HOUSE OF LORDS
European Union Committee

House of Lords
London
SW1A 0PW
www.parliament.uk/hleua

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 December 2009 to April 2010.

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

CONTENTS

ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE (9494/09)

Letter from Lord Myners, Financial Services Secretary, HM Treasury, to Baroness Cohen, Chairman of Sub-Committee A

I would like to thank you and your Committee for the recent opportunity to discuss the AIFM directive. I am writing now to answer the questions we did not have time to get to in the evidence session.

Your first covers data collection by supervisors, how to limit it data which are systemically relevant and the role of the ESRB.

Deciding exactly what information fund managers should provide to their regulator is one of the questions the FSA is grappling with in developing its hedge fund survey. So far, the survey has focused on the larger funds that have a greater potential impact on the effective functioning of markets. The FSA is seeking to refine its approach as it develops the survey. The Commission's proposal as drafted would mean that all UK fund managers would be forced to provide the prescribed information to the FSA – irrespective of whether the FSA believes that the information is important for the monitoring of systemic risk.

The Government wants to ensure that the FSA can target its market monitoring as effectively as possible. There are clearly a large number of funds with little or no systemic relevance. We consider that a fund manager should only be required to make available the prescribed information to its supervisor. This would allow the FSA to request all the information it needed to monitor markets but not force it to waste resource collecting irrelevant data. This approach would be achieved by the latest compromise text prepared by the Swedish Presidency. All AIFM would provide basic summary data to their supervisor. These basic data would allow supervisors to make an informed assessment on which managers they needed to subject to more intensive oversight. The directive would provide for them to collect detailed data from these managers.

Supervisors should use the information that they collect to monitor the impact of a fund's activities on systemically important markets and to decide whether and how to intervene to avoid systemic risk.

The ESRB is being set up to better identify risks in the financial system. There are provisions in the legislation that enable the ESRB to collect the information it requires to fulfil its tasks – from the new European Supervisory Authorities, national competent authorities and, in exceptional cases, individual institutions. It is only right that the ESRB has the information it requires in order to build up a wholesale picture of the EU financial system, to enable it to identify any emerging risks.

This information is subject to a number of confidentiality conditions. In addition, ESRB requests for further information than that which is readily available in collective form must be reasonable and proportionate.

Your second question is how can a fair balance be struck in the Directive between guiding principles (level 1) and implementing measures (level 2)? Deciding what elements of the legislation are incorporated in Level 1 or Level 2 is not always straightforward. Level 1 should establish the core values and framework for the legislation. Level 2 is the vehicle for implementing measures fleshing out the principles in the Level 1 legislation.

This directive includes a large number of level 2 provisions – no fewer than 23 to be precise. We believe on balance that too many level 2 provisions have been included.

In particular, we believe that there should not be a Level 2 provision giving the Commission power to propose quantitative liquidity thresholds which would require different types of funds to hold pre-determined shares of their total assets in cash or liquid securities.

Given the broad range of fund types covered by this directive, we do not think it will be possible to set appropriate thresholds covering all cases. The focus should instead be on requiring managers to have appropriate policies for managing liquidity risk and ensuring the liquidity of their funds' assets is consistent with those funds' redemption policies.

Another example of a level 2 provision that we disagree with is the Commission's power to set ex-ante leverage caps on funds.

Your final question was in relation to the fact that the latest Swedish draft would impose a bonus cap on fund managers and you wanted my comments on this proposal.

I must first say that the Swedish proposal does not to impose a cap on bonuses. However, it does address limiting the amount of bonus that can be taken immediately and what should be deferred for at least 3 years (40% or 60% where the bonus is a particular high amount relative to the fixed income). It also covers the need for greater public transparency of higher earners.

As the G20 leaders agreed in Pittsburgh, it is necessary to impose appropriate controls on remuneration at all significant financial institutions. In this context, the Government has already taken steps to ensure that remuneration paid at systemically significant financial institutions is commensurate with a prudent approach to risk and leads to long-term value creation.

The FSA code, which comes into force on 1 Jan 2010, includes requirements for deferral and clawback from significant banking and other institutions. In addition, the Government is taking legislative measures in the Financial Services Bill that will strengthen the FSA's hand and enable improved disclosure of remuneration, which in turn will facilitate better shareholder oversight of risk.

However, the rules in the AIFM Directive should recognise that the majority of fund managers are not systemically important. We also consider that it is inappropriate to simply copy across the policy on this in the Capital Requirements Directive that was agreed for banks (the genesis of the requirements proposed by the Presidency). So we believe that some further tailoring to the Swedish proposal is necessary. We have been successful in achieving some of these changes in subsequent drafts of the Presidency compromise. For example, it now no longer requires disclosure of the individualised amount of remuneration but rather aggregate data. However, we continue to argue for change so that the timetables for deferral of bonuses should reflect that investment funds have different time horizons.

I hope that my answers have been helpful to your deliberations.

8 December 2009

Letter from the Chairman to Lord Myners

Thank you for the evidence you have provided to us on the Commission proposal for an Alternative Investment Fund Managers Directive (AIFMD). EU Sub-Committee A has taken evidence on the Directive from a variety of sources and we set out our emerging conclusions on the document in this letter. In light of the considerable reservations we have with the document as originally proposed we have decided to hold the document under scrutiny. We set out our reservations below.

The G20 concluded that all financial markets, products and participants should be regulated or subject to oversight, as appropriate to their circumstances, and we welcome broadly the Commission's attempt in this Directive to execute this recommendation. We have, however, serious concerns over some aspects of the proposal as originally drafted, specifically:

- The provisions related to marketing of non-EU funds and possible restrictions on non-EU managers marketing in the EU;
- The lack of differentiation between different sorts of alternative investment – the one-size-fits-all approach;
- Some elements of the proposals for supervision of Alternative Investment Fund Managers (AIFM); and,
- The unnecessary level of protection the proposal provides to well-informed institutional investors and banks.

We are concerned that a European Union Directive to regulate Alternative Investment Fund Managers should be in line with, and complement, global arrangements. Coordination with the US regulatory regime in particular is essential to avoid a situation in which the EU Alternative Investment Fund (AIF) industry loses competitiveness at a global level as a result of regulatory arbitrage. The Directive will seriously damage the EU and UK economy unless it is fully compatible with the global approach to the regulation of AIFM and it permits the marketing of non-EU funds in the EU. Restrictions on non-EU managers operating in the EU should also be removed.

We have also considered the compromise proposals of the Swedish Presidency and we agree that its suggested amendments are moving towards making this Directive more compatible with the emerging proposals in the US and the rest of the G20, and less likely to disadvantage investors in the EU.

RISKS AND SUPERVISION

One of the stated aims of the Directive is to improve the supervision of "the risks that AIFM provide to their investors… and to financial stability". There is no evidence that AIFs caused the financial crisis, but activities linked to some AIFs can increase market instability. These activities include herding behaviour by managers (also known as the crowded trade), where funds concentrate risk by taking similar positions to other funds, and rapid deleveraging in a falling market. It is also true that the sheer size of some hedge funds means that any failure could pose a risk to financial stability. We therefore support the broad aims of the Directive inasmuch as it requires registration of managers, an increase in transparency of alternative investment funds and an increase in disclosure of important information to regulators. We also recognise concerns that the levels of remuneration of hedge fund managers can affect the behaviour of other participants in the finance industry.

In order to achieve the Directive's aims supervisors have to be able to use the information they receive from managers effectively and act, where necessary, to tackle risk. This will involve taking an overall view of the market and the investments of AIFM, in order to identify herding and therefore to take action to reduce the risks that individual fund managers take.

There are, however, serious problems with the detail of the Directive as originally drafted and the tools that the Directive provides for supervisors to tackle risk. The transparency and disclosure requirements of the Directive need to be amended to take into consideration the different types of alternative investment funds. Information requirements have to be proportionate and carefully thought out to ensure that the Directive does not lead to supervisors being swamped with large amounts of irrelevant data. It may be more appropriate to agree that disclosure requirements be set at Level 2, which allows more flexibility than Level 1.

The same problems arise in respect to disclosure requirements as have already been encountered in connection with the regulation and supervision of EU banks, namely whether national supervisors or a pan-European body should collect the data and which body should have the power to act on conclusions drawn from the data. We continue to support the position taken by the Government during negotiations on bank supervision, which was upheld by the Government in the European Council meeting last week; national supervisors should take on the role of data analysis and intervention. Not only will supervision be more effective at a national level but since failed financial institutions or funds can only be supported by national governments with tax raising powers, their supervision can only properly be carried out a national level, in the case of the United Kingdom by the Financial Services Authority (FSA). We commend the research work of the FSA on hedge funds and note that we have found it particularly useful in our inquiry.

The Swedish compromise note stresses the importance of the coordination of supervisory functions and monitoring in the EU including the European Systemic Risk Board (ESRB) and by the Financial Stability Board (FSB) at an international level. Systems should be put in place to require national supervisors to provide relevant data to the ESRB and FSB to ensure that these bodies can identify systemic risks at an EU and global level respectively.

We have heard evidence on the tools that this Directive proposes to reduce risk - including leverage caps and capital requirements. Leverage ratios are not an absolute measure of risk and as such an overall leverage limit or cap, as proposed by the Directive as drafted, will not automatically cap risk and may indeed create systemic risk, by requiring several funds to liquidate positions in a particular company at the same time. We agree however with the FSA that national supervisors should have the power to impose leverage caps where appropriate, based on the aggregated information they receive from fund managers and we therefore welcome the Swedish presidency's proposed compromise on this issue, which would remove the single leverage cap from the Directive and therefore from all AIFM.

Requiring the depositary of a fund to be an EU credit institution will not reduce risk. The evidence suggests that only a few EU credit institutions will be willing to take on the role of depository; this will concentrate deposits in a few institutions and so concentrate and increase risk. It would also increase the cost to the investor. The draft therefore should be amended to allow the use of non-EU depositaries by AIFM.

The Directive in general seeks to provide a level of protection for investor which is not required by the well-informed institutional investors in alternative investment funds. It is a professional market, in which the investor population is small, and who understand the risks they run in any investment. Indeed, institutional investors made it clear to us that they valued the flexible strategies and investment policies on offer from the AIFM as a vital contribution to their own investment policies. Measures designed to protect retail investors should not reduce the value of Alternative Investment Funds to these customers. The Directive also does not acknowledge the role prime brokers play in monitoring the activities of the hedge funds to which they lend.

EU AND THIRD COUNTRY PASSPORTS

The second main aim of the Directive as originally drafted was to facilitate a single market in Alternative Investment Funds in the EU. We have heard evidence that the introduction of a passport for EU funds is attractive to managers in principle. The passport system would help to develop a single market in investment funds within the EU by creating a brand complementary to the UCITS (Undertakings for Collective Investments in Transferable Securities) funds. Many of our witnesses were concerned that the provisions as originally drafted would only serve to limit or prevent investment in the EU by non-EU managers and investment outside of the EU by EU managers. These provisions were described by many witnesses as protectionist and we were told that it may prevent a substantial proportion of funds currently operating within the EU from continuing to do so. We heard evidence from the Wellcome Trust that these provisions would adversely affect their returns and therefore impact adversely the many charitable beneficiaries. Pension funds would also suffer a reduction in investment returns as a result of these provisions as currently drafted.

EU managers should be able to continue to invest in non-EU funds and fund managers located outside the EU should be able to invest in Europe. We are concerned that it will be difficult, if not impossible, for third-country regimes to achieve the equivalency required for AIFM to obtain access to the EU passport. We therefore support the continuation of national private placement regimes to maintain options for investors while workable rules to achieve equivalence are devised in Level 2. We have heard evidence that an EU passport for funds and managers based in third-countries is an attractive prospect and we hope that it will become possible by achieving the required equivalence at some point in the future. We note that the Swedish Presidency compromise proposal goes some way to addressing the problems on this issue.

ONE-SIZE-FITS-ALL

The Directive as originally proposed covered all non-UCITS investment funds. The Directive, however, does not adequately differentiate between the different types of AIFs covered, leading to serious difficulties regarding its application in practice and introducing unintended consequences. We welcome the efforts of the Swedish presidency to address this issue.

We recommend that careful consideration is given to tailoring the Directive in a way that respects the differences in the types of funds it covers. We accept that it may be more appropriate to provide principles in the Directive and set detailed requirements for specific types of funds at Level 2.

We intend to publish a full report on the AIFMD in February next year. As we have described above, the achievement of changes to the original document is crucial to the single market and the EU economy. We will continue to hold the document under scrutiny because of our serious concerns over these matters until the publication of our report.

10 December 2009

Letter from Lord Myners to the Chairman

Thank you for you letter of 10 December. I note that you will be keeping this directive under scrutiny. I thought it would be helpful to update the Committee on where negotiations have got to under the Swedish Presidency.

Although containing a number of deficiencies, which we have been working to address, the Directive has the potential to open up the EU market, providing new opportunities for EU managers, and to extend EU cooperation on systemic issues, which the Government supports.

Several meetings have been held by the Swedish Presidency to try and find a compromise that would allow the Council to agree a general approach. However, as some Member States have been unwilling to compromise at this stage, Sweden has decided that it is better to pause the negotiations to allow heads to clear over the Christmas break.

The Swedish Presidency has produced a Progress report and one further compromise text to hand over to the incoming Spanish Presidency (which I attach to the letter). We expect Spain to seek a general approach sometime between March and May.

We had been expecting this for some weeks and are not unduly concerned. In all my dealings with Spain so far they have been clear, much like Sweden, that their focus will be on agreeing legislation which is properly thought through and which works.

I outline below the main changes in the Swedish compromise:

— LEVERAGE – the original Commission proposal gave powers to the Commission and national supervisors to set *ex-ante* leverage caps. The Swedish compromise removes the Commission's power in this area, leaving it to national regulators to set caps where justified by an immediate systemic risk, which is something we support;

— PORTFOLIO COMPANY DISCLOSURE – the compromise text maintains the requirement for additional disclosure requirements on private equity portfolio companies but substantially pares back those requirements so that they require only notification to the target once a controlling interest is attained and a summary annual financial statement. It also includes a requirement for private equity firms to disclose leverage in a portfolio company to its supervisor immediately pre-buy-out, 6 months post buy-out and 12 months post buy-out;

— DELEGATION – The Commission proposal prevented delegation of portfolio management outside of the EU. The compromise text now allows delegation of portfolio management to non-EU firms provided those firms are authorised as asset managers, which we strongly support;

— VALUATION – the compromise text makes valuation the responsibility of the manager and removes the requirement for an independent valuer. We welcome the fact that this would remove the independent valuation obligation from classes of fund manager – particularly private equity – for which it is not appropriate, but are seeking clarifications to ensure that managers can continue to use independent valuers where appropriate;

— CAPITAL – the compromise text now aligns capital requirements more closely to the UCITS[1] directive, on the grounds that the original proposal would have created too much of a distortion in requirements between a UCITS manager and an AIFM manager. There is also now an option for small/medium size private equity firms to opt into the directive to benefit from the passport but to have a lower capital requirement of 50,000/60,000 euros (figure yet to be discussed in Council);

— SHORT SELLING – removal of rules in this area on the basis that the Commission should bring forward proposals to govern the market as a whole;

— LIQUIDITY – removal of the provision for the Commission to set quantitative liquidity thresholds;

— PASSPORT – as part of the overall compromise, Sweden has proposed restricting the passport to funds both managed and domiciled in the EU. Only EU domiciled and managed funds could be sold without restriction to all EU professional investors. All other funds (i.e. 3rd country funds – even with an EU manager) would be subject to national private placement rules i.e. subject to the marketing requirements in each Member State. EU

[1] Units for Collective Investments in Transferable Securities

managers with 3rd country funds would still have to comply with the directive except for the depositary requirements. Some of the larger Member States do not agree with the carve out of the depositary requirements so this will be a key area for discussion on the Spanish Presidency.

— ACCESS TO THE EU MARKET FOR THIRD COUNTRY FUND MANAGERS – under the Commission's proposal, non-EU managers would only be allowed to sell their funds in the EU where their local regulation had been deemed equivalent to that in force in the EU. Managers which met that test would benefit from the passport. Both of these provisions have been removed. Member States will retain discretion over how much to open their market to third country managers and those managers will not benefit from a passport. The Government broadly supports this as it ensures the UK can maintain its open approach, allowing professional investors access to the best global managers;

— DEPOSITARIES – the compromise text clarifies that for assets which cannot sensibly be held in independent custody (e.g. shares in unlisted companies, real property, derivatives) the depositary should be responsible only for verifying that the assets are held by the fund. There is also provision for a broader range of entities to act as depositary including MiFID investment firms and suitably authorised entities outside the EU and clarification of depositaries' liability for loss of assets and other failures;

— REMUNERATION – The majority view in Council is that these rules should draw heavily on the agreed rules in the Capital Requirements Directive. The initial compromise text had a requirement to defer 40% of the bonus over 3 years 40 % or 60% where the bonus element to fixed remuneration is particularly high. The latest compromise text removes the hard time limit for bonus deferral and now links it to a time period appropriate to the type of fund. This change and the ability to apply the requirements on a proportionate basis, offers flexibility in making sure that these requirements can be applied sensibly. Nevertheless, we will continue to argue that the quantitative limits of 40 and 60% should be removed; and

— SUPERVISION – Finally, concerning greater discretion for supervisors, there is some support for allowing supervisors discretion to collect additional information where justified on systemic grounds (although a concern from the Commission that such additional requirements should not get in the way of an effective single market). The compromise text tries to balance these positions by requiring certain basic information to be provided routinely by all managers and for other information to be provided on request by the supervisor. We believe this strikes an appropriate balance.

17 December 2009

Letter from Lord Myners to the Chairman

I am writing to update your Committee on progress on the Alternative Investment Fund Managers Directive. I welcome the Committee's report of 10 February 2010 on the Directive, and I will be shortly be sending through the Government's response to this. In the meantime, I would like to outline the key dates at the European level for the proposal and where the text is under the Spanish Presidency.

As I mentioned in my letter to you at the end of last year, the Spanish Presidency has been working on this proposal with the aim of getting a Council general approach at the 16 March ECOFIN. This would give the Presidency a negotiating mandate with the European Parliament. The European Parliament intends to vote in Committee in April. After such time, there would then be formal trilogues involving the Council, Parliament and Commission, with the aim of getting an agreement between the institutions before the August break.

Since the last Swedish compromise there have been several meetings held by the Spanish Presidency and three versions of new Spanish compromise texts – and I attach the most recent compromise dated 23 February.

Although this was a rushed proposal by the Commission and contained a number of deficiencies, as you know, we have worked hard in Council to address these deficiencies as we consider that the Directive has the potential to open up the EU market, providing new opportunities for EU managers, and extend EU cooperation on systemic issues, which the Government supports.

I outline below the main changes in the most recent Spanish Presidency compromise:

THRESHOLDS – The original Commission proposal had a threshold which only brought into scope a private equity fund (defined as a fund which is not leveraged and with no redemption rights exercisable during a period of 5 years) that had €500 million or more of assets under management. In the case of all other funds, the threshold was €100 million or more of assets under management. The last Swedish compromise at the end of last year maintained those thresholds but imposed a requirement that all funds below the threshold should nevertheless be registered within each Member State.

The Spanish Presidency compromise slightly changes the position. Instead of carving out managers with funds below the threshold who could then opt-in to the Directive, it now states that all funds are within scope, but that Member States have discretion to carve out those funds below the threshold, if they so choose. The threshold limits still remain unchanged although where Member States choose to exercise this discretion the managers are still subject to registration. There is also an additional change on reporting requirements to supervisors but I address this issue in the 'Supervision' section below.

In the UK, managers must be authorised and regulated by the FSA regardless of the quantity of assets they manage, although, in line with its risk-based approach, the FSA applies more intensive supervision and oversight to larger managers. We will continue to require all managers to be regulated. If the final text is such that it did not impose significant unnecessary burdens on smaller firms, we might not oppose its application to all managers. However, if this cannot be achieved, there would be a case for restricting its application so as to avoid discouraging smaller new entrants to the market.

