknowledged that the Commission’s analysis suggested that proprietary trading represented only a limited part of banks’ activities and revenues, meaning that any ban would be unlikely to lead to significant costs. Nevertheless there were social benefits of banning proprietary trading, including “reducing systemic risks, complexity, interconnectivity and conflicts of interest.”

Dominic Morris referred to the practical difficulty that banks had found of separating market-making activities from proprietary trading, “because there is a point in the day when you are actually holding it on your books”. He said that 1300 pages of the Dodd-Frank regulations sought to deal with this practical interface, “and it would be a nightmare for the regulators to police”. Anthony Browne noted that the US ban on proprietary trading under the Volcker rule had proved more complicated than Paul Volcker initially anticipated: “the trouble is that the more you try to define it, the more complex it is. A lot of activities – such as market making and other forms of client facilitation and so on, which are entirely normal and laudable activities of banks – tend to look very similar to proprietary trading.”

Anthony Browne acknowledged that the Commission’s proposals seemed simpler than the Volcker regulation: “Ultimately, it boils down to intent: if the sole intent of a transaction is to make money on behalf of a bank rather than to facilitate a client, then you could define that as proprietary trading, but it is quite difficult to judge transactions not by what the transaction is but by the intent of the
transaction. You could have two transactions that are basically identical except one has a different intention from the other; one would be banned because the intent is different from the other”.

Sir Win Bischoff was concerned about the proposed ban on proprietary trading, and suggested that the impact of a ban would be greater than many, including the UK Government, had suggested. On the likelihood of the proprietary trading provisions being amended, Sir Win Bischoff expected that “common sense will prevail”, and that a narrow definition would be adopted to allow market making to continue in some form, so as to provide both liquidity and financing.

On the other hand, Anthony Browne asserted that proprietary trading was not a huge part of the business model of UK banks, and was not a high level concern for the BBA’s members, who either did not get involved with proprietary trading or found it to be a totally marginal activity. What would concern them would be an attempt to “Volckerise” the narrow definition, resulting in “all the banks’ activities, such as market making, suddenly [having] to be processed through this lens … There would be a huge cost to that. There would obviously be burdens on the way they operate. They might have to stop doing something that basically no one has a problem with”. In his view, proprietary trading was not so dangerous that it needed to be banned in any case. He argued that 4% of total losses in relation to the global financial crisis were down to proprietary trading. In his view it was preferable to separate proprietary trading activity rather than ban it completely.

Is the Commission’s proposed definition likely to prove effective at banning the trading activity it seeks to target, or could it have any unintended consequences? Or is it so narrowly drawn as to be unlikely to have any practical effect? How will it be enforced, and how can it be ensured that the distinction between such activity and legitimate market-making activity is retained? Do you perceive any dangers in seeking to ban proprietary trading, even on the basis of such a narrow definition? How would you respond to the Commission’s argument that a ban would bring “social benefits”, even if the financial implications are limited? Do you anticipate attempts to broaden the definition of proprietary trading during the negotiating process? If so, what steps are you taking to ensure that any negative effect on the day-to-day activity of UK institutions, for instance in legitimate market-making activity, is minimised? How can the effect of a ban be effectively monitored in the years ahead? What lessons can be learned from the US experience? In light of such experience, are you concerned at the lack of international consistency in the approach to proprietary trading?

STRUCTURAL SEPARATION

On the proposals for structural separation, Martin Spolc noted that the Commission came to the conclusion that, rather than basing a separation decision on size as the Liikanen Group had proposed, “it would be better and more nuanced to base the separation decision on criteria … such as leverage, complexity, profitability, associated market and counterparty credit risk and interconnectedness.” He also stressed the importance of providing a “limited and carefully framed degree of supervisory discretion … to judge the riskiness of certain trading activities on a case-by-case basis”, so that a supervisor could choose to separate certain activities that it judged to pose systemic risk even if the criteria were not exceeded. Alternatively a supervisor could decide not to impose structural separation “if the supervisor was convinced by the arguments put forward by the banks that the trading activities do not cause systemic or financial stability risks”. The supervisor would have to consult the EBA in such cases, and, if it was decided not to enforce separation, the supervisor would have to disclose its decision.

We agree with you that, given the proposal’s application across a diverse set of national banking sectors in the EU, some degree of supervisory discretion is appropriate. Are you content that sufficient safeguards are in place in the proposal as drafted to ensure that this power is not used in an inappropriate fashion?

THE IMPACT ON THE UK AND THE DEROGATION PROVISIONS

Martin Spolc stressed that the Commission proposals were compatible with the UK Banking Reform Act, and shared the same objective of protecting core deposit-taking and lending from trading activities. As a result, he thought the costs of applying both sets of rules to one banking group would be limited. Nevertheless he acknowledged the difference between the two, including the Commission’s proposal to ban proprietary trading, the “conceptual difference” between the UK approach in separating retail activity from trading activity and the Commission’s proposal to separate trading activity from deposit-taking activity (although they led to the same outcome of separating
retail and trading activity), and the territorial scope. On the latter issue, Martin Spolc observed that
the Commission proposed a broader scope because it wanted to avoid regulatory arbitrage and the
possibility of banks circumventing the rules by shifting some of their trading activity outside the EU to
third countries.

Martin Spolc justified the proposed derogation provisions on the grounds that it was logical for the
Commission to scrutinise existing laws and to judge whether they achieve equal or greater results
than the Commission's proposals. He added that banks subject to UK law obtaining the derogation
would not be affected by the EU regulation. However, subsidiaries of the UK banking groups that
carried out important activities in the EU or outside the UK that would not be captured by the UK
law would be captured by the EU law.

Anthony Browne stressed that "it is very important that these European proposals do not make it
impossible for the UK and for the UK banks to implement" the Banking Reform Act, and "that meant
they had to have national derogation, because I cannot see any other way around it." Yet other
countries viewed the derogation provisions as being designed specifically for the UK "because we
were first out of the traps" with domestic legislation.

Anthony Browne agreed that the EU legislation's extraterritoriality was a major difference from the
UK approach: "it affects the global operations of EU banks and, indeed, to some extent, the
operations of global banks operating within the EU, both of which are untouched by the Financial
Services (Banking Reform) Act." He also noted that "if you are a UK-headquartered bank, your global
operations are potentially affected by the Commission proposals in a way that they are not by the
Financial Services (Banking Reform) Act proposals. A lot of non-EU banks' or non-EEA banks' operations in the UK could potentially be affected by this legislation as well." He noted that the
Commission proposal was deliberately designed to capture the entire global operations of EU-
headquartered banks, so long as they fit certain criteria. By contrast, the UK legislation was
deliberately designed not to have such an extraterritorial effect in order to make sure that London's
competitiveness as a global financial centre, nor the competitiveness of UK-headquartered banks,
were not impaired.

You state that the derogation provisions remove the risk of a duplicated compliance burden.
However, we would be grateful for your view of the likely impact of the proposal on a UK-
headquartered group, as well as a UK-headquartered institution, and how the derogation would apply
in each case. For instance, what will be the impact on the global activity of a UK-headquartered
group? What will be the impact on the activity of subsidiaries of a UK-based group operating outside
the UK? What will be the impact on the UK activity of EU banks headquartered in other Member
States? Given the limited extraterritorial effect of the UK Banking Reform Act, is it fair to state that
UK-based banks will be at a competitive advantage compared to those based in other Member States?
Given the interconnection between the financial sector in the UK, the EU and globally, and given the
cross-border nature of banking activity, what assessment have you made of the overall economic
impact of the Commission's proposals on the UK? What is the view of the PRA on the proposals as
the UK's competent authority? Can you provide any more detail about the concerns set out in your
EM that the draft regulation "maintains an appropriate balance between the role of the member state
and the role of the Commission'?

FRANCE AND GERMANY

Martin Spolc noted that the Commission proposal went further than the French and German model
in proposing to ban, rather than separate, proprietary trading, and in seeking to capture a broader
scope of trading activities, such as complex securitisations, "that might be risky and might not be
related only to activities such as lending to hedge funds". While it was too early to state precisely
what the impact of the reforms would be, he said that the Commission's proposal, as it stood, would
have a significant impact on the French and German banking sectors.

Sir Win Bischoff noted a push against the proposal by France and Germany, who would either wish,
through derogation, not to be a part of the regulation "or would wish to persuade the Commission to
do something that is closer, perhaps, to Liikanen, which allows some sort of trading to take place
inside either the ring-fenced entity or the non-ring-fenced entity." In his view, the French and German
approach to proprietary trading was workable, whereas the Commission's proposals were more
problematic for financial institutions. Yet "if they do not find a way in Europe to have a united view of
how banking structure should be carried forward, that is not a good thing for Europe."
Anthony Browne said that in France and Germany, banks, government and regulators alike were “incredibly hostile” to the proposals: “There is an awful lot of anger about it. I have certainly been party to some really quite hostile exchanges between French and German banks and Commission officials on it.” He found it difficult to see how the proposal could survive in its current form without the support of the French and German Governments.

What assessment would you make of the reaction in France and Germany to the Commission’s proposal? Do you recognise the description of their reaction as “incredibly hostile”? Do you agree with our witnesses that the chances of the Commission’s proposal being agreed as it stands are therefore slim? What amendments do you anticipate France and Germany seeking to make? For instance, do you anticipate any amendments to the derogation provisions?

INTERNATIONAL CONSISTENCY AND THIRD COUNTRY EQUIVALENCE

Martin Spolc stressed the Commission’s commitment to international consistency and convergence, noting that it was in contact with all major jurisdictions to ensure that any possible overlaps in application or inconsistencies were minimised. He said that the third country equivalence regime would make it possible for third-country banks operating via branches in the EU, or subsidiaries of the EU banks operating overseas, to be exempted from the regulation. This was designed to reduce compliance costs for banks that undertook cross-border activity.

Sir Win Bischoff noted that some European banks, including Deutsche Bank, BNP, Santander, Barclays and HSBC, were sizeable global operators: “For the regulated, who have to deal with regulation or this kind of structural separation in a number of countries, it is going to be quite difficult. … The extraterritoriality of it is a real difficulty.” Across the financial sector more generally, he stressed how difficult it was to apply global standards: “there may be convergence, but it is going to be increasingly difficult. … There is not going to be that much commonality all that soon”. In his view, it would have been preferable to have a single set of rules across the EU, if not globally.

Anthony Browne agreed: “If you started at the beginning of this process and said, ‘Do we need national legislation in the UK, France, Germany and Belgium and also European legislation on top of that? Is that an ideal framework?’, you would be hard-pushed to find anyone, including many of the authors, to say that would be the case.” He added that part of the reasons why different countries had come up with slightly different answers was because of the complexity of banks. The idea of a level playing field in Europe was a good idea in principle, but the Commission needed to reflect the fact that a lot of activity had already been undertaken in individual countries, notably the UK. Nevertheless, BBA members wanted as much international consistency in legislation as possible: “The more differences there are, the more compliance costs there are and the more difficult it is to do business – and, also, the more scope it creates for regulatory arbitrage”.

