House of Commons
European Scrutiny Committee

Sixty-first Report of Session 2017–19

Documents considered by the Committee on 27 March 2019

Report, together with formal minutes

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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

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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's 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:

- In the area of EU financial services policy, the Committee considered new EU rules on both derivatives trading ('EMIR REFIT') and prudential rules for investment firms (the 'Investment Firm Review') which have recently been agreed between the EU's remaining Member States and the European Parliament and now await formal approval. The Committee concluded in both cases that the new legislation will affect the conditions for UK market access in both sectors after it leaves the Single Market, since they affect the regulatory baseline for 'equivalence'—the EU's legal mechanism to determine whether a non-EU country's supervisory standards in specific financial industries meet its own. Such 'equivalence' decisions, which are not merely technical but also political, can translate into preferential market access (in certain cases approximate 'passporting' rights UK firms currently enjoy while within the Single Market).

Summary

Financial services: EU regulation of the derivatives market

The Committee has cleared from scrutiny the EU's "EMIR REFIT" proposal, new legislation that will update how the European market for derivatives—like currency or interest rate swaps—is regulated, primarily through the obligation to 'clear' such transactions via a Central Counterparty. The new rules are likely to have a direct and significant impact on the UK clearing industry despite Brexit, given the pre-eminent position of the UK's clearing industry worldwide and the large amounts of euro-denominated derivatives that are traded in London. If the UK wants to retain current levels of market access after it leaves the Single Market—in a 'no deal' scenario or at the end of any post-Brexit transitional period if the Withdrawal Agreement is ratified—it will need to obtain 'equivalence' with EU rules, limiting the UK's domestic regulatory flexibility even when EU law now longer directly applies here.

Cleared from scrutiny; drawn to the attention of the Treasury Committee

Financial services: European prudential standards for investment firms

The European Scrutiny Committee considered the state of play on the EU's new stand-alone prudential framework for investment firms (the "Investment Firm Review"), which is due to be formally adopted shortly after more than a year of negotiations in Brussels.

The new legislation is driven in part by Brexit, which will cause a large part of Europe's investment services industry to fall beyond the jurisdiction of EU financial services law. The new legislation therefore introduces stricter conditions for 'equivalence'—the mechanism by which non-EU firms can access the Single Market for investment services—under the Markets in Financial Instruments Regulation. The extent to which this will bind UK financial services regulations to EU law in the long term in return for market access is one of the key concerns flagged by the Committee.

Cleared from scrutiny; drawn to the attention of the Treasury Committee

Stronger EU rules on the return of illegal migrants

The Government informs the European Scrutiny Committee that it has decided not to opt into a proposed EU Directive which seeks to strengthen existing EU rules on the return of illegal migrants and to prevent their re-entry into the EU. The Committee clears the proposal from scrutiny whilst expressing disappointment at the time taken to notify the Government's decision (taken in January). In doing so, the Committee seeks assurance that the procedural safeguards set out in the proposed Directive are adequate given the risk of inadvertent breaches of national immigration rules while UK nationals adjust to the loss of free movement rights after leaving the EU.

Cleared from scrutiny; further information requested; drawn to the attention of the Home Affairs 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: Copyright in the Digital Single Market [Proposed Directive (NC; scrutiny waiver granted)]

Digital, Culture, Media and Sport Committee: Copyright in the Digital Single Market [Proposed Directive (NC; scrutiny waiver granted)]

Environmental Audit Committee: EU framework on endocrine disruptors [Commission Communication (C)]

Home Affairs Committee: Stronger EU rules on the return of illegal migrants [Proposed Directive (C)]

International Trade Committee: EU retaliatory duties on imports from the US (Byrd amendment WTO dispute) [(a) Proposed Delegated Regulation; (b) Commission Report (C)]

Science and Technology Committee: Copyright in the Digital Single Market [Proposed Directive (NC; scrutiny waiver granted)]

Treasury Committee: Regulation of covered bonds [Proposed (a) Directive; (b) Regulation (C)]; Prudential requirements for investment firms [Proposed (a) Regulation; (b) Directive (C)]; Financial services: Trade in over-the-counter derivatives (EMIR REFIT) [Proposed Regulation (C)]

1 Copyright in the Digital Single Market

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted; drawn to the attention of Business, Energy and Industrial Strategy, Digital Culture Media and Sport, Science and Technology Committees
Document details	Proposal for a Directive on Copyright in the Digital Single Market
Legal base	Article 114; ordinary legislative procedure; QMV
Department	Business, Energy and Industrial Strategy
Document Number	(38076), 12254/16 + ADDs 1–4, COM(16) 593

Summary and Committee's conclusions

1.1 This Directive forms part of the Commission's "Copyright in the Digital Single Market" package of September 2016. Its broad range of measures was summarised in the first Report on this matter to our predecessor Committee, referenced at the end of this Chapter.