LEVERAGE – the original Commission proposal gave powers to the Commission and national supervisors to set *ex-ante* leverage caps (i.e. set limits to the amount of leverage managers could employ in respect of their funds). The Swedish compromise removed the Commission's power in this area, leaving it to national regulators to set caps where justified by an immediate systemic risk, which is something we support. The Spanish Presidency compromise does not change this position. We argued successfully for removal of the Commission's power in this area, leaving it to national regulators to set caps where justified by an immediate systemic risk, which is something we will continue to support.

PORTFOLIO COMPANY DISCLOSURE **–** the Spanish Presidency compromise text follows the last Swedish compromise and maintains the requirement for additional disclosure requirements on private equity portfolio companies but substantially pares back the original Commission requirements so that they require only notification to the target once a controlling interest is attained and a summary annual financial statement. The Spanish text now also includes disclosure of the policy of internal and external communications of the target particularly as regards employees and a requirement for private equity firms to disclose leverage in a portfolio company to its supervisor and to AIF investors immediately pre-buy-out, immediately after and then whenever a material change occurs. Although the latter issue was also in the Swedish text, the timing of when this disclosure should be made has changed. We believe that disclosure of the debt should only be made to the supervisor to avoid any risk that this information may be used by competitors to disadvantage private equity ownership.

DELEGATION **–** The Commission proposal prevented delegation of portfolio management outside of the EU. The Spanish Presidency maintains the Swedish compromise text. The compromise text now allows delegation of portfolio management to non-EU firms provided those firms are authorised as asset managers, which we strongly support.

VALUATION **–** the compromise text makes valuation the responsibility of the manager and requires there to be independence of valuation where the managers receives a fee, commission or other payment which is directly or indirectly linked to the performance of the fund. In addition, the manager may make use of an external valuer, if it is subject to registration, can furnish sufficient professional guarantees and have appropriate professional indemnity. When an external valuer is used, that person would be liable to investors for any losses suffered to investors as a result of a failure to perform the valuation. We support the changes that have been made by the Spanish Presidency.

CAPITAL – the compromise text continues to align capital requirements more closely to the UCITS[2] directive, on the grounds that the original proposal would have created too much of a distortion in requirements between a UCITS manager and an AIFM manager. In addition, for private equity managers below the €500 million threshold would have a lower capital requirement of €50,000. We support the approach taken on capital requirements.

SHORT SELLING – the Spanish Presidency compromise follows the approach taken by the Swedish Presidency and maintains the removal of detailed rules in this area on the basis that the Commission should bring forward proposals to govern the market as a whole, although it maintains disclosure requirements to supervisors.

LIQUIDITY – the latest Spanish Presidency compromise follows the approach taken by the Swedish Presidency and maintains the removal of the provision for the Commission to set quantitative liquidity thresholds but national supervisors may do so in exceptional circumstances.

PASSPORT – The Swedish Presidency proposed restricting the passport only to funds both managed and established in the EU. The Spanish Presidency compromise does not change that position and still does not give a passport to funds established outside of the EU even if managed inside the EU. EU managers with third country funds would still have to comply with the Directive except for the depositary requirements. They would, however, be required to notify their home supervisor of the identity of the nominated depositary. Some Member States do not agree with the carve-out of the depositary requirements, so this remains a key area for discussion.

We strongly support offering EU managers a passport to sell their funds across the EU, including third country funds. We continue to argue for this while stressing that the carve out for depositary requirements should be maintained – not least because the EU requirements may contradict with local third country requirements.

THIRD-COUNTRY FUND MARKETING INTO AN EU MEMBER STATE – under the Swedish Presidency compromise there was no restriction on a third country fund marketing into an EU Member State. This was left to the investor protection and marketing rules in each Member State (known as "private placement"). This continues to be the case in the Spanish Presidency text (i.e. there is no passport) but there are now additional EU minimum harmonising disclosure requirements to investors and the third country supervisor. There is also the need to have appropriate cooperation arrangements between supervisors in place.

Free trade in fund management services has been a key component of the UK's success in this area and institutional investors place a high value on maintaining access to a global range of fund management providers. We feel that Member States, which, like the UK, currently permit non-EU funds to be marketed locally, should be allowed to continue to do so.

We do not support the requirements to have EU minimum disclosure requirements outside of the single market. Furthermore, we consider the requirement to disclose to the third country supervisor information required by this directive as being unnecessary and onerous.

DEPOSITARIES – the compromise text clarifies that for assets which cannot be safekept by an independent custody the depositary should be responsible only for verifying that the assets are held by the fund. Exactly what assets cannot be safekept will be determined at Level 2 – but which we consider should include, for example, shares in unlisted companies, real property and derivatives.

There is also provision for a broader range of entities to act as depositary than just a bank. It now also includes MiFID investment firms, depositaries subject to national prudential requirements and on-going supervision, as catered for under the UCITS directive, but subject to national rules in place before this Directive comes into force.

In addition, there is more flexibility for who can act as a depositary for private equity. There is clarification that the depositary is able to delegate custody of assets to other authorised entities including those outside the EU, subject to certain due diligence requirements and an objective reason for the delegation.

There is also clarification of depositaries' liability for loss of assets and other failures and also of the liability for when custody is delegated, with the possibility of a contractual discharge of liability where it is deemed "reasonable" to contract such a discharge. The 'burden of proof' in evidencing that the depositary has met its obligations under the Directive when delegating custody is reversed. The depositary is now deemed liable unless it can evidence that it has fulfilled the requirements of the Directive.

[2] Undertakings for Collective Investment in Transferable Securities

Some Member States continue to argue for a limitation on who can act as a depository, restricting the role of depositary to banks and MiFID firms. They also argue that there should be a strict liability on the depositary or at least stricter than the current proposal. Their aim is to force the depositary to be liable in all instances for any loss of assets. We consider that as this Directive covers a diverse spectrum of funds, any solution needs to cater for the many different business models. Also, limiting the number of firms that could carry on the role of depositary would potentially concentrate risk and reduce competition. Ensuring that we have the right proportioning of liabilities is difficult. Strict liability for custodians would impose significant costs on them and make it much more difficult and costly for EU funds to invest in non-EU jurisdictions which require local custody. Therefore any solution has to be both workable and only confer liability where it is deemed reasonable and fair.

OTHER INVESTMENT ACTIVITIES CARRIED ON BY AN AIFM – FSA currently regulates alternative investment fund managers as MiFID investment firms. As MiFID firms, they are entitled to carry on all the investment services activities related to MiFID, which are not limited to only managing a portfolio.

However, the AIFM directive will restrict the other investment activities that an AIFM would be able to carry on to investment management, safekeeping and administration of units in a collective investment scheme and the receipt and transmission of orders. We have been arguing that the AIFM should be able to carry on other investment activities to avoid the risk of some UK managers having to split their business; one for the AIFM business and the other for MiFID business, creating additional costs and acting as a barrier to entry.

REMUNERATION **–** The majority view in Council is that these rules should draw heavily on the agreed rules in the Capital Requirements Directive. The initial compromise text had a requirement to defer 40% of the bonus over 3 years 40 % or 60% where the bonus element to fixed remuneration is particularly high. The latest compromise text removes the hard time limit for bonus deferral and now links it to a time period appropriate to the type of fund. This change and the ability to apply the requirements on a proportionate basis, offers flexibility in making sure that these requirements can be applied sensibly. Nevertheless, we will continue to argue that the quantitative limits of 40 and 60% should be removed, as we feel that this does not necessarily help in achieving the goal of aligning manager and investor interests.

SUPERVISION – Finally, concerning greater discretion for supervisors, there is some support for allowing supervisors discretion to collect additional information where justified on systemic grounds (although a concern from the Commission that such additional requirements should not get in the way of an effective single market). The latest compromise text tries to balance these positions by requiring certain basic information to be provided routinely by all managers and for other information to be provided on request by the supervisor. There is also an additional requirement now on firms below the threshold to disclose certain information to supervisors. The latest text now allows this information to be an aggregate of the small funds managed by the manager, so as to apply a more proportionate burden on managers with smaller funds. Others continue to argue that equal information requirements should apply to all managers for all funds. We have argued against that and for what is currently in the latest Spanish Presidency compromise text as we consider that this strikes an appropriate balance.

EM 9494/09 and EM 15162/09 are currently held for scrutiny by your Committee. I make myself available to the Committee to provide further information if required but hope this letter provides the Committee sufficient information in its scrutiny process.

2 March 2010

Letter from the Chairman to Lord Myners

Thank you very much for you letter updating the Committee on progress of negotiations on the Alternative Investment Fund Managers proposal under the Spanish Presidency. EU Sub-Committee A considered this at its meeting on 9 March.

The document will remain under scrutiny until our report has been debated. However, we are content to grant a waiver under paragraph 3(b) of the scrutiny reserve resolution in order that you may agree the proposals in Council without giving rise to a scrutiny override.

We note that provisions on marketing of non-EU funds in the EU, thresholds, depositaries, and remuneration remain divisive issues. We set out our views in our report *Directive on Alternative Investment Fund Managers*.

We also note your opposition to the provisions related to the marketing in Europe of non-European funds managed in the EU and the marketing in Europe of non-European funds managed outside the

EU. You argue that the compromise text of the Spanish Presidency would require additional EU minimum harmonising disclosure requirements to investors and third country supervisors.

We observe however, that the relevant Articles (34b and 35) do not require harmonisation of disclosure but rather that "appropriate cooperation arrangements" are in place between the competent authorities of the home member state of the AIFM and the supervisory authority of the third country where the AIF is established in order "to ensure an efficient exchange of information that allows competent authorities of the AIFM to carry out their duties according to this Directive". Could you elucidate further what you believe to be problem with these provisions? We believe that the issue is rather to clarify the terms of "appropriate cooperation arrangements" since the marketing of non-EU funds is conditional to their establishment. Will these provisions constitute an obstacle to managers wishing to market non EU funds in the EU? Are these provisions compatible with the equivalent legislation in the US?

We note that the ECON Committee in the European Parliament held its first formal considerations of the EP amendments. We would like to receive your view on what consensus is emerging from the European Parliament on the most contentious aspects of the proposals, especially regarding the marketing of non-EU funds and provisions on depositaries.

Finally, we would like to be informed of the outcome of the 16 March ECOFIN Council. We also look forward to receiving your response to the report.

10 March 2010

Letter from Lord Myners to the Chairman

Thank you for your letter of 10 March about the Alternative Investment Fund Managers (AIFM) Directive. I note that you will be keeping this Directive under scrutiny and I am very grateful that you have granted a waiver in order that the Government may take a Council position on this Directive without needing to override Parliamentary scrutiny.

As you will be aware the Spanish Presidency had aimed to reach a general approach on this Directive at the March ECOFIN, but deferred agreement to a later Council meeting at the UK's request. The item was therefore withdrawn from the agenda by the Presidency, and was not substantively discussed. It is now a matter for the Presidency to decide how it takes this forward but the Government expects that they will look to secure a general approach to this Directive at either the May or June ECOFIN.

I note your observation that Articles 34b and 35 do not require harmonisation of disclosure requirements. As you know the Spanish compromise has gone through several iterations so for avoidance of doubt, I copy to you the latest version that was dated 11 March 2010.

Article 34b requires that the EU manager of a third country fund which is marketed into the EU must comply with the full requirements of the Directive except for the detailed requirements in Article 17, which addresses depositary requirements. Therefore the EU manager would have to comply with the disclosure requirements as set out in this Directive. In addition, before the fund can be marketed into the EU, there has to be an appropriate cooperation agreement in line with international standards in place between the competent authority of the home Member State and the supervisory authority of the third country where the Alternative Investment Fund (AIF) is established to ensure an efficient exchange of information that allows competent authorities of the AIFM to carrying out their duties according to this Directive. Compliance with this article, and the rest of the Directive, would not, under the current Presidency text, entitle the manager to an EU passport.

In the case of Article 35, the compromise text requires third country managers of third country funds to comply with Articles 19 (annual reports), 20 (Disclosure to investors), 21 (Reporting obligations to competent authorities) and Section 2 of Chapter V (Obligations for AIFM managing AIF which acquire control of non-listed companies and issuers). Therefore the third country manager would have to comply with the disclosure requirements to investors and supervisors as set out in this Directive. There are also similar requirements in Article 34b to have appropriate cooperation agreements between the relevant competent authorities and again, this is still without the benefit of an EU passport.

The Government agrees with the Committee's view that one of the key issues is to clarify the appropriate cooperation agreements. It is because of this that we have argued for alignment to international standards and also have argued for the inclusion of recitals 19aa and 19ab, which clarify that cooperation agreements should not be used as a protectionist barrier and also that international standards should be route in such standards produced by IOSCO (International Organisation of Securities Commission).

However, the Government does have the additional concern that in both cases, the single market benefit of this Directive (ie the EU passport) is not offered to these managers, whilst they are required to meet some or most of the Directive's regulatory standards. We will use the time now available to address this imbalance, and we will continue to argue that managers of third country funds should be entitled to an EU passport.

The Government understands that Jean-Paul Gauzes, the Rapporteur European Parliament, has made over 1500 amendments to the Commission's proposal and that the Committee on Economic and Monetary Affairs (ECON) has delayed its vote on these to 27 April and the Committee on Legal Affairs (JURI) will vote on 19 April. As such their position, even on the key issues, is still unclear at this stage so it is difficult for me to give you a clear view of the European Parliament's position.

I will write again shortly in response to the Committee's very helpful report.

28 March 2010

Letter from the Chairman to Lord Myners

Thank you for your letter of 28 March on the Alternative Investment Fund Managers Directive (document 9494/09). EU Sub-Committee A considered this at the meeting of 1 April. We would like to receive updates on the negotiations on the definition of "cooperation arrangements" as they affect the ability of non-EU funds and managers to market their funds in the EU.

We note your opposition to the current draft of the proposals that would not allow a third country manager to receive the benefits of an EU passport if they pass the requirements to market in the EU specified in the Directive. The EU passport would have strong benefits for the single market in Alternative Investment Funds and we agree, as our report made clear, that third country managers should be able to receive one.

We also look forward to receiving your response to our recent report, Directive on Alternative Investment Fund Managers.

8 April 2010

BANKING SECTOR: CROSS-BORDER CRISIS MANAGEMENT (15049/09)

Letter from the Chairman to Lord Myners, Financial Services Secretary, HM Treasury

Thank you very much for your Explanatory Memorandum 15049/09 on cross-border crisis management in the banking sector. The Committee considered the document at the meeting on 9 December and agreed to hold the document under scrutiny.

We welcome the intent of this Communication as we concur that existing arrangements are clearly insufficient to stabilise and control the systemic impact of cross-border financial institutions.

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

We understand that specific proposals for legislation will follow this Communication and therefore we will retain the document under scrutiny with the view to potentially following up the issue with an inquiry in the near future. We are particularly concerned with your intention to review the home-host model. We reiterate our conclusion that "the call for increased powers for the host supervisor must not lead to a retreat from the single market and the emergence of protectionism."

Finally we note that ECOFIN has reached a general approach on the creation of three ESAs that would be responsible for "ensuring a coordinated response in crisis situations." We observe that the Council Conclusions will direct the way banking crises will be dealt with at EU level.

10 December 2009

Letter from Lord Myners to the Chairman

Thank you for your letter of 10 December 2009 on cross border crisis management in the banking sector, and for the continuing interest of the Select Committee on the European Union in financial regulation and supervision.

I note that you will keep the issue of cross border crisis management under review, and that you may follow up with an inquiry in the near future.

I believe it will be important that Member States adopt common resolution tools so that authorities can intervene quickly to avert or manage the failure of a bank and can coordinate their actions across the Community as may be necessary. As you will know, the UK has led the way in introducing more effective measures for managing a bank failure.

You express concern about a review of the Home-Host model, and stress that more powers for a host supervisor should not undermine the Single Market or enable protectionist action. The Communication on Crisis Management proposes a review of the supervision of cross border branches in light of shortcomings that have been exposed in the cooperation arrangements between home and host authorities in the cross border supervision of bank branches. The principal concern is that the existing powers of a host state to intervene effectively are confined to emergency situations where problems are already manifest. I believe there is a case for considering how these powers may be exercised earlier, in order to prevent a failure, or to minimise the consequences of an impending failure.

I hope this will reassure you that no weakening is envisaged on Single Market principles. My aim is to ensure that EEA bank branches pose no greater threat to taxpayers and financial stability than a UK-owned bank, while respecting the rights of establishment and passporting rights in accordance with the EC Treaty.

15 December 2009

Letter from the Chairman to Lord Myners

Thank you very much for your letter on an EU framework for cross-border crisis management in the banking sector dated 15 December 2009.

EU Sub-Committee A discussed and cleared this document from scrutiny at its meeting on 19 January 2010. We are grateful for your clarification of the terms under which the Home-Host model might be reviewed and are glad to see that no weakening of the Single Market principles are envisaged. We agreed to clear the document from scrutiny while awaiting new legislation on the matter and pondering the opportunity for an inquiry.

20 January 2010

BUDGET FOR THE EUROPEAN COMMUNITIES 2010

Letter from Ian Pearson MP, Economic Secretary, HM Treasury, to the Chairman

Thank you for your letter of 25 November, replying to mine of 4 and 17 November on the negotiation of the Draft EU Budget for 2010.

On 18 November, I represented the UK at the Budget Economic and Financial Affairs Council (Budget ECOFIN). I am pleased to update you on the progress made at that meeting, at which the Council formally agreed its second reading of the 2010 EU Draft Budget (DB), following conciliation with the European Parliament. The amended DB was agreed under qualified majority voting procedure, with unanimous support from Member States.

Council's agreed position ahead of conciliation was based on a package put together by the Swedish Presidency, and supported by the UK, following discussions in Council Budget Committee. The Presidency package proposed total commitment appropriations of €140,555m (£128,130m[3]). This represented an increase of €2.6bn (£2.4bn) from Council's first reading position, although was still €518m (£472m) lower than the level proposed by the Commission's Preliminary Draft Budget (PDB) and the Amending Letters to it. This increase is largely explained by the fact that the Presidency package incorporated €2bn (£1.8bn) of the €2.4bn (£2.2bn) required to finance the outstanding

[3] This and all other sterling figures in this letter , with the exception of those concerning Preliminary Draft Amending Budget no 10/2009, are converted at the rate on 1 December of €1: £0.9116

tranche of the European Economic Recovery Plan (EERP), which had not been included in Council's first reading position. The Presidency package proposed total payment appropriations of €121,488m (£110,748m), an increase of €967m (£882m) from Council's first reading position, and representing 1.04% of EU GNI.

The Presidency package incorporated the changes to the overall Financial Framework and individual heading ceilings in 2009 and 2010, proposed in the Commission Communication "concerning the revision of the multiannual financial framework (2007-2013) and a proposal for a Decision of the European Parliament and of the Council amending the Inter-Institutional Agreement of 17 May 2006 on budgetary discipline and sound financial management" of 27 October (COM(2009) 600, reference HM Treasury Explanatory Memorandum 15208/09 of 3 November 2009). This proposed an increase to the 2010 overall commitments ceiling of €1.3bn (£1.2bn), with a corresponding decrease to the 2009 ceiling. At heading level, it proposed an increase to the 2010 ceiling for heading 1a (Competitiveness for growth and employment) of €1.6bn (£1.5bn), entirely offset by decreases to heading 1b (Cohesion for growth and employment) in 2010, and headings 2 (Preservation and management of natural resources) and 5 (Administration) in 2009 and 2010. Once this revision of the Financial Framework ceilings had been taken into account, the Presidency package left a margin of €1bn (£0.9bn).

