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

This edition includes correspondence from 1 December 2011 – 8 May 2012.

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

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

Thank you for your Explanatory Memorandum 6360/12, dated 6 March 2012, on the Commission’s Alert Mechanism Report. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 13 March 2012.

We note the publication of the report, and like you, we welcome its publication and the Macroeconomic Imbalances procedure as a means of strengthening European economic governance.

We note that the UK exceeded the threshold values on four indicators in the scoreboard (Real Effective Exchange Rate, Export Market Share, Private Sector Debt and Public Sector Debt), and that, as a result, the UK is one of 12 Member States identified for in-depth analysis between now and May. Do you agree with the Commission’s findings in relation to each of these indicators, and its decision to subject the UK to an in-depth review? You state that the Commission should take into account the policy responses the UK is already undertaking to correct these issues. We would be grateful for a summary of the steps that the Government have taken in relation to each of these four indicators.

What further action do you think is necessary to address the Commission’s concerns?

We would also be grateful for further details on the form that this review will take. We note that work was scheduled to begin in February. What activity has taken place up until now? You state that you look forward to working alongside the Commission in its work. What assistance will the Government be giving as the Commission undertakes its review? We also note your wish for the Government’s methodological concerns to be taken into consideration. What concerns do you have in mind? Can you give us an update on what form the analysis will take?

We note that the in-depth review is due to be published in May. We would be grateful if you could provide the Committee with early sight of this analysis, as well as the Government’s response to it.

We note that ECOFIN is scheduled to agree conclusions and formally endorse the report at its meeting on 13 March. We have accordingly agreed to clear the document from scrutiny. However we would be grateful for a response to these questions within the standard ten working days.

13 March 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter, dated 13 March 2012 on Explanatory Memorandum 6360/12 covering the Alert Mechanism Report. The Committee raised a number of questions, which I address below.
You asked about the Government’s assessment of the Commission’s findings; details of the steps we are taking to address the Commission’s concerns and what further action we deem necessary; our methodological concerns, and whether we agree with the Commission’s decision to carry out an in-depth review of the UK. This letter addresses your comments on the relevant macroeconomic indicators in turn.

PUBLIC SECTOR DEBT

On the public sector debt indicator, the UK first exceeded the threshold of 60 per cent of GDP in 2009 as a result of large fiscal deficits accumulated in part because of the financial crisis. The Government is committed to a credible fiscal consolidation strategy, underpinned by clear targets, which will restore the public finances to a sustainable path. As announced in the June 2010 Budget, the Government has set a forward-looking fiscal mandate to achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period. This is supported by a supplementary target for debt that requires public sector net debt as a percentage of GDP to be falling by the year 2015-16. The independent Office for Budget Responsibility’s (OBR) March 2012 Economic and Fiscal Outlook has concluded that the Government remains on course to meet the fiscal mandate and the supplementary debt target.

PRIVATE SECTOR DEBT

On the private sector debt indicator, the UK has exceeded the threshold of 160 per cent of GDP set by the Commission consistently since 2002 for a variety of reasons. The Government recognises that over a number of years preceding the recent financial crisis, economic growth in the UK was partly driven by an excessive build-up of private sector debt, which was unsustainable. In particular, the increase in UK households’ debt is primarily due to the house price boom prior to the recent financial crisis and the relatively higher levels of home ownership in the UK compared with many other advanced economies.

However, UK households’ real net wealth has also increased by around 24 per cent over the past decade, and as a proportion of income, debt has fallen from 158 per cent of GDP in 2008 to 141 per cent in the third quarter of 2011. UK private sector debt as a percentage of GDP is on a downward trajectory, falling from 223 per cent in 2009 to 212 percent in 2010 by the Commission’s measure. The necessary process of deleveraging, or repayment of debt and increasing savings, by the private sector, is therefore already under way. In addition, the Government has established a framework for macro-prudential policy in which the Financial Policy Committee of the Bank of England will be responsible for identifying and addressing systemic risks to the resilience of the financial system arising from unsustainable debt.

The Government has emphasised the need to tackle both public and private sector indebtedness. However, as with several other advanced economies, the process of balance sheet repair after the damaging financial crisis is likely to take a number of years. Any sharp deleveraging would be harmful. The Government’s focus remains on rebalancing the economy in the medium-term, including through fiscal consolidation and raising the growth potential as set out in the Growth Review.

EXPORT MARKET SHARE

On the export market share indicator, since 2004 the UK’s share of the world export market has consistently declined at a faster rate than the Commission’s threshold value of a 6 per cent decline over 5 years. This is for a number of reasons. First, continued strong growth in emerging markets has reduced advanced economies’ share in world GDP and exports. Second, the impact of the financial crisis in the EU has affected demand for UK goods and services, with over 40% of exports going to the euro area. Third, and our primary methodological concern, the sharp depreciation of sterling has reduced the value of UK exports when measured in euros, which the Commission’s indicator is based on, exaggerating the decline of UK export market share. When the exchange rate factor is taken into consideration, there is clear evidence that UK exports have been performing well recently. Over the past two years from 2009 to 2011, the volume of UK exports increased by 12.5%, compared to no growth in volumes in the two years to 2008. The OBR forecast that export volumes will rise by 2.9 per cent in 2012 and 5.3 per cent in 2013.

The Government agrees that exports are critical for rebalancing the economy and has committed via the Growth Review, notably through the White Paper Trade and Investment for Growth (February 2011) to supporting trade finance and insurance, supporting exporters through UK Trade and
Investment, furthering the Single Market, and promoting global trade. Budget 2012 announced further measures to increase exports, including expanding the overseas role of UK Export Finance to enable it to develop finance packages that could help UK exporters secure opportunities identified through UKTI’s High Value Opportunities programme; and continuing to increase UK Export Finance’s regional presence in the UK to support small and medium sized businesses seeking trade finance.

It is worth pointing out that, while the UK is the worst performer on this particular indicator by the Commission’s measure based on the value in euros, many other Member States record declines of between 15 and 20 per cent. Sweden, Germany and the Netherlands with large and sustained current account surpluses all exceed the threshold for the export market share indicator.

**Real Effective Exchange Rate**

On the real effective exchange rate indicator, a measure of a nation’s external competitiveness, the UK has exceeded the Commission’s threshold of an 11% decline over 3 years, recording a 19.7% decline in the 3 years to 2010. The real effective exchange rate declined significantly between 2007 and 2008, largely reflecting the depreciation in the nominal value of sterling during this period.

Under the UK’s macroeconomic policy framework, the exchange rate is allowed to adjust flexibly reflecting market forces while the Bank of England delivers price stability through a symmetric inflation target. As the effects of sterling’s past depreciation feed through, this will help support the Government’s objective of rebalancing the economy towards exports. The OBR, in its March 2012 Economic and Fiscal Outlook, noted that: “the depreciation of sterling in 2008 resulted in falling unit labour costs, towards those in Germany. This has underpinned the 2½ percentage point contribution of net exports to UK growth since 2007.” The OBR expects “UK exports to continue to be supported by the sustained real sterling depreciation that began in 2007.”

**Assessment of Policy Action and Referral for an In Depth Review**

The Government’s assessment is that appropriate and sufficient action is being taken to address the issues raised by the Commission.

The UK has been subjected to an in depth review on the basis of a preliminary analysis of the scoreboard in the Alert Mechanism Report. It is important to recall that the scoreboard itself should not be seen as a final product, particularly given the relative novelty of the Macroeconomic Imbalances Procedure. The Commission have recognised that the indicators and thresholds in the scoreboard can and should evolve as necessary to take due account of enhanced availability of relevant statistics, the evolving nature of the challenges to macroeconomic stability and also developments in economic literature. EU Regulation 1176/2011 makes specific provision for the Commission to report to Council on a regular basis concerning the appropriateness of the scoreboard and indicators it contains.

We look forward to the Commission’s findings.

**In Depth Review**

The Committee raised further questions in relation to the Government’s commitment to work with the Commission during the course of the in-depth review of the UK.

Commission officials will be visiting the UK on 27 and 28 March where amongst other issues, the UK’s macroeconomic performance will be discussed. The Government will use this opportunity to set out recent progress and the policy actions referred to above. More broadly, the Government continues to engage actively with the Commission at all levels, and will set out progress with structural and budgetary reforms in the National Reform Programme and Convergence Programme, which are due to be submitted at the end of April.

The Government expects that the Commission’s in-depth review will contain a more detailed economic reading of the scoreboard, which will be complemented by additional information and indicators taking due account of country-specific circumstances. Discussions in working groups are ongoing and we understand that the Commission’s analysis is ongoing.

We expect that the Commission will present draft in-depth reviews of the UK and 11 other countries alongside draft Country-Specific Recommendations as part of a package at the end of May. These documents will be discussed in Council prior to their endorsement by Heads of State of Government at the June European Council.
CO-FINANCING RULES FOR COHESION POLICY (13400/11)

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

Thank you for your letter, dated 26 October 2011, on EM 13400/11 on a Commission proposal regarding certain provisions relating to financial management for certain Member States experiencing or threatened with serious difficulties with respect to their financial stability. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 6 December.

Thank you for the further information provided in your letter. We would be grateful if you could advise of the outcome of negotiations on this proposal.

6 December 2011

Letter from Mark Prisk MP to the Chairman

Thank you for your letter of 6 December requesting advice on the outcome of negotiations regarding the above proposal.

I can advise you that the European Parliament has adopted the proposal and the negotiations are concluded. The amending Regulation was published in the Official Journal on 20 December 2011.

25 January 2012

COHESION FUND FOR HUNGARY (6893/12, 5352/12, 5387/12)

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

Thank you for your Explanatory Memoranda: i) 5352/12, dated 5 March 2012, on a Recommendation for a Decision establishing that no effective action has been taken by Hungary in response to the Council Recommendation of 7 July 2009; ii) 5387/12, dated 5 March 2012, on a Communication on the assessment of budgetary implementation in the context of the excessive deficit procedures after the Commission services’ 2011 autumn forecast; and iii) 6893/12, dated 7 March 2012, on the Proposal for a Council Decision suspending commitments from the Cohesion Fund for Hungary. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 13 March 2012.

We note the significance of the proposal to suspend commitments from the Cohesion Fund for Hungary, in particular given that this is the first time that this sanction has been applied. Nonetheless, like you, we recognise the importance of Member States taking forward fiscal consolidation as a priority in order to reduce their deficit and support recovery.

You state that on 24 January 2012 Council took the decision to ask Hungary to take steps to address its excessive deficit. You also state that the Commission will reassess Hungary’s actions in 6 months, and the case for lifting the suspension. What further information can you give us on the steps that Hungary is being asked to take?

We agree with you that the timetable has been rushed on this occasion, and hope that this will not become a frequent occurrence. We also note that a Council Decision on EM 5352/12 was taken on 24 January. Can you confirm that the UK supported the Decision? If that was the case, we note that this document was subject to an override. However we note that an override was justified in this case and require you to take no further action.

We would be grateful for a response to these questions, as well as an update on the outcome of the 13 March ECOFIN meeting, within the standard ten working days. In the meantime we have agreed to clear these documents from scrutiny.

13 March 2012
Letter from Mark Hoban MP to the Chairman

I am writing to update you on developments in relation to the above European Commission Proposal, which sought to suspend €495m Cohesion Fund commitments for Hungary from 1 January 2013. You will recall that the measure was proposed in line with the 2006 Cohesion Fund Regulations, following the adoption of the Council Decision (EM 5352/12), on 24 January that Hungary had not taken effective action to address its excessive government deficit.

As you might be aware, this Proposal was adopted by the Council on 13 March, which I attended. Hungary was willing to accept the Decision in light of a statement in the minutes of the meeting making clear that Council would return to the matter at its meeting on 22 June, with a view to lifting the suspension if Hungary undertakes the necessary corrective measures. In light of this, a clear qualified majority in favour of adoption existed.

This proposal was adopted on an accelerated timetable because on 13 March the Council also adopted the Commission’s Recommendations inviting Hungary to take further steps to correct its excessive deficit. Such recommendations relating to the Excessive Deficit Procedure (EDP) - which, as you will be aware, are subject to post-Council scrutiny – are usually agreed by the Council as soon as the Commission presents its assessment. Since the sanction and the revised recommendations are aligned with one another, the two decisions were taken at the same time. Nevertheless, I regret that this Proposal was not given adequate time to pass through national Parliamentary scrutiny prior to adoption.

As you will be aware, this is the first time such sanctions have been implemented. If similar situations arise in the future the Government will endeavour to ensure that sufficient time should be allowed for national Parliamentary procedures to be followed.

I would like to take this opportunity to thank the Committee for considering this document with expediency and for clearing this from scrutiny on 13 March 2011.

As per your request in your letter to me of 13 March, hopefully the above provides you with a detailed update on the outcome of the Commission Proposal.

In your letter, you also asked whether the UK supported the 24 January Council Decision that Hungary had not taken effective action. As indicated in Explanatory Memorandum 5352/12, submitted to the Committee on 5 March, the Government supported the Commission’s Recommendation leading to this Decision, as it is this government’s belief that fiscal consolidation should be taken forward as a priority to reduce deficits and support recovery.

Finally, you requested further information on what additional measures Hungary is being asked to take to correct its excessive deficit. As noted above, the Council on 13 March also adopted a Recommendation by the Commission on further measures to be taken in order to bring Hungary’s government deficit below the EU’s reference value of 3% of GDP in a sustainable manner. I would like to reassure you that once the Decision document has been made public, I will be providing the committees with an Explanatory Memorandum for a summary of these steps.

19 March 2012

COHESION POLICY (15243/11, 15249/11, 15250/11, 15251/11, 15253/11)

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

Thank you for your EMs 15243/11, 15249/11, 15250/11, 15251/11, 15253/11 on the Commission’s proposals to reform cohesion policy. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 20 December.

The package of legislative proposals underpinning the reform of cohesion policy merit careful examination as funds for regional developments are among the EU’s largest area of spending.

The House of Lords European Union Select Committee is conducting an inquiry on the EU financial framework from 2013 which will consider these proposals in greater detail as part of the debate on the EU budget. Meanwhile, we intend to hold the documents under scrutiny.

20 December 2011
Letter from Mark Prisk MP to the Chairman

I am writing to update you on progress of the above draft Regulations which will be discussed at a General Affairs Council (GAC) on Tuesday 24 April where the Presidency will aim for a partial general approach on some of the ‘negotiating blocks’. In particular I am writing to request the Committee consider providing a waiver on scrutiny for those EMs still under scrutiny, so that we may agree to a partial general approach at the GAC. Member States were only notified during Easter recess that the Presidency intended to ask for a partial general approach in April rather than June as originally planned. Had I known about this change I would have written sooner, and I apologise that it was not possible to do so. Your Committee is currently holding the above EMs under scrutiny. EM 15247/11 was submitted by the Minister for Employment, who is aware I am writing.

At the GAC Member States will aim to reach a partial general approach on six of the ‘negotiating blocks’ that the Danish Presidency has been taking forward in negotiations, that is to say to freeze negotiations where the Presidency considers textual changes to the Regulations are mature enough to warrant this. This is explicitly on the basis that ‘nothing is agreed until everything is agreed’, including cross-cutting issues with other blocks and regulations (such as the overarching Financial Regulation). This means we have the opportunity to reopen discussion should the need arise.

I should also underline that the budgetary aspects do not form part of the partial general approach. No numbers will be agreed at the GAC. Agreement on financial aspects will continue to take place through negotiations on the Multiannual Financial Framework and are led by HMT.

The six negotiating blocks where Member States will look to reach a partial general approach are: strategic programming; ex-ante conditionality; management and control; monitoring and evaluation; major projects; and eligibility (the relevant articles are set out in the Annex). In discussions on these so far, the Government has sought to ensure that the principles of subsidiarity and proportionality are strongly highlighted across the negotiating blocks and simplification is achieved wherever possible. For example, the text on ex ante conditionality (the preconditions that need to be met before funds can be spent) contains greater controls on the powers of the Commission.

I am confident that in agreeing to close down debate on these elements of the regulations it will allow discussions to focus on those aspects which require further detailed debate. That the UK is showing willingness to progress the negotiation will also give us further leverage to intervene on issues that really matter going forward.

We have also reserved the right to reopen negotiations on these aspects should that prove necessary. I hope you agree with this approach and that the Committee will therefore grant a scrutiny waiver to enable the UK to agree to a partial general approach on these Articles at the GAC on 24 April. Should you require further information on these changes, my officials would be happy to discuss them with you.

17 April 2012

Letter from the Chairman to Mark Prisk MP

Thank you for your letter dated 17 April 2012 on EMs 15243/11, 15247/11, 15249/11, 15250/11, 15251/11 and 15253/11 on the Commission’s proposals for structural funds.

We note your request that the Committee consider providing a waiver on scrutiny for these EMs in light of the Danish Presidency’s intention to ask for a partial general approach at the meeting of the General Affairs Council (GAC) on Tuesday 24 April. We note that you were only notified during the Easter recess of the Presidency’s intentions to ask for a partial general approach in April rather than June as originally planned. Regrettably, this means that your request could not be considered by the Committee before the GAC meeting, and we are grateful for your recognition that these circumstances are not ideal.

Notwithstanding this, we understand your concern that the UK should show willingness to progress the negotiation. We note your statement that the budgetary aspects do not form part of the partial general approach. We also welcome your statement that the Presidency’s decision “is explicitly on the basis that ‘nothing is agreed until everything is agreed’”, and that this means that you have the opportunity to reopen discussion should the need arise. We also note your view that closing down debate on these elements of the regulations will allow discussions to focus on those aspects that require further detailed debate.
In the light of these exceptional circumstances, we are content on this occasion to grant a scrutiny waiver. However, these are important proposals and we would therefore be grateful for further updates as negotiations progress, including your assessment of the outcome of the 24 April meeting.

19 April 2012

Letter from Mark Prisk MP to the Chairman

I write further to our recent correspondence on the above Regulations, where you agreed a scrutiny waiver so that the UK could agree a partial general approach at the General Affairs Council (GAC) on 24 April. You asked me to let your Committee know the outcome.

At the GAC the Presidency obtained agreement to a partial general approach on the six negotiating blocks concerned: strategic programming, monitoring and evaluation, management and control, major projects, ex-ante conditionality, and eligibility.

The UK, along with other Member States, had concerns regarding the inclusion of text on Country Specific Recommendations in the strategic programming block. We were concerned this text would have given the Commission a stronger role and a greater say in assessing how Member States should address the recommendations, rather than it being left to peer review through the Council. There was also a link to the discussions on macroeconomic conditionality that will take place in the Friends of Presidency group on the Multiannual Financial Framework. It was agreed that this text would be put in square brackets, meaning it did not form part of the partial general approach.

The Presidency recorded in the minutes of the Council that the partial general approach was agreed on the basis that nothing is agreed until everything is agreed, that this does not prejudice negotiations on further blocks in the package of draft Regulations, and that depending on negotiations on further blocks, other Regulations and the overall Multiannual Financial Framework there may need to be retrospective changes made.

I am pleased the GAC was able to agree a partial general approach and believe this was a positive outcome. For example, the deletion of the Partnership Code means Member States will have more scope to organise partnerships as they see fit, taking account of different rules and practices in each, rather than having a model imposed on them by the Commission. The changes agreed on ex-ante conditionality mean they are now more proportionate to their aim, and again this text better reflects subsidiarity. Similarly, I was pleased that the Council agreed that the Common Strategic Framework should be annexed to the Common Provisions Regulation, which would give the Council and the European Parliament the opportunity to agree its contents.

In response, the Commission gave support to changes which clarified the relationship between the Partnership Agreement and the Operational Programmes, but maintained its position that the Common Strategic Framework should be adopted as a delegated act rather than through the ordinary legislative process as the Council agreed in its partial general approach. The Commission also raised some unease at the changes agreed on ex-ante conditionality and the single audit principle. It did however give a particular welcome to the work the UK has been doing alongside Italy and Poland to ensure there was a stronger emphasis on effectiveness and delivering results in programming rather than focusing on how much had been spent.

There is still a long road ahead in negotiations, and we are now turning our attention to other negotiating blocks. These include important issues such as thematic concentration, financial instruments, performance management, financial management, and information and communication. Agreeing the partial general approach means we will be better able to focus on these issues, and I will of course write to your Committee to update you with progress.

2 May 2012

COMMISSION’S MANAGEMENT ACHIEVEMENTS (11264/11)

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

Thank you for your letter, dated 31 October 2011, on Explanatory Memorandum 11264/11 on the Commission Communication Synthesis of the Commission’s Management Achievements in 2010. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 6 December 2011.
We welcome your comprehensive response to our questions. We particularly welcome the information on progress on the concept of a proposed Tolerable Risk of Error. We would welcome further updates as negotiations progress. We also note the information on the interruptions to UK programmes, and we welcome the steps that have been taken to improve performance management and correct errors.

We have decided to clear this document from scrutiny.

6 December 2011

COMMON CONSOLIDATED CORPORATE TAX BASE (7263/11)

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

Thank you for your letter of 29 November seeking further clarification on the Government’s response to the proposal for an EU Directive on a Common Consolidated Corporate Tax Base (CCCTB).

The Committee asks for details of the analysis the Government has undertaken about the implications for the UK of other Member States taking the proposal forward under enhanced cooperation.

The Lisbon Treaty simplified the previous provisions for “enhanced cooperation”, and specified three conditions before any measure can progress. Firstly, that there must be no EU legislation currently in place. As a new proposal, action on CCCTB would satisfy that condition. Second, at least one-third of EU member states (currently a minimum of nine) must wish to take part in an enhanced cooperation group. Again, we believe that there is likely to be enough support across member states to support a move if that should be decided. Finally, participation in the scheme must be open to Member States other than the ones that first approve the measure. However, enhanced cooperation must comply with the Treaties and with Union law, and must not undermine the internal market or economic, social or territorial cohesion, nor constitute a barrier to trade or distort competition.

Acts adopted in the framework of enhanced cooperation can only bind participating Member States. Therefore, if the UK decides not to take part, it would not be obliged to adopt any resulting legislation put in place by others. Nor would there be any danger of a non-participating member state being held to be in infringement. While I acknowledge that there would inevitably be an impact on UK companies operating through their subsidiaries or permanent establishments in those States that had adopted legislation, it is the case that UK companies already have to comply by the tax law of countries within which they operate.

The Government’s analysis of the Commission proposal addresses its tax implications and is based on the assumption that the UK would not take part in a CCCTB regime. If the existing Commission proposal is taken forward (whether under enhanced co-operation or not) our principal concerns are:

— The increased compliance costs for UK business as they undertake monitoring exercises in deciding whether or not it is in the interests of their subsidiaries or permanent establishments to opt into the CCCTB;

— The design of the tax rules, for example the general lack of clear definitions, that will create uncertainty for UK businesses with operations in Member States that may adopt CCCTB;

— Measures that may impact on the competitiveness of the UK tax system. For example, as proposed, financial traders will not be taxed on profit distributions received from financial assets held on the trading book. That competitive advantage may convince some financial traders to locate or relocate within a Member State that opted for a CCCTB containing that provision; and

— We consider the proposed anti avoidance rules in the draft Directive to be less effective than the existing UK rules. Consequently potential tax planning opportunities would be afforded to those adopting the proposed CCCTB.

On the basis that the proposal would remain as drafted, the Government concludes that the UK tax base may be affected, but an assessment cannot be made until the text of the Directive is finalised. If a revised or new proposal is introduced under enhanced cooperation we would, of course, need to look separately at that.
You also ask how much support there is within Council for this proposal. France and Germany have publicly called for support for the proposal. However a number of national legislative bodies\(^1\) have sent Reasoned Opinions to the Commission because they consider that the draft proposal does not comply with the principle of subsidiarity. Representatives of these Member States speak at Council under a scrutiny reservation.

Finally, the Committee asks what discussions we have had with business. The Government has heard a range of views, and discussions between business and Government are ongoing. In general, while business as a whole has not been actively calling for this proposal, it is clear that some businesses have welcomed it - in particular, the prospect of allowing for transfer of tax losses across borders. However, some companies are stressing that their support depends on the optional nature of the proposal. Others have expressed concerns about the potential compliance and administrative costs, which are likely to be large for many companies, and the lack of certainty about how many aspects of the system would work.

The Government will continue to participate fully in the EU discussions on the proposal, and I will, of course, keep the Committee updated on progress.

20 December 2011

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

Thank you for your letter, dated 20 December 2011, on EM 7263/11 on the proposal for a Directive on a Common Consolidated Corporate Tax Base (CCCTB). The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 13 March 2012.

We welcome your comprehensive response to our questions on this document. In the light of this, we have agreed to clear this proposal from scrutiny. However, we recognise the importance of this proposal and would therefore be grateful for further updates on developments as negotiations progress.

13 March 2012

**COURT OF AUDITORS OPINION ON THE GENERAL REGULATION ON STRUCTURAL FUNDS (5798/12)**

**Letter from the Chairman to John Hayes MP, Minister of State for Further Education, Skills and Lifelong Learning, Department for Business, Innovation and Skills**

Thank you for your Explanatory Memorandum 5798/12, on an Opinion of the Court of Auditors on a proposal laying down common provisions on the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund, the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF) covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083 /2006. The House of Lords European Union Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 27 March 2012.

We are pleased to note that the Opinion of the Court of Auditors on the Commission’s proposal for the General Regulation is similar to the UK’s view on the subject and we are content to clear the document from scrutiny.

27 March 2012

**CREDIT RATING AGENCIES (17308/11, 17329/11)**

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

Thank you for your Explanatory Memoranda 17308/11 and 17329/11, dated 7 December 2011, on the Commission proposal for a regulation and a directive on credit rating agencies (CRA3). The House of

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\(^1\) Reasoned Opinions have been sent from Bulgaria, Ireland, Malta, The Netherlands, Poland, Slovakia, Sweden, and the UK.
Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 7 February 2012.

As you know, the Committee published a report entitled Sovereign Credit Ratings: Shooting the Messenger? in July 2011. In that report, we noted that ESMA had only just taken over the direct regulation of credit rating agencies and that the full impact of supervising CRAs under a new regulatory system at EU level had yet to be determined. We argued that the existing legislation should be given time to bed down, and its effectiveness assessed, before further changes are made. Given this, we have grave concerns at the speed with which CRA3 has been brought forward.

Furthermore, though credit rating agencies were guilty of failures in the build-up to the banking crisis (as our report concluded), it is not clear to us whether and how this set of proposed reforms will deal with the problems that then arose. We also stress the importance of distinguishing between proposals for the regulation of sovereign ratings (with which our report was primarily concerned) and the ratings of financial institutions and products. Do you believe that the Commission proposal adequately reflects this distinction?

Notwithstanding these overall concerns, we agree with you that some of the Commission’s proposals may be welcomed. The mechanistic reliance on CRA ratings by financial institutions and the hardwiring of ratings in legislation needs to be tackled. We noted in our report that this mechanistic reaction to rating changes may cause cliff-edge effects, herd behaviour among investors and systemic disruption. We also concluded that responsibility for investment decisions ultimately lies with investors, and they should bear in mind the principle of caveat emptor when deciding how much reliance to place on the judgement of rating agencies. We therefore welcome steps to require financial institutions to conduct their own due diligence, and to oblige the European Supervisory Authorities to review and remove where appropriate references to CRA ratings in their guidelines or rules. However we agree with you that obligations should be proportional on smaller firms with limited capacity. We are also uncertain as to how financial institutions could be made to conduct due diligence. How does the Commission propose to enforce these proposals?

In terms of tackling the opacity around ratings processes and methodologies, we previously acknowledged the importance of ensuring that the methodologies by which agencies produce their sovereign ratings are transparent, and stated that we would support further initiatives in this area so long as the effectiveness of existing legislation had been assessed before further changes were considered. Whilst the proposal for a European Rating Index has some virtue, we agree with you that considerable care needs to be taken in terms of the form that it takes both in order to ensure that no accusations of bias can be brought forward, and to ensure that an aggregation of available ratings does not result in a misleading analysis.