1.2 The Minister of State for Universities, Science, Research and Innovation (Chris Skidmore MP) writes to update the Committee on the progress of the proposal. The Minister explains that there are some reservations about whether the provisions in the negotiated text on addressing the value gap meet the Government's policy objectives. He further states that the other aspects of the Directive are now in line with the UK's negotiating objectives. On that basis, and as a result of the flexibility that has been achieved in terms of how the Directive would be implemented, the Minister states that he is "confident that the final agreement will meet a successful balance between the needs of copyright owners, online service providers and consumers". On that basis, he requests final scrutiny clearance from the Committee.

1.3 The proposal has been subject to a relatively lengthy trilogue process. The Minister explains that the most controversial provens have been those relating to the introduction of a new *press publishers' right* (Art 11) and to addressing the *value gap* (where content is shared on internet platforms) (Art 13 (Art 17 of the negotiated proposal)).

1.4 The Minister sets out that the Government agreed a number of negotiating principles including that: copyright reform should be balanced and proportionate and that interventions should be clear, targeted and justified by evidence. Policy aims included clarifying the obligations of and responsibilities on online services and to ensure they take appropriate action to remove copyright-infringing content; and foster greater cooperation between rights holders and online services.

Press publishers Right

1.5 Article 11 introduces a new right for press publishers, which applies to the online use of press publications by information society service providers (ISSPs) but not to private or non-commercial uses of press publications carried out by individual users. This includes a provision that Member States must provide for authors to receive an appropriate share of additional revenues that press publishers receive for the use of their press publications by ISSPs. It would allow the use of individual words or very short extracts by ISSPs. However, the Minister notes that the mechanism for how this will work in practice is not clear and "may require further judicial interpretation". The Minister further states that he considers that this aspect of the negotiations have been successful from the UK's perspective.

1.6 We note the potential lack of clarity in the practical operation of the provision and would appreciate further information from the Minister on what he considers the focus of any "judicial interpretation" would be.

Value Gap

1.7 The Minister explains that the Article 13 (now Article 17) provisions on the value gap were the most difficult element of the negotiations, with negotiations temporarily suspended in January due to conflicting positions between Member States. The negotiated text seeks to strike an appropriate balance for how obligations are placed on user-uploaded content sharing services.

1.8 The provisions clarify that online content sharing service providers may, in certain circumstances, communicate or make works available to the public, and will be liable for these acts if performed without permission of the rightholder. This liability may, however, be mitigated by taking a series of steps, the first of which being to make best efforts to obtain an authorisation. The Minister explains that the Government was very supportive of this approach.

1.9 Where neither the rightholder nor the platform wishes to enter into a licensing agreement, service providers must make best efforts to prevent the availability of unauthorised works by adhering to "high industry standards of professional diligence". The Minister explains that this would require removal of content in a one-off instance (notice and takedown); and an obligation to remove future instances of the same content (notice and stay-down). There is a carve out for micro and small platforms (those operating for less than three years; with a turnover of less than ten million Euros and under five million unique yearly visitors) which would not need to comply with the notice and stay-down provisions. Given the reference to industry standards, we would welcome further explanation from the Government of what those standards would be in the UK.

1.10 The negotiated text's position on user generated content (UGC) has changed, now requiring Member States to ensure users can rely on exceptions and limitations with uploading UGC. The negotiated position has a narrower approach to this as compared with previous drafts, which the Minister explains will be welcomed by rightsholders who were concerned about a potential reduction in licensing opportunities if the exceptions had been more broadly framed. The Minister states that he is strongly supportive of these elements.

1.11 The Minister does however also note some “less welcome” additions to the negotiated text. He notes that the Article is “not as clear as is desirable” and that SME platforms may remain unclear which obligations apply to them. He notes that SMEs have also argued that they could act as a barrier to investment. The Minister also notes that parts of the music and audiovisual sectors have expressed concern that the provisions may harm the creative economy. While highlighting these concerns the Minister appears to suggest that the requirement for the Commission to work with Member States to provide best practice guidance, will address some of the uncertainties.

1.12 We note that since the date of the Minister’s letter, the European Parliament has published amendments proposed by the political groups to this Article, which include various suggestions to delete or amend it.

Other provisions

1.13 The Minister explains that provisions on fair and proportionate remuneration for authors and performers, and a right for authors and performers to revoke rights granted to third parties, have been incorporated. He notes that the UK did not support these additions because they were not founded on an impact assessment but does not believe that they are contrary to the UK’s negotiating principles and considers that there is sufficient flexibility to allow the UK to ensure any new provisions complement existing UK legislation.

1.14 The Minister explains that the Directive has a 24 month period for transposition. He provides no further assessment of how the UK would engage with the proposed Directive, if passed, in the context of the UK’s withdrawal from the EU.

1.15 The Minister states that he is confident that the final agreement will meet a successful balance between the needs of copyright owners, online service providers and consumers. It is in that context that he seeks scrutiny clearance.

