



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 18 May to 30 November 2010.

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

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ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE (9494/09)

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

I am very grateful to the House of Lords European Union Scrutiny Committee for its work on the Alternative Investment Fund Managers (AIFM) Directive.

The previous Committee wrote to the Government on 8 April requesting to be kept updated about the Government's negotiations on the definition of "cooperation agreements" and the capacity for managers of third country funds to market their funds into the EU under the AIFM Directive. I thought that, at this stage, it would be useful to provide this Committee with an update on where negotiations have reached, both with regard to these issues and more generally. In doing so I will focus on the key differences as I see them between the Council and the European Parliament's respective texts.

As you know, this Directive is under the ordinary legislative procedures (previously co-decision before the Lisbon Treaty) Directive and therefore requires the agreement of both the European Parliament and the Council of Ministers. The European Parliament ECON Committee voted through their draft text on 17 May. The Council of Ministers reached a general approach on the AIFM Directive at the 18 May ECOFIN, which gave the Presidency a mandate to start negotiations with the Parliament. This draft text was unchanged from the proposals of the Spanish Presidency on 11 March. However the Chancellor secured a minutes statement, unanimously agreed, that noted that some Member States still had concerns with certain aspects of the Council text, particularly with regard to the treatment of third countries, and called for the Presidency to take these into account when entering trilogue negotiations.

The negotiations have now moved to the 'trilogue' phase, where the Parliament, Council (represented by the Presidency) and the Commission meet to find a compromise between the two positions. The Government continues to push the UK's position through this process.

The European Council on 17/18 June called for agreement to the Directive before the summer, and both Commissioner Barnier and European Parliament rapporteur Jean-Paul Gauzès have also echoed these sentiments.

THIRD COUNTRIES

The treatment of third country funds and managers under the Directive has been a key issue during these negotiations. There are significant differences between the Council and Parliament texts on this issue. (A summary of the differences between the Council, Parliament and Commission's texts is in the annex.)

A key difference between the two positions is that the Council text does not provide for a passport for third country funds but does offer the option of Member States allowing marketing through national regimes. However, the Parliament text offers the benefit of a passport to third country funds (whether there is an EU manager or a third country manager) but does not offer the possibility of marketing through national regimes.

In addition, in the case of a third country manager, the Parliament text makes ESMA the supervisor of the third country manager but allows it to delegate day-to-day supervision and enforcement to the third country supervisor.

The Committee raised cooperation arrangements in its previous letter. Both the Parliament and the Council texts require cooperation arrangements in the event of a manager of a third country fund seeking to market to EU investors. In both the Council and the Parliament texts, cooperation agreements are required as follows:

- in the case of an EU manager of a third country fund: between the Member State in which the AIFM is looking to market and the third country in which the fund is based;
- in the case of a third country manager of a third country fund: between the Member State in which the AIFM is looking to market and the third country in which the manager is based.

In the Council text the Commission is given a role in setting the standards for such arrangements, although it is a matter for each Member State to negotiate and sign agreements with the relevant third country jurisdiction. These arrangements are linked to international standards (e.g. International Organization of Securities Commissions) in the text. The Parliament's text is silent on the content of the cooperation agreement, and does not assign a role to any particular institution to defining their content or negotiating them.

The Government supports linking cooperation arrangements to international standards, in line with G20 commitments. However, the Government does not agree that the European Commission should be given an explicit role in defining the parameters of these arrangements.

In summary, the Government believes that this Directive should be non-discriminatory and therefore supports the principle of granting a passport to third country funds. It is also important to protect investor access to non-passporting funds. The Government also considers that it is not appropriate to prescribe roles for ESMA in this context, when there is a separate and ongoing European negotiation on the roles of such entities. The Government will continue to push for a third country passport operating parallel to a national regime for non – passporting funds.

DEPOSITARY REQUIREMENTS

A depositary is a financial firm, independent from the AIFM that holds assets on behalf of an investment fund, which acts as an investor safeguard and performs certain other “oversight” functions over the management and operation of the fund. The Parliament and Council take slightly differing positions on some of the issues but the two key issues are:

- Conditions on which entities AIFMs can nominate as their depositary.

The Council text requires all EU AIFMs managing an EU fund to use a single EU depositary. However, for an EU AIFM managing a third country fund – which is in practice, the majority of UK hedge funds / private equity firms – most of the depositary requirements are disapplied because there may be local requirements where the fund is established and because these funds are not granted an EU marketing passport (i.e. the ability to market across the EU under a single authorisation).

The Parliament text requires EU AIFMs managing non-EU funds to ensure that either a single EU depositary or that the jurisdiction of the non-EU depositary has been assessed as ‘equivalent’ by the European Commission. This would require most UK fund managers to change their existing business model and so increase costs.

- The liability of depositary

The Directive poses a change to the status quo and proposes a significantly higher level of depositary liability than either the FSA, current EU “UCITS” legislation, or market practice applies at present. This would result in a rebalancing of investment and depositary risk so that more risk is taken on by the depositary. The perceived need to increase the liability of depositaries was heightened by the loss of assets that occurred in the Madoff affair.

On the core issue of liability in the event of loss of assets, both the Parliament and Council text impose a similar level of liability and look to see whether the event that gave rise to the loss was foreseeable and whether the manager had done all it could to avoid that loss (although we consider that the Parliament text imposes a slightly lower burden on depositaries). The Parliament text also imposes for all other losses, a lower liability test of whether the failure was intentional, due to negligence or improper performance. Both Council and Parliament allow for the exception of force majeure.

On the issue of delegating the liability to a third party, both allow for a contractual discharge of the liability of the depositary in favour of the third party. However, the Council permits a wider set of conditions when this discharge is available. However, the depositary industry has argued that such delegation would not work in practice due to it being impractical and costly.

The Government is arguing for the most appropriate elements from Parliament and Council text that ensure that existing business models are not unnecessarily hindered and investors costs are not disproportionately increased, that the range of persons who can act as a depositary is as broad as reasonably possible to help maintain competition, and that the level of depositary liability is fair to both depositaries and investors.

PRIVATE EQUITY CAPITAL ADEQUACY OF TARGET COMPANIES.

The Parliament text proposes to apply the capital adequacy regime under the Second Company Law Directive (2CLD) to a target company acquired by a private equity fund. 2CLD applies to public companies but not to private companies and it does not allow the provision of financial assistance by the company being acquired. The Council text makes no reference to 2CLD. It is not clear how or whether the Parliament intend this restriction to apply. If it does, this would mean a significant change to the current private equity takeover model, as the debt funding in acquisitions is typically secured on the assets of the target company.

The Government will argue that EU private equity should not be competitively disadvantaged from its other competitors and, if the 2CLD requirements are applied, that they should not be applied to the extent that they damaged or unduly restricted EU private equity and existing business models.

DELEGATION

The Council text permits the delegation of portfolio management and risk management to non-EU third parties in a similar approach to other EU legislation (i.e. MiFID).

The Parliament text only allows the delegation of administrative services to non EU firms subject to certain conditions being met, including the condition that the assets are located in a third country. It also only allows the delegation of risk management, portfolio management and liquidity management to another EU AIFM that manages a fund of the same type, and prohibits sub-delegation.

The Parliament's restriction would almost certainly require a significant change in models and possibly investment strategies used by AIFMs, which could in turn negatively impact returns to investors. Therefore the Government continues to support the Council's position.

SHORT SELLING

The Council text does not impose any restrictions on short selling, instead requiring periodic disclosure of short selling activities. The Parliament text, however, proposes a general amendment to the Market Abuse Directive in relation to short selling. This would affect not only AIFMs, but everyone who engages in short selling.

Short selling is currently subject to a public consultation by the Commission. We expect, and the Government would push for, any subsequent proposal to be backed by an impact assessment. The Government therefore consider it is premature to be introducing short selling requirements in the AIFM Directive, and will support the Council's position.

LEVERAGE

Leverage caps would limit the extent to which a manager could borrow against the value of the fund's assets or use derivatives to collateralise through margin arrangements. The Council text seeks to require national supervisors to set leverage caps on alternative investment funds where they deem necessary to ensure the stability and integrity of the financial system. The Parliament text, however, would give ESMA a greater role in this process and would allow it to set leverage caps on individual funds.

The Government has stressed that setting leverage caps at the wrong level could force AIFMs to sell assets in a falling market to rebalance their asset value to debt ratio, potentially perpetuating a downward spiral. We consider that national supervisors are therefore best placed to make this judgement. In addition, the Government continues to argue that it is not appropriate to prescribe ESMA these powers in this Directive, particularly as the EU has not concluded its deliberations on the EU financial supervision package. The Government will therefore strongly support the Council's text.

SCOPE

The Council text does not impose a “de minimus” scope threshold but does provide Member States with the discretion to exempt AIFM from many of the requirements, subject to the registration of these AIFM and compliance with a general supervisory reporting requirement. The Parliament text has no threshold – so all funds are within scope – but narrows the application of the Directive by excluding certain key requirements for managers of certain types of funds – for example, investment trusts and private equity. This would be welcome from certain sectors of UK industry. The Government will therefore push for the Council’s threshold, but with the optional exclusions in the European Parliament text.

PRIVATE EQUITY DISCLOSURE

The Parliament text differs from the Council’s approach in two key areas.

- The threshold for when these disclosures need to be made are much lower in the Parliament than in Council. The threshold in Parliament is if the target company has more than 50 employees and the private equity fund has achieved 10, 20, 30 and 50% control of that company. Whereas in the Council text, this threshold is aligned to the Commission definition of an SME (250 employees being one of the tests of that definition) and the private equity fund has achieved a 50% control of the target company.
- Once the threshold has been met, the threshold requirement in the Parliament is more than in Council and includes, amongst other things, the disclosure of information on the target company’s environmental policy, management compensation package and remuneration policy and details of any changes to its place of business.

The Government continue to argue that EU private equity should not be unduly disadvantaged competitively against their competitors and that requirements should be proportionate to the size of the business.

REMUNERATION

The Council text requires fund managers to defer 40% or 60% of variable remuneration. This attempts to link the AIFM Directive more closely to the provisions in the Capital Requirements Directive (CRD), as they apply to banks. However, it does not use CRD’s fixed three-year clawback period, but allows a variable period for deferral of remuneration tailored to the life cycle of the fund (which can vary significantly).

The European Parliament extends these requirements to 50% or 60%. It also specifies that the deferral period cannot be less than 4 years. The Parliament text also extends these requirements to cover private equity carried interest and imposes a “claw back” provision of at least 20% variable remuneration over at least a four year period, where risks are identified at some point in the future which would have impacted variable remuneration at the time it was paid.

The Government agrees that the remuneration should be better aligned to the interests of the investor. However, it is inappropriate to cover carried interest as this already aligned the interests of AIFM and investors by ensuring that the AIFM does not receive any variable remuneration until funds have been returned to investors and a minimum “hurdle” rate of return has been met. In addition, to include a minimum deferral period would not be compatible with all funds, some of which have longer life cycles. The Government will continue to push for the Council’s approach.

I hope that the Committee has found this a helpful summary of the key issues of difference between the Council and the Parliament’s preliminary texts, and the position that the Government proposes to take.

As you are aware, the previous Committee granted the Government a waiver to continue to take a position in ECOFIN without having override scrutiny. Is the Committee now willing to clear this Directive for scrutiny? Or, given the speed with which these negotiations are likely to reach a conclusion, is the Committee content for the Government to continue operating under the arrangement proposed by the previous Committee?

21 June 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your detailed letter of 21 June on the Alternative Investment Fund Managers Directive. The EU Sub-Committee on Economic and Financial Affairs and International Trade discussed this letter at the meeting on 6 July.

In line with normal scrutiny procedure, the scrutiny reserve will be lifted following the debate on the Committee's report. This has now taken place and the document has therefore been cleared from scrutiny. We do, however, expect that you will provide regular updates to the Committee on the progress of negotiations in line with the procedures set out in the Committee's report on the co-decision process, Codecision and National Parliamentary Scrutiny.

7 July 2010

BANK RESOLUTION FUNDS (10394/10)

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

Thank you for your Explanatory Memorandum on bank resolution funds. The Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 13 July.

The Commission's Communication on banking resolution funds continues an important debate on how to support the winding up of failing banks. The Government's intention to introduce a bank levy of which proceeds will go into the general budget rather than to a bank resolution fund clearly clashes with the Commission's proposal to establish a resolution fund. Do you think that there is any room for conciliation between the two approaches? Will the unilateral imposition of a UK levy affect the competitiveness of the banking sector in the UK?

We agree that it is important to maintain a global perspective on the discussions on management of the banking crisis. What are the Government's plans to ensure that there is a coordinated and consistent approach in the global discussions on bank levies? We understand that the EU is committed to go forward on resolution funds despite the lack of support from the G20.

We also understand that EU leaders intend to explore the possibility of a financial transaction tax. Is this an idea the UK Government intends to support? We will be keen to receive an update on any progress made in this area.

We intend to monitor the developments on this issue closely especially in light of further legislative developments. In the meantime, we will maintain the document under scrutiny.

We would be grateful to receive an answer to this letter in the standard ten working days.

13 July 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 13 July 2010 on bank resolution funds, and for the continuing interest of your Committee on issues relating to cross border crisis management in the banking sector. I note that you will maintain the document under review and intend to monitor developments in this area.

You are correct to highlight that the Commission's proposal to establish a network of national resolution funds is not consistent with the Government's bank levy, which will flow into general budget. We understand that the UK position is shared by other Member States. Given this divergence of views on the destination of levy proceeds, we think it is important that each Member State is left to decide on the destination of proceeds and whether or not to implement a fund.

You asked whether the unilateral imposition of a UK levy will affect the competitiveness of the banking sector in the UK. At Budget, the Government made a joint announcement with France and Germany on the introduction of levies and the US administration has made clear its intention to introduce some form of financial sector levy. However, the proposed rate does not reflect a judgement on the scope for the sector to make a contribution taking account of current circumstances and the competitive position of the UK.

In regard to ensuring a coordinated and consistent approach internationally, the UK levy is based on valuable work by the IMF and builds on principles discussed at the G20. The Government will continue to seek broader international agreement and will work with international partners to secure a coordinated approach, including within the EU.

You also ask whether the Government intends to support the idea of a financial transaction tax. The Belgian Presidency intends for EU Finance Ministers to have a general discussion on the subject later

this year, but there is currently no Commission proposal on the table. You will be aware that the recent IMF report for the G20 on financial sector contributions did not offer an endorsement of a financial transaction tax and clearly there would need to be further discussion around whether such a model offers a stable and efficient mechanism at this stage. In the meantime we see the bank levy model as offering an effective way forward.

26 July 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letter on bank resolution funds dated 26 July 2010. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 12 October.

We understand that the Government's divergence with the Commission on the use of a bank levy is symptomatic of the difficulties in identifying a single EU approach to bank levies. EU Member States are divided over how to implement a levy and where to direct the funds generated. We note that suggestions for a tax on financial transactions require further discussion to determine their viability, and continue to be at the centre of debate.

It seems that the Commission is determined to push for the EU to adopt a financial activities tax rather than a financial transactions tax on the assumption that it would be easier to implement. While we await the publication of the Commission's proposal on a financial activities tax, and the subsequent Government Explanatory Memorandum, we would like to continue to be informed of any further developments in this area, especially in light of the Government's plan to introduce a bank levy. In the meantime, the Committee agreed to clear this document from scrutiny. We do not require a response to this letter.

12 October 2010

CAPITAL REQUIREMENTS DIRECTIVE (12093/09)

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

On 30th June 2010, EU Permanent Representatives issued a letter on behalf of the Council to the European Parliament agreeing the Presidency compromise text for amending directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (Capital Requirements Directive III). On Wednesday 7th July 2010 the European Parliament voted at Plenary to agree the package. The final agreement was adopted at ECOFIN on 13th July.

I am writing to inform you of a number of changes made to the Capital Requirements Directive III (CRD III) package made since your Committee cleared the document from scrutiny.

TRADING BOOK CAPITAL

On 18th June 2010 the Basel Committee on Banking Supervision announced three changes to the Basel market risk framework, which have been reflected in the CRD III package:

- The trading book elements of the package will now be implemented no later than 31st December 2011.
- Three specific interpretive treatments relating to the application of standardised securitisation charges were adopted. The interpretations relate to the mechanics of implementing the 'maximum possible loss' calculation on individual positions, the clarification of the exposure measure on which standardised securitisation capital charges are based, and clarification of the applicability of offsets of the Basel II framework.
- In addition, those securitisations that are not in the correlation trading book (i.e. standard securitisations and resecuritisations) have been allowed a transitional period of two years following the implementation of the trading book reforms. During this transitional period their capital charges may be based on the larger of the capital charges for net long and net short securitisation positions.

The Government is strongly supportive of the work of the Basel Committee and pushed for CRD III to fully reflect the Basel Agreement.

COVERED BONDS

Before the trilogue process the European Parliament inserted a number of further amendments relating to the treatment of covered bonds that had not been in previous iterations of the CRD III text. These proposed making permanent some transitional clauses in the CRD governing the inclusion of Mortgage-Backed Securities (MBS) in covered bond pools and the favourable capital treatment of certain types of covered bond.

The amendments that were agreed did not make this treatment permanent but postponed a Commission review (which should have been undertaken by the end of 2010) for two years and extended the current transitional framework for three years, subject to some extra safeguards.

The amendments will extend for three years the exemption of the 20% limit on the proportion of a covered bond pool that can consist of MBS, which currently applies for all AAA-rated MBS. In the interim there will be some new safeguards on top of the requirement that the MBS be AAA: only MBS issued by the covered bond issuers themselves will be eligible for the exemption, the issuer will retain the first loss on the MBS, the MBS will be subject to the same domestic regulatory scrutiny as the rest of the pool.

The covered bond amendments will also extend for three years the lower “loss given default” (LGD) assumption of 11.25% that must be used in banks’ internal models that calculate the capital to be held against covered bonds meeting certain strict criteria, e.g. AAA rated, with a maximum of 10% MBS in the cover pool. The normal LGD assumption for covered bonds is 12.5%.

The Government had concerns about the amendments to make permanent the temporary preferential treatment of covered bonds. However, given the lack of review to date, it was willing to accept the compromise of an extension of the treatment, with a commitment for full review, in order to gain agreement for the overall CRD III package.

REMUNERATION

During the trilogue negotiations, two material provisions were added to the remuneration principles.

The first imposes three conditions on credit institutions that continue to benefit from exceptional government intervention:

- In line with the requirements of the FSB Standards, variable remuneration must be limited as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base.
- The competent authority (in the UK, the FSA) shall require these firms to restructure their remuneration practices and ensure they are aligned with effective risk management and long-term growth. In doing so the authority can impose limits on Directors’ remuneration where appropriate.
- The provision also requires variable remuneration only to be paid to Directors of these firms to the extent it is justified. Some clarity is provided on the parameters of this justification and the priorities of a firm that benefits from exceptional government intervention should be to restore capital and provide for the full recovery of all taxpayer assistance. Any variable remuneration payment should reflect these priorities.

The second provision brings discretionary pension benefits within the scope of the payment structuring requirements. The intention behind this provision is to ensure that employees are not inappropriately incentivised through pension benefits that are granted as part of a bonus and, consistent with this, that discretionary pension benefits can be assimilated to variable remuneration. Two conditions are imposed on discretionary pension benefits:

- When an employee leaves a credit institution or investment firm, their pension benefits are to be retained by the firm in question for a period of five years and held in the securities of that firm.
- When an employee retires, the benefits paid to them pursuant to their discretionary pension awards are to be paid in the securities of their firm and subject to a five year retention period.

As with all the other remuneration provisions, these additions will be implemented according to the principle of proportionality and will be applied to firms in a way and to the extent appropriate to the size, internal organisation and the nature, scope and complexity of their activities.

The Directive also includes requirements for the disclosure of remuneration details. Firms under scope will have to disclose a narrative description and explanation of the remuneration policy and the key drivers that determine compensation paid to senior management and significant risk takers. They will also have to prepare and report aggregated quantitative pay data, including the breakdown of remuneration into fixed and variable components, upfront and deferred components and cash and non-cash components. These requirements are also subject to the principle of proportionate risk based application.

The Government supports the remuneration provisions in the Directive. They are consistent with the Government's policy on the remuneration structuring and corporate governance in the financial services sector, they are broadly aligned with the G20 agreed FSB Principles and Standards and they are in line with the Government's policy on the disclosure of pay details.

In addition, the Government supports the amendments agreed in trilogue and discussed above. These additional measures will ensure the proper oversight and structuring of pay in the state assisted banks and will prevent the misuse of company pension awards in the incentivisation of excessive risk taking. The Government also supports proportionate risk-based application of the provisions throughout the financial services industry. On this basis firms will face obligations that are commensurate with their size and the risks they pose.

20 July 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letter of 20 July updating the EU Sub-Committee on Economic and Financial Affairs and International Trade on a number of changes made to the Capital Requirements Directive (12093/09). This document was previously cleared from scrutiny at the Sub-Committee's meeting of 8 December 2009.

We hope that these further changes will reinforce prudential regulations while increasing confidence in the re-securitisation market. We look forward to discussing with you the Commission's imminent proposals on CRD IV and the new BASEL III framework.

We do not require a response to this letter.

19 October 2010

CORPORATE GOVERNANCE: FINANCIAL INSTITUTIONS AND REMUNERATION POLICIES (10823/10)

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

Thank you for your Explanatory Memorandum 10823/10, dated 19 July, on the Commission green paper on corporate governance in financial institutions and remuneration policies. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 12 October.

While the green paper launches a consultation and does not put forward specific legislative proposals, it touches upon important issues. We agree with you that corporate governance shortcomings in some parts of the banking sector contributed to the severity of the financial crisis.

It appears that some of the green paper's proposals are in line with many aspects of corporate governance regulation in the UK but in other respects the green paper appears to go further, especially when considering whether stock options and golden parachutes should be prohibited and if the civil and criminal liabilities of directors need to be reinforced.

We will therefore keep the document under scrutiny while waiting to receive your response to the consultation and a clearer explanation of your position on the most ambitious content of the green paper.

12 October 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 12 October. Please accept my apologies for the delay in responding.

Please find attached the Government's response to the EU Green Paper on corporate governance in financial institutions and remuneration policies, which was submitted to the EU Commission on 8

September 2010. The EU will issue a summary of responses to the Green Paper later this month, whilst we expect any proposals or recommendations to be made in Q1 2011.

In your letter, you asked about the Government's position in a number of areas where the language in the Green Paper suggested that the Commission might be seeking to go further than the current UK position, namely on stock options, 'golden parachutes', and director liability regimes.

The Government has encouraged the Commission to investigate thoroughly the issues it has raised in the Green Paper to ensure that any proposals are based on robust impact analysis.

In relation to stock options, while intended to incentivise executive performance by aligning it with firm performance, there is some evidence that stock options can have perverse effects on behaviour and some firms have chosen to replace options with equity based long term incentive plans. This is not the experience of all firms, and if this is reflected in firms' responses, it is unlikely that banning stock options would be a proportionate response. Indeed, banning stock options could conceivably have the effect of distorting remuneration policies. We have therefore indicated that we would welcome further work on this topic.

Excessive severance payments where performance has been inadequate or losses have resulted from a failure to manage risk effectively are inappropriate but the principal obligation to control these rests on directors and shareholders. The response makes clear that adequate transparency is necessary so shareholders can signal their views to boards.

In relation to director liability regimes, there is little evidence to demonstrate that inadequate liability regimes were responsible for the governance failings that occurred during the crisis. Furthermore, even in those countries whose directors faced higher liabilities, there were still instances of inadequate oversight and excessive risk taking.

In addition, on 25 October 2010, the Department of Business, Innovation and Skills has launched a call for evidence on 'A Long Term Focus for Corporate Britain' to consider whether there are failures in corporate governance and the markets. Although not directly related, this touches on a number of issues covered in the EU Green Paper, and looks at: the problems of short-termism; investor engagement; directors' remuneration; and the economic case for takeovers. This consultation will conclude on 14 January 2011.

3 November 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letter of 3 November on the Commission Green Paper on corporate governance (EM 10823/10). The EU Sub-Committee on Economic and Financial Affairs and International Trade considered this at its meeting on 16 November.

