House of Commons

European Scrutiny Committee

Fifty-first Report of Session 2017–19

Documents considered by the Committee on 16 January 2019

Report, together with formal minutes

Ordered by The House of Commons
to be printed 16 January 2019

HC 301-I
Published on 22 January 2019
by authority of the House of Commons

Notes

Numbering of documents

Three separate numbering systems are used in this Report for European Union documents:

Numbers in brackets are the Committee's own reference numbers.

Numbers in the form "5467/05" are Council of Ministers reference numbers. This system is also used by UK Government Departments, by the House of Commons Vote Office and for proceedings in the House.

Numbers preceded by the letters COM or SEC or JOIN are Commission reference numbers.

Where only a Committee number is given, this usually indicates that no official text is available and the Government has submitted an "unnumbered Explanatory Memorandum" discussing what is likely to be included in the document or covering an unofficial text.

Abbreviations used in the headnotes and footnotes

AFSJ	Area of Freedom Security and Justice
CFSP	Common Foreign and Security Policy
CSDP	Common Security and Defence Policy
ECA	European Court of Auditors
ECB	European Central Bank
EEAS	European External Action Service
EM	Explanatory Memorandum (submitted by the Government to the Committee)*
EP	European Parliament
EU	European Union
JHA	Justice and Home Affairs
OJ	Official Journal of the European Communities
QMV	Qualified majority voting
SEM	Supplementary Explanatory Memorandum
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union

Euros

Where figures in euros have been converted to pounds sterling, this is normally at the market rate for the last working day of the previous month.

Further information

Documents recommended by the Committee for debate, together with the times of forthcoming debates (where known), are listed in the European Union Documents list, which is published in the House of Commons Vote Bundle each Monday, and is also available on the parliamentary website. Documents awaiting consideration by the Committee are listed in "Remaining Business": www.parliament.uk/escom. The website also contains the Committee's Reports.

*Explanatory Memoranda (EMs) and letters issued by the Ministers can be downloaded from the Cabinet Office website: http://europeanmemoranda.cabinetoffice.gov.uk/.

Staff

The staff of the Committee are Jessica Mulley (Clerk), Kilian Bourke, Alistair Dillon, Leigh Gibson, Foeke Noppert, Sibel Taner and George Wilson (Clerk Advisers), Arnold Ridout (Counsel for European Legislation), Joanne Dee and Emily Unwin (Deputy Counsels for European Legislation), Jeanne Delebarre (Second Clerk), Daniel Moeller (Senior Committee Assistant), Sue Beeby, Nat Ireton and Beatrice Woods (Committee Assistants), Ravi Abhayaratne and Paula Saunderson (Office Support Assistants).

Contacts

All correspondence should be addressed to the Clerk of the European Scrutiny Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is (020) 7219 3292/5467. The Committee's email address is escom@parliament.uk.

Contents

Meeting Summary 3

Documents for debate

1	BEIS	Market surveillance	8
2	BEIS	Whistleblowing and breaches of EU law	13
3	DCMS	Privacy and Electronic Communications	18
4	DEFRA	Unfair trading practices in the food supply chain	24
5	HMT	European System of Financial Supervision	27

Documents cleared

6	DFT	Safeguarding competition in air transport	43
7	HMT	Green Finance: Low Carbon Benchmarks	46
8	HMT	EU support for customs authorities 2021–27	52

Documents not raising questions of sufficient legal or political importance to warrant a substantive report to the House

9	List of documents		57

Formal Minutes 60

Standing Order and membership 61

Meeting Summary

The Committee looks at the significance of EU proposals and decides whether to clear the document from scrutiny or withhold clearance and ask questions of the Government. The Committee also has the power to recommend documents for debate.

Brexit-related issues

The Committee is now looking at documents in the light of the UK decision to withdraw from the EU. Issues are explored in greater detail in report chapters and, where appropriate, in the summaries below. The Committee notes that in the current week the following issues and questions have arisen in documents or in correspondence with Ministers:

- Under all Brexit scenarios, the UK will be obliged to make provision for a new EU law on unfair trading practices in the food supply chain.

Summary

Whistleblowing and breaches of EU law

This week we considered three documents relating to whistleblowing at EU level: a Commission Communication, a proposed Directive and a Court of Auditors' Opinion assessing the proposal.

The proposed Directive aims to harmonise national laws to a minimum standard on whistleblowing in relation to breaches of EU law. The proposal seeks to improve on the current piecemeal approach to whistleblowing at EU level by introducing a horizontal approach across many policy areas. It follows in the wake of recent scandals disclosed by whistleblowers like Cambridge Analytica.

The UK leads in the EU in providing legal protection for whistleblowers (see the Public Interest Disclosure Act 1998 and Employment Rights Act 1996). But initially, the Government has not been supportive of the proposal due to the potential costs and burdens for business of internal reporting procedures (the main difference between the UK and proposed EU frameworks).

As currently drafted, an adopted Directive would not have to be transposed before 15 May 2021. So the UK would not have to implement it nor preserve it as EU retained law under the EU Withdrawal Act, either the case of no-deal or a negotiated exit where the implementation period is not extended beyond 31 December 2020.

This chapter reports on the Government's latest letter and its outstanding responses to Committee questions. The Government does not indicate any substantial progress in Council negotiations, despite the European Parliament having agreed its position. The conclusions ask:

- more about the possible pace of future negotiations as this could have implications for the UK having to implement the proposal in the event of negotiated exit and an extended implementation period;
- for further clarification concerning availability for legal aid in the UK for whistleblowers.

Communication and Court of Auditors' Opinion cleared from scrutiny, but proposed Directive retained; further information requested; drawn to the attention of the Business, Energy and Industrial Strategy Committee

Privacy and Electronic Communications

This proposed ePrivacy Regulation was published in January 2017 to replace the current 2002 Directive on privacy and protection of personal data relating to electronic communications (e-coms). E-coms can be very sensitive, for example, if they reveal an individual's state of health, religion, politics or sexual preferences or a company's commercial information. An adopted Regulation could have major implications for individual privacy and the way that sectors such as technology, digital advertising and publishing do business. The current Directive covers confidentiality of e-coms provided via traditional communication services (e.g. emails, SMS). But the proposal will update the rules in the Directive to apply to "Over the Top" services, including internet-based messaging such as What's App and Voice over Internet Protocol (e.g. Skype). It will also govern the use of cookies, other tracking technologies as well as email marketing.

The Commission wanted the proposal to come into force with the GDPR on 25 May 2018. However, it has proved very controversial, delaying negotiations in the Council. Areas of contention include when service providers can use e-coms content and metadata in the running of their business. The EP has taken a restrictive approach, taking the position in October 2017 that processing should only be permitted by explicit consent or if "strictly necessary" for specified purposes. Businesses and some Member States, including the UK, want a different approach which aligns more with the GDPR and allows processing on grounds of "legitimate interests". As a compromise the Austrian Presidency has attempted to include some additional processing grounds in the text. Rules governing cookies and other tracking technologies are also proving contentious.

As the Minister's most recent letter now indicates, it remains unclear when, if at all, an adopted proposal would apply to the UK. We provide an assessment of the position in the case of "deal" and "no-deal" scenarios in the conclusions to our chapter on this dossier. We also highlight the continued relevance of the adopted Regulation to the UK in any event as a third country wishing to trade with the EU, irrespective of the exit outcome. We note the Government's concern about needing an exemption to allow processing for combatting child online abuse as it is relevant to the ongoing inquiry of the Science and Technology Committee on "Impact of social media and screen-use on young people's health". Finally, we ask to be kept up-to-date on the Privacy International reference to the CJEU on the question of the interpretation of the Article 4(2) TEU exemption and how it could impact on this proposal and the UK's future position.

Proposed Regulation retained under scrutiny; further information requested; drawn to the attention of the Digital, Culture, Media and Sport Committee, the Science and Technology Committee, the Home Affairs Committee, the Justice Committee, the Joint Committee on Human Rights and the Exiting the EU Committee

Unfair trading practices in the food supply chain

Agreement on new EU legislation to combat unfair trading practices in the food supply chain has now been reached, but there remain some open questions relating to UK relevance, notably the length of the post-Brexit implementation period and the extension of geographical scope to cover relationships between EU sellers and non-EU buyers (including the UK). Thus far, the Government has been given no indication as to what will be expected of non-EU enforcement authorities and so is unable to give any assessment of the impact of the agreement on the UK. Should the post-Brexit implementation period be extended beyond Autumn 2021, the UK would be obliged to apply the legislation in the UK.

We conclude that—under all scenarios—the UK will be obliged to make provision for this legislation. The intensity of that requirement will be dependent on the nature of the UK's continued obligations under EU law which may be unclear for some time. In the light of the continuing uncertainties over the impact of this legislation on the UK, we retain the document under scrutiny but waive the scrutiny reserve in order that the Government may support the Directive should such support be considered to be in the national interest.

Not cleared; further information requested, scrutiny waiver granted, drawn to the attention of the Environment, Food and Rural Affairs Committee and the Business, Energy and Industrial Strategy Committee

Safeguarding competition in air transport

Trilogue negotiations have concluded regarding this proposed Regulation which would safeguard competition in air transport against subsidisation and unfair pricing practices in the supply of air services from third countries. The Regulation would broaden the scope of the unfair practices covered, set out the procedures to be followed, and allow individual Member States and operators to make complaints in their own right.

The Committee's concerns regarding competence have been addressed by the final text, which the Minister (Baroness Sugg) confirms is in line with UK objectives: the text provides that fair competition between air carriers should preferably be addressed in the context of air transport or air services agreements with third countries, rather than through this Regulation; the text enables an investigation to be suspended if the Member States involved intend to address the same practice under an applicable agreement they have concluded with the country in question; and, although the concept of 'Threat of Injury' is retained, it is clarified so that it relates to more definite circumstances and any redressive measures will not enter into force before the threat of injury has developed into actual injury.

Post-exit, the Regulation will be of relevance to the UK, assuming that it leaves the single market for aviation, as UK stakeholders could potentially be subject to the Regulation if there were any concerns regarding fair competition between EU carriers and UK aviation stakeholders. However, the prospect of it being used in relation to the UK (e.g. due to excessive state subsidies) is low, and the changes made to the Regulation mean that these issues would be more likely to be dealt with through any bilateral air transport agreement.

Cleared from scrutiny

Market surveillance

The Minister (Kelly Tolhurst MP) has written on the mandate issued by the Committee of Permanent Representatives to the European Union (COREPER) in November and subsequent trilogue negotiations with the European Parliament regarding this substantial revision of its market surveillance framework. The proposed Regulation would strengthen enforcement of EU goods rules through the creation of a Union Compliance Network, a system of pre-export checks and controls, and the introduction of a requirement for there to be an authorised representative in the Union who is responsible for compliance.

In the COREPER mandate, the Government secured a dilution of the requirement for businesses outside the Union to identify a responsible person within it with the effect that this requirement is rendered somewhat more risk-based, although the Minister provides very little detail about what precisely has been achieved. Presumably, the provision is applicable to certain higher risk product categories—e.g. chemicals—but not less risky categories. Although the European Parliament appears to be supportive of the Council's text on this point, the Minister indicates that on a wide range of other provisions the Parliament is pressing for a tougher approach which is more closely aligned to the Commission's original proposal. The Minister requests that the Committee clear the proposal from scrutiny or grant a waiver in advance of Competitiveness Council on 18–19 February 2019.

We decided not to grant the Government's request until it provides it with clear information about the outcome of trilogue negotiations. We also ask questions on the scope of Government commitments regarding market surveillance in relation to the Protocol on Ireland/Northern Ireland in the Withdrawal Agreement.

Not cleared from scrutiny; further information requested; drawn to the attention of the Business, Energy and Industrial Strategy Select Committee

Documents drawn to the attention of select committees:

('NC' indicates document is 'not cleared' from scrutiny; 'C' indicates document is 'cleared')

Business, Energy and Industrial Strategy Committee: Whistleblowing and breaches of EU law [(a) Proposed Directive (NC); (b) Communication; (c) Court of Auditor's Opinion (C)]; Market surveillance [Proposed Regulation (NC)]; Unfair trading practices in the food supply chain [Proposed Directive (NC; scrutiny waiver granted)]

Digital, Culture, Media and Sport Committee: Privacy and Electronic Communications [Proposed Regulation (NC)]

Environmental Audit Committee: Green Finance: Low Carbon Benchmarks [Proposed Regulation (C)]

Environment, Food and Rural Affairs Committee: Unfair trading practices in the food supply chain [Proposed Directive (NC; scrutiny waiver granted)]

Exiting the EU Committee: Privacy and Electronic Communications [Proposed Regulation (NC)]

Home Affairs Committee: Privacy and Electronic Communications [Proposed Regulation (NC)]

Joint Committee on Human Rights: Privacy and Electronic Communications [Proposed Regulation (NC)]

Justice Committee: Privacy and Electronic Communications [Proposed Regulation (NC)]

Science and Technology Committee: Privacy and Electronic Communications [Proposed Regulation (NC)]

Treasury Committee: European System of Financial Supervision [(a) Proposed Regulation (NC); (b) Proposed Directive (NC); (c) Proposed Regulation (NC); (d) Proposed Regulation (C)]

1 Market surveillance

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information awaited; drawn to the attention of the Business, Energy and Industrial Strategy Select Committee
Document details	Proposal for a Regulation of the European Parliament and of the Council laying down rules and procedures for compliance with and enforcement of Union harmonisation legislation on products and amending Regulations (EU) No 305/2011, (EU) No 528/2012, (EU) 2016/424, (EU) 2016/425, (EU) 2016/426 and (EU) 2017/1369 of the European Parliament and of the Council, and Directives 2004/42/EC, 2009/48/EC, 2010/35/EU, 2013/29/EU, 2013/53/EU, 2014/28/EU, 2014/29/EU, 2014/30/EU, 2014/31/EU, 2014/32/EU, 2014/33/EU, 2014/34/EU, 2014/35/EU, 2014/53/EU, 2014/68/EU and 2014/90/EU of the European Parliament and of the Council
Legal base	Articles 33 (customs co-operation), 114 (internal market), and 207 (common commercial policy) TFEU; ordinary legislative procedure; QMV
Department	Business, Energy and Industrial Strategy
Document Number	(39394), 15950/17 + ADDs 1–11, COM(17) 795

Summary and Committee's conclusions

1.1 The Minister (Kelly Tolhurst MP) has provided the Committee with an update[1] on the progress of negotiations regarding this proposal for a Regulation, which would strengthen enforcement of EU goods rules through a wide range of measures, including the creation of a Union Compliance Network, a system of pre-export checks and controls, and the introduction of a requirement for there to be an authorised representative in the Union who is responsible for compliance.

1.2 Various aspects of the proposed regulation which have implications for third countries are relevant to the UK in the context of EU exit, most obviously the requirement for businesses to appoint an authorised representative in the Union responsible for compliance, but also other provisions which might potentially increase or decrease the level of market surveillance-related formalities which take place at the EU's external borders. The proposed Regulation is explained in greater detail in the Committee's first report, published on 9 May 2018.[2]

1 Letter from the Minister to the Chair of the European Scrutiny Committee (9 January 2019).

2 Twenty Seventh Report HC 301–xxvi (2017—2019), chapter 2 (9 May 2018).

1.3 In its most recent report on 21 November 2018,[3] the Committee granted the Government a conditional waiver to participate in Council in November at which there was to be a vote on a General Approach. The Minister had informed the Committee[4] that the Commission's proposed text had been made significantly more proportionate by the Presidency, with decisions of the Union Product Compliance Network taking the form of legally non-binding recommendations, addressing the Committee's concerns about encroachment on Member State competence. However, the Minister indicated that she retained significant concerns about the proposal for an authorised representative to be based within the EU, and said that unless the Austrian Presidency adopted a more risk-based approach, which ensured that the provisions were limited only to products which carry a higher degree of risk to the consumer, the Government would not support the proposal. The Committee requested an update from the Government in the New Year.

1.4 In her latest update the Minister informs the Committee that an informal mandate to begin trilogues was adopted at a meeting of the Committee of Permanent Representatives to the European Union (COREPER) on 23 November 2018. She states that Article 4 (the requirement to have a person in the EU responsible for compliance) was discussed, and that the UK supported other Members States' interventions to remove it entirely, but that there was insufficient support for removal and COREPER instead adopted the Working Group's revised text, which better targets the provisions towards products representing a risk to the consumer. The Minister does not, however, provide any further detail about how the original proposal has been modified in this regard (e.g. which product categories are in scope of the provision).

1.5 The Minister states that trilogue negotiations are underway, with 6 technical and 3 political trilogues taking place in December. She considers that the Council's General Approach is more proportionate and better preserves Member State competency than the Commission's original proposal, and is much more closely aligned to the UK position than the European Parliament's mandate.