1.16 **We thank the Minister for his detailed update and for setting out the key issues relating to this Directive so clearly. We also thank him for the clear request to clear the measure from scrutiny but we decline to do so at this stage.**

1.17 **We note that the passage of this proposed Directive has, to date, been relatively lengthy and contentious. We also note that amendments are proposed to the vote in the European Parliament that are due to take place in the week commencing 25 March. In this context we are happy to provide a scrutiny waiver to allow the Government to vote in favour of the proposal, should it come to a vote in Council unamended. However it appears possible that the proposal will be amended when voted on by the European Parliament. If it is amended we ask the Minister to provide the Committee with an update on any amendments made and a further assessment of whether the Government would support these amendments.**

1.18 **The Minister has noted that in the press publishers right, the proposed Directive is not sufficiently clear and could require judicial interpretation. We ask the Minister to provide further details on what he considers the focus of any judicial interpretation would be and whether he considers there are any particular risks for different stakeholders in the UK.**

1.19 **We also ask the Minister to provide an indication of the approach that the UK would take to adopting voluntarily in UK law the provisions of this proposed Directive if the 24 month transposition period were to conclude after the end of any implementation period (according to the terms of the draft UK/EU Withdrawal Agreement, if ratified). Finally, we ask the Minister to indicate what, if any, the implications of the proposed Directive would be for the UK as a third country rather than as a Member State of the EU.**

1.20 **We request clarification on the above points by the end of April 2019.**

1.21 **We draw this chapter and this document to the attention of Business, Energy and Industrial Strategy, Digital Culture Media and Sport, Science and Technology Committees.**

Full details of the documents

Proposal for a Directive of the European Parliament and of the Council on Copyright in the Digital Single Market: (38076), 12254/16 + ADDs 1–4, COM(16) 593.

Previous Committee Reports

Seventeenth Report HC 71–xv (2016–17), chapter 5 (2 November 2016); Thirtieth Report HC 301–xxix (2017–19), chapter 2 (6 June 2018).

2 Copyright in the Digital Single Market Proposal

Committee's assessment	Legally and politically important
Committee's decision	Not cleared from scrutiny; further information requested; but scrutiny waiver granted
Document details	Proposal for a Regulation of the European Parliament and of the Council laying down rules on the exercise of copyright and related rights applicable to certain online transmissions of broadcasting organisations and retransmissions of television and radio programmes.
Legal base	Article 114 TFEU; ordinary legislative procedure; QMV
Department	Business, Energy and Industrial Strategy
Document Number	(38077), 12258/16 + ADDs 1–4; COM (16) 594

Summary and Committee's conclusions

2.1 The proposal is part of the Commission's "Copyright in the Single Market" package of September 2016. It aims to enable the wider dissemination of television and radio programmes across Member States, by "facilitating licensing of copyright and related rights in works and other protected subject-matter contained in broadcasts".[1]

2.2 The then Minister (Mr Sam Gyimah MP) wrote to the Committee in November 2018, to provide an update to the effect that a trilogue to consider the proposal had been scheduled for the "near future". The Minister of State for Universities, Science, Research and Innovation (Chris Skidmore MP) now writes to inform the Committee that the trilogue discussions have advanced and agreed a text, and to request that the proposal be cleared from scrutiny.

2.3 The details of the Minister's reservations about the previous version of the proposal are set out in the Committee's report of 28 February 2018. In summary, the main points of contention were: whether the proposal would be a regulation or a directive; the scope of the rule on country of origin; and whether direct injection would be included (and connections to retransmissions).

Conversion to a Directive

2.4 The Minister explains that several Member States had made their support for the proposal contingent on the Regulation being converted to a Directive, so as to give greater freedom in its implementation and ensure greater consistency with related existing legislation from the Satellite and Cable Directive. The agreed text confirms that the text will be a Directive, not a Regulation. While the Government had not shared this concern, it was content for the legislative text to be adopted as a Directive, so is satisfied with this position.

1 Recital (1) Draft Proposal http://esid.parliament.uk/Documents/398e853a-d6ac-4986–8a70-d3812b4c600f.pdf.

Country of origin rule

2.5 The European Parliament had sought to narrow the country of origin rule, to limit it to news and current affairs for television ancillary online services. The Minister notes that the Government would favour such an approach on the basis that it could preserve the practice of territorial licensing in the sector. The Minister implies, but does not explicitly state, that this is the position in the negotiated text, in that he states that the text "meets the Government's negotiation objectives".

Direct injection

2.6 'Direct injection' refers to a technical means of broadcast, whereby a broadcasting organisation provides the signal directly to a distributor. Some Member States had advocated for direct injection to be included in the proposal, while others were content to accept it provide the proposal was adopted as a Directive rather than a Regulation. The Commission had resisted the inclusion of new provisions on direct injection.