Notwithstanding the reforms being implemented as a result of the UK Banking Reform Act, do you agree with our witnesses that it would have been preferable, in principle, to reach agreement on a common set of rules across the EU, if not globally? Given where we find ourselves, what can be done at this stage to ensure that there is as much international legislative consistency as possible, thereby minimising compliance costs and the risk of regulatory arbitrage? What has been the reaction in other major global financial centres to the proposal?

HOME/HOST RESPONSIBILITIES

In terms of the division of home and host responsibilities, Martin Spolc acknowledged that the proposal gave responsibility to the lead (i.e. home) supervisor. He expected the issue to be prominent in the negotiation process, but at this stage the Commission’s judgment was that “a decision on the structural measures is so important that the lead supervisor should have the final say”.

We would be grateful for a full explanation of the Government’s concerns about the division of home and host responsibilities. What would be the practical impact of the Commission’s proposal, as drafted? Are you concerned at the shift in responsibility to the home authority? Does this set an unhelpful precedent?

DELEGATED POWERS AND SECURITISATION

In his evidence before us, Martin Spolc highlighted a number of issues that he anticipated would be dealt with through delegated powers. This included the definition of thresholds for certain criteria on
which a decision about structural separation would be based, decisions on whether certain trading activities would be separated, the EBA’s role in developing regulatory and implementing technical standards, decisions on third country equivalence and defining good and bad securitisation. On the latter issue, Martin Spolc said that the proposal was the first time that EU legislation had attempted to separate and distinguish between good and bad securitisation. The Commission recognised that good securitisation might be good for long-term financing and providing support to the real economy, whereas some securitisation might be complex and could prove to be toxic.

In light of the concerns expressed in your EM about the scope of such delegated powers, how would you respond to Martin Spolc’s evidence? Are these appropriate measures to be set out in delegated acts? Is it possible to distinguish between good and bad securitisation and, if so, what should be the basis of such a judgment?

THE PROGRESS OF NEGOTIATIONS

Notwithstanding the complexity of these issues, Martin Spolc told us that there was no reason why political agreement should not be reached before the end of 2015. He said that while Member States had expressed some concerns, discussions at the informal ECOFIN in April had been ‘very positive. There was broad endorsement of the objectives of the proposal and the Ministers also decided to start technical discussions on this proposal after Easter.”

Do you share Martin Spolc’s optimism about the prospects for agreement? Is his description of negotiations thus far a fair one? What update can you give us on subsequent discussions, and the timetable for progress over the coming months?

JHA OPT-IN

We also note the Government’s assertion in your letter of 1 June 2014 that the UK’s JHA opt-in protocol is triggered in relation to this proposal. As you know, the Committee’s consistent position is that the opt-in is engaged only if the proposal cites a Treaty base within Title V TFEU. Given that the deadline to notify the Commission of the UK’s decision was 19 May, we regret that this was not brought to the Committee’s attention until now. Whilst we are grateful for your apology for the delay, we note that this is the second time in a matter of weeks that a JHA opt-in issue has been identified at a late stage. On 31 March 2014, the then Economic Secretary to the Treasury, Nicky Morgan MP, wrote to us in a similar vein in relation to EM 17949/13: Proposal for a Directive on the Union Legal Framework for Customs Infringements and Sanctions. What steps are you taking to improve the Government’s internal processes to ensure that JHA issues are identified and brought to the Committee’s attention at an early stage?

CONCLUSION

We appreciate that some of these questions are difficult to answer at this early stage in negotiations. However, we would be grateful for a full response to as many of these questions as is possible at this stage, by 10 July 2014. We will continue our examination of these important proposals as negotiations progress in the coming months. In the meantime we will continue to hold the document under scrutiny.

10 June 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 10 June relating to the Commission proposal on structural reforms of EU credit institutions and to the evidence given to the Sub-Committee at its meeting of 10 June 2014. Whilst I have endeavoured to answer as many of your questions as possible, we are still in the early stages of negotiations on this complex dossier and as such some issues still remain unclear and will need to be returned to in the future.

The first issue you raise in your letter concerns the justification for the proposal. The Government agrees that some globally systemic banks benefit financially from perceived implicit taxpayer guarantees that they will receive financial aid from governments if they are at risk of failing. The Government therefore believes that structural reforms rolled out across the EU could help to level the playing field across the Single Market in this regard. Structural reform measures specifically aim to
address the issue of banks which are “too big to fail” by making them more resolvable and protecting depositors. These are complementary to other EU regulations such as the Capital Requirements Directive IV and the Bank Resolution and Recovery Directive which also aim to tackle the issue of implicit taxpayer guarantees. The proposal is therefore welcome. Overall, the Government believes this proposal is generally in line with its own structural reforms. Relative to the Liikanen proposal, the degree of supervisory discretion is positive. However, there remain areas where we believe the proposals could be improved, such as third country provisions and the powers of home and host authorities.

The Government believes that the application of the proposal is in line with addressing “too big to fail” as it aims to capture banks that are large and complex. Nevertheless, smaller institutions can also prove to be systemic and this often depends on the banking sector in which such institutions operate. Given the diversity of banking sectors across Europe, we consider the proposal adequately addresses this issue by allowing Member States to ring-fence such institutions where necessary to support financial stability. The Liikanen proposal did not provide such supervisory discretion and the Government believes that the Commission proposal in this respect is helpful. Rather than being unlimited, this supervisory discretion will be applied within a common framework set out in the regulation. The Government will however scrutinise this closely to make sure that this is properly calibrated.

You also raise the question of whether or not there would have been any advantages for the proposal to have been brought forward in the form of a directive. The Government’s priority is to ensure that the proposal provides sufficient flexibility to be compatible with implementation of the Banking Reform Act. The Commission proposal does provide for some supervisory discretion as well as a derogation provision and the Government will be seeking to maintain these elements during the course of negotiations.

Moving on to your questions regarding proprietary trading, the Commission’s definition is intentionally narrow so as to minimise unintended consequences and also to ensure that the prohibition is enforceable. As you are aware, the Volcker Rule in the USA also proposed a ban on proprietary trading but with a much broader definition. Private sector analysis of this found that, among other negative consequences, the ban impaired market liquidity trading, reduced access to credit and increased bank fees for consumers and businesses. These are important factors to consider when assessing the Commission proposal. As currently drafted, the Government does not believe that the ban will entail widespread unintended consequences as the Parliamentary Commission on Banking Standards found in its report of 5 March 2013 that there is little to suggest that proprietary trading is commonplace among the UK’s main banks. It is not yet clear at this stage whether or not there will be concrete attempts to broaden the definition of proprietary trading. The Government will however be scrutinising this area of the dossier to ensure that the ban is effective and that useful market-making is not hindered.

The question of whether or not the ban would bring about ‘social benefits’ is an interesting one. The Financial Services (Banking Reform) Act 2013 (“the Banking Reform Act”) provides for an independent review of the case for a proprietary trading ban in the UK to be undertaken in 2021 which may be able to shed more light on this issue. With regard to international consistency in this area, the proposal does include a provision for third country equivalence which would reduce the potential for duplication and excessive compliance costs.

You also raise questions surrounding the impact on the UK and the derogation provisions. The current drafting leaves some room for uncertainty on how the regulation would apply in this respect. Our initial reading is that, given that the UK Banking Reform Act only applies to banks established in the UK and EU branches of UK banks, EU subsidiaries of UK banks would be subject to the Commission’s proposals and the derogation would not apply. The impact on UK subsidiaries of banks headquartered in other EU Member States on the other hand is slightly more complex. The derogation will only apply to UK subsidiaries which are subject to the Banking Reform Act. However, given that this Act only applies to ring-fenced bodies, and that only banks which hold more than £25 billion retail and SME deposits or are members of groups holding more than £25 of such deposits, not all UK subsidiaries will be subject to the Banking Reform Act. Such subsidiaries will not qualify for the derogation and the regulation would therefore apply. The Government will scrutinise closely where this is the case and will work to ensure that any additional requirements are proportionate and effective.
Regarding the extra-territorial impact on third countries, the proposal gives power to the consolidating supervisor to apply structural measures to all group entities – regardless of where they are located. The current drafting of these provisions is unclear and the Government will clarify this as the negotiations progress. However, our understanding is that the Commission intend for this to apply only to subsidiaries which hold deposits that are covered by the UK’s Financial Services Compensation Scheme. Furthermore, the Government would like to make it clear that the purpose of a derogation is not to secure a competitive advantage for UK banks vis-a-vis other Member States but rather to maintain the robust structural reform measures that we have put in place for reasons of financial stability. Regarding the position of the PRA, I understand that they have provided evidence to the Committee on a previous occasion and we are working closely with their officials to ensure that UK priorities for this dossier are aligned.

You also asked for more detail on the question of the appropriate balance between the member state and the Commission. As set out in the EM, the Government is committed to ensuring the draft regulation maintains an appropriate balance between the role of the member state and the role of the Commission. This means that we will be looking carefully at the regulation as it is negotiated to ensure that the Commission is not given a greater role than is justified and that the Council and/or the Member States have an appropriate role provided for in the legislation. In particular, we will seek to ensure that any Commission role in the granting of a derogation is proportionate and that the process is timely and designed to minimise market uncertainty. We will have to judge this on a case by case basis as negotiations continue. We will keep the Committee updated in the event that any issues arise.

The Government considers that the economic impact of the proposal on the UK will be minimal given that the major UK banks will be exempted from the measures as they are covered by the Banking Reform Act. Furthermore, bank structural reform will help to stabilise the European Economic Area, to which UK firms have a large exposure, and it is likely that UK firms will benefit from this added stability. However, there is a possibility that some firms which are not currently covered by the Banking Reform Act may be covered by these new requirements. We estimate the one-off transitional costs for these firms to be between £50m and £500m. The Government will also want to ensure that the third country provisions do not place undue costs on non-EEA firms, or on third-country subsidiaries and branches of EU banks and we will scrutinise these elements of the proposal closely.

You also raise questions concerning international consistency and third country equivalence. The UK financial sector is a very global and interconnected one and it makes sense to ensure that financial regulation in different jurisdictions is compatible. Setting minimum standards at international fora such as the FSB and the G20 is key to ensuring international legislative consistency and this practice should continue. Nevertheless, the UK economy has a large exposure to its financial sector and so the need for consistency should not prevent the UK from introducing a strict regulatory regime where this is deemed necessary for financial stability.

With respect to delegated powers, the proposal includes a large number of delegated acts which create uncertainty and enhance the role of the EBA. The Government will be scrutinising these elements of the proposal closely in order to ensure a sufficient amount of certainty as well as supervisory discretion for competent authorities. The Government agrees that certain characteristics can be used to indicate ‘good’ securitisations, and we welcome efforts from the Bank of England, and others, to develop a ‘qualifying’ designation for securitisation. Furthermore, the draft Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014 permits ring-fenced banks to engage in securitisation subject to safeguards. This is however an instance where the Commission’s power needs to be closely scrutinised and the Government will consider this carefully.