1.6 The Minister states that there has been "significant progress" on the proposal, and that it appears that the European Parliament may be willing to move towards the Council's position on some articles, notably on Article 4 (the requirement to have a person in the EU responsible for compliance); however, she also notes that, on other points, including Article 5 (Declaration of conformity), Article 15 (Market surveillance measures) and Article 20 (Union testing facilities), the Council may move towards the position of the Parliament. The Minister adds that it is not clear whether the amendments made by the Council Working Group to Article 31 (Union Product Compliance Network) will be retained through the trilogue process.

1.7 The Minister concludes that the Romanian Presidency is committed to finalising the proposal as soon as possible with further trilogues scheduled through January with a view to securing final agreement in the first week of February. It is anticipated that the proposal will go before the Competitiveness Council on 18–19 February.

1.8 The Minister emphasises that, given the differences between the Council and Parliament positions on a number of articles, it is too soon to have clarity on what the final compromise text will look like. She reiterates that the Government supports the

3 Forty-Fifth Report HC 301–xliv (2017—2019), chapter 1 (21 November 2018).

4 Letter from the Minister to the Chair of the European Scrutiny Committee (13 November 2018).

overarching principles of the proposal, but states that it is awaiting the compromise text before taking a view on whether the proposal is sufficiently risk-based. The Minister requests that the scrutiny reserve be lifted or waived so that the UK can take a position of opposition or abstention, depending on how trilogue negotiations develop and what provisions are secured or conceded in the final text.

1.9 **We thank the Minister for her update following the informal negotiating mandate issued by COREPER in November, and her helpful summary of subsequent trilogue negotiations. Nonetheless, we regret that the summary of the mandate issued by COREPER does not provide further information about how Article 4 of the proposal (mandating the presence of a person in the EU responsible for compliance) was revised, which would enable us to evaluate the extent to which the Government had achieved its negotiating objective on this point and the implications for UK stakeholders.**

1.10 **Although the Minister requests that the scrutiny reserve be lifted or waived so that the Government can take a position of opposition or abstention at the final vote in Council in February, depending on how trilogue negotiations develop and what provisions are secured or conceded in the final text, given the evident relevance of many of the provisions in the proposal to the UK in the context of EU exit, and the lack of certainty regarding the outcome of trilogue negotiations, we are not yet willing to grant the Government clearance or a waiver on the basis of the information that has been provided.**

1.11 **We therefore request that the Government provide us with:**

- **a thorough summary of the key provisions of the final compromise text as soon as trilogue negotiations conclude, with a particular focus on provisions that may be relevant to the UK when it ceases to be an EU Member State and any implementation period has ended; and**

- **an assessment of the extent to which the proposed Regulation would affect the volume of checks for industrial goods which would have to take place at the EU's external borders (i.e. as a result of increased enforcement of product standards at the EU's external borders to prevent non-compliant goods being placed on the market, and the introduction of a system of pre-export checks and controls) in relation to third countries which do not have preferential arrangements with the EU (not the UK specifically, given the lack of certainty regarding the shape of the future trading relationship), as well as the reasoning behind its assessment.**

1.12 **We also ask that the Government clarify:**

- **Whether (given that Annex 5 of the Protocol on Ireland/Northern Ireland includes certain regulations relating to market surveillance and Article 15(5) of the Protocol provides for Union acts that fall "within the scope" of the Protocol but do not amend/replace Union acts listed in its Annexes to be added to the relevant Annex following a decision by the Joint Committee) the Government considers the Regulation to be *potentially* within the "scope" of the Protocol and therefore liable to be added to the relevant Annex (5)? (Please provide the Government's reasoning on this point.)**

- **Whether the Government would support the addition of the proposed Regulation to Annex 5 of the Protocol if the European Union were to request it?**

- **In light of the Government's recent publication "UK Government Commitments to Northern Ireland and its integral place in the United Kingdom",[5] which states that the Government will "ensure there would be no divergence in practice between the rules in Great Britain and NI covered by the Protocol in any scenario in which the backstop took effect", does the Government intend for Great Britain to unilaterally align in their entirety with Regulations (EU)167/2013 and 858/018 on vehicle approvals and market surveillance thereof, and Regulation (EC) 765/2008 covering market surveillance more generally, as referenced in Annex 5 of the Protocol?**

- **If so, we ask the Government to explain in detail how alignment with these regulations would work in practice, as, although copying EU rules would reduce trade-related frictions between Great Britain and Northern Ireland, Great Britain unilaterally aligning with these regulations would not mean that the UK and its stakeholders would derive the same effects from this alignment as it does through being a Member State (for example, type approvals issued by GB-based accreditation authorities would not automatically be recognised throughout the EU). Is it the Government's intention to align with these rules to reduce to a minimum trade between Great Britain and Northern Ireland, even if aligning with these regulations no longer provides Great Britain with the same market access effects (e.g. in terms of mutual recognition of approvals issued by UK bodies)?**

1.13 **We understand that providing us with this information in sufficient time for us to clear it from scrutiny in advance of Competitiveness Council on 18–19 February—presumably, at our meeting of 13 February—may prove logistically challenging depending on when provisional agreement on a text is reached, but we consider the proposal to be of sufficient importance not to be willing to grant the Government a scrutiny waiver without substantially greater clarity about the compromise text. We ask that you liaise closely with our clerks to ensure that we can report again on the proposal in advance of its adoption in Council.**

1.14 **In this meantime, we retain this proposal under scrutiny, and draw it to the attention of the Business, Energy and Industrial Strategy Committee.**

Full details of the documents:

Proposal for a Regulation of the European Parliament and of the Council laying down rules and procedures for compliance with and enforcement of Union harmonisation legislation on products and amending Regulations (EU) No 305/2011, (EU) No 528/2012, (EU) 2016/424, (EU) 2016/425, (EU) 2016/426 and (EU) 2017/1369 of the European Parliament and of the Council, and Directives 2004/42/EC, 2009/48/EC, 2010/35/EU,

5 HM Gov, UK Government Commitments to Northern Ireland and its integral place in the United Kingdom (9 January 2018).

2013/29/EU, 2013/53/EU, 2014/28/EU, 2014/29/EU, 2014/30/EU, 2014/31/EU, 2014/32/EU, 2014/33/EU, 2014/34/EU, 2014/35/EU, 2014/53/EU, 2014/68/EU and 2014/90/EU of the European Parliament and of the Council: (39394), 15950/17 + ADDs 1–11, COM(17) 795

Previous Committee Reports

Forty-fifth Report HC 301–xliv (2017–19), chapter 1 (21 November 2018); Twenty seventh Report HC 301–xxvi (2017–19), chapter 2 (9 May 2018).

2 Whistleblowing and breaches of EU law

Committee's assessment	Legally and politically important
Committee's decision	(a) Not cleared from scrutiny; further information requested; (b) and (c) Cleared from scrutiny; drawn to the attention of the Business, Energy and Industrial Strategy Committee
Document details	(a) Proposed Directive on the protection of persons reporting on breaches of Union law; (b) Commission Communication: *Strengthening whistleblower protection at EU level*; (c) Court of Auditor's Opinion No 4/2018 on proposal (a)
Legal base	(a) Articles 16, 33, 43, 50, 53(1), 62, 91, 100, 103, 109, 114, 168, 169, 192, 207 and 325(4) TFEU and Article 31 of the Euratom Treaty; ordinary legislative procedure; (b) and (c)—
Department	Business, Energy and Industrial Strategy
Document Numbers	(a) (39695), 8713/18, COM (18) 218; (b) (39696), 8725/18, COM (18) 214; (c) (40122), 13195/18,—

Summary and Committee's conclusions

2.1 "Whistleblowing" is commonly understood to be the act of speaking out and disclosing serious wrongdoing, usually by employees. EU law on whistleblowing already applies in some areas such as financial services, transport safety and environmental protection. The Cambridge Analytica,[6] Lux Leaks,[7] Dieselgate[8] and Paradise/Panama Papers[9] scandals have all highlighted the importance but also the vulnerability of whistleblowers. In their wake, the Commission is proposing this Directive (document (a)) to strengthen and extend protection for whistleblowers across the EU who report breaches of a wide range of EU legislation. As this is a minimum harmonisation proposal, it is open to Member States to legislate for higher levels of protection. We set out a full account of the proposal and the Government's view of it in our last Report of 20 June.[10]

6 Facebook and data analytics firm Cambridge Analytica have been accused of harvesting and using personal data to influence the outcome of the US 2016 presidential election and the UK's referendum on EU exit. See the oral evidence session, Christopher Wylie, 28 March 2018 held as part of the DCMS Committee's inquiry into "Fake News".

7 See BBC website, Luxleaks whistleblower Antoine Deltour has conviction quashed. In 2014 two whistleblower employees leaked confidential information concerning PricewaterhouseCoopers dealings with multinational companies in relation to tax rulings in Luxembourg between 2002 and 2010. They were originally both convicted by the Luxembourg courts but one had his conviction overturned in January 2018.

8 See BBC website, Volkswagen: The scandal explained. The German car manufacturer Volkswagen has since admitted cheating diesel emissions tests in the US.

9 A House of Common Debate Briefing paper called The Paradise Papers explains that Paradise papers consisted of "material …leaked from two offshore service providers and 19 tax havens' company registries" and reported by some of the UK press "reiterating public concerns as to the scale of tax avoidance and evasion, and the ability of offshore jurisdictions to facilitate these activities". This followed the publication in the previous year of the 'Panama Papers'—a leak of financial records from Mossack Fonseca, a law firm that had provided advice on establishing offshore companies to a wide variety of politicians, celebrities and wealthy people.

10 Thirty-second Report HC 301–xxxi (2017–19), chapter 1 (20 June 2018).

2.2 Irrespective of when the proposal may be adopted, the deadline for implementing the Directive once adopted is currently drafted to be 15 May 2021. This means that as things currently stand the UK would not have to implement the proposal,[11] either in the case of "no-deal" or of a negotiated exit where the implementation period is not extended beyond 31 December 2020. However, we considered last time that the UK may either have to align with the proposal as part of the core labour or competition provisions of an EU-UK free trade/other agreement or may choose to do so as part of the Prime Minister's commitment to build on workers' rights after the UK's exit from the EU.

2.3 The UK leads the EU in terms of the legal protection it affords to whistleblowers (see the Public Interest Disclosure Act 1998 and the Employment Rights Act 1996). However, initially the Government did not support the proposal. As indicated in its Explanatory Memorandum in June, the Government considers that a non-legislative measure should have first been attempted by the Commission. It highlights the cost and burden on business of setting up internal reporting procedures (the main difference between the proposal and the current UK legal framework).

2.4 Further to our last Report, the Court of Auditors (CoA) has produced an Opinion on the proposed Directive, as required by Article 325(4) TFEU. The CoA is an EU institution which acts as an independent external auditor. In summary, the CoA is generally supportive of a horizontal EU approach but is worried that the complexity of the material scope of the proposal creates legal uncertainty about whether potential whistleblowers will be protected or not under the proposal. A fuller summary of the CoA's assessments is set out in paragraph 12 below.

2.5 The Parliamentary Under Secretary of State for Department for Business, Energy and Industrial Strategy (Kelly Tolhurst MP) has provided us with her Explanatory Memorandum of 31 October on the Court of Auditor's report on the proposal. Noting that the report raises no direct policy implications for the UK, the Minister provided some helpful information on the timetable for the negotiations on the proposed Directive. She said that the European Parliament (EP) had indicated that trilogues on the proposal would begin in the New Year. This would require a General Approach on the proposal to be agreed by the end of December. Given the number of outstanding issues on the proposal she said it was "unclear" that a General Approach could be reached within this timeframe. Indeed, it is now apparent from the Minister's letter below that no such agreement was reached in the Council in December.

2.6 In a letter[12] of 21 December , the Minister now writes to update us on the progress of the proposal and to respond to a number of questions set out in the conclusions to our last Report as follows:

- **The scope of the proposal and corresponding legal bases**: The issue of legal bases has so far been uncontested and has yet to be substantively discussed in the Council, together with the expected opinion of the Council Legal Service.

11 Nor continue it as retained EU law under the EU Withdrawal Act 2018.

12 Letter from the Minister to the Chair of the European Scrutiny Committee (21 December 2018).

- **Whether any envisaged criminal penalties would be necessary for effective implementation of the proposed Directive**: Discussions so far indicate that the proposed Directive does not require criminal penalties to be introduced, nor does the Government consider them necessary for effective implementation.

- **Whether there was the prospect of a derogation in the national security field**: In ongoing discussions the Commission considers that Recital 21 supports an interpretation that national security issues do not fall within the scope of the proposal. However, as the Minister warns that the Court of Justice (CJEU) may provide a restrictive interpretation of the national security exemption provided at Article 4(2) TEU in the Privacy International/ Bulk Datasets case,[13] the Government would prefer an explicit amendment to the text which has the effect of clarifying that the Directive will not apply to activities outside the scope of Union law, and in relation to national security in particular.

- **The prospect of the UK aligning with the proposal after exit as a reflection on the Government's commitment to not reduce workers' rights protections or because it might have to as part of a future relationship with the EU (e.g. as part of a labour standards chapter in an FTA):** The UK's relationship to EU legislation after exit or after any implementation period as part of a negotiated exit will be a matter for negotiations on the future relationship.

- **Whether state legislatures are to be including in the Article 4 obligations in respect of internal reporting requirements**: The Commission has indicated that state legislatures are intended to be covered by the proposal.

- **If the UK did have to implement the Directive or align with the proposal after exit either voluntarily or to comply with core labour standards in a future trade deal, would it make legal aid available to whistleblowers?** The Government provides a summary of when civil legal aid is currently available but not with specific reference to whistleblowing claims as a distinct category. It says that the scope of civil legal is described in Schedule 1 to the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LASPO). In defining the scope of LASPO, cases involving individual's life, liberty, physical safety and homelessness were prioritised. Legal aid (advice and representation) subject to the statutory means and merits tests, remains available for civil legal services relating to breaches of the Equality Act 2010. Publicly funded advice remains available for Employment Tribunal discrimination claims, and publicly funded advice and representation is available in the Employment Appeal Tribunal. Subject to statutory means and merits tests, exceptional case funding is available where failure to provide legal aid would breach, or risk breaching, the ECHR[14] or EU law. In a post-implementation review of LASPO, the Government will be looking closely at changes to the scope of legal advice and legal representation.

13 Our addition. This is a reference to Case C-623/18 Privacy International v Secretary of State for Foreign and Commonwealth Affairs. This is a preliminary reference from the Investigatory Powers Tribunal on 31 October 2017.

14 European Convention on Human Rights.

2.7 **We thank the Minister for her letter and her Explanatory Memorandum on the Court of Auditors' Opinion. Both have been helpful and have assisted our scrutiny of the proposed Directive. Our staff are also grateful for the informal assistance of the department's officials in keeping them up-to-date with progress on this dossier.**

2.8 **With the UK's exit from the EU imminent on 29 March, our greatest interest rests with the possible pace of the negotiations on this proposal. We are mindful that if there is any chance that the UK might have to implement the proposal by the transposition deadline of 15 May 2021 (in the case of an extended implementation period under a negotiated exit), it would be best for Government to wield its influence on the text before it loses it voting power in the Council after exit. We infer from the Minister's letter that there has not been significant progress in the Council, though we are aware from officials that there might be an attempt to try to agree a partial general approach at the end of January. We therefore ask to be kept as closely informed as possible of any progress in the Council.**[15]

2.9 **We also ask for a further clarification of the Minister's answer to our question about the availability of legal aid for whistleblowers. Does this mean that where a whistleblower's claim does not include discrimination, it is not usually possible for them to obtain legal aid both in terms of advice and representation? If this is the case, will the review of Legal Aid be addressing this issue?**

2.10 **We note the Minister's comments about the Privacy International case concerning the interpretation of the national security exemption provided in Article 4(2) TEU. However, we address this issue in the conclusions to our chapter on the proposed ePrivacy Regulation which also appears in this Report.**

2.11 **Pending further information from the Minister, we retain the proposed Directive under scrutiny. However, we are content to now clear the Communication and the Court of Auditors' Opinion. We draw this chapter and documents to the attention of the Business, Energy and Industrial Strategy Committee.**

Full details of the documents:

(a) Proposal for a Directive of the European Parliament and the Council on the protection of persons reporting on breaches of Union law: (39695), 8713/18 + ADDs 1–3, COM (18) 218; (b) Communication from the Commission to the European Parliament and the Council: *Strengthening whistleblower protection at EU level*: (39696), 8725/18, COM(18) 214; (c) Opinion No 4/2018 (pursuant to Article 325(4) TFEU) concerning the proposal for a Directive of the European Parliament and of the Council: (40122), 13195/18,—.

Summary of the Court of Auditors' Opinion

2.12 In its Opinion, the Court of Auditors:

- welcomes the proposal to counteract the current piecemeal approach at EU level to whistleblower protection and as a complement to internal EU law enforcement;

15 There might be political pressure from the European Parliament for the Council to start trilogue negotiations as soon as possible: the Committee on Legal Affairs of the European Parliament (the JURI Committee) agreed its negotiating mandate for trilogue negotiations, thought this has yet to be agreed in plenary. See the EU-wide protection and support for whistle-blowers Press Release of the EP of 20 November and the Report and Draft Legislative Resolution prepared for plenary.