2.7 The Minister explains that the position in the negotiated text includes direct injection, which will be treated as a retransmission when a broadcast is distributed by a distributor in parallel with the original broadcasting organisation, attracting mandatory collective rights management. We note from the Minister's letter that the Government "expects" that pure direct injection (where the broadcaster provides the signal to a distributor but does not broadcast itself) will "require both the broadcasting organisation and the signal distributor to obtain authorisation, although Member States can choose how this should be done". The Minister states that the Government believes that the proposal's provisions on direct injection provide "adequate protection" for rights holders and "sufficient flexibility" for implementation. While we welcome this information from the Minister, we do query whether his use of the verb "expects" indicates some element of doubt in the manner in which pure direct injection is incorporated into the negotiated text.

2.8 The Minister concludes that the text of the proposal resulting from trilogues is one that meets the Government's negotiation objectives and one that the Government would wish to vote in favour of.

2.9 **We thank the Minister for his letter of 6 March 2019 and the information that he provided. We also thank the Minister for his clear indication that the Government would wish to vote in favour of the proposal.**

2.10 **We note the Minister's request for the proposal to be cleared from scrutiny. In the context we are content to grant a scrutiny waiver on the basis that the text of the proposal, as agreed at trilogue, proceeds to a vote in Council. We do however have a number of points which we would be grateful for the Minister to address, before we consider granting scrutiny clearance.**

2.11 **We ask the Minister to confirm whether there is any underlying uncertainty about how pure direct injection (see paragraph 2.7 above) will operate under the provisions of this proposal. If there is, we ask the Minister to clarify the position and confirm why the Government is content with it.**

2.12 **We note that the Minister has not included any information regarding what the timing of any implementing period for the proposed Directive would be. In a letter of 6 April 2018 the then Minister (Mr Sam Gyimah MP) suggested that the Government did not expect any implementation period to "exceed 18 months". If this expected timeline were accurate, if the proposal is passed soon, and if the draft Withdrawal Agreement were ratified by the UK and EU, it is likely that the UK would be required to introduce this proposal into UK law during the Withdrawal Agreement's transition period. On the basis of the current information, we are unable to comment on the likelihood of this occurring. We request an update from the Minister on this point.**

2.13 **As a related point we also note that the Minister has not provided any assessment on the impacts of this proposal (if any) that would be relevant to the UK as a third country rather than a Member State. We would welcome an assessment from the Minister on this point.**

2.14 **We request clarification on the above points by the end of April 2019. To assist our scrutiny of this matter we request a copy of the final text of the Directive, as adopted at Council.**

Full details of the documents

Proposal for a Regulation of the European Parliament and of the Council laying down rules on the exercise of copyright and related rights applicable to certain online transmissions of broadcasting organisations and retransmissions of television and radio programmes :12258/16 + ADDs 1–4: (38077), COM (16) 594.

Previous Committee Reports

Seventeenth Report HC 71–xv (2016–17), chapter 5 (2 November 2016), Sixteenth Report HC 301–xvi (2017–19), chapter 1 (28 February 2018).

3 MFF Horizon Europe

Committee's assessment	Politically important
Committee's decision	(a) Not cleared from scrutiny; further information requested; (b) Cleared from scrutiny
Document details	(a) Proposal for a Regulation of the European Parliament and of the Council establishing Horizon Europe—the Framework Programme for Research and Innovation, laying down its rules for participation and dissemination; (b) Proposal for a Decision of the European Parliament and of the Council on establishing the specific programme implementing Horizon Europe—the Framework Programme for Research and Innovation.
Legal base	(a) Article 173 TFEU, Article 182 TFEU, Article 183 TFEU, Article 188 TFEU; OLP; QMV; (b) Article 182 TFEU, Article 173 TFEU; QMV.
Department	Business, Energy and Industrial Strategy
Document Numbers	(a) (39882), 9865/18 + ADDs 1–6, COM(18) 435 final; (b) (39880), 9870/18 + ADDs 1–6, COM(18) 436 final

Summary and Committee's conclusions

3.1 The Horizon Europe programme represents the EU's proposal for the next, ninth, Framework Programme (Horizon Europe) which will run from 2021—2027. This is a financial programme and forms part of the wider Multiannual Financial Framework (MFF), which the Committee has scrutinised in its report of 21 November 2018.[2] In its first report on the proposal the Committee granted the Government a waiver to support on a Partial General Approach at the upcoming Competitiveness Council to be held across 29/30 November in relation to the Regulation.

3.2 The present report concerns itself more narrowly with the accompanying proposal for a Decision, also known as the 'Specific Programme', which sets out the policy content of the Horizon Europe Framework Programme. On 21 January 2019 the Minister of State for Universities, Science, Research and Innovation (Chris Skidmore MP) informed the Committee that the Romanian Presidency of the Council would seek a Partial General Approach (PGA) on the Horizon Europe Decision at the Competitiveness Council on 19 February.[3]

2 Forty-fifth Report (HC 301–xliv), chapter 2 (21 November 2018).
3 Letter from the Minister to the Chair of the European Scrutiny Committee (21 January 2019).