In terms of the Commission’s proposal that CRAs should be required to inform entities of ratings changes one working day before release, we have previously expressed concern that any change in this area could, in the case of sovereign ratings, increase the risk that sovereigns will place undue pressures on rating agencies to change their opinion, as well as making it more likely that the information will leak in advance of the rating agencies’ official announcement. We reaffirm our previous conclusion that the status quo, whereby, in the case of sovereign credit ratings, sovereigns should get 12 hours advance notice, should remain.

We note the Commission’s concerns that sovereign ratings changes have exacerbated financial instability. We have previously recognised that whilst rating changes can have disproportionate effects on the financial markets in certain circumstances, it is not possible to determine the extent to which rating agencies may or may not have exacerbated the euro area crisis. Having said that, we recognise that there may be merit in the Commission’s proposals to require Sovereigns to be rated every six months instead of annually, and for sovereign ratings to be published after the close of business and one hour before the opening of EU trading venues. Moreover, it is our judgement that, since our report was published, the analysis of CRAs in relation to the prospects of individual sovereigns has become more assertive. Do you believe that CRAs have taken on a more intrusive role in their analysis of market conditions in recent months?

In terms of the Commission’s perception of a lack of competition in the ratings industry, we previously argued that there is a compelling argument for a thorough competition inquiry into the structure and regulation of the sector, including consideration of the full range of ideas proposed to increase competition in the sector. However, the Committee did not support the establishment of an EU-sponsored credit rating agency, fearing that it would lack credibility. Notwithstanding this, we welcome any steps that will reduce barriers to entry for new participants.
The Commission argue that there are inherent conflicts of interest in the remuneration model of CRAs, leading to a bias in some ratings. In our previous report, we stated that we did not believe that the “issuer-pays” model presented a significant conflict of interest in relation to the rating of sovereign debt. We did note, however, that it was a significant issue with regard to the rating of corporate debt and financial products and one that deserves further, more detailed, consideration. Having said that, we remain to be convinced of the Commission’s case that there should be a regular rotation in the use of CRAs. We agree with you that there would need to be a diversity of high quality options for this proposal to be effective.

We view with deep concern the Commission’s proposal that CRAs should be held liable to investors if the investor suffers a loss as a result of having relied on a credit rating when purchasing a rated instrument. As we observed in our previous report, we do not believe that credit rating agencies should be held legally responsible for the accuracy of their ratings. As is the case at present, however, they should be held responsible for negligence or misconduct when producing those ratings. Like you, we remain to be convinced of the case for a harmonised standard of civil liability across the EU. We welcome your efforts to ensure that any system of harmonised liability is appropriate and suitable in the circumstances.

In terms of the proposal that CRAs would not be able to implement a new ratings methodology before ESMA had confirmed that it complies with the relevant requirements of CRA1, we agree with you that the danger of a perception of public sector validation of ratings needs to be avoided.

We agree with you that the new package should not prevent or unduly hinder the use of third country ratings for regulatory purposes in the EU, and we welcome your efforts to ensure that the standards for third countries are not raised to an unrealistic level.

This last question relates to a final, broad concern. As we noted in our previous report, the big three rating agencies all originated in the US market and remain largely based in the USA. We are therefore uncertain as to the likely impact of this proposal on CRAs not based in the EU. Would this not significantly negate the impact of the Commission’s proposals? Would these proposals, for example, in any way prevent a US-based CRA from undertaking activity in relation to the EU but on behalf of a client from outside the EU? Or could the proposals result in a divergence of credit rating outcomes between those agencies working under the regulatory framework and those operating outside it?

We would be grateful for a response to these concerns, as well as an update as negotiations progress. In the light of the importance of this proposal we have decided to hold the proposed regulation (EM 17308/11) under scrutiny. However, we are content to clear the proposed directive (EM 17329/11) from scrutiny.

7 February 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter dated 7th February, responding to my Explanatory Memoranda 17308/11 and 17329/11 on the European Commission proposal for a Regulation and a Directive on credit rating agencies (CRA3). I thank you for clearing the proposed Directive (EM 17329/11) from scrutiny.

I am pleased that you agree with many of the points I raised in my Explanatory Memorandum on the Regulation. Specifically, we both agree that proposals around reducing overreliance and enhancing transparency are welcome. We also share the view that: the proposals should be evidence-based, proposals on Eurix and ESMA pre approval of methodology should not disperse ratings information in a biased manner, mandatory rotation should not compromise ratings methodology, a system of civil liability should be appropriate in the circumstances, and the use of third country ratings should not be unduly hindered.

You asked for some specific questions and an update on the negotiations, which I address below.

Questions

Does the Commission’s proposal adequately reflect the distinction between the regulation of sovereign ratings and that of financial institutions and products?

We very much agree with the recommendation in your Committee’s report to not let the actions of the rating agencies during the banking crisis colour our assessment of them during the sovereign crisis. The Government will continue to stress this in negotiations. We think overall, the Commission’s proposals do aim to address problems with CRA ratings that were identified during the
banking crisis rather than problems solely identified in relation to sovereign ratings (including a lack of competition, conflicts of interests, overreliance on CRA ratings, lack of transparency and insufficient accountability for their processes). There are relatively few proposals specifically on sovereign ratings. The main concern I raised in Explanatory Memorandum related to whether the proposals would in practice achieve the objectives set out.

**How does the Commission propose to enforce proposals to place requirements on financial institutions to conduct due diligence?**

The Commission proposes to enforce these proposals through an obligation on authorities in charge of supervising these institutions to check the adequacy of their credit assessment processes where particular financial stability risks are identified. We think this would best work in practice if national authorities were responsible for supervision and enforcement, and if they took into account the nature, scale and complexity of an institution’s activities. One potential method for a national authority to supervise the obligation would be to require a self-certification of the way in which firms comply with the credit-assessment requirements, supplemented by spot-checks or thematic supervision where financial stability risks were identified. This would be similar to the ‘comply or explain’ approach adopted in relation to supervision of compliance with the FRC’s Stewardship Code.

**Have CRAs taken a more intrusive role in their analysis of market conditions in recent months?**

It is not the government’s position to assess the actions of rating agencies on other sovereigns and we believe it is too early to confirm a change in the approach of the CRAs. Rating agency actions are driven by a multitude of factors. In a fast changing environment such as the current euro area crisis, it would be difficult to distinguish between triggers from changes in economic fundamentals, a changing regulatory landscape for banks and CRAs, and changes in the approach of the CRAs. However, the existing Regulation does require CRAs to adopt, implement and enforce adequate measures to ensure that the credit ratings they issue are based on a thorough analysis of all the information that is available. Although it is too early to judge the effectiveness of the current Regulation, it is possible to infer that a more intrusive role by CRAs could be one outcome of this provision.

**Would the impact of the Commission’s proposals be negated by the major CRAs being based in the US rather than the EU? Or could the proposals result in a divergence of rating outcomes between those agencies working under the regulatory framework and those operating outside it?**

The three major CRAs are global entities. Though they are headquartered in the US, they have subsidiaries all over the world, including in the EU. The subsidiaries operating in the EU must be registered and comply with EU regulation on CRAs. There has been no suggestion that CRAs would withdraw these subsidiaries due to the Commission’s proposals. Therefore the three major CRAs will come within the scope of the Commission’s proposals.

For third country ratings to be used for regulatory purposes in the EU, the CRA issuing that rating must be based in an ‘endorsed’ jurisdiction- which has a regulatory regime that achieves the same objectives as the EU CRA regulation. Therefore foreign CRA offices based in ‘endorsed’ countries will be able to issue ratings to be used by EU institutions. However, EU investors might not want to buy instruments rated by CRAs based in non-endorsed jurisdictions because those ratings would not be recognised for prudential capital requirements purposes.

If regulatory regimes between countries differ significantly, CRA ratings between jurisdictions could diverge. For example, specific proposals such as imposing unlimited civil liability, or enforcing mandatory rotation as currently drafted could decrease ratings quality in the EU. This is why the Government continues to stress the importance of fostering international regulatory cooperation, allowing regimes to work towards the same objectives in a complimentary fashion without imposing an equivalence approach on foreign jurisdictions.

**UPDATE ON NEGOTIATIONS**

The UK has so far attended two Council Working Groups where all the issues were briefly discussed with a more in depth discussion of mandatory rotation, and the European Securities and Markets Authority (ESMA) gave a presentation. The ambition of the Presidency is to reach a General Approach in Council by May. The European Parliament rapporteur will release his draft report on February 28th and the final plenary vote is due on July 4th.
The Government’s position still remains that which is expressed in my Explanatory Memorandum. The Government believes that it is important to address the problems that were highlighted in relation to CRAs during the financial crisis. We believe that reducing overreliance, increasing transparency, and fostering competition without compromising ratings quality will make the use of credit ratings more effective in financial markets. We are not in favour of public sector interference in rating content or methodology or proposals that might compromise ratings quality.

Your concern about the speed with which the CRA3 proposals are being brought forward without allowing the existing legislation to bed down is particularly pertinent to some of the major proposals, such as mandatory rotation. While the Danish Presidency is keen to progress quickly on this file, we are stressing the need for a thorough discussion, including on impact, before agreeing on some proposals.

The Government also supports measures to foster competition through reducing barriers to entry. As I outlined in my response to the Committee’s report, the competent authority to carry out a competition inquiry into the CRA industry is the European Commission. They should keep the market under regular review once CRA 1, 2, and 3 have bedded down. We believe the proposed measures around reducing reliance on ratings and improving transparency will help to reduce barriers to entry. Indeed, ESMA recently launched CEREP\(^2\), the central information repository for ratings performance, which will help to allow smaller rating agencies to build a credible reputation.

The proposal on mandatory rotation aims to foster competition and address conflicts of interests. However, our concerns about the unintended consequences of the proposal have been echoed by many other Member States.

A number of Member States have also expressed that the proposal on ESMA pre approval of methodology should not involve any ESMA interference with the content of the methodology. The UK, alongside these Member States will seek to ensure that this sentiment is firmly expressed in the legislation.

Member States have had fewer objections to the Commission’s proposal on civil liability. Nonetheless, we are working closely with the Presidency and a number of Member States who share our concerns to encourage Council to discuss the potential impact of the proposal.

The Government, alongside other Member States is continuing to raise strong concerns about unduly hindering the use of third country ratings for regulatory purposes in the EU, and the need to ensure that any European Ratings Index does not result in interference in methodology, misleading representation of ratings information, and increased overreliance.

18 February 2012

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 18 February 2012, on EM 17308/11: Proposal for a regulation on Credit Rating Agencies and EM 17329/11: Proposal for a directive amending a directive on the excessive reliance on credit ratings. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 21 March 2012.

We are grateful for your comprehensive response to our questions. We have already cleared the Directive (EM 17329/11) from scrutiny, and we are now content also to clear the Regulation (EM 17308/11) from scrutiny.

However, we recognise that this is an important Commission proposal, and we urge you to continue to stress the reservations and points of concern that the Committee has raised in ongoing negotiations, including our concern to see an improvement in the methodology by which Credit Ratings Agencies make their judgements. We would be grateful to receive updates as negotiations progress.

22 March 2012

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

Further to the European Union Select Committee’s report on 18 October on the mid-term evaluation of the Customs 2013 programme, I responded in my letter of 16 November 2011 with additional information on the inclusion of law enforcement activities within the programme and greater involvement of candidate and potential candidate countries. In that letter, I also promised to update you on discussions at the subsequent Customs 2013 Management Committee meeting, where the recommendations of the evaluation would be discussed.

At the meeting, the UK made clear that we would not support implementation of recommendation (iv), which implies that funding could be used to finance law enforcement activities, because this is outside the scope of the programme; and recommendation (viii), the expansion of support provided to candidate and potential candidate countries, because of the financial impact. We gained support from a number of Member States and the Commission took note of our position.

Following these discussions the European Commission is now tasked with preparing an action plan to support the effective implementation of the remainder of the programme and the recommendations of the mid-term evaluation, taking on board the views of Member States. This action plan will be presented at the next Customs 2013 Management Committee in April 2012.

13 February 2011

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

We note the Government’s view with regard to the Commission’s proposal to establish a new single programme, FISCUS. We share your concerns about the merger of the Fiscalis and Customs programmes. Furthermore, we are not convinced of the need of an increase of 39% over the combined budgets of the previous programmes. We support the Government’s efforts to limit the financial consequences of this draft Regulation, and would wish to be kept informed about the progress of negotiations. In the meantime we have agreed to hold this proposal under scrutiny.

24 January 2012

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

Thank you for your Explanatory Memorandum 18870/11, dated 10 January 2012, on a report from the European Court of Auditors on whether the control of customs procedure 42 prevents and detects VAT evasion. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 28 February 2012.

We are pleased to note the Government’s recognition of the potential risks identified by the European Court of Auditors to the correct accounting and collection of VAT. We note your view that the changes to the Articles 143 (2) of the VAT Directive, alongside the pan-EU Administrative Agreement, may address some of these risks. Notwithstanding this, we urge you to give due consideration to the case for further reform should it be required.

We note your comments on the sample testing undertaken in the UK in the course of this audit. You state that in some instances there were compliance issues although they did not result in any revenue loss in the UK. You also state that investigations are continuing into one case where the transaction in question was not brought to account in the UK trader’s books and records. How representative a sample are these 15 cases of the degree of compliance within the UK? Is a sample of this size a sufficient basis for the Government to base their judgement of the risks of VAT evasion? You state that the UK is taking steps to address any residual weaknesses that it considers are proportionate to
the risks identified. We would be grateful for clarification of the action you are taking. We would also be grateful for further information on the HMRC VAT Central Liaison Office project to examine potential risks posed by customs procedure 42.

We note the Government’s view in relation to the ECA’s specific proposals, in particular your assertion that the competency for the control and collection of VAT rests with the Member States not the Commission and therefore any EU-wide developments that would impose conditions on Member States’ control would be resisted by the UK. If Commission proposals for amendments to the VAT Directive are brought forward as a result of this report we will scrutinise them in the normal way. We would be grateful for a response to these queries within the standard ten working days. In the meantime we have agreed to clear this document from scrutiny.

28 February 2012

DEPOSIT GUARANTEE SCHEMES DIRECTIVE (12386/10)

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

I wrote to you on 29 September 2011 regarding various aspects of the Deposit Guarantee Schemes Directive (DGSD), which had at that point just entered trilogues. I am now writing to update you on the discussions that have taken place in trilogues since then.

I regret to say that it has not as yet been possible to reach a satisfactory agreement between the European Parliament, European Commission and the Council on this dossier. The main point of difference between the institutions concerns the funding provisions, where the Parliament’s proposals call for a pre-fund of 1.5% of deposits to be built up over 15 years. As you are aware, the Government’s aim has always been to ensure robust, effective protection for depositors without imposing unreasonable burdens on the deposit-taking sector. The view of the UK and other member states is that the Parliament’s approach fails to take into account differences in the structures of member states’ banking markets and could risk imposing unjustified costs on deposit-takers, which would be likely to be passed through to consumers.

On 16 February 2012, the European Parliament voted to adopt the ECON committee’s report as its formal first reading position. The adopted text is available at http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2012-0049&format=XML&language=EN. The Danish Presidency is now considering the best way to take the Directive forward. It is likely that the Council will now formally adopt its general approach and a second reading process will commence. The Council’s general approach (agreed in June 2011) is fully in line with UK aims. Under the second reading process, the European Parliament has up to three months (extendable by a further month if necessary) to adopt, reject or amend the Council’s first reading text.

The dossier was discussed briefly at the ECOFIN meeting on 21 February, at which the Chancellor of the Exchequer set out his view that further discussions on the dossier should take the Council’s general approach as their basis.

While it is disappointing that an agreement has not yet been reached, I take comfort from the fact that UK depositors are already benefiting from the harmonised £85,000 deposit compensation limit agreed under the 2009 Deposit Guarantee Schemes Directive. The Financial Services Authority is also moving forward with reforms to aspects of the Financial Services Compensation Scheme not governed by the DGSD, and hopes to publish a consultation paper in the first half of this year.

The Government will continue to work with the European institutions and other member states to reach an agreement on this Directive which meets the UK’s aims and promotes sound, effective depositor protection across the EU and EEA. I will of course provide a further update once the next steps on the Directive are agreed.

19 March 2012
Letter from the Chairman to David Gauke MP, Exchequer Secretary, HM Treasury

Thank you for your Explanatory Memorandum 17044/11, dated 14 December 2011, on the Commission Communication on Double Taxation in the Single Market. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 28 February 2012.

Like you, we support the case for eliminating double taxation wherever possible, although, as you state, we recognise that eradicating double taxation completely in all cases may be unrealistic. We encourage the Government in their efforts to engage with the Commission and other Member States on this issue.

We note that you state that no issues arise in relation to Gibraltar. We would be grateful for clarification of the position of Gibraltar in relation to this area. What is your understanding of the position and attitude of other Member States, including Luxembourg and Malta, to the Commission’s proposals?

We note your views in relation to the various actions that the Commission intend to take in relation to the removal of double taxation. Like you, we would wish to see clear evidence that there are problems which cannot be effectively dealt with by existing EU directives, bilateral agreements and countries’ unilateral relief arrangements. In particular we appreciate your concern to ensure that any proposal does not threaten or limit the UK’s ability to shape its own tax policy. We look forward to scrutinising any proposals as they emerge, and note that we have already been in extensive correspondence with you on the Commission’s proposal for Common Consolidated Corporate Tax Base.

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

28 February 2012

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

Thank you for your Explanatory Memorandum 18956/11, dated 23 January 2012, on the Commission Communication on Double Taxation of Inheritances. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 28 February 2012.

Like you, we support the case for eliminating double taxation wherever possible, although, as you state, we recognise that eradicating double taxation completely in all cases may be unrealistic. We encourage the Government in their efforts to engage with the Commission and other Member States on this issue.

We agree with you that the Commission’s approach regarding the order of priority of taxing rights is a positive alternative to tax harmonisation, but we note that you reserve the right to enter into DTCs on alternative terms. You also state that the UK is party to a small number of double taxation conventions that cover inheritance tax, including five with other Member States. Which are the Member States in question? We would be grateful for a response to our query within ten working days.

We appreciate the Government’s concern to ensure that any proposal in the sphere of double taxation does not threaten or limit the UK’s ability to shape its own tax policy. In the meantime we have agreed to clear this document from scrutiny.

28 February 2012
Letter from Mark Hoban MP, Financial Secretary, HM Treasury, to the Chairman

I wrote to you on 3 November to set out progress on negotiation of the draft 2012 EU budget and the Government’s approach to conciliation. This letter updates you and your Committee on the outcome of this year’s conciliation process.

Following lengthy discussion at ECOFIN-Budget on 18/19 November, the Council reached a final position on the 2012 EU Budget, as part of negotiations with the European Parliament via a concurrent Conciliation Committee meeting. In summary, it was agreed that EU spending (payment appropriations) in 2012 should total EUR 129.1bn, some EUR 4.0bn below the level advocated by the European Parliament. This limits growth in EU spending next year to only 2.02% above the 2011 EU budget, which is exactly the position proposed by the Council in July.

This outcome achieves a real freeze in EU spending next year, thereby delivering on the Government’s principal objective for this negotiation. It also fulfils the terms of the Prime Minister’s letter from December last year, signed jointly by France, Germany, Finland and the Netherlands, which called on Council to step up progressively its efforts to curb annual growth in EU spending.

As part of the overall deal struck, the level of commitments in 2012 will stand at EUR 147.2bn. This is EUR 987m above the Council’s position but still EUR 530m below the Commission’s proposal. Reinforcements predominantly favour budget areas that the UK prioritises, including; EUR 225m for Heading 1a (Competitiveness for Growth and Employment), of which EUR 120m is allocated to the Seventh Research Framework Programme; and EUR 200m for Heading 4 (EU as a Global Player), of which EUR 96m is allocated to the Development Cooperation Instrument.

On the shape of payments across budget headings, it was agreed to distribute the aggregate cut (relative to the Commission’s draft 2012 EU budget) in a manner consistent with the deal on commitments and to achieve some balance across budgetary headings. In particular, there is a slight rebalancing of payment cuts in favour of Heading 1a, for which payments rise by EUR 66m compared to Council’s position. As a result, payments to Heading 2 (Preservation and Management of Natural Resources) and Heading 4 were reduced. The increase in spending on Heading 1a is welcome, although lower payments to Heading 4 to offset partially reallocations to Heading 5 (Administration) represent a compromise with others’ interests.

An overview of the final outcome in each budget heading is below, supplemented by two tables (annexed) [not printed], which set out the 2012 EU budget by major headings of the Multi-annual Financial Framework.

- Heading 1a (Competitiveness for Growth and Employment)
  Commitments total EUR 14.8bn, which stands EUR 471m below the Commission’s proposal. Within this, notable reinforcements compared to Council’s were agreed for the Seventh Research Framework Programme (EUR 120m), Lifelong Learning and Erasmus Mundus (EUR 54m) and the Competitiveness and Innovation Programme (EUR 16m). The Flexibility Instrument will be mobilised for EUR 50m to cover commitments in excess of the available margin. Payments are set at EUR 11.5bn, which is EUR 1.1bn below the Commission’s proposal and includes EUR 50m for the European Globalisation Adjustment Fund. Nevertheless, these cuts accommodate growth in payments of 21.0% for the Competitiveness and Innovation Programme and 3.9% for the Seventh Research Framework Programme compared to 2011 levels.

- Heading 1b (Cohesion for Growth and Employment)
  Commitments total EUR 52.8bn, which stands EUR 13.7m above the Commission’s proposal. These additional commitments relate to miscellaneous actions and programmes under Structural Funds. Payments are set at EUR 43.8bn, which is EUR 1.3bn below the Commission’s proposal. The vast majority of cuts fall on the Structural Funds, to which payments nevertheless stand 3.1% above 2011 levels.

- Heading 2 (Preservation and Management of Natural Resources)
  Commitments total EUR 60.0bn, which is EUR 97m below the Commission’s proposal. Larger cuts to commitments for market related expenditure and direct aids offset a slight increase in other areas. Payments are set at EUR 57.0bn, which is EUR 831m below the Commission’s proposal. Cuts to Rural Development spending, which has had lower than
expected implementation, constitute the majority of these cuts. This position also incorporates Letter of Amendment No. 3 to the Preliminary Draft Budget for 2012, which updated estimated needs for agricultural expenditure and International Fisheries Agreements.

— Heading 3a (Citizenship, Freedom, Security and Justice)

Commitments total EUR 1.4bn, which stands EUR 27m above the Commission’s proposal with extra funds primarily for the management of migration flows, including EUR 9m for the European Refugee Fund and EUR 9m for the Frontex agency. Payments are set at EUR 836m, which is EUR33m below the Commission’s proposal. The majority of cuts fall on the management of migration flows, to which payments nevertheless are 1.0% above 2011 levels.

— Heading 3b (Citizenship)

Commitments total EUR 0.7bn, which stands EUR 15m above the Commission’s proposal. Payments are set at EUR 649m, which matches the Commission’s proposal, expect for a small increase for miscellaneous preparatory actions.

— Heading 4 (EU as a Global Player)

Commitments total EUR 9.4bn, which is just below the Commission’s proposal. Relative to Council’s position, reinforcements focussed on the Instrument for Pre-Accession (EUR 43m), the Development Cooperation Instrument (EUR 96m), the Instrument for Stability (EUR 34) and Humanitarian Aid programmes (EUR 12m). The Flexibility Instrument will be mobilised for EUR 150m to cover commitments in excess of the available margin. Payments are set at EUR 7.0bn, which is EUR 339m below the Commission’s proposal. This includes EUR 90m for the Emergency Aid Reserve. Compared to 2011 levels, these cuts nevertheless accommodate growth in payments of 11.4% to the Common Foreign and Security Policy and stable spending on Humanitarian Aid and the Instrument for Stability, while spending on the Development Cooperation Instrument and European Neighbourhood Partnership Instrument falls slightly.

— Heading 5 (Administration)

Commitments and payments are set at EUR 8.3bn, which is EUR 16m lower in commitments and EUR 18m lower in payments than the Commission’s proposal. Compared to Council’s position, the majority of reinforcements fall to the Commission (EUR 50m), including EUR 10m for pensions. This position incorporates Letter of Amendment No. 2 to the Preliminary Draft Budget for 2012, which handles mainly administrative costs relating to the expected accession of Croatia to the EU.

This agreement was formally adopted at ECOFIN on 30 November and by the European Parliament on 1 December.

Separately, the Council agreed to adopt Draft Amending Budget No. 6 to the General Budget 2011 (DAB6/2011), which increases the level of EU funds by EUR 200m in 2011 in order to reflect the possibility of overspending on some programmes during the remainder of this year. In the Government’s view, the Commission did not present satisfactory forecasts to demonstrate that extra funds requested under DAB6/2011 were necessary. This Government is committed to improving financial management in the EU, as well as delivering budgetary restraint. Therefore, the Government voted against this in-year adjustment, in order to signal its ongoing dissatisfaction with EU financial management.

To summarise, throughout this year’s annual budget negotiations, the UK and many other Member States argued that we could not afford unrealistic demands for high EU spending, while facing tough decisions on spending at home. The final deal on the 2012 EU budget reflects this austerity.

Looking ahead to implementation of next year’s budget, I recognise that it places tight constraints, to which the Commission must demonstrate its ability to adapt. This means that the Commission should pay much more attention to prioritisation within the year, so that it meets spending pressures via redeployments, rather than extra funds. Member States also need far better information on the path of spending, including in-year forecasts of spending at the end of each year. Otherwise trust is broken. The difficult process for DAB6/2011 illustrated that the Commission must become more transparent regarding implementation, which should aid the work both of the Government and your Committee.

6 December 2011
Letter from the Chairman to Mark Hoban MP

Thank you for your letters dated 28 September, 3 November, 17 November and 6 December 2011 on the 2012 EU Budget. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 20 December 2011. We are grateful for these updates.

We congratulate you on your efforts directed towards securing a freeze in real terms in the overall level of cash payments in the 2012 Budget.

However, we emphasise again that cuts across all the budget lines do not necessarily constitute a constructive and thoughtful approach for an effective EU budget, and there is scope in the future to assess where EU actions add most value. We agree with you that the Commission should pay much more attention to prioritisation throughout the year. We also agree that spending pressures should be met through redeployment where possible, although we acknowledge that this may not always be possible. We also agree with you that it is desirable for Member States to be provided with more information regarding the path of spending.

We note that the Government have repeatedly stressed their intention to push for further efficiency savings under the Administration Heading as well as seeking savings in administrative spending outside Heading 5. Yet we do not believe that our question as to how the Government would wish to see this achieved has been fully addressed. We urge you to provide greater clarity in the future as to what is meant by “administrative savings”.

Whilst we note that our scrutiny of EM 14327/11 on Amending Letter No. 2 was formally overridden, we understand the reasons why this was necessary and require no further action on your part.

20 December 2011

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

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

Thank you for your letter dated 5 October regarding the Explanatory Memorandum concerning the European Commission’s legislative proposal to revise the Energy Taxation Directive 2003/96/EC (ETD).

We note your views on the Government’s objections to the proposal on the grounds that it breaches the principle of subsidiarity. However, we do not consider that the effective functioning of the single market necessitates EU level action as has been set out by the EU Commission in their proposal. The Government remains of the view that elements of the proposal do not meet EU Treaty principles of subsidiarity and proportionality.

You have asked to what extent the current ETD takes account of the environmental impact of fuels. As you know, the current EU minimum energy tax rates were last set in 2003. The levels set out in the ETD reflect the unanimous agreement achieved by the then Member States after taking into account various factors, including their political sensitivities on the EU minimum tax rates for fuels or certain uses of fuels. In practice this meant that the current EU minimum tax rates for some energy products are set at lower rates than others on the basis of environmental impacts. For example, petrol is taxed at a lower rate than diesel per litre in spite of the latter having a higher energy content\(^3\). Coal is also notably one of the lowest taxed energy products despite having the highest CO2 emission. Additionally various reliefs have been built into the framework to take into account social policy objectives. For example, the optional domestic fuel exemption allows Member States to take account of social concerns in deciding whether to tax domestic energy consumption.