You also ask about the implications of the division between home and host responsibilities. The approach for dealing with the division of supervisory tasks between home and host supervisors is established in both the CRD4 package and the Bank Recovery and Resolution Directive. More specifically, the role of the home authority under the CRD4 package is principally to apply capital requirements at the level of the group undertaking; it does not have any direct supervisory powers vis-a-vis subsidiaries located in other Member States. The proposal on structural reform however diverges from this approach by giving decisions regarding structural separation to the consolidated supervisor of the group. There is little scope for the host authority, or for the home authority of a subsidiary of a group which is not the consolidated supervisor, to influence the decision on separation. The Government believes that it is for the Financial Conduct Authority and the Bank of England to regulate banks established in the UK. However, the limited role envisaged for authorities other than the consolidated supervisor could undermine UK authorities’ supervisory powers with
regard to subsidiaries and branches of parent undertakings established in other Member States. The Government will look to improve the text so as to ensure that UK authorities retain supervisory powers over UK banks.

Regarding the progress of negotiations, the third working group took place on 2 July and the Italian Presidency has scheduled a further working group on 17 July. Whilst there is general agreement in the Council surrounding the objectives of the proposal, there are divergent views among Member States as to how these can be achieved and this may take some time to resolve. Furthermore, the European Parliament elections have delayed the appointment of a rapporteur and no internal negotiations or debates have yet taken place. We therefore expect negotiations on this dossier to be lengthy and to conclude around the end of 2015, which is not out of the ordinary for a file of this size and complexity.

Finally, the Government takes very seriously the concerns you express on matters of JHA process and is focused on ensuring we meet our scrutiny commitments to Parliament. As I also noted in my recent letter on the Shadow Banking and the Securities Financing Transactions proposal, this Department and the Government as a whole are taking steps to address this. To ensure the opt-in is identified at an early stage, the Home Office and Ministry of Justice have recently reissued guidance across Whitehall on the opt-in protocol. In addition, specific training on the application of the opt-in, especially in relation to identifying JHA content and understanding the process for asserting the opt-in is being provided to Departments.

As referenced earlier, this is an extensive proposal that will be negotiated over the course of at least the next year and as the dossier progresses I look forward to a continued dialogue with the Committee.

16 July 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 16 July 2014, on EM 6022/14: Structural Reforms of EU Credit Institutions. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 July 2014.

We are grateful to you for this thoughtful response to our 10 June 2014 letter. We are particularly grateful for your helpful clarification in terms of the application of the derogation provision and the issue of home/host responsibilities. The outcome on both these aspects of the regulation evidently remains highly uncertain, and we would therefore be grateful for updates as these issues are discussed further.

We accept that negotiations are still at an early stage and that many issues, these included, therefore remain unclear. Having said that, there are a number of questions in our letter which you have not addressed which are points of principle and information rather than being dependent on the progress of negotiations. These include:

—  Whether this is the final cog in the wheel of the regulatory overhaul of the EU banking system, or whether further reform will be necessary;
—  Whether the use of a regulation rather than a directive sets any kind of unhelpful precedent;
—  What are the implications of a preference for regulations for non-members of the eurozone such as the UK;
—  The reaction in other major global financial centres to the proposal.

Such questions are highly relevant to our new inquiry, launched on 16 July 2014, reviewing the EU financial regulatory framework. As such we would be grateful for a more detailed response to these specific points.

We welcome your promise to keep the Committee updated in the event that any issues arise in relation to discussion of the derogation provision. However you do not mention an extremely significant recent development, namely media reports of a leaked Council Legal Service Opinion questioning the legality of the derogation provision. What are the implications of the Council Legal Service Opinion? What steps are being taken to address the concerns that it has raised? Is it inevitable
that the derogation provision will need to be amended? Do you remain confident that the derogation provision can be retained, and if so, in what form?

We would be grateful for a response to these questions, as well as an update on negotiations including the 17 July Working Group, by 2 September 2014. In the meantime we will continue to hold the document under scrutiny.

22 July 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your follow-up letter of 22 July regarding the Commission proposal on structural reforms of EU credit institutions.

The first question you raise in your letter concerns the regulatory overhaul of the EU banking sector. As you are aware, much has been done in recent years to address the systemic risks posed by the financial sector, which were exposed during the financial crisis. The crisis also revealed that many banks rely on and benefit financially from perceived implicit taxpayer guarantees that they will receive public aid in the event of failure. The EU regulatory agenda has tried to tackle these issues firstly through the Capital Requirements Directive and Regulation in order to increase banks' capacity to absorb losses in times of stress through the introduction of binding capital and liquidity requirements. This legislation is complemented by the Bank Recovery and Resolution Directive which aims to address the issue of “too big to fail” by introducing a regime for the orderly resolution of failing systemic banks. The Directive also helps to tackle implicit public guarantees by ensuring that losses are borne by creditors and that depositors are protected, therefore significantly reducing the likelihood of a taxpayer bailout.

Structural reform of the banking sector is complementary to these measures and is an integral part of reducing implicit taxpayer guarantees. By separating trading activities from core activities which are essential to the real economy and which governments were inclined to protect during the crisis, structural reform measures help to prevent widespread public bailouts. The Government therefore supports structural measures for banks as part of the fuller regulatory reform of the banking system.

Nevertheless, there remains more to be done, including reaching international agreement on binding minimum leverage ratios and loss absorbing capacity for banks. Ensuring international consistency in areas such as cross-border derivatives and shadow banking is also key to reforming the financial sector. Nevertheless, the banking sector is a dynamic one and it is important to adequately assess the impact of regulation across the financial sector. For example, as the Commission notes in its impact assessment, the separation or prohibition of certain trading activities could result in these activities shifting to unregulated sectors such as shadow banking. The Government believes that effects such as these should be closely monitored following extensive regulatory overhaul to ensure that the objectives of reforms are met and excessive unintended consequences are minimised.

You also asked whether the use of a regulation rather than a directive sets an unhelpful precedent and the implications for the UK of a potential preference for regulations. Since the financial crisis, the EU has introduced a stream of reforms to the banking sector comprising both directives and regulations. Indeed, there are some instances where a regulation is more appropriate for a particular policy area than a directive. However, it is the Government’s opinion that such a decision must be based on the content and merits of the proposal. This is an issue that the Government scrutinises closely and will continue to do so across the EU policy spectrum. In the case of Bank Structural Reform, the Government’s priority is to secure a sufficient amount of flexibility for Member States, regardless of the legal form of the measure.

This commitment to flexibility also pertains to the leaked Council Legal Service opinion. This is a piece of evidence the Government will consider alongside a variety of other non-binding sources as discussions progress with all Member States.

Regarding the reaction of other global financial centres to the proposal, there has been a limited reaction to the EU proposal so far. Nevertheless, a Financial Stability Board work stream has been established to assess the effects of structural reforms in different jurisdictions. Discussions have so far been high level and focused around the benefits of structural reform measures, namely reducing the interconnectedness of banks and facilitating their resolution. Comments specifically relating to the EU proposal on bank structural reform have been limited. Nevertheless, some general concerns were raised such as potential impediments to cross-border financial flows and the trapping of liquidity or
capital in domestic silos. Concerns were also raised surrounding the prohibition of proprietary trading which some believe may have a negative impact on the liquidity of foreign financial markets. It was however acknowledged that the concrete impact of measures in different countries was not yet known given that many rules had yet to be finalised.

More specifically on the negotiations on the Bank Structural Reform proposal, the fourth Council working group took place on 17 July. Whilst negotiations are still at an early stage, meetings have established the main issues as being the division of power between home and host authorities, the application of the regulation, the ban on proprietary trading and the derogation. There has been extensive discussion surrounding the ban on proprietary trading, with some Member States raising concerns that an outright ban could potentially shift such activities to the shadow banking sector. The level of supervisory discretion has also been a focus for discussion, with some countries calling for more flexibility for supervisors in deciding whether or not to impose structural measures upon a firm, although a relative few would like to see more automaticity in this respect. Council working groups are set to recommence from the end of September and continue through the autumn. Nevertheless, given the complexity and size of the dossier, we expect negotiations to be lengthy and to conclude by the end of 2015.

I hope this response provides some clarity on the issues you raise in your letter and I look forward to a continued dialogue with the Committee as the negotiations on this dossier progress.

1 September 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 1 September 2014, on EM 6022/14: Structural Reforms of EU Credit Institutions. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 9 September 2014.

We note that negotiations remain at an early stage. Nevertheless the issues at stake which you cite, including the division of power between home and host authorities, the ban on proprietary trading and the derogation provisions are all vital issues. Noting that Council working groups are set to recommence at the end of September, we would be grateful for a further update on negotiations by 3 November 2014. In the meantime we will continue to hold the document under scrutiny.

10 September 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 10 September requesting an update on the negotiations on Bank Structural Reform.

In the Council, there have been six working groups to date, with the most recent occurring on 28 October. These are expected to continue on a monthly basis throughout the Italian Presidency until the end of the year. Discussions have been relatively high-level and no conclusions have been made; and we do not expect there to be an agreement in the Council by the end of the year. During the course of Council negotiations general concerns have been raised by Member States regarding the timing of the proposal, its aims and the overlap with other pieces of financial regulation. The main issues Member States have raised concerns on are: the treatment of proprietary trading, the separation process, home and host responsibilities and the derogation.

The proprietary trading ban has been the subject of numerous discussions in the Council, which have focused firstly on the definition of proprietary trading and secondly on how such activities should be treated. Whilst there are some Member States that believe the Commission’s proposal is appropriate, a number of other Member States are concerned that the narrow definition of proprietary trading would lead to regulatory arbitrage, considering a broader definition to be more appropriate. However, some of these Member States also believe that banning such activities could have a negative impact on other services such as market-making whilst also increasing the risk that these activities move to the shadow banking sector. Member States that take this view generally tend to prefer a separation of these activities rather than an outright ban. The Government will seek to ensure that any treatment of proprietary trading is both effective and does not hinder activities that are essential for market liquidity, such as market-making.
There have also been Council discussions on the process by which banks separate, the focus being placed on how much discretion supervisors should have when deciding whether or not to separate a bank. Some Member States appreciate the level of supervisory discretion that the Commission has proposed but would like to extend this further. On the other hand, some other Member States would prefer more automaticity when deciding if a bank should separate. This would generally involve banks having to meet certain criteria that are detailed in the regulation and, once these are met, they will automatically be obliged to separate. However, such discussions have so far been exploratory, no textual amendments have been proposed and no conclusions have yet been reached.

A number of Member States have also raised concerns regarding the role of supervisors. As I have mentioned in previous correspondence, the Commission proposal gives all decisions regarding the structural separation of banks to the consolidating supervisor of the group. This clearly diverges from the established practice in other EU legislation, such as the Capital Requirements package and the Bank Recovery and Resolution Directive. Some Member States refute this approach, on the grounds that such decisions will have a material impact across Member States and that host authorities should therefore have a more prominent role than is currently envisaged in the Commission’s proposal. The Government shares this concern as it believes that it is primarily the responsibility of the Financial Conduct Authority and the Bank of England to regulate banks established in the UK. The Government will continue to pursue an outcome that does not undermine this point in relation to structural reform.