3.3 In his letter, the Minister noted that:

- he expected the PGA to focus on the elements of the proposal on which agreement could more easily be reached, which could include detail on missions, a new feature of the programme that are planned to prioritise investment and set direction to achieve objectives with societal relevance;
- the process for the selection remained to be agreed, as did the themes for the first Horizon Europe missions;
- there was a possibility that the legal base of the Decision would form part of the PGA: the Commission's proposal for Horizon Europe had set out a dual legal basis for the Decision which would have given a greater role to the European Parliament in shaping the Decision text than the single legal base that was used for previous Framework Programmes; and
- the Council text had returned to a single legal base, as with previous Framework Programmes, consistent with the European Council's legal advice that a second, 'industrial' legal base would only be appropriate if additional industrial components were introduced that were not already supported by the Regulation text. The Government, along with the other Member States, supported this position.

3.4 The Minister indicated that the outcome on this text was unlikely to affect the probability of the UK seeking association to Horizon Europe, and sought a scrutiny waiver so that the Government could participate according to the extent to which the Council text continued to align with UK priorities. However, soon thereafter, officials informed the Committee that the Decision would not be adopted at Competitiveness Council.

3.5 On 20 March 2019 the Minister wrote to the Committee for a second time to request a scrutiny waiver in relation to the proposed Decision.[4]

3.6 In his letter, the Minister provides an update on the Horizon Europe Regulation text. He notes that, since January, there have been several trilogues on the Regulation, and that, overall, these discussions have, from a UK perspective, been successful. He notes that the two outstanding issues are on "the exploitation of research and innovation funded by Horizon Europe" and "the remuneration available to researchers in widening countries".

3.7 Trilogue negotiations regarding the Regulation concluded on 19 March 2019, and, although the consolidated text has not yet been published, Politico reported[5] that the final compromises included the following changes:

- 35% of the total budget would be spent on climate-related research;
- Parliament would get a say over the research missions and partnerships, including a review planned for 2023;
- 3.3% of the budget would be earmarked to improve participation of newer EU states, with efforts by countries to set "attractive salaries for researchers"; and
- mobility research would be incorporated into the energy and climate cluster, instead of being a separate funding stream.

4 Letter from the Minister to the Chair of the European Scrutiny Committee (20 March 2019).
5 Politico Pro, Documents: Horizon Europe trilogue deal (20 March 2019) [paywall].

3.8 As previously noted by the Minister, the limitations on the possibility of third country participation in the Framework Programme has been excluded from the negotiations and will be dealt with as part of horizontal MFF negotiations among the Member States. The European Parliament's Industry, Research and Energy Committee is expected to vote on the proposal on April 2. Final adoption of the Regulation by the Council will not take place until negotiations regarding those aspects of the Regulation which have been excluded to date have been concluded by the negotiators.

3.9 In relation to the Specific Programme text (the proposal for a Decision), the Minister states that on 18 March the Permanent Representatives Committee of the EU Council (COREPER) agreed that there will be a Partial General Approach (PGA) on the Specific Programme and that this vote would be conducted with the simplified written procedure, also known as the "silence procedure", as set out below:

> "Under this procedure, Council Members are not obliged to respond; however, where no response is received by the Presidency's deadline, this is taken as acceptance of adoption of the act in question. The vote must be unanimous. Therefore, if the UK objects to the text, it will be blocked and be forced through the usual process, delaying a decision until May Competitiveness Council at the earliest. The Presidency's intention is to start the procedure on 27 March, with a deadline of between 24 and 36 hours."

3.10 The Minister states that during trilogues on the Regulation text, the Presidency, Commission and European Parliament collectively agreed that Annex Ia, which includes mission areas, would be moved from the Specific Programme to the Regulation, allowing them to be adopted by an Implementing Act. The Minister states that the UK is content with this approach, as it does not conflict with its objectives.

3.11 The Minister also notes that he had previously indicated that there was a possibility that the legal base of the Specific Programme would form part of the PGA, and now confirms that the proposed PGA text "includes Article 182 TFEU as its sole legal base". He states that this is in line with previous Framework Programmes and that "Member States (including the UK) have been unanimous in their opinion that this single legal base is sufficient". Officials have suggested that the Presidency believes that the European Parliament will concede on this issue in negotiations.

3.12 Pressed for further detail on any other substantive policy changes to the text during the course of negotiations, officials have informed the Committee that the names of individual clusters in Pillar 2 had changed and the cluster 'Inclusive and Secure Society' had been separated into two different clusters (one on security and one on social science and humanities).