As such the current ETD takes account of a number of factors not just the environmental impact of each fuel or its use. This flexibility is important so that Member States are able to take into account their individual political, social and economic situation when structuring their domestic energy taxes. Consequently, the Government takes the view that maintaining the flexibility provided under the current Directive is important.

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\(^3\) Current EU minimum for petrol is €359/1000 per litre compared to €330/1000 per litre for diesel
You ask what impact the proposed dual tax base might have on the relative prices of different fuels in the UK and which fuels would be most likely affected. As you will appreciate commercial factors outside the Government’s control will play their part in determining the price of fuel.

The precise impact of the current proposals would depend on how these were implemented:

— Firstly, the greatest impact on national decision making arises from the requirement for a dual tax base (i.e. one tax base to cover carbon emissions of fuels, and the other to cover energy content) combined with the “relativities requirement” (i.e. a requirement for national tax rates to be structured so that different energy products are taxed in relative proportion to their energy content and carbon emissions). This would severely restrict our flexibility to set national tax rates on different fuels independently of each other. So for example the Government would not be able to maintain equal levels of tax per litre on petrol and diesel and their rates would need to be adjusted to reflect the energy content and carbon emissions of the fuels. Other things being equal, this would mean that the tax per litre of diesel would be 11% higher than for petrol. However, provided EU minimum tax levels are respected it would remain for Member States to decide whether to reduce petrol rates or increase diesel rates in order to comply with the ‘relativities requirement’.

— Secondly, when looking simply at the proposed EU minimum tax rates, UK tax rates for diesel, petrol and electricity would not need to be increased to comply with the proposed new EU minima. CCL rates for business use of LPG and coal would need to be quadrupled and those on natural gas would need to be more than doubled. The Government will carefully scrutinise any proposals that would require an increase in UK duty rates. However as you will appreciate, unanimous agreement to the current proposals is highly unlikely.

Turning to your question about whether the same result as is achieved by the UK’s carbon price floor would not also be achieved by the proposal, and without subjecting UK companies to increased costs compared to their EU counterparts. The Government notes that the Commission’s proposal would create a carbon price in sectors outside the EU Emissions Trading Scheme, and that it would explicitly prohibit carbon taxation on sectors already within the Emissions Trading Scheme. Conversely, the carbon price floor augments the carbon price signal for a sector that is within the Emissions Trading Scheme (electricity generation), and serves to promote a transition to low carbon electricity generation. As such, the two schemes have different objectives and impact on different groups. In general, the UK supports the competitiveness of UK industry through higher EU minimum rates of taxation, not by prescribing detailed structural rules on the design of Member States’ energy taxes.

You query the impacts on UK competitiveness where the “proposal would remove an existing differentiation between business and non-business use of electricity and of the energy products used for heating”. The Government considers the key point when looking at business competitiveness is the comparability of business rates across Member States – not the comparability of EU minimum business rates with EU minimum domestic rates.

Along with the above point, it is worth noting that the current provisions allowing an optional relief for domestic use of energy products will remain and therefore the removal of the current differentiation in EU minimum rates has little impact on the UK given that we use the optional domestic exemption provision.

You have also asked about the removal of the reduced rate for commercial diesel. This does not impact on UK fuel duty rates because the UK does not use this provision and sets equal fuel duty rates for commercial and non commercial use of motoring diesel. However the proposal to increase the EU minimum rates of tax on diesel, a proposal the UK Government supports, should help the competitiveness of the UK haulage industry and go some way towards reducing the attractions of “tank tourism”. However there is considerable opposition from other Member States to the proposals for removing the existing option allowing for a reduced rate on the commercial use of diesel, and this is unlikely to be agreed.

Generally, it may be helpful to add in response to your concerns about the impacts on UK competitiveness and the need to support the UK’s manufacturing base, that these are both key factors that the Government will take into account during these negotiations.
In relation to your question about the reaction of other Member States the update on negotiations detailed below highlights the division in views. Specifically, in relation to subsidiarity, it is worth noting that the Parliaments of some Member States have formally expressed their concerns in this respect, for example Poland’s EU Affairs Committee issued a ‘negative opinion’. Although they do not directly cite subsidiarity issues in that note, they cite concerns about the lack of a reliable impact assessment and adverse impacts on Polish competitiveness as their industry is mainly based on coal. The Bulgarian Parliament held that some parts of the proposal breached the principle of subsidiarity and, amongst other concerns also cited the loss of competitiveness and the potential for inflationary pressures. The Spanish Parliament noted that the Commission had failed to provide proper justification on the application of the principles of subsidiarity and proportionality as required by Article 5 of the Protocol which requires a detailed statement making it possible to appraise compliance with those principles.

Although the negotiations appear to be far from a conclusion, it may be helpful to provide an update given that the Presidency has now overseen a complete run through at official level of the proposal’s technical provisions. There is general agreement that they are complex and controversial. Member States are deeply divided on the substance. There are those that share our opposition to key elements of the proposal, notably to the mandatory dual tax base, the "relativities requirement" and the automatic indexation of EU minimum tax rates. On the other hand there are several Member States who support the general direction of the proposal whilst having particular national issues with specific aspects.

The Presidency sought to put this dossier before EU Finance Ministers at the November Economic and Financial Affairs Council (Ecofin) with a view to agreeing a political steer for direction of future work on this dossier. The Presidency suggested that the level of disagreement on key elements of the proposal meant that consensus on the current draft could not be achieved. Therefore, to make progress, the proposal should be amended. They suggested:

— It should remain for Member States to choose whether or not they introduce a carbon emissions related tax;
— Abandoning proposals for the “relativities requirement”;
— Continuing discussions on setting new EU minimum levels of energy taxation.

However, this issue was dropped from the Ecofin agenda following a pre-meeting discussion that demonstrated a clear split amongst Member States. Those that support the Commission’s proposals argued against Ministerial level discussions on the grounds these would as yet be premature. Those Member States who, like us, oppose key elements of this proposal favoured a Ministerial steer along the Presidency’s suggested lines.

The Polish Presidency has scheduled another official level technical meeting in mid December, but it will now fall to the incoming Danish Presidency to take this dossier forward. We know they are keen to progress the negotiations, having had a carbon tax for many years they strongly support the Commission’s proposal. However, given the complex and contentious nature of the proposal, we expect the negotiations to go on for some considerable time and any agreed revision is likely to be significantly different to the Commission’s proposal.

Despite the divide amongst Member States there has been no substantive suggestion thus far, that a smaller number of Member States find it an attractive option to take this forward under enhanced co-operation. Moreover it is worth noting that the current EU energy tax rules already allow Member States to introduce a dual tax base.

I hope you find this information helpful. I will update the Committee if there are significant developments in discussions of this proposal.

12 January 2012

From the Chairman to Chloe Smith MP


We are grateful for the comprehensive response to the questions raised in our letter of 5 October 2011, but we are concerned that it took you over three months to respond. We would be grateful if
you could explain the reason for this delay, and to ensure that prompt responses to the Committee’s correspondence are received in future.

As you state, this is a complex proposal, and we encourage you in your efforts to take into account in ongoing negotiations the impact on UK competitiveness and the need to support the UK’s manufacturing base.

We also note from your letter that there is a clear split between Member States. Which Member States take a similar line to the UK in opposing key elements of the proposal, and which are broadly supportive of the proposal?

We would be grateful for a response to this query, an update on any progress since your letter was sent to us, as well as on future significant developments in due course. Given that considerable uncertainty remains in terms of the final shape of the proposal, we have decided in the meantime to continue to hold the document under scrutiny.

13 March 2012

Chloe Smith MP to the Chairman


I apologise for the late reply to your earlier letter. As you will have seen, the reply dealt with a number of queries. It was also delayed by the uncertainties around the timetable in Brussels, including the plans for discussion of the dossier at the meeting of the November ECOFIN, from which it was dropped. Furthermore, I took the view that it would be helpful to provide your Committee with the latest information available to us, not least to give you some further context as we moved from the Polish Presidency, which had largely been sympathetic to our position, to the Danes, who as you will be aware take a different view.

I take note of your encouragement for efforts to take into account during these negotiations the impact on UK competitiveness and the need to support the UK’s manufacturing base.

You ask which Member States take a similar line to the UK in opposing key elements of the proposal, and which are broadly supportive of the proposal. There are several Member States, for example the Nordics and French who have had a national carbon tax for many years. Such Member States in particular are broadly and publicly supportive of the structural proposals for an EU wide mandatory dual tax base (including an EU wide mandatory carbon emissions base). In contrast Poland and Germany lead a significant group of Member States taking more or less firm positions against these structural proposals.

You have also asked for an update since we last wrote to you in January. The Danish Presidency has held further official level meetings to focus on technical aspects of the proposal without making any real progress. However, that is understandable given that this is a complex and contentious proposal, and the position remains that these negotiations are highly likely to go on for some considerable time. The Danish presidency has indicated their intention to hold a ministerial level discussion on this issue at an ECOFIN meeting in May or June. At this stage it is unclear what such a discussion would involve although it may take the form of an orientation debate to guide further work under future Presidencies.

I hope you find this information helpful. I will update the Committee when there are significant developments in discussions of this proposal.

20 March 2012

ENHANCING ECONOMIC GOVERNANCE IN THE EURO AREA AND A GREEN PAPER ON THE FEASIBILITY OF STABILITY BONDS (17230/11, 17231/11, 17232/11)

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

Thank you for your Explanatory Memorandum 17230/11, 17231/11 and 17232/11 on a Regulation on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area, a Regulation on common provisions for monitoring and assessing draft budgetary plans and ensuring the
correction of excessive deficit of the Member States in the euro area, and a Green Paper on the feasibility of introducing stability bonds. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 16 February.

We noticed that these proposals, which include measures for further closer fiscal coordination and discipline in the euro area, were published before the European summit of 8–9 December 2011 where EU leaders debated how to improve the co-ordination of fiscal and economic policy across the euro area and agreed, with the exception of the United Kingdom (and subsequently of the Czech Republic), to sign up to a “fiscal compact”.

Under the fiscal compact, euro area countries would have to enshrine debt and deficit limits in their national constitutions - rules that would be subject to review by the European Court of Justice. While the fiscal compact has been fully assessed in our recent report on The euro area crisis, it is not clear whether the Commission’s new proposed Regulations by the Commission have been superseded by the Fiscal Compact or whether they will establish a parallel regime.

Some analysts have argued that the focus on fiscal rules will entrench pro-cyclical fiscal austerity whereas others have argued that fiscal rules defined on a structural basis are by design counter-cyclical. What is your assessment of these provisions? Would the fiscal rules embedded in national law bolster enforcement mechanisms, and shift the explicit numerical target to the structural balance, hence avoiding pro-cyclicality?

We note that the proposal requests that euro area Member States submit draft budgets to the Commission and Eurogroup by 15 October each year. Can you confirm that this would give the Commission powers to scrutinise budgets even before they are presented to national parliaments? Can you also explain what the Commission’s role will be, in addition to what is already established in relation to the European Semester?

Turning to Stability Bonds, we welcome the Green Paper as it fosters the debate about how joint issuance of European debt might help to calm financial markets. We have in the past expressed reservations as to whether a eurobond could be designed in such a way as to contain the risk of moral hazard, and to lower the cost of servicing the public debt for some countries in the euro area without increasing pressure on government financing for others. As we concluded in our Euro area crisis report, although eurobonds could relieve pressure in the bond market, they are only likely to become a mechanism available for use in the medium to long term. To some extent, therefore, we agree with you that stability bonds may, in future “form a component of the successful functioning of economic and Monetary Union.” The question of whether they are a necessary step towards solving the euro area crisis needs to be addressed.

It has often been argued that the sharing of risk under a regime of Stability Bonds would require coordination and mutual surveillance of budgetary policy that goes beyond what is currently in place. The key question is whether the new proposed Regulations, together with the fiscal compact, establish the necessary regime on which a move towards the joint issuance of debt would become more credible. Ultimately, however, the success of Stability Bonds will hinge upon the attitude of investors. We would welcome your observations in this respect.

Notwithstanding this, we question your statement that “these proposals apply only to the euro area and as such there are no direct policy implications for the UK.” It would appear to us that the various proposals for a Stability Bond could have significant impacts for the City of London, and some of them may necessitate treaty change. What is your assessment of the potential impact of the models proposed by the Commission and the wider UK economy? How likely is the Commission to bring forward legislative proposals on Stability Bonds given current German opposition?

We would appreciate a prompt response to our concerns, as well as updates as discussions on these proposals progress. In the meantime, we have agreed to clear these documents from scrutiny.

16 February 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 16 February 2012 on the above Explanatory Memorandum, which I note you have cleared from scrutiny.
COMMISSION LEGISLATIVE PROPOSALS ON EURO AREA ECONOMIC GOVERNANCE

You noted that it was not clear whether the Commission’s new Regulations have been superseded by the Fiscal Compact or create a parallel regime. The Regulation on the strengthening of economic and budgetary surveillance of Member States with serious financial difficulties contains separate provisions entirely to those in the Fiscal Compact. It deals with the enhanced surveillance that euro area countries will be subject to in the event of financial difficulties or where they have an economic adjustment programme in place. It is therefore unaffected by the Fiscal Compact.

The Regulation on common provisions for monitoring and assessing draft budgets contains a number of provisions different to those in the Fiscal Compact treaty e.g. the common budgetary timetable, the ability for the Commission to provide an opinion on these, and stronger monitoring and implementation of the excessive deficit procedure for euro area countries. However, the Fiscal Compact envisaged a number of areas that would be implemented in secondary EU legislation - for example economic partnership programmes - and these have now been taken forward in this Regulation. In this regard the Regulation complements the Fiscal Compact. The Government welcomes this as it ensures that secondary legislation implementing aspects of the fiscal rules in the Fiscal Compact apply only to the euro area and does not place obligations on the UK.

You asked for an assessment of whether the fiscal rules are counter or pro-cyclical. The new fiscal rule states that the budgetary position of the general Government shall be balanced or in surplus. This rule is deemed to be respected if the annual structural deficit of the general government is set at or below 0.5% of gross domestic product.

Given the structural nature of the rule, meeting the rule should not entail a pro-cyclical fiscal response unless it was also accompanied by a structural deterioration. If fiscal rules are embedded in national law then there will be a domestic legal requirement for member states to adhere to them. Depending on the precise detail of the national legislation, this would be expected to reinforce the implementation of these fiscal rules. It will be important to monitor the operation of these rules in practice to make a proper assessment.

You asked about the relationship to the European Semester and national parliaments. Under the European Semester, Member States currently present the main characteristics of their public finance plans to the Commission and Council in the spring of every year. As you may recall, in line with public assurances made by both the Prime Minister and Chancellor, the UK only provides details of its budgetary plans to European partners after the final Budget has been presented to Parliament. The Council can agree, on the basis of a Commission opinion, non-binding recommendations to Member States. Under the Regulation on common provisions for monitoring and assessing draft budgets, euro area Member States will additionally be required to publish and submit their draft budgetary plans to the Commission and Eurogroup by 15 October each year. This will be in advance of their adoption by the national parliament. As this applies for the Euro area only it will have no impact for the UK.

The Commission’s role will examine the draft budgets and if they consider it necessary, for example because they do not appear to be in line with obligations under the Stability and Growth Pact (SGP) or European Semester recommendations, to provide an opinion on them. Where it identifies serious non-compliance with the SGP the Commission will also request a revised draft budget from the Member State concerned. However, national Parliaments in the euro area remain sovereign in amending and voting the actual budget.

I would also like to inform the Committee that at the 21 February ECOFIN the Council agreed a general approach on the proposals.

STABILITY BONDS

On the issue of Stability Bonds, the Committee asks for observations on whether the new proposed Regulations, together with the Fiscal Compact, establish the necessary regime on which a move towards the joint issuance of debt would become more credible. In the Government’s view, the so-called “six pack” of legislative measures, which came into force on 13 December 2011, do strengthen the Stability and Growth pact (SGP) in both its preventive and corrective aspects, including introducing earlier and stronger sanctions for euro area countries, and minimum requirements for budgetary frameworks. The new proposals and the Fiscal Compact will, when introduced, go further on strengthening budgetary coordination and surveillance for euro area Member States and other contracting parties to the Treaty.
Any assessment of whether the new, strengthened rules go far enough would depend on:

— The extent to which the euro area wants to avoid or minimise moral hazard concerns associated with joint issuance of debt; and
— the degree and type of joint issuance they might wish to undertake in future.

Ultimately, these will be a matter for the euro area to decide.

The Committee also asked about the models proposed by the Commission and implications for the UK. In its Green Paper, the Commission did not propose any specific models for stability bonds; rather, it set out the details of three possible models and discussed the advantages and disadvantages of each. The Government notes the Commission’s analysis.

The Commission’s public consultation on stability bonds ended on 8 January. The Committee may wish to be aware that, on 14 February 2012, the European Parliament, in plenary session, passed a resolution (no 7_TA-PROV(2012)004) supporting Eurobonds as potentially contributing to the stability of the euro area in the medium term.

27 February 2012

THE EU EQUITY AND DEBT PLATFORMS (16301/11)

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

Thank you for your Explanatory Memorandum 16301/11 on a Commission Communication on the EU Equity and debt platform. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 24 January.

Like you we welcome the Commission’s attempts to streamline and rationalise the framework for innovative financial instruments. In our previous correspondence with you we have already expressed support for the use of private finance so long as the private sector bears a fair share of the risk. The use of innovative financial instruments and other means of leverage should be explored with caution, especially in Member States where administrative capacity is limited and grant funding is easier to handle. We note that the Commission assert that there are few, if any, concerns in terms of budgetary liability. However, you state that the Government’s support is conditional upon using innovative financial instruments to reduce, rather than supplement the overall size of the budget. How do you envisage that this aim can be achieved?

We would be grateful for a response to this question as well as an update as discussions on this matter progress. In the meantime we have agreed to clear the document from scrutiny.

24 January 2012

EU FINANCES ANNUAL STATEMENT

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

I have pleasure in enclosing the annual statement [not printed] on the 2011 EU Budget and measures to counter fraud and financial mismanagement. This is the thirty first in the series.

The report covers annual EU budgetary matters and details recent developments in EU financial management. It describes the EU Budget for 2011 as adopted by the European Parliament; and details the UK’s gross and net contributions to the EU Budget for calendar years 2005 to 2011 and financial years 2005-06 to 2016-17, consistent with the Office of Budget Responsibility’s latest forecast.

I hope that you will find this report interesting and useful.

14 December 2011
THE EUROPE 2020 PROJECT BOND INITIATIVE

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

Thank you for Explanatory Memoranda 16626/11 and 16627/11 on a Commission Communication on a pilot for the Europe 2020 Project Bond initiative. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 24 January 2012.

We recognise the need to revive and expand capital markets in order to finance infrastructure projects. We welcome the Commission’s intention to pilot the Europe 2020 Project Bonds Initiative. The Commission assert that EU budget contributions would be strictly capped and not create contingent liabilities. However, we note that you state that Government support for European Project Bonds is conditional upon using them to reduce, rather than supplement, the overall budget size. How do you envisage that this aim can be achieved in relation to the specific proposal for European Project Bonds?

We would be grateful for a response to this question, and would also welcome updates on further progress in due course. Meanwhile we are content to clear the document from scrutiny.

24 January 2012

EUROPEAN COURT OF AUDITORS ANNUAL REPORT 2010

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

Thank you for your Explanatory Memorandum on the European Court of Auditors (ECA) Annual Report on the implementation of the Budget concerning the financial year 2010. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on Tuesday 31 January 2012.

We share the Government’s concerns over the ECA’s conclusions as revealed in this annual report. We agree that it is unacceptable that the ECA has, yet again, been unable to give a positive Statement of Assurance in its audit of the EU budget (although we acknowledge that a positive Statement of Assurance was possible in terms of the reliability of the EU accounts). Like you, we are particularly alarmed at the increased error rate for Cohesion Policy. These problems need to be addressed as a matter of urgency.

We agree with you that Member States have a responsibility to do more to reduce error rates, and that the Commission’s efforts should be concentrated on those Member States and regions where these errors are most frequent. It is our view that the ECA and the Commission should do more to highlight those Member States where error rates are most frequent. Do you agree?

Bearing this in mind, we note that the UK itself has not been immune from errors. We note your statement that the Government have undertaken a number of measures to improve departmental management of EU funds. What further information can you give us on the steps that the Government are taking to address the problems that have arisen? We look forward to receiving a copy of the Government’s official response to the Commission on the specific issues referred to in the ECA’s report, and would be grateful if you could advise us when this is likely to be received.

We welcome your efforts to make rules and regulations for EU spending simpler and more transparent, and to encourage Member States to take greater responsibility for the parts of the EU budget that are co-managed. What update can you give us on the efforts that the Government have undertaken in this regard?

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

31 January 2012

Letter from Mark Hoban MP to the Chairman

In my Explanatory Memorandum on the ECA report, dated 29 November, I undertook to forward to you and your Committee a copy of the Government’s official response to the Report. I have pleasure in enclosing a copy for your information [not printed].
Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 31 January 2012, regarding my Explanatory Memorandum on the European Court of Auditors (ECA) Annual Report on the implementation of the Budget concerning the financial year 2010.

The Government agrees that more should be done by the Commission and the ECA to highlight poor-performing Member States. Member States’ recognition of their responsibility for properly managing, jointly with the Commission, some EU funds should play an important role in improving EU financial management overall. To this end, the Government used last year’s discharge process to call on the Commission to strengthen Member States’ responsibility and it has since responded by toughening its sanctions regime, including interruptions of payments.

The Government takes the management of EU funds seriously and reiterates its determination and commitment to reduce, and eradicate errors in the management of EU funds in the UK. The Government’s response to the ECA report was sent to the Scrutiny Committee of both Houses on 1 February 2012, which I hope you have now received. This shows that we have taken corrective action and are in active dialogue to resolve remaining problems.

In relation to Structural Funds programmes, which were subject to a number of payment interruptions last year, the relevant UK management authorities have responded, in the first instance, by agreeing new management and control systems for their programmes with the European Commission, tailored to address the specific issues raised, and thereby to reduce errors and allow payment interruptions to be lifted. In the case of European Regional Development Fund programmes in England, the managing authority (Department for Communities and Local Government) has used the opportunity presented by centralisation of the programmes previously administered on their behalf by the Regional Development Agencies to improve and standardise monitoring and verification procedures. The Department for Business, Innovation and Skills, which oversees the Structural Funds programmes in the UK, has also enhanced its monitoring systems to provide clearer oversight of the UK programmes and their progress against targets.

Regarding ongoing negotiation of the Financial Regulations, a trilogue was held between representatives of the institutions on 27 January, which touched on rules relating to EU grants, as well as trust funds, loans and aspects of buildings policy. We await new information from the Presidency to come back to Council for a fresh mandate as the text evolves, as consensus in Council remains elusive on important issues, such as framework rules relating to the management of the Common Agricultural Policy and Structural and Cohesion funds. There will be further trilogue discussions in mid-February and early March. I will keep your Committee updated.

12 February 2012

EUROPEAN GLOBALISATION ADJUSTMENT FUND (12122/11)

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

Thank you for your letter of 24 November and for clearing the Regulation from scrutiny. At the Employment and Social Policy Council on 1 December. During lunch, the Presidency held a discussion on extending the crisis derogations for the EGF, but the blocking minority, which included the UK, confirmed we could not accept a compromise.

Back in Plenary, the Presidency, argued that given the continuing crisis it was only right that the crisis derogations were extended and emphasis was put upon the “Solidarity” of Members States, to which the Commission strongly agreed. Many Member States had concerns about the Fund, which will be discussed further during negotiations on the new proposal for the next Financing Period, but that is a wholly separate negotiation. Finland proposed a compromise amendment to extend the derogations by one year only, which a majority of delegations said they could accept.

In response, Germany, the Czech Republic, the Netherlands, Sweden, Slovakia and Latvia reiterated their scepticism about the value of the EGF. I agreed with this opinion and intervened to say that the EGF was inefficient and did not provide added value, and for that reason the UK could not accept any compromise amendments. In protest, nine delegations (Belgium, Italy, France, Greece, Ireland,
Romania, Cyprus, Portugal and Spain) tabled a minute statement and demanded a vote on the Finnish compromise. In the subsequent show of hands the Secretariat General recorded 111 votes against (comfortably exceeding the 91 votes needed for a blocking minority). The Presidency consequently adopted its Progress Report unchanged, and on this occasion a Political Agreement was not reached.

Following my previous letters, you also asked about previous cases which did not sufficiently meet the EGF criteria and how cases may have fallen foul of the Regulations. I am happy to provide further information.

You will appreciate that the majority of past cases were under the previous administration, under the first Regulation (1927/2006) and under different policy conditions. My understanding is that most redundancies of the right size were checked for EGF compatibility by officials, particularly if they would have had a significant impact on the relevant region. None of these could be said to be clearly relevant to the original EGF conditions, i.e. caused by a major global trade shift with an EU level effect (Article 2).

In any case, the redundancies often took place over a long time period (more than the four months set by Article 2a) rather than as a one-off event. They were absorbed largely, including through Jobcentre Plus services in conjunction with strategic partnerships. There was deemed to be no gap in the provision that justified the additional cost to the UK of using the EGF given the abatement and rebate issues that I have referred to before. Moreover, the EGF Regulation states that it must supplement Member State activity (Article 6.2) so using it for support that we would provide anyway, (which is all measures set out in Article 3), could be deemed to be technically in breach of the Regulation. Also, the EGF can not duplicate other EU funding (Article 6.5) and our main assistance in large redundancy situations includes training services procured by the Skills Funding Agency using the European Social Fund Priority 2, responding to local skill needs and demand.

The EGF was originally based on the UK’s Rapid Response Service model, although the Service does not discriminate on redundancy causes as the EGF does. This does not provide the UK with much scope to complement not duplicate. Even if the Commission did not use this against a UK application, (assuming that the Council and European Parliament agreed), it would still mean that in most cases any EGF investment would be only subsidising departmental expenditure already committed.

Rapid Response is initiated considerably before significant job losses actually occur thus mitigating the shock to the local labour market which the EGF addresses. EGF finance may be received only some nine months after redundancies occur, and the majority of UK job seekers leave the unemployment benefit register within six months of claiming, so it is theoretically possible that in an EGF scenario the funding received would be held by the DWP because the centrally funded support measures had already been carried out. This may fail to provide a sufficient audit trail (under Article 18) to demonstrate that the EGF has been used to invest directly in the support that individual workers receive on the ground.

To provide you with case examples, after the 2009 amended Regulation came into force, with the derogations that are the subject of the current proposal, I am informed that one case received particular attention. That was Corus Teeside Cast Products which came about due to a cancelled contract and lack of alternative demand for the particular type of steel concerned. This led to a commercial decision by the company for which a link could have been made to the global financial and economic crisis, subject to the evidence being available to set out in an application proving that case.

Officials looked at whether they could create a project to supplement the Rapid Response Service for a specific group of workers who needed additional, perhaps more bespoke and costly, support to overcome a significant skills gap for example (using Article 3c). The scope for this was narrowed over the period concerned when European Social Fund flexibility was used to temporarily boost the existing Jobcentre Plus and other support for redundancies. This led to a focus on unique characteristics of new businesses that were developing in the area to try and avoid overlap with the nationwide service. A report on the situation by the North East Regional Committee raised the EGF and the government response, shortly before the Election, noted that the DWP was preparing an economic analysis, and a statistical breakdown of the actual number of redundancies including their training needs, amongst other matters.