The derogation has also been discussed by the Council, however this has not been a focal point of the negotiation so far. Some Member States have raised concerns regarding the derogation as they believe this could fragment the Single Market and some are concerned about the legal approach taken. However, many Member States recognise that the reforms this Government has pursued are more robust than the proposal and they are willing to allow some flexibility in this regard. The Government is focused on ensuring the proposal recognises the ‘super-equivalence’ of the Banking Reform Act and that the UK reforms remain accommodated in the approach.

The European Parliament, on the other hand, has only just started its legislative procedure, and the first exchange of views took place on 4 November. Gunnar Hökmark, a Swedish conservative MEP has been appointed as rapporteur of this dossier. In the past, Mr Hökmark has publicly spoken out against the proposal on the grounds that ring-fencing is unnecessary in light of other regulatory reforms (such as the Capital Requirements package and the Recovery and Resolution Directive) and the potential negative impact on the real economy.

Other shadow rapporteurs include Jakob von Weiszacker (German, Socialist), Syed Kamall (British, Conservative), Sylvie Goulard (French, Liberal), Philippe Lamberts (Belgian, Green) and Fabio de Masi (German, Communist). It is not yet clear whether or not these MEPs share Mr Hökmark’s view and it is therefore uncertain which direction the parliament will take. Nevertheless, Mr Hökmark’s rapporteur’s report is due to be published on 18 December, following a hearing with members of the industry, academics and interested stakeholders on the 2 December. The final report of the European Parliament is due to be voted at the end of March.

I hope you find this update on the negotiations so far helpful, and as the dossier progresses I look forward to a continued dialogue with the Committee.

7 November 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 7 November 2014, on EM 6022/14: Structural Reforms of EU Credit Institutions. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 18 November 2014.

We note that negotiations have thus far been at a relatively high level, and indeed that there remain fundamental divisions in relation to key issues including the ban on proprietary trading, supervisory discretion and home/host responsibilities. What do such divergent views, together with the uncertainty about the European Parliament’s approach, indicate about the prospects of agreement being reached on this legislative file? How real is the danger of fragmentation of the Single Market that some Member States have raised concerns about?

We understand that the issues concerning proprietary trading are complicated due to the definitions involved and whether it is favourable to have a narrow or broad definition. It is however evident that
A number of European banks have already started to reduce their proprietary trading desks in their efforts to deleverage. In light of this trend, can you provide details of the current level of proprietary trading in Europe? Given the rules on proprietary trading in the US, have there been adverse consequences on market making as a result? If market making and proprietary trading activities do start to move out of the regulated sector, is this socially harmful to the financial sector and the development of risks? To what extent are hedge funds regulated in providing such services? Taking all this into account, do you agree that there is a strong case for separation as opposed to an outright ban?

We note your update on the derogation provisions. Given your statement that "many Member States recognise that the reforms this Government has pursued are more robust than the proposal and they are willing to allow some flexibility in this regard", how confident are you that a compromise can be reached to accommodate the UK's position? Which Member States are sympathetic to the UK's position?

You state that concerns have been raised by Member States regarding the overlap with other pieces of financial regulation. Given that the question of inconsistencies between legislative files is a key component of our current inquiry into the EU financial sector regulatory framework, we would be grateful for more details of such concerns. Does the Government share such concerns? You cite the divergence in terms of provision of decision making power to the consolidating supervisor of the group from established practice in other EU legislation such as the Capital Requirements package and the Bank Recovery and Resolution Directive. What would be the consequences of such inconsistency? Has the UK or other Member States drawn attention to any other inconsistencies?

We would be grateful for a response to these questions, together with an update on negotiations, by 8 December 2014. In the meantime we will continue to hold the document under scrutiny.

19 November 2014

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 19 November requesting further information regarding the negotiations on Bank Structural Reform.

You first asked about the progress of the file, given the number of divergent views on a range of issues and the uncertainty surrounding the European Parliament's position. As I have mentioned in previous correspondence, this is a dossier of great complexity and political concern to those involved and we expect negotiations to be lengthy. Although there are many differing views among Member States and MEPs which will make for difficult negotiations, it is worth noting that this has often been the case on previous dossiers which have nonetheless been agreed.

Regarding your questions on proprietary trading, specifically in the UK, the Parliamentary Commission on Banking Standards found in its report of 5 March 2013 that proprietary trading was certainly not widespread amongst UK banks. The Commission's impact assessment states that current levels of proprietary trading in Europe are relatively insignificant: their research showed that, from the banks which responded to their call for data, proprietary trading represented between 0% and 4% of total trading revenues. The Commission's proposed ban is therefore designed to act as a floor in order to prevent a re-emergence of the level of proprietary-trading that we witnessed prior to the financial crisis. The question you raise regarding the impact of the US proprietary trading ban is an interesting one. Some private sector analysis of the USA's Volcker Rule has found that, among other negative consequences, the ban impaired market liquidity trading, reduced access to credit and increased bank fees for consumers and businesses. However, these reforms are in the early stages of implementation and it is difficult to provide information on their full impact. Whilst it is true that a ban could potentially run the risk that proprietary trading will move to the shadow banking sector, the Government believes that since the level of proprietary trading undertaken by banks is generally low, such a narrowly defined ban should not entail significant unintended consequences. In addition, there are international work streams led by the Financial Stability Board, and supported by the Government, that will look to increase transparency and limit risk in the shadow banking sector, which the EU will also be taking forward.

Most hedge funds are regulated entities, which are subject to both Markets in Financial Instruments Directive and Alternative Investment Fund Managers Directive and are supervised by the Financial Conduct Authority. Nevertheless, discussions on this issue are still at an early stage and the...
Government will carefully scrutinise this area of the dossier and seek to ensure that any treatment of proprietary trading is proportionate to the activities which are captured by the proposal.

You also raise a number of questions regarding the derogation provisions. As I mentioned in my previous letter, although some Member States feel that the derogation could potentially fragment the Single Market, most do feel that the UK reforms are indeed 'super-equivalent' and should therefore be accommodated. The Government therefore remains confident that this will eventually be the case and we are working closely with all those concerned to ensure that UK priorities are delivered. Whilst I appreciate your interest in identifying which Member States are supportive of the Government’s concerns, it would be inappropriate to comment on the negotiating positions of other Member States which have been provided in confidence.

Your letter also touches upon the concerns raised by Member States regarding the overlap with other pieces of financial regulation and I hope that I can clarify this matter. Some Member States and MEPs believe that many of the objectives of bank structural reform have already been met by introducing other pieces of regulatory legislation. Indeed, some argue that solving the ‘too-big-to-fail’ problem has already been dealt with in the Capital Requirements package and the Bank Recovery and Resolution Directive: the former by improving banks’ resilience to losses and the latter by ensuring that credible tools are in place to ensure that banks can be wound down in an orderly fashion and that liability is appropriately accorded to shareholders and creditors.

Proponents of these arguments therefore believe that bank structural reform is unnecessary. However, by restructuring banks and by having oversight of this restructuring, supervisors are better equipped to monitor the activities of smaller entities within a larger banking group. In essence, the activities of banks are likely to be more visible, both to supervisors and to investors, if they are concentrated in smaller, simpler entities. Furthermore, structural measures help to provide optionality in resolution. By restructuring banks according to the types of activities they undertake, a resolution authority has more options to deliver a targeted approach to resolution, namely by being able effectively to use different resolution tools on different parts of the banking group, while ensuring that unaffected parts of the group remain untouched.

The question you raise regarding decision-making powers given to the consolidating supervisors is an important one. As I have mentioned before, the proposal for bank structural reform empowers the consolidating supervisor to take all decisions relating to structural separation across the group, with only a consultative role for local supervisors. This differs greatly from the established practice in the Capital Requirements package and the Bank Recovery and Resolution Directive where joint-decisions between consolidating and local supervisors are established.

Diverging from this approach runs the risk of setting a precedent for regulation at the consolidated level which could impair the role of authorities to supervise their local entities of which they have a deeper understanding and with whom they have a close relationship. Local supervisors are also best placed to understand the specificities of the national economy and its specific financial stability concerns – all of which are clearly impacted by the separation of banks. The Government has raised this matter in the context of Council working groups and is confident that the text will be improved along these lines.

I hope this response provides some clarity on the issues you raise in your letter and I look forward to a continued dialogue with the Committee as the negotiations on this dossier progress.

12 December 2014

Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 12 December 2014, on EM 6022/14: Structural Reforms of EU Credit Institutions, and your EM 15924/14, dated 10 December 2014: An ECB Opinion on Structural Reforms of EU Credit Institutions. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 13 January 2015.

Your letter is helpful in addressing many of the points on the timings, proprietary trading, derogation and regulatory inconsistencies. We acknowledge that the dossier is both complex and politically important and that negotiations may take some time until a General Approach is reached. We support the continuing efforts to reform bank structure in Europe due to the need to address underlying uncertainties in cross-border resolution, crisis management, as well as overall objectives to advance the simplicity and transparency of bank operations and improve supervisory operations.
We take note of your approach to ensure consistency and improve the text to allow joint-decision on structural separation, aligning to the approach in CRD IV and BRRD. In supporting this view however, we raise concern as to the extent to which a Member State will support their own 'national champion'. Are you confident that the final decisions on structural separation by a competent authority and a resolution authority are sufficiently clear and workable in practice?

We acknowledge that fragmentation owing to structural reform is a concern, but we also recognise that this is also considered by some to be an intended benefit, reducing interconnectedness between intermediaries, including activity across borders. Given the UK’s Banking Reform Act and objectives underpinning the EU Structural Reform agenda, do you believe the extent and threshold level of ex-ante separation or ring fencing can improve cross-border stability or instead whether it conflicts with the too-big-to-fail agenda? Given such reforms, we would ask you to consider how the EU agenda affects cross border and international operations of globally systemic important banks operating out of the UK and wider EU. Do you believe the text could in any way overly restrict EU credit institutions in their operations abroad?

In light of the comments made in the ECB opinion, we agree with you that a degree of flexibility needs to be included to ensure that the UK is able to implement the Vickers reforms. Has your confidence that the derogation provision will be retained been eroded by the ECB’s Opinion? We also recognise that definition of market-making is complex as it is not always obvious when this transaction has been transacted versus that of a proprietary trade. Do you believe the definition of market-making used by the Commission is adequate? You do not refer to the ECB’s concerns on the activities of credit institutions that fall outside of the scope of the Regulation. How do you evaluate the thresholds given the ECB’s argument that systemic risk can build up in exempt institutions on a large and aggregated scale? Finally, we agree with the ECB’s emphasis on supervisory judgement but would question whether the metrics in the proposal used to determine and separate trading activities are adequate, taking into account the importance of certain activities such as market-making to financial stability.

We would be grateful for a response to these questions, together with an update on negotiations, by 28 January 2015. In the meantime we will continue to hold EM 6022/14 document under scrutiny, but clear EM 15924/14 from scrutiny.

14 January 2015

Letter from Andrea Leadsom MP to the Chairman

Thank you for your letter of 14 January requesting further information regarding the negotiations on Bank Structural Reform and clearing from scrutiny EM 15924/14 on the ECB Opinion on the Commission proposal.