3.13 The Minister concludes that, given that the policy content of the Specific Programme text aligns with the UK's objectives and the text uses an appropriate legal base, "my strong preference would be to indicate the UK's support for the text by voting in favour", and therefore requests a scrutiny waiver for this vote. Due to the use of the written procedure, the Minister acknowledges that the timing of this request is significantly shorter than the Committee's usual timescales and thanks it in advance for considering the document at such short notice.

3.14 **We thank the Minister for his update regarding the Presidency's proposal to conclude a Partial General Approach regarding the Specific Programme of the Horizon Europe Framework Programme, using the simplified written procedure, commencing on 27 March 2019. The changes to the text outlined by the Minister are minor, consisting primarily of the removal of the additional 'industrial' legal base from the proposal, in line with the position of the Member States, some minor adjustments in terms of the names and structures of the different clusters, and the relocation of Annex 1a on mission areas to the Regulation establishing the Framework Programme. This final alteration will mean that mission areas will have to be adopted by Implementing Act.**

3.15 **We have taken note of the Minister's previously expressed view that this text is unlikely to affect the probability of the UK seeking association to Horizon Europe, as well as his assessment that the policy detail of the text has not changed substantially since we last considered it.**

3.16 **The Minister indicates that, given that the policy content of the Specific Programme text aligns with the UK's objectives and the text uses an appropriate legal base, his "strong preference would be to indicate the UK's support for the text by voting in favour". This approach makes sense: given that the Government may wish in due course for the UK to become associated to Horizon Europe when it ceases to be an EU Member State, vetoing such an uncontentious Partial General Approach would in our assessment potentially be counterproductive.**

3.17 **We ask the Minister to provide us with:**

- **a detailed update on the outcome of trilogue negotiations regarding the Horizon Europe Regulation;**
- **clarification as to when we should expect the third country provisions of the Horizon Europe Regulation (Article 12) to be agreed; and**
- **an update on whether there have been any developments, formal or informal, which give any indication of the level of restrictiveness that is likely to apply to third country involvement in Horizon Europe as a whole or specific aspects of it.**

3.18 **We now clear this proposed Decision from scrutiny. We ask for a detailed update regarding the progress of the proposed Regulation, including responses to the above questions, at your earliest opportunity, and not later than 24 April 2019. In the meantime, we retain this proposal under scrutiny.**

Full details of the documents

3.19 (a) Proposal for a Regulation of the European Parliament and of the Council establishing Horizon Europe—the Framework Programme for Research and Innovation, laying down its rules for participation and dissemination: (39882), 9865/18 + ADDs 1–6, COM(18) 435 final; (b) Proposal for a Decision of the European Parliament and of the Council on establishing the specific programme implementing Horizon Europe—the Framework Programme for Research and Innovation: (39880), 9870/18 + ADDs 1–6, COM(18) 436 final.

Previous Committee Reports

Forty-fifth Report (HC 301–xliv), chapter 2 (21 November 2018).

4 EU framework on endocrine disruptors

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny (decision reported on 19/12/2018); drawn to the attention of the Environmental Audit Committee
Document details	Commission Communication—Towards a European Union framework on endocrine disruptors
Legal base	—
Department	Environment, Food and Rural Affairs
Document Number	(40172), 14204/18, COM(18) 734

Summary and Committee's conclusions

4.1 Endocrine disruptors (EDs) are chemicals that have the potential to harm people or wildlife by affecting endocrine (hormone) systems. Exposure to EDs can occur from different sources, such as residues of pesticides or consumer products used or present in daily life. Recognising the need for the EU to step up its efforts, the Commission tabled a new strategy late last year.

4.2 We last considered the Commission's document at our meeting of 13 February 2019, considering it to be a helpful case study of an emerging policy area regarding which it is inevitable that there will need to be a high degree of cooperation between the UK and the EU in the future should there be a desire to maintain strong trade links. We asked the Minister to report back on the discussion at the 5 March Environment Council,[6] extrapolating any potential implications for the UK arising from the Council discussion.

4.3 The Parliamentary Under-Secretary of State for the Environment (Dr Thérèse Coffey MP) has responded,[7] explaining that the Communication was welcomed by Member States, although some countries—including France, Denmark and Sweden—called for more ambitious and concrete actions, such as a ban on EDs in toys and consumer goods.

4.4 For its part, the European Commission summarised the key elements of the Commission and announced the upcoming launch of a fitness check on EDs (a platform to assess current EU legislation with the aim of concluding findings early 2020) and a new comprehensive forum to engage stakeholders.

4.5 The Minister made clear during the discussion that the UK welcomes the communication and is ready to collaborate closely on this important area in the future. She advocated a risk-based approach and suggested some practical strategies to target efforts on the areas of highest potential impact, while minimising testing on vertebrate animals. She was also able to highlight the UK's strong contribution in the area of scientific research

6 Outcome of the Council meeting, Environment Council 5 March 2019, Council document 7171/19.
7 Letter from Dr Thérèse Coffey MP to Sir William Cash MP, dated 15 March 2019.

and alternative test methods, for example through our OECD projects as outlined in our 25 Year Environment Plan. There was a strong consensus on the need for further research in this area, particularly on the effect of mixtures.