- considers that the material scope of the proposal is too complex, creating legal uncertainty for whistleblowers as to whether they are protected or not without having to resort to legal advice—this could deter them from reporting breaches;
- notes that the situation is even more unclear where Member States do not voluntarily extend the scope of the proposal to wider areas, as they are encouraged to do in the Commission's Communication;
- observes that the provision of advice and assistance by competent authorities could act as mitigation;
- supports the personal scope of the proposal, including volunteers, updated trainees and job applicants;
- considers that the exemption from establishing internal reporting channels for municipalities of a population lower than 10,000 reduces the protection afforded as the average size of a municipality in the EU is 5,887;
- identifies that there needs to be more emphasis on awareness-raising and staff training as part of the provisions on internal reporting channels;
- concludes that the determining factor for protection for information disclosed should be public interest and that Member States should not be allowed to exclude protection based on subjective factors, such as the motivation of the whistleblower;
- despite noting that exceptions to the requirement to first report breaches internally may create legal uncertainty for whistleblowers, suggests an additional exception to enable them to report externally where they fear a risk to personal safety or legitimate interests;
- welcomes protection for those reporting to EU institutions and also for anonymous whistleblowers;
- supports the inclusion of protection against a broad range of types of retaliation;
- notes that the lack of time limits on protection means that the Member States cannot unilaterally introduce such limits; and
- considers that both transparency and the extent of proposed optional reporting requirements could be improved, perhaps by using EU funding to assist Member States with the costs of data collection and publication—confidence in whistleblowing framework would increase with better transparency.

Previous Committee Reports

Thirty-second Report HC 301–xxxi (2017–19), chapter 1 (20 June 2018).

3 Privacy and Electronic Communications

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Digital, Culture, Media and Sport Committee, the Science and Technology Committee, the Home Affairs Committee, the Justice Committee, the Joint Committee on Human Rights and the Exiting the EU Committee
Document details	Proposed Regulation on the respect for private life and protection of personal data in electronic communications and repealing Directive 2002/58/EC
Legal base	Articles 16 and 114 TFEU; ordinary legislative procedure; QMV
Department	Digital, Culture, Media and Sport
Document Number	(38455), 5358/17 + ADDs 1–6, COM(17) 10

Summary and Committee's conclusions

3.1 This proposed ePrivacy Regulation was published in January 2017 to replace the current 2002 Directive on the privacy and protection of personal data relating to electronic communications (e-comms). E-coms can concern highly sensitive information about an individual. For example, medical conditions, sexual preferences, religious and political views, or commercially sensitive information about a business. Disclosure could result in personal and social harm, even economic loss. Once adopted, the Regulation could have major implications for the way that sectors such as technology, digital advertising and publishing do business and for individual privacy.

3.2 The current Directive covers confidentiality of e-coms provided via traditional communication services (e.g. emails, SMS). But the proposal will update the rules in the Directive to apply to "Over the Top" services, including internet-based messaging such as What's App and Voice over Internet Protocol (e.g. Skype). It will also govern the use of cookies, other tracking technologies as well as email marketing.

3.3 The Commission had planned for the proposed Regulation to come into force at the same time as the GDPR on 25 May 2018. However, the proposal has proved very controversial, resulting in slow progress in negotiations in the Council. The main point of contention concerns when providers of voice, email, video and other messaging services can use the content and metadata of communications in their services. The European Parliament (EP) has taken a restrictive approach in its position on the proposal adopted in October 2017. It considers that processing should only be permitted subject to explicit consent or where "strictly necessary" for specified purposes. Businesses and some Member States want a different approach which aligns more with the GDPR and allows processing on grounds of "legitimate interests". As a compromise the Council has instead

been looking at the inclusion of some additional processing grounds, as evident in the latest progress report[16] which was discussed at the 4 December Telecoms Council. Rules governing cookies and other tracking technologies have also proved contentious.

3.4 An account of the scope and content of the proposed Regulation and the Government's view of it are set out in our previous Reports (listed at the end of this chapter). In our last letter to the Minister for Digital and the Creative Industries (Margot James MP) of 27 June 2018, we questioned what might be implications of delayed negotiations for the UK as an exiting Member State. The Minister now writes in response and to update us on progress in the Council in her letter of 20 December 2018. In summary, the Government:

- participated with other Member States at the 4 December Telecoms Council in the latest progress report discussions, focussing on Articles 6, 8 and 10, the need for clarity on the relationship between the proposed Regulation and the GDPR and what services fall within its scope;
- considers that the Austrian Presidency's text is "going in the right direction", but remains concerned that certain provisions will create legal uncertainty about how the adopted Regulation should apply, could restrict some legitimate and proportionate data processing and inhibit digital innovation; and
- believes that legal bases for processing should follow more closely those of the GDPR, including legitimate reasons for processing data in the case of vital interests.

3.5 The Minister then addresses specific questions we have raised during our previous scrutiny, under the following headings.

Online child abuse

3.6 The Minister first addresses a question raised informally with officials since the date of our last letter because it was of interest to the Science and Technology Committee. This concerns the need to combat online child abuse.[17] She says that:

- The text needs to be clear that processing electronic communications data for the purposes of tackling crimes such as online child sexual exploitation is not restricted.
- The Government considers that only an explicit condition permitting this processing will be effective to tackle this important global issue, which requires "a coordinated multilateral approach". It is doubtful that a recent clarification of Recital 26 in the text that processing e-coms for the "prevention, investigation, detection or prosecution of criminal offences, including dissemination of child pornography" being exempted in national law would be effective because unilateral national action:
  - cannot tackle cross-border/jurisdiction sharing of imagery or victim to offender communications;

16 See Presidency paper (Council document 2017/0003), progress report on the proposal for a Regulation on Privacy and Electronic Communications

17 See the ongoing inquiry of the Science and Technology Committee into the "Impact of social media and screen-use on young people's health".

- will make compliance too difficult for service providers as data could be stored in multiple or unknown jurisdictions; and
- would create uncertainty as to whether exemptions have been enacted in all Member States and so may deter service providers from the scanning they currently do for abusive material.

Encryption

3.7 Responding to our question about the UK's position on the proposed Article 17[18] of the text concerning encryption, the Minister says the article has now been removed. However, it was replicated in Article 40(3)[19] of the recently recast European Electronic Communications Code (EECC). She adds:

> "The scope of Article 40(3) targets network and service operators; Over The Top Providers (OTTs) would not come under its scope as they do not control signal conveyance across the network. In the EECC negotiations there was consensus across the majority of Member States to explicitly remove proposed mandatory encryption requirements".

3.8 She then explains why the Government is not in favour of requirements for "end-to-end" encryption. Despite the benefits of encrypting some e-coms, for example relating to the provision of banking services, encryption is open to abuse by a minority of service providers and users:

- Some providers deliberately design systems so that they cannot see content and so cannot comply with lawful requests for exceptional access.
- Abuse by terrorists and other criminals seriously impedes the ability of UK law enforcement and intelligences agencies who need lawful and exception access to the content of lawfully intercepted messages to ensure public safety. The Government believes that there are potential technical options which could allow such access without undermining the privacy of lawful users.

National security

3.9 Addressing our question about whether national security activities are caught by the proposal, the Minister explains that:

- the proposal was intended to repeal and replace the current 2002 ePrivacy Directive which was considered by the Court of Justice of the European Union (CJEU) in the Watson/Tele 2 judgment (C-698/15 and C-203/15);

18 Proposed Article 17 on" Information about detected security risks" stated "In the case of a particular risk that may compromise the security of networks and electronic communications services, the provider of an electronic communications service shall inform end-users concerning such risk and, where the risk lies outside the scope of the measures to be taken by the service provider, inform end-users of any possible remedies, including an indication of the likely costs involved".

19 Our addition. Article 40 (3) provides that "Member States shall ensure that in the case of a particular and significant threat of a security incident in public electronic communications networks or publicly available electronic communications services, providers of such networks or services shall inform their users potentially affected by such a threat of any possible protective measures or remedies which can be taken by the users. Where appropriate, providers shall also inform their users of the threat itself".

- the Investigatory Powers Tribunal (IPT) has made a preliminary reference in the Privacy International case (C-623/17) to the CJEU on the question of whether the Watson judgment applies to any extent to bulk communications data (BCD) acquired from telecoms operators by the intelligence agencies;
- the Government is defending the position that Watson does not apply in the IPT reference which will be heard in 2019, followed by the Court's judgment about six months later;
- other preliminary references have been made to the CJEU by courts in Belgium (C-520/18) and France (C-511/18 and C-512/18) which are proceeding behind the IPT reference; and
- since April 2017 Member States have been considering the impact of Watson on the proposed Regulation, with the Government intent on ensuring that the text makes clear that national security is outside the scope of Union law.

Applicability of the proposal to the UK

3.10 In our past scrutiny of the proposal, we have also asked about the implications of the Regulation either being adopted during the implementation period or adopted afterwards, assuming the Withdrawal Agreement is ratified. The Minister reiterates that timing of the application of the proposal, which is deferred after adoption for two years in the current text, remains uncertain. She adds that the UK will take an "active diplomatic interest in any measures which will affect the UK during the implementation period as part of our dialogue with the Institutions and Member States".

3.11 If an adopted Regulation is only applicable after the implementation period, the Government would need to assess whether there would be any advantage to aligning UK law with it.

3.12 **We thank the Minister for her letter.**

3.13 **We turn to the timing of any progress in the negotiations. As the Minister's most recent letter now indicates, it remains unclear when, if at all, an adopted proposal would apply to the UK. Based on that information and the current state of play in the Brexit negotiations, the following scenarios are possible:**

- **In a "deal" situation: This scenario assumes that the Withdrawal Agreement has been ratified before 29 March. If the proposal is adopted before the European Parliament elections in May 2019, it is likely that it will apply directly in UK law before the end of the proposed transition period (31.12.20, with the possibility of extension to 31.12.21 or 31.12.22). This allows for the two-year period after adoption before the Regulation is to apply (deferred application). Should the adoption trail into 2020, it is harder to be certain that it will apply to the UK, even with an extended implementation period.**
- **In a "no deal" situation: Even if the text was adopted before exit day (29 March), it would not form part of retained EU law under the EU Withdrawal**

Act 2018 (EUWA, section 3(3)(a))[20] because of deferred application. Instead existing UK regulations which implement the current ePrivacy Directive would be preserved under the Act (the Privacy and Electronic Communications Regulations 2003).

- **Regardless of the exit outcome, the adopted proposal will continue to affect the UK after EU exit. This is because it has extraterritorial effect (like the GDPR), applying to the provision and use of e-coms services to end-users in the EU, even if the business providing the services is located outside the EU. But also, if the UK wishes to obtain an adequacy decision in the future as the basis for the free flow of personal data between the EU and the UK as a third country, then it is likely to align UK data protection law with an adopted Regulation.**

3.14 **We note that the Romanian Presidency's agenda suggests that they may aim for a general approach on the proposal for the June 7 Telecoms Council.[21] However, by that time we anticipate that the UK will have exited the EU with or without a deal. This reinforces our view that the proposal is likely to be adopted at a time when the UK cannot exert any influence over its final shape or content and yet be affected by it.**

3.15 **Given the potential impact this proposal could have in either "deal" or "no deal" scenarios and in the context of a future trading relationship with the EU, we ask the Government to keep us as closely informed as possible of any developments in the negotiations. In the absence of any progress in January and February, at the very least we request a "state of play" update in early March, well before the UK's exit from the EU on 29th.**

3.16 **Turning to the question of the Privacy International reference to the Court of Justice (CJEU), the Minister's view of the timing of the hearing and any future judgment is very helpful. When she next writes, we would appreciate her confirmation that she agrees with our understanding that:**

- **In a "deal" situation: The judgment is likely to be delivered before the end of the proposed implementation period (31.12.20), even if not extended;**
- **In a "no deal" situation: The judgment will not have been delivered before UK exit on 29 March. As the EU Treaties will no longer apply to the UK after that date in the absence of a Withdrawal Agreement, then the preliminary reference will fall. However, it is helpful that the Minister points out that there are preliminary references from French and Belgian national courts raising similar questions to the UK reference, though these too will be delivered after exit day. Although those judgments cannot therefore form part of "retained EU case law" under the EUWA, Section 6(2) of the Act provides that a UK**

20 Section 3(3) EUWA states that " or the purposes of this Act, any direct EU legislation is operative immediately before exit day if (a)in the case of anything which comes into force at a particular time and is stated to apply from a later time, it is in force and applies immediately before exit day". As the Explanatory Notes state:" It is only if the provision is "stated to apply" from a later time (see section 3(3)(a)), and that time falls on or after exit day, that the provision would not fall within the ambit of the section. So, where there is a stated date of application, and this date falls after exit day, the provision is not converted. This means that, provided it is not expressly stated to apply from a date falling on or after exit day, EU legislation which is in force before exit day will be converted even if it has some effect which crystallises after exit day.

21 See also Politico, Pay Wall, 4 January 2019.

court "may have regard to anything done by on or after exit day" by the CJEU. The courts may well avail themselves of this power if it is important for the UK to continue to align with EU data protection law, including ePrivacy legislation for the purposes of obtaining and maintaining an EU-UK data adequacy decision.

3.17 **We look forward to receiving the Minister's next letter. In the meantime, the proposal remains under scrutiny. We draw this chapter and the document to the attention of the Digital, Culture, Media and Sport Committee, the Science and Technology Committee, the Home Affairs Committee, the Justice Committee, the Joint Committee on Human Rights and the Exiting the EU Committee.**

Full details of the documents:

Proposal for a Regulation of the European Parliament and the Council concerning the respect for private life and protection of personal data in electronic communications and repealing Directive 2002/58/EC (Regulation on Privacy and Electronic Communications): (38455), 5358/17 + ADDs 1–6, COM(17) 10.

Previous Committee Reports

Twenty first Report, HC 301–xx (2017–19), chapter 1 (21 March 2018); Thirty first Report, HC 71–xxiv (2016–17), chapter 6 (8 February 2017); also see (38446), 5034/17: Sixteenth Report, HC 301–xiv (2017–18), chapter 3, (28 February 2018).

4 Unfair trading practices in the food supply chain

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted; drawn to the attention of the Environment, Food and Rural Affairs Committee and the Business, Energy and Industrial Strategy Committee
Document details	Proposal for a Directive of the European Parliament and of the Council on unfair trading practices in business-to-business relationships in the food supply chain.
Legal base	Article 43(2) TFEU, QMV, Ordinary legislative procedure
Department	Environment, Food and Rural Affairs
Document Number	(39625), 7809/18 + ADDs 1–3, COM(18) 173

Summary and Committee's conclusions

4.1 With the aim of improving farmers' and other small and medium sized enterprises' (SMEs) position in the food supply chain, the European Commission proposed new legislation on unfair trading practices (UTPs), which are business-to-business practices that deviate from good commercial conduct and are contrary to good faith and fair dealing.

4.2 At our meeting of 12 December 2018, we waived the proposal from scrutiny to allow the Government to signal its support at the 17–18 December 2018 Council meeting. The Committee sought particular clarification on the agreements relating to scope, territorial scope and the transposition period. The Parliamentary Under Secretary of State for Food and Animal Welfare (David Rutley MP) has written[22] to explain the outcome of discussions in December.

4.3 He explains that there was no discussion at the 17–18 December Council meeting but that political agreement was reached between the European Parliament and Council on 19 December. A date for the Council vote is yet to be confirmed, but it is possible that this will take place on 21 or 28 January. The Minister gives no indication of the Government's likely voting intention.

4.4 On the question of scope, the original proposal was to regulate the relationship between SMEs[23] and buyers ("large" companies). The European Parliament had pushed for it to be extended to cover any actor involved in the agri-food supply chain, regardless of size and role, meaning that it could apply to the relationship between two "large" companies. As a compromise, the Minister confirms that the institutions agreed a "dynamic" approach, whereby any micro, small, medium or mid-range supplier would be protected by the Directive in any of their dealings with a larger supplier as well as their dealings with

22 Letter from David Rutley MP to Sir William Cash dated 8 January 2019.

23 Defined as a business employing fewer than 250 persons and with an annual turnover not exceeding €50 million (£44.5 million) and/or an annual balance sheet not exceeding €43 million (£38.3 million).

"large" buyers. The final threshold for the "mid-range" business category has been agreed at €350 million (£315 million) annual turnover. The various sub-categories below that are divided into businesses with respective turnovers of: less than €2 million (£1.8 million); between €2–10 million (£1.8–9 million); €10–50 million (£9–45 million); €50–150 million (£45–135 million); and €150–350 million (£135–315 million).

4.5 The Government considers the agreed approach on scope to be a sensible one and the upper limit to be acceptable. Other like-minded Member States also consider this outcome to be a positive compromise.