Following the Election, steps were already in train that led to the plant being sold to a new owner. In retrospect this raises another problem with using the EGF. Its conditions, particularly on timescales (10 weeks from redundancy notice under Article 5.1), mean that Member States can only estimate the number of workers to be supported that must be specified in an EGF application. I understand that Commission audits, after final, national reports on completed EGF cases, are resulting in an average 50% return of EGF funding, under the Regulation’s terms (Article 19). This is because mainly many of
the workers targeted did not ultimately need the support over the full implementation period, which is now two years. They can find work by other means, for example, because even during the recession there were vacancies, especially in flexible and dynamic markets. There is a significant risk of this situation arising in the UK given that a redundant worker would when becoming unemployed be subject to benefit conditionality on active job seeking that goes beyond what pertains in most other EU countries, where benefits can be open ended and the unemployed can be detached from the labour market including by being placed in long term training programmes.

Since I became the Minister responsible, I have looked at a number of cases and written to local government or MPs, or MEPs, about these. Examples include the Pfizer facility in Kent, which as in the evidence to the Commons Science and Technology Select Committee was a corporate decision to shift investment away from the strands of research carried out by the site, in line with the structure of the industry overall. Besides that, Pfizer itself contracted careers advice and retraining for its own staff, and EGF funding can not go to a company. Another case was Twinings in Andover and South Shields for which the number of redundancies were below the EGF threshold and were due to relocation within the EU which is counter to EGF criteria. I am aware also that Rio Tinto Alcan announced on Wednesday 16 November its intention to sell (or close) its aluminium smelter in Northumberland and, subject to the 90 day consultation period, make the staff there redundant. Here, Jobcentre Plus are already engaged and I note that the company itself has cited cost overheads due to energy prices and future carbon taxes which have influenced its internal company decision to this particular plant. Rio Tinto is streamlining its global aluminium operations as part of its commercial strategy that will result in them also selling 12 other plants around the world. This appears to put the Lynemouth case out of EGF scope although this may be part of a trend across the sector that will create a trade shift and my officials are in close contact with BIS to look at options over the coming months.

You urge the Government to consider applying to use the Fund should appropriate cases arise in the future. I am happy to reiterate that I have not ruled out use of the EGF absolutely although I would have to be convinced that the benefits outweigh sufficiently the costs, including those arising from the considerable financial management and evaluation requirements on a one-off EU funded project. In particular, EGF would have to enable us to provide support for individual workers affected that is additional to our current response to large redundancies, which is arguably more comprehensive, flexible and rapid than available elsewhere in Europe.

I trust that you now have all the information you require. I will of course write to you again on the negotiations for the 2014-2020 period once we have a clear proposal.

16 December 2011

EUROPEAN GLOBALISATION ADJUSTMENT FUND (13626/11)

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

Thank you for your letter of 25 October, which asks for an update on the Commission’s mid-term review of the EGF.

Regarding the mid-term review of the EGF, the Minister for Employment, Chris Grayling, wrote to you on 2 November last year and committed to send a copy of the review to you and your Committee once it is issued. We hope the review will be released shortly, as regrettably it is already overdue. The Commission plans to hold a conference on the review in Brussels on 2 February.

The Government has repeatedly raised the need for a robust mid-term review of the EGF with the Commission and other Member States at Council Working Group, during the negotiation on the proposed extension of the temporary derogations to the EGF. ON the temporary derogations, you have been in separate written correspondence with the Minister for Employment.

During this negotiation, the Government used the absence of the mid-term review and existing evidence on the limited effectiveness and efficiency of the EGF as arguments against extending the temporary EGF derogations. As a result of concerted UK lobbying, these proposals were successfully blocked at Council on 1 December. This was a significant achievement, which should create better incentives for future applicants to the EGF, potentially raising the added-value of future EGF actions and saving money for the UK taxpayer.

12 January 2012
Letter from the Chairman to the Rt. Hon Chris Grayling MP, Minister for Employment, Department for Work and Pensions

Thank you for your Explanatory Memorandum 15440/11, dated 3 November 2011, on a proposal for a Regulation on the European Globalisation Adjustment Fund (EGF). The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 17 January 2012.

We note that the Government have a principled opposition to the EGF. However, the Government have previously stated that, in spite of its weaknesses, the EGF can play a useful role in responding to the consequences of globalisation, especially in the more disadvantaged areas of the EU. Is this still your view? Do the Government wish to see the EGF reformed or abolished?

We share the Government’s concerns about many aspects of the EGF, in particular the past indicators of a poor return on investments and the low number of applications from, and grants to, newer Member States. We have previously stressed our agreement that the EGF needs to be directed where it is needed most, such as to those Member States with poor labour market structures. We also note with concern that the Commission itself acknowledges that the EGF’s effectiveness has suffered from the length and procedural requirements of the decision-making process, and that its consultation summary states that “the complexity of the procedure and the slowness of the current decision-making process was severely criticised by all.”

Notwithstanding this, we do recognise the case for a rapid crisis intervention instrument in the event of large-scale redundancies. We concur with your own assessment in your letter of 17 October 2011 on EM 12122/11 that “some Member States with insufficient capacity ... do need support for managing labour market shocks and these are likely to continue given the current economic conditions.” Is this still your view? If so, in the event that it is retained, in what specific ways does the EGF need to be reformed in order for it to operate more efficiently? In the event that it is abolished, what support mechanism should replace it in order to provide such support?

Your EM states that “there should be a comparison with the scope of the European Social Fund (ESF), and an open assessment of whether the ESF could meet the purposes of the EGF, for example, through an option for flexible response to labour market shocks, above and beyond the national ESF programme”. We see merit in this suggestion and would therefore be grateful for further details on what you propose. In particular, what do you see as the strengths of such a model in comparison with the Commission’s EGF proposal? How would you envisage such a support mechanism working in practice? Is your proposal feasible? How much support would you anticipate there being for such a proposal amongst other Member States?

We have engaged in extensive correspondence with you in relation to the fact that the UK has not made an application to the EGF. We note the view expressed in your letter of 16 December on EM 12122/11 that, for you to consider making an application, the EGF “would have to enable us to provide support for individual workers affected that is additional to our current response to large redundancies, which is arguably more comprehensive, flexible and rapid than available elsewhere in Europe.” You have also referred to support received in the UK through the European Social Fund in relation to redundancy cases. In what ways has the UK benefitted from ESF support in relation to such cases? What benefit would you wish to see the UK receive from the EU should such cases of redundancy occur in the future?

We would be grateful for a response to these points, as well as an update on negotiations as they progress. In the meantime, we have agreed to keep the proposal under scrutiny.

17 January 2012

Letter from the Rt. Hon Chris Grayling to the Chairman

Thank you for your letter of 17 January following consideration by the Economic and Financial Affairs and International Trade Sub-Committee of the proposal by the European Commission for a new Regulation on the EGF, under the next Multi-annual Financial Framework 2014-20.

I am replying to as many of your questions as I can. However, on the Government negotiating position the Foreign Secretary has not agreed this yet. I am seeking clearance, jointly with the Secretary of State for Environment, Food and Rural Affairs (given the proposal includes a new element of support for farmers), in time for the first Council working group which is expected in mid-
February. The Presidency have only committed so far to a progress report for the Employment and Social Policy Council in June so I will write to both Committees with an update on the situation before that event. Final agreement will be sought by the December European Council.

You ask whether it remains my view that the EGF can still play a useful role in helping disadvantaged areas of the EU in particular to respond to the consequences of globalisation. You ask also whether the Government wish to see the EGF reformed or abolished. You point out that we share with your Committee a concern over the Fund’s effectiveness, efficiency and value to the Member States most in need. While the mid-term evaluation is still awaited, although my officials expect this soon, I am increasingly of the view that no amendment to the construct of the EGF can resolve its deficiencies.

I believe that some Member States, and not just the UK, have shown that strategic use of instruments like the European Social Fund can provide the capacity to mitigate the effects of sudden economic shocks. The ESF can also, by its nature, improve the functioning of national labour markets if it is invested wisely in employment and training support for those at a disadvantage. As the debate becomes more focused in advance of the European Council in March, I expect a clear parallel will emerge between a consensus on priorities for growth and the objectives of the structural and cohesion funds. In particular, those funds explicitly add value to national reforms under Europe 2020, whereas the EGF only provides one-off support.

I have asked my officials to explore with other Member States how the ESF could be used to replace the EGF. I am aware that some, especially smaller Member States, have little room for flexibility to use ESF to respond to unforeseen large redundancies, for example, because they necessarily commit all their funding up front. I would prefer that a simple mechanism be found that is optional, preserves national flexibility, and can be fitted into the new, draft ESF Regulations without too much fuss, for example, by adding an investment priority that is tightly drawn to reflect the EGF scope.

This may be necessary also to allow the Commission to be able to highlight specific actions on solidarity, which often features in their arguments in favour of the EGF. Not all Member States would need such a mechanism. For example, the Skills Funding Agency has used the ESF to procure additional training provision specifically as part of our redundancy response in England. There may well be other examples that show that the ESF already can be used flexibly in a way that EGF can not.

Until we have discussed some ideas with other Member States I can not answer more fully the other questions you put on using the ESF or the chances of our chances of success. I am not in a position to spell out how the EGF could be reformed if it is retained, until the Government has an agreed negotiating position. I will write to you when this has happened. However, I do accept that full abolition could be difficult given the economic forecast for the EU overall. Those Member States with systems that do require more development and modernisation may be constrained fiscally even though I believe that the issues here are not about investment from national budgets alone. Given all this, the Government is considering what its fall back position might be on the EGF proposal. You will know from our correspondence so far that I would like the EGF to be restricted to Member States that demonstrably meet a set of temporary, economic conditions which merit them receiving additional support. I also think that the Commission should be required to provide more robust analysis in advance, and that Member States should set clear objectives for the EGF investment so that the added value can be properly assessed. Moreover, if the EGF was brought within the EU Budget then its approval process would be simpler.

As far as any potential UK application is concerned, I think it right that given the extensive scope of national measures and the cost of using the EGF, particularly the staff resources required, that I set a high benchmark for added value. While I will consider any individual case on its merits, I would hope that we would only use the EGF where it could part-fund measures that were needed by the individuals concerned and that match local labour market needs as well.

If the Government response to a particular large redundancy does progress to the stage of an application to the EGF being considered by myself, in consultation with BIS and Treasury Ministers particularly, then I will of course write to the Committees when appropriate. In the meantime, I will write with further information on this proposal for a new EGF Regulation in due course.

30 January 2012

Letter from the Chairman to the Rt. Hon Chris Grayling

European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 21 March 2012.

We are grateful for the useful update that you provide, and have sympathy with the views that you have expressed. We understand that you are unable to fully answer some of the questions raised in our letter of 17 January, but are grateful to you for offering to write again in order to address these points, and with further information as negotiations progress. We would be particularly grateful for updates on the government’s negotiating position.

We are grateful for your offer to write to the Committee again before the June Council meeting, and would wish to remain in close contact with you regarding this proposal between now and then. We would be particularly grateful for updates as negotiations progress, and in relation to the Government’s mooted fallback position. Given that considerable uncertainty remains concerning the Commission’s proposal, and in anticipation of further correspondence from you, we have decided to continue to hold the document under scrutiny.

22 March 2012

EUROPEAN SOLIDARITY FUND (12794/11)

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

Thank you for your Explanatory Memorandum 12794/11 on a Commission Communication on the future of the European Solidarity Fund. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 24 January.

This Communication appears to be a step in the right direction towards a more effective Fund. However, can you confirm that it is the Commission’s intention to move the Solidarity Fund outside the EU budget? We would have some concerns if this was indeed the case. How, for instance, would funds for the Solidarity Fund be secured? Furthermore, it is not clear whether and how this would increase the effectiveness of the Fund, for instance by making financial aid available much more rapidly. What is the Government’s view of this proposal? What would be its implications? We would be grateful for a response to these questions.

We would, in principle, support moves to speed up the process of agreeing and making financial assistance available, so long as they are in line with the Government’s wish to limit EU spending.

We observe that the Commission does not argue for an increase in the budget ceiling for the Fund and that it has never drawn upon to its full annual ceiling (€1 billion or £867 million).

We would appreciate a prompt response to our concerns, as well as updates as discussions on this proposal progress. In the meantime, we have agreed to clear this document from scrutiny.

24 January 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 24 January, on the future of the EU Solidarity Fund, which raises a number of issues. I will address these below.

The Solidarity Fund is currently financed outside of the normal EU budget headings, as a special instrument. Grants from the Fund must be approved (upon proposal by the Commission, on a case by case basis) by the Budget Authority (the Council and European Parliament) via an amending budget. The funds need to be raised by an extra financial effort of the Member States, over and above their normal EU contributions.

The Commission has not proposed to change this procedure.

To increase the effectiveness of the Fund, and in particular to make financial aid available more quickly, the Commission argues that there is scope for streamlining administrative procedures for providing assistance under the Fund.

The mobilisation of the Fund under the current Regulation involves a number of steps, including: acceptance by the Commission of an application as an eligible case; adoption of an amending budget proposal by the Budget Authority; adoption of a Commission decision addressed to the beneficiary
State awarding the aid (grant decision); and adoption of the agreement for the implementation of the grant (implementation agreement).

The Commission argues that this process can be streamlined by merging the grant decision and implementation agreement. The Commission estimates that, through such a change, aid to disaster-stricken countries could be paid out four to eight weeks earlier than under the current system.

The Government is keen to improve the effectiveness and value-added of the Solidarity Fund, including in terms of making financial aid available more rapidly.

In terms of keeping the Fund outside of the EU budget, the Government considers that all items of EU spending should be included in the budget to ensure proper clarity and sound financial management. In terms of the Budget Authority continuing to approve proposals for assistance, the Government can support this.

In terms of streamlining the decision making process in relation to the grant decision and implementation agreement, the Government can support this specific proposal, which is unlikely to weaken budgetary oversight by the Council. The Government insists that merging documentation should not lower transparency or reduce reporting or evaluation of Fund programmes.

Discussion of the Commission’s communication will be taken forward by the EU’s Structural Actions working group, although no discussions are currently scheduled under the Danish Presidency. I will update you on progress once these discussions start.

1 February 2012

EUROPEAN STATISTICS (9683/11)

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

Thank you for your EM 9683/11 on the Communication from the Commission to the European Parliament and the Council - Towards robust quality management for European Statistics. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 13 December.

We have given a lot of attention to the subject of the quality of statistics, especially in the context of our recent report on The future of economic governance in the EU. We are pleased to note that further progress in relation to this matter is being made. We are content to clear this document from scrutiny.

14 December 2011

EUROPEAN VENTURE CAPITAL FUNDS (18499/11)

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

Thank you for your EM 18499/11, dated 10 January 2012, on a proposal for a Regulation on European Venture Capital Funds. The European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 7 February 2012.

We hope that the proposed harmonised regime for venture capital funds will make it easier for relatively small venture capital funds both to raise capital and invest across national boundaries within the EU 27.

We support the proposal for a specific regime for venture capital funds in that it would allow funds to benefit from an EU-wide passport without having to opt-in to the more burdensome regime established by the AIFMD, which would impose a greater regulatory burden and ill-suited rules on venture capital funds.

We note that the proposed regulation is closely linked with the AIFMD, on which we wrote a report in 2009. The AIFMD is principally designed to minimise systemic risks from hedge funds and large private equity operators and might not necessarily suit the needs of venture capital funds. The AIFMD allows managers of venture capital funds with assets under management above €500 million to benefit from the European passport provided by the AIFMD, yet the majority of the venture capital business in Europe lies below this threshold.
We agree that clarification is required on the relationship between this proposal and AIFMD, particularly in terms of whether funds bearing the European Venture Capital Fund label whose assets under management grow beyond €500 million could continue to benefit from the EVCF label.

We welcome the Commission’s proposition that the proposed regime for venture capital funds should not be compulsory for all funds investing in SMEs, but should instead be available on an opt-in basis.

You express reservations as to whether the proposed minimum 70% level of qualifying investment is appropriate. We note that the Commission argues that a lower threshold would make it harder to distinguish a European Venture Capital Fund from a private equity, whilst a higher threshold such as 90% would give the fund manager very little scope for prudent risk spreading. We would be grateful for a detailed analysis of the Commission’s argument and the reasons for your concern.

We would be grateful for a prompt response to these questions. However, given that we understand that agreement on the proposal at Council level may be sought imminently, we are content to clear the document from scrutiny.

7 February 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter dated 7 February 2012 raising the issue of the appropriateness of the proposed minimum 70 per cent level of qualifying investment.

The main priority of the Commission in this regard is to ensure that qualifying venture capital funds primarily fund promising and innovative SMEs. They are concerned that a lower threshold would cause the “venture capital” identity of the funds to be weaker, particularly if it is separated from “private equity” more broadly, and that there would be greater scope for fund managers to arbitrage the system.

A number of our concerns regarding the threshold have now been addressed. Notably, a compromise text now includes provision for a fund of funds structure to be counted in the qualifying 70 per cent, rather than the non-qualifying 30 per cent. The fund of funds instrument is a key way that large institutional investors, particularly pension funds and university endowments channel investment into venture capital.

Furthermore, our analysis of venture capital investments over the last ten years suggests that significantly less than 70 per cent of venture capital investment in SMEs took the form of what we would consider equity or “quasi-equity”. However the Commission have clarified that they intend a much broader range of instruments than the phrase “quasi-equity” necessarily indicates and have clarified this in a new recital.

I do still have an outstanding concern however. Our engagement with industry suggests that the Commission has significantly underestimated the impact that operational costs will have on the non-qualifying 30 per cent.

The best solution now would be to press for operational costs to count as qualifying investments. This could incur a risk that it would incentivise fund managers to raise their charges, however we feel that this is unlikely as it would make them less attractive prospects to potential investors.

The Presidency has now decided to hold an additional experts and attachés meeting of the Council on 24 February and will seek political agreement by Ministers on 21 March.

We will continue to inform you as required.

18 February 2012

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 18 February 2012, on EM 18499/11 on a proposal for a Regulation on European Venture Capital Funds. The House of Lords European Union Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 24 April.

We are pleased to note that your concerns over the proposed minimum 70 per cent level of qualifying investment have been met. We would welcome an update on the outcome of the 21 March Council meeting and on the progress of negotiations.

25 April 2012
Letter from the Chairman to Chloe Smith MP, Economic Secretary, HM Treasury


Like you, we recognise the value of the customs union and of co-operation between Member States in this important area of policy, and believe that its strategic objectives remain valid ones to pursue. Nevertheless, we acknowledge your concerns about the potential for the competence and scope of the agreement to be widened. You state that you are “mindful of the need to identify use of language that could push the scope beyond the boundaries of EU competence.” Which of the future proposals that have been mooted cause you most concern? Do other Member States share your concerns over any inappropriate extension of the scope of the customs union? You state that the Government were seeking to agree changes on the text of Council conclusions on the report to reflect your concerns. What update can you give us on these negotiations? We would also be grateful for more information on the Government’s concerns in relation to performance targets.

We would be grateful for a response to these queries within the standard ten working days, but noting that any specific proposals arising from the report will be subject to scrutiny in the usual way, we are content to clear the document from scrutiny.

22 March 2012

Letter from Chloe Smith MP to the Chairman

I am writing in response to your letter of 22 March 2012 following your Committee’s consideration of the EM on the Evolution of the Customs Union.

You have asked three specific questions which I have answered below and have also provided the further information requested on performance targets.

Which of the future proposals that have been mooted cause you most concern?

The Government’s main concern for the future is around centralisation and the sharing and pooling of capacities and capabilities that would change the customs business operating model and increase Commission influence in areas of national competence.

The risk is that the Commission will structure their proposals in such a way as to reinforce and drive forward their ambition for much greater integration and centralisation of customs services. Therefore, the Government is working to ensure that Commission plans and proposals are developed in close cooperation with the Member States (MS) to ensure that they do not result in an unacceptable transfer of competence from MS to the Commission, take into account the needs and concerns of MS administrations and businesses and deliver real benefits.

Do other Member States share your concerns over any inappropriate extension of the scope of the Customs Union?

Of those Member States (MS) that have made their views known, some have reservations about the Commission’s overall direction and intentions for developing the customs union; but others do not. There is broad agreement that change is necessary to ensure that customs is able to keep pace with the changing international trading environment and can respond quickly and appropriately to meet new challenges.

A number of key Northern European MS share the Government’s concerns about moving towards a customs union model that increases Commission involvement through a much greater degree of integration and centralisation for delivering customs services in the future. One Northern and a few Southern MS are supportive of the Commission agenda. Some Eastern and Baltic MS are also likely to support the Commission, possibly with the expectation of benefitting from any increase in EU funding for future customs developments. Two other Northern MS, who have in the past been aligned with the UK view, are now more receptive to centralisation proposals given the current financial climate.
What update can you give us on negotiations to agree changes on the text of Council conclusions on the report to reflect your concerns?

The Commission briefly presented the progress report on the Evolution of the Customs Union at the 11 January 2012 Council meeting of the Customs Union Group. A full meeting agenda precluded any detailed discussion of the item.

However, as a result of an early intervention by the UK and with support from other Member States, a commitment was secured from the Presidency that they will pursue Council conclusions on this subject. The Presidency undertook to bring the matter back to the Customs Union Group for further discussion as soon as possible. The Government expects the UK to be a key player in influencing and helping to formulate the conclusions in due course.

In addition to the specific questions, you have also requested more information on the Government’s concerns in relation to performance targets.

The Commission has not yet come forward with any specific proposals but their ambition in the longer term is to set fixed performance targets for customs activities that Member States (MS) will be required to report against.

The Government supports the need to develop an effective performance management system for the Customs Union but is keen to ensure that this is established and agreed in consultation with the MS and contains the right measures. It does not agree that fixed targets, determined by the Commission, is the right way to go as such an approach could compromise how MS are able to manage their national business. Performance measures should be outcome based to allow MS the flexibility to manage their national processes, procedures and resources in the most efficient and effective way to deliver the required results.

The Government will, therefore, work to influence any Commission proposals to ensure that a performance management system and its associated measures do not adversely impact on our ability to address national priorities, risks and threats while still being able to meet our obligations to the Customs Union.

I am grateful to note from your letter that your Committee has been able to clear the document from scrutiny.

6 April 2012

DUAL-USE ITEMS: COMMUNITY REGIME FOR DUAL-USE ITEMS (16726/11)

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

Thank you for your Explanatory Memorandum 16726/11, dated 29 November 2011, on the proposal for a Regulation amending the Regulation for the control of exports, transfer, brokering and transit of dual use items. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 17 January 2012.

We agree with your assessment that the proposal would be a sensible one so long as robust safeguards are maintained. We would be grateful for an update in due course on negotiations in relation to this proposal, in particular in relation to the maintenance of such safeguards.

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

17 January 2012

FREE TRADE AGREEMENTS WITH EGYPT, JORDAN, MOROCCO AND TUNISIA

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

I am writing to inform you of future negotiations on Deep and Comprehensive Free Trade Agreements with Egypt, Jordan, Morocco and Tunisia. The trade Foreign Affairs Council (FAC) in
Brussels on 14 December approved negotiating mandates for the above agreements. This represents strong progress following the political signal given in the FAC of 20 June, which invited the Commission to submit recommendations for negotiating such directives with selected Southern Mediterranean partners as a central pillar of the EU’s response to the Arab Spring.

A key priority of the DCFTAs will be to encourage reform in Egypt, Jordan, Morocco and Tunisia through legislative approximation to, and further economic integration with the EU. Negotiations in each case will not be launched until member states are satisfied that the countries concerned have the capacity to implement the necessary reforms. In parallel, the European External Action Service will make an assessment of ongoing political reform.

A scoping exercise is likely to begin with Tunisia early in 2012, with Jordan and Morocco following. It will likely take longer to begin negotiations with Egypt. Once negotiations are launched they are likely to take at least two years to complete.

As is common practice in trade negotiations, the negotiations will be held in confidence. I will update the Committee once negotiations are launched in each case. When the final proposals have become available for national scrutiny I will prepare the usual explanatory memorandum using the normal parliamentary procedures. However, in the meantime I am taking this opportunity to update you on recent progress.

The mandates contain scope to negotiate ambitious, wide-ranging and comprehensive agreements, building on existing Association Agreements and including trade in industrial and agricultural goods, investment, trade in services, competition policy, customs and trade facilitation, and intellectual property rights. In areas where member states retain competence, they will decide whether to accede in their own right.

17 December 2011

GENERAL AFFAIRS COUNCIL (16 DECEMBER 2011)

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

The EU General Affairs Council will take place in Brussels on 16 December 2011. As the Polish Presidency has asked Cohesion Ministers to attend, I will represent the UK and I will be accompanied by Alun Davies AM, the Welsh Minister for Agriculture and European Affairs.

The main item on the agenda (which I attach) is an orientation debate on structural and cohesion funds for 2014-20. The Presidency has tabled three questions for discussion linked to strategic programming and ring-fencing of funds for specific objectives. At lunch there will be an informal discussion on positive and negative incentives to improve performance in delivering structural and cohesion funds.

I have also attached a Pre-Council Written Ministerial Statement which is being laid in Parliament.

14 December 2011

Letter from Mark Prisk MP to the Chairman

I represented the UK at the General Affairs Council, on 16th December. The agenda covered structural and cohesion funds for 2014-2020.

The Polish Presidency presented its Progress report and tabled three questions for discussion: whether the Common Strategic Framework should be approved by the Council and the European Parliament, or adopted solely by the European Commission; whether Country Specific Recommendations or National Reform Programmes should provide a linkage between EU2020 goals and the development needs of Regions and Member States; and whether funds should be ring-fenced for specific objectives.

On the Common Strategic Framework almost all Member States, including the UK, supported the proposal that the Common Strategic Framework should be incorporated in an Annex to the Regulations, and not adopted solely by the Commission.
On the use of Country Specific Recommendations to ensure structural and cohesion funds deliver EU2020 goals, the majority considered this was best achieved through reference to the funds in National Reform Programme, rather than annual Country Specific Recommendations.

There was significant support for the principle of thematic concentration (the main priorities on which the funds should be spent). However, the UK, together with most Member States, was concerned that further restrictions, by ring fencing at a European level, would not reflect local needs.

There was also an informal lunch which looked at whether both negative and positive incentives are necessary to ensure that funds deliver on EU2020 objectives.

19 December 2011

GENERAL BUDGET GUARANTEES (8613/11)

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

Thank you for Explanatory Memorandum 8613/11, dated 7 May 2011, from Justine Greening MP, on a report from the Commission to the budgetary authority on guarantees covered by the general budget – situation as at 30 June 2010. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 17 January 2012.

It has come to our notice that this document had not been formally cleared from scrutiny. We therefore write to you now to confirm that we have cleared it from scrutiny.

17 January 2012

GENERALISED TARIFF PREFERENCES (10052/11)

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

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

Negotiations in the Council have been difficult. There has been significant pressure from some countries to pull the scheme in a more protectionist direction and exclude even more countries from the preferential market access it provides.

Based on those discussions in Council, the Presidency presented a compromise proposal to the March Foreign Affairs Council (Trade Ministers). The compromise would see all High Income and Upper Middle Income countries removed, as originally proposed by the Commission; maintaining GSP+ eligibility for Pakistan; a small extension of product coverage and some additional special safeguards for textiles. Given the gains made or preserved by the UK in the negotiations, together with the prospect of further pressure to take the regulation in an increasingly protectionist direction, Ministers judged that it was in the UK’s interests to accept the Presidency’s compromise proposal. Nevertheless, to mitigate the impact on Upper Middle Income countries, the UK argued for and secured transition periods for those countries which have concluded but not yet ratified an alternative market access arrangement. UK pressure also resulted in agreement for a fixed entry into force of the regulation (1 January 2014) and a five-year review of the impacts of the regulation on trade and tariff income.

The majority of Member States agreed to the Presidency compromise at the March Foreign Affairs Council (Trade) and authorised the Presidency to enter into so-called ‘trilogue’ discussions with the European Parliament and European Commission on that basis. The ‘trilogues’ are now underway. I will update the House further once discussions have been concluded.