The Presidency package substantially reverted back to Council's first reading position, with the following amendments and additions:

— The package partially accepted Amending Letter 1, incorporating €95m (£87m) in commitment appropriations and €60m (£55m) in payment appropriations for EU support to Palestine.

— It accepted in full Amending Letter 2, providing for: €75m (£68m) in commitment appropriations for the decommissioning of the Kozloduy nuclear plant in Bulgaria; €1,587m (£1,447m) and €377m (£344m) in commitment and payment appropriations respectively for energy projects under the EERP; and emergency support to the dairy sector, and small adjustments to some budget lines under heading 2, as well as €420m (£383m) in commitment appropriations for the rural development/CAP healthcheck component of the EERP, resulting in a net increase under heading 2 of €739m (£674m) and €414m (£377m) in commitment and payment appropriations respectively. My letter of 4 November provides more detail on Amending Letters 1 and 2.

— It reverted to PDB levels on several budget lines under heading 2, leading to an increase compared to Council's first reading of €71m (£65m) in both commitment and payment appropriations, while maintaining the substantial reduction in Council's first reading to the European Agriculture Guarantee Fund clearance of accounts budget line of €230m (£210m).

— It accepted some comparatively small amendments made by the European Parliament in its first reading, including increases for the European Parliament's administration budget, as well as in heading 1a and heading 4 (EU as a global player).

Tables summarising the changes between the PDB, Draft Budget, the EP's first reading amendments and the Presidency second reading package are set out in Annex 1 to this letter.

Agreement reached between Council and European Parliament

Before proceeding with the second reading of the DB, the Council held its customary conciliation meeting with a delegation from the European Parliament. During this, it was clear that no agreement would be found on the 2010 EU budget without first agreeing on the financing of the full €2.4bn (£2.2bn) remaining tranche for the EERP. This, and key elements of the 2010 EU budget were agreed as follows:

— Total payment appropriations were set at €122,937m (£112,069m), corresponding to approximately 1.04% of EU GNI, below the level proposed by the Commission in its PDB and Amending Letters, and €4.6bn (£4.2bn) below that proposed by the EP in its first reading.

— Political agreement was reached on a revision of the Financial Framework in 2009 and 2010 in order to finance in full the outstanding €2.4bn (£2.2bn) tranche of the EERP. Most importantly, this was achieved without any overall increase to the Financial Framework for 2009 and 2010. The heading 1a ceiling in 2010 was increased by €1.8bn (£1.6bn), with corresponding decreases: in heading 2 of €1.3bn (£1.2bn) in 2009 and €158m (£144m) in 2010; in heading 5 of €174m (£159m) in 2009 and €126m (£115m) in 2010; in heading 1b of €1m (£0.9m) in 2009 and €6m (£5m) in 2010; and in heading 3a (Freedom, security and justice) of €5m (£5m) in 2009.

— Mobilisation of €195m (£178m) from the Flexibility Instrument in 2010, meaning €315m (£287m) would be available under the Instrument for the 2011 budget negotiation4. €120m (£109m) of the amount mobilised was allocated towards financing energy projects under the EERP. €75m (£68m) was allocated towards financing the decommissioning of the Kozloduy nuclear plant in Bulgaria, an expenditure demand contained in Amending Letter 2 that the European Parliament did not wish to see financed from the Heading 1a margin before the EERP energy component was fully financed.

— Acceptance of Amending Letter 2, amended to include €1.98bn (£1.8bn) in commitment appropriations for the energy component of the EERP, resulting from the revision of the Financial Framework outlined above, the mobilisation of the Flexibility Instrument, and the redeployment of €81m commitments (£74m) from within heading 1a in 2010.

— The amount of the CFSP budget for 2010 was set at €282m (£275m) in commitment appropriations, subject to the European Parliament's final vote on discharge in relation to the Council's accounts in 2007, which subsequently took place on 25 November.

Four joint statements were agreed at Budget ECOFIN, concerning: continuity of the 2010 budgetary procedure in view of the entry into force of the Lisbon Treaty on 1 December; the building policy of EU institutions and bodies; simplification and a more targeted use of structural and cohesion funds in the context of the economic crisis; and the use of the margin in heading 5 in 2010. In addition, the EP, Commission and Council also agreed that, before 1 December, they would agree a joint declaration on transitional measures applicable to the budgetary procedure after the entry into force of the Lisbon Treaty (my letter of 29 October refers). This declaration has now been agreed by written procedure and is expected to be formally approved by both institutions shortly.

There was also agreement at Budget ECOFIN to adopt Preliminary Draft Amending Budget no. 10 to the 2009 budget (COM(2009) 1464 and Explanatory Memorandum 15173/09 of 3 November 2009). This had been updated by the Commission on 11 November in the light of the latest information on revenue and expenditure, and is now as follows:

— an overall decrease to revenue from VAT- and GNI-based contributions of €1,386m (£1,321m[5]); and an overall increase to Traditional Own Resources revenue of €600m (£572m);

— an overall reduction in payment appropriations of €3,204m (£3,052m), which now includes a reduction of €135m (£129m) in both commitment and payment appropriations for the European Agriculture Guarantee Fund in heading 2; and

— a reduction of payment appropriations under the EAFRD of €1.7bn (£1.6bn).

In addition, Preliminary Draft Amending Budget no. 10 was further modified at Budget ECOFIN to include a decrease in both commitment and payment appropriations under heading 5 of €42.5m (£40.5m): €40m (£38.1m) underspend from the Council's budget, and €2.5m (£2.4m) from the budgets of the European Economic and Social Committee and the Committee of the Regions.

The effect of these changes result in a total reduction in member states' GNI-based contributions of €3,488m (£3,322m), of which the UK share is €442m (£421m).

---

[4] The Flexibility Instrument permits up to €200m (£182m) to be budgeted above the ceilings of the Financial Framework and these funds may be carried over for up to two years.

[5] This, and all further sterling figures relating to PDAB no. 10/2009, has been converted at the 31 December 2008 rate of €1:£0.9525, which is the rate at which UK VAT-based and GNI-based contributions to the 2009 EC Budget are converted

AMENDING LETTER NO 3 COVERING ADDITIONAL RESOURCES FOR CHANGES TO THE FUNCTIONING OF THE EUROPEAN COUNCIL AND THE COUNCIL IN 2010 (FOLLOWING THE ENTRY INTO FORCE OF THE LISBON TREATY)

Largely as a result of UK lobbying, this Amending Letter (on which I wrote to you on 17 November) was not adopted but merely "noted" at Budget ECOFIN, rather to be adopted under a written procedure by 30 November. In my first intervention at Budget ECOFIN, I stressed the importance of member states and national Parliaments being given adequate time to consider all budgetary proposals related to the implementation of the Lisbon Treaty. For the purpose of the written procedure, the letter was formally issued on 26 November as Commission document SEC(2009) 1635 final, which has been deposited and is therefore available for your reference in the usual way. The text and substance of the Commission document was unchanged from the elements I set out in my letter of 17 November, with the exception of a reduction of €1.5m (£1.4m) in the contingency reserve, for which the UK and other Member States had argued strongly. Due to the underspend in the Council's administration budget in 2009 outlined above, it will be possible to finance the full amount of €23.5m (£21m) requested in Amending Letter 3 while still reducing the overall level of administration spend in 2009 and 2010.

UK approach and next stage of budget procedure

In line with the approach and objectives that I have previously outlined to and discussed with your Committee, I believe the UK achieved the best possible outcome from this stage of the EU Budget negotiations. Through tough negotiation and close engagement with other member states, the UK secured a 2010 budget with payment appropriations below the level of the Commission's proposals in the PDB and Amending Letters. At the same time, the budget contains the full financing for the remaining tranche of the European Economic Recovery Plan. This was achieved without any overall increase to the Financial Framework 2007-2013; and through redirecting resources towards competitiveness and growth, and away from areas of the budget that represent poorer value for money, such as administration and CAP spending.

The consensus reached at Budget ECOFIN set overall payment appropriations for the 2010 budget. Council has now concluded its second reading of the 2010 EU budget and compulsory expenditure (mainly on agriculture) has been settled. The EP will formally agree the non-compulsory expenditure part of the EU budget for 2010 in its second reading culminating in the plenary session on 14-17 November November. This will mark the formal adoption of the 2010 EU budget, and I will keep you informed of the final outcomes at that stage.

7 December 2009

ANNEX

TABLE 1: SUMMARY OF 2010 PDB, DRAFT EU BUDGET, EP FIRST READING AND COUNCIL SECOND READING PACKAGE – EUR MILLION

Heading	FF Ceiling (1)	2010 PDB		Council first reading		EP First reading		Council second reading package[6]	
		CA(2)	PA(3)	CA	PA	CA	PA	CA	PA
1. Sustainable growth[7]	61,782	62,152	47,365	62,052	46,663	64,255	51,418	63,734	47,061
1a. Competitiveness for growth and employment[8]	12,388	12,269	10,982	12,170	10,574	14,367	12,568	13,852	10,972
Margin[9]	-	*119*	-	*218*	-	*-1,979**	-	*123*	-
1b. Cohesion for growth and employment	49,394	49,382	36,382	49,382	36,089	49,388	38,850	49,382	36,089
Margin	-	*12*	-	*12*	-	*6.4*	-	*1*	-
2. Preservation and management of natural resources	60,113	59,004	58,075	58,640	57,583	59,808	58,959	59,450	58,068
Margin	-	*1,109*	-	*1,473*	-	*305*	-	*539*	-
3. Citizenship, freedom, security and justice	1,693	1,629	1,360	1,608	1,306	1,674	1,462	1,608	1,306
3a. Freedom, security and justice	1,025	980	720	974	692	1,006	794	974	692
Margin	-	*45*	-	*51*	-	*19*	-	*51*	-
3b. Citizenship	668	649	640	634	614	668	668	634	614

[6] Calculations of the margins for Council's second reading package take into account the proposed revision of the Financial Framework
[7] CA totals for Sustainable Growth include €500m appropriations for the European Globalisation Adjustment Fund.
[8] [3] CA totals for Heading 1a exclude €500m appropriations for the European Globalisation Adjustment Fund.
[9] €500m appropriations for the European Globalisation Adjustment Fund are excluded from calculation of the margin.

Margin	-	*19*	-	*34*	-	*0*	-	*34*	-
4. European Union as a global player[10]	7,893	7,921	7,665	7,832	7,156	8,141	7,823	7,934	7,223
Margin[11]	-	*221*	-	*310*	-	*0.4*	-	*208*	-
5. Administration	8,008	7,851	7,851	7,812	7,812	7,866	7,865	7,829	7,829
Margin[12]	-	*230*	-	*276*	-	*222*	-	*109*	-
TOTAL (4)	139,489	138,557	122,316	137,944	120,521	141,745	127,526	140,555	121,488
Margin	-	*1,761*	-	*2,374*	-	*-1,427*	-	*1,065*	-
Appropriations payments as a percentage of EU GNI			1.03%		1.02%		1.08%		1.04%

Notes

(1) FF = Financial Framework
(2) CA = commitment appropriations
(3) PA = payment appropriations
(4) Due to rounding, the sum of the lines may not equal the total

*The margin for Heading 1a left by Parliament, excluding its amendment to raise the Financial Framework ceiling to finance €1.98bn for the European Economic Recovery Plan, amounts to €706,340

[10] €248.9m appropriations for the Emergency Aid Reserve are included throughout in both commitments and payments totals for Heading 4, with the exception of Council's first and second readings, where €248.9m for the Reserve is excluded from the payments total.

[11] €248.9m appropriations for the Emergency Aid Reserve are excluded from calculation of the margin.

[12] For calculating the margin for Heading 5, account is taken of the footnote (1) of the Financial Framework 2007-2013 for an amount of €78m for the staff contributions to the pension scheme.

TABLE 2: SUMMARY OF 2010 PDB, DRAFT EU BUDGET, EP FIRST READING AND COUNCIL SECOND READING PACKAGE – GBP

Heading	FF Ceiling (1)	2010 PDB		Council first reading		EP First reading		Council second reading package[13]	
		CA(2)	PA(3)	CA	PA	CA	PA	CA	PA
1. Sustainable growth[14]	56,320	56,658	43,178	56,567	42,538	58,575	46,873	58,100	42,901
1a. Competitiveness for growth and employment[15]	11,293	11,184	10,011	11,094	9,639	13,097	11,457	12,627	10,002
Margin[16]	-	*109*	-	*199*	-	*-1,804**	-	*112*	-
1b. Cohesion for growth and employment	45,028	45,017	33,166	45,017	32,899	45,022	35,416	45,017	32,899
Margin	-	*11*	-	*11*	-	*5.8*	-	*0.9*	-
2. Preservation and management of natural resources	54,799	53,788	52,941	53,456	52,493	54,521	53,747	54,195	52,935
Margin	-	*1,011*	-	*1,343*	-	*278*	-	*491*	-
3. Citizenship, freedom, security and justice	1,543	1,485	1,240	1,466	1,191	1,526	1,333	1,466	1,191
3a. Freedom, security and justice	934	893	656	888	631	917	724	888	631
Margin	-	*41*	-	*46*	-	*17*	-	*46*	-
3b. Citizenship	609	592	583	578	560	609	609	578	560
Margin	-	*17*	-	*31*	-	*0*	-	*31*	-

[13] Calculations of the margins for Council's second reading package take into account the proposed revision of the Financial Framework
[14] CA totals for Sustainable Growth include £456m appropriations for the European Globalisation Adjustment Fund.
[15] CA totals for Heading 1a exclude £456m appropriations for the European Globalisation Adjustment Fund.
[16] £456m appropriations for the European Globalisation Adjustment Fund are excluded from calculation of the margin.

4. European Union as a global player[17]	7,195	7,221	6,987	7,140	6,523	7,421	7,131	7,233	6,584
Margin[18]	-	*201*	-	*283*	-	*0.4*	-	*190*	-
5. Administration	7,300	7,157	7,157	7,121	7,121	7,171	7,170	7,137	7,137
Margin[19]	-	*210*	-	*252*	-	*202*	-	*99*	-
TOTAL (4)	127,158	126,309	111,503	125,750	109,867	129,215	116,253	128,130	110,748
Margin	-	*1,605*	-	*2,164*	-	*-1,301*	-	*971*	-
Appropriations payments as a percentage of EU GNI			1.03%		1.02%		1.08%		1.04%

Notes

(1) FF = Financial Framework
(2) CA = commitment appropriations
(3) PA = payment appropriations
(4) Due to rounding, the sum of the lines may not equal the total

*The margin for Heading 1a left by Parliament, excluding its amendment to raise the Financial Framework ceiling to finance £1.8bn for the European Economic Recovery Plan, amounts to £643,900

[17] £227m appropriations for the Emergency Aid Reserve are included throughout in both commitments and payments totals for Heading 4, with the exception of the 2010 draft budget, where €248.9m for the Reserve is excluded from the payments total.
[18] £227m appropriations for the Emergency Aid Reserve are excluded from calculation of the margin.
[19] For calculating the margin for Heading 5, account is taken of the footnote (1) of the Financial Framework 2007-2013 for an amount of £71m for the staff contributions to the pension scheme.

Letter from the Chairman to Ian Pearson MP

Thank you for your letter of 7 December 2009 on the second reading of the 2010 draft EU Budget. This was considered by EU Sub-Committee A on 12 January 2010. We would also like to thank you for your timely updates on negotiations throughout the budgetary process.

We are pleased to see that the European Economic Recovery Plan will be largely funded through reductions to Agricultural spending under Heading 2 of the financial framework. We now consider all items related to the 2010 draft budget (including documents 16763/09, 15172/09 and 12793/09, which were previously cleared) to have been cleared from scrutiny.

We look forward to your final update on the formal adoption of the 2010 budget in due course.

13 January 2010

Letter from Ian Pearson MP to the Chairman

Further to my letter of 7 December 2009, I am pleased to update you on the outcome of the European Parliament's second reading of the 2010 EU budget and the budget's formal adoption, which took place on 17 December.

The final outcome was consistent with the agreement reached between the Council and European Parliament (EP) during conciliation at Budget ECOFIN on 18 November. Overall, commitment appropriations were set at €141.5bn (£125.7bn[20]) and payment appropriations at €122.9bn (£109.1bn), corresponding to approximately 1.04% EU GNI. This is below the level proposed by the Commission in its Preliminary Draft Budget and Amending Letters, and €4.6bn (£4.1bn) below that proposed by the EP in its first reading. The EP also agreed to the revision of the 2007-2013 Financial Framework (FF), to finance the European Economic Recovery Plan, and to the mobilisation of the Flexibility Instrument, as agreed with Council at Budget ECOFIN.

The agreement on 18 November set the overall totals for commitment and payment appropriations, and the Council's second reading determined the final level of expenditure for compulsory (mainly agriculture) expenditure. The EP had the final say on setting appropriations for non-compulsory expenditure, at its plenary session on 17 December.

An overview of the EP's second reading (the adopted budget) for the 2010 EU budget is contained in the tables in the Annex. The major points are summarised below.

UNDER HEADING 1A (COMPETITIVENESS FOR GROWTH AND EMPLOYMENT), commitments were set at €14.9bn (£13.2bn), €510m (£453m) higher than Council's second reading after excluding provision for the European Globalisation Adjustment Fund (€500m, £444m) from the totals. No margin was left below the FF ceiling, which was surpassed by an additional €194.4m (£172.6m), mobilised from the Flexibility Instrument for the financing of the European Economic Recovery Plan and for nuclear decommissioning activity at Kozluduy in Bulgaria. Payments were set at €11.3bn (£10.0bn), €370m (£329m) higher than Council's second reading, though some €1.2bn (£1.1bn) lower than the EP's first reading.

In comparison to 2009 adopted budget payment levels, the sub-heading as a whole received an increase of €318m (£282m) or 3%. Relative to the 2009 adopted budget, the most significant changes in payments were in the following budget areas:

— Social Policy agenda – an increase of €31m (£28m) or 21%;

— Nuclear decommissioning – an increase of €110m (£97.7m) or 50%;

— Seventh Research Framework programme – a decrease of €546m (£485m) or 8%; and

— EGNOS and Galileo – a decrease of €307m (£273m) or 40%.

In addition, the 2010 adopted budget includes payments of €1.0bn (£0.89bn) for energy projects to aid economic recovery, as part of the European Economic Recovery Plan.

UNDER HEADING 1B (COHESION FOR GROWTH AND EMPLOYMENT), commitments were set at €49.4bn (£43.9bn), €6m (£5.3m) higher than Council's second reading, leaving a margin of €407,908 (£362,263) under the FF ceiling. Payments were set at €36.4bn (£32.3bn), €296m (£263m) higher than Council's second reading and €2.5bn (£2.2bn) lower than the EP's first reading.

[20] This and all other sterling figures in this letter are calculated at the exchange rate on 30 December 2009 of £1=€0.8881

In comparison to the 2009 adopted budget payment levels, the sub-heading as a whole received an increase of €1.4bn (£1.2bn) or 4%. Relative to payment levels in the 2009 adopted budget, the key changes were as follows:

— Structural funds – an increase of €1.8bn (£1.6bn) or 6.6%, including an increase of €3.2bn (£2.8bn) or 16.4% in the Convergence objective, offset by reductions elsewhere.

— Cohesion Fund – a decrease of €427m (£379m) or 5.9%.

UNDER HEADING 2 (PRESERVATION AND MANAGEMENT OF NATURAL RESOURCES), commitments were set at €59.5bn (£52.8bn), €49m (£44m) higher than Council's second reading. The commitments total includes €420m (£373m) for the rural development and CAP healthcheck components of the European Economic Recovery Plan, and leaves a margin of €456m (£405m) below the FF ceiling. Payments were set at €58.1bn (£51.6bn), €68m (£60m) higher than Council's second reading, although €823m (£731m) lower than the EP's first reading.