4.6 As regards the territorial scope of the Directive, it was agreed to amend the text so that the Directive would apply also to relationships where a buyer is established outside of the EU and trades with a seller established inside the EU. Exactly how third country enforcement is expected to operate is still unclear, says the Minister, and the timeline for provision of further clarification from the Commission is uncertain. The UK will need to wait until further detail is available before any detailed planning can be undertaken.

4.7 The extension in the territorial scope of the Directive does create long-term implications for the UK, notes the Minister. The UK's 12 largest retailers are already regulated by the Groceries Supply Code of Practice in their dealings with EU-based suppliers, so the applicability of this Directive to buyers beyond the borders of the EU introduces an additional (and different) set of laws.

4.8 Concerning the transposition period, the compromise text retained the deadlines of 24 months for transposition and publication of laws and 30 months for those laws to take legal effect. If the current timetable for the general Brexit Implementation Period remains as planned, this will mean the UK will not be required to implement this Directive under the same obligations as EU Member States.

4.9 The Minister acknowledges that, even as a third country, there may nevertheless be some requirement for the UK to undertake enforcement activities. He states that the new statutory codes of practice, to be introduced under powers in the Agriculture Bill, will also require an enforcement regime and body. Decisions on whether this is an existing body (such as the Rural Payments Agency) or a new body will be influenced by the scale and nature of the statutory codes to be introduced, which will be subject to consultation. It is likely that the same body would also undertake enforcement of any requirements resulting from the Directive on Unfair Trading Practices. The Minister assures the Committee that the Government will conduct a full assessment of the requirements and costs of enforcement should any result from the Directive. This includes consideration of the most appropriate enforcement body.

4.10 **We note with some concern the continued uncertainties about the impact of this Directive on the UK and the potential enforcement challenges. This concern is more acute than previously now that the institutions have agreed to extend the territorial scope of the Directive to include relationships between EU suppliers and third country (including the UK post-Brexit) buyers.**

4.11 **The Minister notes that clarification is awaited from the Commission on how third country enforcement is expected to operate, but that the timeline for provision of this clarification from the Commission is uncertain. Until such time as the information**

has been received, the Minister explains, no detailed planning can be undertaken. We expect the UK—working with other affected third countries—to take a robust position, demanding clarity on what is expected.

4.12 **The Minister refers to the provisions in the Agriculture Bill on new statutory codes of practice promoting fair contractual dealing by the first purchasers of agricultural products. We note that a "producer" for the purpose of the Bill can be outside the UK. To that extent, as he says, the enforcement regime and body established by the Bill may well provide the basis to implement the requirements of the Directive. That said, the Directive goes much further in its scope than the Bill. In particular, it regulates relationships throughout the food supply chain.**

4.13 **On Brexit-related matters, we note the agreed extended transposition period, which means that the UK would only be required to implement the Directive in a manner equivalent to that of an EU Member State if the post-Brexit implementation period were extended beyond autumn 2021. Under the terms of the proposed withdrawal agreement, the implementation period may be extended until 31 December 2022. At this stage, therefore, it is impossible to know what the transposition requirements on the UK will be—uncertainty which may endure until mid-2020. We therefore caution the Minister against making any assumptions in that regard and urge him to proceed on the basis that the UK may be required to transpose the Directive.**

4.14 **In conclusion, it appears that—under all scenarios—the UK will be obliged to make provision for this legislation. The intensity of that obligation is dependent on the nature of the UK's continued obligations under EU law which may be unclear for some time.**

4.15 **In the light of the continuing uncertainties over the impact of this legislation on the UK, we are unable to clear the document from scrutiny. We waive the scrutiny reserve, however, in order that the Government may support the Directive should such support be considered to be in the national interest. We invite the Minister to report back to us on the stance taken by the UK and on progress in seeking clarification about third country enforcement requirements. We also invite the Minister to set out the UK's intended strategy towards implementation (both full transposition and implementation of third country requirements), noting the ongoing uncertainties.**

4.16 **We draw this chapter to the attention of both the Environment, Food and Rural Affairs Committee and the Business, Energy and Industrial Strategy Committee.**

Full details of the documents:

Proposal for a Directive of the European Parliament and of the Council on unfair trading practices in business-to-business relationships in the food supply chain: (39625), 7809/18 + ADDs 1–3, COM(18) 173.

Previous Committee Reports

Forty-eighth Report HC 301–xlvii (2017–19), chapter 3 (12 December 2018); Thirty-ninth Report HC 301–xxxviii (2017–19), chapter 3 (10 October 2018); Thirty-third Report HC 301–xxxii (2017–19), chapter 4 (27 June 2018); Twenty-eighth Report HC 301–xxvii (2017–19), chapter 1 (16 May 2018).

5 European System of Financial Supervision

Committee's assessment	Politically important
Committee's decision	(a)—(c) Not cleared from scrutiny; further information requested; drawn to the attention of the Treasury Committee; (d) Cleared from scrutiny
Document details	(a) Proposal for a Regulation on the European Supervisory Authorities; (b) Proposal for a Directive amending Directive 2014/65/EU on markets in financial instruments (MiFID II) and Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II); (c) Amendment of the proposal for a Regulation as regards the authorisation of CCPs; (d) Amended proposal for a Regulation amending Regulation 1093/2013 establishing the European Banking Authority and Directive 2015/849 on the prevention of the use of the financial system for the purposes of money-laundering or terrorist financing
Legal base	(a)—(d): Article 114 TFEU, ordinary legislative procedure; QMV
Department	Treasury
Document Numbers	(a) (39052), 12420/17 + ADD1–2, COM(2017) 536; (b) (39053), 12422/17, COM(2017) 537; (c) (39056), 12431/17, COM(2017) 539; (d) (40057), 12111/18, COM(2018) 646

Summary and Committee's conclusions

5.1 Following the financial crisis, the EU adopted numerous pieces of legislation to help prevent another destabilising run on European banks, such as the fourth Capital Requirements Directive and the Bank Resolution & Recovery Directive. It also passed three Regulations to establish the European Supervisory Authorities (ESAs) to help oversee financial sector: the European Banking Authority (EBA), the Securities & Markets Authority (ESMA) and the Insurance & Occupational Pensions Authority (EIOPA).

5.2 Known collectively as the European System of Financial Supervision or ESFS,[24] these Authorities have far fewer direct supervisory responsibilities than national regulators like the Bank of England, but assist the European Commission in drafting technical regulations and can—as a last resort—exercise powers to override national supervisors if it believes they are not properly applying EU legislation. Even though part of the ESA's role is to monitor the performance of the EU's national financial authorities, by law their governance structures are controlled by those same regulators.

24 The ESFS also compromises the European Systemic Risk Board (ESRB), which is not a regulatory body but monitors the build-up of macro-prudential risks in the financial system (e.g. housing bubbles).

5.3 In September 2017, the European Commission proposed wide-ranging changes to the statutory framework that governs the work and powers of the ESAs, referred to as the ESFS review. Its proposals, which can be amended and must be approved by the European Parliament and a qualified majority of EU Member States to take effect, would alter the ESA's governance structures to make them more assertive vis-à-vis the Member States' domestic financial regulators; giving them a larger role in the supervision of non-EU firms providing financial services to EU-based customers; and expand the powers of ESMA to give it more supervisory responsibilities over European capital markets which are currently exercised at national level.

5.4 In September 2018, the ESFS review was supplemented by a further proposal to give the European Banking Authority more powers to tackle money laundering following a series of banking scandals in different EU countries.[25] This would give the EBA the ability to instruct national regulators to carry out investigations where it suspects anti-money laundering laws have been breached, and establish a centralised data hub for weaknesses in specific banks' AML practices.

5.5 The European Scrutiny Committee previously set out the detail of the proposed reforms, including the Government's negotiating position and the potential implications for the UK in the context of its withdrawal from the EU, in its Reports of 13 December 2017 and 28 February 2018, and published a further report on the new amendments relating to money laundering on 24 October 2018.

5.6 In our Reports, we noted in particular that many of the Commission's proposals were driven by the UK's decision to withdraw from the EU. This had led to concerns that British financial services providers could seek to preserve their current market share after Brexit without being subject to EU law, by establishing 'letter box' entities in those Member States with the perceived 'easiest' regulatory approach. To counteract this perceived risk, the Commission had drafted the ESA reforms to give the ESAs more centralised oversight of financial markets and close any potential 'loopholes' for access by non-EU firms created by divergent national application of EU legislation.

5.7 The ESFS review could therefore create new restrictions on how the British financial services industry accesses European markets after EU exit. Moreover, the legislation affect both the industry and its regulators in the UK—the Bank of England and the Financial Conduct Authority—during the proposed post-Brexit transitional period, when EU law would continue to apply as if the UK were still a Member State (but, crucially, without representation or voting rights for UK Government or regulators in EU institutions and bodies like the ESAs). Given the contentious proposals to strip domestic supervisors of certain regulatory responsibilities and transfer them to the ESAS, it seemed likely negotiations would be protracted.

5.8 On 9 January 2019, the Economic Secretary to the Treasury (John Glen MP) provided a detailed update on the state of play in the negotiations on the reforms between the EU's Member States in the Council of Ministers.

5.9 He explained that Member States had fast-tracked their discussions on the September 2018 AML proposals, given the perceived urgency in addressing gaps in enforcement of

25 In parallel, the Commission also proposed changes to the functioning of the European Systemic Risk Board. We cleared this proposal from scrutiny on 21 February 2018.

the EU's existing Anti-Money Laundering Directive. EU Finance Ministers are therefore expected to adopt the Council's common position on those elements of the proposal when they meet in Brussels on 22 January 2019. Explaining that Member States have agreed number of changes to legal text in line with the UK's objectives, the Minister asked for scrutiny clearance to enable the Government support the compromise text.[26] The changes sought still need to be agreed with the European Parliament, which adopted its position on 10 January 2019.

5.10 Negotiations between the Member States on the remaining aspects of the ESFS review—including the governance of the ESAs, their supervision of non-EU firms and the powers of ESMA—are on-going. The Minister noted that national Governments are seeking to significantly water down the Commission's proposals, by preserving the dominant role of the national regulators in the running of the ESAs and limiting their role in the oversight of non-EU–British firms active within the Single Market. After the Member States agree on their 'general approach', they will need to negotiate with the European Parliament on the final shape of ESA reforms. The Minister has highlighted in particular that Parliament wants to extend EU-level oversight of the settlement infrastructure for derivatives transactions, which the Treasury strongly opposes. (It also remains unclear whether the Parliament is willing to discuss the AML provisions referred to above separately from the overall package of reforms, in which case their entry into force could be delayed.)

Our conclusions

5.11 **We thank the Minister for the information on the negotiations for the reform of the EU's financial Supervisory Authorities provided in his letter of 9 January 2019.**

5.12 **As we have noted in previous Reports on the reform of the European System of Financial Supervision, we remain concerned about the implications of this legislative process for the UK despite its scheduled withdrawal from the European Union in March this year. During the proposed post-Brexit transitional period, which could last until 31 December 2022 under the draft Withdrawal Agreement, EU financial services law would remain applicable in the UK as if it were still a Member State. However, from 30 March the Treasury would no longer have a right to participate in the legislative deliberations in Brussels; the Government would no longer have a vote in the Council of Ministers; and the Bank of England and Financial Conduct Authority would be shut out from the governance bodies of the ESAs.**

5.13 **Any new powers the ESAs gain while the transition is in force would extend to the UK. The reforms as originally proposed would be particularly problematic for the UK if they took effect during the transitional period, because they could give the Authorities more powers over national regulators and individual firms while the UK—uniquely among all countries in the Single Market[27]—would not be represented on their Boards of Supervisors or have a say over the independent membership of the proposed Executive Boards. In particular, the European authorities could potentially**

26 See paragraphs 49 to 54 of this chapter for more information on the changes sought by the Member States in relation to the anti-money laundering proposals.

27 Norway, Iceland and Liechtenstein have implemented the original EFSF Regulations as part of the EEA Agreement, but the direct and indirect supervisory functions of the ESAs are performed by the EFTA Surveillance Authority for those countries. The EFTA Surveillance Authority and the domestic regulators of the EFTA-EEA countries also have the right to participate in ESA meetings as observers.

instruct UK regulators to carry out investigations into specific firms, or take over some of the supervisory responsibilities for certain financial products and market infrastructure.

5.14 **Our recent observations about the relevance of other on-going EU negotiations on financial services legislation to the future UK-EU trade arrangement also apply to the ESFS review. Whether or not the Withdrawal Agreement is ratified and the transitional period takes effect, the Government has accepted that any preferential access for UK firms to the EU's market for financial services will be based on EU law. In particular, the focus will be on the 'equivalence' mechanism that allows the European Commission to declare the UK's regulatory approach in a specific financial sector as equivalent to the EU's, in some cases providing enhanced market access rights. The ESFS review could result in a greater role for the ESAs in preparing and monitoring equivalence decisions (although they would have no formal power to rescind or modify such arrangements).[28] It also foresees more ESA oversight of the application of EU law related to delegation and outsourcing—both ways for non-EU firms to carry out financial services for EU-based customers. This draft legislation could therefore have a significant impact on the UK's access to the Single Market for financial services after Brexit.**

5.15 **We reiterate in this respect that, without the interim period provided by the transition under the Withdrawal Agreement, market access rights for British financial services firms will be severely disrupted on 30 March 2019. In the context of the broader political acrimony of a 'no deal' scenario, it is unlikely the European Commission would begin equivalence assessments until the 'separation issues' contained in the Agreement—notably as regards Ireland, citizens' rights and the settlement of the UK's financial commitments vis-à-vis the EU—were resolved.**

5.16 **It is noteworthy in this respect that the recent Financial Services (Implementation of Legislation) Bill would give the Treasury the power to implement a number of pending EU financial services proposals, including the ESFS review, into UK law by means of Statutory Instrument in the event that the Withdrawal Agreement is not ratified (and EU law ceases to apply in the UK in March 2019).[29] The need for domestic implementation of the ESA reforms in a 'no deal' scenario seems counterintuitive, given that the proposals relate to the powers of EU bodies that, by definition, would have no jurisdiction over the UK in such an eventuality. We understand the Government included the proposal in the scope of the Bill to make it easier to implement changes to allow financial markets to continue functioning as smoothly as possible, for example to allow the Financial Conduct Authority to share information with the ESAs in return for EU investment firms 'delegating' their activities to UK-based entities after Brexit.**

5.17 **As requested by the Minister, we are content to now grant the Government a scrutiny waiver in relation to the anti-money laundering elements of the proposal, given the relatively straightforward nature of those proposals. However, we retain the overarching proposal to amend the ESA Regulations under scrutiny pending further information on developments in the legislative process.**

28 There are also various other pending proposals which are likely to affect the parameters for equivalence assessments of the UK following Brexit, including the investment firm review and proposals to amend the Market Infrastructure Regulation.

29 See the Financial Services (Implementation of Legislation) Bill.

5.18 **As regards the powers being sought by the Government to implement 'in flight' EU proposals—including the ESFS review—by Statutory Instrument, we note that the Financial Services Bill would give the Treasury the power to implement EU legislation which is likely to still be in draft form when the Bill receives Royal Assent. We would urge Parliament to carefully consider the scope of the powers given to the Government to implement *new* EU financial services legislation by regulations after EU exit, when it is no longer under a legal obligation to do so, and whether primary legislation would be more appropriate.**

5.19 **We draw these developments to the attention of the Treasury Committee, given their interest in the implications of Brexit for the UK financial services industry and the potential substance of any future UK-EU arrangement in that area.**

Full details of the documents:

(a) Proposal for a Regulation on the European Supervisory Authorities: (39052), 12420/17 + ADD1–2, COM(2017) 536; (b) Proposal for a Directive amending Directive 2014/65/EU on markets in financial instruments (MiFID II) and Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II): (39053), 12422/17, COM(2017) 537; (c) Amendment of the proposal for a Regulation as regards the authorisation of CCPs: (39056), 12431/17, COM(2017) 539; (d) Amended proposal for a Regulation amending Regulation 1093/2013 establishing the European Banking Authority and Directive 2015/849 on the prevention of the use of the financial system for the purposes of money-laundering or terrorist financing: (40057), 12111/18, COM(2018) 646.

Background

5.20 After the financial crisis, the EU Member States made major changes to the supervision of their financial markets. Notably, they created the European System of Financial Supervision (ESFS), which is built on a two-pillar system of macro-prudential and micro-prudential supervision. Collectively, these efforts were aimed at preventing another shock to the financial system. To underpin this work, many new regulatory initiatives were introduced at EU-level in recent years, including the Capital Requirements Regulation for banks, Solvency II for insurers and the second Markets in Financial Instruments Directive (MiFID II) for investment firms.

5.21 At Member State level, the relevant domestic financial authorities, like the Bank of England and the Prudential Regulation Authority in the UK, implement the ESFS. These are referred to as 'national competent authorities' or NCAs in the legislation. In most cases, national regulators retain direct supervisory oversight of financial institutions in their jurisdiction, even where their powers and responsibilities are set out in EU law. At EU-level, the macro-economic oversight is provided by the European Systemic Risk Board (ESRB), which issues advice and reports on overall risks to financial stability in the European Union.