We appreciate you providing us with the Government's response to the Commission consultation on the Green Paper and we have agreed to release the document from scrutiny. We will return to the subject when more specific proposals are put forward by the Commission next year.

16 November 2010

CREDIT RATING AGENCIES (10827/10)

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

Thank you for your explanatory memorandum of 17 June on the amendment of the Regulation on credit rating agencies (document 10827/10). The EU Sub-Committee on Economic and Financial Affairs and International Trade considered this at its meeting on 6 July.

We note that this proposal would provide the European Securities and Markets Authority (ESMA) with the role of overall supervision of credit rating agencies. This raises questions in relation to the subsidiarity principle, namely whether the supervision would be more effective at an EU or at a national level. We would like to receive further details on why you think that supervision would be more effective if carried out by ESMA. Further, what is your view on the possibility that subsidiarity concerns could arise in some Member States but not others, for example as supervision may be more effective at an EU level for some Member States, but not in others because of the differing levels of capacity to conduct supervision of rating agencies by national authorities.

The proposal also raises a number of other questions which we would be grateful if you could answer:

- In the explanatory memorandum you highlight possible problems in relation to the workability of the proposals. Can you provide further details on these problems?
- Will this proposal set a precedent for the transfer of supervisory responsibilities to an EU level?
- To whom will the European Securities and Markets Authority be accountable in its supervisory role?
- Which UK body will be responsible for the aspects of supervision of credit rating agencies that would remain at a national level under these proposals?
- What capacity will the European Union have to supervise US-based rating agencies and how does this regulatory regime compare to that in the US?
- What is the current route of accountability for the ratings provided by credit rating agencies?
- What is the Government's opinion on entrusting supervision of rating agencies to a body whose powers have not yet been defined as discussions on the EU supervisory package are still ongoing?

Lastly, we would like to know how the proposals will apply to Gibraltar.

We would be grateful to receive a reply to this letter in the standard ten working days.

7 July 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 7 July. You have requested more detailed information in particular on the role of ESMA in the overall regulation of credit rating agencies particularly in relation to the subsidiarity principle.

Direct supervision of CRAs was agreed by the European Council in June 2009 as part of a compromise agreement on EU supervision in general.

You also asked a number of other questions which are dealt with in turn below:

IN THE EXPLANATORY MEMORANDUM YOU HIGHLIGHT POSSIBLE PROBLEMS IN RELATION TO THE WORKABILITY OF THE PROPOSALS. CAN YOU PROVIDE FURTHER DETAILS ON THESE PROBLEMS?

The amending Regulation Credit Rating Agencies is expected to come into force in December 2010. In the relatively short time available there are a number of technical changes needed to ensure that ESMA is properly able to fulfil its remit. For example, ESMA will have the power to delegate any task to a national authority on an ad hoc basis. This it implies potential unmet ongoing costs for national authorities. It would also be difficult for national supervisors to ensure the availability of adequate expertise and resource when needed. The Government is seeking amendments to the regulation to limit this discretion by making explicit provision for the circumstances in which a delegation to national authorities can take place and also to at least cover the funding that will be provided to competent authorities for delegated tasks. Similarly, we are proposing that the transitional provisions allowing transfer of registration from competent national authorities to ESMA should be extended beyond the 30 day period currently provided for to ensure that ESMA has adequate time to prepare.

On endorsement and equivalence of ratings the EU legislation adopted this year provided that an EU registered CRA can endorse a rating issued by a third country member of its global group of companies under certain conditions. The effect of this endorsement regime is to allow the use of local expertise to rate local third country securities, but retain accountability by requiring endorsement of the rating by the EU registered CRA. The legislation also provides for a second method for using third country ratings – certification based on equivalence. Under this regime ratings from third countries may be used in the EU for regulatory purposes if the college of supervisors certifies the third country CRA. This regime may be useful to small CRAs without a physical presence in the EU. Small CRAs may also apply to be exempted from certain organisational requirements by its supervisor where these requirements are disproportionate to its size or activities. However, the amending Regulation seems to leave open the possibility of the Commission amending the criteria for assessing the equivalence and endorsement of ratings given in non-EU countries. The Government will seek to ensure that the amending Regulation does not extend the endorsement and equivalence regime beyond what was originally agreed.

WILL THIS PROPOSAL SET A PRECEDENT FOR THE TRANSFER OF SUPERVISORY RESPONSIBILITIES TO AN EU LEVEL?

No. ESMA was given a direct supervisory role in respect of CRA's because they are not financial firms.

TO WHOM WILL THE EUROPEAN SECURITIES AND MARKETS AUTHORITY BE ACCOUNTABLE IN ITS SUPERVISORY ROLE?

ESMA will be an agency of the EU Commission. Its decisions will be subject to review by the Board of Appeal which is a joint body of the 3 European Supervisory Authorities (ESAs). Acts of ESMA may be challenged before the Court of Justice of the European Union.

WHICH UK BODY WILL BE RESPONSIBLE FOR THE ASPECTS OF SUPERVISION OF CREDIT RATING AGENCIES THAT WOULD REMAIN AT A NATIONAL LEVEL UNDER THESE PROPOSALS?

The FSA will be the competent UK authority on 1 January 2011. The Government will consider the most appropriate future home for this as part of its work on institutional reform in financial services.

WHAT CAPACITY WILL THE EUROPEAN UNION HAVE TO SUPERVISION OF US-BASED RATING AGENCIES AND HOW DOES THIS REGULATORY REGIME COMPARE TO THAT IN THE US?

All CRAs operating in the EU will be subject to supervision by ESMA and the competent national authorities. This will include subsidiaries of the three global CRAs. For ratings to be available for use to meet regulatory obligations in the EU they must be endorsed by a EU CRA within the same global group or be from a certified CRA (only available to non-systematically important CRAs).

Pending the amendments that will be introduced by the current Reform Bill the US regime for regulating CRAs was assessed by the Committee of European Securities Regulators (CESR) as being broadly equivalent. The Reform Bill will move the US regime more in-line with the EU regime but key differences will remain in overall approach.

WHAT IS THE CURRENT ROUTE OF ACCOUNTABILITY FOR THE RATINGS PROVIDED BY CREDIT RATING AGENCIES?

Registration of CRAs is currently undertaken by competent national authorities. Colleges of regulators are required to approve each application at group and subsidiary levels. These arrangements will remain in place until ESMA is granted powers and formally comes into being.

WHAT IS THE GOVERNMENT'S OPINION ON ENTRUSTING SUPERVISION OF RATING AGENCIES TO A BODY WHOSE POWERS HAVE NOT YET BEEN DEFINED AS DISCUSSIONS ON THE EU SUPERVISION PACKAGE ARE STILL ONGOING?

As noted above direct supervision was agreed by the previous Government in June 2009 as part of a compromise agreement on EU supervision in general.

HOW WILL THE PROPOSALS APPLY TO GIBRALTAR?

Gibraltar is part of the EU as a "territory for whose external relations a Member State is responsible" (Article 299(4) TEC). By virtue of the operation of Article 299(4) TEC and the UK Act of Accession, EU law applies to Gibraltar (with some exceptions). The UK is responsible for Gibraltar in the EU. Consequently the CRA Regulations will apply to Gibraltar. Under the 2006 Gibraltar Constitution the Government is competent for the transposition and implementation of EU measures. The CRA Regulations will be implemented in Gibraltar by domestic legislation.

I hope that the foregoing is helpful in clarifying the Government's approach. I look forward to working further with you on these issues.

5 August 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letter of 5 August on the amendment of the Credit Rating Agencies Regulation. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered this at its meeting on 12 October.

Our previous letter questioned whether ESMA's direct supervisory role in respect of CRAs would set a precedent for the transfer of supervisory responsibilities to an EU level. Although you did not seem to contemplate such a possibility, the Commission's proposal for legislation on derivatives point out that ESMA could also have "a central role in the authorisation and monitoring of central counterparties and trade repositories." Do the Government believe that such concentration of powers on ESMA is justified? What impact will ESMA's creation have on how CRAs are regulated in the UK?

On a separate issue, we note that some Member States have strong opinions against the downgrading of the Greek credit rating by a US based credit rating agency at a sensitive time. Will ESMA's supervision of European subsidiaries of US CRAs go some way to temper the weight these agencies have? The Commission seems keen to establish a European rating agency as a balance to the US based agencies. Do you believe that the creation of a European Rating Agency will contribute to making financial markets more stable?

On a final point, our 2009 report on The future of EU regulation and supervision concluded that ratings had assumed excessive importance because of their incorporation into the Basel rules on capital requirements. Have recent changes to the Basel rules removed this reliance on ratings?

We will continue to keep the document under scrutiny. We would be grateful for a reply within the standard ten working days.

12 October 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 12 October. You have raised a number of further questions in relation to the above proposal and I have answered these in turn below.

THE COMMISSION'S PROPOSAL FOR LEGISLATION ON DERIVATIVES POINTS OUT THAT ESMA COULD ALSO HAVE "A CENTRAL ROLE IN THE AUTHORISATION AND MONITORING OF CENTRAL COUNTERPARTIES AND TRADE REPOSITORIES." BEARING THAT IN MIND YOU HAVE ASKED: DO THE GOVERNMENT BELIEVE THAT SUCH CONCENTRATION OF POWERS ON ESMA IS JUSTIFIED? WHAT IMPACT WILL ESMA'S CREATION HAVE ON HOW CRAs ARE REGULATED IN THE UK?

The UK agreed at ECOFIN in December 2009 that the European Supervisory Authorities could assume direct responsibility for supervising CRAs. This was in recognition of the fact that credit ratings from a CRA based in one country can be used throughout the EU, so a failure in national supervision can have widespread and unpredictable impact throughout the EU. It also recognised the unique status of Credit Rating Agencies in financial markets; which cannot require government support if they fail, and whose oversight will cover mainly corporate governance and authorisation issues, rather than ongoing prudential or capital issues. The decision to allow ESMA to supervise CRAs at EU level does not therefore set a precedent for the supervision of financial institutions more generally. The Government welcomes the general consensus in the ECOFIN Council that that day-to-day supervision of financial institutions should remain at the national level, and has asserted this point strongly in EU fora, including in the discussions of this regulation.

The net effect of this regulation is that ESMA will be responsible for the supervision of CRAs in all member states, including the UK. In addition the regulation proposes further requirements in relation to structured finance products. This is aimed at providing a more consistent approach. It is likely that ESMA will need to rely, to an extent, on the assistance of member state authorities particularly in the immediate aftermath of the transition of responsibilities.

The Government believes that national authorities should be responsible for the authorisation and ongoing supervision of both CCPs and Trade Repositories. We look forward to answering any further questions the Committee may have on this issue as part of its consideration of the Commission's proposal on derivatives.

WILL ESMA'S SUPERVISION OF EUROPEAN SUBSIDIARIES OF US CRAs GO SOME WAY TO TEMPER THE WEIGHT THESE AGENCIES HAVE?

ESMA's supervision is intended to provide a balanced, more uniform form of supervision of CRAs across the EU. There are further workstreams at EU and G20 which aim to look at the need for further regulation of CRAs and ensure uniform regulation on a global scale. This will include reducing the reliance on credit ratings in financial markets and for official purposes

DO YOU BELIEVE THAT THE CREATION OF A EUROPEAN RATING AGENCY WILL CONTRIBUTE TO MAKING FINANCIAL MARKETS MORE STABLE?

The Commission has indicated that it will consider the options for an “EU sponsored” CRA in its Green Paper on further regulation of CRAs due before the end of this year. An EU governed CRA would raise a number of questions around issues such as independence and market acceptability of any ratings issued by such a body. Ultimately the credibility of any such body would be judged by financial markets and institutions. The Government would need to assess the impacts of any potential business funding model proposed very carefully to assess the likely impact on the financial markets. We would only be able to do this when detailed proposals are actually available.

HAVE RECENT CHANGES TO THE BASEL RULES REMOVED THIS RELIANCE ON RATINGS?

The changes to the Basel rules have not removed the reliance on ratings. Under Basel 3 external credit ratings are still used to calculate capital requirements. However, the Government is supportive of EU and G20 initiatives to further consider the risks posed by ratings reliance to the financial system. The Government has recently welcomed the report of the Financial Stability Board High Level Working Group on reducing reliance on CRA ratings. The High Level Working Group is chaired by Paul Tucker, Deputy Governor for Financial Stability at the Bank of England. The Commission’s Green Paper will cover further issues around CRAs that may be the subject of a further regulation in 2012. Reducing the reliance on ratings for market and regulatory purposes are among the topics which will also feature in that paper.

23 October 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letter of 23 October on document 10827/10 on the amendment of the Credit Rating Agencies Regulation. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered this at its meeting on 2 November.

We are satisfied with the responses you provided, and have agreed to clear the document from scrutiny. We would, however, appreciate continuing updates on the progress of negotiations. We will continue to examine any further proposal on credit rating agencies, especially in light of the forthcoming Green paper on this matter.

We do not require a response to this letter.

02 November 2010

DATA: QUALITY OF STATISTICAL DATA (6559/10)

Letter from Lord Sassoon, Commercial Secretary, Her Majesty’s Treasury, to the Chairman

I am writing in response to Lord Roper’s letter of 24 March to my predecessor, Ian Pearson MP, concerning the amendments to the EU Excessive Deficit Procedure Statistics Regulation. I will now be responsible for this dossier and look forward to working with your Committee.

I am glad that your Committee agrees with the basic underlying principle of this amendment – to give Eurostat the powers to audit a Member State’s national debt and deficit statistics in case of doubt about their reliability. The Government shares this view that, in light of the problems in Greece, such EU level checks are necessary to ensure that any possible irregularities with statistical data of this kind can be swiftly identified and remedied.

Much has happened in the negotiations on this proposal since the Committee last considered the text. Attached to this letter is the final Regulation, which now contains the following improvements to the original Commission proposals:

- There is now a limitation on the type of data to which Eurostat may have access. The original proposals sought to extend the scope of this information beyond the statistical domain, whereas the final text agreed by Council states that Eurostat should only be able to request “relevant statistical information” limited to the information strictly necessary to check the compliance to international statistical rules.
- Article 11b of the final text contains a non-exhaustive list of criteria by which the quality of a Member State’s national statistics could be judged. Whilst

Eurostat has the discretionary power to examine other factors outside this list, the list provides a very clear indication of the standards expected from a Member State. It also allows for some flexibility on the part of the Member State – for example by stating that revisions to the debt or deficit figures should not necessarily give cause for concern unless these revisions are frequent, sizeable and without clear explanation.

- There is a new provision in the fifth recital to the text that confirms the need for Eurostat to respect existing European provisions on the independence of national statistical authorities when undertaking audit visits to Member States.
- Article 11 of the text now differentiates between the routine biannual “dialogue” visits that are already made by Eurostat to Member States basis to check over methods used to generate excessive deficit statistics, and these audit visits (defined as “methodological visits” in the Regulation).
- Finally, the text now requires Eurostat to inform the CMFB (Committee on Monetary, Financial and Balance of Payments - a statistical committee composed of the Member States’ government and central bank statistical experts) prior to making audit visits. It also requires Eurostat to provide updates on visits to the Economic and Financial Committee.

The Government believes that the Council amendments are satisfactory, as they provide helpful clarification of the scope of these audit visits and limit the amount of information that may be required from Member States. The text of the amendments to the Regulation is now clearer and contains explicit references to the importance of both Eurostat and the Member State respecting European rules on confidentiality of statistical data in the course of the audits. The UK Office for National Statistics has been closely involved in the negotiations on this text, and is also in full agreement with the Presidency proposals.

The UK National Statistics Authority has the statutory objective for independent monitoring and assessment of all official statistics produced in the UK, including data on the national debt and deficit. The Office for National Statistics is committed to the production of high quality, independent statistical data, and would be happy to explain its methodologies or revisions to data to Eurostat. The Government therefore believes the standard of our national debt and deficit statistics is extremely high, and that it is unlikely that Eurostat would find it necessary to make an audit visit to the UK.

At the 8 June ECOFIN, a general approach was agreed by the Council by a qualified majority vote. As the UK Parliament had not yet been able to issue its opinion on the final Regulation, the Government retained its scrutiny reserve and abstained from voting. A statement in the minutes of the Council was laid to clarify an abstention by the UK on the grounds that its position had not yet been cleared by Parliament. However, the Government is satisfied with the content of the final text. The Regulation will be formally adopted at a forthcoming Council meeting once the European Parliament has issued its opinion, and is expected to enter into force this autumn.

I hope that the above information is satisfactory to the Committee, and that the Committee agree with the Government’s view that the final text of this Regulation represents a good outcome for the UK.

18 June 2010

DEPOSIT GUARANTEE SCHEMES (12386/10)

Letter from the Chairman to Mark Hoban MP, Financial Secretary

Thank you for your Explanatory Memorandum on document 12386/10 on deposit guarantee schemes. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 19 October.

We support the objectives of this recast to maintain financial stability by preventing bank runs and protecting depositors’ savings. There are a number of aspects of the proposals that we would like to discuss further.

First, the recast provides for the establishment of a mandatory mutual borrowing facility. In your Explanatory Memorandum you state that the proposal for requiring schemes to lend to one another could have fiscal consequences for national governments. Under what circumstances this happen? What do you believe are the pros and cons of a mandatory scheme? Do you feel the objections raised

by the Swedish Parliament and others that a mandatory lending scheme might lead to a moral hazard situation are justified? Would such a facility imply that if a similar situation to that involving Icesave occurs again, the UK would have an obligation to lend to Iceland in order to offer guarantees to British depositors who have accounts in Icelandic banks? Are there any consequences for Member States outside the Eurozone taking part in this lending scheme that might arise from exchange rate fluctuations?

Second, the recast stipulates that the host country should be the reference for depositors in a branch in another Member State. We considered issues related to the home-host divide in our 2009 inquiry on the future of EU financial regulation and supervision. The Icesave case showed the deficiencies of the current model when a bank faces a major crisis. While we recognise the legitimate concerns of host Member States in respect of the presence of branches of cross-border banks in their countries, we did not consider the call for greater power for the host supervisor the right answer, concluding that this could cause a fragmentation of the single market. Do you believe that the Commission's suggestion to give more responsibility to the host country could lead to a retreat from the single market in the future? Finally, to what extent will the establishment of the new European Banking Authority help manage issues arising from the home-host country supervision in the context of deposit guarantee schemes?

We would like to be updated on the progress of negotiations of the dossier, especially with regard to the European Parliament's position, and we agreed to hold the document under scrutiny. We would be grateful for a response within the ten working days.

19 October 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 19 October on the Deposit Guarantee Schemes Directive. I am pleased that you support the aims of the Directive, as I do. I respond to your questions below.

MUTUAL BORROWING

In your letter, you raise a number of questions about the Commission's proposals to introduce mutual borrowing between schemes. The proposals are intended to give schemes an additional source of funding, so that if they are unable to meet their obligations in the event of a failure, they are able to borrow from the other schemes. The cost of the loan would be split amongst schemes in proportion to their size (with the exception of any other schemes that are underfunded, who will not be obliged to lend). Mutual borrowing would have the advantage that the cost of funding another Member State's scheme would be spread between the other signatories of the Directive. However, as you are aware, the Government objects to the mutual borrowing proposals for a number of reasons:

Contagion: If one scheme is underfunded and borrows from other schemes, it could leave the lending schemes underfunded and at risk of failing to meet their own obligations in the event of a failure. Lending schemes may then have to raise additional levies from the industry to fund themselves (or borrow from the state – see below). This could be a particular problem in a time of financial instability, when several schemes could require additional funding at the same time, placing serious strain on the lending schemes.

Fiscal implications: You asked about the fiscal consequences for the UK exchequer. In several Member States, deposit guarantee schemes have access to Government funding if needed, as is the case with the UK's Financial Services Compensation Scheme (FSCS). If a scheme was forced to borrow from the state in order to lend to another scheme (or to meet its own obligations in the event of a failure, having already used its own resources to lend to another scheme), this would amount to an EU Directive mandating a loan from one Government to another. The Government believes that this would breach the fiscal sovereignty of national Parliaments, and on this basis, we fundamentally object to mutual borrowing.

Role of the European Banking Authority: There are also serious concerns about the role of the European Banking Authority (EBA) in the mutual borrowing process. The draft Directive proposes that the EBA should confirm whether a scheme may borrow from other schemes, and set the terms of the loan (how it is apportioned between other schemes; rate of interest; length of loan and so on). As I have set out above, this is a decision that has clear fiscal impacts, whereas Member States have agreed that the EBA should not impinge on national fiscal sovereignty.

You asked whether there is a moral hazard risk associated with a mandatory mutual borrowing scheme. As you note, the Swedish Parliament has raised these objections. Moral hazard arises from a scheme being confident that its liabilities will be fully met, regardless of the circumstances. Consequently, any moral hazard that might exist would occur whether a scheme is funded by

guaranteed loans from the Government or from the mutual borrowing requirement in the Directive. As a result, I do not think that the proposals would create any additional moral hazard risk in comparison to a scheme that is already backed by a Government, as is the current situation with the FSCS. In any case, any moral hazard risk is minimised by the boundaries imposed by the Commission on mutual borrowing. For example, schemes may only borrow up to 0.5% of their total covered deposits, the borrowing cost would be split between all other schemes and schemes may only borrow if they have been judged by the EBA to have fulfilled their other funding obligations. However, the proposals still present an unpredictable and unacceptable fiscal risk to the UK Exchequer.

The Government believes that an alternative to mutual borrowing would be to ensure that schemes have access to reliable sources of short-term funding, for example supplied by the state or commercial loans. Treasury have put forward this position in comments to the Commission.

You also ask about how mutual borrowing would have affected a situation such as that faced by the Icelandic deposit guarantee scheme. Under the Commission's proposals, a scheme that could not meet its obligations to depositors would have the option to borrow from all the other schemes in the European Economic Area, with the cost of any loan being split between the other schemes proportionate to their size (provided it met the conditions in the Directive). Equally, provided it was not itself judged to be underfunded, the FSCS would be obliged to contribute to a loan to any scheme permitted to borrow by the EBA (whether or not any UK depositors held deposits in firms covered by that scheme).

With regard to your question about exchange rate fluctuations, this issue is not addressed in the Directive and would need to be resolved should the mutual borrowing proposals be adopted. However, given that the UK is opposing mutual borrowing in any case, along with a majority of other Member States, I do not consider it worthwhile to press for an amendment to the Directive to take account of exchange rate fluctuations during the borrowing process.

CROSS-BORDER COOPERATION

The second part of your letter concerns some of the cross-border cooperation aspects of the Directive. The Commission has proposed that schemes should be able to act on behalf of another Member State's scheme, where banks have branches outside their home state. This means that the host scheme provides a single point of contact for depositors in that country – for instance, all UK depositors will be able to contact the FSCS in the first instance, regardless of whether they hold deposits in a UK-authorized bank or in a branch of an EU-authorized firm such as ING Direct. This will include communication with depositors, and also paying out on behalf of the home country scheme. I do not believe this will negatively impact on the single market as these responsibilities are not a significant addition to the host state powers. They are instead provisions designed to speed up payout, which will improve the confidence of consumers with deposits in cross-border branches of EEA banks.

The Government is therefore supportive of these proposals; however, the Directive should clarify that the home scheme must provide the necessary information and funds to allow the host scheme to pay out on its behalf. We have made this clear to the Commission and the Belgian Presidency.

The establishment of the EBA should be helpful in managing cooperation between home and host schemes. Under the Commission's proposals, schemes must notify the EBA of the existence of cooperation agreements between deposit guarantee schemes; and the EBA can also settle any disagreements between schemes. The EBA, has also been given an important role in administering the stress-testing and peer review of schemes, which will shore up consumer confidence by demonstrating that schemes are robust and allow schemes to challenge one another, should there be any concerns about a scheme's soundness. However, as I have set out above, the Government does not support the role proposed for the EBA in administering mutual borrowing.

UPDATE ON PROGRESS OF NEGOTIATIONS

HM Treasury and FSA officials have now attended two Council Working Group meetings on the Directive, and also submitted written comments to the Presidency. At Working Group, all Member States have been generally supportive of the Commission's proposal, in particular the confirmation of the increase in the protection limit to €100,000 and increased consumer protections. However, there is strong and widespread opposition to mutual borrowing. Many Member States have also voiced their opposition to the high levels of pre-funding required in the proposal and the reduction to seven days of the deadline for schemes to payout to depositors in the event of a bank failure.