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

Thank you for your Explanatory Memorandum 16081/11 and 15930/11, dated 14 November 2011, on follow-up to and a recommendation for amendment of the Council Decision of 12 July 2011 addressed to Greece. The European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 6 December 2011.

You state that, as a result of recent events, the Council is withholding any decision on this item until further notice. We are aware that events have moved on since the Explanatory Memorandum was written. We would therefore welcome an update on progress in the period since the Explanatory Memorandum was published.

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

6 December 2011

Letter from Mark Hoban MP to the Chairman

On 14 November 2011, I issued Explanatory Memorandum (EM) 16081/11 and 15930/11, on the Commission communication and draft Council Decision to reinforce and deepen fiscal surveillance in Greece, and give notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit. These documents were published on 27 October 2011, and deposited in Parliament on 1 November 2011. In response, you asked for an update on recent progress.

As you are aware, events have been moving at a fast pace. George Papandreou resigned as Prime Minister on 6 November 2011. On 10 November, at a meeting chaired by President Papoulias, the leaders of the three parties supporting a transitional Greek Government formally committed to implementing the 26 October agreement.

Following this, on 11 November 2011, Loukas Papademos was formally appointed as Greece’s new Prime Minister and the new Government was sworn in. In his first statement to the Greek Parliament, Papademos said that Greece’s economic and political interests are best served by remaining a full member of the EU and euro area and urged MPs to back structural reforms of the Greek economy. He also formally announced the composition of the new Government.

On the basis of a formal commitment by the three leaders to implement the 26 October agreement and the Council decision to enhance fiscal surveillance in Greece, the euro group and the IMF board were then able to agree disbursement of the sixth tranche of the Greek financial assistance programme. This was initially due in September and had been postponed, as explained in the EM.

Discussion is now focusing on implementing other elements of the 26 October agreement, including the new private sector involvement (PSI) deal – with a 50% face-value reduction of Greek sovereign bonds - and the proposed second package of financial assistance for Greece – worth €100 billion, with an additional €30 billion from euro area countries in support of the PSI offer.

However, I would like to clarify that in order to allow disbursement of the 6th tranche as soon as possible, Coreper adopted the two proposals covered by the EM on 7 and 10 November. As you will be aware, decisions on excessive deficit procedures of euro area member states are adopted under Articles 126(9) and 139, and only euro are member states are required to vote.

19 December 2011

INVESTOR COMPENSATION SCHEMES (12346/10)

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

Thank you for your letter, dated 8 November 2011 in which your Committee cleared this document from scrutiny. In your letter you asked for an update following the Coreper meeting. The directive was discussed at Coreper on Wednesday 23 November and a general approach was agreed, based on the compromise text that secured all of the UK’s key negotiating aims as outlined in my previous letter.

19 December 2011
In the meeting, the Commission, supported by Spain, Portugal and Malta, expressed disappointment in the latest compromise proposal, referring in particular to the limited harmonisation of the compensation level, the removal of an ex ante funding regime and the exclusion of third party custodians from scope. The Presidency emphasised that, after a year and a half of negotiations between Member States, the proposal on the table was the best possible compromise, and concluded that they had the necessary mandate to begin negotiations with the Parliament.

Following the general approach, the directive will now move to trialogue negotiations between the European Parliament, Council and the Commission. Discussions in trialogues are unlikely to start until 2012, with a final agreement on the directive likely later that year.

In your letter you note the need to ensure that UK investors are aware of the level of investor compensation available under the Financial Services Compensation Scheme (FSCS). I agree with this point, and with the need to ensure that investors are made aware of any changes to investor protection made as a result of this directive.

Information on the level of investor compensation is available on the FSCS’s website at www.fscs.org.uk/what-we-cover/eligibility-rules/compensation-limits. Firms are currently required to make actual and potential investors aware of the compensation scheme, including the amount and scope of the cover. The revisions to the ICSD may, in the finalised text, introduce additional disclosure requirements.

Once the final directive is agreed, should it necessitate a change in FSCS compensation coverage level, I would expect the FSA and the FSCS to take appropriate steps to ensure that investors are aware of the new level.

5 December 2011

IRELAND: FINANCIAL ASSISTANCE (13569/11, 13571/11)

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

Thank you for your EMs 13569/11 and 13571/11, dated 15 September 2011, on a proposal for amendment of the decision on granting financial assistance to Ireland, and a communication on the action taken by Ireland with a view to bringing an end to the situation of excessive Government deficit. The European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 13 December 2011.

We note that the document was classified as “limité” prior to Council and so was deposited for scrutiny after Council. Although this formally constitutes an override, we acknowledge that an override was necessary in this instance. Accordingly, we do not require you to take any further action in relation to this matter.

14 December 2011

MACRO-FINANCIAL ASSISTANCE (MFA) (12726/11, 12793/11)

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

The Government on 3 August issued Explanatory Memorandum (EM) 12726/11, on the Commission’s proposal of July for a Framework Regulation for EU Macro-Financial Assistance (MFA). This letter provides an update on the negotiations to date and next steps.

Since the summer, the draft Regulation has been discussed and negotiated in Council via the Financial Counsellors’ working group. Orientation discussions were held in July and September, after which the working group considered the draft Regulation in detail.

To summarise, there has been significant progress at Council working group in terms of updating and improving the draft Regulation. This includes in relation to removing the original proposal to confer implementing powers upon the Commission and in terms of strengthening the budgetary aspects of the draft Regulation. The Government has supported these and the other changes, as set out in more detail below.
The progress made on two key issues (conferring implementing powers upon the Commission and the budgetary aspects of MFA), are noted below:

— Article 7: the Government led Member States in the working group to oppose the original proposal to confer implementing powers upon the Commission — that is, the power for the Commission to grant MFA with limited oversight by Member States on a case-by-case basis. Consequently, under the latest draft of the Regulation, the Council and European Parliament maintain their current powers to scrutinise MFA applications.

— Article 3: the current draft Regulation makes clear that MFA shall generally take the form of a loan; and that, in exceptional cases, the assistance may be provided in the form of grants or a combination of loans and grants. The Government can support this, as we believe loans offer better value for money to taxpayers compared to grants.

— Articles 4 and 5: the current draft Regulation makes clear that MFA should be within the limits set out in the Multi-Annual Financial Framework EU budget ceilings. It also reintroduces the limits to the level of EU support in individual MFA cases, which the Commission wanted to remove. The Government called for these changes at working group.

Other important issues are noted below:

— Article 2: the Government, along with other Member States, resisted proposals to remove the possibility of granting MFA to third countries (those politically, economically, and geographically close to the EU) in exceptional and duly justified circumstances.

— Article 6: the current draft of the Regulation has stronger text on the objectives of and conditionality surrounding MFA, which the Government welcomes as means of improving value for money.

— Article 12: the current draft of the Regulation now calls on the Commission to evaluate, regularly and at least every three years, the results and efficiency of MFA and to present the findings of the evaluation to the Council and European Parliament. The Government can support this as it will help improve the efficiency and transparency of MFA.

— Article 15 (now part of Article 13): the original proposed draft Regulation stated that it would expire on 31 December 2013 – which in effect would mean that it would have expired soon after its entry into force. The current draft of the Regulation instead calls on the Commission, no later than four years after the adoption of the Regulation, to present to the Council and European Parliament a report on the application of the Regulation, accompanied if appropriate by a proposal for its amendment. The Government has supported this change.

The proposed Regulation will be adopted in Council by qualified majority voting (QMV). The Polish Presidency aim to formalise and finalise the Council’s general approach this month.

This is also a co-decision dossier, so it must be jointly agreed with the European Parliament, which has yet to take a firm position on this dossier. The Polish Presidency expect trialogue discussions (between the Danish Presidency, European Parliament, and Commission) to begin early next year, although a precise timetable for this is not yet clear.

12 December 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your Explanatory Memorandum 12726/11, and your letter dated 12 December 2012, on a Commission proposal for a Framework Regulation for EU Macro-Financial Assistance (MFA). The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 31 January 2012.

We welcome the Commission’s proposal to improve the provision of MFA and we are grateful for your account of developments in terms of the Council’s consideration of the Commission’s proposal. You state that a total of 55 MFA decisions benefiting 23 countries have so far been approved. We
would be grateful for details of the 23 countries that have benefited. Also, we would be grateful if you could clarify whether the UK’s contribution to MFA contributed towards its foreign aid target. We are pleased with the important improvements that have been secured, and we now clear the document from scrutiny.

31 January 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 31 January 2012 concerning the Commission’s proposal for a Framework Regulation for EU MFA.

COUNTRIES THAT HAVE SO FAR RECEIVED MFA

The annex to this letter contains details of MFA provided to third countries since 1990, as at the end of December 2010. This information is drawn from a Commission staff working paper that accompanied the Commission’s 2010 annual report on MFA, from July 2011.

MFA AND OFFICIAL DEVELOPMENT ASSISTANCE (ODA)

You asked whether the UK’s contribution to MFA counts towards its foreign aid target. MFA is designed to address exceptional financing needs of pre-accession and neighbourhood countries, in the form of balance of payment and budget support through loans and grants. It helps them deal with serious short-term difficulties, underpinning the implementation of strong adjustment and structural reform measures in the recipients designed to remedy these difficulties.

As the recipient countries that currently receive MFA are eligible to receive ODA, in line with the OECD Development Assistance Committee (DAC) definition based on Gross National Income (GNI) per capita, the UK’s share of this does contribute towards its ODA target of 0.7% of GNI. It is calculated as a pre-abatement share, the current estimate of which is 15.11% for 2011. Further detail on UK ODA is available on the DFID website (http://www.dfid.gov.uk/About-us/How-we-measure-progress/Aid-Statistics/Official-Development-Assistance/).

13 February 2012

Letter from the Chairman to Mark Hoban MP

Thank you for your Explanatory Memorandum 12793/11, and your letter dated 13 February 2012 on EM 12726/11, on a Commission proposal for a Framework Regulation for EU Macro-Financial Assistance (MFA). The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 31 January 2012. We are grateful for your response to our queries, and we also confirm that we have cleared EM 12793/11 from scrutiny.

27 March 2012

MARKET ABUSE (16000/11, 16010/11)

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

Thank you for your Explanatory Memorandum 16000/11 and 16010/11 on a Commission Proposal for a Regulation on insider dealing and market manipulation (market abuse) and an accompanying Proposal for a Directive on criminal sanctions for insider dealing and market manipulation. The House of Lords European Union Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 17 April 2012. We have decided to hold the documents under scrutiny whilst we seek to enhance our understanding of the legislation.

17 April 2012
MIFID II (15938/11, 15939/11)

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


The MiFID proposals represent a comprehensive and profound set of reforms which will determine the ways in which financial services operate. We have therefore decided to hold the documents under scrutiny whilst we seek to deepen our understanding on the legislation. We understand that the progress on this area is slow but we would be grateful for a continuous update on negotiations whilst we form our views on the MiFID Review. As the European Parliament has published a draft report on this matter containing amendments we would particularly appreciate your comments of what is proposed in the EP's report.

17 April 2012

Letter from Mark Hoban MP to the Chairman


Markus Ferber MEP, rapporteur for the MiFID review, produced separate draft reports on the Directive and Regulation on 16 March and 27th March. The reports propose amendments which the European Parliament’s Economic and Monetary Affairs committee is now considering. Members of the committee have until 10 May to table further amendments, and the committee plans to vote on a consolidated package of amendments on 9 July. I include as an annex [not printed] a summary of the amendments proposed in Ferber’s report.

30 April 2012

ORIGIN MARKING OF CERTAIN PRODUCTS IMPORTED FROM THIRD COUNTRIES (5091/06)

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

Although little has happened I thought I should let you have an update on this dossier as at the end of the Polish Presidency.

The Poles arranged three Council Working Group discussions (two in the usual Commercial Questions Group and one in the Customs Union Working Group). The deep division between Member States remains. And while all Member States have expressed a readiness to examine new ideas in order to try to make progress many, including the UK, made clear that any new proposal based on the existing Commission proposal was unlikely to be acceptable.

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

16 January 2012
PAKISTAN: AUTONOMOUS TRADE REFERENCES (14969/10)

Letter from the Rt. Hon Vince Cable MP, Secretary of State for Business Innovation and Skills, Department for Business, Innovation and Skills, to the Chairman

Further to Edward Davey’s letter of 27 June 2011, I am writing to update you with progress on the waiver request in the World Trade Organisation (WTO) for additional autonomous trade preferences for Pakistan, following the devastating floods in 2010.

As you know, the UK has actively lobbied at official and Ministerial level for agreement to the package both internally within the EU and in the WTO so as to obtain a waiver. Last June we informed the Committee that due to the waiver request being blocked in the WTO by a small number of countries including India, the European Commission would be ceasing consultations on the measures.

India withdrew its objection last November and the Commission resumed consultations with the remaining concerned countries. Following these consultations the Commission submitted a revised proposal and consensus was reached at the WTO Council for Trade in Goods on 1 February. The WTO General Council is expected to endorse that decision on 14 February. This requires an EU decision and we expect the EU Presidency to send this to Council shortly before the WTO General Council.

The Committee considered and cleared the original proposal at the end of 2010 (Council doc. No. 14969/10). The revised proposal (Council doc. No. 5910/12) (attached) is not substantially different from the original. It contains tariff rate quotas on 20 of the original 75 product lines and a revised timeline from 1 January 2012 to 31 December 2013.

We believe that, despite the time lapse since the initial request, Pakistan still needs enhanced market access for its reconstruction and long-term development following the floods. As a result securing the waiver would be an extremely positive development. If the waiver is granted as expected, we will then need to reach agreement between Council and the European Parliament on the internal EU Regulation to enact the tariff cuts, at which time we will further update the Committee.

I recognise that the document would normally be subject to a separate EM, but following consultation with the Committee’s clerk it was judged appropriate that the issue was covered by an updating letter linked to the earlier proposal which both Committees had cleared and that further updates will be provided as the Regulation moves through the legislative process.

7 February 2012

PORTUGAL: FINANCIAL ASSISTANCE (13333/11, 13334/11, 16670/11)

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

Thank you for your EMs 13333/11 and 13334/11, dated 15 September 2011, on a proposal for a Council implementing decision amending implementing decision 2011/344/EU on granting Union financial assistance to Portugal. The European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 7 February 2012.

We note that the document was classified as “limité” prior to Council and so was deposited for scrutiny after agreement at Council. Although this formally constitutes an override, we acknowledge that an override was necessary in this instance. Accordingly, we do not require you to take any further action in relation to this matter. However, we would be grateful for an update on developments in Portugal since this document was published.

7 February 2012

Letter from Mark Hoban MP to the Chairman

I am writing to you about the Council decisions taken on the programmes of financial assistance for Ireland and Portugal.

As you will be aware, a number of Council decisions have been taken on these programmes, following the initial decision to grant the Member States financial assistance from the EFSM.
In particular, the Troika (Commission, European Central Bank and International Monetary Fund), conduct quarterly reviews of each Member State’s financial assistance programme. Following these reviews, the Commission may propose that the Council take a decision to amend the policy conditions attached to financial assistance. This has happened in a number of the quarterly reviews so far, and it might happen in the future.

As you will understand, the timetable between the publication of the Commission proposal for a Council decision, and the Council decision being taken, is necessarily short. This is so that the decision on the disbursement of the next tranche of assistance is taken using an up-to-date assessment from the Troika. Usually, the time between publication of these documents and the Council decision being taken is less than two weeks. In the case of the Proposal for a Council Implementing Decision amending Portugal’s financial assistance programme following the second review (EM 16670/11), the Document was made public on the 12 December, while Council agreement through written procedure took place on the 14 December. Therefore, while the Government agreed with the substance of the proposal, the UK abstained as it had not cleared Parliamentary scrutiny.

As agreed with the Clerks of both Committees, we did not deposit this Decision for scrutiny while we investigated the timetable for these Documents with the Council secretariat and the Commission. The Council secretariat and the Commission have acknowledged that the timetable for these decisions do not allow sufficient time for national Parliamentary scrutiny, but are unable to change this due to their time sensitive nature. I would like to propose therefore, that on the occasions that these Commission proposals are published, the Government will endeavour to provide the explanatory memorandum to you within five working days, rather than the usual ten. To try to ensure that Parliamentary scrutiny of the document can take place before the Council decision is taken, I would like to encourage you to ensure that your Committee considers the document at the first Committee meeting following the submission of the EM. This will not always eliminate the risk of an override, but it should go some way to reduce that risk.

Following the Government’s enquiries, the Council secretariat has agreed, however, that they will remove the ‘limite’ markings on the Commission proposals for Council decisions, which are made public by the Commission. This has caused confusion in the past, as ‘limite’ suggests that the documents are not subject to Parliamentary scrutiny, when in fact they have been made public by the Commission and are subject to Parliamentary scrutiny.

I would like to add that the Government intends to vote in favour of these Council decisions, where the Government agrees with the policy content and even if Parliamentary scrutiny has not been cleared. Not supporting these Council decisions runs counter to the Government’s overall support of the financial assistance programmes. Furthermore, this does not lend full support to our bilateral and EU relationships.

I would like to assure you that where possible, the Government endeavours to ensure that proper Council procedure is followed, to enable full Parliamentary scrutiny. In October 2011, the Council took a decision on documents 14332/11 and 14331/11, regarding the pricing of the European Financial Stability Mechanism. This decision was taken at General Affairs Council on 11 October 2011, following the Commission proposal on 14 September 2011. I understand your Committee were flexible in considering the document on an accelerated timetable to help avoid a scrutiny override, for which I am grateful. However, as the Council process did not allow for proper time for Parliamentary scrutiny, the Government made a minute statement to put this on record. This has recently been published and I have copied the relevant text below:

STATEMENT BY THE UNITED KINGDOM

"The UK government cannot support the decision of the Council to take a decision on this issue (EFSM pricing): only four weeks after the Commission published its original proposal; to a timetable not consistent with the Council’s own conventions on national Parliamentary scrutiny; and when, given the retrospective nature of the proposal, no undue urgency was required."

I hope that you will recognise the efforts that the Government has made, and continues to make, to ensure that proper Parliamentary scrutiny is followed, and agree to the changes that I suggest.

15 March 2012
Letter from the Chairman to Mark Hoban MP

Thank you for your Explanatory Memorandum 16670/11, dated 14 March 2012, and your letter dated 15 March 2012, on the proposal for a Council Implementing decision amending Implementing Decision 2011/344/EU on granting Union financial assistance to Portugal. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 27 March 2012.

We acknowledge the Government’s consideration of the need for parliamentary scrutiny in your decision to abstain from the vote for the proposal, although we understand that you agreed with its substance. We note the tight timetable that applies in relation to proposals such as these, and are grateful to you for your efforts in seeking to ensure that proper parliamentary scrutiny takes place. We also acknowledge the Government’s desire to reaffirm their support for the financial assistance programmes and for the UK’s bilateral and EU relationships by voting in favour of these decisions where the Government agrees with the policy content.

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

We are pleased to hear that the Council secretariat has agreed to remove the ‘limité’ markings from such documents, as this had caused confusion in the past.

We have now agreed to clear the document from scrutiny.

27 March 2012

Letter from Mark Hoban MP to the Chairman

I am writing in response to your Committee’s request of 6 December to be kept informed on the progress of negotiations on the Commission’s proposal to replace the Capital Requirements Directive (Directives 2006/48/EC and 2006/49/EC, as amended by Directives 2009/111/EC and 2010/76/EU), with a Regulation on prudential requirements and a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

Council’s financial services working group met on several occasions in October and November 2011 to discuss aspects of the Commission’s proposals, together often known as the Capital Requirements Directive (“CRD”) 4. Given the timeframe for negotiations, progress under the Polish Presidency focused on identifying the key issues to be negotiated under the Danish Presidency. This culminated with a presentation from the Presidency to the November ECOFIN on the key issues to be negotiated under the Danish Presidency.

Following detailed written comments from Member States on the Commission’s proposal, the Danish Presidency circulated its first compromise text on 6 January 2012. Throughout January and the
beginning of February, the text was discussed in Council’s financial services working group. Under the
guidance of the Presidency, the working group focused on provisions relating to the key issues
identified by Member States, such as:

— the flexibility for Member States to implement more stringent prudential
requirements on a permanent basis or for macroprudential policy;
— deviations from the Basel 3 agreement, in particular on the quality and
quantity of capital that institutions are required to hold, the introduction of
liquidity standards and the leverage ratio; and
— The introduction of provisions concerning the governance arrangements of
management bodies and diversity requirements for selecting members of the
management body.

Of particular concern to Member States, including the UK, remains the limited flexibility to implement
more stringent prudential standards on a permanent basis or for macro-prudential policy reasons. A
number of Member States share the UK’s view that flexibility is required to respond in a timely manner
to systemic risks as they arise or to mitigate fiscal risk, since Member States remain ultimately
responsible for financial stability in their jurisdiction. The Government will therefore continue to
work with likeminded Member States to enable the application of macro-prudential policy and ensure
sufficient flexibility to implement more stringent prudential requirements than the minimum, where
justified.

On the Commission’s interpretation of the Basel 3 accords, many Member States are generally
content with the provisions put forward by the Commission. In fact, there is significant pressure to
further weaken the liquidity provisions proposed by the Commission for the observation period,
which runs until 2015. Many Member States have suggested that this is, in part, due to the fact that
the Basel Committee will not finalise the calibration of the liquidity coverage ratio (LCR) until the end
of the year and EU liquidity legislation should not pre-empt the Basel Committee’s final decision.
Furthermore, many Member States have indicated a strong preference to implement the LCR through
a co-decision procedure, rather than through a delegated act, as is set out in the Commission’s
proposal. The Government will therefore continue to make the case for the full and faithful
implementation of the Basel 3 agreement in the EU. The Government maintains the view that the
agreement reached by the Basel Committee is one of the most important aspects of the
internationally agreed response to the financial crisis, addressing many of the deficiencies of the
financial system.

Although most Member States welcomed the intentions of the new provisions on corporate
governance, Member States were generally of the view that provisions concerning the governance
arrangements of management bodies could have significant implications for Member States with
limited expertise in the financial sector. In addition, Member States questioned the rationale for
including diversity requirements for selecting members of the management body in CRD 4, as the
issue of diversity is not limited to the financial sector.

On 25 January 2012, the European Central Bank (ECB) published its opinion on the Commission’s
proposal for CRD 4. As the explanatory memorandum on the ECB’s opinion sets out (EM 5876/12),
the ECB’s opinion is closely aligned with the Government’s position on CRD 4. In particular, the ECB
highlight the importance of giving individual Member States the flexibility to apply more stringent
prudential requirements where systemic risks to financial stability arise and calls for a full
implementation of the Basel 3 requirements for capital, liquidity, leverage and capital buffers.

The Presidency intend to circulate a second compromise text in mid-February and continue
negotiations in Council’s financial services working group shortly after, with a view to agreeing a
Council position in March for trialogues with the European Parliament and the Commission. The
Presidency remains committed to finalising an agreement on CRD 4 in June 2012.

I hope your Committee finds this update useful.

13 February 2012

Letter from Mark Hoban MP to the Chairman

I am writing to inform your Committee of a change to the Council timetable for negotiations on the
Commission’s proposal to replace the Capital Requirements Directive (Directives 2006/48/EC and
2006/49/EC, as amended by Directives 2009/111/EC and 2010/76/EU), with a Regulation on prudential
requirements and a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, together known as “CRD 4”.

As the explanatory memorandum on the European Central Bank’s opinion on the Commission’s proposal for CRD 4 (5876/12) highlights, the Danish Presidency aimed to agree a general approach in Council at the March ECOFIN. However, the Presidency has recently removed CRD 4 from the March ECOFIN agenda. It is not yet clear how Council will finalise a negotiating position in the coming few weeks, but the Presidency remains committed to finalising an agreement on CRD 4 by June 2012.

I hope your Committee finds this update useful.

5 March 2012

Letter from the Chairman to Mark Hoban MP

Thank you for your letters on EM 13284/11 and 13285/11, dated 13 February and 5 March 2012, on proposals to reform EU prudential requirements, and for your Explanatory Memorandum 5876/12 on the ECB’s opinion on the proposals. The House of Lords European Union Economic and Financial Affairs and International Trade Sub-Committee considered these documents at its meeting on 21 March 2012.

We are grateful for your update on the progress the Council is making on the proposal under the guidance of the Danish Presidency.

We note that no reference is made in your letter to the fact that Basel III and CRD IV maintains the zero risk weighting for EU government debt. Although sovereign assets are still a relatively low risk asset class, we do not believe that zero risk weighting for sovereign debt is appropriate. Do the Government support the view that the risk weight assigned to sovereigns should be subject instead to a regulatory capital charge that bears closer reflection to their respective credit quality? Do other Member States oppose zero risk weighting in Council negotiations?

Neither have you reported any developments in relation to the role of ratings agencies in the assignment of risk categories. Whilst the Commission is seeking to reduce regulatory reliance on ratings agencies in the latest CRA Regulation, the CRD IV proposal continues to assign to credit rating agencies a central role in the determination of the risk weights. In our report on sovereign ratings, we argued that reliance on ratings for regulatory purposes should be removed where possible. Are the Government, in Council negotiations, pressing for a reduction in reliance on credit rating agencies?

We support your attempts to defend the provisions in terms of quality and quantity of capital that institutions are required to hold. It is important that the proposals on the leverage ratio and liquidity risk framework are rigorously calibrated to avoid sources of instability for the financial markets.

We would be grateful to receive further updates as negotiations progress, especially with regard to discussions over Member States’ flexibility to apply more stringent prudential requirements. Significantly, in light of the European Parliament’s initial report, we note that the maximum harmonisation approach has not been changed so far. Which other countries support the UK’s opposition to maximum harmonisation? What would you anticipate to be the likely outcome of Council negotiations on this point?

Finally, we believe that the International Finance Reporting Standards (IFRS) need to be reviewed in the context of this proposal. What is your view on this point?

We would be grateful for a response to these questions. In the meantime, whilst we are content to clear EM 5876/12 from scrutiny, we will continue to hold EMs 13284/11 and 13285/11 under scrutiny.

22 March 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter dated 22 March 2012 and for the support given to the Governments objective of implementing a robust prudential regime in the EU.

In your letter you raise a number of points, which you would like clarification on. However, before I turn to your specific points I would like to update you on the timetable that Council is working to on this dossier. We have recently been informed that the Danish Presidency aims to convene an extraordinary ECOFIN on the 2 May with the aim of agreeing a general approach. The European
Parliament’s Economic and Financial Committee is planning to adopt their report on 26 April. The Danish presidency would like to start the Trialogue with the European Parliament immediately after the extraordinary ECOFIN.

**SOVEREIGN RISK WEIGHTS**

You ask for the Government’s view on the issue of the zero percent risk weight assigned to EU sovereign debt under the Capital Requirements Regulation (CRR). You rightly highlight that under the CRR the risk weighting of EU sovereign debt has not been changed, and remains at zero percent. It is clear that the risk weight assigned to some sovereign debt under the CRR does not fully align with the prudential risk these instruments entail and this is an issue which should be considered carefully in due course. However, the Government feels there could be very significant consequences attached to amending the risk weight in the current economic climate and these need to be considered fully before proceeding. There is also very limited support amongst other Member States for amending risk weights at this particular time.

**REDUCING RELIANCE ON EXTERNAL CREDIT RATING AGENCIES**

The Government fully supports the principle of reducing the reliance on external credit rating agencies (CRAs), in line with the Financial Stability Board’s (FSB) principles on the issue. In your letter you ask what steps are being taken in the CRR proposal to support this aim. Whilst it is true to say that in many cases external credit ratings will continue to be central to calculations such as the capital requirements for some assets, there are a number of areas where the proposal aims to reduce this reliance.