4.6 After the UK leaves the EU, says the Minister, the UK will remain fully committed to the effective and safe management of chemicals. Ensuring that endocrine disrupting chemicals do not harm human health or the environment will continue to be a priority. Harmful chemicals will continue to be regulated tightly, either through agreed terms of an implementation period and negotiations on a future economic partnership, or through the regulatory provisions that have been made for a no deal outcome.

4.7 The impact of emerging EU policy on the UK regime will depend on what, if any, specific measures are brought forward by the EU following the current fitness check exercise. After EU Exit, the UK may be able to make its own regulatory decisions, either independently or in response to EU evaluations and decisions. The extent to which the UK will be able to either diverge from, or influence, EU regulatory decisions will be determined by the terms on which the UK leaves the EU.

4.8 **We welcome the Minister's summary of the discussion on this topic at the 5 March Environment Council and note both the emerging nature of policy and the potential impact of future EU policy on the UK. While we accept that the impact on the UK will depend on what measures emerge from the EU, it is also the case that the UK must not be a passive recipient of any such policy. The UK's working assumption must be that there will indeed be new policy and that it will affect the UK and therefore the UK must have its own strategy to influence that policy, whether from inside or outside the EU.**

4.9 **The Environmental Audit Committee is undertaking an inquiry into toxic chemicals in everyday life, including endocrine disruptors. We therefore draw this chapter to the attention of that Committee. The document has already been cleared from scrutiny and we require no further information from the Minister.**

Full details of the documents

Commission Communication—Towards a European Union framework on endocrine disruptors: (40172), 14204/18, COM(18) 734.

Previous Committee Reports

Fifty-fifth Report HC 301–liv (2017–19), chapter 6 (13 February 2019); Forty-ninth Report HC 301–xlviii (2017–19), chapter 8 (19 December 2018).

5 EU retaliatory duties on imports from the US (Byrd amendment WTO dispute)

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny; further information requested; drawn to the attention of the International Trade Committee
Document details	(a) Commission Delegated Regulation (EU) …/... of 27.2.2019 amending Regulation (EU) 2018/196 on additional customs duties on imports of certain products originating in the United States of America; (b) Commission Report on the exercise of the power to adopt delegated acts conferred on the Commission pursuant to Regulation (EU) 2018/196 of the European Parliament and the Council of 7 February 2018 on additional customs duties on imports of certain products originating in the US.
Legal base	(a) Article 3(3) of Regulation (EU) 2018/196; QMV (to raise an objection) (b) Article 4(2) of Regulation (EU) 2018/196
Department	International Trade
Document Numbers	(a) (40431), 6951/19 + ADD 1; (b) (40430), 7189/19 + ADD1, COM(19) 118

Summary and Committee's conclusions

5.1 Since 2005, the EU has applied retaliatory measures against the US in the context of the EU's (and others') World Trade Organisation (WTO) dispute on the US Continued Dumping and Subsidy Offset Act of 2000 (CDSOA) (also known as the Byrd Amendment).

5.2 The amount of EU retaliation must be adjusted each year that the US continues to remain in non-compliance with the WTO ruling because the amount the US distributes to its companies is different each year. The adjustments are made by either changing the list of goods or by changing the amount of extra duty on the designated goods imported from the US.

5.3 The draft Commission Delegated Regulation relates to the 2019 adjustment of retaliatory measures (to be applied from 1 May). It proposes decreasing duties on US imports of sweetcorn, spectacle frames and mountings, crane lorries and women's denim trousers from 0.3% to 0.001%.

5.4 The Commission Report summarises the exercise of the Commission's power to adopt such delegated regulations since 2014.

5.5 In his Explanatory Memorandum of 14 March 2019, the Minister of State for Trade Policy (George Hollingbery MP) fully supports the Commission's proposed Delegated Regulation for 2019 on the basis that "it simply makes a necessary technical adjustment to amend the level of retaliation as authorised by the WTO". He implicitly supports the Commission Report.

5.6 On the Brexit implications of the draft Delegated Regulation, the Minister states that:

- in the event of a negotiated withdrawal, "the UK would apply any additional customs duties on imports imposed by the EU as part of the Common External Tariff" (CET) during the transition/implementation period (in accordance with the draft Withdrawal Agreement of 14 November 2018); and

- post-exit (in a no deal scenario on exit date) or post-transition period, when the UK is no longer bound by the CET, the UK can apply its own countermeasures. He states that the Taxation (Cross-Border Trade) Act 2018 "would allow the UK to vary duties in response to trade disputes as necessary", with any new additional duties requiring secondary legislation (that would be scrutinised under the negative procedure). However, the UK "would not transition these additional customs duties…noting their very low value, and that the US is in any case phasing out the measures under dispute".