3 November 2010

DUAL USE TECHNOLOGY: CONTROL OF EXPORTS OF DUAL-USE ITEMS AND TECHNOLOGY (5011/09)

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

I am writing in response to Lord Roper's letter of 3rd March 2010 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 Third formal update.

Since the last formal update, three further meetings of the Council Working Group on Dual-use goods (the European Group made up of Member States, Commission and Council representatives responsible for the Dual-Use Regulation) have taken place, on 3rd March 2010, 15th April 2010 and 11th June 2010. The discussions continued on proposals EU003 (Export after repair/ replacement); EU004 (Temporary Export for Exhibition or Fair); EU006 (Telecommunications) – this now only covers telecommunications and excludes Information Security; and EU007 (Chemicals). The main changes from the original proposal set out in Council Document 5011/09 are as follows:

- On EU003 (Export after repair/replacement) - changes to the goods schedule -categories 5A002.a.2 to 5A002.a.9 now excluded; reduction in the number of countries permitted from 108 to 23 with 3 further countries under consideration; and some tightening of conditions.
- On EU004 (Temporary Export for Exhibition or Fair) - changes to the goods schedule-categories 5A002.a.2 to 5A002.a.9 now excluded; reduction in the number of countries permitted overall from 28 to 23 with only 15 countries remaining from the original proposal, and a 3 further countries under consideration ; and some tightening of conditions.
- On EU006 (Telecommunications) - The scope of this licence has been reduced and now only covers telecommunications equipment i.e., the information security element has been removed. The previous proposal to have a separate CGEA covering information security has now been dropped.; with the reduction in the goods schedule 1 new country has been added with 2 further countries are under consideration; and some tightening of conditions.
- On EU007 (Chemicals) – goods cover remains as previously proposed however the chemicals are now specifically listed; the country cover has been reduced from 38 to 6 and now only permits exports to countries which are members States of the Australia Group (AG), which is an international non-proliferation regime responsible for making recommendations on what chemical participating States should control for export purposes; and some tightening of conditions.
- There has been very little discussion on EU002 (Low Value Shipments) as generally Member States are not in favour of this Licence, however the Commission is reluctant to remove this licence completely from the scope of the proposal and is intending to provide a revised more restrictive text for further discussion.
- With EU005 (Computers) this has now been withdrawn from the proposals as the goods coverage is now redundant due to changes in the control parameters.
- A paper setting out the latest position on the negotiations was issued by the Spanish Presidency, (for assisting the European Parliament), and a copy of the paper is attached for your information (see Annex I).

Since the adoption of the Lisbon Treaty the procedures for approving the Commission proposals has changed and will now also require approval of the European Parliament (EP). To assist the EP with their discussions the Spanish Presidency prepared, on behalf of all Member States and the Commission, a position paper setting out the current state of play in respect of the CGEA proposals.

It is expected that discussions will continue at the next meeting of the Council Dual-Use Working Group scheduled for 6th July 2010 under the Belgium Presidency but are likely to be concluded shortly thereafter or at least before the end of their 6 month Presidency.

12 July 2010

Letter from the Chairman to Mark Prisk MP

Thank you for your letter of 12 July updating the EU Economic and Financial Affairs and International Trade Sub-Committee on the progress of negotiations on document 5011/09. We have appreciated these detailed updates, and the Committee have agreed to clear this document from scrutiny.

20 July 2010

ECONOMIC POLICY COORDINATION (9433/10, 11807/10)

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

Thank you for your Explanatory Memorandum on documents 9433/10 and 11807/10, dated 26 July, on economic policy coordination. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 12 October.

Our current inquiry, The future of economic governance in Europe, will examine in greater detail the ideas put forward by the Commission and the Van Rompuy task force, and in the meantime we will retain the documents under scrutiny.

We look forward to discussing these issues with you in more detail during the course of our inquiry. We do not require a response to this letter.

12 October 2010

EU BUDGET 2010: DRAFT AMENDING BUDGET NO 7 (12119/10, 9606/10)

Letter from Justine Greening MP to the Chairman

I am enclosing with this letter an Explanatory Memorandum on this Draft Amending Budget (document reference 12119/10), as well as on the Council Regulation establishing a European Financial Stabilisation Mechanism (document reference 9606/10), adopted at an emergency ECOFIN meeting on 9 May.

As you will know, the Regulation formed part of a package of exceptional measures agreed to support vulnerable EU economies judged, by ECOFIN, to be facing a severe deterioration of borrowing conditions "beyond the control of Member States". The second part of this package was an intergovernmental agreement among euro-area Member States also to establish a Special Purpose Vehicle, lasting three years, and worth up to €440 billion; the UK declined to participate in this second element of the package.

While these decisions were taken by the previous Government, this Government judges them to be an appropriate response to the crisis. The Mechanism created by the Regulation, in accordance with Article 122(2) of the Treaty, is available for any Member State to draw upon, and is not confined to the euro-area. Taken together with the decision not to participate in the Special Purpose Vehicle, the UK's support for the Regulation represents, in our view, a sensible position that strikes a balance between UK support, and the need for the euro-area to take a lead in resolving these problems.

Unfortunately, it was not possible for the Regulation to undergo Parliamentary scrutiny before its adoption, due both to the timing of the Council's decision on it, and the speed with which it was adopted. However, I am sure that your Committee will wish to examine both the Regulation and the accompanying Explanatory Memorandum in detail, and I look forward to hearing your views on it.

Draft Amending Budget No7 to the EU Budget is technical in nature. Its purpose is to establish a line in the EU budget on the expenditure side, and a corresponding article on the revenue side, needed for the European Financial Stabilisation Mechanism to be fully operational. There are no resource implications from the Draft Amending Budget, as it is not necessary to provision the budget line with any funds at this stage.

While the Draft Amending Budget was only published on 13 July, we expect it to be adopted at the Foreign Affairs/General Affairs Council meeting on 26 July. This very swift adoption is to ensure that there is no undue delay in operationalising the European Financial Stabilisation Mechanism, in the event that a Member State should need to draw upon the funds available at short notice.

Due to this timeline, I anticipate that it will again not be possible to complete Parliamentary scrutiny on the item before its adoption in Council. It is important that the European Financial Stabilisation Mechanism is seen to have the full backing of Member States if it is to achieve its purpose, and therefore that the UK support the technical steps proposed in the Draft Amending Budget. I regret

therefore that, in this instance, the Government must override scrutiny in order to give its support to the measures proposed.

18 July 2010

Letter from the Chairman to Justine Greening MP, Economic Secretary, Her Majesty's Treasury

Thank you for your letter dated 18 July and accompanying explanatory memoranda 12119/10 and 9606/10. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered the documents at its meeting on 27 July.

We regret that a scrutiny override has occurred in the case of the Regulation establishing a European Financial Stabilisation Mechanism. However, we understand the necessity of supporting it given the circumstances you outlined in your letter. While we regret that it will not be possible for the Committee to complete scrutiny of Draft Amending Budget No.7 in time for the Council's decision on 26 July, we agree with you that it is in the interests of all Member States to support a stable and fully functioning euro-area.

We also note that the Regulation creating a European Financial Stabilisation Mechanism was based on Article 122.2 of TFEU. This is of great interest to the Committee which has, on several occasions, discussed with the Government the potential use of Article 122.2 to provide assistance to a defaulting member of the Eurozone. We have always believed that there were inconsistencies between the no-bail out clause for Eurozone countries set out in Article 125 and the medium-term financing facility available to all Member States except those that have already adopted the Euro.

The previous Government told this Committee that there was no question that any Member State could receive a bail-out under Article 122 (ex-Article 100 TEC). The current situation proves that this assurance was misplaced. While we do not disagree that the Government should support the continuation of a stable and functioning Eurozone, we are disappointed that the Committee was not promptly informed when this situation changed.

This is extremely significant in light of the UK's participation in the European Financial Stabilisation Mechanism (EFSM). We are conscious that if there were defaults of loan repayments the EU budget would be called upon to meet the cost of those repayments. This would require an increase in the budget and, in turn, an increase in Member States' contributions to the EU budget. What does the Government think is the likelihood that the €60 billion fund will be called upon by EU Member States? Are States more likely to use the European Financial Stability Facility? How confident are the Government that the EFSM will prevent Member States defaulting on their debts, and have they assessed the level of the risk that they might be required to meet the cost of other Member States defaulting on all or part of their loan repayments under the EFSM?

In light of the potential risks, we urge the Government to ensure that the EFSM is operated transparently, and that faults are reported to the Committee if they arise.

We take note of the fact that the UK has chosen not to participate in the Special Purpose Vehicle (SPV). With the SPV, the EU is creating a separate legal entity backed solely by the 16 members of the EMU with the addition of Poland and Sweden, in contrast with the existing balance of payment facility which is backed by all 27 Member States. We intend to explore in greater detail the implications of the UK's decision not to participate in the SPV in our forthcoming inquiry on economic governance.

27 July 2010

Letter from Justine Greening MP to the Chairman

Thank you for your letter dated 27 July on the European Financial Stabilisation Mechanism.

I would first like to thank the Committee for their understanding in the use of a scrutiny override in this instance, allowing us to support the technical steps necessary for the EFSM to become operational. In my letter of 18 July, I explained that we had expected adoption of Draft Amending Budget No 7 to the EU Budget for 2010 at the 26 July General Affairs Council or Foreign Affairs Council. In fact, final adoption was slightly delayed, and took place at the 13 September General Affairs Council. My officials were in touch with your Committee Clerk in July to notify them of this slight delay. It continues to mean that full scrutiny of the Draft Amending Budget was unfortunately not possible before it was adopted by Council.

You raise an important question about the consistency between assistance provided under Article 122.2 (ex Article 100.2 TEC) and the no bail-out clause set out in Article 125 (ex Article 103).

Article 125 of the Treaty provides a clear assurance that no Member State shall receive a bail-out, stating: "The Union shall not be liable for or assume the commitments of ... governments ... A Member State shall not be liable for or assume the commitments of governments ... of another Member State". The Government's view is that this does not rule out either the EU, or the Member States, from lending each other money; further, Article 2.1 of the EFSM Regulation (407/2010) makes clear that the financial assistance envisaged under that Regulation is strictly confined to either a loan or a credit line¹ - i.e. it would need to be paid back. I would refer the Committee to a European Commission press release (Memo/10/173 of 10 May 2010) accompanying the adoption of Regulation 407/2010 that states: "This mechanism would allow the provision of loans, not grants. Loans have to be repaid with interest. As such it is compatible with Art 125 TFEU."

I would further note that there is precedent in support of this view: Article 125 applies not only to euro-area Member States but to all Member States, yet (as you rightly note) the EU has already provided loan assistance to several member states through the Balance of Payments Facility.

I am sure that you will agree that it would be inappropriate for me to comment and/or speculate on the likelihood of any EU Member State needing to draw upon the facility. Since the adoption, by ECOFIN, of Regulation 407/2010, many EU economies have announced fiscal consolidation plans; the Government believes it is now important that all governments implement the measures they have announced in a rigorous manner in order to rebuild confidence. I would also emphasise that the Government is not aware of any euro-area economies seeking support under the EFSM (or, indeed, the €440 bn Special Purpose Vehicle agreed by euro-area Member States).

As I noted in Explanatory Memorandum 9606/10, the EU Budget would meet the cost of repayments in the event of any defaults on loan repayments. The UK's estimated share would be an important amount, albeit one that is manageable for the UK finances. That is why there are strong safeguards to ensure a default does not happen, and why I am happy to assure you that the Government will continue to monitor the operation of the Mechanism.

Finally, I note your intention to examine the UK's decision not to participate in the €440 bn Special Purpose Vehicle; you will recall that, at the time, the previous government did not judge it in the UK's national interest to participate and we agree that this was the right decision.

27 September 2010

Letter from the Chairman to Justine Greening MP

Thank you for your letter of 27 September on documents 12119/10 and 9606/10 on the EFSM and Draft Amending Budget No 7. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered them at their meeting on 19 October.

It is important that action is taken to re-establish the credibility of the Eurozone system, especially in light of current discussions aimed at reforming the Stability and Growth Pact.

We already had the opportunity to discuss with you some questions arising from the establishment of the European Stabilisation Mechanism, and we now intend to examine these issues further within the context of our current inquiry on economic governance. We nevertheless remain keen to receive updates on significant developments on these dossiers.

We do not require a response to this letter.

19 October 2010

EU BUDGET: FINANCIAL REGULATION AND COMMUNICATION ON TOLERABLE RISK OF ERROR (10561/10, 10346/10)

Letter from the Chairman to Justine Greening MP, Economic Secretary, Her Majesty's Treasury

Thank you for your Explanatory Memoranda on documents 10561/10 and 10346/10, dated 18 August. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 19 October.

On the Financial Regulation (FR), we note that you have concerns about the Commission's proposals to allow institutions to raise loans to purchase their buildings. What are your specific concerns about

¹ Regulation 407/2010 Article 2.1: "Union financial assistance for the purposes of this Regulation shall take the form of a loan or of a credit line granted to the Member State concerned."

this proposal? How might it present additional spending implications, and how does the Government propose this risk might be limited? In addition, is the Government content with the Commission's suggestion that the FR be reviewed only on an ad hoc basis in future?

Turning to the issue of tolerable risk of error (TRE), do the Government oppose the introduction of the concept of TRE into the FR entirely or do they simply oppose any recalculation of the level of TRE at the present time?

We note that you stress the need for Member States to take greater responsibility to improve the management of EU funds at national level. Yet, you also express concern about the Commission's plans to harmonise further control and audit obligation. Would the Commission's proposals not help improve Member States' management of EU funds?

We would also appreciate an update on how discussions progressed on these documents at the September budget committee. In the meantime, we will hold these documents under scrutiny.

We would be grateful for a response to this letter within the standard ten working days.

19 October 2010

EU DRAFT BUDGET 2011: GIVING EVIDENCE

Letter from the Chairman to Justine Greening MP, Economic Secretary, Her Majesty's Treasury

Thank you for your explanatory memorandum on the Draft Budget 2011, dated 17 June. The Sub-Committee on Economic and Financial Affairs and International Trade considered this at the meeting on 29 June. Further to this, I would like to invite you to give evidence to the Sub-Committee on 6 July from 11.00am – 12 noon on the Government's priorities for the Budget ECOFIN meeting.

30 June 2010

EU INVESTMENT POLICY: TOWARDS A COMPREHENSIVE EUROPEAN INTERNATIONAL INVESTMENT POLICY (11952/03, 11952/10)

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

Thank you for your Explanatory Memorandum on documents 11952/10 and 11953/10, dated 28 July. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered the documents at its meeting on 12 October.

We agree with your support for the aims of the Commission's Communication on a comprehensive European international investment policy. We believe that it can only be beneficial for all European investors to enjoy the same level of legal protection, rather than having to rely on bilateral agreements entered into by individual Member States. We also support the creation of EU investment agreements so long as they offer investors the same level of protection as the UK's existing bilateral investment agreements. We have agreed to release this document (11952/0) from scrutiny.

We recognise your concerns over the scope of the powers the draft Regulation would give the Commission to remove authorisation of existing bilateral agreements, and in particular we note that this would threaten the legal security investors enjoy under existing agreements. We support your position that existing agreements should only be removed once new EU level agreements are in place and provide investors with at least the same level of protection.

We will continue to hold the draft Regulation (11953/10) under scrutiny, and would like to receive regular updates on negotiations as it progresses.

13 October 2010

EUROPEAN CENTRAL BANK: OPINION ON THE QUALITY OF STATISTICAL DATA IN THE CONTEXT OF THE EXCESSIVE DEFICIT PROCEDURE (8300/10)

Letter from the Chairman to Lord Sassoon, Commercial Secretary, Her Majesty's Treasury

Thank you for your letter and your Explanatory Memorandum 8300/10. The EU Sub-Committee on Economic and Financial Affairs and International Trade discussed the documents at its meeting on 20 July. We note that the proposal to amend the Regulation was agreed to by the Council before the Committee had cleared the document from scrutiny. As the UK abstained from voting, this does not constitute a scrutiny override.

We believe that this proposal to entrust Eurostat with additional audit powers could help ensure that prompt action is taken regarding irregularities with statistical data in the context of the excessive deficit procedure. As the lack of reliable Greek statistics has, to some extent, contributed to a crisis of confidence in the single currency, it is important that action is taken to re-establish the credibility of the Eurozone system, especially in light of current discussions aimed at reforming the Stability and Growth Pact. This is an issue we might return to within the context of our future inquiry on economic governance.

We are pleased to hear that the quality of UK national statistics will make an audit visit from Eurostat unlikely. However, the Committee did discuss the wider responsibilities this proposal would give Eurostat staff. Are the Government satisfied that there are enough top quality professionals from the UK working in Eurostat? Are you satisfied that, given Eurostat's role in taking a broader overview of Member States' budgets, their recruitment process ensures they have staff with the necessary experience and judgement, not only technical qualifications?

We note your disagreement with the ECB's suggestion to re-examine the definition of government deficit in order to align it with international statistical standards. While we recognise that this could indeed be examined separately at a later stage, we believe that the ECB is raising a legitimate point when it recommends that the proposal should include provisions to prevent countries from using swaps to cut excessive budget deficits. In our letter to Ian Pearson MP, dated 10 March 2010, we raised a similar point when we argued that Eurostat should have acted earlier to prohibit these types of transactions. As we did not receive a response from the previous Government on this issue, we would like to take the opportunity to reiterate our view that there should be more transparency on the use of derivatives to conceal debt levels, and that EU rules should be amended so that countries cannot manipulate their budget figures. We regret that it is now too late for you to consider our position ahead of the Council discussions as the proposal has already been agreed, but we would like your assurance that you will endorse this view should another opportunity arise.

Finally, we note that the European Parliament has no co-decision power on this dossier. Its Opinion recommends that officials from European Central Bank should take part in Eurostat's methodological visits. Have the Government been supportive of this suggestion in light of the central role the ECB and national central banks play in the preparation of debt and deficit statistics?

We would be grateful for a reply within the standard ten working days.

20 July 2010

Letter from Lord Sassoon to the Chairman

Thank you for your letter of 20 July regarding scrutiny of the EU Excessive Deficit Procedure (EDP) Statistics Regulation. I am pleased to hear that the Committee agrees with the Government's view that this Regulation should help to improve the quality of reported national statistics by Member States.

Your letter raises a number of different issues about other elements of the EU statistical regime. Firstly, on staffing of Eurostat, the Government is satisfied that this agency has sufficient resources to conduct the monitoring visits that are provided for in this new Regulation. Eurostat already has a great deal of experience in running routine dialogue visits to Member States to discuss the methodology behind national debt and deficit statistics, and this expertise will stand them in good stead for the monitoring visits. The Committee may already be aware that Eurostat is beginning a monitoring visit to Bulgaria over the summer, following Bulgaria's upward revision of its published deficit levels.

You asked whether the Government is satisfied that there are sufficient UK personnel within Eurostat. Eurostat recruits its permanent staff by means of open competition through the European Personnel Selection Office, and at the moment, there are 30 British members of staff working within

Eurostat. The Government is aware of the general problem of UK under-representation in the EU institutions and we are working hard to address this. The Government is relaunching the European Fast Stream and preparing a range of additional measures to support UK candidates for recruitment to the EU institutions and bodies, including Eurostat. Both HM Treasury and the Office for National Statistics also send staff on secondment to EU institutions, working to place people in posts that are most likely to deliver UK priorities for EU economic and financial policy, whilst ensuring best value for money.

With regard to currency swaps, part of the problem is that there are now two definitions of general government net borrowing as a result of amendments made several years ago to the European System of Accounts (known as ESA 95). At the time of its introduction, ESA 95 recorded the income from swaps as interest, a non-financial item. General government deficit (as used for Excessive Deficit Procedure purposes) was therefore the same as general government net borrowing. However, ESA was subsequently amended, so that the swaps were moved into the financial account. The definition of general government deficit was not changed, so that there are now two versions of general government net borrowing (one for National Accounts, one for EDP). The ECB Opinion suggests that the EU should return to a system of having only one definition of government deficit, which would exclude income from swaps and forward rate agreements. Should the opportunity arise in future to have these discussions, the Government could support this proposal by the ECB.

The Government certainly agrees with the Committee's view that it must never be possible for Member States to manipulate their deficit figures in any way. However, the Government believes that there is nothing inherently wrong with currency swaps. The UK does not make great use of these transactions – they have never exceeded 0.1% of GDP in our national accounts in any year, so the difference between the figures for government net borrowing and the government deficit as measured by ESA95 is very slight in our case. Member States are required to report the effect of swaps on their headline deficit to Eurostat every year, and this information is publicly available on the Eurostat website. Therefore, as long as the underlying data are reliable, the Government is content that Member States' currency swap transactions are sufficiently transparent.

As to the involvement of ECB officials in the Eurostat monitoring visits, as proposed in the European Parliament's Opinion on the dossier, the Government agrees that this makes sense for monitoring visits, as the ECB's experience would be useful in forming judgments about the reliability of the statistics under examination. The ECB already participate in dialogue visits to Member States; therefore it is logical that they could also make a valuable contribution to these monitoring visits, particularly for eurozone countries.

10 August 2010

Letter from the Chairman to Lord Sassoon

Thank you for your letter dated 10 August on Explanatory Memorandum 8300/10 on a Proposal for a Council Regulation as regards the quality of statistical data in the context of the excessive deficit procedure. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered this document at its meeting on 19 October.

It is important that action is taken to re-establish the credibility of the Eurozone system, especially in light of current discussions aimed at reforming the Stability and Growth Pact.

We already had the opportunity to discuss with you the consequences of the unreliability of the Greek government's deficit and debt statistics, and we now intend to examine these issues further within the context of our current inquiry on the future of economic governance in the EU. We nevertheless remain keen to receive updates on significant developments on these dossiers.

We do not require a response to this letter.

19 October 2010

FINANCIAL SUPERVISION: EUROPEAN SUPERVISORY AUTHORITIES AND EUROPEAN SYSTEMIC RISK BOARD (13645/09, 13648/09, 13652/09, 13653/09, 13654/09, 13656/09, 13657/09, 13658/09)

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

I am writing to provide an update to your Committee on the European Commission's proposed legislation to establish new EU Supervisory Authorities and a European Systemic Risk Board.

The Commission proposed this legislation in September 2009, and the ECOFIN Council agreed to a general approach in December 2009. The Government supports this agreement. Since then, the European Parliament's ECON committee has also agreed a negotiating position, at its meeting on 10 May 2010.

The ECON reports propose a series of amendments to the Commission's proposals that are very different to the original proposals. In particular they propose EU level supervision of all significant cross-border financial institutions, the establishment of European Stability Funds, and European Guarantee Schemes to protect consumers.

The Government believes it is appropriate for day-to-day supervision of financial institutions to remain at the national level. Furthermore, it is key to ensure that no EU decisions over national supervisors can have an impact on Member States' fiscal responsibilities. Finally, the new Authorities must be established on a sound legal footing, and have high standards of governance, transparency and accountability.

In this context the Government does not support many of the amendments proposed by the European Parliament's ECON committee, and in particular those outlined above that would undermine national supervision.

The Council and European Parliament must now try to agree a joint text in the 'trilogue' process. This is currently underway. If a first reading deal can be agreed, representatives of the European Parliament and Council will agree a text that both can accept, and the European Parliament will adopt it at its plenary on 6 July 2010. The Council would then also adopt the same text shortly afterwards. Otherwise, the European Parliament could delay its vote until September (at the earliest). If the European Parliament and Council adopt different texts, the proposal will move to a second reading.

The Government supports the swift conclusion of a first reading deal, if possible, and is working closely with our European partners to find agreement.

28 June 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letter of 28 June on the package for reform of EU financial supervision. The EU Sub-Committee on Economic and Financial Affairs, and International Trade considered this at its meeting on 13 July.

We would like to receive further details on which specific areas of disagreement between the texts of the European Council and Parliament are stalling negotiations on a compromise, particularly in relation to whether these disagreements are over mechanisms or principles. We would also like to receive the Government opinion on each of these areas and how you believe a compromise might be found.