5.22 Meanwhile, the major innovation of the ESFS was the creation of three "European Supervisory Authorities" (or ESAs), which became operational in 2011. They have sector- and firm-specific responsibilities covering the banking, insurance and securities

markets respectively. The role of the ESAs—the European Banking Authority (EBA),[30] the European Insurance & Occupational Pensions Authority (EIOPA) and the European Securities & Markets Authority (ESMA)—is to oversee the uniform implementation of the EU's post-crisis regulation of the financial services industry. They have four broad sets of powers under EU law:

- drafting **Technical Standards** to give full effect to EU financial regulation within their remit. These ESA standards are not in themselves legally binding, but must be translated into Implementing and Delegated Acts—in essence, EU statutory instruments—by the European Commission;[31]
- issuing **non-binding guidelines, recommendations and opinions** to both financial services providers and domestic regulators;
- fostering **regulatory and supervisory convergence** throughout the EU through dispute settlement powers (in cases of disagreements between NCAs in different Member States), investigating potential breach of EU law by domestic regulators, and conducting peer reviews. The aim of these powers is to ensure that the national competent authorities across the EU apply European financial regulation in a "consistent and proper" way;[32] and
- exercising **direct supervisory powers**, notably authorisation and ongoing supervision of specific types of financial firms. At present, such powers are only available to ESMA in respect of credit rating agencies (CRAs)[33] and trade repositories (TRs) for over-the-counter derivatives.[34]

5.23 The decision-making powers of each ESA—for example to issue draft technical standards or declare a national regulator in breach of EU law—rest with its respective Board of Supervisors (BoS), on which only the Member States' national competent authorities have a vote (with qualified majority voting rules for the most important decisions).[35] Although day-to-day management of the ESAs is handled by Management Boards, they are also dominated by a sub-set of national supervisors,[36] and they have few direct responsibilities. In practice therefore, the UK's regulators—in particular the Prudential Regulation Authority and Financial Conduct Authority—have had a significant influence over the work of the ESAs, in particular by being closely involved in the drafting and approving of technical standards in a range of financial sectors that subsequently become European law.

30 The EBA has been based in London since its establishment, but will move to Paris from 29 March 2019 due to the UK's withdrawal from the EU.

31 Regulatory Technical Standards proposed by the ESAs take the form of Delegated Acts, which can be vetoed by either the European Parliament or the Member States in the Council by qualified majority. Implementing Technical Standards take the form of Implementing Acts which must be approved by a qualified majority of Member States.

32 European Commission Impact Assessment SWD(17) 308, p. 24.

33 See Regulation (EU) No 462/2013 on credit rating agencies.

34 See Regulation (EU) No 648/2012 on the European Markets Infrastructure (EMIR).

35 The UK is currently represented by the Prudential Regulation Authority (PRA) of the Bank of England (EBA), the PRA and the Pensions Regulator (EIOPA) and the Financial Conduct Authority (ESMA). Votes on the Board of Supervisors are weighted for the most important decisions (e.g. the adoption of draft technical standards). The EFTA-EEA countries Norway, Iceland and Liechtenstein are entitled to attend Board meetings as observers.

36 Members of the Management Boards are elected by and from the domestic regulators represented on the Board of Supervisors. The UK is not currently represented on any of the three Management Boards.

Review of the European System of Financial Supervision

5.24 The European Commission carried out a comprehensive evaluation of the ESFS from 2014, which highlighted concerns about the governance and effectiveness of the ESAs in using their existing powers to foster regulatory convergence, given their functioning is effectively controlled by the national regulators whom they are meant to monitor and, if necessary, censure. It also concluded that other political developments—including the UK's decision to withdraw from the EU, the increased cross-border flows of capital as part of the Capital Markets Union, and the further integration of the European banking sector—necessitated a rethink of the Supervisory Authorities' remit and powers.

5.25 In the light of these developments, the Commission in September 2017 tabled a package of proposals to amend the 2010 Regulations that established the Supervisory Authorities.[37] As we described in some detail in our previous Reports of 13 December 2017 and 28 February 2018, these reforms would expand the powers of the ESAs, in particular for the European Securities & Markets Authority (ESMA); alter their governance structures to make the ESAs more assertive vis-à-vis the Member States' NCAs; and impose a new industry levy to fund their work and make them independent of the EU budget.[38] In September 2018, the Commission added a further proposal to expand the powers of the European Banking Authority to tackle money laundering following the various banking scandals involving EU financial institutions.

5.26 We have described the individual elements of the proposals in more detail in paragraphs 31 to 56 below, in light of the most recent information received from the Treasury about the Member States' negotiations on the reforms.

Previous Parliamentary scrutiny of the proposals

5.27 The European Scrutiny Committee considered the proposals at the early stages of the legislative process in December 2017 and February 2018, on the basis of an Explanatory Memorandum submitted by the Treasury in October 2017. We concluded that the proposed legislation was of major political importance: it would substantially alter the European System of Financial Supervision as it was created seven years ago, and expand the powers of the Supervisory Authorities.

5.28 In particular, it was abundantly clear from the explanatory notes accompanying the European Commission's original proposals that its ESA reform efforts were driven, at least in part, by the UK's withdrawal from the EU. The Commission expressed concerns that UK financial services firms might try to establish 'letter-box' entities in the EU, servicing European clients from the UK without substantially moving their operations to an organisation within the Single Market as required by EU law. This, the Commission argued, increased the need for stronger ESAs so they could ensure that all Member State regulators apply the EU's regulatory requirements for "third country" firms in the same way.

37 In parallel, the Commission also proposed changes to the functioning of the European Systemic Risk Board. We cleared this proposal from scrutiny on 21 February 2018.

38 The ESFS review as tabled by the Commission consisted of the core proposal amending the ESA Regulations, as well as two supplementary proposals amending EU legislation on investment services & insurance and securities to ensure consistency. In addition, in September 2018 the Commission added a further supplementary proposal related to the EBA's anti-money laundering powers (see paragraphs 49 to 54 of this chapter).

5.29 Moreover, during the proposed post-Brexit transitional period, the ESAs would retain their powers in relation to the UK financial services industry and regulators (even though the Bank of England and Financial Conduct Authority would lose their voting rights and representation within the Boards of Supervisors, the *only* national regulators within the Single Market to be deprived of representation in this way).[39] Even after transition, the Government wants to sustain the substantial export of financial services to the EU, which will inevitably require cooperation with the ESAs—in particular if they take on an increased role in the process of determining whether the UK is 'equivalent' with the EU as the basis for preferential market access rights.

5.30 As such, the impact of the proposals on the UK financial services industry could be significant for many years after the UK ceases to be an EU Member State. We were disappointed therefore that the Treasury's Memorandum did not reflect on the implications of the proposals for the UK financial services industry in the context of Brexit, or offer any substantive assessment of the proposed reforms in general.

Developments since February 2018

5.31 On 9 January 2019, the Economic Secretary to the Treasury (John Glen MP) wrote to the Committee with an update on the state of play in the negotiations on the ESFS review, including the more recent proposal relating to money laundering.

Governance of the ESAs

5.32 With respect to the governance of the ESAs—that is to say, who controls their decision-making processes—the Commission proposed to reduce the dominance of the domestic regulators on the management structures of the Supervisory Authorities. It noted, for example, that none of the three ESAs have ever declared a breach of EU law by a national supervisory authority (since those authorities themselves have a vote on whether to declare such a breach).[40]

5.33 The Commission therefore argued that the effectiveness of the ESA's independent monitoring of individual Member States should be improved. This would ensure it could effectively monitor whether domestic regulators apply EU law uniformly, and take action if not. One of the main aims would be to ensure that non-EU financial services firms—especially British ones—would not be able to find a Member State with a 'light touch' regime allowing them to establish 'letterbox entities' within the EU while carrying out their actual operations back in their home country.[41]

5.34 To achieve this, the Commission proposed to replace the ESA's Management Boards—which have few powers, and are controlled by a sub-set of domestic regulators—with new Executive Boards with more powers. These Boards would have full-time independent

39 Norway, Iceland and Liechtenstein have implemented the original EFSF Regulations as part of the EEA Agreement, but the direct and indirect supervisory functions of the ESAs are performed by the EFTA Surveillance Authority for those countries. The EFTA Surveillance Authority and the domestic regulators of the EFTA-EEA countries also have the right to participate in ESA meetings as observers.

40 The Commission also argued that the restriction of voting rights on the Boards to national authorities only "implies that an inherent EU perspective is both numerically underrepresented and carries no weight in terms of votes".

41 See Commission Impact Assessment SWD(17) 308, p. 96. All three ESAs have also warned of the risk of UK companies establishing "letter box" companies within the EU after Brexit. See the warnings from the EBA, EIOPA and ESMA.

members,[42] and take over some key decisions from the ESA's Board of Supervisors, such as determining whether a national regulator had failed to correctly apply EU financial services legislation.[43] In addition, this new body would set EU-wide priorities for supervision in the form of a "Strategic Supervisory Plan" (SSP), against which all competent authorities would be assessed.[44] It would also conduct independent reviews of the national implementation of EU law with less direct involvement of the staff of the domestic regulators themselves.[45]

5.35 In his letter of 9 January 2019, the Minister explained that "Member States remain divided" about reforms of the ESA's governance structures. In late 2018, a new proposal was put forward by Austria which would reject most of the Commission's suggestions in this area and instead change the composition of the Management Board to five members elected from the Board of Supervisors (BoS), but with the addition of "two full-time external and independent members with clearly defined policy and managerial tasks". (The other option under consideration within the Council is to simply retain the status quo and make no changes to the Authorities' governance at all). The Minister notes that the UK—given its scheduled withdrawal from the EU—has "remained relatively quiet on this debate" but voiced its support "for retaining the status quo". Under either option, it does not appear there be a significant dilution of the control exercised by the NCAs over the work of the ESA's.

New powers for the ESAs

5.36 The second element of the Commission's ESA reform proposals concerned the specific powers exercised by the Authorities. In particular, it suggested that the ESAs should play a larger role in supervising access of non-EU firms active on the EU market (whether under a so-called forma 'equivalence' regimes, or by means of outsourcing and delegation of tasks by EU companies to 'third country' entities), and give new direct supervisory responsibilities to ESMA in relation to investment prospectuses, market data, financial benchmarks and certain types of investment funds.

Equivalence, outsourcing and delegation

5.37 As noted, the Commission proposals contain several suggested changes to the way in non-EU financial services firms operating within the EU are supervised. This was driven, to a large extent, by Brexit amid concerns that the British financial industry could try to maintain current levels of activity within the EU without being subject to European law (for example through 'letter box' entities).

42 The members of the Executive Boards would be appointed by the Council after approval of a shortlist by the European Parliament.

43 For Central Counterparties (CCPs), organisations that act to absorb the risk of a party defaulting in a derivatives trade, the Commission put forward a supplementary proposal that indirect supervisory powers—like a 'breach of Union law' procedure—would lie with the 'Executive Session', a CCP-specific body within ESMA (rather than with the Board of Supervisors or the Executive Board).

44 The Minister's latest letter does not indicate whether the Member States have supported or rejected the proposals in relation to Strategic Supervisory Plans, although the UK had already said it was opposed to the idea.

45 Under the Commission proposal, in situations where ESMA exercises direct supervisory powers (for example in relation to the authorisation of credit rating agencies or trade repositories), its Board of Supervisors would only be able to reject draft decisions by the Executive Board by a 'super-majority'.

5.38 First, the proposals reinforce the role of the Supervisory Authorities in the equivalence process. Under certain pieces of EU financial legislation, the European Commission can make a legal determination that a non-EU country's regulatory regime for specific financial products or services is equivalent to the EU's. Such an 'equivalence decision' confers certain benefits on companies based in the country in question, which can range from prudential and regulatory reliefs for EU firms that deal with them to full 'passporting' rights allowing non-EU firms to operate throughout the Single Market. The precise advantages of equivalence therefore vary sector-by-sector.

5.39 As part of the ESFS review, the Commission had proposed to formalise the role of the ESAs in providing advice when preparing equivalence decisions, and to entrust them with the responsibility for monitoring on an on-going basis the regulatory and supervisory developments in third countries for which equivalence decisions are already in place. They would submit a confidential report on their findings to the Commission on an annual basis, which would use this information to decide whether to maintain, modify or withdraw equivalence. The ESAs would also have to agree administrative arrangements with the third country supervisor allowing for exchange of information, and permitting the ESA to perform on-site inspections in their territory.

5.40 Secondly, again in response to the UK's withdrawal from the EU, each Supervisory Authority would gain new powers to obtain data from national regulators about their supervision of 'third country' firms. This would include information on each EU country's authorisation or registration of financial firms whose business plan "entails the outsourcing or delegation of a material part of its activities […] into third countries", meaning they would "benefit from the EU passport while essentially performing substantial activities or functions outside the Union". Information gathered in this way would then enable the ESAs to assess whether the Member States are effectively supervising outsourcing, delegation and risk transfer arrangements in third countries.

5.41 The Minister's update of 9 January 2019 notes that, with respect to supervision of non-EU countries within the Single Market, the Member States' negotiations focused on the ESAs role in the on-going monitoring of 'equivalence' once granted by the European Commission. They have accepted a larger role for the Supervisory Authorities in monitoring continued compliance with the conditions for equivalence by 'third countries', focussed on "implications for financial stability; market integrity; investor protection; the functioning of the internal market; relevant regulatory and supervisory developments and practices; and market developments relevant to a risk-based equivalence assessment".[46]

5.42 As regards the ESA's monitoring of outsourced and delegated activities by EU-based firms to non-EU (e.g. UK) entities, the Minister notes that the Member States want to delete the power for the EBA, ESMA and EIOPA to "approve or challenge" individual firms plans for outsourcing, delegation and risk transfer arrangements to third countries. Instead, the Austrian Presidency of the Council suggested the creation of 'coordination groups' to promote supervisory convergence in these areas.

46 However, under amendments being considered by the Council, the ESAs would only produce one overarching annual report to cover their monitoring of all equivalence decisions within their remit, rather than on a country-by-country basis. Moreover, the requirement for national authorities to share their draft administrative arrangements with non-EU supervisory authorities would be removed; instead the ESAs would develop model administrative arrangements that national regulators "will be encouraged, but not required, to follow".

5.43 Given the importance of the EU's approach to the treatment of non-EU firms on its market for financial services for the UK—not least by means of 'equivalence' decisions, this is a key area of the negotiations for the Treasury. In his letter, the Economic Secretary says the UK "will continue to push for greater transparency in this process", specifically by asking for the ESAs annual report on equivalence "to be shared with the Council and European Parliament".

New supervisory powers for ESMA

5.44 As part of the ESFS review, the European Commission also proposed a substantial expansion in the direct supervisory responsibilities of the European Securities & Markets Authority (ESMA). This is the Paris-based EU Supervisory Authority that oversees EU legislation that affects capital markets, notably the second Markets in Financial Instruments Directive; the Benchmarks Regulation; the Prospectus Regulation; and the European Market Infrastructure Regulation (EMIR).

5.45 A common thread that runs through these laws is that they typically create a framework for market participants to operate across the Single Market in the relevant sector (the so-called 'passport'), but have kept supervisory responsibility for market participants at Member State level. A key principle in this context is that the regulator of the home Member State of the firm typically has primary supervisory responsibility, even in respect of activities carried out elsewhere in the EU.[47] When making its ESA reform proposals, the Commission expressed concerns that this system has allowed for divergence in the way EU capital markets laws are being applied by different Member States, with gaps appearing especially in the enforcement of investor and consumer protection rules for activities carried out in another EU country than the home Member State.[48] This creates the risk of firms seeking to establish themselves in the EU country with the perceived least-intrusive supervisory approach, from where activities can be undertaken throughout the EU with limited powers for other NCAs to intervene.

5.46 In light of these developments, the Commission proposed to increase the direct supervisory responsibilities of ESMA to ensure greater consistency in the application of EU law irrespective of the Member State in which a financial services firm is based.[49] In particular, it wanted to make the Authority responsible for authorisation and supervision of:

- market data reporting services providers (DRSPs) under the second Markets in Financial Services Directive;[50]

47 The exceptions are EU-based credit rating agencies and trade repositories for derivatives contracts, which are supervised directly by ESMA for all activities within the EU.

48 In particular, the Commission said that "there are concerns that home [competent authorities] might be less strict in enforcing rules, in particular on consumer and investor protection, in relation to activities carried out in Member States other than the home Member State. This might be due to constraints in (financial) resources or (language) skills or due to a lack of incentive or simply due to consumers or investors having problems to identify and to address the competent authority in another Member State."

49 The Five Presidents' Report on Completing Europe's Economic and Monetary Union of June 2015 set the objective of, ultmately, a single capital-markets supervisor for the entire EU.

50 The Commission argued that data reporting services are "an inherently Union-wide business", and that regulatory and supervisory problems in this sector "cannot be addressed by Member State action alone". In addition, it wanted to consolidate the collection of trading data within ESMA, replacing the current system where each NCA must gather data from multiple operators throughout the EU, which is then transmitted to ESMA for compilation and analysis, and then sent back to the competent authorities to be used as part of their supervisory responsibilities.