In comparison to 2009 adopted budget payments levels, the sub-heading as a whole received an increase of €5.6bn (£5.0bn) or 10.6%. Relative to the 2009 adopted budget, the most significant changes in payments were in the following budget areas:

— Rural development – an increase of €3.2bn (£2.8bn) or 31%;

— European Fisheries Fund – a decrease of €80m (£71m) or 14.3%; and

— The Life+ (environment) programme – a decrease of €132m (£117m) or 38%.

UNDER HEADING 3A (FREEDOM, SECURITY AND JUSTICE), commitments were set at €1.0bn (£0.89bn), €32m (£28m) higher than Council's second reading, leaving a margin of €18.5m (£16.4m) under the FF ceiling. Payments were set at €738.6m (£695.9m), €47m (£42m) higher than Council's second reading and €55m (£49m) lower than the EP's first reading.

In comparison to 2009 adopted budget payment levels, the sub-heading as a whole received an increase of €121.1m (£107.5m) or 19.6%. Relative to the 2009 adopted budget, the most significant changes were in the following budget areas:

— Solidarity and management of migration flows – an increase of €53.4m (£47.4m) or 18%; and

— Decentralised agencies – an increase of €74.4m (£66.1m) or 53.3%.

UNDER HEADING 3B (CITIZENSHIP), commitment appropriations were set at €668m (£593m), €34m (£30m) higher than Council's second reading, leaving no margin under the FF ceiling. Payments were set at €659.4m (£585.6m), €45m (£40m) higher than Council's second reading, and €9m (£8m) lower than the EP's first reading.

In comparison to 2009 adopted budget payments levels, the sub-heading as a whole received a decrease of €19.6m (£17.4m) or 2.9% (although this does not account for potential future mobilisation of the EU Solidarity Fund, which may result in an increase to overall payments under this sub-heading). Relative to the 2009 adopted budget, the most significant changes in payments were in the following budget areas:

— 'Other actions', education and culture area – an increase of €9.6m (£8.5m) or 44%;

— Public health and consumer protection programme – a decrease of €17.3m (£15.4m) or 21.4%; and

— Communication actions – a decrease of €7.3m (£6.5m) or 7.7%.

UNDER HEADING 4 (EU AS A GLOBAL PLAYER), commitments were set at €8.1bn (£7.2bn), including the Emergency Aid Reserve. This total was €207m (£184m) higher than Council's second reading, and leaves a margin of €875,530 (£777,558) under the FF ceiling. Payments were set at €7.8bn (£6.9bn), also including the Emergency Aid Reserve. This total was €316m (£281m) higher than Council's second reading (if the Emergency Aid Reserve is included), and €35m (£31m) lower than the EP's first reading.

In comparison to the 2009 adopted budget payments levels, the heading as a whole received a decrease of €536m (£476m) or 6.4%. Relative to the 2009 adopted budget, the most significant changes in payments levels were in the following budget areas:

— Democracy and human rights – an increase of €10.1m (£9.0m) or 6.8%;

— Instrument for Pre-Accession Assistance – a decrease of €522.6m (£464.1m) or 22.7%; and

— Other actions and programmes (development and relations with ACP states) – a decrease of €98.4m (£87.4m) or 17.7%.

UNDER HEADING 5 (ADMINISTRATION), commitments were set at €7,889.1m (£7,006.3m), €60m (£53m) higher than Council's second reading, leaving a margin of €72.9m (£64.7m) under the FF ceiling. Payments were set at €7,888.6m (£7,005.9m), higher than Council's second reading by €60m (£53m) and than the EP's first reading by €24m (£21m). This largely reflects the additional financing in Amending Letter 3, required for changes to the functioning of the European Council and the Council following the entry into force of the Lisbon Treaty. However, due to underspend in the Council's administration budget in 2009, it was possible to finance this while still reducing the overall level of administration spend in 2009 and 2010.

In comparison to 2009 adopted budget levels, the heading as a whole received an increase of €187.8m (£166.8m) or 2.4%.

The UK's objectives and the Adopted Budget

The outcome of the EP's second reading finalising the 2010 EU budget marks the end of negotiations on this budget, and reflects the agreement reached between the EP and the Council at Budget ECOFIN on 18 November.

As I set out in my letter of 7 December, I believe that, through tough negotiation and close engagement with like-minded Member States, the UK achieved the best possible outcome in negotiations on the 2010 budget. A key priority was the full financing of the remaining tranche of €2.4bn (£2.1bn) for the European Economic Recovery Plan, without any overall increase to the Financial Framework spending envelope. Not only did final agreement on the 2010 budget incorporate the full outstanding sum, but it did so within the overall FF envelope (despite calls from the EP for an increase to that envelope). In addition, this was achieved through reallocating substantial sums to the competitiveness and growth heading, and away from areas of the budget that are lower value for money; for example over €1bn (£0.89bn) was moved from the agriculture heading for this purpose, and the administration heading was also reduced. As a result, the 2010 budget delivers the fiscal stimulus that EU leaders have agreed is necessary, while respecting the overall spending limits set in 2005.

Even though the 2010 budget provides this important fiscal stimulus, and is therefore larger than the 2009 budget, the UK also made some progress in negotiations on our objective to limit increases to the overall budget size. The final budget was below the level proposed by the Commission in its Preliminary Draft Budget (PDB) and Amending Letters and, at €4.6bn (£4.1bn) lower than that proposed by the EP at its first reading, saving the UK taxpayer nearly £450m. The lowest percentage increases in payments levels between the PDB and the adopted budget were in agriculture (0.1%) and administration (0.5%); the highest in citizenship, freedom, security and justice (2.8%) and the external actions heading (1.6%).

Perhaps inevitably, accommodating the full remaining tranche of the European Economic Recovery Plan, within the overall Financial Framework spending envelope, has resulted in a 2010 budget with a smaller margin than we would like. We will need to push hard throughout the year for strong budget discipline, including through reprioritisation of funds to meet urgent and unforeseen demands throughout the year, to avoid serious pressure on this margin.

I hope this information is helpful to the Committee.

29 January 2010

ANNEX

TABLE 1: SUMMARY OF 2010 PDB, COUNCIL'S 1ST READING, EP 1ST READING,COUNCIL 2ND READING, AND EP 2ND READING (ADOPTED BUDGET) - EUR MILLION

Heading	FF Ceiling	2010 PDB		Council 1st Reading		EP's 1st Reading		Council 2nd Reading		Adopted Budget (5)		Diff: 2010 PDB & Adopted Budget	
		CA	PA	CA	PA	CA	PA	CA	PA	CA	PA	CA	PA
1. Sustainable Growth	**63,555**	**62,152**	**47,365**	**62,052**	**46,663**	**64,255**	**51,418**	**63,734**	**47,061**	**64,249**	**47,727**	**2,097**	**362**
1a. Competitiveness for Growth and Employment	14,167	12,269	10,982	12,170	10,574	14,367	12,568	13,852	10,972	14,362	11,342	2,093	360
Margin	-	*119*	-	*218*	-	*-1,979*	-	*123*	-	*-194*	-	-	-
1b. Cohesion for Growth and Employment	49,388	49,382	36,382	49,382	36,089	49,388	38,850	49,382	36,089	49,388	36,385	6	3
Margin	-	*12*	-	*12*	-	*6.4*	-	*1*	-	*0.4*	-	-	-
2. Preservation and Management of Natural Resources	**59,955**	**59,004**	**58,075**	**58,640**	**57,583**	**59,808**	**58,959**	**59,450**	**58,068**	**59,499**	**58,136**	**495**	**61**
Margin	-	*1,109*	-	*1,473*	-	*305*	-	*539*	-	*456*	-	-	-
3. Citizenship, Freedom, Security and Justice	**1,693**	**1,629**	**1,360**	**1,608**	**1,306**	**1,674**	**1,462**	**1,608**	**1,306**	**1,674**	**1,398**	**45**	**38**
3a. Freedom, Security and Justice	1,025	980	720	974	692	1,006	794	974	692	1,006	739	26	19
Margin	-	*45*	-	*51*	-	*19*	-	*51*	-	*19*	-	-	-
3b. Citizenship	668	649	640	634	614	668	668	634	614	668	659	19	19
Margin	-	*19*	-	*34*	-	*0*	-	*34*	-	*0*	-	-	-
4. European Union as a Global Partner (7)	**7,893**	**7,921**	**7,665**	**7,832**	**7,405**	**8,141**	**7,823**	**7,934**	**7,472**	**8,141**	**7,788**	**220**	**123**
Margin	-	*221*	-	*310*	-	*0.4*	-	*208*	-	*0.9*	-	-	-
5. Administration (8)	**7,882**	**7,851**	**7,851**	**7,812**	**7,812**	**7,866**	**7,865**	**7,829**	**7,829**	**7,889**	**7,889**	**38**	**38**
Margin	-	*230*	-	*276*	-	*222*	-	*109*	-	*73*	-	-	-
TOTAL (9)	**140,978**	**138,557**	**122,316**	**137,944**	**120,770**	**141,745**	**127,526**	**140,555**	**121,737**	**141,453**	**122,937**	**2,896**	**621**
Margin	-	*1,761*	-	*2,374*	-	*-1,427*	-	*1,065*	-	*354*	-	-	-
Appropriations for payment as % of GNI		1.18%	1.03%	1.17%	1.02%	1.2%	1.08%	1.19%	1.04%	1.2%	1.04%	-	-

Notes:

(1) As revised by the Council and European Parliament to finance the European Economic Recovery Plan. Margin calculations throughout the table for all stages prior to the adopted budget do not reflect the agreed, revised FF.

(2) CA = Commitment Appropriations

(3) PA = Payment Appropriations

(4) Due to rounding heading totals for Council's and EP's first readings may not fully match those in previous updates.

(5) Council's 2nd reading incorporates Amending Letters 1 and 2; the European Parliament 2nd Reading/the adopted budget incorporates Amending Letters 1-3.

(6) For consistency totals for sub-heading 1 incorporate the commitment appropriations related to the European Globalisation Adjustment Fund (€500m), however as it sits over and above the margin it is not incorporated in the margin totals shown. Totals for sub-heading 1 and 1a, and the margin calculations, also reflect the mobilisation of €195m from the Flexibility Instrument.

(6) Commitments and payments totals for Heading 4 incorporate €249.8m in appropriations related to the Emergency Aid Reserve (EAR), however as it sits over and above the margin for Heading 4 it is not incorporated in the margin totals shown. Please note that in previous updates the amount was excluded from the payments total in Council's first and second readings; it is included here for consistency and to aid comparison.

(8) For calculating the margin for Heading 5, account is taken of the footnote (1) of the Financial Framework 2007-2013 for an amount of €78m for the staff contributions to the pension scheme.

(9) Due to rounding the sum of the heading totals may not equal the total

TABLE 2: SUMMARY OF 2010 PDB, COUNCIL'S 1ST READING, EP 1ST READING,COUNCIL 2ND READING, AND EP 2ND READING (ADOPTED BUDGET) – GBP MILLION

Heading	**FF Ceiling (1)**	**2010 PDB**		**Council 1st Reading (4)**		**EP's 1st Reading (4)**		**Council 2nd Reading (5)**		**Adopted Budget (5)**		**Diff: 2010 PDB & Adopted Budget**	
		CA (2)	**PA (3)**	**CA**	**PA**	**CA**	**PA**	**CA**	**PA**	**CA**	**PA**	**CA**	**PA**
1. Sustainable Growth	56,443	55,197	42,065	55,108	41,441	57,065	45,664	56,602	41,795	57,059	42,386	1,862	321
1a. Competitiveness for Growth and Employment (6)	12,582	10,896	9,753	10,808	9,391	12,759	11,162	12,302	9,744	12,755	10,073	1,859	320
Margin	-	*106*	-	*194*	-	*-1,758*	-	*109*	-	*-172*	-	-	-
1b. Cohesion for Growth and Employment	43,861	43,856	32,311	43,856	32,051	43,861	34,503	43,856	32,051	43,861	32,314	5	3
Margin	-	*11*	-	*11*	-	*5.7*	-	*0.9*	-	*0.4*	-	-	-
2. Preservation and Management of Natural Resources	53,246	52,401	51,576	52,078	51,139	53,115	52,361	52,798	51,570	52,841	51,631	440	55
Margin	-	*985*	-	*1,474*	-	*271*	-	*479*	-	*405*	-	-	-
3. Citizenship, Freedom, Security and Justice	1,504	1,447	1,208	1,428	1,160	1,487	1,298	1,428	1,160	1,487	1,242	40	34
3a. Freedom, Security and Justice	910	870	639	865	615	893	705	865	615	893	656	23	17
Margin	-	*40*	-	*45*	-	*17*	-	*45*	-	*17*	-	-	-
3b. Citizenship	593	576	568	563	545	593	593	563	545	593	585	17	17
Margin	-	*17*	-	*30*	-	*0*	-	*30*	-	*0*	-	-	-
4. European Union as a Global Partner (7)	7,010	7,035	6,807	6,956	6,576	7,230	6,948	7,046	6,636	7,230	6,917	195	110
Margin	-	*196*	-	*275*	-	*0.4*	-	*185*	-	*0.8*	-	-	-
5. Administration (8)	7,000	6,972	6,972	6,938	6,938	6,986	6,985	6,953	6,953	7,006	7,006	34	34
Margin	-	*204*	-	*245*	-	*197*	-	*97*	-	*65*	-	-	-
TOTAL (9)	**125,203**	**123,052**	**108,629**	**122,508**	**107,256**	**125,884**	**113,256**	**124,827**	**108,115**	**125,624**	**109,180**	**2,572**	**551**
Margin	-	*1,564*	-	*2,108*	-	*-1,267*	-	*946*	-	*314*	-	-	-
Appropriations for payment as % of GNI		1.18%	1.03%	1.17%	1.02%	1.2%	1.08%	1.19%	1.04%	1.2%	1.04%	-	-

Notes:
(1) As revised by the Council and European Parliament to finance the European Economic Recovery Plan
(2) CA = Commitment Appropriations
(3) PA = Payment Appropriations
(4) Due to rounding heading totals for Council's and EP's first readings may not fully match those in previous updates.
(5) Council's 2nd reading incorporates Amending Letters 1 and 2; the European Parliament 2nd Reading/the adopted budget incorporates Amending Letters 1-3.
(6) For consistency totals for sub-heading 1 incorporate the commitment appropriations related to the European Globalisation Adjustment Fund (£444m), however as it sits over and above the margin it is not incorporated in the margin totals shown. Totals for sub-heading 1 and 1a, and the margin calculations, also reflect the mobilisation of £173m from the Flexibility Instrument.
(7) Commitments and payments totals for Heading 4 incorporate £221m in appropriations related to the Emergency Aid Reserve (EAR), however as it sits over and above the margin for Heading 4 it is not incorporated in the margin totals shown. Please note that in previous updates the amount was excluded from the payments total in Council's first and second readings; it is included here for consistency and to aid comparison.
(8) For calculating the margin for Heading 5, account is taken of the footnote (1) of the Financial Framework 2007-2013 for an amount of £69m for the staff contributions to the pension scheme.
(9) Due to rounding the sum of the heading totals may not equal the total

BUDGET: IMPLEMENTATION OF THE BUDGET FOR THE FINANCIAL YEAR 2008

Letter from the Chairman to Ian Pearson MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memorandum of 2 December 2009 regarding the European Court of Auditors Annual Report. This was cleared from scrutiny by EU Sub-Committee A at its meeting of 12 January 2010.

We recognise the importance of the EU Budget receiving a positive statement of assurance for reliability, and we are glad to see this is again the case this year. It is none the less disappointing to see that there are uncertainties relating to over half of budget expenditure. We are sure you will continue to press for further improvement.

13 January 2010

CAPITAL REQUIREMENTS DIRECTIVE (12093/09)

Letter from the Chairman to Lord Myners, Financial Services Secretary, HM Treasury

Thank you for your letters of 6 and 17 November on the amendment of the Capital Requirements Directive, which EU Sub-Committee A considered at the meeting of 8 December.

We regret that we were unable to consider the letters before a general approach on the proposal was reached. However, we are aware that a scrutiny override has not occurred in this case as the United Kingdom abstained and the decision was reached by a qualified majority.

In our letter of 14 October, we noted that the Financial Services Authority is developing a remuneration regime to apply to all UK regulated firms. We also asked to what extent this has been influenced by EU legislation, or vice versa. We would be grateful if you could provide an answer to this question.

10 December 2009

Letter from Lord Myners to the Chairman

Thank you for your letter of 10 December 2009 regarding the meeting of EU sub-committee A which considered amendments to the Capital Requirements Directive (12093/09).

You have asked to what extent the FSA remuneration regime had been influenced by EU legislation or vice versa.

In August 2009 the FSA published its remuneration code of practice which comes into force on 1 January 2010. The code contains principles relating to the governance of remuneration, risk management and performance measurement and the structure of remuneration for senior staff.

The FSA code covers UK firms and the subsidiaries of overseas firms. It does not cover branches of European Economic Area banks that are passported into the UK as these are subject to home-state regulation.

The UK played a leading role in developing an international approach to remuneration through the Financial Stability Board (FSB). The interventions made by the Government were based on the work of the FSA. The FSB delivered its Principles for Sound Compensation Practices to the London G20 Leaders' Summit in April 2009 and then its Implementation Standards for those principles to the Pittsburgh G20 Leaders' Summit in September 2009. G20 Leaders endorsed both of these and called for their swift implementation.

The FSB Implementation Standards include:

- Transparency – disclosure of senior staff pay and its composition aggregated in bands.
- Pay Structure – global benchmark for pay structure for senior staff:
    - A substantial proportion of compensation, such as 50%, should be variable and paid on the basis of individual,

business-unit and firm-wide measures that adequately measure performance;

- A substantial proportion of variable compensation, such as 40 to 60%, should be payable under deferral arrangements over a period of years; and
- These proportions should increase significantly along with the level of seniority and/or responsibility. For the most senior management and the most highly paid employees, the percentage of deferred variable compensation should higher than 60 percent.

— Governance – better selection and evaluation processes, and increased directors' time commitment and financial services expertise.

The remuneration principles in the recent proposal for a revision to the Capital Requirements Directive (CRD) are based on the EU recommendation of remuneration in the financial services sector. As this proposal has progressed through the European Council, it has been revised, so that the adopted Council common position reflects more closely the FSB implementation standards. Therefore, the work of the UK in developing an international approach at the G20 level has fed into the EU legislative approach.

The UK supports the inclusion of internationally agreed remuneration principles in the CRD, as it will help to ensure a level playing field. Implementing the CRD will mean that banks in other Member States, which are not subject to the FSA's code, are covered by internationally agreed remuneration principles.

4 January 2009

Letter from the Chairman to Lord Myners

Thank you for your letter of 4 January on the amendment of the Capital Requirements Directive, which EU Sub-Committee A considered at the meeting of 19 January. This document was previously cleared from scrutiny at the Committee's meeting of 8 December.

As this proposal has been agreed and you have answered all the Committee's questions on this subject, we now consider scrutiny of this document complete.

20 January 2010

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

Letter from Lord Davies of Abersoch, Minister for Trade, Investment and Small Business, Department for Business, Innovation and Skills, to the Chairman

I am writing to update you on the position of the EU proposal on origin marking introduced in 2005.

Whilst there is no new or revised proposal, the European Commission has recently produced an options paper. This suggested a number of possible ways to make progress in order to gather an updated picture of Member State positions' on the proposal. The options were:

1. narrowing the product coverage to 'end-user' goods;
2. amending the geographical application to address potential anomalies for certain preferential trading partners; and,
3. setting up a 3 year pilot scheme to evaluate costs and benefits of the regime over an initial period and covering consumer products in a range of sectors (Textiles & Clothing, Ceramics, Furniture, Brooms).

The proposal remains that made by the European Commission in 2005, on which the UK and a number of other Member States had strong reservations. The main concerns then were that country of origin labelling would not deter origin fraud; was not wanted by consumers nor the majority of stakeholders; could be difficult and expensive for manufacturers and government to implement; would send the wrong signals in the context of the Doha Development Round of trade negotiations; could be seen as a protectionist technical barrier to trade; and ran contrary to the trade-facilitation agenda.