For example, the Commission’s proposal requires supervisors to encourage financial institutions to develop internal models and that internal models should not rely mechanistically on external ratings. The Government agrees that where appropriate financial institutions should be encouraged to reduce their reliance on external credit ratings and supports provisions that aim to do so. As outlined in the FSB’s principles, these obligations should be proportionate to the complexity and size of banks as smaller institutions do not have the resources to carry out own internal risk assessments for all investments.

It is also worth noting that the measures proposed in CRD 4 also build on the significant steps taken in CRD 2 to reduce the use of external credit ratings of securitisations, a sub-class of which proved particularly undercapitalised during the crisis.

**MAXIMUM HARMONISATION**

As you know the UK strongly opposes the Commission’s wish to prevent Member States from applying higher prudential standards than the minimum levels agreed internationally. This position is shared by a number of Member States. Specifically Spain, Sweden and the majority of the Baltic, Central and Eastern Member States share, to some degree, the UK’s concerns.

The current Presidency proposal offers Member States further flexibility than envisaged by the Commission’s proposal, but not to the degree the UK and other Member States feel necessary to ensure financial stability in their jurisdictions. The UK will continue to work with likeminded Member States to push for adequate flexibility within the proposals. However, it is difficult at this stage to predict the outcome of the negotiations in this respect, and maximum harmonisation is likely to play a prominent role in the debate at ECOFIN.

**INTERNATIONAL FINANCIAL REPORTING STANDARDS**

You ask for the Government’s view on the interaction between Basel 3 and the International Financial Reporting Standards (IFRS). Basel 3 developed better measures that are intended to meet prudential regulator’s need for capital that can absorb losses on a going and gone concern basis. In particular, the range of prudential filters in Basel 3 is intended to adjust the measures of assets and liabilities that are generated by IFRS so as to reflect the needs of prudential regulators.

Accounting standard setters will continue to work to improve IFRS, and prudential regulators work with them, but there is nothing in Basel 3 that necessitates a radical review of IFRS: indeed, it would be counter-productive to launch such a review when the IASB is already working on many of the key issues (e.g. macro-hedging and expected loss accounting for loans and receivables).
Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 12 April 2012, on EM 13284/11, a proposal for a Regulation on prudential requirements for credit institutions and investment firms and on EM 13285/11, a proposal for a Directive on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. The House of Lords European Union Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 24 April.

In anticipation of a general approach at the next extraordinary ECOFIN meeting on 2 May, we have agreed to clear the proposal from scrutiny. However we would welcome an update on the outcome of the ECOFIN meeting, in particular in relation to the provisions related to maximum harmonisation. We hope that you will be able to ensure that the General Approach adopted would not conflict with the recommendations of the Vickers Report.

25 April 2012

RESIDENTIAL PROPERTY DIRECTIVE (8680/11)

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

Thank you for your Committee’s letter dated 24 November, which raised a number of questions following the oral evidence session on 1 November. I note that the proposal will be kept under scrutiny and I will write to your Committee to seek clearance in due course.

As noted in previous correspondence to the Committee, the Directive is subject to co-decision, or “ordinary legislative procedure”, and is therefore currently subject to amendment by both the European Council and the European Parliament.

Member States continue to negotiate the Directive in the European Council. The Presidency has circulated a number of revised drafts of the Directive based on these discussions, the latest produced on the 2 December. I have set out below the progress we have made against the UK’s negotiating priorities, as set out in my letter of 8 June 2011. We expect the Directive to go to ECOFIN in first quarter of 2012.

Additionally, responsibility for the Directive in the European Parliament has been split between the Economic and Monetary Affairs Committee (ECON) and Internal Market and Consumer Protection Committee (IMCO). As discussed by those attending your evidence session, a significant number of amendments have been tabled in the European Parliament, over 820 by ECON and 300 by IMCO. The MEPS within these committees continue to discuss these amendments, with voting on final amendments expected to take place in early 2012.

Once separate compromise texts have been agreed by both the Council and European Parliament, the Directive will then be subject to ‘trilogue’ discussions between the European Parliament, the European Council and the Commission. As a result, particularly given the number of amendments being considered by the European Parliament, the final impact of the Directive on mortgage lending across the EU is not clear.

Turning to the specific issues raised in your letter, you asked a number of questions about the costs of the Directive, and whether there would be benefit for UK and wider-EU consumers. You also asked whether this should be a priority for the Commission at this point in time, and about the impact on the UK mortgage market and the housing sector.

I outlined in my previous letter the Commission’s intention to address the consumer detriment that has occurred in EU mortgage markets, and I reiterated that the Government recognises the importance of responsible lending and borrowing, and a sustainable mortgage market for EU consumers to support a stable housing market.

The Government’s initial Impact Assessment noted that the UK, like many EU Member States, already benefits from an existing high level of mortgage regulation. As you are aware, many of the Directive’s more detailed proposals are consistent with the FSA’s current regulation of the UK mortgage market. It is therefore unclear whether the Directive will provide additional benefits to UK consumers, and so the UK’s negotiating priorities have focused on addressing those areas that are likely to impose the most significant cost to UK industry and consumers.
You asked about responsible lending in the UK. As noted in the Government’s Housing Strategy, the financial crisis of 2008 laid bare weaknesses in financial markets, which had enabled mortgages to be granted without proper consideration of the affordability or assessment of risk. Though these problems did not cause the crisis, ensuring that mortgages are affordable in the future will ensure sustainable growth in credit.

On the specific question of whether this proposal could have prevented the problems suffered by Northern Rock in 2007, it is important to note that this proposal looks only to address the pre-contractual stage of entering into a mortgage contract.

The National Audit Office report of 29 March 2009 states that Northern Rock’s growth was based on making competitively priced mortgages easily available. To do so, Northern Rock became increasingly reliant on the wholesale market to meet its funding needs. When financial markets started to experience the credit crunch, Northern Rock found itself unable to access short-term funding on the wholesale market and therefore, was unable to meet its obligations.

Northern Rock experienced financial difficulties in 2007 primarily because its business model became unsustainable during the financial crisis. While Northern Rock may have sold some unaffordable mortgages to its customers, the Mortgages Directive would have been unlikely to ease the financial pressure on Northern Rock in 2007 as Northern Rock’s problems were primarily due to its dependence on the wholesale funding market.

You also asked about the interaction and alignment of the provisions within the Mortgages Directive and the Financial Services Authority’s (FSA) Mortgage Market Review (MMR). The FSA has stated that it intends to publish the next MMR consultation paper before the end of the year, and will follow this up with its final package of rule changes in 2012. The FSA has been closely involved in discussion on the Directive to date, and have recognised that they do not want to impose any rule changes as part of their MMR that would lead to two sets of regulatory changes.

I welcome the Committee’s view that the Directive should be drafted to provide greater protection for those EU markets that require it, without placing an unnecessary burden on already well-regulated markets, such as the UK. This is consistent with the Government’s negotiating position. The Government felt that the Commission’s initial proposal did not achieve this balance, which is why we have sought improvement in a number of areas. We continue to work through European Council to ensure that the Directive remains at a principles-based level, so as to avoid an extra layer of regulation over the UK mortgage market.

As noted above, my letter of 8 June set out the UK’s key negotiating priorities. The four key priorities were scope, disclosure, passporting, and delegated acts. I will seek to answer your remaining questions alongside an update on the latest Council position on each of them.

**Scope**

The Government’s initial Impact Assessment noted that the majority of mortgage lending in the EU was to consumers borrowing from mainstream lenders, either to buy their residential home or to refinance an existing mortgage. The Government believes that the proposed Directive should focus on this mainstream lending, and that decisions over the regulation of any niche products should be left to those Member States in which these products are offered.

As you are aware, one of the niche products that the Government considers should be exempt from the scope of the Directive is buy-to-let lending. As raised by those at your evidence session, amendments have been tabled by a number of UK MEPs within their European Parliamentary Committees, which would seek to exempt these types of lending from the scope of the Directive. Additionally, the Government continues to make the argument that buy-to-let mortgages are a product unique to the UK market, and that any decision over the regulation of this product should be left to the UK. Other Member States, like France and Germany, regulate these mortgages alongside mainstream residential mortgages and so they do not agree with the need to exempt them from the proposed Directive.

The UK has also sought to secure exclusions for high-net-worth lending, lending by Credit Unions, bridging finance and shared equity lending. While the application of the Directive to these niche forms of lending is not as significant as the inclusion of buy-to-let, it does add to the UK’s overall concern over the impact of the proposal.
DISCLOSURE AND ADVICE

Your letter raised concerns over the Commission’s initial proposals regarding advice. These provisions meant that advice could only be given where products from the “whole of market” had been considered. This would have essentially meant that one lender could not have given advice without also considering products from another lender. The UK argued both lenders and intermediaries should be able to provide advice; as long as the consumer knows what product range has been considered. We would not expect a lender to give advice on a competitor’s products, provided they make the consumer aware that they have only considered their own product range. I am pleased to say that the current Council compromise text reflects the UK’s position and that a number of amendments have also been put forward in the European Parliament that also reflect the UK view.

Your letter also asks about the provisions relating to pre-contractual information and the European Standard Information Sheet. There is a growing recognition within Council of concerns about information overload for consumers. While the current draft of the Directive contains the same overall number of articles providing for disclosure of information as previously, the overall volume of information consumers would receive has been reduced to some extent. While the UK has sought to demonstrate that consumers “switch off” when presented with too much information, other Member States and the Commission have been reluctant to reduce the amount of information provided to consumers.

The evidence session also raised questions over the European Standard Information Sheet (ESIS). The ESIS is very similar to the UK’s existing Key Facts Illustration (KFI). However, the transition costs of moving from the KFI to the ESIS are expected to be high and the benefits for consumers extremely limited.

As noted in previous correspondence, the UK has been negotiating for an approach that would allow Member States to keep their own standardised disclosure where this is equivalent to the ESIS. The Commission, however, see the ESIS as a key deliverable from this Directive. A number of Member States, like France and Germany, already use the ESIS on a voluntary basis. As a result, we have so far failed to gather sufficient support to oppose the ESIS in Council.

You should also be aware that a number of MEPs – including those from the UK – have come out very strongly against the ESIS as “standardisation for the sake of it”. While we expect this will be reflected in the European Parliament’s compromise text in early 2012, we cannot guarantee that this will remain a key priority for MEPs.

PASSPORTING

Your letter asks a number of questions about the Directive’s passport provisions and the potential for future cross-border activity. The UK continues to work in Council meetings to ensure that the passport provisions do not undermine consumer protection in the UK and other established EU mortgage markets. The current compromise text supports the UK position and, subject to some minor drafting issues, the Government believes gives sufficient powers to the FSA.

The UK remains sceptical that this Directive will achieve the Commission’s single market objective. There remain a number of significant obstacles, such as language, legal systems and consumer attitudes towards home ownership. That said, a number of UK lenders have already established separate offices in other countries in Europe, and are therefore active in these markets to a small extent. Whether credit intermediaries seek to utilise the passport is a commercial decision for those intermediaries.

With regard to your questions on firms acting over the internet into other countries, those involved in arranging or advising on a mortgage secured against a property in the UK are undertaking a regulated activity, and as a result need to be authorised by the FSA. Under the Directive this will remain a regulated activity. Where the firm is based overseas they will be required to be authorised by the regulator (‘competent authority’) in that Member State. We continue to look to ensure that Directive’s provisions provide adequate protection for UK consumers looking to take out a mortgage, regardless of whether this is over the internet, over the telephone or face-to-face.

DELEGATED ACTS

The UK’s position has been that delegated acts should only be used in limited circumstances, and in compliance with pre-existing agreements between the Commission, the European Council and the European Parliament. The number of delegated acts has been significantly reduced, however the
Government does not agree that they all comply with these inter-institutional agreements. We continue to push the Presidency on this issue.

I hope that I have been able to answer all your questions satisfactorily.

16 December 2011

Letter from the Chairman to Mark Hoban MP

Thank you for your letter, dated 16 December 2011, on EM 8680/11 on the Commission’s proposal for a Residential Property Directive. The European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 7 February.

We are grateful for your comprehensive response to the points raised in our letter of 24 November. We note the update you give us on the progress of negotiations, and are pleased to hear that a number of the Government’s negotiating priorities have been met in the revised text. However we note that there are a number of issues where the UK has so far been unable to secure agreement, most notably in relation to regulation of the buy-to-let sector, and we urge the Government to continue their efforts towards achieving their negotiating goals. What assessment have the Government undertaken of the likely impact of this proposal on the UK buy-to-let sector, as well as the wider mortgage market, if the final text does not reflect the Government’s preferred position?

Given that the proposal remains under discussion both at Council and in the European Parliament we would be grateful for further updates as negotiations progress, in particular in relation to the matters that we have raised both in previous correspondence and in this letter. However, noting that the proposal is due to go to ECOFIN shortly, we are content to clear the document from scrutiny.

7 February 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter dated 7 February 2012, and I note that the EU Mortgages Directive has been cleared from scrutiny. Your letter asks what assessment the Government has undertaken on the likely impact of this proposal on the UK buy-to-let sector, as well as the wider mortgage market, if the final text does not reflect the Government’s preferred position.

As noted in previous correspondence, the majority of the provisions contained in the Directive are consistent with the existing regulation of the UK mortgage market.

The Government is continuing to work with lenders, intermediaries, consumer groups, and the Financial Services Authority (FSA) to fully understand the impact of the proposed Directive on the buy-to-let sector. This includes assessing the current and possible future shape of the buy-to-let market, the number of active lenders, likely volumes of transactions and the proportion of landlords that are professionals and therefore exempt from the requirements of the Directive. This will inform the Government’s position as discussions continue in the Council.

The final impact of the Directive will depend on the agreed final text following further Council and trilogue discussions, and I will write to the Committee again to provide an update in due course, in particular on matters that you have raised in previous correspondence. My officials will also conduct a full impact assessment of the final Directive.

20 February 2012

RISK SHARING INSTRUMENTS (15527/11)

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

Thank you for your Explanatory Memorandum 15527/11 on a Commission proposal for a Regulation regarding certain provisions relating to risk sharing instruments for Member States experiencing or threatened with serious difficulties with respect to their financial stability. The House of Lords European Union Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 12 March.
We recognise your concerns that the proposal may demand additional payments from the budget in 2012 and 2013. However, since EU spending in this area remains within the limits set by the multi-annual financial framework from 2007-13, we would support the Commission’s proposal as it would be of immediate benefit to those countries hit hardest by the euro area crisis.

We have agreed to clear the proposal from scrutiny, but we would be grateful to receive further details over how these instruments would work and update on progress of negotiations.

13 March 2012

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

I am responding to your letter of 13 March asking for further details over how these instruments would work and requesting an update on progress of the negotiations.

The proposal addresses liquidity problems faced by financial institutions in Member States most affected by the financial crisis. The aim is to address liquidity problems that affect the privately financed part of Cohesion Policy projects. The proposal creates the possibility to establish, by means of a cooperation agreement to be concluded between the European Commission and the European Investment Bank or similar bodies, a risk-sharing instrument with to facilitate investment and growth. Following discussions in the Council Working Group the proposal now caps the financial allocation to the Risk Sharing Instrument at up to 10% of the ERDF and Cohesion Fund allocation for the period 2007-2013 in each Member State.

The Commission has now provided more detail on how the funding will be structured. Structural and Cohesion Funds will provide a (subordinated) first loss finance to share the credit risk with the international financial intermediary (IFI). The IFI takes the remaining risk. The risk is priced according to market terms. The IFI builds a portfolio of loans to final beneficiaries or guarantees to banks lending to final beneficiaries. In case of defaults on operations in the portfolio, the EU risk share is utilised first. For defaults after the EU risk sharing tranche is depleted, the IFI tranche is utilised. With the cushion from the EU, the IFI can achieve a multiple of extra loan financing.

As you are aware, the Government was concerned with the potential impact on the annual EU Budget. As such, the Government has secured a Joint statement by the Commission and the Council on the budgetary impact to accompany the proposal, which states that any call on additional resources should be considered in the context of the budgetary restraints facing all Member States, and that any increased amounts for the payments should, if necessary, utilise resources freed up via the Global Transfer exercise for 2012.

A draft proposal was agreed in COREPER on 13 March and has now been forwarded to the European Parliament for consideration.

The Parliament’s REGI Committee voted on 20 March regarding the “amendment of Council Regulation (EC) No 1083/2006 as regards certain provisions relating to risk sharing instruments for Member States experiencing or threatened with serious difficulties with respect to their financial stability” which they voted to adopt. This will now go to the April plenary.

22 March 2012

**STATUTORY AUDIT OF ANNUAL ACCOUNTS AND CONSOLIDATED ACCOUNTS**

**(16971/11)**

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

In 2009, the European Parliament called on the Commission to evaluate how the current audit Directive has been transposed into national legislations. This Commission Staff Working Document examines the status of this transposition.

The transposition deadline was 29 June 2008 and by July 2010 all Member States had transposed the Directive into their national laws.

*Transposition of the terms “public interest entity”*

All Member States provide for a definition of the term Public Interest Entity (PIE) and include listed companies in this category. All Member States except one include banks and insurance companies in
this category, and that Member State includes listed banks and insurance companies in that category. Some Member States have used the option to enlarge the category of PIE. The draft Regulation has significantly increased the list of PIEs to all listed companies, banks, insurance companies, UCITS and Alternative Investment Funds.

**Key audit partner rotation**

The current Directive requires that the key audit partner for a statutory audit of public interest entities rotates from the audit engagement after a maximum of 7 years. Most Member States have applied 7 years. The Commission’s working document does not explicitly state this, but the UK has implemented a period of 5 years. The draft Regulation proposes mandatory audit firm rotation after 6 years.

**Establishment of public oversight system**

All Member States now have a public oversight system. The proposals in the draft Directive and Regulation reinforce the powers and include certain measures to further enhance their independence from the profession. The draft Directive’s prohibition on delegation to the professional bodies of the inspection of non-public interest audits is in my view and that of many Member States unnecessarily burdensome.

**Cooperation between public oversight authorities**

The Commission sees that there is a misalignment between the European wide networks of audit firms and the nationally based audit supervisors, who currently meet periodically as the European Grouping of Audit Oversight Bodies (EGAOB), a group of experts set up by the Commission composed of representatives of Member States’ public oversight bodies. Therefore the proposal establishes that EU level audit oversight is coordinated by ESMA. The paper describes the subgroups of the EGAOB and the areas in which they have been cooperating.

**Exchange of audit working papers**

The Commission is concerned by the treatment of confidential information contained in audit working papers that would be transferred to the national audit oversight bodies of third countries for the purpose of matters such as audit inspection where the company being audited is listed on the Stock Market of that third country. This is dealt with in Article 47 of the current Directive. There is no harmonised approach in respect of personal data comprised in the audit working papers to the competent authorities of third countries, since the means of implementation of the Data Protection Directive 95/46/EC varies between Member States. A data protection working party has drawn up a template Memorandum of Understanding which may be used by the national competent authorities. The UK competent authority is satisfied that it has followed the UK requirements for Data Protection Directive in any agreements with third countries.

**International Standards on Auditing (ISAs)**

The Commission’s Green Paper on Audit raised the issue of the binding adoption of ISAs in the EU. The Commission’s document states that this was supported by most professional audit bodies and auditors. The majority of investors sought a flexible, non-binding approach to adoption of ISAs. Companies wanted a flexible approach, if the governance and due process of the body responsible for ISAs, the IAASB, were reinforced. In the Commission’s proposal ISAs will be endorsed by Member States, but they will be able to adapt them for specificities arising from their own national law.

**Adoption of implementing measures by the Commission**

The new proposals align the powers of the Commission to adopt implementing acts with the new legal framework following the entry into force of the Lisbon Treaty.

**Transitional period for audit activities of third country auditors**

When third country companies list their securities on EU stock exchanges, EU legislation requires the UK competent authority to apply its system of regulation to the auditors of the third country company. There are exceptions where the company is incorporated in a country that has been recognised as “equivalent” by the Commission through a process set out in the Directive and described in the Commission’s document.

**Cooperation on public oversight of statutory auditors and audit firms**

The proposal seeks to enhance cooperation between national audit oversight bodies.

5 March 2012
Letter from the Chairman to Norman Lamb MP

Thank you for the Explanatory Memorandum 16971/11 and 16972/11 from your predecessor Edward Davey MP, dated 19 December 2011, on the Commission proposal for a Directive on statutory audits of annual accounts and consolidated accounts, and for a Regulation on specific requirements regarding statutory audit of public-interest entities. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 6 March 2012.

The Commission proposals contain much detail, and your Explanatory Memorandum raises a number of issues that we would like to address.

In relation to subsidiarity, we note that the Reasoned Opinion deadline has regrettably now passed. We would take this opportunity to reiterate the importance that we attach to maintaining effective communication with the Government in relation to such areas of concern in order to address them a timely manner. Notwithstanding this, we would wish to advise you that we have some serious concerns as to whether this proposal might breach the subsidiarity principle. How do you respond to the Commission’s argument that, whilst Member States have relied on self-regulation by the audit profession, the financial crisis has demonstrated the weakness of this approach? How do you respond to the Commission’s suggestion that dealing with the problems at Member State level would seriously undermine the single market, and that there are positive advantages of taking action at EU level? You state that the Government will be considering whether the proposals are consistent with the principle of subsidiarity, and whether the Commission’s actions are proportionate in the context of the financial crisis. What conclusions have you come to?

In addition, we have underlying concerns in terms of the Commission’s overall approach. In our view it is necessary to first establish the principles on which the auditing process should operate. We are not convinced that the Commission’s proposal to impose various prescriptive caps and limits is the best way to address these issues. How would you respond to this? Do you agree with us that there would be some merit in seeking to establish such principles at a global level?

You state that the Government have established a stakeholder group to consider these proposals. What is the nature and scope of this group? What update can you give us of its discussions? What assessment do affected UK organisations make of the proposal?

In terms of the Directive, you state that the Government are cautious about the Commission’s proposal to extend the definition of PIEs to all the entities proposed. Which entities do you consider should not fall under the definition of a PIE, and why? On EU passporting, we agree with you that, providing adequate safeguards are in place, audit firms in one Member State should be able to provide audits in other Member States. Are you satisfied that sufficient safeguards are in place?

In terms of the regulation, we have a number of questions under the various headings given.

In relation to independence, you express concern at the proposal to limit fees for related financial audit services, arguing that the auditor is often particularly well-suited to provide certain services, and that there are strong efficiency gains so long as there is sufficient transparency. Having said that, are there any cases where you would agree with the Commission that undertaking such work would constitute a conflict of interest?

In relation to performance of the statutory audit, you concede that audit firms have been criticised for not always applying sufficient scepticism, and UK regulators have examined the issue. What work have they undertaken, and what conclusions have they come to? On what basis do you believe that measures to tackle this problem might be better addressed through Ethical Guidelines? What particular guidelines do you have in mind?

We agree with you that consideration should be given to audit reporting, but that it is important to ensure that the reporting process does not become unduly onerous.

In relation to transparency reporting, you argue that, since audit firms in the UK are already subject to the UK audit profession’s voluntary code of practice, UK firms should already be transparent. Notwithstanding this, are there any ways in which you think that transparency reporting can be improved?

In relation to the appointment of auditors by PIEs, you state that some of the Commission’s proposals are highly interventionist. Which do you have in mind? You state that the Government will want to consider if the Commission’s proposals could reduce audit quality. What conclusions have you reached? You concede that the UK market is very concentrated. What update can you give us on the
Competition Commission’s inquiry? Do the Government have a view at this stage as to what, if anything, needs to be done to tackle this concentration?

We note your concerns about the difficulty which PIEs may encounter in trying to meet the Commission’s proposals for membership of Audit Committees. In our view this is an issue of fundamental importance. What is the Government’s view of the best outcome in relation to the role of such audit committees? You agree that the Commission’s proposals for rotation of audit firms may be a way of opening up the market, but warn that it may run the risk of disenfranchising audit committees. Can you elaborate on your concerns?

In relation to oversight of auditors by PIEs, we agree with you that it is sensible for major audit firms to develop contingency plans. We also agree with you that greater co-operation between national audit supervisors is desirable. However, we note that you question whether this necessitates ESMA being given the power to issue guidelines or draft regulatory technical standards at EU level, or whether it is better left to national audit supervisors. You also state that the Government will consider whether EU regulation might impact upon the development of trust and openness between auditor and regulator. What is the basis for these concerns?

Finally, we would be grateful for an update on progress made, as well as the provisional timetable, since the Explanatory Memorandum was published. We would be particularly grateful for further information on the view of other Member States.

We would be grateful for a swift response to these questions. In the meantime we have agreed to hold these documents under scrutiny.

7 March 2012

Letter from Norman Lamb MP to the Chairman

Thank you for your letter of 7 March, following consideration of the Explanatory Memorandum dated 19 December 2011. Your Committee has raised a number of issues, each of which I address below.

I. HOW DO YOU RESPOND TO THE COMMISSION’S ARGUMENT THAT, WHilst MEMBER STATES HAVE RELIED UPON SELF-REGULATION BY THE AUDIT PROFESSION, THE FINANCIAL CRISIS HAS DEMONSTRATED THE WEAKNESS OF THIS APPROACH?

There are two elements to this question – (i) whether the audit profession could or should have prevented or anticipated the financial crisis and (ii) whether there is any evidence that the audit profession’s role in relation to the financial crisis was affected by the way that it was regulated at that time.

As you will be aware, the Government believes that many market regulators and participants contributed to the financial crisis. The audit profession’s role was to report on the financial statements of banks and other financial service companies; it was a role, therefore, that addressed the historic position of such companies and auditors were not required to anticipate the success or failure of companies’ future business activities and strategies. Auditors have, however, been criticised for failing to adequately assess the future financial requirements of companies in this sector (for example, by failing to anticipate the need for banks to raise further capital) – i.e. after the financial crisis had occurred.

None of the investigations or reports into the causes of the financial crisis has identified any connection between the events that occurred and the form of auditor regulatory regime in place at that time.

Turning to the second point, it is incorrect to describe audit as being self-regulated. The Statutory Audit Directive, which was required to be transposed into national legislation by June 2008, included the requirement for Member States to organise an effective system of public oversight for statutory auditors and audit firms. In the UK, since 2004, the auditors of public interest entities (PIEs) have been regulated by the Professional Oversight Board (POB), which has a regime of inspection for the audits of PIEs. The POB publishes annual inspection reports on the auditors of PIEs. Auditors of PIEs are also subject to an independent disciplinary regime that is operated by the Financial Reporting Council (FRC). The Financial Reporting Review Panel (also part of the FRC) reviews the financial statements of listed companies and can require companies to publish corrective data or accounts.

The oversight and discipline of non-PIE auditors is undertaken by the professional accounting institutes. The POB is responsible for ensuring that those institutes have an effective system of
oversight and discipline. The POB has the power to conduct its own inquiries into individual auditors and audit firms. Its ultimate sanction would be to remove the audit registration of a firm.

2. **HOW DO YOU RESPOND TO THE COMMISSION’S SUGGESTION THAT DEALING WITH THE PROBLEMS AT MEMBER STATE LEVEL WOULD SERIOUSLY UNDERMINE THE SINGLE MARKET, AND THAT THERE ARE POTENTIAL ADVANTAGES OF TAKING ACTION AT EU LEVEL?**

The Commission is concerned at the uneven implementation of Directives – and therefore favours a Regulation as it would ensure uniform implementation of its proposals across the EU. However, the Government’s position is that the Statutory Audit Directive was properly implemented in the UK and the other principal EU economies in a timely manner.

The case for dealing with the issues at Member State level is as follows: audit firms are mostly nationally based, even though they have pan-EU and indeed international networks. Similarly, the governance and reporting obligations of PIEs are determined by the laws and regulations of the country where they are incorporated and listed.

As is recognised by the Commission (by the fact that EU company and securities requirements are established by Directives), Member States achieve policy objectives in different ways. In the UK, the requirements of the relevant Directives are achieved by a combination of company legislation, regulation and by codes of conduct. For example, many areas of policy in relation to corporate governance, of which audit forms an important part, are established through regulations or codes, such as the Corporate Governance Code, which is very effectively enforced through a comply or explain mechanism. The UK favours this approach as codes are much more flexible and easy to change as the situation demands: the same is not true for EU law.