- critical and non-EU financial benchmarks under the Benchmarks Regulation (removing the possibility for national regulators to approve the use of a 'third country' benchmark without the need for an EU-wide equivalence decision);[51]
- investor prospectuses[52] for companies active in the fields of property, scientific research, minerals and shipping, and those issued by non-EU firms, making ESMA responsible for pre-publication scrutiny and approval of such documents under the Prospectus Regulation;[53] and
- European Venture Capital Funds (EuVECA),[54] Social Entrepreneurship Funds (EuSEF) and Long-term Investment Funds (ELTIF), which are all specific types of investment funds whose legal framework is set out in EU Regulations.

5.47 The Minister's latest update on the negotiations explained that most of these proposals have been rejected or watered down by the Member States. They are seeking to remove the amendments relating to prospectuses altogether, while limiting ESMA's direct supervisory responsibilities in relation to critical benchmarks (leaving domestic discretion on recognition of non-EU benchmarks intact) and data reporting service providers.

5.48 However, the European Parliament is pursuing an amendment to the ESA proposals to give ESMA "direct supervision of third country Central Security Depositaries and Trading Venues" under the EU's CSD Regulation.[55] This governs the market infrastructure that allows for the settlement of securities transactions in the EU; many of the firms that provide such services are British, meaning the UK post-Brexit would be disproportionately affected by a change in how their access to the European market is regulated. The Minister has informed us that it is a "priority" for the Treasury to "water […] down" the Parliament's proposals in this area.

51 Benchmarks used in financial contracts by EU financial institutions, like LIBOR and EURIBOR, can be compiled and administered from a non-EU country. However, under the 2016 Benchmarks Regulation, this requires the regulatory system of the home country of the benchmark to have been deemed 'equivalent' by the European Commission, or for it to get formal 'recognition' by the financial regulator of an EU Member State under certain conditions.

52 To raise capital through public offers or have securities admitted to be traded on regulated markets, companies need to provide potential investors with a prospectus which describes the company's business, structure and finances. In the EU, the contents and issuance of such documents are regulated by the new Prospectus Regulation, which will replace the existing Prospectus Directive from July 2019. Prospectuses are approved by national authorities, and are valid throughout the EU.

53 Under the Prospectus Regulation, non-EU firms can issue prospectuses if they either submit it for approval by a Member State or if their domestic regulatory regime has been deemed 'equivalent' to the EU's by the European Commission.

54 Funds with EuVECA or EuSEF designation which hold more than €500 billion (£440 billion) in assets under management must be managed by a fund manager authorised and supervised by their national competent authority under the Alternative Investment Fund Managers Directive (AIFMD). For these funds, the Commission proposes that ESMA should be responsible for ensuring both compliance with the EuVECA and EuSEF Regulations, and with the relevant national law implementing the AIFMD.

55 The original Commission proposal does not foresee extending ESMA's powers under the CSD Regulation. The Parliament's reasoning for its proposed change is set out in amendment 325 of document PE627.677.

Anti-money laundering powers of the EBA

5.49 In response to several scandals—including notably the revelations that Danish lender Danske Bank potentially laundered as much as €200 billion of criminal proceeds through its Estonian branch between 2007 and 2015—the European Commission in September 2018 decided further action was necessary to coordinate the combat against money-laundering in the EU.

5.50 To achieve this, the Commission proposed a further amendment to the Regulation establishing the European Banking Authority in the context of the ESFS review. Its supplementary proposal would give the EBA an explicit statutory mandate to work with national banking regulators properly apply the EU's anti-money laundering rules as part of their supervisory work. In particular, the Authority would:

- gain the power to instruct a national regulator to investigate a suspected breach of EU law on anti-money laundering or terrorist financing (or national laws implementing European law in those areas), and ask it to "consider" taking action against a specific "financial sector operator" to ensure compliance with the Anti-Money Laundering Directive;[56]
- collect information on AML weaknesses identified by national regulators in relation to specific banks or other institutions, acting as a centralised "data hub" for confidential information which national regulators could access to address money-laundering risks in their own jurisdiction; and
- have to establish a new Anti-Money Laundering Committee for cooperation with and among the EU's national financial regulators, as well as playing a role for the EBA in leading the EU's cooperation with 'third country' anti-money laundering supervisors (including, after Brexit, the UK's National Crime Agency).

5.51 In a parallel development, the European Parliament has also pushed for amendments to the Capital Requirements Directive to address legal restrictions on confidentiality that prevent prudential regulators from cooperating and exchanging information with anti-money laundering authorities, including those in other EU Member States.[57] (The logic behind this is that financial regulators have more powers than law enforcement agencies to intervene in the operation of banks and investment firms, including—as a last resort—suspending or withdrawing their operating licence, and that they should therefore be able

56 If it is not satisfied with the regulator's response, the EBA's ability to instigate a 'breach of Union law' procedure would be extended to anti-money laundering legislation. This could theoretically result in the EBA ordering either the national regulator or a specific financial market operator to "take all necessary action" to comply with their legal obligations. However, the initiation of a "breach of Union law" procedure against a national regulator would ultimately have to be made by the EBA's Board of Supervisors. Under the current legal framework, it is only the EU's national regulators themselves who are voting members of the Board. Under the Commission's wider ESFS reform proposals, such decisions would be taken by a new four-person Executive Board composed of full-time independent members.

57 The relevant amendments are contained in European Parliament Report A8 2018/243, in relation to a new article 4a of Article 117 ("Competent authorities [and] financial intelligence units […] supervising obliged entities listed in [the AMLD], shall cooperate closely with each other within their respective competences and shall provide one another with information relevant for this under […]") and a change to Article 56 on exchange of information ("[The Capital Requirements Directive] shall not preclude the exchange of information between competent authorities within a Member State, between competent authorities in different Member States or between competent authorities and the [competent authorities referred to in Article 48 of the Directive (EU) 2015/849], in the discharge of their supervisory functions".

to cooperate in anti-money laundering investigations.)[58] These discussions are taking place in the context of a different set of proposals on risk reduction measures for the banking sector, which we considered in our Report of 9 January 2019.

5.52 The Minister's letter in January 2019 provided a detailed update on the state of play in the negotiations on the role of the EBA in relation to anti-money laundering, as this aspect of the ESA reform proposals has been fast-tracked given the spate of recent money laundering scandals. The Economic Secretary reiterates that the Government "is in favour of a more coordinated [EU] approach to anti money laundering" and is "supportive of the EBA playing a leading role in achieving this".

5.53 Following negotiations among Member States in the Council, a number of changes have been proposed in the following areas:

- A number of EU countries raised concerns about the proposed ability for the EBA to instruct national regulators to carry out investigations based on possible breaches of both domestic and European anti-money laundering legislation. However, following detailed legal consideration, all but one (unidentified) Member State now supports this aspect of the proposal.[59] They are seeking to extend the time to comply with such a request from 10 to 15 working days;[60]

- The role of EIOPA and ESMA within the new Anti-Money Laundering Committee should be strengthened, amid concerns that the original legal text could "inadvertently restrict their ability to share expertise".[61] As regards the Member State representatives on the Committee, most countries want to send "high-level representatives" rather than Chief Executives of their national banking regulator, given that the latter would potentially not have "an adequate level of AML expertise";[62]

- With respect to what type of information on AML 'weaknesses' identified in financial institutions by national regulators the EBA would be empowered to collect, the Austrian Presidency drafted a more precise definition of "material weakness" to delineate the EBA's powers in this area.[63] A majority of Member States also supported restricting access by national competent authorities to the collected information compared to the original Commission proposal, requiring

58 In May 2018, the Member States and the European Parliament amended the EU's Anti-Money Laundering Directive to improve the exchange of information between anti-money laundering and prudential authorities. However, there is no "mandatory mechanism or detailed guidance" on structural cooperation between the two—especially between different Member States.

59 The Minister's letter notes that the Council Legal Services used "previous examples" to demonstrate that the draft text as amended by the Austrian Presidency—which inserted a clarification that the EBA could only order investigations for breaches of national laws "to the extent that they transpose [EU] Directives" is "workable and legally sound".

60 The UK had sought a further extension to 25 days, but the Minister says that the Treasury "appreciate[s] that 15 is a good compromise".

61 The Minister notes in his letter that recent cases of money laundering, as well as terrorist financing, took place through sectors within ESMA, like trading venues.

62 Chief Executives of national financial regulators would still be involved in the work of the AML Committee through their representation on the ESA's Boards of Supervisors.

63 The revised legal text would define a weakness as a "breach, potential breach or ineffective/inappropriate application of legal provisions". The Member States want to lay down further details of the EBA's collection of information by means of a Delegated Act at a later stage.

a "reasoned request" as to why information on a particular institution was "relevant for their supervisory activities".[64] The Minister's latest letter indicated the Treasury supports these changes; and

- Finally, the Minister also noted that the legal language on the EBA playing a "leading role in facilitating cooperation" between the EU and the financial regulators of non-EU countries had been "toned down", so that it does not interfere with bilateral contacts between countries. This has been welcomed by the UK, since this is an area of importance for British regulators in view of the imminent withdrawal from the existing structures of cooperation with counterparts in the EU-27.

5.54 Given the perceived urgency in addressing gaps in the EU's enforcement of its anti-money laundering rules, this element of the ESFS proposals has been prioritised in discussions among Member States. The Minister has now informed us that EU Finance Ministers are likely to formally adopt a 'general approach' on the AML powers of the EBA—reflecting the proposed changes described above—at their meeting on 22 January 2019. This would constitute the basis for negotiations with the European Parliament on the final text of the legislation in the near future. As such, the Minister has requested the Committee clear the AML proposal from scrutiny to "enable us to support the agreement that meets the UK's objectives" at the Council meeting.

Funding mechanism for the ESAs

5.55 The final element of the original Commission proposals for reform of the ESAs concerned the way in which they are funded. At present, the Authorities get obligatory contributions from the Member States' national competent authorities, a subsidy from the EU budget, and—in the case of ESMA—fees paid by market participants subject to direct supervision.[65] The Commission had suggested the Supervisory Authorities should instead charge a levy on firms within their remit to cover 60 per cent of the relevant ESA's running costs, with the remainder being drawn from the EU budget.[66] The direct contribution by NCAs would be eliminated entirely.

5.56 The Treasury noted in its initial Explanatory Memorandum that "the proposals for increased industry funding will […] be contentious, and […] unlikely to be supported by the financial services sector". In his letter of 9 January 2019, the Economic Secretary confirmed that the most recent compromise legal text circulated to Member States "deletes all references to financial contributions from industry", which the UK and many other Member States support.

64 The Council is also seeking an amendment that would require the EBA to inform the national regulator which originally provided the requested information about the request. The original Commission proposal allowed national regulators to access information on AML weaknesses held by the EBA on simply on "a need-to-know and confidential basis".

65 The ESAs get 60 per cent of their budget from NCA contributions and 40 per cent from the EU budget. National contributions are proportionate to each country's share of votes under the Council qualified majority rule as it applied until October 2014. As a result, the UK contributes approximately 8 per cent of the NCA contributions each year (amounting to €4.4 million in 2016).

66 The industry levy would be set on an annual basis, based on the estimated workload for each Authority for each category of market participants.

Next steps in the legislative process

5.57 As described in paragraph 54 above, EU Finance Ministers are expected to agree on their joint position on the specific proposal on the EBA's anti-money laundering powers at their meeting on 22 January 2019. That would open the way for negotiations on the final text of that element of the draft legislation with the European Parliament.

5.58 The Parliament's Economic & Monetary Affairs Committee adopted its position on the ESFS reform proposals—including the anti-money laundering powers of the EBA—on 10 January 2019, but the resulting Report has not yet been published. The Minister's letter noted that the Government expected MEPs to keep the AML elements linked to the remainder of the ESFS proposals, rather than fast-tracking separately like the Council has done. The Treasury is "working with other Member States" to begin negotiations on the AML part of the text as soon as possible to ensure they can enter into force before the rest of the package is agreed. With respect to the non-AML elements, the Government is seeking to "delay the main [ESFS] proposal from being agreed" before the European Parliament is dissolved in April ahead of the European elections, delaying its eventual entry into force.[67]

5.59 As we have noted, the ESFS reform proposals remain important for the UK in the context of its withdrawal from the EU (both during the proposed post-Brexit transitional period, when amendment to European financial services law would apply in the UK, and during negotiations on a future UK-EU trade agreement). Therefore, the proposals remain under scrutiny while the legislative process continues. We have set out our assessment of the potential implications of the reforms described in this Report in our conclusions in paragraphs 11 to 19 above.

Previous Committee Reports

See (39052), 12420/17 + ADD 1–2, COM(17) 536: Fifth Report HC 301–v (2017–19), chapter 9 (13 December 2017) and Fourteenth Report HC 301–xiv (2017–19), chapter 7 (21 February 2018).

67 The Minister also informed the Committee in his letter of 9 January 2019 that the Treasury had "belatedly" identified 'Justice and Home Affairs' content in the ESFS proposal, relating to exchange of information between financial regulators and law enforcement authorities. The Government maintains triggers the UK's opt-in protocol for such measures even where the draft EU legislation has an 'internal market' legal base, and the Minister says the UK has therefore purported to opt-out of this particular element of the proposals. The Committee's long-standing position is that the JHA protocol is not engaged unless draft EU legislation as a legal base in Title V of the Treaty.

6 Safeguarding competition in air transport

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny
Document details	Proposal for a Regulation of the European Parliament and of the Council on safeguarding competition in air transport, repealing Regulation (EC) No 868/2004
Legal base	Article 100(2) TFEU, ordinary legislative procedure, QMV
Department	Transport
Document Number	(38826), 10146/17 + ADDs 1–2, COM(17) 289

Summary and Committee's conclusions

6.1 Trilogue negotiations have concluded regarding the European Commission's proposal for a Regulation safeguarding the aviation sector against subsidisation and unfair pricing practices in the supply of air services from third countries.

6.2 The proposed Regulation, adopted by the Commission in June 2017, would replace Regulation (EC) 868/2004, which has not been used to date due to its narrow scope, the fact that it lacks a specific complaint mechanism, and because it does not permit individual carriers and Member States to make complaints in their own right. In addition to enabling carriers and Member States to make complaints, the proposal would introduce investigation procedures covering both the violation of applicable international obligations and practices adopted by a third country or third-country entity affecting competition and causing either injury or threat of injury to Union air carriers.

6.3 In the Government's initial response to the proposal, the Minister (Lord Callanan) raised questions over whether the proposed Regulation would enable the Commission to impose redressive measures which might impact international air services covered by Member States' own bilateral air services agreements with third countries.[68] The Committee sought further reassurance on this, and other competence-related points, in its first report.[69]

6.4 In two subsequent updates,[70] the Minister's successor (Baroness Sugg) informed the Committee that the text of the proposal had become more aligned with UK objectives, in that it (i) recognised that fair competition between air carriers should preferably be addressed in the context of air transport or air services agreements with third countries, rather than through the proposed Regulation, (ii) contained provisions enabling an investigation to be suspended if the Member States involved intend to address the practice

68 Explanatory Memorandum from the Minister, DfT, to the Chair of the European Scrutiny Committee (22 June 2017).

69 First Report HC 301–i (2017–19), chapter 14 (13 November 2017).

70 Letter from the Minister to the Chair of the European Scrutiny Committee (17 April 2018); Letter from the Minister to the Chair of the European Scrutiny Committee (8 May 2018).

being investigated under an applicable agreement they have concluded with the third country concerned, (iii) excluded the suspension or limitation of traffic rights granted by a Member State to a third country from being imposed as redressive measures, and (iv) clarified that harm to consumers should be specifically considered in investigations and the impact of redressive measures on them taken account of when imposing such measures. The Minister also noted that a concern had arisen in that some Member States were lobbying for text regarding "threat of Injury"—which would lower the threshold under which the procedure could be invoked, and which had previously been deleted—to be reinstated. On this basis the Committee granted the Government a waiver to support a General Approach at Transport Council on 7 June 2018.[71]

6.5 On 11 December 2018 the Minister wrote to the Committee to inform it that trilogue negotiations with the European Parliament, which commenced following the agreement of the Council's General Approach, had reached a provisional agreement which continued, in her assessment, to be aligned with UK objectives.

6.6 The Minister states that the provisional agreement achieves UK objectives on the following outcomes:

- It retains "an explicit recognition" that fair competition between air carriers should preferably be addressed in the context of air transport or air services agreements with third countries.
- It retains provisions which allow an investigation to be suspended if the Member States involved intend to address the practice being investigated under an applicable agreement they have concluded with the third country concerned.
- Traffic rights are excluded from potential use as redressive measures, in line with the UK position.
- Regarding the process for imposing redressive measures, these will be adopted through the examination comitology procedure, which requires a qualified majority from the national representatives.
- The concept of 'Threat of Injury', to which the Government objected, has returned to the text has been substantially clarified, so that it "relates to more definite circumstances, beyond just conjecture or remote possibility" and that redressive measures will not enter into force "before the threat of injury has developed into actual injury." The Minister states that this is an acceptable outcome.