Your letter first asks about decisions on structural separation and whether the process for arriving at such decisions where both a competent and a resolution authority may be involved are sufficiently clear and workable. The ECB Opinion includes consideration of this issue and some suggested textual improvements to Article 19 of the proposal. The issue of effective cooperation between competent and resolution authorities is important because both authorities will have the responsibility for assessing credit institutions and both will have the power to require separation. The ECB Opinion does recognise that the competent authority and the resolution authority will carry out their assessments and could require separation on the basis of rather different criteria and for different reasons, but this isn’t fully reflected in the amendments the ECB proposes. My officials and those of other Member States have already pointed to the need for much greater clarity about the processes involved here and indeed about the need for clearly articulated objectives in the proposal.

Regarding your questions on cross-border stability and the impacts of the EU Structural Reform agenda on cross-border activity, the key consideration is around striking an appropriate balance between the desired aims of protecting the taxpayer and the wider economy from disruption in the event of a bank failure, whilst maintaining the competitiveness of UK and EU credit institutions. The Government has already made a decisive and strong commitment to improving financial stability through implementing the Vickers recommendations and addressing the implicit taxpayer subsidy for trading activities from which a number of large, systemically important banks benefit.

A number of participants in the wider EU institutional debate, including prominent voices in the European Parliament, have strong reservations about the potential impacts of the Commission proposal and the consequences for the universal banking model in Germany and the Nordic countries. They not only argue the European banking system needs to deliver much more support and
underpin investment for the “real economy” through lending and credit lines for corporates, but that
the perceived presumption to separate will hamper EU credit institutions from competing with large
and growing international banks from outside the EU. Those defenders of the universal banking model
state that the EU agenda should focus on addressing risk and not structure.

For the Government’s part, our objectives in the negotiation on these issues remain: that we should
avoid application of an EU regime alongside the Banking Reform Act that would lead to excessive
burdens for international banks operating in the UK; and that any trading restrictions do not
disproportionately impact the competitiveness of UK and international banks operating in London.

Your letter outlines several other subjects covered in the ECB Opinion. The ECB’s criticism of the
Commission’s proposed derogation in Article 21 is primarily based on concerns about the
effectiveness of the SSM and its own ability to apply legislation in a consistent manner. The ECB is also
concerned about precedent. However, the ECB’s concerns have been tempered in the wider
discussions by the clear willingness of the majority of Member States to seek an accommodation for
the UK (as set out in the Italian Presidency’s progress report on the dossier, attached for your
reference). Several ECON Committee MEPs across political groups also recognise that the regime the
UK has established is clear and robust. How that accommodation can be best framed in the
Regulation is the subject of many ongoing discussions we are having with the Commission, the
Presidency and other Member States, and we remain committed to achieving a satisfactory outcome.

Similarly, the proposal’s provisions on market-making are set to be discussed further and developed
both by the Council and by the European Parliament. We regard the definition in the Commission
proposal is adequate, but would be open to exploring with other Member States any further
refinements that can help distinguish the activity from proprietary trading.

Within its comments on prohibited trading activities and as you have identified, the ECB sets out
costs about the high-risk activities engaged in by credit institutions that do not fall within the
scope of the proposed Regulation. We would be content with a review of the Regulation that
included any exemptions to prohibition, but our emphasis on this point as well as on the proposal as a
whole will continue to be about having clear objectives for the regulation aimed at addressing
systemic risk. Where the regulation or scrutiny of such high-risk activities is already covered by
existing EU legal instruments, we would argue that there should be no duplication or confusing
overlap in the Bank Structural Reform file.

Your final observation about the importance of the metrics to be used when determining the scope of
application of the proposed Regulation and when identifying which trading activities are to be
separated is well made. This is indeed going to be the subject of much further debate in both the
Council and the European Parliament as negotiations progress and the Latvian Presidency has asked
the Commission to do some more detailed modelling on how the metrics would be applied and
indeed what results they might yield. We would support such metrics being clear and used in a way
that helps ensure predictability of outcome for credit institutions, be it separation or otherwise, and
that allows for consistent enforceability by the competent authorities concerned.

Since I last wrote to you in December, the Latvian Presidency has held one Council working group on
19 January at which Member States discussed the separation process and the principles predictability,
applicability and enforceability. A further working group is scheduled for 13 February.

On the European Parliament side, the ECON Committee rapporteur for the dossier, Gunnar
Hökmark, published his report on the Commission proposal on 6 January with an amendment
deadline set for 30 January. Over 800 amendments have now been submitted. The report diverges
from the original proposal by making separation optional (supervisors may instead enhance
supervision or apply increased capital requirements if they wish), but it also reformulates the
derogation into an exemption aimed at achieving the same effect. The ECON Committee had an
exchange of views on the proposal on 21 January. MEPs will now consider and discuss the raft of
amendments with a view to voting on them in late March.

I hope this response provides some helpful information on the issues and questions you raise in your
letter and I look forward to further dialogue with the Committee as the negotiations on this dossier
progress.

3 February 2015
Letter from the Chairman to Andrea Leadsom MP

Thank you for your letter, dated 3 February 2015, on EM 6022/14: Structural Reforms of EU Credit Institutions. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered these documents at its meeting on 2 March 2015.

Your letter is helpful in addressing many of the points on decisions made by resolution and competent authorities, cross-border stability issues, derogation, metrics and exemptions. We acknowledge that the Commission is providing additional expertise to Member States that will help discussions on the metrics used for decisions on separation of an institution. How would you respond to concerns about the consequences arising from a possible fracturing of implementation practices between EU Member States? Where does this possible fracturing leave the Regulation itself? We welcome further clarity on decisions made by competent and resolution authorities under the proposal.

Regarding the derogation, we note your assurance about the views of other Member States and MEPs alike that recognise the UK’s regime as being clear and robust. We would be grateful for your assessment of whether the alternative of an exemption under consideration in the European Parliament would be equally satisfactory. We would welcome additional comments you may have on the draft report by the European Parliament Rapporteur, Gunnar Hokmark.

We would be grateful for a further updates to the Committee on any significant developments being made in Council Working Groups. In light of the forthcoming dissolution of Parliament, we would be grateful for a further update by 26 May at the latest, or sooner if there are significant developments before then. In the meantime we will continue to hold EM 6022/14 document under scrutiny.

2 March 2015

SYNTHESIS OF THE COMMISSION'S MANAGEMENT ACHIEVEMENTS IN 2013
(10944/14)

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

Thank you for the Explanatory Memorandum from the former Financial Secretary to the Treasury, Rt Hon Nicky Morgan MP, dated 7 July 2014, on EM 10944/14 on the Commission Communication: Synthesis of the Commission’s Management Achievements in 2013. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 22 July 2014.

I would first like to take the opportunity of welcoming you to your new position.

While the number of reservations has declined, the Committee notes the importance of the increase in scope and financial exposure of the new reservations, as well as the translated amount of risk therein. Are you encouraged by the fact that financial recoveries and corrections in 2013 exceeded the average amount for 2009-2013? Does this suggest that the Commission’s supervisory and control systems have demonstrated a positive trend in terms of their corrective capacity?

We note that the UK is subject to three reservations; miscellaneous aid schemes on market measures funded by the European Agricultural Guarantee Fund (EAGF); management and control systems for operational programmes under the European Regional Development Fund/Cohesion Fund/Instrument for Pre-accession Assistance (IPA); and management and control systems for operational programmes in the European Structural Fund. The Commission states that action has been taken in each of these area. Can you provide more detail on the nature of the issues at hand and the steps that have been taken to address that problems that have arisen?

We strongly advocate the need for the EU budget to be managed with effective internal control systems in place, strengthening accountability and transparency of DGs and Heads of Services in the process. As raised in relation to the Committee’s scrutiny of management achievements in 2012, we favour effective forms of deterrence. We therefore welcome the new mechanism for suspending agricultural payments as an ex-ante instrument to protect the EU budget from weaknesses in Member States’ control systems. Do you believe more ex-ante instruments should be in force in other expenditures of the EU budget?
You note that a number of problems have been identified with the way the net financial corrections are currently applied. While statistics on net financial corrections per Member State are welcomed, do you agree with the Commission’s assessment that a quicker procedure for net corrections would incentivise Member States to address weaknesses in their management and control systems? The Commission also emphasise the challenges of shared management. We note the Commission’s concerns on shared management, in particular the observation by the European Court of Auditors that two-thirds of errors could have been identified by national authorities. What practical changes can the Government undertake to implement the Commission’s recommendations to support first level checks?

We would be grateful for a response to this letter by 2 September 2014. In the meantime we will continue to hold the document under scrutiny.

22 July 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter of 22 July on the above named report. Your letter contains a series of questions on the detail of the report, specifically in relation to reservations.

FINANCIAL RESERVATIONS

Your letter asked whether the Government is encouraged by the Commission’s figures for financial recoveries and corrections in 2013. The Government notes the Commission’s continued efforts to take effective action where errors are identified, including through the use of financial corrections. However, as set out in HM Treasury’s explanatory memorandum summarising the Commission’s communication on the application of financial corrections for agricultural and cohesion policy (EM 18030/13 of 16 January 2014), a number of problems have been identified in the way the Commission currently applies financial corrections.

As such, while the Commission’s clear engagement in this area is encouraging, we will continue to urge the Commission to ensure that financial corrections are consistently applied in appropriate circumstances and reflect the genuine misuse of EU budget funds.

UK RESERVATIONS

Your letter also asked for further information regarding three UK financial reservations referenced in the report. It is worth noting that there has been no suggestion of misuse of funds in any of the programmes concerned. The financial corrections made were the result of technical deficiencies rather than the misappropriation of funds or the failure of management and control systems.

— The reservation under the European Agricultural Guarantee Fund (EAGF) concerned the Fruit and Vegetable Producer Organisation regime. The UK has already conducted a thorough review of associated Producer Organisations and no longer approves those that do not meet the scheme’s requirements. DEFRA will continue to actively engage with the Commission to better understand the nature of residual concerns.

— The Commission identified technical deficiencies in the management and control mechanisms of some UK MAs in relation to EU Structural Funds (ESF). Working with Commission services, the MAs concerned have implemented agreed actions to remedy identified deficiencies. Following the satisfactory implementation of these changes, the Commission lifted the partial interruptions to the Northern Ireland ESF programme in December
2013 and to the England programmes in March 2014. Welsh and Scottish MAs continue to actively engage with the Commission to address identified shortcomings.

**EX-ANTE INSTRUMENTS**

You asked about the wider use of ex-ante instruments to protect the EU budget. While ex-ante measures, such as suspensions, are a useful means of ensuring that EU budget funds are only received and deployed in accordance with existing rules, the Government highlights the importance of ensuring that these measures are deployed carefully to maximise their impact.

In the HM Treasury EM mentioned above (EM 18030/13), the then Economic Secretary confirmed that the Government supports the reduction in the length of the conformity procedure. This would both improve the impact of financial corrections and the Commission’s ability to accurately calculate the appropriate level of correction.