As you know, it has been the view of this Committee that day-to-day supervision of financial institutions should remain at a national level. We would like to know how the Government intend to ensure that this is maintained in the final compromise agreement, given that the European Parliament is pushing for it to be moved to an EU level. Do other Member States agree with the UK Government position on this point of subsidiarity?

It has also been reported that the Government has concerns over the appointment of the chairpersons of the three supervisory bodies. Who will oversee the appointment of these chairs? What is the Government's opinion on this matter?

We would like to receive a prompt response to this letter given the rapid progress of negotiations, within the standard 10 working days.

13 July 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 13 July concerning the European Supervisory Authorities and European Systemic Risk Board. You asked for further details on which specific areas the European Parliament (EP) and Council disagree, and the Government's opinion on each. This letter provides these further details, as well as updating your Committee on the latest ECOFIN discussion of the Commission's proposals.

ISSUES RAISED IN YOUR LETTER

As set out in my previous letter, the area of greatest disagreement with the European Parliament is over whether supervision should remain national, or be undertaken at the EU level.

In line with the Committee, the Government strongly believes it is appropriate for day-to-day supervision of financial institutions to remain at the national level, and it is key to ensure that no EU decisions over national supervisors can have an impact on Member States' fiscal responsibility. I am pleased that this is well reflected in the current text agreed by the Council:

“The European System of Financial Supervisors should be a network of national and Community supervisory authorities, leaving day-to-day supervision of financial institutions at the national level” [Recital 7, European Banking Authority].

Member States have agreed this position unanimously, first in December, and again most recently at ECOFIN on 13 July.

The Government would therefore not support any amendment which would undermine this principle. The European Parliament has proposed EU supervision of all systemic cross-border groups. This is clearly beyond the December and July ECOFIN agreements. We are working closely with our European partners to ensure that the European Parliament's concerns can be taken on board, without undermining this fundamental principle.

In addition to the issue of who should conduct day-to-day supervision, the European Parliament also propose the creation of a mandatory European Deposit Guarantee Scheme, and a European Banking Stability Fund. Both would be financed through contributions from all financial institutions, determined by the level of deposits and the risk exposure of the financial institution, and would be used to protect depositors and resolve institutions, respectively. The Government does not support either of these additional proposals, for subsidiarity and workability reasons. Neither proposal has significant support in Council.

There are therefore three fundamental areas of disagreement in which the Government is not prepared to compromise. We believe the European Parliament will have to move substantially in all three areas for a final deal to be possible.

OTHER AREAS OF DISAGREEMENT WITH THE EUROPEAN PARLIAMENT

In addition to the areas outlined above, there are many other more minor areas where the Government is more open to compromise with the European Parliament's proposals. These include the European Parliament's proposals for a role for it in the oversight and governance of the new authorities, for example holding the chair regularly to account, European Parliament oversight of the ESA's rule-making, and rights to receive information from the authorities. The Government supports the addition of such roles, as part of efforts to find a joint text with the European Parliament. Furthermore, there are many other changes that are de minimis and stylistic, for example changing the name of the European Banking Authority to the European Supervisory Authority (European Banking Authority). The Government does not believe such changes are substantive and so has no concerns with such proposals.

APPOINTMENT OF THE CHAIRPERSON

Your letter also asked for further details on how the chairs of the new authorities will be selected. All of this remains to be agreed with the European Parliament, however the current consensus in ECOFIN Council is that the chair and vice-chair of the ESRB should be chosen by and from the EU's central bank governors. The Government supports this.

For the three new European Supervisory Authorities, the Government believes that there should be an open and transparent process that ensures that the best candidates are selected. The current consensus in the ECOFIN Council is that the Chairpersons will be appointed by the Authority's Boards of Supervisors, on the basis of merit, skills, knowledge of financial institutions and markets, and experience relevant to financial supervision and regulation, following an open selection procedure organised and managed by that Authority's Board of Supervisors. Once the Chairperson has been selected by the Board of Supervisors, they must be confirmed by the European Parliament. The Government supports this process.

UPDATE ON THE JULY ECOFIN AGREEMENT ON SUPERVISION

At the ECOFIN Council on 13 July, EU finance ministers agreed a revised position on the Commission's proposals to establish a European Systemic Risk Board and three new European Supervisory Authorities. In this agreement, the Council:

- Reaffirmed its December 2009 agreement that supervision should remain national, that the proposed EU roles in mediation and crisis should be subject to safeguards to protect member states' fiscal responsibilities, and that EU direct powers over firms should not override national supervisors' discretionary decisions.
- Rejected demands by the European Parliament (EP) for an EU resolution fund and EU supervision of cross border firms.
- Reaffirmed that the European Banking Authority will be based in London.
- Sought to limit and tie down the role suggested by the EP for the European Supervisory Authorities in banning products. As a result, the Council agreed that such powers would:
 - be specifically agreed by Council and EP in legislative proposals;
 - be subject to a sunset to require the authority to regularly reaffirm its decision;
- include an appeal procedure requiring a qualified-majority vote to support a ban if a Member State requests it.

The Presidency will now take forward negotiations on the basis of the new mandate, and will seek to find agreement ahead of the September EP plenary vote. The Government supports this new ECOFIN consensus, and looks forward to a swift agreement with the EP and the establishment of the bodies by January 2011.

26 July 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letter of 26 July on the package of reforms of EU financial supervision. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered the documents at its meeting on 12 October.

Since your last update on the progress of negotiations on the EU supervisory framework an agreement was reached in Brussels in September. While the reform responds to a need for better supervision, we are pleased to see that the agreement confirms that the day to day supervision of financial institutions will remain at the national level and ESAs will not be allowed to impinge on a Member State's fiscal authority. These have been aspects of the reform of the EU supervisory framework on which we had strong views since the publication of the Commission's proposals.

The agreement provides for the new European Systemic Risk Board and the three European Supervisory Authorities to be established by January 2011. We would be therefore grateful if you could provide us with a final assessment of the agreement, and a general update on the progress made in establishing the new framework, with a particular focus on the on-going UK's influence on these organisations. Do the Government feel that these new supervisory arrangements, that seem to mark only a restrained shift in power to the EU, could evolve into more ambitious arrangements in the future?

We would be grateful for a reply within ten working days.

12 October 2010

Letter from Mark Hoban MP to the Chairman

I am writing to provide a further update to your Committee on the European Commission's proposed legislation to establish new EU Supervisory Authorities (ESAs) and a European Systemic Risk Board (ESRB), as the legislation is now reaching its final stages of agreement.

You will remember that I wrote in June to update you on negotiations. In that letter, I set out that while the Government supported an agreement in line with the December 2009 ECOFIN agreement, the Government could not support the European Parliament's ECON committee amendments to the draft legislation, which sought to establish European Stability Funds, European Guarantee Schemes and EU level supervision of all significant cross-border financial institutions.

Similarly, the Government was determined to ensure that the European Banking Authority (EBA) would be located in London, where the European Parliament had pressed for Frankfurt, and that central counterparties (CCPs) would not be supervised at the EU level.

In this context, the Government welcomes the package of legislation that was voted through the European Parliament on 22 September, and which will come back to the Council for final agreement shortly. This revised text ensures that day-to-day supervision of financial institutions will remain at the national level, establishes that the new ESAs cannot take decisions that impinge on Member States' fiscal responsibilities, and improves the legal issues in the Commission's original proposals. It also ensures that the new authorities have requirements for high standards of governance, transparency and accountability. Finally, EBA will be based in London, and there is no proposal in the text for CCPs to be supervised by an ESA.

This new European framework has the potential to fundamentally improve the quality and consistency of supervision, ensure more effective rulemaking and enforcement, and better identify risks in the financial system, and the Government therefore supports it. We have seen from the recent crisis that reform is necessary: Our experience of the Icelandic banks operating branches in the UK, where the FSA had little or no oversight, and where there was no mechanism to ensure supervisory quality in the home Member State, demonstrates that there are unacceptable failings in the current cross-border arrangements. The new arrangements will improve cross-border supervision, provide mechanisms for us to ensure supervisors are complying with their legal obligations, and ensure national supervisors are of high quality. While facilitating better co-ordination of supervision, the final agreement ensures that national governments and regulators retain their frontline responsibility to protect the national taxpayers' interest. These proposals are supported by the City, and in particular cross-border institutions operating from London.

FURTHER DETAIL ON THE PROPOSALS

As you will know, the legislation establishes three new European Supervisory Authorities (ESAs) - the European Banking Authority (EBA) to be based in London, the European Securities and Markets Authority (ESMA) to be based in Paris, and the European Insurance and Occupational Pensions Authority (EIOPA) to be based in Frankfurt - and the European Systemic Risk Board (ESRB), also to be based in Frankfurt.

The ESAs will play a key central role in ensuring high quality supervision in Europe. In particular, they will have, within the framework provided by directives, a strong independent rulemaking role by setting strong and rigorous standards for national supervisors to apply, a role in enforcing rules and, in the unusual event that a national supervisor ignores an ESA law-enforcement decision, the ESA would be able to directly instruct firms. They will ensure greater supervisory quality by setting high quality guidance, undertaking peer review and facilitating cooperation. They will have powers to settle disagreements between supervisors, and to take coordinating decisions in emergencies over supervisors. We believe that these measures will help ensure that the high standards of supervision and regulation evident in the UK apply across Europe.

It has also been agreed that the ESAs will be able to ban products, but the Government ensured such provisions were only temporary and Member States can appeal in a procedure requiring a Qualified Majority Vote (QMV) to support a ban. Finally, the ESAs will have powers to supervise credit rating agencies (as agreed in December), given their unique status in financial markets.

The European Systemic Risk Board (ESRB) will act as an effective macro-prudential early warning system, issuing warnings on significant risks and, where appropriate, recommendations on how to mitigate such risks, working closely with the new structures being established in the IMF/Financial Stability Board. Responsibility for taking action in respect of these identified risks will continue to rest with national governments and supervisors.

Overall, the agreement represents a very good outcome for the UK, and is broadly in line with the general approach agreed at ECOFIN in December 2009.

Now that the proposals have been agreed by Member States, the focus moves to establishing the bodies by January 2011. This includes ensuring that other legislation proposed by the Commission does not undermine the compromise achieved here. The Government intends to be fully involved at all stages in ensuring these bodies are successful.

11 October 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 12 October. You have raised a number of questions in relation to the above proposals and I have answered these in turn below.

In your letter, you ask for a final assessment of the agreement. You will have seen my letter of 11 October that updates you on the agreement. In that letter, I set out that the agreed text ensures that day-to-day supervision of financial institutions will remain at the national level and establishes that the new ESAs cannot take decisions that impinge on Member States' fiscal responsibilities. I am glad that you welcomed these provisions in your letter.

You also asked for a general update on the progress made in establishing the new framework, with a particular focus on the on-going influence of the UK in these organisations, and whether the Government feels that these new supervisory arrangements could evolve into more ambitious arrangements in the future.

ENSURING THE UK'S INFLUENCE IN THE NEW ARCHITECTURE

The FSA, or the equivalent domestic authorities responsible for supervision following the UK's domestic reorganisation of supervision and regulation, should be a very influential representative in the new ESAs. As set out in the Government's consultation document "A new approach to financial regulation: judgement focus and stability", the new Prudential Regulation Authority (PRA) will hold the UK's voting seat on the EBA and the EIOPA and the consumer protection and markets authority (CPMA) will represent the UK's interests on ESMA. Given the relatively small size of the staff in each ESA (approximately 40-60 people), the ESAs will rely heavily on their members.

We will expect the FSA (and, in due course, the PRA and CPMA) to put significant time and effort into ensuring that the UK's voice is heard and that the ESAs decisions are appropriate. The UK regulatory authorities will be well placed to influence and take part in the technical work of the ESAs, for example the development of binding technical standards, and the production of guidance and advice.

Alongside this, the FSA (and, in due course, the PRA and CPMA) will have a significant formal role in representing the UK's competent authorities in the ESA board of supervisors, and voting in the board on ESA decisions. Similarly the Governor of the Bank of England will be represented in the ESRB and vote on any warnings and recommendations.

Finally, it will also be very important that the UK regulatory authorities encourage their staff to take up temporary secondments in the new ESAs. The FSA are currently reviewing their staffing and deployment policies to ensure that they promote such participation in the new ESAs. We will expect the Bank of England to take a similar approach to the ESRB.

The Government is committed to ensuring that the transition to the new domestic arrangements for supervision and regulation works smoothly and maintains the strength of the UK's involvement.

FUTURE EVOLUTION OF THE FRAMEWORK

There are clearly some, in particular in the European Parliament, that see this agreement as a first step towards the centralised EU supervision of financial institutions in the EU.

I should be clear that the Government would not support such a position. It is clear to us that the day-to-day supervision of financial institutions should remain at the national level, for the reasons I have set out to you in my previous letters.

However there will be some necessary and useful additions to the framework in the coming months and years. Following the "Omnibus Directive", which was also voted through in September and amends ten existing financial services directives to ensure that the new ESAs can carry out their tasks effectively, the Commission will shortly propose a second "Omnibus" amending directive, which will seek to give the ESAs their rulemaking role, primarily in the insurance sector (amendments are necessary to other EU legislation to allow for such rulemaking), as well as their roles in mediation, and the enforcement of EU law.

The new Omnibus will also make general amendments to the sectoral legislation so that it is compatible with the new ESAs. The Government supports these roles, which are in line with the agreed framework, and will engage constructively in the 'Omnibus II' discussions to ensure that the outcome is workable and compatible with the framework agreement. We can expect further 'Omnibuses' to cover other directives, over the coming year.

The European Securities and Markets Authority (ESMA) will shortly be given responsibility for supervision of credit rating agencies (CRAs). This reflects the agreement at ECOFIN in December

2009 that the ESAs could assume direct responsibility for supervising CRAs. The regulation to confer these powers to ESMA is detailed with in my explanatory memorandum (10827/10) of 17 June and subsequent correspondence with the Committee.

We can also expect proposals for other roles for the ESAs and the ESRB in other forthcoming legislation. The Government will look at each proposal carefully, to ensure that it is line with the agreement reached here, and that it does not set wider precedent. We will inform your Committee of such proposals as they come forward, in the normal way.

I hope this answers your Committee's questions.

2 November 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letters of 11 October and 2 November on the reform of the financial supervisory architecture. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered these at its meeting on 9 November.

We welcome your comprehensive assessment of the EU financial supervisory framework. We are pleased to note your support for it and we share your the belief that it will improve the quality and consistency of supervision, ensure more effective rule-making and enforcement, and better identify systemic risks in the financial system. It also represents a major step towards an effective single market in financial services.

We remain interested in forthcoming proposals in this area, and we will continue to scrutinise current proposals for legislation that set out the role of ESMA in the OTC derivatives regulatory framework. We note the European Parliament's view that the current agreement should be the first step towards a more centralised supervision of financial institutions at an EU level. We are aware that the current arrangements will be reviewed in three years time, and we hope that this will allow sufficient time to assess the effectiveness of the new regulatory framework and consider whether the European Parliament's position has merit.

We do not require a response to this letter.

10 November 2010

FUNCTIONING OF THE INTERINSTITUTIONAL AGREEMENT ON BUDGETARY DISCIPLINE AND SOUND FINANCIAL MANAGEMENT (9193/10)

Letter from the Chairman to Justine Greening MP, Economic Secretary, Her Majesty's Treasury

Thank you for your Explanatory Memorandum on document 9193/10 on the functioning of the interinstitutional agreement on budgetary discipline and sound financial management. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 19 October.

While we note your aim to limit UK contributions to the EU Budget, we believe it is important that the EU can meet unexpected challenges in the second half of the current multiannual financial framework. Why do you think that all the possible options set out in the Committee's report might "undermine fiscal discipline, weaken incentives for sound financial management, and increase the cost exposure of the UK"?

We also recognise your desire to ensure that any funds for new programmes are found by redeployment within the existing multiannual financial framework, rather than by increasing the aggregate ceilings. Given the Commission's conclusion that the margins available for redeployment are shrinking, in particular those found within heading 2 which are traditionally a source of flexibility, how does the Government propose to incorporate the necessary flexibility in the EU's Budget?

We have agreed to release the document from scrutiny, but we would appreciate a response within the standard ten working days.

19 October 2010

Letter from Justine Greening MP to the Chairman

Thank you for your letter of 19 October, in which you raised questions regarding the Government's position on flexibility in the EU budget.

You ask why the Government is concerned about the conclusions on flexibility in the Commission's report on the Interinstitutional Agreement (IIA) on budgetary discipline and sound financial management. The report sets out three main options for flexibility: redeployment within headings; mobilisation of the Flexibility Instrument; and revision of the ceilings in the Financial Framework. The report also argues that redeployment would apply only for limited amounts and that the Flexibility Instrument is overstretched. Although I would contend these arguments, the weight of emphasis in the report lies on the last option.

The Government is concerned by proposals to deliver flexibility in the EU budget by revising upwards the ceilings of the Financial Framework. These ceilings are important tools of budgetary discipline, which limit the funds available to the EU budget. The Commission should not be able to compensate for poor programming or lax financial management by raising these ceilings and thereby increasing the costs borne by Member States. At a time when the Government is implementing a tough deficit reduction plan, and assessing the value of all public spending extremely closely, I believe that EU spending should be subject to equally stringent scrutiny and discipline.

You also ask how the Government proposes to incorporate the necessary flexibility in the EU's budget. The issue is not whether the EU has enough funds, or how easily the funds available to the EU budget might be increased by altering the ceilings in the Financial Framework. Rather, it is whether the EU can prioritise its spending to support its key priorities.

I believe that the tools to adequately prioritise spending in the EU budget are already available. The report describes these tools in some detail. Moreover, the annual budget process provides the Commission and other EU institutions with ample opportunity to shape the EU's budget to meet Europe's most pressing needs. The task for the EU now is to face up to tough decisions on its spending priorities. When resources are scarce and unexpected costs arise, the EU must decide what spending to protect and how to make savings, just like millions of households across Europe, as well as national governments. It should not simply be given more money.

Of course, the EU might face a serious, genuinely unexpected crisis in the near future. In such events, I believe that procedures and instruments to deal with any financial impacts will be found.

2 November 2010

Letter from the Chairman to Justine Greening MP

Thank you for your letter of 2 November on Explanatory Memorandum 9193/10 on the interinstitutional agreement, and your letter of 6 November on the EU Budget 2011. The EU Economic and Financial Affairs and International Trade Sub-Committee considered these at its meeting on 16 November.

With respect to the interinstitutional arrangement, we recognise your desire to ensure that, at a time when national governments are facing severe budgetary pressures, the EU is required to consider its own spending priorities carefully before allocating new funding. These issues will be considered again when the forthcoming Budget Review is scrutinised, and we look forward to discussing these issues with you in more detail at that time.

Your letter of the 6 November covers two issues: the ITER project and the Multiannual financial framework regulation. The EU Internal Market, Energy and Transport Sub-Committee is scrutinising the ITER project, and your update on this area is being dealt with in a separate letter. Turning to the multiannual financial framework regulation, we query why you are opposing a measure in what is merely a technical exercise incorporating existing budget rules into new legal instruments, as required by the Lisbon Treaty. Since the regulation will be revised when the new multiannual financial framework for 2014 onwards is negotiated, that would seem to be a more appropriate time for this discussion to take place.

We would be grateful for a response to this letter within the standard ten working days.

17 November 2010

GREECE: FISCAL SURVEILLANCE (9443/10, 12936/10)

Letter from the Chairman to Mark Hoban MP, Financial Secretary

Thank you for your Explanatory Memoranda 9443, dated 26 July, and 12936 & 7, dated 22 September. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 19 October.

We note that these documents were the subject of scrutiny overrides, but recognise that in one case Parliament was dissolved, and in the other in recess. We are therefore content that these overrides were justified.

It is important that action is taken to re-establish the credibility of the Eurozone system, especially in light of current discussions aimed at reforming the Stability and Growth Pact.

We already had the opportunity to discuss with you the consequences of the unreliability of the Greek government's deficit and debt statistics, and we now intend to examine these issues further within the context of our current inquiry on the future of economic governance in the EU. We nevertheless remain keen to receive updates on significant developments on these dossiers.

We do not require a response to this letter.

19 October 2010

HM TREASURY SCRUTINY PERFORMANCE

Letter from Justine Greening MP, Economic Secretary, Her Majesty's Treasury, to the Chairman

I am writing with regard to HM Treasury's overall performance on the submission of explanatory memoranda to the EU scrutiny committees - although this is a matter that has not yet been raised directly with me by your committee.

I am aware that we have submitted a number of EMs late, with some left outstanding for months. This is not the standard of service that I wish for the Committee and, with officials, I am working hard to set the situation straight now and for the future.

There are a number of reasons for the delays, including increased workload and clerical errors; we have taken steps to address these problems, including measures to help prevent mistakes from occurring.

We have tried to limit the business implications of delays by processing EMs with tight Council deadlines ahead of those that are for information only. We have also tried to redistribute work internally.

In the meantime, I want to reassure you that Parliamentary scrutiny of EU dossiers remains very important to the Government and we will do all we can to facilitate the process.

30 November 2010

IMPLEMENTATION OF THE COHESION POLICY PROGRAMMES (8321/10)

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

I would like to update you on recent policy developments relating to the above Commission document for which an Explanatory Memorandum was submitted for scrutiny on 26 May. Your Committee cleared this document from scrutiny on 23 June.

The Council conclusions on the above document were discussed at the General Affairs Council held on 14 June 2010. The Foreign Secretary represented the UK at the meeting. The Council conclusions focus on Cohesion Policy and are very much broader and separate from the Strategic Report itself which provides a summary of the progress being made across the 27 Member States in implementing current Cohesion policy programmes. Given that the Government's position on the future of the Structural and Cohesion Funds is still to be determined, the line that UK officials took in discussions on the conclusions was that we could not agree to text that would pre-judge the negotiations on the next financial perspective. The final conclusions include this important qualifier. I am enclosing the relevant text of the Council Conclusions for your information.

The conclusions invite the Commission to explore possibilities for a better co-ordinated and simplified policy and note that Cohesion Policy will need to support the Europe 2020 strategy and should continue to foster competitiveness, innovation, employment and economic, social and territorial cohesion in the European Union.

3 August 2010

INVESTOR COMPENSATION SCHEMES (12346/10)

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

Thank you for your Explanatory Memorandum on document 12346/10 on investor compensation schemes. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 19 October.

We note your opposition to the Commission's proposal to fix the maximum compensation for investors at a lower level than that currently guaranteed by the Government. Does the Government disagree therefore with the Commission's view that a fixed limit is necessary to avoid arbitrage and to ensure an investor's choice is not influenced by different compensation levels within the single market? In addition, we note that the proposed Directive would still contain the following statement in Article 4, paragraph 3: "This Article shall not preclude the retention or adoption of provisions which afford greater or more comprehensive cover to investors". How do the Commission's proposals comply with this requirement?

We would also like to know why the Government has decided to continue to rely on state-run compensation schemes, rather than requiring investment firms to ensure they have adequate private insurance that would allow those firms with strong credit ratings to benefit from low insurance rates. Are there any measures proposed by the Commission that would put the burden on investment firms to ensure their investors are covered, rather than on governments?

You state that pre-funding investor compensation schemes would reduce investor returns without offering increased protection. What mechanism would the Government like to see in place to offer the same level of protection without pre-funding?

We note your opposition to the mandatory lending between national compensation schemes. What are your reasons for opposing this provision? Do you feel the objections raised by the Swedish Parliament and others that a mandatory lending scheme might lead to a moral hazard situation are justified? Are there any consequences for Member States outside the Eurozone taking part in this lending scheme that might arise from exchange rate fluctuations?

You state that the Government will argue for "continued national discretion" in the operation of investor compensation schemes. Perhaps you could expand on the areas where you believe continued national discretion is necessary, and your reasons for doing so.

Finally, we recognise your concerns over the extension of cover to include UCITS depositaries while discussions on UCITS are due to start in 2011. We would like to be kept informed about how your discussions progress in this area.

We will keep this document under scrutiny while we await your reply. We would be grateful for a response within the standard ten working days.

19 October 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 19 October on the Investor Compensation Schemes Directive (ICSD). I will address your questions below.