6.7 The Minister concludes that she regards the text as striking a balance "between allowing the aviation market between the EU and third countries to continue to grow and innovate, while ensuring that growth takes place within an environment that promotes fair competition". She also adds that no further changes are expected before the proposed textis put to the European Parliament and the Council of Ministers for final adoption, and requests that the Committee clear the proposal from scrutiny.

6.8 **Trilogue negotiations on the proposal for a regulation safeguarding the aviation sector against subsidisation and unfair pricing practices in the supply of air services**

71 Thirtieth Report HC 301–xxix (2017–19), chapter 11 (6 June 2018).

from third countries have resulted in the provisional agreement of a compromise text which, in the Minister's assessment, "continues to be aligned with UK objectives" and strikes a balance between promoting fair competition and growth.

6.9 **The Committee's specific concerns regarding competence have been thoroughly addressed: the Minister confirms that the text provides that fair competition between air carriers should preferably be addressed in the context of air transport or air services agreements with third countries, that it retains the provisions enabling an investigation to be suspended if the Member States involved intend to address the practice being investigated under an applicable agreement they have concluded with the third country concerned, and that it precludes the use of traffic rights as redressive measures.**

6.10 **The concept of 'Threat of Injury', to which the Government had objected, has been reinstated, however the Minister observes that the concept has been clarified so that it now relates to more definite circumstances and that any redressive measures proposed in response will not enter into force before the threat of injury has developed into actual injury—an outcome which is acceptable to the Government. Regarding the process for imposing redressive measures, the Minister states that the Commission will have to adopt implementing acts through comitology in accordance with the examination procedure, meaning that a qualified majority will be needed to impose measures, in line with UK preferences.**

6.11 **The regulation is of relevance to the UK, which is expected to become a third country with respect to the Single Market in aviation when it leaves the European Union, meaning that UK stakeholders could in principle be subject to its provisions if there were any concerns regarding fair competition between EU carriers and UK aviation stakeholders.**

Full details of the documents:

Proposal for a Regulation of the European Parliament and of the Council on safeguarding competition in air transport, repealing Regulation (EC) No 868/2004: (38826), 10146/17 + ADDs 1–2, COM(17) 289.

Previous Committee Reports

Thirtieth Report HC 301–xxix (2017–19), chapter 11 (6 June 2018); First Report HC 301–i (2017–19), chapter 14 (13 November 2017).

7 Green Finance: Low Carbon Benchmarks

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny; drawn to the attention of the Environmental Audit Committee
Document details	Proposal for a Regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks
Legal base	Article 114 TFEU; ordinary legislative procedure; QMV
Department	Treasury
Document Number	(39798), 9348/18 + ADDs 1–3, COM(18) 355

Summary and Committee's conclusions

7.1 In May 2018, the European Commission introduced draft EU legislation with the aim of ensuring that the financial services industry plays its part in the fight against climate change. The Commission argues this would benefit the environment and lead to more sustainable economic growth (as well as being in the industry's own interest by reducing insurance claims related to environmental damage and ensuring the viability of long-term investments). The overall aim of the proposals is to channel more investment into sustainable activities by incorporating 'Environmental, Social and Governance' (ESG) considerations into investment industry practices.

7.2 Concretely, the European Commission tabled three legislative proposals as part of its 'Green Finance' package. The first two of these would create a 'Sustainability Taxonomy', to aid the assessment of how environmentally-friendly a given investment is, and introduce new mandatory Environmental, Social and Governance (ESG) disclosure requirements for asset managers, institutional investors and investment advisors, requiring them to be transparent with their customers about the environmental footprint of their investment decision-making or advisory process. We cleared the latter from scrutiny at our meeting on 9 January 2019.

7.3 The third proposal, on which this chapter focuses, would establish statutory EU-wide requirements for financial benchmarks. These purport to show whether the carbon footprint of a specific investment is greater or smaller than a baseline—the benchmark—of a hypothetical portfolio of 'low carbon' or even 'carbon positive' investments (i.e. the activities of a set of companies deemed to have a relatively small carbon footprint). More specifically, the draft legislation would amend the 2016 Benchmarks Regulation:[72] a key piece of post-crisis financial law adopted following the LIBOR and EURIBOR benchmark manipulation scandals, intended to govern the accuracy and integrity of indices used in financial contracts throughout the EU.

72 Regulation 2016/1011.

The Benchmarks Regulation

7.4 As it stands, the 2016 Regulation sets harmonised rules for their production and governance, such as management of conflicts of interest—a key failure in the LIBOR and EURIBOR scandals, which were manipulated by banks for their own gain at the expense of other parties—and the standards of supervisory oversight by national and European regulators of individual benchmarks offered by EU-based companies. Moreover, supervised entities such as banks, investment firms and insurance companies in the EU can normally only use a benchmark in their contracts or other operations if its administrator is authorised in the EU. For non-EU benchmarks, use is permitted only if its home country has been given 'equivalence' decision, or if its specific administrator has been granted 'recognition' by the financial regulator of a Member State.[73] (This system of 'recognition', which to some extent removes the need for an overall determination of equivalence, is currently subject to negotiations, after the Commission proposed it should be abolished as part of the review of the European System of Financial Supervision.)

The Commission proposal on 'low carbon' and 'carbon positive' benchmarks

7.5 Where investors want to make environmentally sustainable investments, their asset managers can compare their investments against low carbon or sustainability benchmarks to ascertain whether that objective is being achieved. The Treasury has explained that, at present, those benchmarks typically consist of a standard benchmark (such as the S&P 500 or NASDAQ 100) within which companies with relatively high carbon footprints are removed or under-weighted. In that way, the climate impact of specific investments can be compared to the performance of low-carbon economic activities more broadly.

7.6 However, the European Commission argued that specific legislation is necessary to ensure that benchmarks used to measure the sustainability performance of investments are accurate and sound.[74] It therefore proposed a new Regulation to define two new categories benchmarks (namely 'low carbon' and 'positive carbon impact'), and introduce specific transparency requirements for their administrators, obliging hem to disclose the methodology underpinning those benchmarks.[75] The Regulation as originally proposed would empower the European Commission to establish—by means of Delegated Acts—the minimum criteria for the actual calculation of sustainability benchmarks.[76] These would cover the choice of the underlying assets against which an investment would be

73 Moreover, under Article 51 of the Benchmarks Regulation, EU and third country benchmarks already in use in June 2016 can continue to be used until June 2020 as a transitional measure.

74 More specifically, the Commission said EU legislation was needed because Low carbon benchmarks remain relatively insignificant in terms of their use in overall portfolio allocation by asset managers, despite a relatively wide range of them having been developed; there are divergent levels of openness between administrators about the methodologies underpinning their low carbon benchmarks and as a result they are difficult to compare; and in the absence of a common regulatory framework, there is a risk that all low carbon benchmarks are perceived as being equally suitable to measure the sustainability performance of a given investment despite having different characteristics (potentially leading to 'green washing' where investments seen more environmentally-friendly than they are).

75 However, under the proposal benchmark administrators would not be required to use the EU Sustainability Taxonomy, to allow them the "necessary degree of flexibility" when designing their products.

76 Delegated Acts are adopted by the European Commission but can be vetoed by either the European Parliament or a qualified majority of Member States in the Council.

benchmarked; the method for the weighting of the underlying assets relative to each other; and the method for the calculation of carbon emissions and carbon savings associated with the underlying assets.[77]

7.7 Based on an Explanatory Memorandum submitted by the Treasury in summer 2018, the European Scrutiny Committee considered the proposed Low Carbon Benchmarks proposal in some detail in its Report of 18 July 2018. The Government's position was that it was "not opposed to the introduction of specific [rules] for sustainability benchmarks if it helps investors to make more informed decisions", but that the new Regulation should not be "overly prescriptive" in determining how such benchmarks should be calculated because it could "hinder innovation and competition" and "discourage firms from providing these benchmarks".

7.8 When we last considered the proposal, there was a large degree of ambiguity around the implications of the amendments to the Benchmarks Regulation, as it was unclear to who they would apply and what their practical impact on the market would be. Moreover, noted that the new requirements for 'green' benchmarks might apply to the UK industry directly and indirectly even after its formal withdrawal from the EU in March 2019. We have made a fuller assessment of the potential implications of the Low Carbon Benchmarks proposal for the UK in paragraphs 14 to 17 below in light of the most recent developments in the Brexit process.

Developments in the legislative process since July 2018

7.9 On 9 January 2019, the Economic Secretary to the Treasury (John Glen MP) provided us with an update on the negotiations among EU Member States on the Low Carbon Benchmarks proposal.[78] The Minister's letter noted that the "proposals have not changed a great deal from the original text" following discussions among national officials. However, significantly, the Commission has clarified that the 'low carbon' and 'positive carbon impact' benchmarks are intended to be *optional* product labels, applicable only to benchmark providers "who wish to market their benchmark using these accredited labels". As a consequence, the revised legal text would make it explicit that providers would only be bound by the calculating methodology for the 'green' benchmarks set out under the Regulation if they actively *choose* to use those appellations. The Minister explained that this clarification enabled the UK to "achieve [its] key objective in the file", namely to "ensure that the Regulation does not prescribe a methodology or framework for all environmental impact investing benchmarks, thereby allowing room for innovation in this rapidly developing market".

7.10 The Minister's letter also explains the Member States want to use the legislative process to introduce a further amendment to the Benchmarks Regulation, which is unrelated to the broader sustainability question. This concerns an extension of the existing transitional period—which ends on 1 January 2020—during which benchmarks in use before the Regulation took effect in June 2016 would not need to be fully in line with its requirements.

77 An earlier draft of the Commission proposal would have introduced a fully harmonized regime for the methodology of calculating the low carbon and carbon positive benchmarks, including the use of the new EU Sustainability Taxonomy (see above). This approach was abandoned after a negative opinion by the Commission's Regulatory Standards Board.

78 Letter from John Glen to Sir William Cash (9 January 2019).

Because two 'critical' benchmarks[79]—EONIA and EURIBOR, both administered from Belgium—are unlikely to meet the January 2020 deadline, the Member States are looking to extend the transition until the end of 2021.[80]

7.11 The Minister has signalled the Government's acceptance of this new proposal, because the "cessation of these benchmarks"—which would occur automatically if they are not compliant by the deadlines set out in the Regulation—"could cause disruption to both investors and consumers, with potentially severe repercussions on financial stability". He adds that LIBOR, which is administered in the UK, is the only other critical benchmark in use in the EU, but it is already authorised under the Regulation by the Financial Conduct Authority.

Next steps

7.12 The Economic Secretary's letter also explained that the EU Finance Ministers are expected to formally adopt a 'general approach'—a mandate for negotiations with the European Parliament on the final text of the Low Carbon Benchmarks Regulation—in January 2019 to reflect their suggestions and concerns as described above.[81] He therefore asks the European Scrutiny Committee for scrutiny clearance, to enable the Government to support the Member States' common position on the proposal.

7.13 The Parliament's Economic & Monetary Affairs Committee adopted its position on the proposal on 13 December 2018. Following the Council vote, final negotiations on the text of the Regulation will begin between the Romanian Presidency of the Council and MEPs, with a view to reaching agreement before the dissolution of the European Parliament in April 2019.

Our conclusions

7.14 **We thank the Minister for his letter informing us of the state of play on the amendment to the Benchmarks Regulation, and the potential impact it could have on the UK financial services industry. We note that the Commission's clarification of the scope of its proposal, namely that it is an optional label whose rules are applicable only where a financial benchmark provider explicitly chooses to market a product as 'low carbon' or 'carbon positive'. This means the overall impact of the new Regulation is likely to be fairly limited. We have also taken note of the new amendments relating to the extension of the transitional period for the EURIBOR and EONIA benchmarks to be brought in line with the requirements of the Regulation.**

7.15 **For reasons set out more comprehensively in our recent Report on the related EU proposal on sustainability-related disclosures by asset managers and investment advisers, we do still consider that this new EU legislation on low carbon benchmarks—once adopted at EU-level—could still be relevant for the UK:**

79 Critical benchmarks under the Regulation are those used as a reference for financial instruments or financial contracts or for measuring the performance of investment funds, having a total value of at least €500 billion.

80 The Member States also want to give the Belgian financial regulator more power to compel the continued contribution to, and administration of, the EURIBOR benchmark (extending existing powers to do so from two to five years). There were concerns that, if the existing two-year mandatory period was triggered in the near future, the reforms to make the benchmark compliant with the Regulation would still not be completed in time.

81 The Council's position were informally signed off by the Member States' Permanent Representatives in COREPER before the 2018 Christmas recess.

- **If the Withdrawal Agreement is ratified, the Low Carbon Benchmarks Regulation would apply directly in the UK during the post-Brexit transitional period (which could last until December 2022);**[82]

- **Under the controversial Northern Ireland 'backstop' in the Withdrawal Agreement, the UK would have to "ensure that the level of environmental protection provided by law, regulations and practices is not reduced below the level provided by the common standards applicable within the Union and the United Kingdom at the end of the transition period in relation to […] climate". We have already asked the Treasury to clarify if any EU law relating to low carbon benchmarks would fall within the scope of this provision;**[83]

- **UK law could have to remain aligned with the Benchmarks Regulation, including the pending amendment relating to 'low carbon' and 'carbon positive' benchmarks, if the UK wants to have 'equivalence' in place with the EU. An assessment by the European Commission that the UK's regulatory framework for benchmarks is equivalent to the EU Benchmark Regulation would allow British-administered benchmarks to continue to be used freely by EU financial institutions;**[84] **and**

- **The Low Carbon Benchmarks proposal is included in the scope of the Government's recent Financial Services (Implementation of Legislation) Bill, which would allow the Treasury to implement "in-flight" European financial services legislation—i.e. those still being negotiated in Brussels—in the event of an exit from the EU without a Withdrawal Agreement. In summary, this means the new Regulation could be implemented into UK law by means of Statutory Instrument in a 'no deal' scenario, if the Financial Services Bill is approved by Parliament.**[85]

7.16 **Given the above, we consider that the new Low Carbon Benchmarks Regulation could impact on the UK financial services industry directly and indirectly for a number of years. We are however content to now clear the proposal from scrutiny, given that the European Commission has clarified the optional nature of using the 'low carbon' or 'carbon positive' labels for a financial benchmark. We also draw these developments to the attention of the Environmental Audit Committee.**

82 The Member States want the Low Carbon Benchmarks Regulation to apply from April 2020.

83 The relevant provision of the backstop—Article 2 of Annex 4—does not list the specific EU legal acts which would constitute the 'common standards' it refers to, and it is also explicitly excluded from the scope of the dispute resolution mechanism created by the Agreement, which can refer questions of EU law to the Court of Justice. It is therefore not clear if the measures in the Green Finance package, which are explicitly linked to the EU's implementation of the Paris Climate Change Accord, fall within the scope of Article 2 of Annex 4 to the Protocol (although they are based on Article 114 of the EU Treaty, relating to the Single Market, and not Article 192, which governs EU rules on environmental protection).

84 As part of the wider review of the European System of Financial Supervision, the Member States and the European Parliament are also considering strengthening the centralised role of the European Securities & Markets Authority (ESMA) in the oversight of non-EU benchmarks. For example, under a Commission proposal, supervision all benchmarks administered from outside the EU (but used within it) would become the direct responsibility of ESMA. This includes responsibility for granting recognition or endorsement to third country administrators in the absence of an equivalence decision. As a result, national authorities would lose the ability to grant such recognition. It remains unclear what the outcome of the negotiations on this proposal will be, but it could clearly have an impact on the use of UK-administered benchmarks on European financial markets.

85 See for more information the Financial Services (Implementation of Legislation) Bill, and especially Schedule 1. We have discussed the implications of the Bill in more detail in our Report of 9 January 2019 on the EU's banking reform package.

7.17 **We understand that negotiations on the third proposal in the Green Finance package, relating to Sustainability Taxonomy, are still on-going within the Council. No agreement expected in the short-term, and it therefore remains under scrutiny.**

Full details of the documents:

Proposal for a Regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks: (39798), 9348/18 + ADDs 1–3, COM(18) 355.

Previous Committee Reports

See (39798), 9348/18, COM(18) 355: Thirty-sixth Report HC 301–xxxv (2017–19), chapter 4 (18 July 2018).

8 EU support for customs authorities 2021–27

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny
Document details	(a) Proposal for a Regulation establishing the 'Customs' programme for cooperation in the field of customs; (b) Proposal for a Regulation establishing, as part of the Integrated Border Management Fund, the instrument for financial support for customs control equipment
Legal base	Articles 33, 114 and 207 TFEU; ordinary legislative procedure; QMV
Department	Treasury
Document Numbers	(a) (39887), 9929/18 + ADDs 1–3, COM(18) 442; (b) (39928), 10325/18 + ADDs 1–3, COM(18) 474

Summary and Committee's conclusions

8.1 Since 1991, the EU has operated a long-term support programme for the customs authorities of its Member States. This provides financial support for customs training and IT systems, as each EU country relies on the others to safeguard the Union's external border with respect to the entry of goods since the abolition of intra-EU customs controls as part of the Single Market in the early 1990s.