**HMG ACTION TO IMPLEMENT COMMISSION’S RECOMMENDATIONS**

The Government will continue to push for clarity and consistency in the interpretation of the complex legislation and rules governing EU budget expenditure. While we remain of the view that the mismanagement of EU funds by national authorities is unacceptable, the Commission has a role to play in ensuring that all those involved in the use and monitoring of EU funds are considering and applying the rules in the same way.

The Government continues to actively engage with both the Commission and the European Court of Auditors to improve the quality of first level checks and, where appropriate, make changes to existing processes. For example, the Rural Payments Agency has introduced pro-active land change detection to improve the quality and currency of data in its land registry.

12 September 2014

**Letter from the Chairman to David Gauke MP**

Thank you for your letter, dated 12 September 2014, on EM 10944/14 on the Commission Communication: Synthesis of the Commission’s Management Achievements in 2013. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 14 October 2014.

We are grateful for the explanation and detail of the financial reservations brought upon the UK in each of the three areas identified by the Commission. We welcome the fact that necessary reviews have already taken place and that technical deficiencies are being prioritised. We note your response on the use of ex-ante instruments, and the relatively successful efforts by the Commission’s supervisory and control systems that have demonstrated a positive trend in terms of their corrective capacity.

We would be grateful for clarification of your statement that ERDF payments to Wales were temporarily interrupted on technical grounds, but that the Welsh Government is optimistic that the situation will be resolved shortly. Can you confirm that in the meantime Wales continues not to receive ERDF funding? We would be grateful for clarity as to the details involved.

It is hoped that the Government’s continued commitment to keep a watchful eye over the EU budget, coupled with the Commission’s improved supervisory and control systems will help to mitigate the inefficiencies and errors at the national level. Nevertheless, significant challenges remain at the national level surrounding weak management and control systems. The Committee would welcome practical recommendations and innovative ways to support and improve first level checks.

We now clear EM 10944/14 from scrutiny.

14 October 2014
**Letter from David Gauke MP to the Chairman**

Thank you for your letter of 14 October 2014 on the above mentioned EM. Your letter sought further information regarding the temporary interruption of European Regional Development Fund ("ERDF") payments to Wales referred to in my letter of 12 September.

The Welsh European Funding Office has confirmed that on 14 October 2014, the Commission Services communicated that the conditions for lifting the procedure to interrupt ERDF interim payments concerning the West Wales and the Valleys (2007UK161P0002) and East Wales (2007UK162P0012) programmes had been fulfilled and that interim payments for these programmes can now be processed again. This is indicative of the UK’s responsive and collaborative approach to financial management.

I thank the Committee for clearing this report from scrutiny.

21 November 2014

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**Letter from the Chairman to David Gauke MP**


We note that ERDF interim payments relating to the West Wales and the Valleys and East Wales programmes can now be processed again. Can you clarify why the interruptions occurred, and which conditions were fulfilled to enable the interruption to be lifted?

We would be grateful for a response to this letter by 16 December 2014.

2 December 2014

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**Letter from David Gauke MP to the Chairman**

Thank you for your letter of 2 December 2014 in which you request further information on the interim ERDF payments relating to Wales.

The interruptions occurred because of weaknesses identified by DG REGIO’s audit mission in the methodology applied by the Welsh Audit Authority. These included concerns with the sampling methodology and the lack of reporting confirming that the Managing Authority was recognising the bodies managing all or part of the aid schemes as the “beneficiary” instead of the “final recipients” of aid.

The Welsh authorities have engaged and cooperated with the Commission resulting in the implementation of the following measures to strengthen control systems:

— Provided assurances that sufficient audit work had been conducted in relation to 2012 expenditure;

— Submitted revised projected error rates for expenditure audited in previous years and, where appropriate, applied corrections to those years;

— Followed up with the relevant Managing Authority on the treatment of “beneficiaries” in the case of aid schemes;

— In relation to the 2013 Annual Control Report (“ACR”), ensured the completion of all procurement checklists and reassessed the public procurement audit;

— Submitted a revised 2013 ACR and annual opinion which reflected the corrective measures implemented and indicating the any financial corrections to be made;

— Confirmed that, where appropriate, programme authorities had applied financial correction and submitted a comprehensive overview of all decertified expenditure; and
Confirmed that a statistical sampling methodology would be used for future ACRs.

Following the successful implementation of these corrective measures, the Commission confirmed the lifting of the interruptions in October 2014.

5 January 2015

UPDATE ON THE UK’S LEGAL CHALLENGE TO THE ECB’S LOCATION POLICY
(UNNUMBERED)

Letter from Andrea Leadsom MP, Economic Secretary to the Treasury, HM Treasury, to the Chairman

Following the appearance of my colleague, David Gauke, the Financial Secretary to the Treasury, at the Lords EU scrutiny committee hearing on 24 February, I am writing in response to your committee’s request for an update on the UK’s legal challenges to the ECB’s location policy.

The UK’s legal challenges relate to the publication by the ECB in July 2011 of an updated location policy for central counterparties ("CCPs") – key financial market infrastructures which interpose between counterparties’ transactions, guaranteeing they complete. The relevant language was contained in a policy document relating to the role of Eurozone central banks in the Eurosystem, and states that CCPs which clear euro-denominated instruments above certain thresholds must "be legally incorporated in the euro area with full managerial and operational control".

While the ECB has had oversight policies relating to market infrastructure for some time, the July 2011 statement for the first time created a clear residence requirement for CCPs to locate in the Eurozone if they offer euro-denominated services above certain thresholds. The policy applied not only to CCPs based in the UK or other Member States, but also to clearing infrastructures in third country jurisdictions such as the US. The ECB had not consulted on the policy before its introduction, forestalling any other means of resolution.

Accordingly, the Government brought a case to the General Court of the European Union in September 2011, arguing that these were jurisdictions and entities over which the ECB did not have power to impose such a location policy.

In addition, the UK argued that such a location policy was in breach of Single Market rules, and did not respect the rights of all EU Member States, whether located in the Eurozone or not, as afforded under the EU Treaties – specifically, the freedom of establishment and free movement of capital.

The UK subsequently launched two further challenges to the location policy, in line with our legal advice, following its incorporation into later instruments published by the ECB in order to protect our position.

Separate oral hearings were convened on the three cases on 9 July last year.

The Court ruled on the first of these three UK challenges on 4 March. The Court accepted the Government’s arguments that the ECB had acted beyond its powers in applying this policy to CCPs, and annulled the policy framework in so far as it sets a requirement to be located within the Eurozone for CCPs involved in the clearing of securities. The Court did not consider it necessary to examine the Government’s other arguments. This is an excellent result for the financial services industry in the UK and an important step in protecting the rights of euro-outs and ensuring a level playing field for all EU Member States, whether in the Eurozone or not.

The remaining two cases are still under consideration from the Court, which will rule on both at a later date, but the Government does not have any reason to expect a different outcome.

11 March 2015
Letter from the Chairman to David Gauke MP, Financial Secretary to the Treasury, HM Treasury

Thank you for your letter, dated 11 March 2015, on the UK’s legal challenge to the ECB’s location policy. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 17 March 2015.

We welcome the General Court of the European Union’s ruling in favour of the UK’s challenge, and its argument that the ECB had acted beyond its powers in applying this policy to CCPs. However, we are concerned about the possible implications of the Court’s conclusion that it was not necessary to examine the Government’s other arguments. Is there a danger that the UK’s arguments that such a location policy was in breach of Single Market rules and did not respect the rights of all Member States may be challenged, for instance in the context of an appeal by the ECB to the Court of Justice of the European Union? Have you received any indication as to the ECB’s response to this ruling? If an appeal is lodged, we ask to be informed promptly of the grounds of the appeal.

How would you respond to the General Court’s suggestion of a potential political solution in paragraph 108 of its ruling, namely to amend the ECB Statute under Article 129(3) TFEU to give the ECB express power to regulate clearing houses? How would the UK respond in the event that such an amendment were proposed?

You state that the policy would have applied to clearing infrastructures in third country jurisdictions such as the US. Can you elaborate on the implications of this for such jurisdictions? What was the response in such countries as the US to the ECB’s location policy? Has there been any US response to the General Court’s ruling?

We would be grateful for a response to this letter by 26 May 2015.

17 March 2015

UPDATING THE EUROPEAN UNION COMMITTEE AHEAD OF THE DISSOLUTION OF PARLIAMENT ON REMAINING SCRUTINY BUSINESS CONCERNING STATISTICAL REGULATIONS (UNNUMBERED)

Letter from Rob Wilson MP, Minister for Civil Society, Cabinet Office, to the Chairman

I am writing to you in advance of the dissolution of Parliament to provide an update on remaining business before the Committee on matters which are the responsibility of the Office for National Statistics. I will also provide details of any potential new business including proposed delegated acts which the European Commission is expected to publish in the coming months.

I have written on similar terms to the Chair of the House of Commons European Scrutiny Committee.

I am also replying to your Committee’s letter of 24 February 2015 on EM 16612/14 in which the Committee cleared the EM from scrutiny and requested further updates as negotiations progress and asked when a General Approach is likely to be agreed.

REMAINING BUSINESS

DOCUMENT NO. 11177/13: PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON THE PROVISION AND QUALITY OF STATISTICS FOR THE MACROECONOMIC IMBALANCES PROCEDURE.

Your Committee has retained the proposal under scrutiny. Nick Hurd wrote to you on 1 October 2013 in response to a number of questions from your Committee and undertook to write again with news of any significant developments.

The Government’s aims are to secure either a substantial re-draft of the proposed Regulation or its removal altogether, as it is a disproportionate response to the policy need, it would not be able to meet its objectives, and it proposes to create a sanctions regime not foreseen by the Treaty. Your Committee has reported that it shares the Government’s concerns and is awaiting a formal update on negotiations, particularly once the findings of the CMFB Task Force are understood and with news of any further significant developments.
The proposal is still under negotiation at Council Working Party level - where most Member States are currently overwhelmingly opposed to the Commission's proposals - and there has been no substantive progress at the Committee stage in the European Parliament.

Related to this matter, late in 2014, the Economic and Finance Committee called for stakeholders to evaluate whether the Commission's proposal was the best means of achieving the objectives. The Committee on Monetary, Finance and Balance of Payments Committee (CMFB) has produced a firm proposal for an alternative, less burdensome, approach to achieve the aims of the Commission's proposal, which would not necessarily require regulation at all. This proposal is now being further refined by the CMFB, with good progress made.

It is, however, still not clear how the Commission will respond to these developments. The Latvian Presidency has stated that discussions are currently on hold.

**DOCUMENT 16612/14 AND 16612/14 ADD 1: PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL IN HARMONISED INDICES OF CONSUMER PRICES AND REPEALING REGULATION (EC) NO 2494/95**

Your Committee considered the EM of 7 January 2015 and in its letter of 24 February 2015 cleared the matter from scrutiny. Your Committee requested further updates as negotiations progress and asked when a General Approach is likely to be agreed.

There have been no significant developments to date. Initial consideration of the proposal at Council Working Party level started on 18 February and will continue at the next Working party meeting on 17 March.