MAXIMUM HARMONISATION OF COMPENSATION LIMIT

You note that the Commission's view is that a fixed compensation limit is necessary to avoid regulatory arbitrage between Member States. However, while Member States competed on deposit guarantee limits during the financial crisis, this did not happen in the investment sector and the Commission has not produced any evidence to support its view that arbitrage may occur. While it is therefore sensible to have maximum harmonisation of deposit guarantee limits, the Government does not believe this is the case for investor compensation. The main risk for depositors is the bank defaulting; for investors it is investment risk, for which there is of course no compensation. Consumers are therefore less likely to be influenced by investor compensation limits when choosing investment services than they would be by deposit guarantee limits when choosing a depositor.

You note that the continued existence of Article 4, paragraph 3 is inconsistent with the proposal to fix the compensation limit. However, this provision does not only currently allow Member States to offer higher compensation limits, but it allows Member States to provide greater scope. As explained in my Explanatory Memorandum (EM) in September, the UK's Financial Services Compensation Scheme (FSCS) goes further than is required by the ICSD and also covers investment losses resulting from breaches of the conduct of business rules, for example, mis-selling and unsuitable advice. I

understand it is not the Commission's intention to prevent this or other increases in scope, but, if maximum harmonisation remains in the proposal, we would seek an amendment to Article 4 to ensure the UK can continue to provide greater scope. The majority of the FSCS's investment claims are for breaches of the conduct of business rules, indicating the importance to consumers of compensation in these cases.

STATUTORY SCHEMES

You ask whether the Government has considered requiring investment firms to purchase private insurance rather than contribute to a statutory scheme, as firms with strong credit ratings would be able to benefit from lower insurance premia. However, this assumes a strong link between a firm's credit rating and the probability of compensation claims, which is not necessarily the case. When a bank defaults, depositors may lose their deposits, but when an investment firm defaults, there is a legal and regulatory framework in place to ensure investor loss is minimised. Investor compensation therefore has to cover the risk of firms not adhering to the rules and regulations, for example due to fraud, and not simply credit risk.

More importantly, there is widespread recognition, including among firms themselves, of the value of having a statutory fund of last resort, as this helps give consumers confidence to do business with regulated firms. The FSCS contributes to confidence because of its simplicity, which I do not believe would be the case with a system of private insurance. Such a system would be more complicated for the consumer, for example by the lack of a single point of contact and the possibility of the insurer itself being unable to meet its obligations and therefore leaving investors without compensation. This complexity would also make it difficult for insurance firms to provide similar cover at the same or lower cost.

On putting the onus on investment firms to ensure investors are covered, the existing ICSD makes it clear that firms must be members of a national compensation scheme in order to gain authorisation. It also makes clear that compensation schemes are to be funded by their participating firms. The Commission's proposal does not change this position, but does increase the requirements on firms for providing investors with information about the compensation cover.

PRE-FUNDING

In my EM I argue that disproportionate levels of pre-funding would take away large sums of investor money, affecting investors through reduced investment returns, without increased protection. Pre-funding itself would not necessarily have that effect, but the Commission's proposed target fund level of 0.5% is excessive. We are working with industry, the Financial Services Authority and the FSCS to analyse the full impact of the proposal, but our initial assessment is that the opportunity cost does not have a commensurate improvement in investor protection and confidence; and that the fund would take money away from firms that could otherwise be used to strengthen their businesses, increasing the possibility of default and the risk to investors.

In any case, Member States are able to take into account the characteristics of their own markets and are best placed to decide whether schemes should be pre-funded or not, as they should be responsible for the liquidity of national schemes. However, schemes should have access to reliable source of short-term funding, for example supplied by the state or commercial loans, to avoid payout delays which would affect consumer confidence.

CONTINUED NATIONAL DISCRETION

It is important that there is continued national discretion in the operation of investor compensation schemes in the areas of funding, compensation and scope.

As explained above, the Government will argue for a more proportionate approach on funding that recognises that Member States are best placed to ensure schemes are able to meet their obligations.

In order to avoid a reduction in the protection currently afforded to UK investors, the FSCS should be able to continue to provide a higher level of compensation than is proposed and provide further cover for example for breaches of the conduct of business rules, as explained above.

MUTUAL BORROWING

The Government objects to the mutual borrowing proposals in the ICSD for many of same reasons I set out in my letter to you on the Deposit Guarantee Schemes Directive (DGSD). There is contagion risk whereby schemes that lend to other schemes are at risk of not being able to meet their own obligations and having to raise otherwise unnecessary additional levies from industry. Similarly, a

scheme could be forced to borrow from the state having used its own resources to lend to another scheme, amounting to a loan between Governments. The Government believes that this would breach the fiscal sovereignty of national Parliaments, and on this basis, we fundamentally object to mutual borrowing.

Also as explained in my letter on the DGSD, I do not think that the proposals would create any additional moral hazard risk to any scheme that is already backed by a Government, as is the current situation with the FSCS. In any case, any moral hazard risk is minimised by the boundaries imposed by the Commission on mutual borrowing. However, the proposals still present an unpredictable and unacceptable fiscal risk to the UK Exchequer.

Similarly, the issue of exchange rate fluctuations is not addressed in the proposal and would need to be resolved should the mutual borrowing proposals be adopted. However, as with the DGSD, given that the UK is opposing mutual borrowing along with a majority of other Member States, I do not consider it worthwhile to press for an amendment to the Directive to take account of exchange rate fluctuations during the borrowing process.

UCITS DEPOSITARIES

You asked to be kept informed about discussions on UCITS depositaries. This issue has been discussed at the first two Council Working Group meetings on the proposal, where there has been strong opposition from Member States to the extension of scope to include UCITS depositaries. The Commission has argued that the discussions on compensation within the ICSD and liability within forthcoming work on UCITS depositaries can be separated. However, most Member States agree that the UCITS depositary liability discussions should take place first.

15 November 2010

OTC DERIVATIVES, CENTRAL COUNTERPARTIES AND TRADE REPOSITORIES (13917/10)

Letter from the Chairman to Mark Hoban MP, Financial Secretary

Thank you for your Explanatory Memorandum 13917/10 on a Commission proposal for a Regulation on OTC derivatives. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 26 October.

We welcome this proposed regulation and consider that it will bring greater transparency and responsibility to the OTC derivatives markets. In our inquiry, The future regulation of derivatives markets: is the EU on the right track?, we looked favourably at increased standardisation and central clearing of OTC derivatives as a means to increase transparency and stability. We concluded that not all products, nor all standardised products, are suitable for central clearing. We also felt that EU legislation should avoid forcing these products through central clearing, noting that this may increase the risk in the system if a CCP cannot effectively manage the risk associated with a product. We welcome the fact that the Commission's proposed regulation incorporates the principle that a CCP should not be forced to clear a product whose risk it is not comfortable managing.

We note that the proposal alleviates our concerns over the potential stricter requirements on businesses which use derivatives by providing clearing exemptions for non-financial companies using OTC derivatives for the purpose of risk management. However, we note that much discretion is left to ESMA to devise rules that will exempt non-financial end users of OTC derivatives where they are hedging commercial risk, or where they are not systemically significant.

We also note that ESMA will have other responsibilities, such as clarifying which derivatives must be centrally cleared. We concur with you that the overall impact of the proposed legislation will depend on the decisions made, and the technical standards developed by ESMA. What is the justification for leaving significant issues to delegated legislation when ESMA has yet to be put in place?

With regard to the authorisation and supervision of CCPs, the Commission suggests a hybrid arrangement whereby a central role is assigned to ESMA while respecting the competences of national supervisory authorities. The Commission's proposal also suggests that CCPs should have access to central bank liquidity given that they are set to gain more systemic relevance. We would welcome further consideration of the suggestion that CCPs have access to central bank liquidity. Will this arrangement make the derivatives market more robust or will it simply create moral hazard? Would access to reliable commercial bank liquidity be preferable? Where is the most likely location for CCPs and how are their numbers going to be determined? Is there an argument for CCPs to be based in the Eurozone if the clearing is in euro-denominated instruments?

We note that the Government “broadly agrees” with the Commission’s impact assessment – what exactly are the Government’s reservations about this document?

On a final note, we would like to hear your view on whether the proposed regulation is aligned with the US’s Dodd-Frank Reform Act, and whether you see any risk of regulatory arbitrage.

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

26 October 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 26 October. You have raised a number of questions in relation to the above proposal, in particular with regard to the proposed role of the European Securities and Markets Authority (ESMA).

I can confirm that the Commission proposal exempts from the clearing obligation all OTC derivative transactions linked to the commercial activities of non-financial entities. On the question of ESMA having discretion, the Government is clear that all future legislation should be in line with the recently agreed European Supervisory Authority (ESA) regulations which set out the roles and responsibilities for the ESAs. In examining, for example, which class of derivatives should be subject to a clearing obligation, it is proposed that ESMA’s role will conform to the Meroni principle on delegation of powers, with the final decision being adopted by the Commission.

On the question of CCP access to central bank liquidity, you highlight the potential for moral hazard if a requirement for access to central bank liquidity is hardwired into the legislation. The government agrees with your view that reliance on the provision of central bank liquidity presents a moral hazard and could lead to downward pressure on risk management standards. The Commission proposal helpfully recognises that there are in fact various mechanisms through which CCPs can seek to mitigate liquidity risk, for example through committed facilities with commercial banks or through a mutualisation of these risks with clearing members. The Government further considers that it should be for independent central banks to decide to which institutions they offer their services in accordance with their (typically statutory) objectives. Any requirement to establish liquidity facilities with every central bank whose currency a CCP is clearing would be overly burdensome and in practice lead to a highly fragmented market structure. It would also appear at odds with the single market principles of the European Union, and the government therefore does not believe that the clearing of OTC derivatives should be tied to a particular currency zone within the Union.

The European Commission’s impact assessment, which accompanies the proposal, provides a helpful outline of the different options that were considered by the European Commission and evaluates associated costs and benefits. It notes the benefits of increasing transparency and reducing counterparty credit and operational risk in the OTC derivative markets. It also acknowledges the significant operational and capital costs associated with achieving these benefit, for example through CCPs’ margin requirements. The impact assessment concludes that the greatest net benefit will be achieved by requiring market participants to report their OTC derivative portfolios to trade repositories, requiring CCP clearing for those OTC derivatives that meet certain pre-defined criteria, and setting out pre-defined standards for bilateral transaction processing and clearing.

Regarding the recent legislative reform in the US, the Dodd-Frank Act covers a much broader remit than the Commission proposal. Amongst other things, it addresses mandatory trading on electronic trading platforms whereas in the EU any move to increase on-exchange trading will be addressed by the review of the Markets in Financial Instruments Directive (MiFID). The main aim of the Commission proposal is to mandate clearing of OTC derivative products, reporting of transactions and setting high standards for central counterparties operating in the EU. On those issues, the Commission proposal is broadly in line with the Dodd-Frank Act. To ensure there is consistency of approach with regards to the more detailed implementation of these measures, the Treasury, Bank of England and FSA are in regular contact with the US authorities and are working closely with them through the G20 and the FSB working groups.

5 November 2010

Letter from the Chairman to Mark Hoban MP

Thank you for your letter dated 5 November 2010 on Explanatory Memorandum 13917/10 on a Commission proposal for a Regulation on OTC derivatives. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 16 November.

We note that your letter did not provide much information on the likely location and numbers of CCPs. As you might recall from our previous report on derivatives, we believe that these are important elements of the proposal as the fiscal responsibility for a failure of a CCP would most likely be borne by the Member State in which the CCP is established. Therefore it is important that national supervisors retain some form of responsibility for CCP authorisation and supervision. We would therefore be grateful to receive an update on any progress made in these areas during negotiations.

We would also appreciate updates on developments regarding CCPs access to central bank liquidity, rules on recognition of non-EU CCP and trade repositories established outside the EU, and on any other point creating controversy in the working group and the Council. In addition, we would also be interested to know the position the European Parliament is taking on these issues.

We note your summary of the Commission's impact assessment, but we would like to know why the Government only "broadly agrees" with this document. We recognise that you agree with the overall conclusions, but in which areas do you not fully agree with the Commission's analysis?

You also provide some information about how the EU and US are working together to ensure a consistency of approach in this area. We welcome this work, but we note that there are differences, and we would be grateful for your assessment of whether there is any risk of regulatory arbitrage arising from these differences.

We wonder if there are concerns at the wide discretion ESMA will have to decide which derivatives should be subject to a clearing obligation. Its decisions in this area could have a considerable impact, and would be grateful to know the rationale of leaving such a significant power to delegated legislation.

Finally, we would be grateful if you could confirm what kinds of financial contracts will be covered by the definition of 'derivatives' used in the proposed Regulation. Will it, for example, cover a forward contract negotiated by a farmer to sell wheat at a specified price on a specified date? And, if so, would these kinds of forward contracts be subject to a clearing obligation?

We would be grateful for a response within the standard ten working days.

17 November 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 17 November. You have raised a number of questions in relation to the above proposal.

With regards to the clearing landscape across the EU, there are currently 17 CCPs based in the EU with a further six providing services to clearing members based in the EU. These CCPs clear a variety of asset classes including securities and derivatives. From a UK perspective, four of these CCPs hold a recognised clearing houses license whilst a further seven have acquired a recognised overseas clearing house license. Given the current changes in the market, it is difficult to predict to what extent future consolidation and new entrants will alter the clearing landscape across the EU. We fully agree with your view that in light of potential fiscal implications of a CCP failure, responsibility for authorising and supervising these CCPs should lie firmly with the Member State where the CCP is established. The current proposal of the European Commission is consistent with that view.

On central bank liquidity, it is in our view not advisable to mandate CCP access to central banks given the potential for moral hazard and infringements on central bank independence. We agree with the European Commission's proposal that CCPs should be able to source liquidity from other sources, including commercial banks. On third country recognition, the current Commission proposal sets out clear processes for recognising third country CCPs and trade repositories. Both require a registration with the relevant ESA but transitional arrangements will mirror those available to EU CCPs. The UK government strongly supports the ability for third country CCPs and trade repositories to offer their services in the EU and are supportive of the current proposal by the European Commission in those areas.

The European Parliament has not yet responded to the European Commission's proposal. It has convened a first exchange of views in the ECON committee for the 30th November and the final Committee vote is expected in late March 2011.

With regards to the impact assessment, we agreed with the content of the assessment but felt that the study could have contained more quantitative analysis of the impact this proposal will have on the European markets, especially with regards to the collateral that will be held at the CCPs. However, we acknowledge that given the opaque nature of this market, reliable data is more difficult to obtain.

In relation to differences between the EU and the US legislation, there is the potential for regulatory arbitrage around the different asset classes that may be required to be centrally cleared. The Commission proposal and the US legislation do not currently spell out which products would be covered by the clearing obligation as it is expected that regulatory authorities will determine the scope of clearing eligible derivatives over the coming years. We expect and will encourage the relevant authorities to work closely together on this particular issue.

With regards to implementing the clearing obligation in the EU, it is in our view essential that the process allows for adequate discretion. Imposing a rigid procedure which would force all market participants to apply the clearing obligation at once and for the totality of their derivative transactions could inadvertently lead to an increase in systemic risk, for example by breaking offsetting netting sets between different products. As noted in my previous response, given the necessity for discretion in applying the clearing obligation, it is the UK government's view that the decision should be taken in accordance with the procedure set out at article 15 of the ESA regulation and not be decided solely by the relevant ESA.

With regards to the scope of derivatives covered, the current text of the European Commission's proposal defines derivatives by reference to the Markets in Financial Instruments Directive (MiFID). This does not cover physically settled agricultural commodity products such as the example listed in your letter. Forward derivative contracts in general are not covered by the MiFID definition and are therefore not considered derivatives for the purpose of this legislation.

25 November 2010

REPUBLIC OF KOREA: FREE TRADE AGREEMENT (6307/10, 8502, 8523)

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

I refer to Lord Roper's letter of 25 March 2010 regarding the recent Explanatory Memorandum on the bilateral safeguard clause of the EU-Korea Free Trade Agreement.

The Committee raised concerns about the length of an investigation and the related length of provisional safeguard measures, the latter potentially expiring before an investigation could be concluded. We too noted this apparent discrepancy in the text of the draft regulation which we raised with the Commission when the draft was presented to Member States.

The Commission confirmed that its normal practice in the area of trade defence is to ensure that there is no vacuum between expiry of provisional and the implementation of definitive measures. On this basis, we can accept the current version of the draft.

I understand that from past experience, in practice the Commission would be unlikely to require more than six months to complete an investigation if clear evidence emerges that the imposition of measures is justified. The periods specified in the draft regulation are in any case shorter than the usual EU process, and are maximum lengths rather than mandated periods.

I hope that this addresses the Committee's concerns. Please do not hesitate to contact me if you have any further questions before clearing the document from scrutiny.

27 May 2010

Letter from Edward Davey MP, to the Chairman

I refer to Lord Roper's letter of 8 April 2010 in response to an OTNYR Explanatory Memorandum on the EU-Korea Free Trade Agreement (FTA). The Committee asked for an update on how negotiations are proceeding for a similar FTA with Japan.

At the EU-Japan Summit held in Tokyo on 28 April, it was agreed to establish a joint High-Level Group to identify options for strengthening and integrating all aspects of the EU-Japan economic relationship addressing issues of interest to both sides, including tariffs and non-tariff measures. I agree that a closer trade and investment relationship would be economically beneficial for both parties, but further work would be needed before the EU would be ready to open FTA negotiations with Japan.

27 May 2010

Letter from the Chairman to Edward Davey MP

Thank you for your explanatory memorandum dated 28 May and your two letters dated 27 May on the EU-South Korea Free Trade Agreement and safeguard clause. The EU Sub-Committee on Economic and Financial Affairs and International Trade discussed these documents at our meeting of 29 June.

As we set out in our letter sent in March before the dissolution of Parliament, we strongly support such agreements given the trade benefits they bring to the economies of all involved. We note, however, that you consider that an opt-in applies in relation to the Mode 4 provisions of the FTA. Three questions arise from your position:

- The Treaty bases cited in the two draft Decisions do not include any in Title V, Part 3 TFEU. How does the UK opt-in Protocol apply to the proposals?
- Do you consider that a Treaty base in Title V must be added to the draft Decisions? Are the provisions in the Free Trade Agreement on the movement of persons such as to justify the addition of a Treaty base?
- What are the arguments for and against opting in to this section of the FTA, assuming the opt-in applies?

We also note concerns raised by the automobile industry that the Agreement will have a negative impact on the industry in the EU. What is your assessment of the effect the FTA will have on the competitiveness of the EU automobile industry?

We decided to hold documents 8502/10 and 8523/10 on the FTA under scrutiny, as well as document 6307/10 on the bilateral safeguard clause, in anticipation of your reply.

We would be grateful to receive a reply within the standard 10 days.

29 June 2010

Letter from Edward Davey MP to the Chairman

Thank you for your letter of 29 June following the discussions of the EU Subcommittee on Economic and Financial Affairs and International Trade about the EU-Korea Free Trade Agreement. Please find below responses to your questions.

First, regarding the opt-in. We have now taken the decision to invoke it, with support from the Secretaries of State for Foreign & Commonwealth Affairs and for Home Affairs.

On the legal base, Article 207(6) of TFEU prevents the EU from acting externally under Article 207 in a way that would circumvent restrictions on its competence if it were acting internally. In our view internal EU legislation requiring Member States to admit third country national service providers would require recourse to Title V of TFEU and would therefore be subject to the UK and Irish Opt-in Protocol. As a result, we consider that the EU cannot bind the UK in an international agreement containing Mode IV commitments unless the UK exercises the opt-in in relation to those commitments. We do not consider, however, that it is necessary to push for the addition of a Title V legal base in these circumstances.

In addition to the legal argument above, we consider it important to opt-in to ensure that the UK can formally ratify the agreement and therefore share in the economic benefits it will provide. Not doing so would call into question the UK's support for the FTA and ability to properly implement it.

Second, regarding the automobile industry. There has been concern amongst EU automobile producers over the impending liberalisation in the sector due to the EU-Korea FTA. An impact assessment by the Commission acknowledges that the EU automobile sector will gain significant market access in Korea as a result of the FTA, but will face increased competition from Korean producers particularly in the small car sector. A combination of tariff liberalisation, the depreciating Won against the Euro and generous Korean scrappage schemes means that competition in Europe from Korean brands is likely to increase significantly. The automobile sector in Europe is also currently in overcapacity with reduced demand due to the economic crisis and a shift to lower value cars making it an already difficult environment in which to sell cars. Automobile parts will be little affected by the Korea FTA as the EU sources most of its imports from other competitive locations such as China. There may be a slight impact on these low cost suppliers such as China and the USA from cheaper Korean imports, however this is not expected to be significant and will not affect UK companies.

In the UK the automobile sector has 3,400 enterprises, £52bn sales amounting to £11bn Gross Value Added and employs 180,000 people. The UK is likely to be less affected by the increased competitive

pressures as we are not a large producer of small, lower value cars, with small margins and greater price sensitivity. Copenhagen Economics have estimated that output in the UK automobile sector is likely to increase by 0.4% per annum in the long run.

The FTA has secured elimination from the outset of important technical barriers to automobile trade with Korea, by ensuring that EU technical and safety standards will be considered equivalent to those in Korea. This means that there will be no need for EU automobile exporters to undertake expensive and time-consuming re-testing in Korea.

The EU has put in place a range of safeguards which we judge will be effective in preventing the automobile industry (or other sectors) from the risk of damage from implementation of the FTA. Firstly, the tariff reductions on automobile imports will be phased in gradually over periods of three years (for large and medium cars) and five years (for small cars). This, and the possibility of support from EU structural funds, allows adjustment for the automobile sector. Secondly, the bilateral safeguard clause allows the EU or South Korea to suspend tariff concessions to address "serious injury" or the "threat of serious injury" to domestic industry caused by increased imports arising from trade liberalisation under the FTA. This clause will be applicable from entry into force of the agreement. Thirdly, to address concerns about a potential increase of foreign parts sourced for future exports under the FTA, the agreement contains a special clause on duty drawback. This will put a cap on refundable duties if there is a significant increase in sourcing of foreign parts from countries which have not concluded an FTA with Korea (i.e. China and Japan). It will come into effect after five years. Finally, a special accelerated dispute settlement process, within 75 days, will ensure compliance with the rules negotiated in the FTA for the automobile sector.

Overall we estimate that the benefits of the FTA will outweigh any potential negative impact on the automobile sector with £4.7 billion benefit to the EU each year in the long term, and £500m each year to the UK.

I hope that this addresses your concerns. Please do not hesitate to contact me if you have any further questions before clearing the documents from scrutiny.

17 July 2010

Letter from the Chairman to Edward Davey MP

Thank you for your letter of 17 July on the EU-Republic of Korea Free Trade Agreement. The EU Sub-Committee on Economic and Financial Affairs and International Trade discussed this letter at its meeting on 27 July.

We remain unconvinced by your argument, based on Article 207(6) TFEU, that these proposals are subject to the UK opt-in. It is stretching this provision and the terms of the opt-in protocol to consider that an opt-in exists when the EU exercises its competence under the common commercial policy in respect of mode 4 services. Your interpretation, if correct, would be inconsistent with the participation of Denmark (and Ireland if it has not also sought to opt in) in the Agreement. In any event we consider it unsatisfactory, as creating legal uncertainty, for a single proposal for legislation to include some elements subject to the UK opt in and some which are not, as these do. This difficulty is compounded if there is no delimitation on the face of the legislation of these distinct elements.

We appreciate that the UK wishes to participate fully in this Agreement and therefore arguments about the existence or not of an opt-in lack practical significance. However, the absence of any acknowledgement on the face of this legislation, particularly the absence of the usual recitals recognising the position of the UK, Ireland and Denmark, would make this an unhelpful precedent should the Government wish to stay out of any future similar agreement.

The Committee have agreed to clear documents 8502/10, 8523/10 and 6307/10 from scrutiny since the concerns we raise above will have no effect on this particular agreement. However, we would like a reply to the points we raise above.

27 July 2010

Letter from Edward Davey MP to the Chairman

Thank you for your letter of 27 July 2010 regarding the Government's decision to opt-in to the EU-Republic of Korea Free Trade Agreement.

Please accept my apologies for the length of time it has taken to respond to this letter. The opt-in issues touch on the responsibilities of a number of departments and it was necessary to seek their views on this issue before responding.