8.2 The European Commission proposed to extend the Customs Programme in summer 2018 for the duration of the EU's next long-term budget—the Multiannual Financial Framework (MFF) 2021–2027. The main objective of the Programme is to support the full implementation of the 2016 Union Customs Code, the EU's core rulebook for the operation of its Customs Union and trade in goods with third countries. In particular, the Programme will support on-going work to switch to a fully digitalised customs environment for businesses by removing paper-based procedures (due for completion in 2025, after a 2020 deadline proved impractical), including the launch of the Import Control System 2 (ICS2), a new customs risk management tool.

8.3 While the fundamental set-up and purpose of the Customs Programme would remain unchanged under the proposal, there would be a number of changes in the way the EU supports its Member States' customs authorities. For example, in response to a request by a number of countries, the Commission has also laid draft legislation to create a new funding mechanism—the Customs Control Equipment Instrument—dedicated specifically to the purchase and maintenance of customs equipment such as scanners by national authorities.[86] The Customs Programme would also help the remaining Member

86 In addition, the Commission has also proposed to add an explicit legal basis for the use of the Customs Programme to fund the necessary modifications to extend partial access to EU customs systems to third countries or international organisations.

States pay for the customs-related costs of the UK's exit from the EU, which will involve "disentangling the United Kingdom as a Member State from all existing customs electronic systems".[87]

8.4 The draft legislation for both instruments has been under discussion in the European Parliament and the Member States in the Council, which must jointly decide on the final shape of the programmes. The Financial Secretary to the Treasury (Mel Stride) submitted an Explanatory Memorandum on the proposals in June 2018. This states that "there may be a case for cooperating with the EU on shared IT systems", which the Government "will take into account in negotiating a future customs arrangement with the EU". The Minister also noted that, if the 'backstop' to keep the Irish border free of customs infrastructure ever became operational, the UK's proposal for its practical implementation would require "continued access to EU shared IT systems". He added that the application of the proposed Customs Programme during the backstop—meaning the UK's ability to draw funding from it—"would be subject to negotiation", presumably because that would require a new UK financial contribution.

8.5 The proposed Customs Programme and the Customs Control Equipment Instrument have a combined provisional budget of €2.25 billion (£2 billion) over the 2021–2027 period (of which €950 million would be earmarked for customs authorities' IT systems and training, and €1.3 billion funding line for customs equipment). However, the final financial allocation is yet to be decided by the Member States and the European Parliament.[88]

Progress in the legislative process since July 2018

8.6 On 22 December 2018, the Financial Secretary to the Treasury (Rt Hon Mel Stride MP) wrote to the Committee with an update on the negotiations on both of the European Commission's customs support proposals. He explained that "good progress" had been made on both proposals, and that the Austrian Presidency received a mandate from the EU's Member States for negotiations on the final substance of the Customs Programme with the European Parliament in December 2018. According to the Minister, "few changes" were made to the original Commission proposals, with a focus on better reporting of progress made against the Programme's objectives to ensure its funding is being used effectively.[89]

8.7 The Minister adds that "the UK could seek to participate in the Customs Programme if we expect to have continued access to shared IT systems following our withdrawal from the EU". As the proposed Customs Control Equipment instrument is not open to third countries, it has "fewer implications for the UK". Overall, the Minister notes that the Government "can support" the revised texts for both proposals as a basis for negotiations with the European Parliament, which he expects to begin in the first half of 2019.

87 The total costs of this, the Commission says, are not yet known because the substance of a future UK-EU customs cooperation agreement could negate the need for total 'disentanglement'.

88 The proposed €2.25 billion budget for the two programmes would be significantly larger than the 2014–2020 Customs Programme (€523 million).

89 With respect to the Customs Control Equipment Instrument, the Minister notes that "particularly the Eastern Member States" have welcomed the proposal, others had "expressed concern over a number of matters, including the budget to be set, the process to determine whether equipment is required and the general administrative burden". In the light of this, the Minister says, the original Commission proposal "has been revised to make clear that customs controls remain a Member State competence, and that the reporting requirements should aim to provide feedback on the effectiveness of the Instrument without being overly burdensome".

Our conclusions

8.8 **We thank the Minister for his latest update on the negotiations on the Customs Programme and the Customs Control Equipment Instrument under the EU's next long-term budget.**

8.9 **The UK has participated in the EU's Customs Programme since its inception in 1991 by virtue of its EU membership. It will cease to do so in December 2020 if its Withdrawal Agreement on an orderly exit from the EU is ratified, or in March 2019 if it is not. The 2021–27 Customs Programme is also open to formal 'association' by non-EU countries, including the UK after it leaves the EU. Whether there would be added value in this would have to be decided in light of the future customs cooperation arrangements between the UK and the EU, and especially whether HM Revenue & Customs would have shared IT systems with the EU to facilitate risk assessments and reduce the intensity of customs controls on UK-EU trade.**

8.10 **As we noted in our previous Report on the Customs Programme, the scale of the initial systematic 'disentanglement' that Brexit entails in the field of customs is clear from the** draft Withdrawal Agreement**: in June 2018, the Government and the European Commission agreed on the gradual ending of the UK's use of, and access to, 20 EU-level 'networks, information systems and databases' related to customs, including the NCTS and the EU's Import & Export Control Systems. The phasing out is intended to allow the UK and EU to finalise customs procedures and processes related to cross-border trade that took place before the UK leaves the Customs Union. This would take place after the end of the transitional period (during which the UK would stay in the Customs Union and therefore retain access to the relevant EU systems).[90] If there is no Withdrawal Agreement, the UK would lose its access overnight on 29 March 2019. The necessary technical modifications could be funded from the current or proposed Customs Support Programmes.**

8.11 **While the Customs Programme 2021–27 is likely to part-fund the complete technical 'disentanglement' of the UK from EU customs systems after the end of the transition, it could also have a role to play in implementing any subsequent UK-EU customs cooperation agreement. Some form of cooperation between HM Revenue & Customs and its counterparts in other EU countries will remain necessary even after Brexit irrespective of the shape of the future economic partnership. In particular, by definition, the UK cannot unilaterally replace information-sharing or risk assessments that rely on exchange of data with the customs authorities of the remaining Member States via shared EU systems. The Government's intention is to negotiate a new customs cooperation agreement with the EU which may involve "shared IT systems" even after the transitional period ends.**

8.12 **Moreover, the controversial Protocol on Ireland and Northern Ireland in the Withdrawal Agreement would *de facto* keep the UK as a whole in the EU's customs union at the end of the transitional period. This would be the approach "unless and until" a new free trade agreement supersedes it, by removing the need for physical customs-related infrastructure on the border in Ireland even when the UK has become**

90 The transitional period is due to end on 31 December 2020, with a possible extension to December 2022, providing the UK and the EU with more time to prepare for the UK's gradual removal after the end of the transition, which in many cases involves only partial access—such as 'read-only' permissions—for a limited amount of time.

a separate customs and regulatory territory with its own tariffs and trade protection measures.[91] To facilitate the practical implementation of the 'backstop' if necessary, Article 15 of the Northern Irish Protocol states that the EU can give the UK "full or partial access" to "any network, any information system, and any database established on the basis of Union law" (i.e. the Import Control System[92] and the Automated Export System)[93] if this is considered "strictly necessary to enable the United Kingdom to comply with its obligations under this Protocol" and the exchange of information cannot "cannot be facilitated by the [UK-EU joint consultative] working group". The Customs Programme could provide financial support for any modifications to the systems to provide UK officials with such access, meaning the overall cost of these technical works to the British taxpayer would be less.

8.13 **Even if the Withdrawal Agreement is not ratified, and the Irish Protocol is rejected, it will be in the interest of both the UK and the EU to discuss new customs cooperation agreements to facilitate trade in goods, given the UK's geographic proximity to the EU and the scale of the bilateral trade flows. In the absence of formalised cooperation on customs risk management, UK exports to the EU (and vice versa) could face a relatively high proportion of checks once the UK leaves the Customs Union and Single Market, adding costs and delays. We accept, however, that due to the wider political uncertainty around the circumstances of the UK's withdrawal from the EU in March 2019 and the shape of a new customs arrangement in those circumstances, it is impossible to judge at this stage the potential benefit of UK participation in the EU's Customs Programme from 2021.**

8.14 **In any event, the Minister has made clear that the substance of the Customs Programme and the associated Customs Control Equipment Instrument are not controversial, and the legislative process is it entering its final stages. We are therefore content to clear both proposals from scrutiny. Any British participation in the Programme would require a specific legal agreement to that effect, including the modalities of a financial contribution towards its operational and administrative costs.[94] We expect the Government to notify Parliament as and when a decision is made whether to apply for 'third country' association with the 2021–27 EU Customs Programme (and other EU funding instruments) in due course.**

Full details of the documents:

(a) Proposal for a Regulation establishing the 'Customs' programme for cooperation in the field of customs: (39887), 9929/18 + ADDs 1–3, COM(18) 442; (b) Proposal for a Regulation establishing, as part of the Integrated Border Management Fund, the instrument for financial support for customs control equipment: (39928), 10325/18 + ADDs 1–3, COM(18) 474.

91 Article 1(4) of the Protocol. Other provisions of the Protocol serve to keep Northern Ireland effectively in the Single Market for goods, requiring it to continue applying EU legislation in areas like food safety and animal health, Value Added Tax and excise duty.)

92 The Import Control System 2 (ICS 2) is an upgrade of the current system (ICS) that is responsible for the capture and processing of pre-arrival safety and security declarations. Importantly, it includes risk analysis of incoming goods and allows the results to be shared across Member States.

93 The Automated Export System under the Union Customs Code is an upgrade to an existing system that will enable the full automation of export procedures and exit formalities when goods are exported from the EU.

94 The proposed Customs Control Equipment Instrument is not open to participation by 'third countries'.

Previous Committee Reports

See (39887), 9929/18 + ADDs 1–3, COM(18) 442: Thirty-seventh Report HC 301–xxxvi (2017–19), chapter 14 (5 September 2018).

9 Documents not raising questions of sufficient legal or political importance to warrant a substantive report to the House

Department for Business, Energy and Industrial Strategy

(40200) 14590/18 COM(18) 740	Report from the Commission to the European Parliament and the Council on the Operation of the Radio Equipment Directive 2014/53/EU.
(40202) 14657/18 COM(18) 764	Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee Harmonised standards: Enhancing transparency and legal certainty for a fully functioning single market.
(40230) 14788/18 SWD(18) 481	Commission Staff Working Document The European Union's efforts to simplify legislation—2018 Annual Burden Survey.

Department for Education

(40229) — —	Court of Auditors Report on the annual accounts of the European Schools for the financial year 2017.

Department for Environment, Food and Rural Affairs

(40249) 15268/18 COM(18) 790	Report from the Commission to the European parliament and the Council on the implementation of the Common Monitoring and Evaluation Framework and first results on the performance of the Common Agricultural Policy.
(40252) 15344/18 COM(18) 817	Proposal for a Regulation of the European Parliament and of the Council Amending Regulations (EU) No 1305/2013 and (EU) No 1307/2013 as regards certain rules on direct payments and support for rural development in respect of the years 2019 and 2020.
(40255) 15384/18 COM(18) 811	Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Progress in the implementation of the EU Forest Strategy 'A new EU Forest Strategy: for forests and the forest sector'.

(40284) 15722/18 + ADD 1 COM(18) 837	Proposal for a Council Decision on the position to be taken on behalf of the European Union within the Working Group on Wine set up by the Economic Partnership Agreement between the European Union and Japan as regards the forms to be used for certificates for the import of wine products originating in Japan into the European Union and the modalities concerning the self-certification.
(40287) 15716/18 COM(18) 847	Report from the Commission on the exercise of the power to adopt delegated acts conferred on the Commission pursuant to Directive 2008/105/EC on environmental quality standards in the field of water policy (the "Priority Substances Directive")

Department of Health and Social Care

(40274) 15607/18 + ADD 1 COM (18) 818	Report from the Commission to the European Parliament and the Council Implementation of the third Programme of the Union's action in the field of health in 2015.

Department for International Development

(40241) – –	Court of Auditors Special Report no: 32: European Union Emergency Trust Fund for Africa: Flexible but lacking focus

Department for Transport

(40257) 14965/18 + ADDs 1–2 COM(18) 793	Proposal for a Council Decision on the position to be taken on behalf of the European Union in the Regional Steering Committee of the Transport Community as regards certain budgetary and personnel matters in relation to the implementation of the Treaty establishing the Transport Community.
(37011) 11154/15 + ADD 1 COM(15) 389	Proposal for a Council Decision establishing the position to be adopted by the Union at the 12th General Assembly of OTIF as regards certain amendments to the Convention concerning International Carriage by Rail (COTIF) and to its Appendices.

Foreign and Commonwealth Office

(40236) — —	Council Decision (CFSP) 2018/1797 of 19 November 2018 amending and updating Decision (CFSP) 2018/340 establishing the list of projects to be developed under PESCO.

(40313) — —	Council Decision to support activities of the Organisation for the Prohibition of Chemical Weapons (OPCW) in the framework of the implementation of the EU Strategy against Proliferation of Weapons of Mass Destruction.

HM Treasury

(39604) 7407/18 + ADDs 1–2 COM(18) 134	Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures.
(40226) 14651/18 + ADDs 1–2 COM(18) 766	Communication from the Commission Third Progress Report on the Reduction of Non-Performing Loans and Further Risk Reduction in the Banking Union.

Home Office

(40246) 15237/18 + ADD 1 COM(18) 798	Communication from the Commission to the European Parliament, the European Council and the Council Managing Migration in all its Aspects: Progress under the European Agenda on Migration.

Formal Minutes

Wednesday 16 January 2019

Members present:

Sir William Cash, in the Chair

Martyn Day	Mr David Jones
Marcus Fysh	Andrew Lewer
Kate Hoey	Michael Tomlinson
Kelvin Hopkins	Dr Philippa Whitford

Scrutiny Report

Draft Report, proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1.1 to 9 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Fifty-first Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

[Adjourned till Wednesday 23 January at 1.45pm

Standing Order and membership

The European Scrutiny Committee is appointed under Standing Order No.143 to examine European Union documents and—

a) to report its opinion on the legal and political importance of each such document and, where it considers appropriate, to report also on the reasons for its opinion and on any matters of principle, policy or law which may be affected;

b) to make recommendations for the further consideration of any such document pursuant to Standing Order No. 119 (European Committees); and

c) to consider any issue arising upon any such document or group of documents, or related matters.

The expression "European Union document" covers—

i) any proposal under the Community Treaties for legislation by the Council or the Council acting jointly with the European Parliament;

ii) any document which is published for submission to the European Council, the Council or the European Central Bank;

iii) any proposal for a common strategy, a joint action or a common position under Title V of the Treaty on European Union which is prepared for submission to the Council or to the European Council;

iv) any proposal for a common position, framework decision, decision or a convention under Title VI of the Treaty on European Union which is prepared for submission to the Council;

v) any document (not falling within (ii), (iii) or (iv) above) which is published by one Union institution for or with a view to submission to another Union institution and which does not relate exclusively to consideration of any proposal for legislation;

vi) any other document relating to European Union matters deposited in the House by a Minister of the Crown.

The Committee's powers are set out in Standing Order No. 143.

The scrutiny reserve resolution, passed by the House, provides that Ministers should not give agreement to EU proposals which have not been cleared by the European Scrutiny Committee, or on which, when they have been recommended by the Committee for debate, the House has not yet agreed a resolution. The scrutiny reserve resolution is printed with the House's Standing Orders, which are available at www.parliament.uk.

Current membership

Sir William Cash MP (*Conservative, Stone*) (Chair)
Geraint Davies MP (*Labour/Cooperative, Swansea West*)
Martyn Day MP (*Scottish National Party, Linlithgow and East Falkirk*)
Steve Double MP (*Conservative, St Austell and Newquay*)
Richard Drax MP (*Conservative, South Dorset*)
Mr Marcus Fysh MP (*Conservative, Yeovil*)
Kate Green MP (*Labour, Stretford and Urmston*)
Kate Hoey MP (*Labour, Vauxhall*)
Kelvin Hopkins MP (*Independent, Luton North*)
Darren Jones MP (*Labour, Bristol North West*)
Mr David Jones MP (*Conservative, Clwyd West*)
Stephen Kinnock MP (*Labour, Aberavon*)
Andrew Lewer MP (*Conservative, Northampton South*)
Michael Tomlinson MP (*Conservative, Mid Dorset and North Poole*)
David Warburton MP (*Conservative, Somerton and Frome*)
Dr Philippa Whitford MP (*Scottish National Party, Central Ayrshire*)