In your letter of 10 February your Committee requested to be informed of when a General Approach is likely to be agreed. It is possible that the Council will be asked to agree a general approach before your Committee is able to consider a further update in the next Parliament. I will of course write further on developments.

**DOCUMENT 9122/12: PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL AMENDING REGULATION (EC) NO. 223/2009 ON EUROPEAN STATISTICS**

Your Committee cleared the proposal from scrutiny in September 2012.

I wrote to you on 5 January 2015 in connection with unwelcome developments with the text which introduces provisions for sanctions regimes in future statistical regulations which the Government believes would be illegal and which the Government could not support. I wrote again on 20 February 2015 to confirm that the Government does not intend to challenge immediately the provision in the European Court of Justice.

Following consideration of legal-linguistical revisions to the text, the proposal was approved by Coreper on 4 March and final adoption was agreed at the Energy Council on 5 March. The UK voted against the proposal and laid a minute statement at Council to the effect that Article 338(1) TFEU does not constitute an appropriate legal basis for Article 12.3(b) of the proposed regulation. The Presidency then transmitted the Council position to the European Parliament for its approval during its March plenary.

**NEW BUSINESS**

No further new business is expected to arise from the Presidency plans.

In February 2015 the European Statistical System Committee considered two draft delegated acts, based on the powers provided in Article 2(5) of Regulation (EU) No 549/2013 on the European system of national and regional accounts in the European Union:

A delegated regulation amending the methodology for the classification of products by activity;

A delegated regulation setting out the format in which the national accounts research and development expenditure data shall be transmitted by Member States to the Commission.

The Government is satisfied that the delegated acts do not go beyond what is provided for by the basic act and does not foresee any difficulty or significant costs. My officials will consult your clerk in
the usual way when they have been published for a view on whether the Committee should see an
EM on the proposals.

I hope that you find this update helpful. I shall write again, as appropriate, in the next Parliament to
inform your Committee of any significant developments.

9 March 2015

Letter from the Chairman to Rob Wilson MP

Thank you for your letter, dated 9 March 2015, providing the Committee with a pre-dissolution
update on remaining scrutiny business concerning statistical regulations. The House of Lords
European Union Sub-Committee on Economic and Financial Affairs considered this document at its
meeting on 17 March 2015.

EM 11177/13: PROPOSAL FOR REGULATION ON THE PROVISION AND QUALITY OF STATISTICS FOR THE
MACROECONOMIC IMBALANCES PROCEDURE

We are grateful for this update. What further detail can you give us on the proposals of the
Committee on Monetary, Finance and Balance of Payments? Does the UK support its proposals? We
would be grateful for a response to these questions, together with any update on negotiations, by 26
May 2015. In the meantime we will continue to hold the document under scrutiny.

EM 16612/14: PROPOSAL FOR A REGULATION ON HARMONISED INDICES OF CONSUMER PRICES AND
REPEALING REGULATION (EC) NO 2494/95

We note that it is possible that the Latvian Presidency may seek to agree a General Approach in the
coming months. We would be grateful to receive a separate update on negotiations on this proposal,
as and when it is clear whether and when a General Approach will be sought.

EM 9122/12: PROPOSAL FOR A REGULATION AMENDING REGULATION (EC) NO 223/2009 ON EUROPEAN
STATISTICS

We note that the proposal has now been agreed and require no further response.

17 March 2015

VALUE ADDED TAXATION RETURN (15337/13)

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

I am writing to provide you with an update on progress under the Greek and Italian Presidencies on
the Commission proposal for an EU wide standard VAT return. In the Explanatory Memorandum
dated 7 November 2013, I explained that while it could offer real benefits for businesses involved in
cross border trade, it would be challenging to achieve a balance between simplification for EU
business and the needs of the tax authorities of all 28 Member States, for whom the VAT return is an
important tool. The Commission therefore introduced a compromise solution to provide a certain
amount of flexibility.

In your letter of 14 February 2014 you asked to be updated on progress, and in the meantime your
Committee decided to continue to hold the document under Scrutiny. The Greek Presidency
concentrated on provisions in relation to VAT return processes. Essentially this covered error
correction, submission of returns (including by electronic means) and payment of VAT. The
consequence is that the current text would enable the UK to retain its existing procedures, which are
much favoured by UK businesses.

An orientation discussion at ECOFIN in June 2014 set the tone for the Italian Presidency. In
particular that:

— The objective should be to reduce administrative burdens for businesses and
  national tax authorities, whilst at the same time ensuring no increase in the
  overall burden for businesses in any individual Member State.
— The Commission should explore a cost effective solution for setting up an EU VAT web portal to provide readily available information to businesses on the VAT rules across the Member States.

The Italian Presidency has begun discussions on the information requirements of the standard VAT return. Some Member States are keen to include more and more information. Others, in particular the UK, want to keep things as simple as possible.

The UK's current 9 box return is supported by UK businesses and they want to retain that. As the Office for Tax Simplification said in its recent report - Review of the Competitiveness of the UK Tax Administration - "The UK's VAT return always wins praise for simplicity - as one person put it 'I support the idea of a common EU VAT return, but only if the return is based on the UK model.'"

However, the Presidency has to date given ground and increased the information requirements, and also suggested that a common template should be mandatory. We and others do not agree and are therefore resisting that due to the potential for increased burdens, costs and errors for businesses.

The Italian Presidency gave a progress report to ECOFIN on 7 November and undertook to reflect on the best way forward to obtain agreement. From bilateral discussions with Latvia, we know the forthcoming Latvian Presidency plans to continue negotiations.

I will continue to keep you informed of the progress of negotiations.

27 November 2014

Letter from the Chairman to David Gauke MP


We regret to learn that the Italian Presidency is moving away from the simplified model of a VAT return favoured by the UK. Can you provide more detail on the information requirements that it is seeking to include. You state that some Member States favour more information, whereas others favour a simplified model? Where would you state that the balance of opinion within the Council lies? Which Member States are sympathetic to or at variance with the UK's position? What efforts are you making to convince Council colleagues of the merits of the UK model?

We would be grateful for a response to this letter by 31 January 2014, together with an update on negotiations as they progress. In the meantime we will continue to hold the document under scrutiny.

9 December 2014

Letter from David Gauke MP to the Chairman

Thank you for your letter of 9 December 2014 on the proposal for a standard VAT return.

I understand your concern over the Italian Presidency’s move away from the simplified model of a VAT return favoured by the UK. I share your concern, not least as our objective is to keep things as simple as possible. We continue to make our arguments forcefully.

Many Member States have continued to press for a standard VAT return that would allow them to maintain their existing national approach in relation to information requirements. That is not surprising: we continue to do much the same.

The balance of opinion within Council on information requirements broadly reflects Member States’ current national approach. A small number of Member States favour a simplified VAT return. These Member States are sympathetic to a simple approach such as the UK’s. Many other Member States are at variance with this position. They favour a more complex return which closely reflects their existing national version (with numerous boxes which they regard as a necessary compliance tool).

The Italian Presidency’s accommodation of such requests resulted in an increasing total number of possible boxes which would be imposed on all Member States through a mandatory common template.
Member States’ requests for additional (optional) information requirements beyond the basic mandatory boxes (such as VAT due and deductible VAT) include:

— The category of business activity
— An IBAN / international bank account code
— E-mail address and/or telephone number
— Seven boxes on categories of transactions where VAT is due
— Seven boxes on categories of transactions where VAT is not due and
— Sixteen boxes regarding categories of input tax deductions

Some of the boxes listed above are further split to require transactions for each different rate of VAT. In general this reflects current practice in many Member States, but contrasts unfavourably with the UK’s simple approach of a nine box return.

We continue to promote the merits of the UK approach in Council, bilaterally with key Member States and at other relevant meetings. However, many Member States have established compliance systems reliant on a return with numerous boxes. They see benefit in sharing best practices but they make the point that flexibility is needed to respond to individual national circumstances. This reflects the concerns some Member States have on subsidiarity and proportionality.

Reaching agreement on a mandatory common standard VAT return that meets the objective of simplifying obligations for business looks increasingly unlikely. Officials continue to work closely with each Presidency and with the Commission to steer towards an outcome that offers benefits for UK businesses trading across Member States.

At their first Council meeting on this dossier in mid-January, the Latvian Presidency noted that most Member States support the objective to simplify businesses’ obligations. However, they also noted key issues remain i.e. the information requirements on a standard VAT return and the Italian Presidency’s idea of a mandatory common template.

In an attempt to make progress, the Latvian Presidency has also asked Member States to consider a standard VAT return on the basis of implementation being optional for Member States.

Such an approach would effectively mean:

— UK businesses could continue to benefit from the simple UK VAT return for domestic transactions;
— UK businesses involved in cross border trade would benefit where Member States, in which country they trade, adopt a simplified VAT return; and
— The direction of travel set by the proposal would enable businesses to apply pressure for reform in those Member States that do not have, or adopt, a simplified VAT return.

This may be an acceptable outcome which could be improved if supported by an EU web portal. The Commission has recently introduced a limited web portal to support the recent changes to the VAT place of supply rules (in respect of telecommunications, broadcasting and electronically supplied services). This portal provides, in a single place, information about the relevant rules in all Member States, including rules on VAT rates and invoicing, and is available to all businesses across the EU. We support this initiative and are pressing for a wider application of it to be progressed, including details of Member States’ VAT returns and the processes behind them as well as to provide businesses with more information on the underlying VAT rules. This further expansion could provide substantial benefit to businesses trading across Member States.

It is not yet clear what other Member States think about this and the Latvian Presidency is continuing to reflect on the way forward. The next meeting is scheduled for 27 February. I will keep you informed of progress.

19 February 2015
Letter from the Chairman to David Gauke MP


We regret that it now looks unlikely that a simplified mandatory tax return model will be adopted. However we welcome efforts to promote an optional scheme, accompanied by an expanded web portal. We note that further discussions took place on 27 February 2015. In order to allow the Committee to consider a further letter before the end of the parliamentary session, we would be grateful for an update on these negotiations by 10 March 2015. In the meantime we will continue to hold the document under scrutiny.

2 March 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter of 2 March 2015 on the proposal for a standard VAT return. You asked for an update on the negotiations.

As I explained in my letter of 19 February, the Latvian Presidency had asked Member States to consider a standard VAT return on the basis of implementation being optional for Member States.

At the technical meeting of 27 February all Member States signalled support for an optional standard VAT return. This formed the basis of discussion and as a consequence there was broad agreement to reducing the information boxes on the standard VAT return. The Member States saw merit in a common format (in terms of numbering and content of the boxes) but saw no real benefit in any common presentation (colour, logo etc). Member States agreed that there should be no need for any of the provisions to be left to the comitology process.

As I explained in my previous letter, an optional standard VAT return is an approach the UK could support since UK businesses trading across the EU Member States could see a benefit. It is unlikely that the UK will want to opt into a standard VAT return because UK businesses value our existing simple nine box return and are very clear that they would prefer to keep that.

We, with others, also continue to make the case for a wider application of the EU web portal as this initiative has the potential to provide substantial benefit to businesses trading across the Member States.