I note the Committee's view that these proposals are not covered by the UK opt-in. I disagree with that view, and do not consider that our interpretation is stretching the provisions of Article 207(6) TFEU.

As regards your concern that a single proposal contains some elements falling within the scope of the opt-in and some which do not, it is common for international agreements to include both Title V and non Title V content. Consequently, in some situations the UK opt-in will apply to only some provisions. The wording of Article 2 of the Title V Protocol supports this interpretation in that it refers to a separable "provision" of an international agreement not being binding on the UK in the absence of an opt in. In our view, the purpose of the Title V Protocol would be frustrated by the suggestion that the opt-in could never apply to an agreement combining both Title V and non Title V content.

I agree that, where possible, obtaining a recital recording the basis of UK participation in a particular instrument is desirable, as is reaching an agreed position with Ireland. However, this is not always achievable. In this instance, we have published a declaration on adoption of the Council Decision to sign this Agreement setting out the position on UK participation in relation to the Title V provisions, and we consider that this sufficiently safeguards the UK position on the opt-in in this instance.

Thank you for your interest in this matter. I hope this letter answers your questions.

11 October 2010

Letter from the Chairman to Edward Davey MP

Thank you for your letter dated 11 October on the EU-Republic of Korea Free Trade Agreement. The EU Economic and Financial Affairs and International Trade Sub-Committee considered it at its meeting on 19 October.

We remain of the view that the UK opt-in does not apply to the signature or conclusion of this Agreement. In this case, as we previously pointed out, the issue does not have practical significance. However we can envisage circumstances in which it could, and therefore we wish to record our disagreement with the Government's view that the opt-in applies and our view that the declaration by the UK is unlikely to safeguard the Government's position.

Furthermore, we find your further arguments in support of the Government position unconvincing. Whilst it is true that international agreements can and do contain both Title V and non-Title V content, it nevertheless remains the case that it should be clearly ascertainable which rights and obligations under such agreements apply to the UK. This Agreement does not, nor do the Decisions for its signature and conclusion. Furthermore, the wording of the Protocol makes it clear that a provision of an international agreement is, in principle, to be disapplied in respect of the UK only if it is concluded pursuant to Title V of Part Three of the TFEU. The Decisions make it clear that this Agreement is not concluded by the EU pursuant to this Title.

We do not require a response to this letter.

19 October 2010

SHORT SELLING AND CREDIT DEFAULT SWAPS (13840/10)

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

Thank you for your Explanatory Memorandum 13840/10 on a Commission proposal for a Regulation on short selling and certain aspects of credit default swaps. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 2 November.

We welcome the proposal's main aim of establishing a harmonised framework to increase transparency and ensure coordinated regulation of short selling and credit default swaps (CDS).

We note that the proposal would grant the European Securities and Markets Authority (ESMA) additional powers in emergency situations. Given the proposed extent of these powers, careful consideration should be given to the criteria used to determine an emergency situation and we question whether it is appropriate to leave the definition of these criteria to delegated legislation.

We are concerned that the proposal gives ESMA disproportionate discretionary powers, since in an emergency situation ESMA would be able to take direct control of short selling in the UK and override national measures. How does the Government feel these powers are consistent with the principle of subsidiarity? Since ESMA is yet to be put in place, it remains to be seen whether it will have the ability to ensure the effective coordination and consistency of national measures put in place

during exceptional circumstances. Are other Member States expressing reservations about these provisions?

We note that that the proposal does not propose a permanent ban on CDS or short selling. What is your view of the balance between the impact of any temporary restrictions or ban on short selling or CDS against the benefit which such restrictions could bring in terms of reducing the risk of negative price spirals in distressed markets?

You express reservations over the proposed restrictions on naked CDS relating to sovereign debt, arguing that they have the potential to have a negative impact on sovereign bond markets across the EU and on the sovereign cost of borrowing. What evidence is there to support this view? How do you balance your position against the argument that CDS are prone to price increases unrelated to the riskiness of sovereign bonds, but which have the effect of raising the cost of funding for the bond issuer to cover the buyer's higher costs of insuring against default through a CDS?

Finally we would like to receive your view on whether the provisions of the Dodd-Frank Act are comparable to the proposed EU legislation.

We have agreed to hold this document under scrutiny, and would be grateful for a reply within the standard ten working days.

02 November 2010

Letter from Mark Hoban MP to the Chairman

Thank you for your letter of 2 November 2010. I am writing in response to the issues raised by the Committee in the course of its consideration of the proposed Regulation.

The Committee questioned the appropriateness of defining in delegated legislation the criteria used to determine when adverse events or developments may arise. We consider that such emergency conditions cannot be predicted but have to be judged as and when they arise from a unique set of circumstances. The Government therefore argues for such conditions to remain undefined as, of course, there is always a risk that any definition is not all encompassing and does not capture future risks.

Under the current proposals, the European Securities and Markets Authority (ESMA) could only intervene in the markets when the activities carried out threaten the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system, there are cross border implications and ESMA was not satisfied that the Competent Authority (or Competent Authorities) had taken adequate measures to address the threat. In the Government's view, this does accord with the principle of subsidiarity as it would not be possible for effective uniform action to be taken across more than one member state without at least coordination by a central body. The Government fully supports better coordination between national supervisors, and the enforcement of EU legislation. Member States should cooperate when considering such measures, but we object to ESMA being given intervention powers because we are concerned about the impact on market confidence and, in particular, the effect on the UK markets should these intervention powers be used. Other Member States are also expressing their concerns over these provisions.

The whole notion of emergency intervention is predicated on the assumption that benefits will outweigh costs. There is some evidence to suggest that the FSA's actions in autumn 2008 had some impact on liquidity and gave rise to increased volatility. However, swift and decisive regulatory action at that time was needed to support confidence in what were highly distressed markets. Positive impacts in these circumstances are near impossible to measure because the relevant comparator is performance of the markets in the same (distressed) circumstances without regulatory intervention.

Several Member States have strongly opposed an outright ban on naked short selling as it could have very significant adverse effects on sovereign bond markets by reducing its diversity price discovery and liquidity. This view is held both within industry in the UK and by the Debt Management Office. While the Government is aware that it has been argued that investors can manipulate the CDS market, which can cause adverse consequences (or 'contagion') for sovereign bond markets, there is no concrete evidence, of which we are aware, to demonstrate such contagion from CDS markets destabilising sovereign bond markets. Even if there was evidence of such manipulation, the Government believes that, in general, the additional liquidity provided by CDS markets boosts the liquidity and performance of the sovereign bond market.

The Dodd-Frank Act ('the Act') requires the Securities and Exchange Commission (SEC) to conduct a study on short selling both on exchange and Over the Counter (OTC) within two years of the Act's enactment. This includes a study on the feasibility, costs and benefits of public and private (to the regulator) disclosure of short positions in real time within one year of the Act's enactment. This appears similar, in outline at least, to the Commission's proposal. Currently, the US rules require

reporting of short positions twice a month. The Commission proposals require disclosure at T+1 which, whilst not strictly speaking real-time, is sufficiently close in time to the transaction to give the market a meaningful and current picture of net short positions and, as a result, impact on investors' decision-making.

The Act also requires the SEC to conduct a study on the feasibility, costs and benefits of conducting a voluntary pilot program in which public companies agree to have all trades of their shares marked 'short', 'market maker short', 'buy', 'buy-to-cover' or 'long' and reported in real time. Currently, the US rules require sell orders to be marked 'long', 'short' or 'short exempt'.

Lastly, the Act extends the coverage of the existing SEC rules on manipulative short sales, and also requires that customers be notified that they may elect not to allow their securities to be used in connection with short sales. Short selling which is carried out in connection with abusive strategies is already covered by the EU Market Abuse Directive. Stock lending is not covered in the Commission proposals. In the UK, such customers should have both market standard legal agreements and custody agreements that set out all the terms of the lending programme.

15 November 2010

SUPERVISION OF FINANCIAL ENTITIES IN A FINANCIAL CONGLOMERATE (I2940)

Letter from the Chairman to Mark Hoban MP, Financial Secretary

Thank you for your Explanatory Memorandum on document I2940/10 on the supplementary supervision of financial entities in a financial conglomerate. The EU Economic and Financial Affairs and International Trade Sub-Committee considered this document at its meeting on 19 October.

We are content that this proposal would help ensure that a consistent level of regulation is applied to conglomerates operating across multiple Member States. We are reassured by your assurance that the proposed changes to the Directive are in line with current UK policy on financial regulation. We agreed to clear this document from scrutiny.

We do not require a response to this letter.

19 October 2010

THE DRAFT EU BUDGET 2011

Letter from the Chairman to Justine Greening MP, Economic Secretary, Her Majesty's Treasury

Thank you for providing oral evidence on the EU Draft Budget 2011 (DB) on Tuesday 6 July. The EU Sub-Committee on Economic and Financial Affairs, and International Trade found this a useful and informative session. Thank you also for your letter of 9 July setting out further details on the Government opinion on the DB.

This letter sets out the Sub-Committee's view on the DB and on the negotiating line the Government will take on negotiations on the Budget.

THE EU DRAFT BUDGET 2011

The Committee is concerned that, at a time when Member States across the EU are taking difficult decisions to cut government deficits, the Commission should produce a draft budget advocating a 5.8% increase in payment appropriations. We note that the increase in the Draft Budget includes pay increases for its staff; insensitive at a time when public employees across the EU are being subject to pay freezes and in some cases pay cuts. The Committee supports your objective of securing a freeze in the overall level of cash payments in the DB 2011, and hopes that the EU will be in a position to repay money to Member States at the end of 2011 that will help with reducing budget deficits across the EU.

This should not, however, necessarily involve a freeze or reduction in spending under all Headings and on all projects. As you highlighted, many EU initiatives have a positive impact on economic growth and help create jobs. We therefore believe that spending increases should be subject to a test of their value for money and their effectiveness based on past spending. This should help align EU spending to where it can be most effective, particularly in stimulating economic growth and creating jobs for EU citizens.

You noted that in many cases where increases are proposed in the DB, low implementation rates mean there is often a significant underspend. We agree that it is in these areas where you should focus attempts to reduce cash payments in the DB. This will protect spending under Headings where you have identified a positive impact.

Although we welcome your goal of freezing the overall draft budget, it will require the support of more Member States than just the United Kingdom to support this approach if it is to be achieved. We are encouraged by your comments that other Member States may share the position of the UK, and agree with the objective of working with other Member States to build support for this position. We also observe that British MEPs might be enlisted to achieve this objective, given their extended role in budget scrutiny under the Lisbon Treaty.

ADMINISTRATIVE SPENDING

During our discussion you noted that the DB proposes a substantial increase under the Administration Heading, including increases in the funding for the Commission itself. We support your work towards a solution where funding for the European institutions is frozen, as has happened with the funding for many national administrations. It is important for public opinion that European institutions are seen to be contributing to more cost effective public services at both EU and national level.

BUDGET REVIEW AND THE NEXT FINANCIAL FRAMEWORK

We continue to believe that the Budget Review provides a good opportunity to review all spending at EU level to ensure that it is orientated towards the projects that are most effective in achieving their objectives. As you noted, much of the spending under Heading 2, Management of Natural Resources, does not fit these criteria and delivers poor value for money for the EU taxpayer. We are therefore disappointed that the Review has again missed a publication deadline and believe that you should push for the Commission to meet the new September deadline for its publication. This will provide the basis for a more thoughtful debate on EU spending.

The present Financial Framework expires at the end of 2013. We are convinced that the new framework which replaces it should be more flexible in reacting to changing economic situations within the EU. We also agree that the possibility of a shorter timeframe for the new framework should be explored. A shorter budgeting period would allow for the budget to be readjusted more regularly in the light of value for money performance and to meet the changing demands on it. In terms of the DB 2011, we agree that it is important that sufficient margins are allocated under Budget Headings to allow the EU to meet unexpected challenges in 2011 without exceeding the ceilings set in the Financial Framework.

We also believe that the negotiations on the Financial Framework should thoroughly examine all areas of EU expenditure to ensure that the Framework focuses spending on where it can be most effective.

We agreed to clear the document from scrutiny. We would appreciate regular updates on the negotiations on the Budget as it progresses.

13 July 2010

Letter from Justine Greening MP to the Chairman

Thank you for your letter of 13 July on the EU Draft Budget for 2011. I am writing to update you and your Committee on the Council's first reading position on the 2010 EU budget, agreed under written procedure on 12 August.

I am grateful to the Committee for their thorough and thoughtful scrutiny of the Commission's Draft Budget for 2011. This is a key period for the development of the EU budget, and it is important to me to be able to hear the Committee's expert opinion and to exchange views on the budget for next year and beyond.

I want to begin by reiterating clearly, as I explained to the Committee at the evidence session on 6 July, the Government's over-riding priority for this annual budget negotiation. At a time of profound fiscal consolidation across the EU, it is not acceptable for the EU budget to grow, and especially not at the proposed rate of 6%. The EU budget cannot be immune to the economic and financial pressures acting on member state governments across the EU. It must contribute to fiscal consolidation efforts. That is why the Chancellor and I have repeatedly called for the budget to be frozen at its 2010 level, and for greater value for money within the budget.

COUNCIL'S FIRST READING POSITION

The process for agreeing Council's first reading position this year varied from previous years. A Budget ECOFIN was not held, after the position was agreed at official level in Council's budget committee and at COREPER. In addition, the final adoption of the first reading position was completed by written procedure on 12 August, rather than at a Ministerial Council. This unusual process was necessary this year to ensure that national Parliaments were allowed the due 8 weeks to conduct scrutiny on the Commission's draft budget before Council agreed its first reading position (the Commission formally deposited the draft budget in all Parliaments only in late June). UK officials in Brussels pushed hard to ensure that this period was preserved, contrary to the institutions' original plans.

Council's first reading position was agreed by a qualified majority. The UK and 6 other member states voted against it; all others supported it. Those that joined the UK in opposing Council's position were Austria, the Czech Republic, Denmark, Finland, the Netherlands and Sweden.

As detailed above, the Government's objectives in this negotiation are to achieve a cash freeze in the 2011 budget, to push for greater value for money in EU expenditure, and to ensure adequate budget margins below the Financial Framework ceilings. The Government opposed Council's first reading position, because it did not sufficiently reflect these goals. Specifically, Council's first reading position reduced payments levels by €3,609m (£2,977m), or 2.77%, from the Commission's draft budget. Payments levels nevertheless remained €3,571m (£2,945m), or 2.91%, higher than in the 2010 budget at €126,527m (£104,359m). Council's first reading position also reduced commitments levels by €788m (£650m), or 0.55%, from the Commission's draft budget. This resulted in an overall commitments figure of €141,777m (£116,938m), €285m (£235m) or 0.22% higher than in the 2010 budget.

The Council reduced commitments and payments levels in some areas of spend that the Government assesses as poor value for money, including administration and agricultural market interventions under the Common Agricultural Policy. However, the Government's view was that Council's first reading position did not go far enough in targeting both these areas, as well as those where very large increases had been proposed without full justification, and those where a poor implementation rate in the past meant that the budget proposed for 2011 seemed unrealistic. At the same time, the Government's view was that Council's first reading position went too far in reducing appropriations for some areas of high value for money spend within the budget, for which increases were duly justified and implementation is historically strong. This included, for example, some programmes under the competitiveness for growth and employment heading.

The Annex contains a summary of overall commitment and payment levels in Council's first reading position by heading. A heading-by-heading breakdown follows here.

Under sub-Heading 1a (Competitiveness for growth and employment), Council's position reduces commitments and payments by €47m (£39m) and €891 m (£735m) respectively, compared to the Commission's draft budget. The margin under the Financial Framework ceiling for commitments was increased to €97m (£80m). The decreases reflect reductions in a number of areas, including notably:

- A €7.4m (£6.1m) reduction in commitments and a €217m (£179m) reduction in payments on the "Co-operation" budget lines of the 7th Research Framework Programme. Other reductions in the programme included: €67.2m (£55.4m) in payments on the "Capacities" budget lines; €100m (£82m) in payments on the "Ideas" budget line; and €100m (£82m) in payments on the "People" budget line; and
- A €100m (£82m) reduction in payments for financial support for projects of common interest in the trans-European transport network.
- A €0.9m (£0.7m) reduction in commitments and a €85.9m (£70.9m) reduction in payments for the Competitiveness and Innovation Programme;
- A €10.1 m (£8.3m) reduction in payments and commitments for administrative management, management and staff costs;

Under sub-Heading 1b (Cohesion for growth and employment). Council's first reading position reduces payment appropriations by €1,075m (£887m) compared to the Draft Budget. There were no changes to commitment appropriations. The margin under the Financial Framework ceiling for commitments therefore remains €17m (£14m). Reductions in payment appropriations were made largely through:

- A decrease of €551 m (£454m) for the European Regional Development Fund, including a reduction of €165m (£136m) for the completion of 2000-2006 programmes;

- A decrease of €249m (£205m) for the European Social Fund, including a reduction of €120m (£99m) for the completion of 2000-2006 programmes;
- A reduction of €275m (£227m) for the completion of pre-2007 projects under the Cohesion Fund.

Under Heading 2 (Preservation and management of natural resources), Council's first reading position reduces commitment and payment appropriations by €475m (£392m) and €821 m (£677m) respectively compared to the Draft Budget. The margin under the Financial Framework ceiling for commitments was increased to €1,326m (£1,094m).

These decreases largely reflect targeted reductions in the following areas:

- A €420m (£346m) decrease in payments and commitments for the accounting clearance of previous years' accounts with regard to shared management expenditure under the European Agriculture Guidance and Guarantee Fund and the European Agriculture Guarantee Fund;
- A decrease of €98m (£81 m) in payments in rural development programmes on the basis of anticipated implementation rates;
- A decrease of €95m (£78m) in payments for the convergence objective under the European Fisheries Fund;
- A decrease of €39m (£32m) in both payments and commitments in relation to market interventions; and
- A decrease of €38m (£31 m) in payments for Life+ (financial instrument for the environment, 2007-2013)

Under sub-Heading 3a (Freedom, security and justice), Council's first reading position reduces commitment and payment appropriations by €10.9m (£9m) and €49.6m (£40.9m) respectively, compared to the Draft Budget. The margin under the Financial Framework ceiling for commitments was increased to €81.7m (£67.4m). The decreases largely reflect targeted reductions in the following areas, in some cases decreasing substantial proposed increases, to bring appropriations levels more into line with likely implementation:

- A reduction of €9.5m (£7.8m) in payments for the European Fund for the Integration of Third Country Nationals;
- A reduction of €9.1 m (£7.5m) in payments for the European Return Fund;
- A reduction of €8.4m (£69m) in payments for the External Borders Fund;
- A reduction of €4.3m (£3.5m) for the "prevention and fight against crime" programme; and
- A reduction of €4m (£3.3m) for criminal and civil justice budget lines.

Under sub-Heading 3b (Citizenship), Council's first reading position Increases commitment appropriations by €0.16m (£0.13m). This is due to the inclusion of €4m (£3.3m) in commitments and €1 m (£0.8m) in payments for a preparatory action for the preservation of commemorative sites in Europe; this is intended to cover costs related to the long-term conservation works of sites such as the Auschwitz-Birkenau concentration camp, which is currently facing serious deterioration due to climatic conditions and its age. This increase is offset by a reduction in commitments of €149m (£1.22m) for the decentralised agencies under this sub-Heading.

Council's first reading reduces payment appropriations by €19.3m (£15.9m), compared to the Draft Budget. The margin under the Financial Framework ceiling for commitments was decreased to €15m (£12m). The decreases comprise reductions in the following areas, aligning appropriations levels more closely with anticipated needs and implementation rates:

- A decrease of €8.1 m (£6.7m) in payments for EU action in the field of health;
- A decrease of €3.9m (£3.2m) in payments for the Culture Programme 2007 - 2013; and
- A decrease of €2m (£1 .6m) in commitments and €6m (£4.9m) in payments for civil protection within the EU.

Under Heading 4 (EU as a global player), Council's first reading position reduces commitment and payment appropriations by €93.7m (£77.3m) and €590.9m (£487Am) respectively. The margin under the financial framework ceiling for commitments was increased to €164.1 m (£135.3m). The decrease

in payments is partly due to the fact that €203m (£167m) for the Emergency Aid Reserve has been removed in Council's first reading position. The commitments level of the Reserve every year is set in the Inter-Institutional Agreement; appropriate payments are made available for it throughout the year as needed to respond to emergency needs, and therefore Council considers that payments do not need to be presented in its first reading position.

The remaining reductions largely reflect targeted decreases in the following areas, often bringing appropriations levels closer into line with implementation rates:

- A reduction of €52m (£43m) in commitments and €191.2m (£157.7m) in payments for the Instrument for Pre-Accession;
- A reduction of €44m (£36m) in payments for the Instrument for Stability;
- A reduction of €45m (£37m) in payments for the Development and Cooperation Instrument, including €40m (£33m) on the budget line "environment and sustainable management of natural resources, including energy";
- A reduction of €30m (£25m) in payments for the European Instrument for Democracy and Human Rights; and
- A reduction of €24.7m (£20.4m) in both commitments and payments for expenditure on administrative management.

Under Heading 5 (Administration), Council's first reading position reduces commitment and payment appropriations by €162.2m (£133.8m) compared to the Draft Budget. The margin for commitments under the Financial Framework ceiling is increased to €322.8m (£266.2m). The reduction in Heading 5 was established by:

- Limiting the increase in administrative expenditure of the institutions, apart from the European Parliament, by setting budgets based on each institution's specificities and real and justified needs;
- Making targeted reductions on certain budget lines for the institutions, taking into account actual spend in 2009 and real needs;
- Accepting only part of the appropriations requested in relation to Croatia's accession, on the basis of accession in 2012;
- Not accepting the institutions' budgeting for an additional 1.85% salary increase relating to the 2009-2010 budget period, pending a decision on this issue by the European Court of Justice;
- Increasing the standard flat rate abatement on salaries for most of the institutions, taking into account their current vacancy rate; and
- Not accepting any new posts requested by the institutions, with the exception of 11 posts for the European Council, because it is a new institution.

In addition, Council's first reading position also reduced the levels of budgets for the decentralised agencies, with the aim of bringing budgets closer into line with real needs. Council's approach was to limit budget increases for agencies at "cruising speed" to a maximum of 1.5%; and to a maximum of 3% for agencies with new tasks to perform, allowing for half of the new posts requested by the agencies to be established. The proposed budgets of new agencies were left unchanged in Council's first reading, with the exception of the agency for operational management of large-scale IT systems under sub-Heading 3a. For this new agency, appropriations for 6 months were granted, and the staff posts proposed were accepted.

Council's first reading position was accompanied by two draft declarations. The first, as is customary, calls on the Commission to submit draft amending budgets throughout next year if the appropriations entered in the 2011 budget prove insufficient to meet needs under Headings 1, 2 and 4. The second deals more specifically with sub-Heading 1b. It urges the Commission to present latest figures and estimates by the end of September 2011, as well as a draft amending budget if required.

NEXT STEPS

The European Parliament will now consider the Draft Budget and Council's amendments, and form its own position on the 2011 EU budget. The Council and European Parliament will then meet in a 3-week conciliation committee from the end of October, to agree the final budget for 2011. The Government's objectives during this process will remain consistent with its approach so far; and we

will be working very hard with other member states, and with the European Parliament, to secure the best possible outcome for British taxpayers in the 2011 EU budget.

16 September 2010

Letter from the Chairman to Justine Greening MP

Thank you for your letter of 16 September 2010 on the Council's first reading position on the draft EU Budget 2011. This was considered by the EU Economic and Financial Affairs and International Trade Sub-Committee at its meeting on 12 October 2010.

We note that the Government is continuing to pursue an EU budget frozen at 2010 levels, while also trying to safeguard spending levels in those areas which offer high value for money, particularly in relation to economic growth and job creation.

We look forward to hearing how negotiations progress.

12 October 2010

Letter from Justine Greening MP to the Chairman

Thank you for your letter of 12 October, confirming that your Committee had considered the update I provided on Council's position on the 2011 Draft Budget, adopted on 12 August.

I am writing to update you on the European Parliament's (EP) position on the Draft Budget, adopted by the EP plenary on 20 October; and on the second and third Amending Letters to the Draft Budget, which have been presented by the Commission in recent weeks.