An initial discussion was held with Member States on 23 October 2009. Although Member States generally expressed support for exploring the options further, a number also reiterated their original concerns. The Swedish and succeeding Spanish Presidencies are now discussing the way forward with the Commission.

Development of the options is still at an early stage and the Government has not come to a definitive position. It will consult stakeholders again once the promised further work has been done by the Commission.

21 January 2010

Letter from the Chairman to Lord Davies of Abersoch

Thank you for your letter of 21 January 2010 providing an update on the proposal for a regulation on the indication of origin of third country products. EU Sub-Committee A considered this at its meeting of 2 February 2010.

We would be grateful to receive your opinion on the options suggested by the Commission paper in due course and would like to receive updates on further progress gained in negotiations. We would also like to know whether you object to the proposal for country of origin labelling in principle. We decided to continue to hold the document under scrutiny.

3 February 2010

Letter from Lord Davies of Abersoch to the Chairman

Thank you for your letter of 5 February, about Proposal for a Council Regulation on indication of the country of origin of certain products imported from third countries asking for the Government's opinion on the 3 options put forward by the European Commission and asking that you are kept informed of any progress.

As indicated in our previous letter, the Government has a number of reservations about the Commission's original 2005 proposal. In particular, it was seen as:

— Imposing an unnecessary and additional burden on business when issues of concern are adequately covered by the EU's existing Intellectual Property and Unfair Commercial Practices Regulations,

— Arbitrary in its product coverage and lacking robust criteria for determining how/if other products might be added, and

— inconsistent with the EU's open markets/trade facilitating objectives in the DDA, and directly contrary to the approach taken in the EU initiative on textile, clothing and footwear labelling.

These concerns have not been satisfactorily addressed in the options paper recently put forward by the Commission. Looking at the three options, in particular:

1. **narrowing the product coverage** to 'end-user' goods still leaves unanswered questions about the criteria by which these products have been chosen, the need for such regulation given existing EU legislation and the regulatory cost of the proposal.
2. **amending the geographical application** in some way to address potential anomalies for certain preferential trading partners. This seems to be a backward step in terms of acceptability and with an even greater question mark over WTO compatibility; and
3. **sequencing entry into force by setting up a pilot scheme** to evaluate costs and benefits of the regime over an initial 3 year period. This option is light on detail and rationale.

At an informal working group meeting in Brussels on 14 December 2009, Member States raised similar concerns. In response, the Commission undertook to consider further work on options 1 and & 3 (option 2 was informally considered to be a non-starter). The Government is ready to consider constructively the results of this further work on the options in consultation with UK stakeholders before coming to a final position. I hope that this gives a clearer understanding of the situation.

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

18 February 2010

Letter from the Chairman to Lord Davies of Abersoch

Thank you for your letter of 18 February on the proposal for country of origin labelling (EM 5091/06). EU Sub-Committee A considered this at its meeting of 2 March.

We note that you have serious concerns over each of the three options proposed by the Commission. We would like to receive an update on the work being undertaken by the Commission on options 1 and 3 when this is completed, along with your opinion of this work. Until this time we have decided to keep this document under scrutiny.

3 March 2010

DATA: QUALITY OF STATISTICAL DATA (6559/10)

Letter from the Chairman to Ian Pearson MP, Economic Secretary, HM Treasury

Thank you for your explanatory memorandum of 10 March on the collection of statistical data on government debt and deficits (EM 6559/10). EU Sub-Committee A considered this at its meeting of 23 March.

Further to our letter of 10 March on the Greek deficit statistics, in which we noted the role of Eurostat in not addressing the poor quality of data collection processes in Greece, we agree with the principle of this proposal to increase the ability of Eurostat to monitor the collection of deficit statistics. We hope that Eurostat will use the powers it has to monitor the collection of deficit statistics effectively. It is also important that Eurostat is both independent and well-staffed in order to effectively carry out its role.

You note several issues on the proposal that you will follow up in negotiations. We would be grateful to receive updates on the progress of negotiations on your concerns. We agreed to hold the document under scrutiny in anticipation of your reply.

24 March 2010

DERIVATIVES MARKETS: FUTURE POLICY ACTIONS (15047/09)

Letter from the Chairman to Lord Myners, Financial Services Secretary, HM Treasury

Thank you for your explanatory memorandum 15047/09 and your letter of 26 October on ensuring safe and sound derivatives markets. EU Sub-Committee A considered these at its meeting of 8 December.

The Committee has decided to hold these proposals under scrutiny and conduct a short inquiry on the Commission's intended future policy actions. We expect to publish a report on this subject before Easter.

10 December 2009

CONTROL OF EXPORTS OF DUAL-USE ITEMS AND TECHNOLOGY (1334/00, 5011/09)

Letter from Ian Lucas MP, Minister of State, Department for Business, Innovation and Skills, to the Chairman

I am writing in response to your letter of 13 May 2009 to update the Committee on the progress made in negotiations on proposals to increase the number of Community General Export Authorisations (CGEA) available to exporters. This is the second formal update.

Since the last formal update two further meetings of the Council Working Group on Dual-use goods (the Group responsible for the Dual-Use Regulation) have taken place, on 30 November 2009 and 29 January 2010. The discussions concentrated on proposals EU004 (Temporary Export for Exhibition or Fair), EU006 (Telecommunications and Information security) which has now been split into two, separating Telecommunications from Information Security and EU007 (Chemicals). Details as follows:

- On EU004 (DS6/2010) the changes from that previously notified include addition of Macao (Special Administrative Region) and deletion of Malaysia and some minor changes to the conditions;
- On EU006a (Telecommunications) (DS7/2010) this now only applies to items falling within Category 5 Part 1. With the removal of items falling within Category 5 Part 2 current proposals are to add India, Israel and China to the list of permitted destinations;
- On EU006b (Information Security) (DS 8/2010) this will now only apply to items falling within Category 5 Part 2 however discussions are continuing on range of items covered. Destinations remain the same as originally proposed;
- On EU007 (Chemicals) two proposals are currently being considered. The first proposal (DS62/1/2009), covers the majority of chemicals listed under Categories 1C350 and 1C450 but limited to 6 destinations. The second proposal (DS9/2010) has a more restrictive list of chemicals limited to a few falling within Category 1C350 only but with an increase in the destinations covered. Both proposals will need further discussion.

Although there has been some progress an agreement on the final text has yet to be made.

Discussions are to continue at the next meeting of the Council Dual-Use Working Group scheduled for 3 March 2010. To date the Working Group has not considered the EU002 (Low Value Shipments) or EU005 (Computers and related equipment) set out in the Commission proposal.

15 February 2010

Letter from the Chairman to Ian Lucas MP

Thank you for your letter of 15 February updating the Committee on the progress of negotiations on document 5011/09. EU Sub-Committee A appreciated these detailed updates on the negotiations and would like to continue receiving quarterly updates. We agreed to continue to hold the document under scrutiny.

3 March 2010

ENDING THE ITUATION OF EXCESSIVE GOVERNMENT DEFICIT (15765/09)

Letter from the Chairman to Ian Pearson MP, Economic Secretary, HM Treasury

Thank you for your explanatory memorandum (document 15765/09) which was cleared at the last chairman's sift. As your EM makes clear, under current plans the UK will not meet the 2014-15 deadline for reducing the budget deficit to 3% by 2014-15. What importance do the Government place on recommendations of the Commission to Member States on the scale of fiscal deficits and their reduction?

We also note that the Council Conclusions of 25/26 March called for reinforcing the overall economic policy coordination across Member States "by making use of the instruments provided by Article 121 of the Treaty." Do you believe that the continued failure by the UK to comply with the Council's recommendation could potentially trigger the use of the procedures included in such article? What are the implications for the UK of greater economic-coordination at EU level as stated in Article 121?

8 April 2010

EU – KOREA: FREE TRADE AGREEMENT (6307/10)

Letter from the Chairman to Lord Davies of Abersoch, Minister of State for Trade, Investment and Small Business, Department for Business, Innovation and Skills

Thank you for your explanatory memorandum of 25 February (EM 6307/10) on the bilateral safeguard clause of the EU-South Korea Free Trade Agreement. This was discussed by EU-Sub Committee A on 23 March.

We note that provisional measures under the clause may be applied for 200 days in advance of the completion of an investigation into a complaint. However, Article 4 of the proposal stipulates that an investigation should be concluded within six months of its instigation. This may be extended to nine months in "exceptional circumstances". We are concerned that a nine month investigation would not be completed before provisional measures expired after 200 days. Do you share our concerns? Will investigations be conducted in good time to prevent provisional measures expiring before the completion of investigations?

We agreed to hold the document under scrutiny in anticipation of your reply.

25 March 2010

Letter from the Chairman to Lord Davies of Abersoch

Thank you for your explanatory memorandum on the Free Trade Agreement between the European Union and the Republic of Korea. This was considered by EU Sub-Committee A at the meeting of 7 April.

We are grateful for the opportunity to examine your memorandum before the dissolution of Parliament in advance of the deposit of the documents on the conclusion of the Agreement. We strongly support such agreements given the trade benefits they bring to the economies of all involved.

We understand that the proposals for conclusion are likely to be agreed in April or May and that this could lead to the need for an override of the scrutiny reserve resolution. We acknowledge the necessity of concluding the agreement and if this situation does occur, we would be grateful to receive an update from the Minister on the progress of negotiations once Parliament returns.

In view of its importance the global economy, how are negotiations proceeding on the similar Free Trade Agreement between the EU and Japan?

8 April 2010

EUROPEAN MICROFINANCE FACILITY (11778/09)

Letter from the Chairman to Lord Davies of Abersoch, Minister of State for Trade, Investment and Small Business, Department for Business, Innovation and Skills

Thank you for your letter of 19 November on Explanatory Memorandum 11778/09 on the PROGRESS microfinance facility. EU Sub-Committee A considered this at its meeting of 8 December.

We initially expressed concerns over the subsidiarity of the proposal – that the aims of the proposal could better be achieved through a scheme operated at a national level. However, we note your argument that by operating the scheme at an EU level greater leverage for funding can be achieved, which shows the added value of operating the scheme at an EU level.

We remain concerned that sophisticated groups may be able to gain access to money through this facility through fraudulent means, but we accept that this is always a risk with a facility of this type.

We are content to clear this document from scrutiny.

10 December 2009

Letter from Lord Davies of Abersoch to the Chairman

I am writing to update you about the establishment of the PROGRESS Microfinance Facility (11778/09) and the reallocation of funding from the Community Programme for Employment and Social Solidarity (PROGRESS) DWP EM 11717-09, both of which have been cleared from scrutiny. Given the two proposals are linked, I thought you would appreciate a single update on both, this response therefore includes information from DWP colleagues.

As I said in my letter of 19 November the European Parliament had opposed funding the Microfinance Facility through the reallocation of EURO 100 million from the PROGRESS budget. Instead, they proposed increasing the funding to EURO 150 million, to be taken from the margins.

The UK has always supported the original Commission proposal, and we have consistently pushed to ensure that we achieve an outcome as close to these original proposals as possible. During negotiations, the UK formed part of a blocking minority in Council to resist the European

Parliament's proposals, lobbying finance ministries in other Member States to ensure they maintained an equally budget disciplined approach.

As a result of the position taken by the Council, the European Parliament agreed to drop their proposal to increase the funding for the Microfinance Facility from EUR 100 million to EUR 150 million. They also agreed to compromise on the amount of funding from the margins, agreeing to set up the Facility with EURO 60 million from PROGRESS and EURO 40 million from the margins.

As part of the compromise package, the Commission will also make an official declaration stating that the Council and the European Parliament may consider making available an additional EURO 20 million of funding for PROGRESS over the course of the Microfinance Facility. However, this statement simply restates what would in any case be possible and places no binding commitment on the Member States. Any increase in the PROGRESS budget would need to be justified during budget negotiations by an activity statement from the Commission, and it remains the prerogative of the Council to oppose any unnecessary or inappropriate increase. Given the position of the different Member States during the negotiations I believe is unlikely that agreement would be obtained.

We believe this is a good final compromise. Through a successful negotiating strategy on the part of the Council, the European Parliament has given considerable ground from their starting position. There have been no material changes to the PROGRESS Microfinance Facility (11778/09), which is fully in line with UK objectives and which we continue to support. The Government is therefore proposing to vote in favour of both the establishment of the Facility, including the new funding proposal.

18 February 2010

MACRO-FINANCIAL ASSISTANCE TO UKRAINE (15429/09)

Letter from the Chairman to Ian Pearson MP, Economic Secretary, HM Treasury

Thank you for your explanatory memorandum (15429/09) on the provision of macro-financial assistance to Ukraine. EU Sub-Committee A considered this at its meeting of 30 March.

We note that a previous decision of 2002 granted €110m of macro-financial assistance, to Ukraine. Given the poor condition of the Ukrainian economy as set out in the proposal, why was this assistance not implemented? We would also like to know whether any loans provided to third countries under provisions for macro-financial assistance have been repaid? By what date would Ukraine be expected to repay this loan?

We agreed to clear this document from scrutiny, given that it is in line with the conditions for the provision of macro-financial assistance.

30 March 2010

FINANCIAL MANAGEMENT: AMENDMENTS CONCERNING GENERAL PROVISIONS OF THE FUNDS (12425/09)

Letter from the Rt Hon Rosie Winterton MP, Minister for Regional Economic Development and Coordination, Department for Business, innovation and Skills, to the Chairman

Thank you for your letter of 23 October to Kevin Brennan MP regarding Explanatory Memorandum Council doc no. 12425/09. This has been forwarded to me as Minister for Regional Economic Coordination.

In the discussions of the proposal in the Structural Funds working group, the original Commission proposal was rejected on the grounds of cost. The Commission subsequently issued a revised proposal in October involving:

a. increasing the advance payments for the European Social Fund (ESF) and for the Cohesion Fund for all new Member States plus Spain, Portugal, and Greece. This would result in a cost to the EU budget of 3,200 €m (approximately £2,860 m).

b. extending the deadline by which Structural Fund allocations for 2007 need to be spent, by an extra year. The Commission sets annual spending targets for the Structural Funds programmes.

This is called the N+2 rule whereby expenditure allocated to year N has to be spent by year N+2. Thus the first N+2 spending target for the 2007-13 programmes is 31 December this year. Each programme has its own spending target and, if the target is not met, any under-spend is lost to the programme and returned to the EU budget. The process or returning under-spends is known as "decommitment". The extension would apply to all Member States.

Throughout the discussions, we have pressed for an outcome that provides targeted assistance to the Member States most in need and that limits the cost to the EC Budget. The Commission's revised proposal did not secure the necessary level of agreement in the working group. The Swedish Presidency has recently issued a compromise package, which all Member States have supported, with the exception of ourselves. While we support the policy aims of this compromise package, we have principled objections to the financing mechanism for decommitment.

The Presidency compromise package is to make advances payment equal to 4% of a Member State's ESF allocation and 2% of their Cohesion Fund allocation. However, the advances would be limited to only the 5 Member States. These would be those that are currently receiving EU Balance of Payments Facility support (Hungary, Romania, Latvia) and those with negative growth of 10% or more (Estonia and Lithuania). This would result in a cost to the EU budget of 775 €m (approximately £693m). The decommitment proposals are unchanged from the Commission's revised proposal.

The compromise package needs to be agreed with the European Parliament and it is very likely that this will not happen until 2010. We believe, therefore, that this raises a fundamental budgetary principal. In the discussion on the European Economic Recovery Plan earlier this year, we argued that unspent EU funds or unallocated margins from 2008 could not be called upon once 2008 had passed. The Council Legal Service helpfully supported the UK and others when it opined that such a retrospective use of unspent funds would go against EC Budgetary principles.

We believe that defending this principle is crucial to guard against any retrospective use of margins or elapsed commitments in previous years' annual budgets, which would have potentially substantial cost implications in the future. We would only be in a position to support the Presidency compromise, or abstain from voting, if we were to receive assurances that the budgetary principle described above was not at risk

I hope the information above will be useful for the Committee. I will continue to keep the Committee informed of further progress on the compromise package.

7 December 2009

Letter from the Rt Hon Rosie Winterton MP, to the Chairman

Further to my letter to you of 7 December 2009, I am writing to inform you of progress on the Commission proposal to amend the general regulation for structural funds.

The Commission proposal as documented in EM 12425/09 put forward a number of amendments to existing Articles within the General Regulation No, 1083/2006 in order to simplify and accelerate the implementation of Community funding to ensure timely delivery to beneficiaries most affected by the economic downturn.

After discussions within working groups, the UK was able to support those amendments which help to further simplify and accelerate the implementation of current Structural Fund programmes. The UK position throughout discussions has been to aim for an outcome that provides targeted assistance to the Member States most in need and that is affordable.

The proposed amendment relating to Article 77 was not however supports by a sufficient majority of Member States – including the UK – on the grounds both of cost and insufficient targeting. The Commission amendment to Article 77 proposed a change to the co0financing rules, allowing Member States to temporarily suspend the requirement to co-finance ESF projects.

The Commission subsequently issued a revised amendment in October 2009 which did not secure a sufficient level of agreement in the working group. The then Swedish Presidency hence issued a compromise amendment as a way forward to further discussion over Article 77, where the working group had failed to reach agreement. This compromise amendment from the Presidency constitutes a change to a single Article within the original Commission proposal as set out in my letter of 7 December 2009.

The compromise put forward by the Swedish Presidency consisted of two major components;

— Advance payments equal to 4% of a Member State's ESF allocation and 2% of their Cohesion Fund allocation. These advances would only be available to 5

Member States. The criteria for being eligible for these funds was that the country was either currently receiving EU Balance of Payment Facility support or had a negative growth of 10% or more. Hungary, Romania, Latvia, Estonia and Lithuania were therefore eligible. The total immediate cost of this measure to the EU Budget is estimated to be around €775m (approximately £693m). However it will be budget neutral by the end of the programming period with a corresponding adjustment to be made as part of the closure process. As this principle is targeted to specific countries in need, this is in line with the UK position.

— Extending the deadline by which structural fund allocations for 2007 need to be spent, the Commission sets annual spending targets for the Structural Funds Programme and expects funds for year N to be spent within two years (hence N+2) (or three years in certain new member states). Each programme has its own spending target, and if that target is not met the under spend is returned to the EU budget in a process known as decommitment.

The extension would apply to all Member States and is therefore not in line with the UK's position that all changes must be targeted to those most in need. In addition, we were concerned that a proposal to 'reactivate' unspent commitments from the 2009 budget, which would not be agreed until 2010 , breached the fundamental budgetary principle that commitments decomitted at the end of one budgetary year could not be used again in future budgetary years. After receiving certain legal assurances on this point, the UK was able to abstain on the final proposal, thus allowing the Presidency to pursue discussions with the European Parliament on the basis of unanimity.

The European Parliament decided on 4 February that the proposal falls under the competence of the Regional Committee. The amendments as a result of the Coreper compromise were presented at the Committee meeting on 22 February for discussion. The Committee is expected to adopt its draft report at its meeting on 18 March with a view to a vote on the report at the April plenary session.

17 March 2010

Letter from the Chairman to the Rt Hon Rosie Winterton MP

Thank you for your letters of 7 December 2009 and 17 March 2010 on amendments to the general provisions of the European Funds (explanatory memorandum 12425/09). EU Sub-Committee A considered these at its meeting of 30 March. We agreed to clear the document from scrutiny.

Thank you for your second letter which clarified the progress of negotiations. However, we regret the fact that this did not reach the Committee in time in order for us to consider it before agreement was reached on the proposal in the European Council.