It is noteworthy that this incompatibility between the proposed Regulation and national law has led various Member States in the working groups to object to the use of a Regulation to implement the proposals to apply to the audits of PIEs.

3. **YOU STATE THAT THE GOVERNMENT WILL BE CONSIDERING WHETHER THE PROPOSALS ARE CONSISTENT WITH THE PRINCIPLE OF SUBSIDIARITY, AND WHETHER THE COMMISSION’S ACTIVITY ARE PROPORTIONATE IN THE CONTEXT OF THE FINANCIAL SERVICES. WHAT CONCLUSIONS HAVE YOU COME TO?**

In relation to subsidiarity, there continue to be lively discussions in the Council working groups in relation to most of the controversial measures in the proposal and particularly whether a Regulation is the appropriate legal vehicle, rather than a Directive which, depending on its wording, may give Member States more flexibility in implementation.

Given the Commission’s objective of addressing deficiencies in the operation of the audit market that have become apparent from analysing the causes of the financial crisis, the starting point when considering the proportionality of the Commission’s proposals is to consider what deficiencies have been identified and whether the proposals address those deficiencies.

Following publication of the Commission’s Green Paper, the Commission’s consultation revealed that there are areas of practice which could be improved across the European Union - for example, in relation to the oversight and regulation of the audit profession, the adoption of international audit standards, and improvements in audit reporting. Accordingly, the Government does support proposals that address such issues and, subject to a number of detailed points, those proposals are broadly proportionate. It is important that your Committee appreciates that these areas and the proposals to address them account for the majority of the Articles in the draft documents.

However, not all the proposals can be so categorised. Some of the Commission’s proposals have, as a primary or ancillary objective, the restructuring of the audit market. The prime example is the requirement that audit firms (as opposed to audit partners) should rotate every 6 years (the ‘mandatory rotation’ proposal).

The Government objects to this proposal on the grounds that the Commission has not established any connection between the financial crisis and any deficiency in the performance of the audit profession or the operation of the audit market as a result of the structure of the audit market. In addition, this proposal will or may have unintended consequences that have the potential to damage audit quality. The mandatory rotation proposal involves a risk that an incoming audit firm will not have the necessary knowledge of a company’s business to identify risks and undertake an effective audit (as was the experience when mandatory rotation was introduced in Italy). Further, there may be circumstances where a company cannot appoint an audit firm with the requisite experience and/or
expertise because other firms already act for competitors or cannot meet the applicable independence requirements because of other engagements that they are undertaking or have undertaken.

The level at which the Pure Audit Firm threshold is set would also be likely to restructure the audit market. We believe that there are alternative measures that may reduce the current levels of concentration more proportionately, such as allowing Member States to remove ownership restrictions on audit firms; greater transparency in the auditor selection process; mandatory tendering every 10 years on a comply or explain basis; and a ban on Big 4 only clauses.

Another example of a proposal the need for which has not been established and which is not proportionate is the prohibition on delegation to professional institutes of the inspections of non-PIE audits (in Article 1(16) of the proposed Directive). There is no evidence that the current system of inspection of non-PIE audits by professional bodies has failed.

4. WE ARE NOT CONVINCED THAT THE COMMISSION’S PROPOSAL TO IMPOSE VARIOUS PRESCRIPTIVE CAPS AND LIMITS IS THE BEST WAY TO ADDRESS THESE ISSUES. HOW WOULD YOU RESPOND TO THIS? DO YOU AGREE WITH US THAT THERE WOULD BE SOME MERIT IN SEEKING TO ESTABLISH SUCH PRINCIPLES AT A GLOBAL LEVEL?

The Government agrees with your concerns.

The caps and limits proposed by the Commission (such as the 10% limit on audit related services and the 6 year mandatory rotation period) are arbitrary in nature. There is no data relied upon or objective basis for such caps and limits – they are wholly subjective and, for the reasons discussed above, disproportionate.

You identify, in our view correctly, the need for a number of these issues to be progressed at a global level on a principled basis. If this does not happen, there is a real risk that other countries or regions will benefit from the increased regulatory burden and cost involved in the Commission’s proposals, if companies move out of EU capital markets.

However, it is also important to recognise that other significant bodies with responsibility for audit (such as the Public Company Auditing Oversight Board in the US) have no incentive to participate at a global level.

5. YOU STATE THAT THE GOVERNMENT HAS ESTABLISHED A STAKEHOLDER GROUP TO CONSIDER THESE PROPOSALS. WHAT IS THE NATURE AND SCOPE OF THIS GROUP? WHAT UPDATE CAN YOU GIVE US OF ITS DISCUSSIONS? WHAT ASSESSMENT DO AFFECTED UK ORGANISATIONS MAKE OF THE PROPOSALS?

The Government consults with interested regulators (the Financial Services Authority and FRC), the accountancy bodies, representatives of companies affected (through the CBI and the 100 Group), investors through their professional associations (such as the ABI, NAPF and the IMA), and the accountancy and audit profession.

These discussions take place on a regular basis usually following each working group meeting, to gather views and report on the progress of the negotiations. We have also invited comments from interested parties via the auditing, accounting and reporting policy section of the BIS website.

UK corporates, investors and auditors are particularly worried at the proposal for mandatory audit rotation. The Big 4 audit firms, UK corporates and investors are also concerned about the Pure Audit Firm proposal, as this would currently catch one audit firm in the UK and possibly two others in other Member States. Some Member States support mandatory rotation, especially those countries that already practise it; whereas for others, this proposal is burdensome, risks reducing audit quality and may increase concentration in the audit market.

6. YOU STATE THAT THE GOVERNMENT ARE CAUTIOUS ABOUT THE COMMISSION’S PROPOSAL TO EXTEND THE DEFINITION OF PIES TO ALL THE ENTITIES PROPOSED. WHICH ENTITIES DO YOU CONSIDER SHOULD NOT FALL INTO THE DEFINITION OF A PUBLIC INTEREST ENTITY, AND WHY?

Concern primarily arises from the fact that the current approach would characterise as PIEs all UCITS and Alternative Investment Funds: some of these are generally considered too small to warrant such categorisation. It appears that this view is shared by other Member States.
7. ON EU PASSPORTING, WE AGREE WITH YOU THAT, PROVIDED ADEQUATE SAFEGUARDS ARE IN PLACE, AUDIT FIRMS IN ONE MEMBER STATE SHOULD BE ABLE TO PROVIDE AUDITS IN OTHER MEMBER STATES. ARE YOU SATISFIED THAT SUFFICIENT SAFEGUARDS ARE IN PLACE?

The Government's concerns relate to the adequacy of the inspection regime. In particular, the Government is concerned to ensure that, where the audit of a company incorporated in Member State A is undertaken by an audit firm from Member State B, that audit firm will be subject to inspection by the audit regulator of Member State A. This is important if the interests of investors in companies in Member State A are to be protected.

8. YOU EXPRESS CONCERN AT THE PROPOSAL TO LIMIT FEES FOR RELATED FINANCIAL AUDIT SERVICES, ARGUING THAT THE AUDITOR IS OFTEN PARTICULARLY WELL-SUITED TO PROVIDE CERTAIN SERVICES, AND THAT THERE ARE STRONG EFFICIENCY GAINS SO LONG AS THERE IS SUFFICIENT TRANSPARENCY. ARE THERE ANY CASES WHERE YOU WOULD AGREE WITH THE COMMISSION THAT UNDERTAKING SUCH WORK WOULD CONSTITUTE A CONFLICT OF INTEREST?

The Government is satisfied that the services identified in the Regulation as being related financial audit services ('audit related services') are services that should properly be provided by auditors – and that assessment is supported by the FSA and the FRC.

Furthermore, we do not believe that there is any reason to place restrictions of any nature on the auditor providing audit related services (such as audits of interim financial statements, assurance on corporate governance statements and assurance on regulatory returns). Such restrictions could prevent the prudential regulator of financial institutions from commissioning additional reports from the auditor on a timely basis, which in turn could have systemic implications. Thus this measure is not proportionate, as it goes much further than is appropriate or necessary to achieve the stated aim.

I should add that audit related services must be distinguished from non-audit services. For major listed companies it would never be appropriate for aggressive tax advice or internal audit (where the auditor was going to be relying on this internal audit work) to be provided to the company by the auditor. It would, therefore, be hard to object to a ban on areas such as these.

9. YOU CONCEDE THAT AUDITORS HAVE BEEN CRITICISED FOR NOT ALWAYS APPLYING SUFFICIENT SCEPTICISM, AND UK REGULATORS HAVE EXAMINED THE SITUATION. WHAT WORK HAVE THEY UNDERTAKEN AND WHAT CONCLUSIONS HAVE THEY COME TO? ON WHAT BASIS DO YOU BELIEVE THAT MEASURES TO TACKLE THE PROBLEM MIGHT BE BETTER ADDRESSED THROUGH ETHICAL GUIDELINES? WHAT PARTICULAR GUIDELINES DO YOU HAVE IN MIND?

A considerable amount of work has been undertaken by the FSA and the FRC.

Jointly, those bodies published a Discussion Paper setting out their concerns at the adequacy of professional scepticism in the audit of the financial statements of entities in the financial services sector. This was based on their experience of the approach taken by audit firms prior to and during the financial crisis.

The Auditing Practices Board (APB) (an operating body of the FRC) undertook a three stage process to explore this further - involving a Discussion Paper, a Feedback Paper based on the responses to that Discussion Paper and culminating in the publication of a paper that confirms the vital importance of professional scepticism as a cornerstone of the audit process and analyses the ways in which professional scepticism can be promoted.

The APB has reviewed all its auditing standards to determine the extent to which improvements in such standards could promote professional scepticism. It concluded that to add additional requirements and guidance in auditing standards in relation to auditor scepticism was more likely to increase a 'box-ticking' mind-set to auditing than to promote professional scepticism – so it has not pursued that approach. Nonetheless it will promote enhancements to international auditing standards when the current standards are reviewed over the coming years.

However, the POB undertook a review of the way that auditors and audit committees had addressed circumstances where it would have been important to exercise professional scepticism – including, for example, those circumstances where assets or liabilities were difficult to value and weight was placed on management's evaluations. The output of that was used to brief audit committee members and audit firms on the ways in which they could improve their critical evaluation of such matters. In addition the AIU provided the major UK firms, and the profession more generally, with examples of where they had identified a lack of scepticism on specific audit engagements.
During 2010, the FRC, on behalf of International Federation of Independent Audit Regulators, led a discussion with the global leadership of the major accounting firm networks about the lack of scepticism identified during audit inspections. They agreed to take action to address the issue and discussions are taking place to assess their progress in doing so.

Objectivity and independence lie at the heart of the Ethical Standards in force in the UK and those Ethical Standards are used to address the enemies of professional scepticism (such as familiarity, economic dependence, self-review). Furthermore, the FRC is ensuring that the inspections undertaken by the Audit Inspection Unit focus, amongst other areas, on the extent to which audit teams have exercised professional scepticism.

10. IN RELATION TO TRANSPARENCY REPORTING, YOU ARGUE THAT, SINCE AUDIT FIRMS IN THE UK ARE ALREADY SUBJECT TO UK AUDIT PROFESSION’S VOLUNTARY CODE OF PRACTICE, UK FIRMS SHOULD ALREADY BE TRANSPARENT. ARE THERE ANY WAYS IN WHICH YOU THINK TRANSPARENCY REPORTING CAN BE IMPROVED?

The Government does not believe that transparency reporting by audit firms in the UK needs improvement as the UK audit profession’s voluntary code of practice, which exceeds the requirements of the current Statutory Audit Directive, is sufficient.

A particular criticism relates to Article 26 of the draft Regulation, which concerns the provision of financial information in relation to audit firm networks. This provision goes well beyond existing requirements in the Statutory Audit Directive and would require the preparation of audited consolidated financial statements for networks. It is far from clear that networks would, at present, prepare these because, in many instances, to do so would involve consolidating entities that do not meet the consolidation criteria of control. The measure is also inappropriate because it has extra-territorial effect - as networks will have members that will be outside the EU.

11. IN RELATION TO THE APPOINTMENT OF AUDITORS BY PIES, YOU STATE THAT SOME OF THE COMMISSION’S PROPOSALS ARE HIGHLY INTERVENTIONIST. WHICH DO YOU HAVE IN MIND? YOU STATE THAT THE GOVERNMENT WILL WANT TO CONSIDER IF THE COMMISSION’S PROPOSALS COULD REDUCE AUDIT QUALITY. WHAT CONCLUSIONS HAVE YOU REACHED?

The principal proposals that the Government considers to be highly interventionist are the requirement for audit firm rotation every six years and the prescriptive approach taken to audit related services.

The proposal to require audit firm rotation every six years (Regulation Art 33) is likely to prove expensive for companies and auditors and an unnecessary burden on business. In order to ensure independence, the existing Statutory Audit Directive requires, for PIES, lead audit partner rotation every 7 years; but the requirement in the UK is stricter, requiring audit partner rotation after 5 years.

In order to ensure that the audit committee tests the market regularly, we would support moving to retendering every 10 years on ‘a comply or explain’ basis. There is evidence that the Commission’s proposals may make market concentration worse, and have negative effects on firms just outside the Big 4. For example, when rotation was introduced in Italy, it led to the market for the audit of PIES being shared amongst the four largest firms and all other firms being excluded.

The proposed 10% limit on audit related services as a percentage of the audit fee (Regulation Art 9(2)) is inappropriate. Such fees should be unrestricted as the auditor is the best placed person to conduct all audit related services and produce high quality work on the short timescales often demanded. In the Government’s view, if this limit is retained, there is a significant risk that the quality of audit related work undertaken will be reduced as firms without the requisite knowledge of the PIE try to meet essential time requirements.

12. YOU CONCEDE THAT THE UK MARKET IS VERY CONCENTRATED. WHAT UPDATE CAN YOU GIVE US ON THE COMPETITION COMMISSION’S INQUIRY? DO THE GOVERNMENT HAVE A VIEW, AT THIS STAGE, AS TO WHAT IF ANYTHING NEEDS TO BE DONE TO TACKLE THIS CONCENTRATION?

The Competition Commission inquiry has been gathering evidence. According to its current timetable, it will be publishing its provisional finding and possible remedies in November this year. If it finds that there is no adverse effect on competition it will publish its final report in January 2013, and if it finds an adverse effect it will publish it in July 2013.
13. **WE NOTE YOUR CONCERNS ABOUT THE DIFFICULTY WHICH PIEs MAY ENCOUNTER IN TRYING TO MEET THE COMMISSION’S PROPOSALS FOR MEMBERSHIP OF AUDIT COMMITTEES. IN OUR VIEW THIS IS AN ISSUE OF FUNDAMENTAL IMPORTANCE. WHAT IS THE GOVERNMENT’S VIEW OF THE BEST OUTCOME IN RELATION TO THE ROLE OF SUCH AUDIT COMMITTEES? YOU AGREE THAT THE COMMISSION’S PROPOSALS FOR THE ROTATION OF AUDITORS MAY BE A WAY OF OPENING UP THE MARKET, BUT WARN THAT IT MAY RUN THE RISK OF DISENFRANCHISING AUDIT COMMITTEES. CAN YOU ELABORATE ON YOUR CONCERNS?**

The Government would like to see an improvement in communication between the Board and shareholders in relation to audit. A key way of doing this is through the report of the audit committee.

In its report on Effective Company Stewardship the FRC proposed that the audit committee could disclose more about the selection of the auditor, the accounting decisions taken, and key risks or key judgements addressed in preparing and finalising the financial statements. It also considered the extension of the remit of the audit committee to include consideration of the whole annual report, including the narrative report, with a view to determining whether it provides the information necessary for stakeholders to assess the performance and prospects of the company; and whether the annual report, viewed as a whole, is fair and balanced. I understand the FRC will be consulting this month on introducing enhancements such as these on a “comply or explain” basis by amendments to the Corporate Governance Code.

The proposals relating to mandatory rotation and to limit the fees that a company’s auditor may receive for providing audit related services risk disenfranchising audit committees by restricting their ability to choose the audit firm they consider most appropriate to undertake the work in question. These proposals would mean that, in some circumstances, audit committees would be required to appoint an audit firm that they believe is less capable than the incumbent, simply because of these proposed requirements.

14. **IN RELATION TO OVERSIGHT OF AUDITORS OF PIEs, WE AGREE WITH YOU THAT IT IS SENSIBLE FOR MAJOR AUDIT FIRMS TO DEVELOP CONTINGENCY PLANS. WE ALSO AGREE THAT GREATER CO-OPERATION BETWEEN NATIONAL AUDIT SUPERVISORS IS DESIRABLE. HOWEVER, WE NOTE THAT YOU QUESTION WHETHER THIS NECESSITATES ESMA BEING GIVEN POWER TO ISSUE GUIDELINES OR ISSUE DRAFT REGULATORY TECHNICAL STANDARDS AT EU LEVEL, OR WHETHER IT IS BETTER LEFT TO NATIONAL AUDIT SUPERVISORS. YOU ALSO STATE THAT THE GOVERNMENT WILL CONSIDER WHETHER EU REGULATION MIGHT IMPACT ON THE DEVELOPMENT OF TRUST AND OPENNESS BETWEEN AUDITOR AND REGULATOR. WHAT IS THE BASIS FOR THESE CONCERNS?**

The Commission proposes that ESMA will be required: to develop draft regulatory technical standards; to specify policies and procedures to avoid conflict of interest by auditors; to coordinate cooperation between national audit supervisors; and to issue guidelines on common standards on content and presentation of, for example, the audit report, audit committee report, audit rotation, auditor dismissal, enforcement, exchange of information, quality assurance reviews and colleges of regulators. The Government questions whether all these roles are appropriate.

A European level audit supervisor should do the following: enhance co-operation between national audit supervisors; co-ordinate action in the event of a major firm failure; and develop broad principles acting by unanimity rather than qualified majority voting.

At a time when ISAs are to be adopted on an EU-wide basis, it is inappropriate to task a new body, ESMA, with producing standards that duplicate and inevitably conflict with the ground covered by ISAs.

The proposed EU-wide standardised approach is incompatible with, and fails to recognise the differing approaches taken in different Member States - the UK operates through the Listing Rules and the Corporate Governance Code - including comply and explain. ESMA should not be issuing technical standards, which by their nature will need to interact with national legislation, guidance and ethical standards. Technical standards should be a matter for the national audit supervisor, operating under the ISA regime, as set out in the Commission’s proposals.

There is also an issue about ESMA’s capacity to conduct this role, since ESMA is made up of securities regulators, not accounting and auditing experts.

Our Explanatory Memorandum said that, in the context of the quantity and quality of dialogue between auditors and financial services supervisors, we would want to consider if EU regulation in this area might impact on the development of trust and openness between auditor and regulator. The FSA Code of Practice for the relationship between the external auditor and the supervisor requires
discussions about each of the banks between the relevant auditor and the regulator twice a year — with one of those meetings including the bank in question. These discussions are happening and the code appears to be working. Under the Financial Services Bill, the Prudential Regulation Authority (PRA) will be the prudential regulator of banks. The future management of the PRA have made clear that they understand “the need for on-going dialogue between bank management, its auditors and supervisors” and that this will be an important part of the PRA’s approach to banking supervision. Both PRA and Financial Conduct Authority (FCA) will have powers to make rules imposing duties on auditors and actuaries to report to the regulator on specified matters.

The Government is concerned that the proposal that ESMA should issue guidelines and standards in these areas will run counter to the substantial and important progress that has been made in these areas in the UK.

15. WE WOULD BE GRATEFUL FOR AN UPDATE ON PROGRESS MADE, AS WELL AS THE PROVISIONAL TIMETABLE, SINCE THE EXPLANATORY MEMORANDUM WAS PUBLISHED. WE WOULD BE PARTICULARLY GRATEFUL FOR FURTHER INFORMATION ON THE VIEW OF OTHER MEMBER STATES.

The current Presidency is arranging one working group a month on the dossier. Since the Explanatory Memorandum was published, there have been three meetings of the European Council working groups, and the Government has, at the end of March, in response to the request by the Danish Presidency, provided written comments on the proposed Directive. There has been no request for written comments on the proposed Regulation.

The Cypriot Presidency, which will take over from July, has not yet announced its intentions.

The European Parliament’s provisional timetable is for the presentation of the draft report of the responsible committee on 9-10 July, the vote on the draft JURI report on 27 November 2012 and a vote in plenary 14 January 2013.

In the European Council working group, Member States have said that they are happy to support proposals that would deliver a better quality of auditing. A variety of Member States have objected to the proposal for Pure Audit Firms as currently drafted, the ban on all non-audit services, the limit on audit related services, mandatory audit firm rotation after only 6 years, the proposed role of ESMA, the broadened definition of Public Interest Entities and the Commission’s choice of legal instrument, preferring some or all issues to be addressed in a Directive as opposed to a Regulation.

The Committee may also wish to know that the House of Lords Select Committee on Economic Affairs debated its report “Auditors: Market concentration and their role” on 14 March.

1 May 2012

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

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

Thank you for your letter of 15 November 2011 on the above Explanatory Memoranda relating to the Council Proposals to sign and conclude the Free Trade Agreement (FTA) between the EU and Colombia and Peru. Please accept my delay in responding. As communicated to your clerk, we have been waiting for confirmation on competence.

Starting with the competency, I can now confirm that the FTA will be a mixed competence agreement, after this was unanimously agreed at the Trade Policy Committee (Deputies) on 2 December. This means that signing and concluding the agreement will not have implications for UK competence.

You also asked about the steps being taken by Colombia, the UK and the EU to address human rights concerns. The UK has led efforts within the EU to ensure that the FTA contains a robust human rights clause, which will allow for immediate suspension of the agreement in case of egregious human rights violations, and will act as a catalyst for frank dialogue on the issue. The UK, the EU and other Member State Governments regularly raises human rights with the Colombian Government. The FCO talks regularly to human rights defenders and local NGOs to identify and support important
initiatives, and funds bilateral project work in Colombia and Peru on human rights issues. In Peru, for instance, the FCO has two on-going projects tackling human trafficking. The Department for International Development (DFID) funds a number of civil society groups in the region which are playing a pivotal role in advocacy and transparency, as well as direct support to victims of violence. DFID’s partners in Latin America are ActionAid, CAFOD, CARE, Christian Aid, HelpAge International, International HIV and AIDS Alliance, OXFAM, Plan International, Progressio, Save the Children, World Vision and the WWF. Their overall shared purpose in Latin America is to reduce poverty and inequality through empowering civil society to address social, economic and political exclusion.

The Colombian Government has taken a number of significant steps to improve human rights. During President Santos’s recent visit to the UK, he committed to implementing the UN Principles on Business and Human Rights in the joint declaration on human rights between the UK and Colombia. Other notable steps include the following:

— The Colombian Ministry of the Interior is currently preparing a new directive, which includes creating an integrated and more comprehensive monitoring system to ensure improved protection for human rights defenders.

— President Santos has committed to improving the Colombian justice system by implementing a package of reforms to depoliticise the judiciary, improve its administration, give it greater resources, and decongest its caseload.

— The Colombian Attorney General has also committed to providing extra prosecutors for the National Human Rights and International Humanitarian Law Unit, the aim of which is to address the high levels of impunity in Colombia.

— Finally, the new Land and Victims Law, passed in May 2011, aims to reinstate approximately 6 million hectares of land to 450,000 families who have been forcibly displaced. In addition, approximately 4 million internally displaced from 1985 onwards will receive financial compensation.

My department believes that the FTA does trigger the UK’s Justice and Home Affairs (JHA) opt-in. This specifically applies to the services provisions, where we believe that Article 207(6) of the Treaty on the Functioning of the EU (TFEU) - which concerns the exercise of the competence required to enter into Mode 4 commitments - is applicable. As internal EU legislation requiring Member States to open their markets to the provision of services by natural persons from third countries would require a Title V TFEU legal base and be subject to the UK opt-in, our view is that Article 207(6) provides that the EU cannot bind the UK in an international agreement containing commitments in Mode 4 services unless we opt-in to those provisions.

I hope this response sufficiently addresses your queries on competence and human rights, and that the House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade is able to clear these elements.

I will write next week to confirm the UK Government’s position on the JHA opt-in. I would be grateful if you could prepare to consider this issue urgently, as the UK’s JHA opt-in deadline is 22 December.

7 December 2011

Letter from the Chairman to Edward Davey MP

Thank you for your letter, dated 7 December 2011, on EM 14757/11 and 14760/11 on a proposal for a Decision on the signing of, and the conclusion of, the Trade Agreement between the EU and Colombia and Peru. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 13 December 2011.

We note that this is now proposed to be a mixed agreement. It would have assisted us if you had answered our request for clarification of the provisions of the Agreement that the Government believed gave rise to Member State competence. Can you now tell us on what grounds it has been decided that the Agreement will be a mixed competence agreement? As we indicated in our earlier letter a consequence of this being a mixed agreement is that there should be a declaration of the respective competences of the EU and the Member States in order to respect legal transparency. We should be grateful for an update on this matter.
The fact that this is now a mixed agreement also means that the issue of the UK opt-in now has little practical significance. As you know we do not agree with your assertion that the impact of the Agreement on mode 4 services triggers the UK opt-in even in the absence of an express Title V legal basis in the proposal.

We do however note that if the only reason for the UK entering into this Agreement in its own right is that it touches on mode 4 services then the UK should not also be seeking to exercise its opt-in to participate in the Agreement as part of the EU.

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

14 December 2011

Letter from Edward Davey MP to the Chairman

Thank you for your letter of 14 December confirming that the House of Lords European Scrutiny Committee had cleared the EU-Andean Multiparty Trade Agreement from scrutiny.

I wrote on 7 December in response to your letter of 15 November, confirming that Member States had unanimously agreed that competence to sign and conclude the Agreement was shared between the Commission and Member States; and setting out the steps being taken by Colombia, the UK and EU to address human rights concerns.

I also explained the basis for the Department of Business, Innovation and Skills’ view that the Agreement triggers the UK’s Justice and Home Affairs (JHA) opt-in under Title V of the Treaty on the Functioning of the European Union. Having considered the matter further, I can now confirm that this is the UK Government’s view.

Further to your query on which areas of the Agreement give rise to mixed competence, the EU and Member States have not yet arrived at a settled view. The European Council Legal Service set out its views in its opinion 8804/11, and the UK submitted comments on this. Specifically we argued that the Agreement’s transport provisions, and the political clauses relating to human rights, the rule of law and the proliferation of WMD, either fell within Member State competence or had not been shown to fall wholly within EU competence. We also argued this in respect of the provisions on Intellectual Property which require the parties to abide by TRIPS.

Further to your query on which areas of the Agreement give rise to mixed competence, there is not an agreed EU assessment of which elements of the Agreement make it mixed competency, as the European Commission holds a different view from Member States and the Council Legal Services. The UK Government’s view is that the Agreement’s transport provisions, the commitments on intellectual property, and the political clauses relating to human rights, the rule of law and the proliferation of WMD, either fall within Member State competence or have not been shown to fall wholly within EU competence.

17 December 2011

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

My predecessor, Edward Davey, wrote to you on 17 December to inform you of progress on this dossier, in particular the Government’s view that the Agreement triggers the UK Justice and Home Affairs opt-in under Title V of the Treaty on the Functioning of the European Union.

I am writing now to update the committee of the progress of this FTA. I can confirm that the UK has expressed its support for the Council Proposals on signature and conclusion of this Agreement. You will recall that the mixed competency of the Agreement was unanimously agreed by Member States on 2 December 2011. We will be supporting the provisional application of the FTA with the exception of those provisions that are exclusive Member State competence, such as the weapons of mass destruction clause.