Given the strong support from Member States we expect the Latvian Presidency to seek political agreement at ECOFIN (in May or June) to an optional standard VAT return with the proviso that work should then continue on the detail to reduce the number of information boxes and to firm up content.

Overall, this would be a welcome outcome for UK businesses. They would continue to benefit from the simple UK return. Those that trade with Member States who adopt a standard VAT return would benefit too. And businesses would be able to call for reform in Member States that do not have a simplified VAT return. The Commission is now looking at ways to take forward the initiative for a wider application of the EU web portal building on the 2015 model so as to include additional information.

I hope the information provided will enable your Committee to consider clearing the proposal from scrutiny, in order that the Government can take a positive position at ECOFIN should the Latvian Presidency seek political agreement.

9 March 2015

Letter from the Chairman to David Gauke MP

We are pleased to learn that progress has been made towards agreement on an optional standard VAT return. In anticipation of the Latvian Presidency's attempt to reach a General Approach, we are now content to clear the document from scrutiny. However, we would be grateful for an update on negotiations, including on continuing work on the detail to reduce the number of information boxes and to firm up content, and on the Commission’s efforts to take forward wider application of the EU web portal. We would be grateful to receive such an update by 26 May 2015.

17 March 2015

VALUE ADDED TAXATION - THE TREATMENT OF VOUCHERS (9926/12)

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

I am writing to update you on the proposal to amend the Principal EU VAT Directive to provide a uniform VAT treatment of vouchers across the EU. After several years of intermittent official level discussion, there is a possibility that the Proposal will come to ECOFIN in the coming months for agreement. This would be the first time the issue has come before Ministers. As we reach the end of the Italian Presidency of the EU, it seems an appropriate time to update you on this file.

The principal EU Directive on VAT needs to be amended because it fails to provide clear rules for vouchers. This has become more important as case law has clarified the VAT rules and the use of vouchers, particularly with the rise in technology, has increased. An example of this failure would be where VAT law would expect any prepayment to be subject to VAT. While a simple voucher (say a CD token) might be able to comply with this rule, a gift voucher for a shop would not because at the time of issue, the VAT rate of the goods and services to be provided in return for the voucher are not yet identified. Vouchers also produce difficulties in identifying the correct tax base so the current law has had the unforeseen effect of distorting one of the key principles of VAT, that it is a tax on consumption. It identifies the payment that is subject to VAT as being all that the seller receives and assumes that this is the same as what the customer pays. However, where an issuer of a voucher is not the redeemer, this will not necessarily be the case because the issuer will make money by charging more for the voucher than he pays the redeemer. The matter is made worse when the voucher is distributed through a long chain of intermediaries, making the difference between what the redeemer receives and what the buyer pays even greater. There is a further complication in that the buyer of a voucher receives two things (the voucher and the underlying goods and services) for each payment, whereas the VAT system more generally is intended to be based on "a supply for a consideration" concept.

The VAT treatment of vouchers has been brought more into focus as a result of the need to standardise rules for telcoms top-ups and vouchers for electronically supplied services because the EU VAT place of supply rules for these services will change with effect from 1 January 2015. This change, with the introduction of the Mini One Stop Shop system for cross border VAT declaration, requires identical treatment of the related vouchers to be truly effective. However, it has been clear for some time that a change for the voucher treatment would not be made in time for this introduction and we have held discussions with these businesses as to how any temporary difficulties can be mitigated.

The VAT treatment of vouchers will always be complex. Although we welcome the broad intention of the Commission Proposal to solve this problem, it has failed to provide a credible solution. During consultation it became particularly evident that UK businesses had concerns that the Commission Proposal would require them to divulge commercially sensitive details in order for VAT to be collected on distribution.

We subsequently engaged with a series of Presidencies to consider possible alternatives. The official level Working Party has in turn examined a variety of alternative ideas of VAT treatment in this area, all of which we have discussed with UK businesses in order that the impact of any change could be properly represented.

Following this engagement, the Proposal now concentrates on face value vouchers; it does not now cover any voucher that offers merely a discount. It also now clearly excludes any instrument that is more generally a means of payment. The new rules identify two groups of face value vouchers, Single-Purpose Vouchers (SPV) and Multi-Purpose Vouchers (MPV).
SINGLE-PURPOSE VOUCHERS

This definition will cover vouchers where all the information to charge the correct amount of tax is available at the time of issue of the voucher. The new rules are very straightforward – the supply of the voucher at each stage of distribution is seen as a supply of the underlying goods or services. This approach is broadly consistent with current UK law.

MULTI-PURPOSE VOUCHERS

This definition will cover vouchers for unspecified goods or services, so tax cannot be charged at issue. Several options therein were examined at official level, and two primary options were brought forward. The first main option would have seen all MPVs taxed along the distribution chain from issue to redemption. The second option, which is the version in the current text, foresees taxation at the redemption stage only.

Both of these options have positive and negatives. Taxation throughout the chain, the first option, ensures that tax is collected on the base of what the consumer pays but the appropriate VAT rate is difficult to achieve. This approach would inevitably require some form of adjustment, requiring VAT rate information to pass from the redeemer to the final seller of the voucher. Margin schemes and schemes based on a redeemer’s effective VAT rate were also considered, which would have reduced the need for adjustment, but these were deemed to be excessively burdensome and difficult to operate in cross border situations.

The second option would also require some transfer of information (about the final price paid for the voucher) but in easier circumstances, both in terms of the information to be passed and the timing. Businesses would gain certainty that would aid cross border trade (the UK are leaders in this field) and the harmonised approach would lead to less double and non-taxation. This system would be easier to administer.

The Italian Presidency pressed for agreement based on the second option for MPVs, having concluded that the most effective and least burdensome approach would be to rule that all distribution is outside the scope of VAT, with tax to be accounted for by the redeemer based on the face value of the voucher, or if known, the amount that the customer actually pays. There is considerable support from Member States for this approach but not all can agree.

However, despite the broad support, it has so far proved impossible to develop an approach to MPVs that will please everyone. A particular concern of some is that an agreement to treat all the distribution as outside the scope of VAT would mean voucher issuers and some distributors would not only no longer have to charge VAT but would also no longer be able to deduct the VAT incurred on their costs. Their business would no longer be VAT neutral and their costs would increase.

An additional concern that the Government holds is that, if distribution were taken out of the scope of VAT, there is one small group of redeemers (where multi-purpose vouchers are distributed through a network of intermediaries acting in their own name) who could theoretically end up having to pay more VAT than they currently do because it is most unlikely that they would be able to identify what the buyer of the voucher has paid the intermediary. Where now they account for VAT on what they receive from the issuer, in future they would have to account for VAT on the face value of the voucher. To get round this problem contracts would have to be amended to ensure the VAT to be accounted for is reflected in the distribution payments. We understand that for this group (which includes several High Street names) a change in distribution model is the more likely impact.

Although some further changes to the legal text suggested by the UK Government to make this more acceptable to UK businesses were accepted in principle by the Italian Presidency, in the event others were reluctant to commit to such a significant change without a greater understanding of the impacts. As a result we have to wait to see what direction the Latvians will take this work in the New Year.

Though there is a grandfathering rule in the current text, Member States have already noted that it will take at least a year to implement new rules, with businesses having to reset contracts and systems. The firm dates of the Directive coming into force are therefore still to be agreed.

18 December 2014
Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 18 December 2014, on EM 9926/12: the Commission proposal to amend the Principal VAT Directive to seek to provide a uniform VAT treatment of vouchers across the EU. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 13 January 2015.

We are grateful to you for this comprehensive account of the progress of negotiations. We note in particular that the proposal now identifies two groups of face value vouchers: Single-Purpose Vouchers (SPV) and Multi-Purpose Vouchers (MPV). You state that the rules on SPV are straightforward and in line with current UK law. Can you therefore confirm that broad agreement on these rules has now been reached?

We also note that the treatment of Multi-Purpose Vouchers has proved more problematic. We note that the current version of the text, foreseeing taxation at the redemption stage only, would be easier to administer. We therefore welcome the Italian Presidency's efforts to seek agreement based on this option. You state that you have sought further changes to the legal text in order to make it more acceptable to UK businesses. Can you be more specific about the amendments you were seeking? What further information can you give us about the likely approach of the Latvian Presidency, and its timetable for agreement of the Directive? We would also be grateful for confirmation of the date when the Directive will come into force once this is known.

We would be grateful for a response to this letter by 14 February 2015, or sooner if significant progress towards agreement is expected in the meantime.

14 January 2015

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 14 January in which you ask further questions about EU work to amend the VAT Directive in respect of the treatment of vouchers.

You ask whether broad agreement on the future treatment of Single Purpose Vouchers (SPVs) has now been reached. I should make it clear that this is a package of work on vouchers in general, which means that it is unlikely that legal changes will be made in respect of SPVs without agreement on Multi Purpose Vouchers (MPVs) also. It is therefore fair to say that nothing is agreed until everything is agreed. There is also one specific outstanding point with regard to SPVs, which is whether the definition of an SPV should require the identity of the redeemer to be shown on the voucher for it to qualify as an SPV. A few Member States have argued that this is essential, some are strongly opposed to this idea and others, including the UK, do not have a strong position.

An example of a voucher where this would have an impact would be the issue by a manufacturer of a voucher (for payment) for a specific bottle of champagne, redeemable at different unspecified outlets. We would generally expect such a voucher to be an SPV. But if the test to be an SPV included the requirement that the business accepting it has to be actually specified on the voucher, then the voucher in this case would classed as an MPV. While we would prefer to see such a voucher to be treated as an SPV, as there is sufficient knowledge about the product for tax to be charged at issue, we do not think this particular matter is that significant against the wider background of work. We are still waiting for fuller discussion on this point and expect agreement one way or another will be reached in due course.

With regard to your question about the amendments we are seeking with respect to MPVs, we have questioned whether the impact of the treatment of voucher distribution as outside the scope of VAT is fair. The current version permits one type of distributor (who acts as an intermediary charging a vatable commission) to deduct VAT on related costs, whereas a distributor who actually buys and sells the MPVs as a principal (whose activity would be outside the scope of VAT), would not be able to deduct VAT on related costs. In addition, we have suggested that, given that postage stamps have their own VAT rules, these should be specifically excluded from the amending Directive. These matters remain under discussion in the Working Group.

We are expecting the Latvian Presidency to hold several Working Groups on this file and it currently plans to place this on the agenda for agreement at the June ECOFIN. It is too early to say whether that will in fact happen or when this amending Directive will come into force.

16 February 2015
Thank you for your letter, dated 16 February 2015, on EM 9926/12: the Commission proposal to amend the Principal VAT Directive to seek to provide a uniform VAT treatment of vouchers across the EU. The House of Lords European Union Sub-Committee on Economic and Financial Affairs considered this document at its meeting on 24 February 2015.

We are grateful to you for this update. We would be grateful for an update on the outcome of negotiations on these matters, and confirmation of whether the Latvian Presidency is seeking a General Approach, by 26 May 2015, or sooner if there are significant developments in the meantime.

24 February 2015