7 April 2010

FRAUD: REVERSE CHARGE MECHANISM IN RELATION TO GOODS AND SERVICES SUSCEPTIBLE TO FRAUD (13868/09)

Letter from the Chairman to the Rt Hon Stephen Timms, MP Financial Secretary, HM Treasury

Thank you for your letter of 17 November on the reverse charge mechanism. EU Sub-Committee A considered your letter on the proposal for a temporary and optional application of the reverse charge mechanism of 12 October at its meeting on 30 November.

You have addressed our concerns and we are content to clear the proposal from scrutiny. We would like to be informed about the final outcome of the negotiations and provided with a copy of the impact assessment once it is completed.

4 December 2009

Letter from the Rt Hon Stephen Timms MP to the Chairman

Thank you for considering and clearing this proposal from scrutiny.

I am writing to confirm that agreement was reached on a general approach, at ECOFIN Council on 2 December, to a draft Directive that would allow Member States to implement, on an optional and temporary basis, a VAT reverse charge on greenhouse gas emission allowances only.

The Directive, which is now waiting for the consultation process with the European Parliament to be concluded before it can be formally adopted, will apply until June 2015.

As you know, the original Commission proposal would have extended the reverse charge option to a select list of goods but with little support in Council for some of these commodities, as indicated in my letter of 17 November, the list of goods was reduced to just mobile telephones and computer chips. In the event, December ECOFIN could only agree to the emissions allowances part since this was urgently sought by several member states and opposed by none.

Helpfully for business, it was agreed that no mandatory additional reporting requirements would be necessary since given the structure of the market there was little risk of losses through abuse of the reverse charge on emissions allowances. However, we accept that some burdens will be incurred by businesses in changing their accounting systems to accommodate the reverse charge. In the event that an Impact Assessment is needed we will ensure that your committee is provided with a copy.

Even though agreement could not be reached at this stage on phones and chips, the Council has committed to continue to work on the goods part of the original proposal. Even though the UK's current reverse charge for phones and chips derogation lasts until the end of April 2011, we also welcome the agreement to a Council minute statement authorising Member States that currently have such a derogation to continue to apply it until agreement is reached on a new derogation or amendment to the VAT Directive."

21 December 2009

GREECE: STABILITY, EXCESSIVE DEFICIT, ECONOMIC POLICIES (6560/10, 6145/10, 6131/10)

Letter from the Chairman to Ian Pearson MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memorandum (EM 6560/10, 6147/10, 6145/10 & 6131/10) covering different documents on the Greek fiscal situation, discussed at the European Council on 16 February. EU Sub-Committee A discussed these documents at its meeting on 23 March and decided to clear them from scrutiny.

We would like to be kept informed on how the fiscal situation of Greece evolves. As discussions over the establishment of a European Monetary Fund are taking place in Brussels, we would like to receive your view as to whether such a plan to create European Monetary Fund will continue now that it looks likely that Greece will have to turn to IMF if it needs financial assistance.

We count on you to inform us immediately of an specific proposals for financial assistance or support for Greece which have or could have any impact on UK Government expenditure.

We also take note that for the first time the Council has resorted to a Lisbon Treaty article that allows the EU to send a warning to a Member State whose economic policy does not conform to EU guidelines on economic policies. We welcome the use of this article as it goes some way to reinforce economic surveillance.

24 March 2010

GREEK GOVERNMENT DEFICIT AND DEBT STATISTICS (5175/10)

Letter from the Chairman to Ian Pearson MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memorandum on the report on the Greek budget deficit. EU Sub-Committee A discussed the document at its meeting on 2 March and decided to clear the document from scrutiny.

The Commission’s report on the Greek Government’s deficit and debt statistics casts some light on the problems relating to the inadequacy of Greek statistics which is a matter of concern to us and to the EU. We note that the report was discussed at ECOFIN on 19 January 2010 where the UK Government supported prompt action to rectify the situation in Greece.

We agree that unless the institutional weaknesses identified in this report are addressed, the reliability of Greek deficit and data will remain in doubt. Eurostat should have exerted more pressure on the Greek statistical authorities to address the statistical problems upon their early identification.

We are aware that the Commission is requesting an explanation from the Greek authorities on alleged currency swaps to mask the size of its debt. We would like to receive clarification as to why currency swap arrangements concealing debt levels have only recently been questioned when it is clear that Eurostat could have acted beforehand to prohibit these transactions.

We are currently considering the Commission's future policy actions to increase the transparency of the over the counter (OTC) derivatives markets. The report will be published in the next two months. However, our inquiry does not focus on the use of derivatives and securitisation for public debt and deficit management.

We note that ambiguity remains regarding the type of actions the EU could take and that if the measures taken in the stability programme are not sufficient to solve the Greek debt crisis, an EU solution to avoid knock-on effects on other countries may become inevitable.

We have previously discussed with the Government the potential use of Article 100 TEC (now Article 122 in TFEU), to provide assistance to a defaulting member of the eurozone when we discussed proposals to provide financial assistance to Hungary, Romania and Latvia through the balance of payment facility. We understand that in Brussels discussions have again emerged around the use of Article 100 TEC as a legal basis to provide financial assistance within the eurozone. We would appreciate your view both on the likelihood of an EU response to the Greek situation based on Article 122 TFEU and on the UK's involvement in any such response.

10 March 2010

MACRO-FINANCIAL ASSISTANCE TO BOSNIA AND HERZEGOVINA (15427/09)

Letter from the Chairman to Ian Pearson MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memorandum 15427/09 and letter of 22 November on providing macro financial assistance to Bosnia and Herzegovina. EU Sub-Committee A considered this at its meeting of 19 January. We note that a scrutiny override has occurred in this case.

Your memorandum states that the EC Budget is a matter of exclusive EC competence, implying no subsidiarity issues arise with this document. Establishing and managing the EU Budget is indeed a matter of exclusive competence, as only the EU as a whole can decide its budget. However, this proposal is based on Article 308 of the Treaty (now Article 352 of the Treaty on the Functioning of the EU). This is not subject to exclusive competence and so subsidiarity issues and the reasoned opinion procedure do apply. Do you agree? Given this, do you believe that the proposal is in line with subsidiarity principles?

Your Explanatory Memorandum on the proposal notes that the loan will be conditional on economic policy conditions. Can you describe what these policy conditions are?

We are content to clear this document from scrutiny.

20 January 2010

Letter from Ian Pearson MP to the Chairman

Thank you for your letters of 4 December 2009 and 20 January 2010, which confirm that EU Sub-Committee A has cleared these documents from scrutiny. You also ask for further detail on the economic policy conditions associated with the loans in question and on the legal base of the proposals and the subsidiarity principle. I am happy to provide that further information here, including an update on Council discussions on legal issues.

The provision and indeed each disbursement of grants and loans in the context of Community macro-financial assistance (MFA) to Serbia, Armenia, Georgia and Bosnia is intended to complement support from the IMF as foreseen by the Stand-By Arrangements agreed between the IMF Board and assistance recipients. It is these Stand-By Arrangements, therefore, that set out the economic policy conditions to which Community assistance is linked. Where the IMF assesses that recipients are taking the necessary and appropriate action, or corrective measures and reforms, to meeting agreed objectives, then disbursements of further assistance can take place. Community assistance is managed by the European Commission consistent with these assessments and in consultation with the Council Economic and Financial Committee.

An annex to this letter provides a summary of the broad economic policy objectives for each country concerned here as part of their IMF Stand-By Arrangements. It should also be noted that Community financial assistance is provided in accordance with the Financial Regulation[22] to ensure appropriate measures for the prevention of, and the fight against, fraud, corruption and other irregularities affecting the assistance.

With regard to the legal basis of Article 308 of the former EC Treaty for the provision of MFA, the Government considered that the use of this article rather than Article 181a under the former Treaty framework was both necessary and justified given Declaration No.10 to the Nice Treaty and the past jurisprudence of the European Court of Justice. EM 15427/09 (covering a proposal made and adopted under the previous Treaty framework) explains this more fully. The provision of Community MFA to third countries involving Community borrowing, lending and the guaranteeing of loans is essentially a matter of EU budgetary policy and therefore a matter of exclusive Community competence.

The new and expanded equivalent Article 352 of the Treaty on the Functioning of the EU does make provision for the monitoring of the subsidiarity principle as you have pointed out, but arguably this would not alter the nature and budgetary character of Community MFA or mean that it would not comply with the subsidiarity principle. However, Article 212 of the Treaty on the Functioning of the EU modifies former Article 181a such that there is now explicit provision for the Union to carry out financial assistance (with the European Parliament also involved in the ordinary legislative procedure), and also no Treaty Declarations have qualified this Article, as was the case previously. For these reasons both the Commission and Council Legal Service have suggested that MFA proposals under the new Treaty framework ought now to fall under the legal basis of Article 212 or alternatively 213, rather than the catch-all Article 352.

This may therefore address your concerns around the appropriateness of the use of Article 352 in these instances. In Council discussions, the Government will seek to ensure that under any new legal base or legislative procedure, the same emphasis is given to economic policy conditionality and complementarity with IMF programmes, and to maintaining financial discipline when MFA proposals are considered and decided upon.

I hope you find this helpful.

29 January 2010

ANNEX

IMF STAND-BY ARRANGEMENT (SBA) PROGRAMME OBJECTIVES

Serbia -

SBA of 16 January 2009 making $530.3m of Fund resources available. Increased to $4bn on 15 May 2009. Specific programme objectives include:

— **Tightening of the fiscal stance** in 2009-10, with the 2009 general government deficit limited to 1¾ percent of GDP, followed by further fiscal consolidation in 2010. This involves strict incomes policies for containing public sector wage and pension growth and a streamlining of non-priority recurrent spending;

— **Strengthening the inflation targeting framework** while maintaining a managed floating exchange rate regime;

— **Making good use of the accumulated financial sector buffers**, while enhancing financial crisis preparedness;

— **Implementing structural policies** to address the roots of the economy's low capacity to produce, save, and export.

Armenia -

SBA of 6 March 2009 making $540m of Fund resources available. Increased to $822.7m on 22 June 2009. Specific programme objectives include:

[22] Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002.

— **Returning to a flexible exchange rate regime**. The authorities will no longer intervene in the market, except to smooth extreme volatility. Under a managed float, gradual return to an inflation-targeting framework;

— **Strengthening financial stability.** Short-term emergency measures to stabilize the system, while at the same time enacting more structural measures to ensure the soundness of the system going forward;

— **Fiscal priorities will be revised.** Cut back on non-priority spending and introduce some tax policy measures, yielding savings of about 0.8% of GDP;

— **The protection of social spending**. The program accommodates an increase in social spending of 0.3 percent of GDP, relative to the budget;

— **Wide-ranging structural reform as outlined in the Sustainable Development Program.** Deepening productivity, enhancing structural reforms, and improving governance. Continued efforts to strengthen the business environment - tax administration reforms and fight against corruption.

Georgia -

— SBA of 15 September 2008 making $750m of Fund resources available. Specific programme objectives include:

— **Make significant resources available in order to replenish international reserves** and bolster investor confidence, with the aim of sustaining private capital inflows that have been critical to Georgia's growth performance;

— **Limit the deterioration in the external accounts** by containing the fiscal deficit, maintaining a cautious monetary stance, and further strengthening the financial sector;

— **To reduce current expenditures** in order to free resources for relief and reconstruction;

— **Monetary policy will focus on providing sufficient liquidity to the banking system** while maintaining a stable exchange rate and an adequate level of international reserves. The program envisages actions to strengthen the framework for providing liquidity to the banking system and to build up the capacity of the Financial Supervision Agency (FSA).

Bosnia -

SBA of 8 July 2009 making $1.57bn of Fund resources available. Specific programme objectives include:

— **Reduce the structural fiscal balance** to limit the government's financing needs and bring public finances on a sustainable medium-term path;

— **Re-establish public wage restraint**;

— **Support adequate liquidity and capitalisation of banks**;

— **Secure sufficient external financing** and improve confidence.

MACRO-FINANCIAL ASSISTANCE TO SERBIA, ARMENIA AND GEORGIA (14343/09, 14659/09, 14884/09, 15427/10)

Letter from the Chairman to Ian Pearson MP, Economic Secretary, HM Treasury

Thank you for your Explanatory Memoranda 14343/09, 14659/09 and 14884/09 on the provision of macro-financial assistance to Serbia, Armenia and Georgia respectively. EU Sub Committee A considered this at its meeting of 1 December.

We agree with the provision of funding in each case in principle should be provided at EU level given that this will increase the effectiveness of coordination of the funding.

We would be grateful if you would provide details on the economic policy conditions that have been set out as part of these loans.

We are content to clear these documents from scrutiny.

4 December 2009

Letter from Ian Pearson MP to the Chairman

Thank you for considering and clearing this proposal from scrutiny.

I am writing to confirm that agreement was reached on a general approach, at ECOFIN Council on 2 December, to a draft Directive that would allow Member States to implement, on an optional and temporary basis, a VAT reverse charge on greenhouse gas emission allowances only.

The Directive, which is now waiting for the consultation process with the European Parliament to be concluded before it can be formally adopted, will apply until June 2015.

As you know, the original Commission proposal would have extended the reverse charge option to a select list of goods but with little support in Council for some of these commodities, as indicated in my letter of 17 November, the list of goods was reduced to just mobile telephones and computer chips. In the event, December ECOFIN could only agree to the emissions allowances part since this was urgently sought by several member states and opposed by none.

Helpfully for business, it was agreed that no mandatory additional reporting requirements would be necessary since given the structure of the market there was little risk of losses through abuse of the reverse charge on emissions allowances. However, we accept that some burdens will be incurred by businesses in changing their accounting systems to accommodate the reverse charge. In the event that an Impact Assessment is needed we will ensure that your committee is provided with a copy.

Even though agreement could not be reached at this stage on phones and chips, the Council has committed to continue to work on the goods part of the original proposal. Even though the UK's current reverse charge for phones and chips derogation lasts until the end of April 2011, we also welcome the agreement to a Council minute statement authorising Member States that currently have such a derogation to continue to apply it until agreement is reached on a new derogation or amendment to the VAT Directive."

14 February 2010

ANNEX

ANNEX – IMF STAND-BY ARRANGEMENT (SBA) PROGRAMME OBJECTIVES

Serbia -

SBA of 16 January 2009 making $530.3m of Fund resources available. Increased to $4bn on 15 May 2009. Specific programme objectives include:

— ***Tightening of the fiscal stance*** in 2009-10, with the 2009 general government deficit limited to 1¾ percent of GDP, followed by further fiscal consolidation in 2010. This involves strict incomes policies for containing public sector wage and pension growth and a streamlining of non-priority recurrent spending;

— **Strengthening the inflation targeting framework** while maintaining a managed floating exchange rate regime;

— **Making good use of the accumulated financial sector buffers**, while enhancing financial crisis preparedness;

— **Implementing structural** *policies* to address the roots of the economy's low capacity to produce, save, and export.

Armenia -

SBA of 6 March 2009 making $540m of Fund resources available. Increased to $822.7m on 22 June 2009. Specific programme objectives include:

— **Returning to a flexible exchange rate regime**. The authorities will no longer intervene in the market, except to smooth extreme volatility. Under a managed float, gradual return to an inflation-targeting framework;

— **Strengthening financial stability.** Short-term emergency measures to stabilize the system, while at the same time enacting more structural measures to ensure the soundness of the system going forward;

— **Fiscal priorities will be revised.** Cut back on non-priority spending and introduce some tax policy measures, yielding savings of about 0.8% of GDP;

— **The protection of social spending**. The program accommodates an increase in social spending of 0.3 percent of GDP, relative to the budget;

— **Wide-ranging structural reform as outlined in the Sustainable Development Program.** Deepening productivity, enhancing structural reforms, and improving governance. Continued efforts to strengthen the business environment - tax administration reforms and fight against corruption.

Georgia -

SBA of 15 September 2008 making $750m of Fund resources available. Specific programme objectives include:

— **Make significant resources available in order to replenish international reserves** and bolster investor confidence, with the aim of sustaining private capital inflows that have been critical to Georgia's growth performance;

— **Limit the deterioration in the external accounts** by containing the fiscal deficit, maintaining a cautious monetary stance, and further strengthening the financial sector;

— **To reduce current expenditures** in order to free resources for relief and reconstruction;

— **Monetary policy will focus on providing sufficient liquidity to the banking system** while maintaining a stable exchange rate and an adequate level of international reserves. The program envisages actions to strengthen the framework for providing liquidity to the banking system and to build up the capacity of the Financial Supervision Agency (FSA).

Bosnia -

SBA of 8 July 2009 making $1.57bn of Fund resources available. Specific programme objectives include:

— **Reduce the structural fiscal balance** to limit the government's financing needs and bring public finances on a sustainable medium-term path;

— **Re-establish public wage restraint**;

— **Support adequate liquidity and capitalisation of banks**;

— **Secure sufficient external financing** and improve confidence.

Letter from the Chairman to Ian Pearson MP

Thank you for your letter of 14 February on the provision of macro-financial assistance to Serbia, Armenia, Georgia and Bosnia and Herzegovina (EMs 14343/09, 14659/09, 14884/09 and 15427/09). EU Sub-Committee A noted that you have provided details on the economic policy conditions of these loans, however we would also be keen to receive a "term sheet" for each of the loans.

In our previous letter we raised the issue of subsidiarity of these proposals, which was related to competence. You note in your letter that the provision of macro financial assistance "is essentially a matter of EU budgetary policy and therefore a matter of exclusive community competence" implying subsidiarity principles do not apply. We agree that the EU budgetary process is a matter of exclusive competence. However, we disagree that proposals for the provision of macro financial assistance are exclusively a matter of EU budgetary policy. To use another example, the ceilings for agricultural policy are set through the budgetary process, but legislation entailing the disbursement of the funds is not a matter of EU budgetary policy and so not a matter of exclusive competence. Following this logic, we believe that macro financial assistance is not a matter of exclusive competence and therefore subsidiarity principles do apply to these proposals. Do you agree? Given this, do you believe the proposal is in line with subsidiarity principles?

3 March 2010

Letter from Ian Pearson MP to the Chairman

Thank you for your letter of 3 March on the provision of macro-financial assistance to Serbia, Armenia, Georgia and Bosnia and Herzegovina.

On the issue of conditionality, you requested the macro-financial assistance loans' "term sheets". As you know, the policy conditionality attached to the loans is always in step with the IMF's relevant Stand-By Arrangement – the provisions of which we will include as routine in future Explanatory Memoranda on macro-financial assistance decisions. For each decision to provide macro-financial assistance, the Commission agrees a Memorandum of Understanding with the third country concerned. These Memoranda are not currently publicly available, although we have raised the issue of publication with the Commission, and will continue to follow this up with them.

You also asked about the application of subsidiarity principles to decisions to grant macro-financial assistance. As I mentioned in my letter of 14 February, there has been ongoing consideration of the appropriate legal base for macro-financial assistance under the Lisbon Treaty. As expected, it seems now resolved that macro-financial assistance will fall under Article 212 as a general rule, with Article 213 used in urgent circumstances.

The Committee will shortly receive Explanatory Memorandum 15429/09 and Addendum 1 on macro-financial assistance to Ukraine. The subsidiarity section in the Explanatory Memorandum outlines that according to Article 212 TFEU, the EU has competence to carry out economic, financial and technical cooperation measures, including assistance, in particular financial assistance, with third countries other than developing countries. The Union's operations and those of the Member States shall complement and reinforce each other; and that subject to this, the competence of the EU to act under Article 212 TFEU, and in accordance with the EU budget, is exclusive.

As you have rightly identified, the change in legal base raises a number of questions regarding competence, subsidiarity, legal and procedural issues. We are still working through the detailed implications of all of these, as is the Commission, with whom we have raised some of these questions after receipt of your letter.

The Government will consider these issues further when the Commission updates its proposal. I will of course keep you updated as thinking develops, and fully appreciate the Committee's keen interest in the subsidiarity question and the importance of resolving it.