Let me begin by once again stressing that the Government remains determined to oppose the Commission's – and now EP's – proposals for a 6% increase in payments in the 2011 budget. I visited Brussels on 14 October, to discuss this issue with European Parliamentarians, the Belgian Presidency and the Commission. I put the case strongly that such a proposal was profoundly out of step with the fiscal consolidation efforts being made in Member States; and that it risked damaging the credibility of EU institutions with the taxpayers whom they exist to support.

As you know, the UK voted against Council's position for a 2.91% increase in the 2011 budget, adopted formally in August. 6 other Member States did likewise, but fell just short of forming a blocking minority. The usual dynamic of the annual budget negotiation would mean that the final discussions would focus on trying to reach agreement between the Council's and the EP's positions. The Government was determined that this should not be the case this year.

The Prime Minister therefore led efforts to build an alliance among Member States before and at last week's European Council, to block any increase above that already agreed by Council. As a result, 13 Heads of Government issued a joint letter on 29 October, stating that a 6% budget increase is "especially unacceptable at a time when we are having to take difficult decisions at national level to control public expenditure"; and that those Heads of Government 'are clear that they cannot accept' any more than the Council's proposed increase. This means that, either Council and the EP will have to agree to this level of increase; or no agreement will be reached, in which case the 2010 budget (adjusted for inflation) will be rolled over into 2011 unless and until a final budget for 2011 can be agreed.

EUROPEAN PARLIAMENT POSITION ON THE DRAFT BUDGET

The EP's amendments propose a total of €143.1bn (£124.3bn²) in commitment appropriations and €130.6bn (£113.4bn) in payment appropriations. This represents increases for commitments of €1.3bn (£1.1bn), or 0.9%, above the level of Council's position on the Draft Budget; and €4bn (£3.5bn), or 3.2%, for payments. The amount of commitments in the EP's proposal corresponds to 1.14% of EU GNI, and the level of payments to 1.04%.

Under Heading 1a (Competitiveness for growth and employment), the EP increased commitment appropriations by €95m (£82.5m) and payment appropriations by €909m (£790m), compared to Council's position; to a total of €13.5bn (£11.7bn) in commitments and €12.1bn (£10.5bn) in payments. This leaves a margin of €1.4m (£1.2m) under the Financial Framework ceiling for commitments. The EP increases in large part reverse Council's reductions to the Draft Budget, and exceed Draft Budget levels for some budget lines including:

² This and all subsequent sterling figures in this letter have been converted at the exchange rate on 29 October of €1=£0.8686

- An increase of €18m (£15.6m) in both commitments and payments for the Lifelong Learning Programme;
- An increase of €10m (£8.7m) in both commitments and payments for the People programme;
- In the energy field, an increase of €10m (£8.7m) in both commitments and payments for research related to energy; and an increase of €10m (£8.7m) in commitments only for the Intelligent Energy-Europe programme under the Competitiveness and Innovation Framework Programme; and
- Also under the Competitiveness and Innovation Framework Programme, an increase of €10m (£8.7m) in commitments only for the Entrepreneurship and Innovation Programme.

The EP also decreased both commitment and payment appropriations by €47m (£40.8m) for the ITER nuclear fusion project.

Under Heading 1b (Cohesion for growth and employment), compared to Council's position, the EP increased commitment appropriations by €10.5m (£9.1m) and payment appropriations by €1.1bn (£1bn), to €51bn (£44.3bn) and €42.6bn (£37bn) respectively. This leaves a margin of €6.4m (£5.6m) under the Financial Framework ceiling for commitments. The EP amendments restored appropriations throughout the heading to the level proposed in the Draft Budget. They suggest increases above this in the following areas:

- €2.5m (£2.2m) in both commitments and payments for a new budget line "Technical assistance and dissemination of information on the EU Strategy for the Baltic Sea Region and an improved knowledge of macro-regions strategy"; and
- €8m (£6.9m) in both commitments and payments for several new preparatory actions and pilot projects.

Under Heading 2 (Preservation and management of natural resources), the EP proposed a total commitments level of €59.9bn (£52bn) and a payments level of €58.5bn (£50.8bn), leaving a margin of €462m (£401m). This represented increases above Council's position of €864m (£750m) and €1.2bn (£1.0bn) in commitments and payments respectively. The EP proposed increases in some areas above the level of the Commission's Draft Budget, including:

- €300m (£261m) in both commitments and payments for a new dairy fund, to provide support in particular to milk producers;
- €25m (£22m) in both commitments and payments for the Programme for Deprived Persons;
- €10m (£8.7m) in both commitments and payments for the school milk and school fruit programmes; and
- €8m (£6.9m) in both commitments and payments for specific aid for bee-keeping.

Under Heading 3a (Freedom, security and justice), the EP proposed an increase in commitment appropriations of €4m (£3.5m), to a total of €1,139m (£989m); and a decrease in payment appropriations of €4m (£3.5m), to a total of €848m (£737m), compared to the Draft Budget. This leaves a margin of €67m (£58m), and represented increases above the Council's position of €15m (£13m) in commitments and €46m (£40m) in payments. Compared to the Draft Budget, the most significant changes proposed by the EP were:

- An increase of €2.4m (£2.1m) in both commitments and payments for the DAPHNE fight against violence programme;
- Increases of €1m (£0.9m) in both commitments and payments for the drugs and crime prevention programmes;
- An increase of €4.5m (£3.9m) in both commitments and payments for preparatory actions and pilot projects;
- A decrease of €5.2m (£4.5m) in both commitments and payments for the agency for the operational management of large-scale IT systems in the area of freedom, security and justice;
- A decrease of €4.3m (£3.7m) in payments for the crime prevention programme; and

- Decreases of €2m (£1.7m) in payments for the criminal and civil justice programmes.

Under Heading 3b (Citizenship), the EP proposed an increase in commitment appropriations of €15m (£13m), to €683m (£593m); and in payment appropriations of €9.9m (£8.6m), to €649m (£564m), compared to the Draft Budget. This left a margin under the Financial Framework ceiling for commitments of €0.1m (£0.09m), and represented an increase above Council's position of €15m (£13m) in commitments and €29m (£25m) in payments. By and large the EP restored the appropriations levels of the Draft Budget, with significant increases above that level for:

- “annual events”: an increase of €4m (£3.5m) in both commitments and payments, particularly to co-finance the organisation of the World Special Olympics Summer Games in Athens next year; and
- Youth in Action programme: an increase of €3m (£2.6m) in both commitments and payments.

Under Heading 4 (EU as a global player), the EP increased commitments by €69m (£60m), to a total of €8,683m (£7,542m); and payments by €45m (£39m), to a total of €7,646m (£6,641m), compared to the Draft Budget. This left a margin of €1.3m (£1.1m), and represented increases above Council's position of €163m (£142m) and €635m (£552m) in commitments and payments respectively. The EP restored some of the levels of funding of the Draft Budget, with the most significant exceptions being:

- An increase of €100m (£87m) in both commitments and payments for financial assistance to the Palestinian Authority, the peace process and the UN Relief and Works Agency;
- An increase of €32m (£28m) in commitments and €8m (£6.9m) in payments for cooperation with developing countries in Asia;
- An increase of €20m (£17m) in commitments and €6m (£5.2m) in payments for cooperation with developing countries in Latin America;
- A decrease of €45.7m (£40m) in both commitments and payments for the Common Foreign and Security Policy, as well as some regrouping of the budget lines here;
- A decrease of €18m (£16m) in commitments and €5m (£4.3m) in payments for the Bananas Accompanying Measures; and
- A decrease of €17m (£14.8m) in commitments and €2.8m (£2.4m) in payments for cooperation activities other than Overseas Development Assistance.

Under Heading 5 (Administration), the EP decreased both commitments and payments by €32m (£28m) from the level of the Draft Budget, to a total of €8,223m (£7,142m) in commitments and €8,224m (£7,143m) in payments. This left a margin of €193m (£168m), and represented an increase above Council's position of €130m (£113m) in both commitments and payments. Compared to the Draft Budget, the most significant decreases proposed by the European Parliament were, in both commitments and payments:

- €9m (£7.8m) from the European Economic and Social Committee;
- Supporting the Council's own reduction of €8m (£6.9m) in its own budget; and
- €6m (£5.2m) from the budgets of the Committee of the Regions and the European Parliament itself.

Tables summarising the changes between the Draft Budget, the Council's position and the EP's position are set out in Annex I to this letter.

In addition, in Headings 1a, 2, 3a and 4 of the budget, the EP proposed creation of a generic budget line “Lisbon mid-term review needs” in each area. These are not provisioned with funds at this stage. Each line is, however, accompanied by the same set of stipulations from the EP, namely that Council and EP agree amongst other things on:

- Providing the EU with a sufficient level of spending – “Lisbonisation of the budget” – and focusing on European added value;
- Starting a mid-term review of the Financial Framework through the 2011 budget;

- “Proper involvement” of the EP in the process of agreeing the Financial Framework;
- Opening of negotiations on Own Resources; and
- Agreeing “appropriate legislative and budgetary instruments” related to the European Financial Stabilisation Mechanism.

AMENDING LETTER NO 2

Amending Letter No 2 (SEC(2010) 1199 final) was published on 12 October, and discussed in Council’s budget committee from 14 October. The Letter proposes three amendments:

- An increase of financing for Europol of €552,000 (£479,467), and of its human resources by four extra staff posts. This is to enable Europol to implement the EU/US Terrorist Financing Tracking Programme, following the EP’s and Council’s consent to conclude the EU/US agreement on the processing and transfer of financial messaging data for this purpose.
- Increases in financing for the three new financial supervisory bodies. This reflects: the Commission’s proposal³ to give the European Securities and Markets Authority (ESMA) responsibility for the authorisation and supervision of credit rating agencies; and the decision to assign new tasks to ESMA, the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA). No contribution will be needed from 2012 onwards to cover the cost of supervision of credit rating agencies by ESMA; but in the transitional year of 2011, the EU budget is envisaged to supply 40% of the costs, with Member States’ contributions providing the remaining 60%. €2.5m (£2.2m) is needed in additional funding for 2011, and the Amending Letter proposes EU budget funding of 40% of this, that is €1m (£0.9m).

The additional tasks that have been remitted to all three agencies result in the need for an additional €1.7m (£1.5m). However, this is offset by a decrease in the budgets for these agencies of €1.1m (£1m), resulting from updated estimates for some costs in their original budget proposals. The net increase required due to the additional tasks is therefore €560,000 (£486,416), of which the EU budget is proposed to contribute 40%, or €224,000 (£194,566).

- Creation of a new budget item on the expenditure side of the budget, and a corresponding article on the revenue side, to provide the budget structure required to operationalise the European Financial Stabilisation Mechanism. This was agreed on 11 May⁴, and therefore after the publication of the Commission’s Draft Budget for 2011. The EU budget would only be required to provide funding, and be subsequently reimbursed, in the event of default on a loan under the Mechanism. The Amending Letter does not therefore propose that these budget lines be provisioned with funds at this stage.

The net effect of the Amending Letter is an increase of €1.8m (£1.6m) in both commitments and payments to the Commission’s Draft Budget. The Government strongly supports the implementation of the EU/US Terrorist Financing Tracking Programme; and believes it essential that the new financial supervisory bodies have the necessary resources to fulfil their mandates effectively. However, we believe that the funding required could and should be found through reprioritisation of existing programmed resources in the relevant budget headings; and that the proposed increase in the EU budget is therefore neither necessary nor appropriate. For this reason, the UK did not support adoption of Amending Letter No 2 at budget committee on 22 October. All other 26 Member States voted in favour.

AMENDING LETTER NO 3

Amending Letter No 3 to the Commission’s Draft Budget was published on 20 October, and discussed in Council’s budget committee from 22 October. It concerns three elements:

- A downwards revision for agriculture expenditure of €346m (£301m) in both commitment and payment appropriations. This is based on changing market factors, legislative decisions adopted in the sector since the Draft Budget was published, revised estimates of needs for some direct payments,

³ COM (2010) 289 FINAL

⁴ Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism

and any proposals that are expected to impact on the budget in the coming year. The decrease is largely explained by higher than expected assigned revenue received in 2010, and the favourable situation on agricultural markets.

- A decrease of €1m (£0.9m) for commitment appropriations for International Fisheries Agreements. This is based on the most recent information concerning fisheries agreements.
- The creation of a new budget line “Energy projects to aid economic recovery – energy efficiency and renewable initiatives”. This is needed to operationalise an amendment to the energy component of the European Economic Recovery Plan⁵, due to be adopted by the end of this year, to create a dedicated financial instrument to support energy efficiency and renewable initiatives (DECC EM 10457/10 of 23 June refers). It is not provisioned with funds at this stage, as it will be funded through existing allocations for the energy component of the Recovery Plan.

The Government is content with the Commission’s updated estimates, and welcomes that they reduce the proposed commitments and payments levels in the 2011 budget. It also supports the proposed amendment to the energy component of the European Economic Recovery Plan, and can therefore support adoption of this Amending Letter.

NEXT STAGES OF THE EU BUDGET PROCEDURE

A conciliation committee of the Council and the European Parliament met for the first time on 27 October. Under the Treaty on the Functioning of the European Union, it has 21 days to try to reach agreement on a Joint Text of the EU budget for 2011. We also expect it to take decisions on the longer-term financing of the ITER nuclear fusion project (HMT EM 12614/10 of 8 September refers), on which I will update your committee in advance; and to adopt the Regulation on the Multi-Annual Financial Framework, and changes to the Financial Regulation and the Inter-Institutional Agreement⁶ (HMT EM 7180/10 of 11 March refers), all required by the entry into force of the Lisbon Treaty. I will be attending the final scheduled ministerial meeting of the conciliation committee on 11 November. I will of course inform you of its discussions.

2 November 2010

Letter from Justine Greening MP to the Chairman

Further to my letter of 2 November on negotiations on the 2011 EU budget, I am writing to update you on two issues that, while not directly related to those negotiations, may nevertheless be raised – and decisions made on them – at the meeting of the conciliation committee on 11 November. They are: the Commission’s proposal to address the additional financing needs of the International Thermonuclear Experimental Reactor (ITER) project⁷; and the Commission’s proposal for a regulation laying down the multiannual financial framework for the years 2007-2013.

ITER

You will recall that there is an identified financing shortfall for the ITER project of a total of €1.4 billion in commitment appropriations in 2012 and 2013. The Commission’s financing proposal under reference identified €860 million of funds to meet this shortfall: €400m from the unused budget margin under Heading 2 (Preservation and management of natural resources) in 2010; and €460 million derived from reallocation of programmed amounts within Heading 1a (Competitiveness for growth and employment) in 2012 and 2013.

My Explanatory Memorandum of 8 September (EM 12614/10) set out the Government’s approach to this as pushing for: the full financing shortfall to be identified at once; and for a more substantial proportion of the solution to be found through reprioritisation within Heading 1a, to comply with Council conclusions of 12 July calling for the funding solution to be based primarily on redeployment

⁵ Regulation (EC) 663/2009 of the European Parliament and of the Council of 13 July 2009 establishing a programme to aid economic recovery by granting Community financial assistance to projects in the field of energy

⁶ Interinstitutional Agreement of 17 May 2006 between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management

⁷ COM(2010) 403 Proposal for a decision of the European Parliament and of the Council amending the Interinstitutional Agreement of 17 May 2006 on budgetary discipline and sound financial management as regards the multiannual financial framework, to address additional financing needs of the ITER project

within that Heading. A large number of Member States shared this view when the Commission's proposal was discussed in Council's budget committee on 6 September.

On 2 November, a Commission non-paper was circulated to Member States on this issue. It explained that, as the end of the budget year approaches, it is possible to predict with some certainty the final amounts that will be unused in the budget margins for this year. Specifically:

- As set out in Draft Amending Budget No 10/2010 (HMT EM 15250/10 refers), there is a reduction in 2010 of €358 million in commitment appropriations in Heading 2. This increases the unused margin in the Heading to €814 million. The same Draft Amending Budget also sets out a reduction of €15 million in commitment appropriations in Heading 1a in 2010.
- The margin in Heading 3a (Freedom, Security and Justice) of €18 million will not be used this year.
- The non-paper also explains that, due to estimated decreases in the adjustment of the institutions' staff salary for the period of July 2010-June 2011, around €39 million will be freed up in Heading 5 (Administration) in 2010. Adding this to the existing unused budget margin will give a total available of €93 million in the Heading.

The Commission explains that, taking these total available margins, and the €460 million redeployment within Heading 1a already proposed, leads to a total of €1.4 billion. They therefore propose a revision of the Financial Framework to allocate these unused margins to Heading 1a in 2012 and 2013. In practice, the Financial Framework would be reduced in 2010, and increased correspondingly in 2012 and 2013. This change would affect commitment appropriations only; associated payment appropriations, and thus any impact on the UK's contribution to the EU budget, would not flow until after the end of this Financial Framework. There would be no overall increase to the Framework. Any such increase would be completely unacceptable to the Government.

The European Parliament (EP) has pushed for the entire shortfall in ITER financing to be funded through an overall increase to the Financial Framework. The Council and EP positions therefore remain some distance apart, and it is not yet clear how they will be reconciled when this is discussed at the conciliation committee meeting on 11 November.

It is reassuring that the Commission has proposed a means of meeting the entire ITER funding shortfall, while respecting the overall Financial Framework ceiling. The Government's objectives remain to secure the full amount required to finance ITER, while limiting the additional contributions required from Member States, and adhering to the Council's call for the solution to be primarily based on redeployment within Heading 1a. The Commission's non-paper is helpful insofar as it identifies some 'unspent' commitments in 2010 that can in essence be reallocated to ITER in future years, with no additional cost to Member States. However, the Government is concerned by the proposed use of unallocated margins, which would entail additional cost to Member States, and will continue to push for the Council's call for redeployment within Heading 1a to be more fully respected.

MULTIANNUAL FINANCIAL FRAMEWORK REGULATION

In order to implement the Lisbon Treaty, Council is required to adopt a regulation laying down the multiannual financial framework (MFF) for the years 2007-2013. The Commission issued its proposal for this new regulation in March. Its approach was largely technical, dividing existing budgetary rules and the current 2007-2013 Financial Framework between the new regulation and other existing legal instruments. HMT Explanatory Memorandum of 11 March (EM 7182/10) sets out these proposals in detail.

This autumn, it has become apparent that, for legal reasons, it might not be possible to transpose an existing provision that allows for the MFF to be revised by up to 0.03% of EU gross national income, by QMV in Council, into the new MFF regulation, which must be agreed by unanimity.

In order to resolve any legal uncertainty, the Presidency has this week proposed amending the draft Regulation to replace the QMV revision procedure with creation of a new 'contingency margin', with the aim of preserving the flexibility that existed in the budgetary rules before entry into force of the Lisbon Treaty. Under the proposal, similarly to the previous provision for MFF revision, this new margin would: be capped at €3.5 billion per year (approximately 0.03% of EU GNI); be provisioned only if needed; and be accessed through QMV decision in Council. Technically, it would sit above the MFF ceilings.

There was a preliminary discussion of this issue in Council's budget committee on 3 November, when it was clear that opinions differed amongst member states. Some, including the UK, raised questions

over the precise implications of this change. This has not yet been discussed with the European Parliament; but, given their consistent push for increased resources for the EU budget, we expect them to support the Presidency's proposal (and possibly even to wish to expand it).

The Government acknowledges that this proposal is designed as part of a series of technical changes to transpose the existing MFF and budgetary rules into a new legal framework that reflects the entry into force of the Lisbon Treaty. The Government broadly supports the Commission's and Presidency's technical approach. In these circumstances, however, the Government will explore ways of limiting the Presidency's proposed contingency margin, as a reflection of the period of deep fiscal consolidation throughout the EU. It would of course be completely unacceptable for this new proposal to result in any higher potential EU spending level than that previously enshrined in the Inter-Institutional Agreement.

6 November 2010

Letter from the Chairman to Justine Greening MP

Thank you for your letter of 2 November on the European Parliament's position on the draft EU Budget 2011. This was considered by the EU Economic and Financial Affairs and International Trade Sub-Committee at its meeting on 9 November 2010.

We note that the Government are continuing to try to limit any increase in the EU Budget 2011, and we support your attempts to ensure that under no circumstances does the budget rise above the 2.91% increase in payment levels agreed at Council's first reading. We also support the increased funding for Europol and the three new financial supervisory bodies proposed in Amending Letter No 2, although we accept your view that this can be found through reprioritisation of existing programmed resources. We urge you to ensure that spending in this area, and in these those areas which offer high value for money, particularly in relation to economic growth and job creation, is safeguarded in any agreement on the EU Budget 2011.

We look forward to hearing how negotiations progress.

10 November 2010

Letter from Justine Greening MP to the Chairman

I am writing to update you on the meetings of Budget ECOFIN, and of the Council-European Parliament (EP) conciliation committee on the 2011 budget, on 11 and 15 November.

As you know, the Government had called for the 2011 budget to be maintained at cash levels equivalent to 2010, opposing the Commission's proposed 6% increase. While we pushed very hard for this, the majority in Council adopted a position of a 2.91% increase in the summer. The UK, Sweden, the Netherlands, the Czech Republic, Finland, Denmark and Austria voted against this. In October, the EP adopted a position calling for an increase of 6%, which the Government considered completely unacceptable. In order to ensure that the final negotiations did not simply 'split the difference' between EP and Council positions, the Prime Minister led 12 other EU leaders in a joint letter on 29 October stating clearly that we and they could not accept any increase above the 2.91% agreed by a majority in Council.

I participated in the Budget ECOFIN meetings on 11 and 15 November with the aim of securing a budget for the EU in 2011 that met this objective. The Council position was very clear, and firm that no further increase beyond the level of 2.91% could be agreed. The EP side also said that, in principle, it could accept this budget level. I therefore believe that agreement could have been reached at these meetings, on this budget level.

However, the EP set certain conditions for its agreement to the 2011 EU budget. Specifically, it requested a Council-EP political declaration giving the EP an increased role in future decisions on the next Multi-Annual Financial Framework and the EU's Own Resources. It also, late in proceedings on 15 November, stated that there must be agreement too on flexibility to increase the Multi-Annual Financial Framework in future.

The Government was not prepared to agree to these demands as the price for securing the EU budget in 2011. The UK had already demonstrated flexibility in showing willingness to accept a budget increase of 2.91%. Our view was that the EP had introduced into the negotiation longer-term, strategic issues that had no place in discussions on the 2011 budget, and that did not need to be decided alongside those budget discussions. Nor could we accept any proposal to alter the institutional roles enshrined in the Lisbon Treaty.

A number of other member states shared our concerns, including France, Germany, the Netherlands, Sweden and Denmark. These represent nearly half the population of the EU and contribute more than half of all financing of the EU budget. Talks ended at midnight on 15 November, with the EP declaring that time had run out on the conciliation process. It was also the EP side that ended discussions at the 11 November ministerial level conciliation meeting.

In these circumstances, the Government believes it was better not to reach agreement during the conciliation process at all, rather than making a bad agreement which was counter to the interests of UK taxpayers. The Government is continuing to engage constructively in further negotiations aimed at securing agreement to a 2011 EU budget, at the level that all sides have already said they can accept.

NEXT STEPS

The Commission must now present a new draft budget proposal for 2011 as a basis for further negotiations. If agreement cannot be reached on a final budget by the end of this year, then the 2010 budget will be rolled over into 2011 and disbursed in monthly instalments, until a final 2011 budget can be established.

The Commission and Presidency are pushing to ensure that agreement can finally be reached on the 2011 budget by the end of this year. The EP is scheduling an exceptional plenary session on 21 December to that end. We expect the Commission to publish its new draft budget proposal on 1 December, setting out the detail of a budget increase of 2.91% that has garnered consensus so far. As this would be based on Council's own adopted position from the summer, the Presidency is hoping to be given a mandate by Council to negotiate with the EP on it almost immediately. We understand that there is a budgetary trilogue scheduled between Council and the EP on 6 December for that purpose. If both sides can agree, the Presidency intends that Council would adopt its position on the draft budget formally on 10 December (as an A point at the Competitiveness Council). If the EP then approves Council's position, the budget will be adopted.