We expect the signature of the Agreement to be approved by Member States at the EU Foreign Affairs Council (Trade) on 16 March, and for signature to take place soon thereafter. We expect conclusion of the Agreement to receive European Parliament consent in late summer and for provisional application to commence at that time, with conclusion taking place after that.
I can also confirm that the UK has exercised its opt-in under Title V TFEU in relation to this Agreement. This was also set out in a Written Ministerial Statement to both Houses, made on 31 January 2012.

27 February 2012

TRADE FOREIGN AFFAIRS COUNCIL

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

The EU Trade Foreign Affairs Council will take place in Geneva on 14 December 2011. I will represent the UK. The agenda will cover the eighth WTO Ministerial Conference taking place 15-17 December, which I will be attending on behalf of the UK; the accessions to the WTO of Russia, Samoa and Montenegro and the Deep and Comprehensive Trade Agreement (DCFTA) with the Middle East and North African Nations (MENA).

Please see attached a Pre-Council Written Ministerial Statement [not printed] which is being laid in Parliament.

13 December 2011

Letter from Edward Davey MP to the Chairman

I represented the UK at the Trade session of the above Foreign Affairs Council in Geneva, Switzerland, on 14 December.

Please see attached [not printed] a Post-Council Written Ministerial Statement which is being laid in Parliament.

19 December 2011

TRANSPARENCY DIRECTIVE (16353/11)

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

Thank you for your Explanatory Memorandum 16353/11, dated 12 November 2011, on a proposal for a directive amending the directive on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 16 February 2012.

Like you, we support high levels of transparency as part of the effort to balance the goals of investor protection, consumer confidence, efficiency, legal clarity and the reduction of administrative burdens. We believe that this proposal seeks to improve transparency in an appropriate way.

We note that the Government will seek to ensure that there is no diminution of transparency and investor protection in the move towards harmonising the calculation of thresholds for notification of major holdings of voting rights. In that context, are you content with the proposal as it stands, or are there improvements that you would wish to see made?

We would be grateful for a prompt response to this question as well as an update as negotiations progress. In the meantime we have agreed to clear this document from scrutiny.

16 February 2012

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 16 February on the draft Directive amending the Transparency Directive. You requested further information on the harmonisation of the calculation of thresholds for notification of voting rights and an update on the negotiations.

The European Commission’s proposal has been discussed at European Council working groups where Member States are broadly supportive of the proposals.
The draft Presidency compromise clarifies that the move towards harmonising the calculation of thresholds for notification of major holdings of voting rights does not diminish transparency and investor protection. In particular, it clarifies that the proposal permits Member States to continue to be allowed to set lower national thresholds than those foreseen in the Transparency Directive to ensure appropriate transparency of holdings. The Government supports the clarifications that have been made to the Commission proposal. This is an important part of the UK regime, where disclosure has a starting threshold of 3% (the Transparency Directive minimum threshold is 5%) with subsequent 1% incremental changes being notifiable.

The draft Presidency compromise proposal also clarifies that the proposal is also not intended to affect the UK Takeover Panel’s ability to regulate takeover bids - where the Takeover Panel oversees enhanced transparency during takeover bids and we would not wish to see transparency reduced.

I hope that this further information is helpful in considering the European Commission’s proposal. The Danish Presidency is planning for agreement in May/June.

14 March 2012

TREATY ON STABILITY, CO-ORDINATION AND GOVERNANCE IN THE ECONOMIC AND MONETARY UNION

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

Please find attached a copy of the latest draft [not printed] of the proposed Treaty on Stability, Co-ordination and Governance in the Economic and Monetary Union.

I think it important in the spirit of openness and transparency that the Scrutiny Committees should see this document, though it is not of course covered by the scrutiny reserve resolution as it is not an EU document and in any case the UK will not be a signatory.

Please be aware that all those participating in the Working Group considering this draft Treaty have been asked that, where it is national practice to transmit drafts to our national Parliaments, safeguards to ensure due confidentiality should be in place.

13 January 2012

Letter from the Rt. Hon David Lidington MP, to the Chairman

Further to my letter of 13 January 2012 which enclosed an earlier draft of the Treaty on Stability, Co-ordination and Governance in the Economic and Monetary Union, please find attached a final copy [not printed]. As this is now a public document, the earlier issues around confidentiality no longer arise and I am placing a copy in the libraries of both Houses.

15 February 2012

Letter from the Rt. Hon David Lidington MP, to the Chairman

Further to my letter of 15 February 2012 which enclosed the final copy of the Treaty on Stability, Co-ordination and Governance in the Economic and Monetary Union, please find attached a letter [not printed] from Jon Cunliffe, the UK’s Permanent Representative to the EU, to the European Council Secretariat. I am placing a copy of the letter in the libraries of both Houses.

22 February 2012

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

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

The Green paper (published in December 2010) launched an EU wide consultation with all EU stakeholders. During the six month consultation the Commission received 611 substantive responses from businesses, academics, citizens and tax authorities (plus 1115 campaign letters targeted at two countries, not the UK).

The White Paper contains a list of future priority actions, which are a mix of EU discussion points, guidance and best practice work, monitoring, evaluation and reporting, in depth analysis and legislative proposals. For ease a full list of these actions is included as an Annex [not printed].

I hope you find this information helpful.

6 January 2012

Letter from the Chairman to David Gauke MP

Thank you for your Explanatory Memorandum 18288/11, dated 12 January 2012, and your letter dated 6 January 2012, on the Commission Communication on the future of VAT. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 6 March 2012.

We note that many of the priority areas raised by the White Paper correspond to ideas included in the previous Green Paper on VAT. The most significant suggestion is the idea that exemptions should be abandoned in order to create a common VAT regime, cut business costs and improve the functioning of the European single market. We believe that the Commission proposal to reduce VAT exemptions should not impinge on the UK’s ability to maintain a VAT exemption for certain items. What would be the implications of such a move for the UK? To what extent would such a new VAT system remove obstacles that currently exist for businesses engaged in cross-border activity?

We note that the suggestion that the EU might move to an “origin” based tax system (where VAT is charged in the country of origin, rather than sale) contained in the original Green Paper has been dropped on the basis that “this principle remains politically unachievable.” We previously concluded that any change to the current destination based tax system, where VAT revenues accrue directly to the Member State of consumption, would mark a significant overhaul of the VAT system. We note the abandonment of the origin principle, which would require a greater degree of harmonisation of VAT rates. What is the Government’s own view on how the VAT system can be improved?

We look forward to scrutinising any proposals as they emerge, and note that we have already been in extensive correspondence with you on the Commission’s Green Paper on the future of VAT. We would be grateful for a response to our queries within the standard ten working days. In the meantime we have agreed to hold the White Paper under scrutiny.

7 March 2012

Letter from David Gauke MP to the Chairman

Thank you for your letter of 7 March, in response to my letter of 6 January and EM of 12 January 2012, on the Commission Communication on the future of VAT.

The White Paper sets out the Commission’s vision for an improved EU VAT system in general terms, under the themes of a simpler, more efficient and robust VAT system, tailored to the single market. Then, more specifically, the Commission identifies various Priority Actions, which are first steps towards that vision.

Issues regarding VAT rates, including exemptions, fall within the Commission theme of a more efficient VAT system. Although ideas in the preceding Green Paper were perhaps more radical (to promote debate), the White Paper is more nuanced (reflecting responses to that debate) and limited in its approach.

So, the White Paper does not conclude that the exemptions should be abandoned. It does however suggest that they ought to be reviewed to see whether the economic, social or technical reasons for them are still valid and whether the way they are applied can be improved. This would not be a quick or easy task, nor is it a priority for the Commission. Indeed, early work is to be limited to public bodies, passenger transport and non-profit making organisations.

On the first, the Commission will focus on areas where the current rules are likely to cause distortions of competition between the public and private sectors. This is a sensible approach, though we will need to consider the detail of any proposals, if and when they emerge.
As regards passenger transport, we and many other Member States remain to be convinced of the need for any action here. We understand the Commission’s more recent thinking is to carry out a detailed study of the current rules to see how they are applied across the EU. This seems to be a more logical first step and we await the outcome of that study with interest.

Finally, the Commission suggests that there are existing options within the current EU VAT law which can alleviate the burden of VAT for non-profit making organisations. We would agree. Indeed, the UK already takes advantage of a comprehensive range of simplification measures and procedures within the framework of current EU law. These benefit a broad range of businesses and organisations, including non-profit making bodies. Measures and procedures include:

— A high registration threshold, to take businesses and organisations out of the VAT net altogether;

— Cash Accounting and Annual Accounting simplification schemes, to reduce the burdens on businesses and organisations within the VAT net; and

— Targeted compensation (refund) schemes, to alleviate the cost of VAT in certain circumstances.

Of course, we also apply UK-specific reliefs for charities amounting to around £200m, provided through zero rating from VAT.

You also asked for the Government’s view on how the current VAT system can be improved. The Government is particularly pleased to see the priority given in the White Paper to the introduction of the VAT mini One Stop Shop concept. I recently sent you an Explanatory Memorandum (5389/12 - which your Committee has since cleared) on the Commission’s proposed Council Implementing Regulation to underpin the mini One Stop Shop. In my covering letter dated 30 January 2012, I set out the context and importance of that simplification for businesses in the telecoms, broadcasting and e-services sectors. But it is also potentially an important technological step on which it may be possible to build in the future, including for example, through a managed broadening of the concept over time, as suggested by the Commission in the White Paper. Much will depend on the successful introduction of the mini One Stop Shop across the EU on 1 January 2015. That remains a top priority of the UK Government, for many UK businesses and our EU partners.

As you know, the UK’s written response to the Green Paper consultation also supported the effective basis for the current EU VAT system, based on taxation at the place of destination. It confirmed that the UK is in favour of an examination of the current VAT system, to see how it could be made to work better. This approach is one with which many UK and EU businesses and our EU partners agree. This too is reflected in the White Paper. The Commission quite rightly suggests the need for in-depth technical work and a broad based dialogue to examine the detail, and the UK will be an active participant in this.

The Commission also proposes an EU VAT Forum as an EU channel of communication for the exchange of views, including the identification of problems and irritants and promulgation of best practice, on practical issues. Potentially, this could also be an effective route to help inform policy development in the future. UK officials are already involved in preparatory work aimed at bringing that idea to fruition.

One of the areas that the UK will want to focus on as part of the work on these initiatives is the suggestion in the White Paper that doing business with non-EU partners is becoming ever easier and more profitable than doing business with EU firms. HMT and HMRC have been exploring this as part of their ongoing dialogue with UK businesses.

UK businesses suggest this is mostly about practical issues which arise in connection with the current EU rules on movements of goods within the Community, including for example stock in trade. The EU VAT Forum may therefore be the best way to take the issue forward. If, however, it transpires that there are any systemic issues to be addressed, these could and should be factored into the work aiming to examine and improve the current destination based system.

Another top priority for us and others is to protect and secure revenues. In that context, the Government is pleased to see a range of measures aimed at strengthening Member States’ ability to fight VAT fraud. This includes cost effective non-legislative ways to reduce fraud, such as continuing to improve the system of administrative cooperation between tax authorities and exchange of information and best practice. It also includes more radical ideas, such as continued work to look at the way VAT is collected and monitored and the so called ‘Quick Reaction Mechanism’, to enable speedy, temporary adoption of certain (fraud combating) derogations from EU law, pending
agreement following the more normal legislative route. These ideas are attractive in principle. We will need to thoroughly analyse any resulting proposals in detail if and when they emerge, including evaluating their effectiveness and the impact on businesses.

Of course, any proposals arising from areas identified in the White Paper would be subject to scrutiny in the normal way and would be subject to negotiation with our EU partners, requiring the unanimous agreement of all 27 Member States before any changes could be made.

As regards next steps, the Danish Presidency is now in the process of drafting Council Conclusions, with a view to reaching agreement on those at a future ECOFIN, most likely on 15 May 2012.

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

15 March 2012

Letter from the Chairman to David Gauke MP

Thank you for your letter, dated 15 March 2012, on EM 18288/11: the Commission Communication on the future of VAT. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 24 April 2012.

You state that the UK already takes advantage of a comprehensive range of simplification measures and procedures within the framework of current EU law, including a high registration threshold, to take businesses and organisations out of the VAT net altogether. We would be grateful for further explanation of the impact of such a high threshold on UK businesses and organisations. What is the opinion of other Member States on the application of such a high threshold? We would be grateful for a prompt response to these queries. In the meantime, the Committee has decided to clear the document from scrutiny in anticipation of future legislation on this matter.

25 April 2012

VAT: MINI ONE STOP SHOP (MOSS)

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

The Commission published a Council Implementing Regulation for the VAT Mini One Stop Shop (MOSS) on 13 January 2012. That is the subject of the attached EM. I thought it might be helpful to set out some of the background to this.

The so called ‘VAT Package’ (EMs 5051/04, 11439/05 and 14248/04) was agreed in December 2007 and adopted by ECOFIN in February 2008. It is being introduced in the EU in stages, the key ones being those on 1 January 2010 and 1 January 2015.

The 1 January 2010 changes included the introduction of the electronic cross-border VAT refund procedure to make it easier and quicker for businesses to recover VAT incurred in EU Member States where they are not VAT registered. This needed EU and national IT changes to support it. However, there were IT delivery problems in some Member States (not the UK) with a corresponding knock-on effect for some businesses.

As a consequence the Commission bought forward a proposal to extend the deadline for VAT refund claims and to grant the Commission additional powers to further harmonise certain aspects of national VAT refund portals (EM 12391/10). Although Member States agreed to the deadline extension, they did not agree to grant the Commission any additional powers. The Commission instead set up a Working Group under the Fiscalis programme to undertake a proper analysis of any remaining problems and potential solutions. That group is expected to report back to the Council in the spring of this year and I will update you on that in due course.

The MOSS is one of two key elements of changes which are to be introduced across the EU from 1 January 2015. Changes are to be made to the VAT place of supply rules on EU cross-border supplies to consumers in the telecoms, broadcasting and e-services sectors. The MOSS will be made available as an optional system to suppliers affected by those changes, to help minimise business compliance burdens under the new rules. It is a simplified EU VAT registration and declaration IT system, operated through a web-portal in the Member State where the supplier is located.

In order to avoid a repetition of the sort of problems we saw with the electronic cross-border VAT refund procedure, the UK has been at the forefront of calls to ensure priority is given to work to
successfully introduce the MOSS. This was reflected in the UK response to the Commission consultation on the Green Paper on the future of VAT in the EU (EM 17491/10). The UK response also pointed out that success means ensuring a common understanding and agreed set of mandatory technical and functional (process) specifications. That would ensure the right supporting information technology is in place and is there on time and could lay the foundation for further potential changes in the future.

This is now reflected in the Commission Communication (White Paper) on the future of VAT which was published on 6 December 2011 (EM 18288/11). That contains a list of future priority actions, which includes ensuring the smooth introduction of MOSS across the EU, and the possibility of broadening the concept over time.

As regards broadening the concept, the original proposed Directive to introduce a range of simplification measures (EM 14248/04) included a much broader VAT One Stop Shop concept, as well as proposals to give Member States more flexibility in setting national thresholds and to agree categories of expenses on which expenditure by business is not eligible for a full deduction of VAT. There was also a proposed Regulation to support those measures. These aspects were not taken forward as part of the VAT Package and they remain on the Council table, although no Presidency has taken them up since agreement to the VAT Package in 2008.

The Implementing Regulation which is the subject of the attached EM, is intended to provide the detail to underpin the MOSS and ensure a common interpretation and application of the IT system across the EU. Agreement in good time is important to enable Member States to go on to finalise the functional and technical specifications of the central IT system and their national web-portals.

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

30 January 2011

WORLD TRADE FEDERATION: ACCESSION OF RUSSIA AND SAMOA (16748/11, 16758/11, 16770/11, 16771/11, 16800/11, 16803/11, 16809/11, 16812/11, 16821/11, 16824/11, 16785/11)

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

I am writing to give you advance warning that the Government will need to override Parliamentary Scrutiny on the above proposed Council Decisions. The first and second refer to Council Decisions on the position regarding the accessions of Russia and Samoa to the WTO and the third and fourth refer to Council Decisions on the signing, provisional application and conclusion of a side-agreement on the preservation of commitments in trade in services contained in the current EU-Russia Partnership and Cooperation Agreement.

The UK has strongly supported both accessions for several years, the Prime Minister made his support for the Russian accession very clear on his visit to Moscow in September. It is particularly important that the accessions are agreed in time for the WTO Ministerial Conference on 15 December. This is a difficult time for the WTO with the failure to reach agreement on the Doha round. Adding new members, particularly one the size of Russia, will be a good sign that the WTO remains at the centre of global trade. For these reasons we feel a scrutiny override is necessary to allow us to support the proposals at the Trade FAC on 14 December.

I am also giving you advance warning that we will over-ride Parliamentary Scrutiny on the fifth proposed decision listed above, establishing the position to be taken by the EU at the WTO Ministerial on agreeing a waiver to allow for the granting of preferential access in trade in services for service suppliers from Least Developed Countries.

We only received the Commission’s proposal last Tuesday (6 December) and did not have the time necessary to submit an Explanatory Memorandum for the Committee’s consideration. Rather than submit the EM to you one day and then send you this letter the next, I have enclosed a copy of the relevant EM with this letter as covering explanation.

The proposal will allow the EU to join the consensus which has emerged very recently that the forthcoming WTO Ministerial should agree a waiver from the Most-Favoured Nation provision in the General Agreement on Trade in Services for Least Developed Countries (LDCs). This means that Members will be able to grant preferential access to their markets in services to those WTO
Members which are also LDCs without at the same time being required to grant that same access to all other WTO Members.

This measure is very much in line with our trade and development policy but the speed of developments from the end of November onwards took us and many other WTO Members by surprise. Although negotiations had been under way for some years on the possibility of agreeing a waiver, those negotiations had stalled until late-November when the Norwegian Chair of the group of WTO Members looking into this issue proposed a Decision for the forthcoming Ministerial. Consensus was reached rapidly and unexpectedly easily at official (Ambassadorial) level on a text at the meeting of the Special Session of the Council for Trade in Services on the 28th November. Subsequently, the Commission has made a proposal for a Council Decision to allow the EU to join this consensus. This proposal (dated 5th December) will need to be agreed before the WTO Ministerial in order to allow the EU to take a position. This means we will need to agree the proposal at the forthcoming meeting of the FAC on 14 December.

It is the speed of developments in Geneva and the late presentation of the proposal by the Commission which has necessitated this over-ride.

I hope that you will accept my explanations.

13 December 2011

Letter from the Chairman to Edward Davey MP

Thank you for your EMs 16748/11, 16758/11, 16771/11, 16770/11, 16800/11, 16803/11, 16809/11, 16812/11, 16821/11, 16824/11, dated 6 December 2011, on a proposal for a Decision on the accession of the Russian Federation to the World Trade Organisation and related matters, and EM 16785, also dated 6 December 2011, on a proposal for a Decision on the accession of Samoa to the World Trade Organisation. The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade discussed these documents at its meeting on 13 December 2011.

We support the accession of both the Russian Federation and Samoa to the World Trade Organisation.

With regard to the opt in, the Committee have taken the consistent view that the UK is an automatic participant in a proposal, and that the opt-in under Protocol 21 does not arise, unless that proposal expressly cites a legal basis found in Title V of Part Three TFEU. However we appreciate that in this instance the point at issue has very limited practical consequence as you intend to opt in to the proposals.

We note that if, as you assert, the opt-in did apply then the proposal should not be adopted until three months after its initial presentation to the Council; and Parliament should, in the absence of special reasons making an early opt-in essential, have a period of eight weeks in order to consider the opt-in. We appreciate that the timetable for these measures does not presently allow for this delay and that the EU institutions and other Member States are unlikely to afford it since they do not accept that the UK opt-in applies. Given the benefits arising from these measures and our own view that, in the absence of an express Title V legal basis, the UK is automatically participating in the adoption of these measures without the necessity to opt in, we do not intend to withhold clearance for this reason.

In the meantime we have agreed to clear these documents from scrutiny.

14 December 2011

Letter from Edward Davey MP to the Chairman

I am writing to thank you for your letter of 14 December confirming the Committee’s clearance of the proposals relating to the accessions of the Russian Federation and Samoa to the World Trade Organisation and to acknowledge your support for the accessions. You will have seen my letter of 13 December giving you advance warning of our decision to override scrutiny on the proposals which was sent before we received your clearance.

The UK voted in favour of all the proposals at the Trade Foreign Affairs Council, in Geneva, on 14 December and subsequently the EU joined the consensus at the eighth WTO Ministerial Conference on 15 December where both accessions were adopted. I can also confirm that the UK has exercised
its opt-in under Title V in relation to the Decisions concerning the accession of Russia and Samoa to the WTO.

The UK along with other WTO members welcomed both accessions; Russia's full participation in the WTO will help boost the multilateral trading system and confirm the WTO's status as a truly global organisation; and for Samoa, a fellow member of the Commonwealth family, this participation in the global trade economy is a significant step in their development.

At the trade FAC we also felt it necessary to override scrutiny on the proposal Council Decision establishing the position to be taken as regards a request for granting a waiver in order to give preferential treatment to services and service suppliers of Least Developed Countries. As I said in my previous letter this was due to speed of developments in Geneva and the late presentation of the proposal by the Commission.

20 December 2011

UK CONVERGENCE PROGRAMME 2011-12

Letter from Lord Sasoon, Commercial Secretary to the Treasury, to the Chairman

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

Article 121 of the ‘Lisbon’ Treaty requires the UK to submit an annual Convergence Programme to the European Commission, reporting on its fiscal situation and policies. The EU’s deadline for receipt of the Convergence Programme is 30 April 2012. This was set in accordance with the new European Semester combined timetable for both Convergence and National Reform Programmes. The Government supports the European Semester as an important development in the EU’s overall surveillance framework.

Section 5 of the European Communities (Amendment) Act 1993 requires that the content of the Convergence Programme is largely drawn from an assessment of the UK’s economic and budgetary position, which has been presented to Parliament by the Government for its approval. This assessment is comprised of the Budget report and the Office for Budget Responsibility’s Economic and fiscal outlook and it is, therefore, that content, and not the Convergence Programme itself, which requires the approval of the House for the purposes of the Act. This is the reason for the debate that will be held on 25 April, moved by Lord de Mauley.

The UK’s Convergence Programme will be submitted to the European Commission by 30 April. Copies of the Convergence Programme will be available before the debate and will be deposited in the Library of the House. The document will also be available electronically via HM Treasury’s website.

A Written Ministerial Statement will be laid in the House setting out the position but I wanted to make sure that you were aware of this rather complicated situation.

26 March 2012

UN FIREARMS PROTOCOL: PROPOSED REGULATION (10963/10)

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

Thank you for your letter of 1 November in which you asked about our analysis of the final outcome of the negotiations on this Regulation. I must apologise for the delay in providing this response.

I would, initially, like to take this opportunity to update you on the latest state of play with regard to the signing-off of this Regulation. As you are aware, this item has been planned to be on the agenda of several different Council meetings (the most recent being the Competitiveness Council in November) since this Regulation was agreed in the Council Working Group at the end of the Hungarian Presidency. This has not happened and we are not aware of any plans to include it on the agenda of any near to hand Council meetings. Our understanding is that the Regulation will be with
the jurist linguists for a little while yet as the first consideration of their amendments only took place as recently as the 16 February and this work is still ongoing.

The delays I have outlined above are in stark contrast to the indecent haste with which the Presidency and the Commission concluded the discussions in the Council Working Group. Despite this last minute rush, I do believe that the outcome of the negotiations can be deemed as satisfactory from the overall HMG perspective. I outline some of the key points below. However, I would like to stress, that most importantly there will only be a very limited impact on UK export licensing arrangements for firearms. Furthermore, as outlined in the IA checklist previously provided to you, there are no new costs for SMEs or to those individuals who participate in sporting activities using firearms.

The final Regulation under “Subject, Definitions and Scope” contains the licensing options available to an exporter. This now includes simplified licensing options along the lines of the UK model that were inserted at UK insistence. These supplement and clarify the Commission licensing arrangements in their draft Regulation that were quite restrictive and difficult to understand. This will help to reduce the burdens on exporters in circumstances where use of these licences is appropriate.

The most significant “win” for the UK was our insistence to include a consultation mechanism in the text at Article 4. The Commission Proposed Regulation would have allowed an exporter of firearms to seek an authorisation from any Member State without the exporting Member State having any say in the matter. There is now a need for consultation between relevant Member States with the ultimate right of veto in place for the exporting Member State.

You will be familiar with our concerns with the tacit consent arrangements in Article 7 from our previous correspondence for use in cases when firearms transit third countries. Despite a good deal of opposition to these arrangements, which many Member States saw as unworkable, the Commission arguments held sway and they remain in the final Regulation. Most importantly, however, these arrangements are optional (acceptable to the UK and the representatives of the UK Gun Trade Association) and we will work on the basis of written approvals.

The Council Working Group spent a large amount of time on discussing the simplified arrangements outlined in Article 9. UK officials influenced the text considerably and we feel it is now in reasonable shape compared to the very poor initial Commission text. This is still not perfect. The amounts of ammunition for hunters and sport shooters are wide of the mark (too many for hunters, and too low for sport shooters) but the UK voice was not heard on this issue. Furthermore, in spite of our best efforts, we were unable to get demonstration included on the list of activities that can benefit from simplified procedures.

Finally, on Article 11 (grounds for refusing to grant an export licence authorisation), the UK had to keep a close eye on the discussions to ensure that attempts to broaden the offences that would debar individuals from exporting were kept within acceptable limits. The final text has turned out to be acceptable.

I hope this brief explanation of some of the more important elements of the final discussions of the Regulation is helpful. As ever, with any piece of European legislation, it is difficult to “win” all the arguments in the endgame. I do believe, however, that on the most important issues that HMG can be satisfied with the outcome.

28 February 2012

UNION CUSTOMS CODE (6784/12)

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

Thank you for your Explanatory Memorandum 6784/12, dated 7 March 2012, on the Commission proposal for a Regulation laying down the Union Customs Code (Recast). The House of Lords European Union Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 24 April 2012.

Like you, we support efforts to modernise and simplify customs rules procedures, and agree that the 24 June 2013 date of application is no longer achievable. We support the Government’s efforts to ensure clarity and agreement on what needs to delivered in order to allow for full implementation of the UCC.
We note your concerns that elements of the proposal could be potentially counterproductive by removing some existing simplifications and adding costs. We also note your concerns that the proposals are not flexible enough to cater for national situations or allow for appropriate variations in customs controls. Which particular elements of the proposal did you have in mind? What specific improvements will you be seeking in order to address these concerns?

We also note the Government’s view that the proposal does not achieve the right balance between delegated and implementing acts and that these have been wrongly weighted in favour of the Commission. Whilst we sympathise with these concerns, we would be grateful for further information on which specific proposals for delegated acts the Government feel are inappropriate.

We note that the Government are engaged in consultation with UK businesses. What assessment have you made of their view concerning the Commission proposals? You also state that the Government are working closely with like-minded Member States. We would be grateful for further details of the views of other Member States in relation to this proposal, and in particular which Member States share the Government’s concerns.

We would be grateful for a prompt response to these questions. In the meantime we have agreed to continue to hold the proposal under scrutiny.

25 April 2012

WORLD TRADE ORGANISATION: MARRAKESH AGREEMENT WAIVERS (16993/11)

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

I am writing to apologise for the lateness of the enclosed Explanatory Memorandum regarding the Marrakesh Agreement Waivers. We received notification of the proposal too late in the day to submit for clearance before Coreper on 29 November hence we decided to place a scrutiny reservation on the item and abstained from the vote, the proposal was subsequently adopted as an A point at the Foreign Affairs Council on 5-6 December.

As you are aware my officials have been extremely busy preparing for the various accessions at this week’s WTO Ministerial Conference which has further delayed the submission of this EM. We will make every effort in future to submit at the earliest possible opportunity.

17 December 2011