17 March 2010

Letter from the Chairman to Ian Pearson MP

Thank you for your letter of 17 March on macro-financial assistance (EM 14343/09, 14659/09 and 15427/09). EU Sub-Committee A considered these at the meeting of 30 March.

We note your explanation of the subsidiarity implications of the choice of legal base under the Treaty on the Functioning of the EU and would be keen to receive any further updates on this issue as negotiations progress. We would also like to receive a copy of a Memorandum of Understanding of the loan agreements if the status of these documents as publicly unavailable should change.

30 March 2010

MEDIUM-TERM FINANCIAL ASSISTANCE TO ROMANIA (6243/10, 5244/10)

Letter from Ian Pearson MP, Economic Secretary, HM Treasury, to the Chairman

I am writing to alert you to a vote that took place in the ECOFIN Council of 16 February 2010 on a proposed Council Decision to amend decision 2009/459/EC of 6 May 2009 which provided Community medium-term financial assistance to Romania.

The accompanying Explanatory Memoranda (EM 6243/10 and 6244/10) provide full details of the decision to amend 2009/459/EC. There was a very tight timetable between consultations and the vote in the Council, with the unfortunate consequence of this being that the Government has been unable to alert Parliament until now to the proposed Decision. HM Treasury did not receive the final version of the proposed Decision until 11 February, with the European Commission seeking a decision at the 16 February ECOFIN. This has meant there was not sufficient time to accommodate the Parliamentary scrutiny process, which I regret. However, given the severity of the recession in Romania and the risk of contagion across the EU, economic policy conditions for the disbursement of instalments of the assistance needed to be revised to ensure consistency with the recently revised deadline for the correction of Romania's excessive deficit under the excessive deficit procedure (EDP), and therefore amendment to Council decision 2009/459/EC. I believe that it was right for the UK to support this as it sends a strong signal on the EU unity, ability and willingness to act swiftly and decisively to support Member States facing difficulty. The UK therefore voted in favour of the amendment at the 16 February ECOFIN.

24 February 2010

Letter from the Chairman to Ian Pearson MP

Thank you for your Explanatory Memorandum on the granting of medium-term financial assistance to Romania, and your letter dated 24 February. These documents were considered by EU Sub-Committee A at its meeting on 9 March.

Sub-Committee A cleared the document from scrutiny and recorded the item as a scrutiny override.

10 March 2010

PUBLIC PRIVATE PARTNERSHIPS (16586/09)

Letter from the Chairman to Ian Pearson MP, Economic Secretary, HM Treasury

Thank you very much for your Explanatory Memorandum 16586/09. EU Sub-Committee A considered the document at its meeting on 19 January.

The benefits and risks of Public Private Partnerships (PPPs) are still a matter of discussion and investigation. We note that the Economic Affairs Committee of the House of Lords is currently engaged in an inquiry *Private Finance Projects and off balance sheet debt.* We also think that the results of the their inquiry and, more generally the UK experience with PPPs should be made known to the Commission and fed into the European PPP Expertise Centre (EPEC) which aims to promote good practice on all aspect of design, procurement and delivery of PPPs projects across the EU.

In addition, as we are monitoring developments on EU cohesion policy and structural funds have been delivering projects through PPPs, we are eager to receive an account of the UK experience of delivering such projects.

We are content to clear the document from scrutiny as it contains no legislative proposals. We nevertheless will closely scrutinise future EU initiatives on this matter, especially potential future legislation on service concessions and the use of PPPs in structural fund projects.

28 January 2010

Letter from Ian Pearson MP to the Chairman

Thank you for your letter of 28 January and your confirmation the Committee is content to clear the above explanatory memorandum from scrutiny on the basis the document contains no legislative proposals.

With reference to the Economic Affairs Committee of the House of Lords I was happy to be called recently to appear before them and contribute to their inquiry on Public Private Partnerships (PPPs). I am looking forward to considering their conclusions and recommendations once published.

The UK Government is regularly engaged with the European PPP Expertise Centre (EPEC) and is contributing to all of their ongoing work streams. This work is wide ranging and covers issues such as the procurement of PPPs, the financing, budgeting and accounting for PPPs and the impact of the credit crisis on such partnering projects. The Government will share the Economic Affairs Committee's report with EPEC and wider Commission staff when available.

HM Treasury has close and regular engagement with the EU on project financing and European funding, which comes via the European Investment Bank (EIB). The EIB has supported a significant number of UK infrastructure investments, including £120m of investment to the Greater Manchester Waste Authority in March 2009. The Committee may be interested in the complete list of projects supported, which can be found on the EIB website:

http://www.eib.org/projects/loans/regions/european-union/gb.htm

Further, the recently established Infrastructure UK has been tasked with investigating the full range of financing options available to UK PPP infrastructure projects.

On the specific point of the delivery of structural funds to projects, the responsibility for this lies with colleagues in the Department of Communities and Local Government, who may be better placed to provide more information.

10 February 2010

REFORM OF FINANCIAL SUPERVISION (13645/09, 13648/09, 13653/09, 13654/09)

Letter from Lord Myners, Financial Secretary, HM Treasury, to the Chairman

I understand that your Committee was not able to clear these proposals from scrutiny following the evidence session and debate held on 10 November. Nevertheless, the Committee's views were well known to the Government and enabled us to be fully engaged in the negotiations in Council, in order to bring about the required changes to the legislative texts.

As you know, the Government has been absolutely clear that Parliament needed time to fully consider these proposals. That is why the Chancellor did not agree to a general approach on the European Systemic Risk Board (ESRB) at the October ECOFIN. That is also why the Government worked hard to ensure that your Committee could understand the Government's position and why I was very happy to appear before you a number of times to discuss these proposals.

However, it had always been the intention of European Governments to agree the package of legislation by the end of the year. This timeline was set out by the June European Council and reiterated in October by finance ministers and Heads of government.

The UK therefore did give agreement to the set of proposals setting up a new supervisory structure for the EU at the ECOFIN meeting of 2 December. We expect Heads of government to signal their approval to this agreement at European Council on 11 December.

Drawing on your specific questions, I am able to update you on the position agreed at that ECOFIN meeting.

ENSURE THE ESRB WILL NOT BRING PRESSURE TO MEMBER STATES TO CONFORM TO ITS OWN ECONOMIC OR FISCAL POLICIES.

The ESRB has no powers to enforce its recommendations on Member States, however its recommendations will carry weight. This has to be right – we want a strong and effective early warning system.

IT IS VITAL THAT THE UK HAS GUARANTEED REPRESENTATION ON THE ESRB STEERING COMMITTEE.

Following the consensus in the Council for amendments to the text of the ESRB Regulation so that there would be five, not three, additional central bankers on the ESRB Steering Committee, there was unanimous support for our proposal that two of these must come from non-eurozone central banks.

ENSURE THAT ALL ESA POWERS ARE WITHIN THE LEGAL BOUNDS OF THE TREATY.

The Government's overriding objective has been, and continues to be, that the new framework must be able to withstand legal challenge. This will be a top priority during the upcoming negotiations with the European Parliament.

WHAT WILL BE THE CHANGE TO THE LEGAL BASIS AS A RESULT OF LISBON COMING INTO FORCE?

Article 95 becomes Article 114 of the Treaty on the Functioning of the European Union (TFEU) and Article 105 becomes Article 127 TFEU. The substance of these Articles will remain largely unchanged.

ANY DECISIONS APPLYING DIRECTLY TO INDIVIDUAL FIRMS SHOULD BE EITHER AGREED BY UNANIMITY OR DELETED.

The UK has found unanimous support in Council for ensuring that there are no direct powers over individual firms that undermine national supervision. Therefore, direct powers will be deleted with regards to emergency powers (Article 10) and mediation (Article 11). However, in the Council text the direct powers over firms remain as a last resort where a supervisor is not enforcing EU law. This will only apply when national supervisors are continuing to refuse to comply with EU law once a clear breach of the law has been identified, and have already been provided with a number of warnings. The Government believes that the ESAs need a strong enforcement role and therefore is able to support this limited provision.

PUSH FOR CLARIFICATION OF THE PROCEDURES IN THE SAFEGUARD CLAUSE THAT WILL PREVENT ESAS FROM SEEKING TO ENFORCE DECISIONS THAT IMPINGE ON MS FISCAL AUTHORITY.

The text clearly states that decisions by the ESAs should not impinge in any way on the fiscal responsibilities of Member States. Furthermore, there is a process for a Member State to opt out of an ESA decision where it feels this would have a fiscal consequence. As you know, the Government has been pushing to ensure that this procedure is workable and that, while guarding against potential abuse, it serves to sufficiently protect Member States' fiscal sovereignty.

I hope you find this information useful in your discussions of the EU supervision package.

7 December 2009

Letter from the Chairman Lord Myners

Thank you for providing evidence to the Committee on 10 November on the Commission's proposals for a Directive on Alternative Investment Fund Managers and also on the reform of the structure of financial supervision within the European Union. In this letter we set out our points of concern relating to the proposals for the reform of financial supervision and what we hope you can achieve in your negotiations on the proposal.

EUROPEAN SYSTEMIC RISK BOARD

We welcome the establishment of the European Systemic Risk Board (ESRB). It can play an important role in the detection of systemic risk in the European Union and in a global "early warning system" in terms of imbalances within the financial system. A future crisis will affect EU or global institutions, rather than be limited to a single country, and risk detection systems at a level higher than national bodies can provide will be needed. A European Union wide body will be more effective at identifying problems in the EU than one based exclusively within any member state but global imbalances by definition can only be detected by global bodies. It is therefore crucial that the ESRB work in coordination with the Financial Stability Board and that data exchange occurs between these two bodies.

We recognise that the ESRB will not have binding powers and it will be advisory only. However, concerns have been raised that the ESRB could seek to insist that individual Member State governments conform to its own economic or fiscal policies. We assume the UK will be working, both during negotiations and after agreement of the proposals, to ensure that the ESRB will not bring pressure to bear on individual governments in this way.

As you know, we have concerns over the organisation and structure of the ESRB. As the proposal is drafted the Board will have 61 members; this is too many to achieve effective decision making, particularly in a possible crisis situation. We acknowledge that the Steering Committee will be able to increase the effectiveness of the ESRB and it is vital that the United Kingdom has guaranteed representation on this committee.

The Directive as drafted would entrust the secretariat of the ESRB to the European Central Bank (ECB) and we welcome the use of the ECB. It is well placed to collect data on systemic risk and has sufficient expertise to carry out this task.

EUROPEAN SUPERVISORY AUTHORITIES

We welcome the overall objective of the European Supervisory Authorities (ESAs) – to work towards a single European rulebook and to facilitate increased cooperation between European supervisory authorities – as both positive in terms of increasing cooperation between national supervisors and an important step in creating a true single market in financial services.

We understand that the authorities are to be constituted under Article 95 of the EC Treaty. The power given to the ESAs to provide opinions on the success of individual Member States' implementation of decisions and their dispute settlement powers cast doubts over whether Article 95 can be used in this way. We urge you to work towards ensuring that all powers of the ESAs are within the bounds granted to them by the Treaty. We would be grateful if you could provide details of changes to the legal base that will occur as a result of the coming into force of the Lisbon Treaty.

Our specific concern, which we know you share, is that an ESA will have the power to apply a decision directly to an individual institution if a national supervisor fails to implement that decision. As decisions are decided by Qualified Majority Voting, this could lead to a decision being directly applied to UK financial institutions, without the Financial Services Authority (FSA) having the power of veto. This appears to go against your assertion, with which we strongly agree, that day-to-day supervision must remain the responsibility of the national supervisor. We urge you to ensure that decisions made in an ESA to apply a rule directly to a national financial institution must be done so by unanimity or alternatively that the ESAs have no power directly to apply a decision to a financial institution in an individual member state. Any other outcome would amount to day-to-day supervision and intervention being effectively in the hands of the ESA.

Finally, we acknowledge concerns that have been raised over the process for appeal where decisions impinge upon Member States' fiscal authority. We urge you to push for clarification on the system of safeguards which will prevent the ESAs from seeking to enforce decisions that impinge on Member State fiscal authority.

In conclusion, we believe these proposals are a positive step toward a unified system of financial supervision which will have benefits both for financial stability and the single market in financial services. However, the key concerns raised above need to be addressed before the proposals are agreed in Council. In view of the huge importance of the proposals to the financial institutions of the United Kingdom and our serious concerns over the proposed powers of the ESA we intend to retain the document under scrutiny.

We appreciate that if the proposal is amended as we suggest in relation to the ESAs more attention will be needed to be given to the problem of home-host supervision but we believe that the problems around this subject can and will be resolved as the ESAs bed down and gain experience.

13 January 2010

Letter from Lord Myners to the Chairman

Thank you for your letter dated 13 January regarding the Commission's proposals for EU financial supervision.

I'm pleased that you welcome the changes that the Government has secured during the ECOFIN Council negotiation process, including on the makeup of the European Systemic Risk Board (ESRB), on the European Supervisory Authorities (ESAs) proposed powers over firms, and on Member States' fiscal responsibilities.

In your letter you asked for further detail on emergency situations and ESA mediation. The Government believes that it is important that the ESAs role in such situations is clear. The Government believes that the wording has significantly improved from the Commission's original proposal, however there is still some ambiguity in the wording of the relevant articles. However as a result of the ECOFIN negotiations, the powers and roles of the ESAs in providing mediation and in crisis times will need to be defined in amendments to the relevant legislation, for example through consequential amendments to the CRD. The current Commission proposal on the 'Omnibus Directive'[23] is an example of this, and sets out in detail the process for mediation in a number of areas (for example it amends the procedure for dispute settlement as it relates to CRD article 129). The priority for the Government in negotiating this proposal is to ensure that the remaining ambiguities are removed, and, although negotiations are at an early stage, I think we can make progress here. Furthermore, the Government will raise these points with the European Parliament as

[23] http://ec.europa.eu/internal_market/finances/docs/committees/supervision/20091026_576_en.pdf

it agrees the package of proposals, and will seek to ensure that these ESA articles are even more clearly defined.

I hope this answers your, and your committee's, further questions.

20 January 2010

Letter from the Chairman to Lord Myners

Thank you for your letter on EU financial supervision dated 20 January 2010. EU Sub-Committee A discussed the document at its meeting on 26 January. We agreed to clear the document from scrutiny.

There remains ambiguity around the role of ESAs in mediating between supervisors and in emergency situations. We note that you will raise these points in negotiations with the European Parliament and welcome your intention to ensure that ambiguities are removed. We expect to receive further updates on the progress of negotiations in line with the conclusions of the Select Committee's report *Codecision and national parliamentary scrutiny.*

3 February 2010

STATE AID SCOREBOARD: SPRING 2009 UPDATE (8812/09)

Letter from Lord Myners, Financial Services Secretary, HM Treasury, to the Chairman

I am writing in response to your letter of 5 November 2009, where your Committee requested to receive updates on Commission opinions on the Government's restructuring policies for banks that received state aid in the United Kingdom.

The European Commission approved the state aid provided to Northern Rock on the 28 October 2009. This aid includes loan and working capital facilities, a capital injection and arrangements to guarantee retail deposits and wholesale liabilities. Under the terms of the EC approval, Northern Rock is required to adhere to a number of compensatory measures to minimise any competitive distortion resulting from the provision of the state aid. The official decision letter was published on the 10 January 2009 and is attached to this letter.

As a condition of European Commission state aid approval both the Royal Bank of Scotland (RBS) and Lloyds Banking Group (LBG) have agreed to a number of divestments from their businesses. This is in order to remedy the competition distortions created by the state aid both banks have received, and also to ensure that both banks refocus on their core and profitable activities. The Government is a firm supporter of the state aid rules and has maintained a constructive and cooperative dialogue with the European Commission on the business plans for the recapitalised banks.

On the 18 November 2009, the European Commission approved the LBG restructuring plan. The Commission published the official decision letter on the 24 February 2010. The decision letter, providing details on the Lloyds restructuring, is attached to this letter.

On the 14 December 2009, the European Commission approved the impaired asset relief measure, the Asset Protection Scheme (APS), and restructuring plan of RBS. The Commission's approval encompasses the state recapitalisation of £20 billion on 13 October 2008, £25.5 billion on 22 December 2009 along with the commitment to provide contingent capital of £8 billion should RBS's core tier 1 capital ration fall below 5% in the coming five years, and RBS's accession to the APS as announced on 26 February 2009 and finalised in November 2009. Under the terms of the APS and accompanying aid package, the Government will cover 90% of the losses that arise from a £282 billion portfolio of assets. RBS will retain the first £60 billion of losses and the residual 10% of all further losses.

The RBS restructuring plan provides for a number of business divestments to satisfy state aid requirements. RBS will divest of its insurance arm RBS Insurance, its card processing business Global Merchant Services, and its interest in the joint commodities venture RBS-Sempra. On the 16 February 2010, RBS agreed to sell RBS-Sempra's Metals, Oil and European Energy business lines to J.P. Morgan for a total cash consideration of $1.7bn, of which RBS's share post partner distributions is approximately 47%.

RBS will also make a significant divestment from its retail and commercial business. This divested entity will consist of 311 RBS England & Wales branches and 7 Natwest Scotland branches, which account for approximately 2% of the personal current accounts market. The divestment will also have a 5% market share in the UK Small and Medium Enterprise market (companies with an annual turnover up to £25m), a 5% share in the mid-corporate market (companies with an annual turnover between £25m and £1bn) and the necessary business-banking infrastructure to support these services.

We are currently discussing redactions with the Commission on the official RBS decision letter, and we expect that the Commission will publish the letter in the near future. Once published, a copy will be passed onto your Committee.

19 March 2010

REGIONAL DEVELOPMENT FUND: HOUSING INTERVENTION (12281/09)

Letter from the Rt Hon Rosie Winterton MP, Minister for Regional Economic Development and Coordination, Department for Business, innovation and Skills, to the Chairman

I am writing to inform you of the current position regarding the above proposal following Agreement reached at the European Parliament on 16 February 2010.

Under the present Regulation, with the exception of energy efficiency and renewable energies intervention accessible to all Member States, ERDF supported interventions in the housing sector are reserved only for Member States that acceded to the European Union on or after 1 May 2004, and according to specific conditions (which are set out in Article 7 paragraph 2 of Regulation No 1080/2006 and Article 47 of the Commission Regulation No 1828/2009).

The European Parliament and the Council asked the Commission to take action to promote inclusion of those communities facing deprivation and marginalisation with the intention to support measures to improve the living conditions of these communities through the ERDF. The Commission document COM(2009)0382 therefore proposed a change to European Regional Development Fund Regulation (ERDF) (EC) No 1080/2006, Article 7(2) to extend the types of housing for which the ERDF can provide financial support in the Member States that acceded to the European Union on or after 1 May 2004.

The proposal included amendments to the Regulation so that expenditure for such purposes is programmed within one of the following frameworks:

— the framework of an integrated urban development approach for areas experiencing or threatened by physical deterioration and social exclusion;

— the framework of an integrated approach for marginalised communities.

On 10 February the European Parliament adopted the text of the Regulation in Plenary Session but proposed modifications to the text such that the amended proposal would apply to all Member States ie:

"Expenditure on housing, except for energy efficiency and the use of renewable energy as set out in paragraph 1a shall be eligible in the following cases:

— For the Member States that acceded to the EU on or after 1 May 2004 and in the framework of an integrated urban development approach for areas experiencing or threatened by physical deterioration and social exclusion;

— For all Member States only in the framework of an integrated approach for marginalised communities."

Following further discussion at the Working Party on Structural Actions held on 15 February 2010 the majority of the Member States agreed to the European Parliament amendment in the interest of a first reading deal. However they also acknowledged that housing should remain the competence of Member States and an accompanying statement was subsequently issued by the Commission and Member States (with the exception of Germany, Hungary and the Czech Republic) to the effect that the proposal should only be applied when interventions are part of an integrated approach to tackling the social and economic conditions of marginalised communities and that this exception should in no way be regarded as a general opening of Cohesion Policy to financing housing interventions.