At the same time, the Presidency is also taking forward negotiations on the Multi-Annual Financial Framework, including the 'contingency margin' provision that I outlined in my letter of 6 November. This would move, into the appropriate negotiating process, the EP's demand for discussion of flexibility to increase the Financial Framework in future. This negotiation would also encompass agreement on the €1.4bn funding shortfall for the ITER nuclear fusion project. This is inextricably linked to the draft Multi-Annual Financial Framework Regulation, as the Commission's proposal to transfer available budget margins from 2010 to 2012 and 2013 for ITER would take effect through the Regulation itself. The Government's goals for these negotiations remain as set out in my letter of 6 November.

PARLIAMENTARY SCRUTINY

The Presidency's proposed timeline is obviously very compressed, and ambitious. Insofar as it is a theoretically feasible option for securing agreement to the 2011 budget by the end of this year, the Government will continue to engage constructively on it. I am keenly aware, however, that this timeline allows hardly any time for national Parliamentary scrutiny of the Commission's proposed draft budget. The Presidency has suggested that it will propose Council decide that, in these exceptional and pressing circumstances, the normal 8-week scrutiny period for national Parliaments will not apply.

As you know, I consider Parliamentary scrutiny to be a very important part of the process of making EU policy. On an issue such as the EU's annual budget, in the current economic and financial climate, this is particularly true. The Presidency's proposal for a Council decision on the scrutiny period is not acceptable, and the Government will not support it. It is likely to be adopted by a qualified majority nevertheless. I appreciate that the Committee will be concerned by this and the prospect that this may set a very unwelcome precedent. I believe it will not, however: the circumstances in which we find ourselves are extremely unusual, and I hope will not be repeated in future.

This notwithstanding, I undertake to ensure the Committee receives an Explanatory Memorandum on the Commission's draft budget by the end of next week, and to do all I can to answer any questions the Committee may have before the proposed Council adoption of its position on 10 December.

23 November 2010

Letter from Justine Greening MP to the Chairman

On 26 November the Commission published Amending Letter No 1 to Draft Amending Budget No 10 (DAB10). It gives a brief summary of a proposed revision to the figures set out in DAB 10. It explains that, following the completion of the agricultural year on 15 October, the needs for the European Agriculture Guarantee Fund (EAGF) are higher than previously estimated. The Commission therefore suggests reversing reductions proposed in DAB 10 of €330m (£293m) to commitment and payment appropriations in Heading 2 (Preservation and management of natural resources). Specifically, these break down into €280m (£249m) for “milk and milk products” and €50m (£44m) for “Refunds on non-Annex I products”. The Commission explains that it expects that all the voted appropriations will be used as well as some assigned revenue generated in 2010.

The effect of this revision is to decrease the overall expenditure reductions set out in DAB10 from €373m (£331m) to €43m (£38m) in commitment appropriations, and from €1,091m (£969m) to €761m (£676m) in payment appropriations.

EM 15250/10 explained that the overall reduction in the level of payment appropriations in the 2010 budget, as set out in DAB10, would have the effect of reducing the UK contribution to the 2010 budget, after abatement, by €228m (£208m) compared to the contribution shown in Amending Budget No 4/2010. This amendment to DAB10 has the effect of decreasing this reduction by €45m (£40m). Therefore, the reduction to the UK contribution to the 2010 budget, after abatement and compared to Amending Budget No 4/2010, is now €183m (£168m). However, the amendment also states clearly that assigned revenue generated in 2010, but not used, will be carried over to 2011. This will have the effect of reducing the need for voted appropriations, and therefore Member States' contributions, in 2011.

The process for adopting DAB10 has not been very clear. We had originally expected that, as in previous years, Council would adopt its position on the document at Budget ECOFIN on 11 November. It did not, and the Commission now plans for the institutions to adopt their positions on DAB10 alongside the process for considering the new Commission proposed Draft Budget for 2011. This means that the Council is scheduled to adopt its position on DAB10 on 10 December.

The Commission has noted that this date provides for only 7 weeks of national Parliamentary scrutiny of DAB10, and has therefore requested that Council decide to shorten the 8-week scrutiny period to 7 in this instance. While there is a practical reason for such a change, the Government will not support this decision in Council, on the principle that any such reduction in the time given to national Parliaments to consider EU budget documents is very unwelcome. We will make our concerns clear and ensure they are put on record. I note that, in the case of DAB10, your Committee has been able to consider and clear the original document, for which I am grateful.

30 November 2010

TRADING ON A REGULATED MARKET (13688/10)

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

The European Commission's proposal amending the Prospectus Directive was discussed in Council working groups and a general approach was agreed at the Committee of Permanent Representatives (COREPER) on 17 December 2009. Following the last Trilogue between the Presidency, European Commission and European Parliament a text was agreed at COREPER on 2 June.

The Government supports the process of review of the existing legislation and the resulting proposal for amendments to improve the balance between the goals of investor protection, consumer confidence, efficiency, legal clarity, and reduction of administrative burdens.

The Government has sought revisions to the proposals to improve this balance and has been successful. These include:

- Maintaining the current 12 month reporting period for which a prospectus is valid;
- Clarifying the period when publication of a prospectus, or supplementary information to it, is required. As a result whilst a public offering is being conducted the prospectus will need to be updated regardless of whether the securities have been admitted to a regulated market, increasing investor protection; and

- Introducing a proportionate disclosure regime for rights issues when shares are admitted to trading on a regulated market or an exchange-regulated market.

The Government supports the substantive proposals as improving this balance.

For information, during the review process other revisions have been made to Commission's proposals. These are to:

- Reflect the distinction between retail and professional investors in terms of investor capacity by raising the threshold of EUR 50 000 to EUR 100 000 in Article 3(2)(c) and (d).
- Remove a duplicative exemption. Article 4(1)d exempts offers allotted free of charge to existing shareholders from the requirement to publish a prospectus. This duplicates Article 3(2)e where an offer with a total consideration of less than EUR 100,000 euro is exempt from the requirement to publish a prospectus.
- Clarify what information should be included in the final terms to a base prospectus.
- Ensure the prospectus is published in an electronic form to enable easy access to information.
- Introduce changes to take into account the entry into force of the Lisbon Treaty.

I hope that this further information is helpful. The European Parliament adopted the text at Plenary on 17 June and the Presidency is likely to seek a general approach following this.

28 June 2010

UN FIREARMS PROTOCOL: PROPOSED REGULATION (10936/10)

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

Thank you for your Explanatory Memorandum on a proposed Regulation implementing Article 10 of the United Nations' Firearms Protocol. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 20 July.

We recognise that the Government were not expecting the proposal to be published at this time, and that you have not been able to make any assessment of the policy or financial implications of the proposed Regulation. We also note that you have no information as to when this proposal might be discussed at an EU level.

We would like an update on the Government's view of this proposal, including a copy of the UK-specific Impact Assessment, when you have had time to undertake a proper assessment. In the meantime, we agreed to hold this document under scrutiny.

We do not require a response to this letter within the standard ten working days.

20 July 2010

Letter from Mark Prisk MP to the Chairman

Thank you for your letter of 20 July about the outcome of the consideration given to Explanatory Memorandum 10963/10 by the EU Sub-Committee on Economic and Financial Affairs and International Trade.

I wanted to briefly update your Committee on the latest state of play. With regard to the Government consideration of the proposed Regulation, an initial assessment has been made that has been supplemented with views from The Gun Trade Association who hold the main industrial interest in the UK.

I judge however that it is still not possible at this stage to provide you with a proper assessment of the Regulation (including the UK-specific Impact Assessment) until details of the Regulation have been properly explained to Member States by the Commission. These discussions have only just commenced with the Working Party on Customs Union (Customs Legislation and Policy) including an Article-by-Article run through of the Regulation on the agenda of the 7 October meeting, and a

further discussion on 21 October. The item will be included on future meeting agendas until discussion is completed.

Depending on the progress that is made in these working group meetings, I would hope then to be in a better position to make a proper interpretation of the policy underpinning the Regulation together with any financial implications. At that stage, we can fulfil our commitment to you to provide you with an accurate assessment on which you can then make your judgement of the proposed Regulation.

28 October 2010

Letter from the Chairman to Mark Prisk MP

Thank you for your letter dated 28 October on a proposed Regulation implementing Article 10 of the United Nations' Firearms Protocol. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 9 November.

We are content to hold this document under scrutiny until you are able to provide us with your assessment of the proposed Regulation, and we recognise that you will require time to clarify the details of the proposal through working group discussions.

We do not require a response to this letter within the standard ten working days.

10 November 2010

VAT: COMBATING FRAUD (12886/09)

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

An Explanatory Memorandum was submitted in September of 2009, in response to the European Commission's proposal for a Council Regulation on administrative co-operation and combating fraud. An exchange of letters followed. I am writing at the earliest opportunity in order to update you on the progress and likely outcome of the proposal.

Progress at Council has accelerated recently under the Spanish Presidency, which has made this proposal a tax priority. There have been extensive changes to the new parts of the Regulation as a result of negotiations.

The key changes relate to the areas identified in the Explanatory Memorandum. Comitology will no longer have a role to play in the establishment of common minimum standards for registration and de-registration and has been restricted to the governance of the technical details of exchange for "direct access". Furthermore, Comitology has been deleted from the Eurofisc provisions, instead the details on how the system will operate have been set out in the Regulation and an accompanying explanatory Minutes Statement.

As a result of the changes to the proposal, the Government is satisfied that it respects both the principles of subsidiarity and proportionality. We believe that the proposal will provide anti-fraud benefits for the UK and other Member States as a whole, while ensuring that no additional burdens on business are generated.

The basic elements of the proposal remain unchanged from the original. Common minimum standards should help to ensure that entry to the VAT system will be better policed and Member State's VAT registers more up to date. The access changes to specified information will speed up the checking of basic information and thus help authorised officials in their investigations, whilst the establishment of Eurofisc will facilitate the exchange of targeted information thus acting as an early warning system for frauds. The introduction of feedback arrangements will help Member States to ensure that the information exchanged is useful and in turn provide material to refine the system. Finally, the enhanced VAT number checking system will assist business engaged in intra-community trade.

Given the absence of any impact on business, and only a limited resource requirement for HMRC, I can confirm that an Impact Assessment will not be necessary for this proposal.

The Presidency are keen to close down discussions on this proposal, and have tabled it for political agreement at ECOFIN Council meeting on 8 June. All other Member States have indicated their willingness to agree.

The decision to put this proposal forward for political agreement has put the Government in a very difficult position.

If the UK was to block agreement at ECOFIN on the grounds that Parliamentary Scrutiny is not yet concluded, we would in effect be blocking agreement to an important anti-fraud proposal that we support, and for which the Presidency and other Member States have made significant concessions helpful to the UK in order to get our agreement.

As all other Member States want to see the proposal agreed, blocking agreement would risk sending out unhelpful and misleading signals that the UK Government is reluctant to fight fraud or help other Member States do so. This would be particularly sensitive in the current economic climate where all Member States have been affected by VAT fraud and all are looking to protect tax receipts in order to repair their fiscal positions.

Therefore, we have reluctantly decided that if we are the sole Member State blocking agreement on 8 June, it would not be in the UK's best interest to block agreement to the proposal. However, mindful of the fact that neither scrutiny committee will have had an opportunity to consider the significant developments that have been made on the proposal, we plan to abstain from the vote.

We are aware that since this is a tax proposal and decided under unanimity this will still result in the proposal being agreed prior to the conclusion of the Parliamentary scrutiny process. Nevertheless we felt it important to reflect our scrutiny position and make it clear that in the circumstances we could not vote for the proposal.

Our decision to not block agreement was particularly guided by our belief that all of the concerns expressed previously by the scrutiny committees have been satisfactorily addressed in the current proposal. In addition, to block the proposal would risk the possibility of the package being reopened at a later stage which could only result in a revised proposal that would be less acceptable to the UK Government. I thought that it would be appropriate to write before the meeting to warn you of the likely agreement of this proposal. In these circumstances I hope you can appreciate the impetus behind the decision.

7 June 2010

Letter from the Chairman to David Gauke MP

Thank you for your letter of 7 June on the proposal for combating VAT fraud (12886/09). EU Sub-Committee on Economic and Financial Affairs and International Trade considered this at its meeting of 29 June.

We have recorded the item as an override of the scrutiny reserve resolution, but given the strong case for not blocking the agreement and the fact that the discussions on the proposal occurred before the Committee was set up after the election, we agreed to clear the document from scrutiny. We are pleased to see that our concerns relating to the overuse of the comitology procedure have been addressed in the final draft of the proposal.

We do not expect a reply to this letter.

30 June 2010

VAT: MINIMUM STANDARD RATE (11582/10)

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

Thank you for your explanatory memorandum dated 12 July on a minimum standard rate of Value Added Tax (11582/10). The EU Sub-Committee on Economic and Financial Affairs and International Trade considered it at its meeting on 27 July 2010.

We are content to clear the document from scrutiny on the basis that the proposal will maintain the existing minimum VAT rates of 15 % across the EU. We are, nevertheless, very keen to follow developments regarding the Commission's plan to launch a new VAT strategy.

On a related note, we would be keen to know the Government's view on the observations contained in a report produced by Mario Monti on the single market. Do the Government agree with the statement related to tax coordination that "variation in VAT rates affect capital and trade movements and therefore coordination of policies directed at raising standards VAT rates or limiting the application of reduced VAT rates may be beneficial?"

27 July 2010

Letter from David Gauke MP to the Chairman

Thank you for your letter of 27 July and for clearing my explanatory memorandum of 12 July on this issue from scrutiny. I note your interest in following developments regarding the Commission's new VAT Strategy and will write to you again on this in due course.

You also pose a question regarding the recent Monti report on the single market, namely whether the Government agrees with the statement: "Variation in VAT rates affect capital and trade movements, at least in the short - medium term, and are therefore relevant for the functioning of the single market. In a context of a trend towards increasing consumption taxes, coordination of policies directed at raising standard VAT rates or limiting the application of reduced VAT rates may be beneficial."

Overall, the Government has welcomed the Monti report as an important contribution to the future direction of the single market. The report contains a number of recommendations on greater tax coordination, including on VAT rates. In the Government's response to the tax elements of the report, we have emphasised the importance of upholding tax sovereignty, and of focusing on areas where co-ordination is necessary to improve the functioning of the single market. We have committed to discussing these issues with other Member States at a high level tax policy group, shortly to be established, where I will represent the UK.

The Government accepts there is a case for having an EU-wide standard minimum VAT rate to minimise the risks to the single market alluded to by the Monti report, which the Government accepts do exist. Whilst harmonisation should not be an aim in itself - something the Monti report also explicitly recognises - I do agree that it is helpful for Member States to coordinate their rates to ensure as level a playing field as possible and to discourage distortive behaviour such as "rateshopping"

However, I do not believe that such coordination should go so far as to undermine the right of national governments to ultimately set the VAT rates appropriate for their particular national circumstances. The Government continues to attach importance to the principle of tax sovereignty and protecting Member State competence on tax, to ensure that all countries have the flexibility to develop tax policies appropriate to their own economic circumstances. I therefore believe it is right that Member States should continue to have the flexibility to apply their own choice of VAT rates to further their domestic priorities and social objectives, whilst ensuring that this does not materially affect the functioning of the single market - something that the application of a standard minimum rate across the EU achieves. Such decisions can, and should only, be taken by national governments.

With regards to limiting the application of reduced VAT rates, as suggested by the report, I would again stress that I believe this must remain a decision for national governments. The VAT Directive allows Member States to apply reduced VAT rates only in specific areas, as set out in Annex III to that Directive, precisely to ensure that only those types of supply are eligible for a reduced rate which are at low risk of distorting the single market through incentivising cross-border shopping - in other words, reduced rates are confined to supplies which tend to be locally-provided or are largely immobile. There is therefore already an inbuilt recognition in Annex III of the importance of maintaining the proper functioning of the single market.

Finally, turning to whether Member States should together agree a higher minimum standard VAT rate, this is, as you know, not the proposal currently on the table from the Commission. If the Commission decides to come forward with such a proposal in the future, the Government will consider such a proposal on its merits and in the context of the particular economic conditions at the time.

23 August 2010

VAT (RECAST) (17760/09)

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

An Explanatory Memorandum on a Commission legislative Proposal (17760/09) laying down implementing measures for Directive 2006/112/EC (the VAT Directive) was sent by the previous Government in January 2010, for consideration by your Committee.

At a subsequent meeting, your Committee cleared the draft Council Regulation from scrutiny. This letter provides a brief update on where things stand.

The Belgian Presidency is taking this dossier forward as a matter of priority and may be able to conclude the EU discussions in the next few months, with the dossier going to ECOFIN thereafter.

Officials have continued to hold discussions with UK business representatives and feed UK business views into the EU discussions. UK businesses welcome the overall clarity and consistency that the latest text provides and would now like to see agreement as soon as possible.

On that basis, the Government would be prepared to accede to a political agreement on this proposal should it come to ECOFIN before the end of the Belgian Presidency.

I hope you find this information helpful.

27 July 2010

VAT REFUND PROCEDURES (12391/10)

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

In July 2010, I sent an Explanatory Memorandum covering a Commission proposal on the EU cross-border electronic VAT refund system. You will recall that the Commission proposal had two key elements.

The first was a proposal to extend the deadline for the submission of electronic VAT refund claims for 2009 by VAT registered businesses from 30 September 2010 to 31 March 2011. The Commission argued that the extension is necessary, as some Member States (not including the United Kingdom) did not have fully functioning electronic portals in place until mid May and therefore taxpayers need additional time to submit their VAT refund claims.

The second element was that the Commission wishes Member States to harmonise some features of their national VAT refund web portals to make them more inter-operable and accessible for taxpayers.

The Commission proposal was first discussed at a Council Working Group on 20 September. At that Working Group UK officials challenged the Commission about the appropriateness of the proposals. With regard to the proposed extension to the deadline, the Commission referred in general terms to the problems which businesses across the EU are having submitting their VAT refund claims and insisted that action here was necessary. In response, all Member States except the UK were willing to accept an extension to the deadline. The UK entered both a policy and Parliamentary Scrutiny reservation.

As regards the second element of the Commission's proposal, several Member States joined the UK in challenging the need for the Commission to be given additional (unspecified) powers to further harmonise the functioning of Member States' VAT refund systems. As a result, the Presidency concluded that this element of the proposal would need to be discussed further at the next EU Standing Committee on Administrative Co-operation (SCAC) meeting on 11 October 2010.

However, given the current deadline for EU businesses to submit 2009 VAT refund claims is 30 September 2010, the Presidency concluded that there is an urgent need to come to a conclusion on the proposed extension to the deadline. The Presidency has therefore decided to take that element to Coreper on 29 September (the European Parliament is expected to deliver a favourable opinion on the extension by then) to seek general agreement. It would then go to a future Council meeting for final adoption.

In the light of the Working Group discussion, HMRCs most recent experience with claims submitted by UK businesses to two Member States and representations from businesses, there is a far stronger case for the deadline extension than appeared to be the case before.

There are clearly problems with a number of VAT refund web portals. All EU businesses (including UK businesses) are having difficulties making claims to two particular Member States as a result of technical issues at their end. And EU businesses (but not UK ones) are highlighting problems with at least nine other Member States too. There has also been a general expectation within the EU business community (largely as a result of the Commission Press Release at the time the proposal emerged) that the extension will be granted, and many EU (and UK) businesses have therefore held off putting in their refund claims.

It is also now apparent that an extension of the deadline for making claims will not in fact entail costly IT system changes for HMRC or for VAT refund agents.

Given these circumstances, the Government now accepts that an extension of the deadline would be the most desirable outcome and businesses across the EU need to be given a clear signal about this before 30 September, when the current deadline runs out. The Government is therefore now willing to agree to this aspect of the proposal and will indicate that at Coreper on 29 September. Any other

approach would create uncertainty and potentially deny many businesses their legitimate rights to be able to submit VAT refund claims.

I regret that the scrutiny process could not be completed but hope that you will understand the reasons behind our decision.

27 September 2010

Letter from the Chairman to David Gauke MP

Thank you for your Explanatory Memorandum dated 27 July 2010 and your letter dated 27 September on the Commission proposal on rules for the refund of VAT. The EU Sub-Committee on Economic and Financial Affairs and International Trade considered these documents at its meeting on 12 October.

We have recorded your use of a scrutiny override on the first element of the Commission proposal, namely extending the deadline for the submission of electronic VAT refund claims for 2009 from 30 September 2010 to 31 March 2011, and note that this was necessary due to Parliamentary recess. We support the Government's view that this extension is justified given the difficulties experienced by businesses across the EU, but we would like to know why it took the Government until the end of September to establish that UK businesses were having difficulties making claims, and that extending the deadline would not, in fact, entail costly IT system changes.

On the second element of the proposal, we agree with your view that the Commission has not made a persuasive case for the need for further powers to harmonise the functioning of the VAT refund system. In particular, the Commission does not seem to have made any assessment of the impact of changing core requirements of electronic VAT refund systems which have only just been finalised and implemented by Member States. We would appreciate updates on the progress of these negotiations, and have decided to hold this document under scrutiny. We would be grateful for a reply within ten working days.

12 October 2010

Letter from David Gauke MP to the Chairman

Thank you for your letter dated 12 October 2010 and for the Committee's appreciation of the reasons why the Government needed to override scrutiny in respect of the first element of this particular proposal. I am sorry for the delay in replying.

You asked why it took the Government until the end of September to establish that UK businesses were having difficulties making VAT refund claims, and why extending the deadline would not in fact entail costly IT system changes.

Under the new electronic VAT refund system a business submits its claim through a portal in the Member State of Establishment (for UK businesses, the UK) where it is validated and then sent electronically to the Member State of Refund for consideration and payment.

As the UK (HMRC) national VAT refund web portal was developed and opened on time at the beginning of January 2010, UK businesses have not had any difficulties submitting their cross-border VAT refund claims. However, the VAT refund portals of two Member States suffered major technical failures at the end of July, which meant that VAT refund claims sent to them by HMRC, and by other EU tax administrations, were not accepted into the IT system of those two Member States MSR for consideration and payment.

The extent and seriousness of the technical problems in these two Member States only became apparent during August. Despite initial assurances by them that the problems would be fixed quickly, they were not fixed and indeed still have not been. As a result, a significant number of claims are still queued up awaiting formal acceptance into their systems. HMRC and others are pressing hard for these IT issues to be sorted out so these outstanding claims can be properly considered.

Although an extension to the deadline would not have resolved these particular cases, it became apparent during discussions with our European partners that there were problems elsewhere affecting EU businesses (but not UK ones). It was also apparent from discussions with EU and UK business representatives that these problems and the Commission Press Release at the time the proposal emerged meant some businesses had held off putting in claims. An extension was therefore a justified solution.

When in July the Commission originally published its proposal to extend the VAT refund system deadline, HMRC was advised by its IT contractors that any extension to the deadline would require them to change the UK VAT refund web portal. The nature of such a change would have had timing

and cost implications for HMRC and potential knock on impacts for VAT refund agents too. However, following further detailed discussions between HMRC and its IT contractors, an alternative (low cost) solution presented itself late in the day. That alternative solution does not have an impact on VAT refund agents.

You also asked to be kept informed on the progress of the negotiations of the second element of these proposals. As I had previously indicated would be the case, this element was discussed at the EU Standing Committee on Administrative Cooperation on 11 October 2010. The conclusions from that meeting were that the Commission should draw up a prioritised Action Plan in respect of problems with the VAT refund system; that Action Plan would then be discussed at a future meeting; and in the meantime, it was premature to talk about introducing additional powers to harmonise the functioning of the VAT refund system.

I hope you find this information helpful.

8 November 2010

WHITE PAPER: INSURANCE GUARANTEE SCHEMES (12360/10)

Letter from the Chairman to Mark Hoban MP, Financial Secretary

Thank you for your Explanatory Memorandum on document 12360/10 on insurance guarantee schemes. The EU Economic and Financial Affairs and International Trade Sub-Committee considered it at its meeting on 26 October.

We recognise that the Commission's proposals for a Directive on insurance guarantee schemes have similarities with proposed amendments to the Directive on Deposit Guarantee Schemes and the Investor Compensation Schemes Directive. As we are currently corresponding with you about these proposals, we will hold this document under scrutiny until our correspondence is completed. In addition, we would like to receive a copy of the Government's response to the Commission's White Paper.

We do not require a response to this letter.

26 October 2010