The proposal was submitted as an 'I' point at Coreper on 23 February. A delay in the process is currently being experienced as text changes to the recitals are being discussed in order to reach an agreement between the Council and the European Parliament on appropriate wording. This is however a minor delay relating to a wider procedural issue due to the entry into force of Lisbon and does not impact on the substance of any of the points concerning the Structural Fund Regulations.

17 March 2010

TAXATION: ADMINISTRATIVE COOPERATION IN THE FIELD OF TAXATION (6035/09)

Letter from the Rt Hon Stephen Timms MP, Financial Secretary, HM Treasury, to the Chairman

Thank you for your letter of 25 November expressing support for the proposed Administrative Cooperation Directive and clearing it from scrutiny. I am sorry for the delay in replying.

There was an initial discussion of the proposed Directive at ECOFIN on 10 November. As expected, Austria and Luxembourg expressed political reservations and called for the Directive to be considered as part of a package with other "good governance" tax dossiers, including the Savings Directive and Mutual Assistance Recovery Directive. There was some discussion of the extent of automatic exchange of information under the proposed Directive and varying views were expressed by Member States.

At ECOFIN on 2 December Ministers considered a proposal for an amended Savings Directive (EM 15733/08, cleared by Sub-Committee A on 1 December). Other good governance proposals, including the Administrative Cooperation Directive, were on the agenda. However, agreement was not reached on the Savings Directive, again due to reservations by Austria and Luxembourg. There was therefore no discussion of the other proposals.

There was a further discussion of the good governance package at ECOFIN on 19 January. Austria and Luxembourg lifted their reserves on one element, the Recovery Directive (EM 6147/09, cleared by sub-committee A on 1 December). This Directive was therefore agreed but ECOFIN will return to the other dossiers at a later date.

You ask about the categories of income and capital that are likely to be subject to automatic exchange of information in the Administrative Cooperation Directive. As I have indicated, this has not yet been resolved. However, we anticipate that the Directive will provide for automatic exchange of information in the following categories: employment income, directors' fees, dividends, capital gains, royalties, life insurance, pensions and immovable property. In most of these categories automatic exchange will take place in so far as information is readily available under existing reporting arrangements in the providing Member State. However, a number of Member States would like automatic exchange of information to be mandatory in some categories, whether it is readily available or not.

The extent of automatic exchange of information does not affect compliance with the OECD standard of bank transparency. This standard is based essentially on exchange of information on request. The Directive will require information held by a bank to be provided on request for tax purposes. We and other Member States have ensured that the text closely reflects relevant OECD language on this matter.

With regard to the question of an impact assessment, we do not think that an impact assessment is necessarily required for automatic exchange of information in the possession of, or readily available to, tax authorities without the introduction of new reporting burdens. But we agree that an impact assessment would be appropriate for any automatic exchange of information requirements that may go beyond this. In any event, we intend to carry out an impact assessment before the Directive is implemented in UK domestic law.

25 January 2010

Letter from the Rt Hon Stephen Timms MP

Thank you for your letter of 25 January 2010, on administrative cooperation in tax matters. EU Sub-Committee A considered this at its meeting of 9 February. We had previously cleared this document from scrutiny.

We note that there is still some controversy surrounding the proposal and we would be grateful if you could keep us informed of significant developments in negotiations.

22 February 2010

TAXATION: COMBATING VAT FRAUD (12886/09)

Letter from the Rt Hon Stephen Timms MP, Financial Secretary, HM Treasury

Thank you for your letter of 23 October raising a number of queries on EM 12886/09 and requesting an update on our negotiating position on the Regulation.

Your first concern related to the proposal for Common Minimum Standards for VAT registration and de-registration, but there is also a link here to your query on Comitology decision making. The moment at which a business registers for VAT is clearly of significance, as this is the point at which a person intent on VAT fraud would enter the VAT system and begin to steal VAT revenues. Equally, if a cancelled VAT number is not immediately removed from the tax authority database, or shown as no longer valid, it can be hijacked and exploited to fraudulently justify the zero rating of cross-border supplies. We therefore agree that the idea of introducing common minimum standards for VAT registration and for managing tax authority VAT databases, has attractions. However, if the minimum requirements are not specified and agreed by unanimity in the adopted EC legislation, but are instead left to be determined on a qualified majority basis in the Comitology Standing Committee on Administrative Co-operation (SCAC), there is a risk that unwelcome additional administrative burdens might be imposed. For example, a majority of Member States might want businesses applying for a new VAT registration to provide additional information which we would consider unnecessary or inappropriate. The operation and control of VAT is clearly an area in which the Community has no competence and which is a matter for the Member States alone. Accordingly, while there is a case for co-ordination at EU level, we are wary of allowing matters which could have a direct effect on businesses and VAT registration to be set by a QMV committee.

With regard to your points on Eurofisc, the government sees a value in multi-lateral cooperation to help identify businesses possibly involved in VAT fraud. However, we need to be confident that any such system or network has a sound legal base; that the information supplied will be kept confidential; and that the system will be effective. Member States' views on Eurofisc's organisation, governance and functions cover a wide spectrum. As with Common Minimum Standards for VAT registration, part of the debate will undoubtedly be over the scant detail provided in the draft Recast Regulation and the resultant use of Comitology to implement the new provisions. Comitology already features as a part of the existing Regulation 1798/2003, but it is only used to deal with detailed matters of application, such as the design of forms, or to elaborate provisions which are entirely optional. We would be uncomfortable if more significant matters were dealt with under Comitology which went beyond administrative matters and touched on matters of substance. In the tax sphere these should remain the subject of unanimity decision making. This view of course goes for all the main new elements proposed in the recast, which are all in some way subject to Comitology.

The issue of Comitology is, of course closely connected to subsidiarity. As already mentioned, because fraudsters try to exploit the existence of the different approaches to compliance and control taken by Member States' tax authorities, we accept that there is a need for co-ordination of anti-fraud work and exchange of information. The overall proposal therefore complies with the principle of subsidiarity. Nevertheless, a significant number of Member States, including the UK, are concerned about the use of Comitology and whether the envisaged detailed operation of the proposal would have the capacity to infringe subsidiarity.

There has only been limited discussion of the proposal under the Swedish Presidency. Accordingly we have had little opportunity to explore the proposal with other Member States and test our interpretations of the original text.

I hope that this additional information will be helpful in your further consideration of the proposal.

14 December 2009

Letter from the Chairman to the Rt Hon Stephen Timms MP

Thank you for letter of 14 December 2009 on the proposal on combating VAT fraud which was considered by EU Sub-Committee A at its meeting of 12 January 2010.

We note your concerns regarding the subsidiarity of the proposal. We recognise the need for an EU wide approach to combating cross-border VAT fraud and so believe that in principle the proposal as a whole does not infringe upon subsidiarity principles.

We believe that the issues you raise refer to the inappropriate use of the comitology procedure to decide details which should be set in the Directive itself. We agree that the use of the comitology procedure is too extensive in the case of this Directive and that both common minimum standards and operation of Eurofisc should be set in the Directive itself.

We would like to receive an update on the opinion of other Member States on the proposal and in particular on the use of the comitology procedure.

We have decided to keep the document under scrutiny in anticipation of your reply.

13 January 2010

TAXATION: MUTUAL ASSISTANCE FOR RECOVERY OF CLAIMS RELATING TO TAXES, DUTIES AND OTHER MEASURES (6147/09)

Letter from the Chairman to the Rt Hon Stephen Timms MP, Financial Secretary, HM Treasury

Thank you for your letter of 23 November on mutual assistance for the recovery of taxes. EU Sub-Committee A considered this at the meeting of 1 December.

We agree in principle with the aims of proposal to facilitate cooperation between Member States in the recovery of taxes. As you have provided answers to our questions on the proposal we are content to clear the document from scrutiny.

4 December 2009

TAXATION OF SAVINGS INCOME IN THE FORM OF INTEREST PAYMENTS (15733/09)

Letter from the Chairman to the Rt Hon Stephen Timms MP, Financial Secretary, HM Treasury

Thank you for you letter of 26 November on the amendments to the Savings Directive and the impact assessment that you have provided. EU Sub-Committee A considered this at its meeting of 1 December.

Given that you expect a general approach to be agreed at the ECOFIN of 2 December, we are content to clear this document from scrutiny. However, we are interested whether financial institutions have been consulted on the benefit of this Directive to them. You note the substantial costs of implementation of the proposal to these institutions and the clear rules and more consistent approach the Directive will bring to Member States. Are financial institutions satisfied that the benefits are proportional to the cost of implementation?

We also note that this impact assessment was produced one week before agreement was due to be reached in Council, in response to our letter of January 2009.

4 December 2009

TAXATION: VAT GROUPING (11734/09)

Letter from the Rt Hon Stephen Timms MP, Financial Secretary, HM Treasury, to the Chairman

Thank you for your letter of 23 October 2009 regarding Explanatory Memorandum 11734/09 on VAT grouping. I agree with the Sub-Committee that regulation should avoid imposing unnecessary burdens on business wherever possible. You ask about the reaction of other Member States to the Commission Communication on VAT grouping.

It maybe helpful if I explain that VAT grouping is an optional scheme in EU law and it is taken up by 15 of the 27 Member States. The European legislation relating to this scheme is very brief, and it is left to the discretion of Member States to lay down the detailed rules about how a VAT grouping scheme works in their domestic legislation.

As the Commission Communication is not a formal proposal it has not been on the agenda of any meetings between Member States and we are not aware of any other Member State reaction.

4 December 2009

Letter from the Chairman to the Rt Hon Stephen Timms MP

Thank you for your letter of 4 December clarifying the status of VAT grouping schemes. EU Sub-Committee A considered this at the meeting of 12 January. We are now content to clear this document from scrutiny.

13 January 2010

TAXATION: VAT ON POSTAL SERVICES (11338/04)

Letter from the Rt Hon Stephen Timms MP, Financial Secretary, HM Treasury

Further to your letter of 15 July 2009, I write to provide you with an update on this issue.

The Proposal for a Directive, which seeks to apply an optional reduced VAT rate to standard postal services, received renewed interest under the Swedish Presidency (as a result of recent European Court of Justice "ECJ" case law), having last been discussed by officials in July 2004.

In April 2009, the ECJ decision in the matter of TNT Post (UK) Ltd (C-357/07) confirmed that VAT exemption applied to the universal postal service provided by Royal Mail, even though services being provided by other operators are subject to VAT. It also confirmed that VAT exemption does not extend to supplies of services for which terms have been individually negotiated.

The decision caused a few Member States, including Sweden, which tax such postal services, difficulties. It also meant that some postal services supplied by Royal Mail, which have, in the past, been treated as exempt will become liable to VAT. To address this, HM Revenue and Customs will implement some changes to domestic VAT legislation – see appended Business Brief 64/09.

The Swedish Presidency scheduled a discussion on the Proposal at officials level in July 2009, but failed to persuade the majority of Member States that the Proposal warranted further discussion. It therefore took the matter to a Council meeting on Economic and Financial affairs (ECOFIN) on 2 December 2009 where Finance Ministers agreed to ask officials to examine the interaction between the VAT Directive and the Postal Liberalisation Directive and to report back to ECOFIN no later than December 2010.

The extent to which the Proposal will be discussed over the course of 2010 is unclear. Any changes to this would, of course, have to be agreed unanimously. Many Member States, including the UK strongly object to VAT on public postal services and, importantly, the two Presidencies in waiting (Spain and Belgium) have not indicated that this is a priority for them.

I will update you if there are any developments on this Proposal in 2010.

14 December 2009

Letter from the Chairman to the Rt Hon Stephen Timms MP

Thank you for your letter of 14 December 2009 providing an update on the proposal for Value Added Taxation of postal services (11338/04). EU Sub-Committee A considered this at its meeting of 12 January 2010.

As no further progress has been achieved in negotiations we will continue to hold the document under scrutiny.

13 January 2010

VAT: INVOICING (5985/09, 5991/09)

Letter from the Rt Hon Stephen Timms, MP Financial Secretary, HM Treasury, to the Chairman

In February 2009 I sent an Explanatory Memorandum covering a linked Commission Communication and a legislative Proposal to amend Directive 2006/112/EC (the VAT Directive) for consideration by your Committee.

At a subsequent meeting, your Committee cleared the Communication but retained the draft Council Directive under scrutiny pending information on the result of the Government's consultation with UK business, in particular with regard to the effect of the proposed changes to general rules on VAT invoicing and the effectiveness of the proposals aiming to prevent VAT fraud.

HMRC and HMT have been carrying out informal consultations with UK business during the course of the negotiation of the proposed legislation. You will recall that the key issue in the Commission's Proposal concerned the VAT rules on electronic invoicing. The intention was to address the varied application of the VAT rules on electronic invoicing across the EU, a current deterrent to its widespread acceptability and use by businesses.

The Proposal was to remove the options that enabled Member States to require the use of an advanced electronic signature or electronic data interchange. This would enable businesses to be free to send electronic invoices under the same conditions as they would send paper invoices. The Government and UK businesses support that approach.

Another part of the Proposal concerned the VAT rules on invoicing more generally. The aim was to remove some inconsistencies in the current rules. However, although this was mostly uncontroversial and supported by UK business, one aspect was opposed by the exempt sector, including in particular financial and insurance businesses.

The effect of the Commission Proposal would be to make it compulsory for all businesses to issue VAT invoices for all supplies, including those that are exempt from VAT. By contrast, current EU legislation allows Member States the possibility to release businesses from that obligation in respect of exempt supplies made in their territory. The UK applies that option. The Commission Proposal therefore had a potential negative impact on these exempt sectors, as it would have increased their administrative burdens substantially. The finance and insurance sectors were able to provide a solid body of evidence to demonstrate that. The UK was therefore able to pass this information on to our European counterparts to help inform the negotiation process.

A third aspect of the Proposal concerned measures to combat VAT fraud. You will recall that the Government remained to be convinced of the arguments for including fraud measures within this set of proposals, which were predominantly for the benefit of business. Indeed, in the event UK businesses made strong representations about the way the proposed shortening of the timeframe for recapitulative statements would work in practice.

The aim of the original Commission Proposal was to create a single date on which the tax becomes chargeable, being the date of the chargeable event as determined by the time of the supply. By requiring the invoice to be issued by the 15th day of the month following the chargeable event, the invoice would still remain the principle document evidencing the intra-Community supply.

There were two principle objections to this proposed change. The first was that as drafted, it would also impact on the treatment of domestic invoices. While businesses could accept that there was a rationale for a change with regard to intra-Community supplies, they could see no sense in changing the current treatment Member States apply to invoices within their territory. The second objection was a practical one. Most businesses do not keep a record of the chargeable event, and indeed in some cases it can be rather difficult to tie down. Such a rule was potentially unworkable and would impose unnecessary additional burdens. By contrast, a rule based on the date of invoice could work, was practical and would not impose unnecessary additional burdens.

The fourth aspect of the Proposal was to enable all Member States to offer the cash accounting scheme as an option for SMEs below a certain turnover threshold. You will recall that the UK (as do some other Member States) applies such a scheme by derogation and it is important to UK SMEs that it continues.

The negotiations on the proposed legislation developed as follows. Initial discussions commenced under the Czech Presidency in the first half of 2009, based on the original Commission Proposal. The Swedish Presidency continued the discussions during the second half of 2009, based on Swedish Presidency compromise texts. More recently, the Spanish Presidency made the dossier a VAT priority for its Presidency. It produced a large number of legal texts and held many meetings in quick succession over recent weeks. From a UK perspective, none of these legal texts were wholly acceptable, given the valid concerns UK business had raised. The UK therefore continued to press for substantial improvements to the legal text. Finally, on 12 March 2010, a text emerged which included all of the following:

— The Proposal on electronic invoicing retained the principles that the Commission aspired to and would enable businesses to be free to send electronic invoices under the same conditions as they would send paper invoices. This would therefore help provide the right sort of environment for greater take up of electronic invoicing in the future and potentially reduce business burdens across the EU.

— The legal text included an option to enable Member States to remove the obligation to issue VAT invoices for exempt supplies made in its territory. In addition, it introduced a mandatory provision to remove the obligation to issue VAT invoices in respect of cross border exempt finance and insurance supplies within the EU.

— The legal text included the fraud provision, but it did not impact on domestic treatment. In addition, the rules for cross-border supplies were changed so that they would be based on the date of invoice, and so would be more practical from a business perspective.

— Finally, the legal text also provided the legal base for the UK to continue to operate the cash accounting scheme, once the existing derogation runs out at the end of 2012.

The Presidency then pushed this forward to ECOFIN to agree the general approach based on that legal text. At ECOFIN, the legal text was further strengthened by the inclusion of a review clause. This commits the Commission to assess (based on an independent economic study) the effectiveness of the new rules on electronic invoicing by 31 December 2016.

Given that this legal text so closely reflected UK negotiation objectives, and the very real risk that any further delay would potentially put UK hard won gains at risk, the UK, as did all other Member States, accepted the general approach.

Following some final tidying up of the legal text, we expect it to go forward to a future Council for adoption in the near future, with 8 June ECOFIN a possibility.

The attached Impact Assessment is based on the most recent text.

While it is regrettable that the scrutiny procedures were not completed I hope that you can understand why the UK accepted the general approach, given the circumstances.

22 March 2010

Letter from the Chairman to the Rt Hon Stephen Timms, MP

Thank you for your detailed letter of 29 March on VAT invoicing (documents 5985/09 and 5991/09). EU Sub-Committee A considered this at the meeting on 7 April.

Thank you for providing the impact assessment on the proposal. We are pleased to see many of the concerns of UK businesses were addressed in the agreed version of the text. For this reason we are content to clear this document from scrutiny.

We note that agreement was reached at ECOFIN on this proposal before we completed scrutiny of the document, and therefore the scrutiny reserve resolution has been breached. The failure to inform us in advance of the agreement is wholly unacceptable. You note that the Spanish Presidency produced five legal texts in six weeks. We consider that this would have provided ample time for you to inform the Committee of a possible forthcoming breach of the scrutiny reserve resolution. In future, we would be grateful to receive such a letter warning of the possibility of a breach of the resolution occurring, if it is not possible for you to provide the Committee with a more detailed response. We would also like to receive progress reports on any document that is moving towards agreement.

We do not expect a reply to this letter.

8 April 2010

VAT: VAT SYSTEM (17760/09)

Letter from the Rt Hon Stephen Timms, MP Financial Secretary, HM Treasury, to the Chairman

In January 2010 I sent an Explanatory Memorandum covering a Commission legislative Proposal laying down implementing measures for Directive 2006/112/EC (the VAT Directive) for consideration by your Committee.

At a subsequent meeting, your Committee cleared the draft Council Regulation from scrutiny. You might, however, be interested in a brief update on where things stand.

The Spanish Presidency has so far held two Working Party meetings, which provided a first run through of the Proposed VAT Implementing Regulations. The Presidency is currently in the process of producing a compromise legal text, though that has not yet been issued. The expectation is that this will then be discussed at meetings planned for 14 April and 5 May. Depending on the content of the expected Presidency compromise text and the outcome of the planned discussions, there is a possibility that the Presidency could then take the dossier to ECOFIN on either 18 May or 8 June for political agreement.

Officials held initial discussions with business, through existing HMRC and HMT liaison fora, including the Joint VAT Consultative Committee (JVCC) and the VAT Forum. This led to the creation of a Joint Working Group, to review the legal text in detail. Business welcomes the clarity and consistency that such implementing measures would provide and so early agreement would be advantageous, provided the content is satisfactory. The Joint Working Group will undertake a review of the Presidency compromise legal text when it emerges to test that. This will then inform the UK negotiation position for the meetings in April and May.

If the legal text or the outcome of those discussions provides UK businesses with the right level of clarity and consistency, then business will be keen to see early agreement and the Government would certainly not wish to stand in the way of that.

29 March 2010