5.7 The Minister further states that the UK "will of course need to take matters such as this into account in developing the country's trading relationship with the US going forward".

5.8 **We thank the Minister for setting out the Brexit implications of the periodic review and adjustment of these WTO-permitted retaliatory duties against the US, as requested. We note that the Government does not intend to apply these countermeasures from the end of any negotiated Brexit transition period, or immediately following a 'no deal' EU exit, on the basis of "their very low value, and that the US is in any case phasing out the measures under dispute".**

5.9 **We clear both documents from scrutiny, but ask the Minister to provide a summary table:**

- **listing all existing EU retaliatory measures/countermeasures against third countries (which the UK currently applies as a member of the EU); and**

- **explaining whether these measures will be applied post-exit/transition period, and if not, the reasons for their termination and what analysis the Government has carried out in respect of the impact on the UK of terminating these measures.**

5.10 **Furthermore, we highlight the Minister's statement that "[t]he UK will of course need to take matters such as this [retaliatory duties] into account in developing the country's trading relationship with the US going forward".**

5.11 **In the context of escalating trade tensions between the EU and US and the desire of the UK government to conclude an ambitious future economic partnership with the EU and free trade agreement with the US post-exit, we ask the Minister to share the Government's analysis on how the continued application, or not, of existing EU countermeasures against the US post-exit is expected to:**

- **influence the negotiation and conclusion of future trade agreements with the EU and US respectively; and**
- **impact different UK stakeholders.**

5.12 **We draw the Minister's Explanatory Memorandum and our conclusions to the attention of the International Trade Committee.**

Full details of the documents

(a) Commission Delegated Regulation (EU) …/... of 27.2.2019 amending Regulation (EU) 2018/196 on additional customs duties on imports of certain products originating in the United States of America: (40431), 6951/19 + ADD 1; (b) Commission Report on the exercise of the power to adopt delegated acts conferred on the Commission pursuant to Regulation (EU) 2018/196 of the European Parliament and the Council of 7 February 2018 on additional customs duties on imports of certain products originating in the US : (40430), 7189/19 + ADD1, COM(19) 118.

Background

The EU-US dispute

5.13 In 2000, the US passed the CDSOA (also known as the Byrd Amendment). It provides that anti-dumping and countervailing duties collected by US authorities during the previous fiscal year should be distributed directly to the affected domestic companies (rather than to the Treasury).

5.14 The EU, along with eight other WTO members, challenged the legislation in the WTO. In January 2003, the WTO found that the CDSOA did not comply with WTO rules and should be repealed. The US was given till the end of 2003 to comply with the ruling.

5.15 The US failed to bring itself into compliance with its WTO obligations and the EU was authorised by the WTO to impose an additional customs duty above its bound customs duties (i.e. the permitted maximum tariff rates generally allowed to be imposed by one WTO Member on imports from another Member) on a list of US products covering, on a yearly basis, a total value of trade not exceeding 72 per cent of the CDSOA duties collected on imports from the EU for the most recent year for which data are available. The other complainants were also granted authority to impose identical retaliatory measures.

5.16 Since 1 May 2005, the EU has applied additional customs duties on imports of certain products originating in the US on a yearly basis, adjusting the level of retaliation proportionately (by adjusting the rate of additional import duty and/or adding or deleting products covered by the list) to the amount disbursed from duties collected on EU products in the most recent distribution.

5.17 In his Explanatory Memorandum, the Minister states that whilst the CDSOA has been repealed, it continues to have transitional effects such that the EU remains authorised to imposed retaliatory measures.

The proposed Commission Delegated Regulation

5.18 The draft Commission Delegated Regulation amends Regulation (EU) 2018/196 establishing additional customs duties on imports of certain products originating in the US. It proposes decreasing, with effect from 1 May 2019, the amount of additional duty applied by the EU on imports from the US of sweet corn, frames and mountings for spectacles, crane lorries and women's denim trousers and breeches from 0.3 per cent to 0.001%.

5.19 The Minister's Explanatory Memorandum notes that "[t]his year's proposed retaliation of USD 3,355.82 (£2,540.36) represents a negligible sum compared to the 2018 level of retaliation, which amounted to USD 682,823 (£516,897) and that has been applied since 1 May 2018".

The Commission Report

5.20 The Commission report summarises the Commission's exercise of powers to adopt delegated acts conferred on the Commission pursuant to Regulation (EU) 2018/196. However, as the EU Regulation entered into force on 8 March 2018, no delegated acts have been adopted since then because the 2019 delegated regulation is yet to be adopted. This report therefore provides a summary of four delegated acts adopted by the Commission from 2015 to 2018 regarding these additional duties.

5.21 The delegation of power is automatically extended for a further five-year period unless the European Parliament or the Council opposes such extension not later than three months before the end of each period.

Previous Committee Reports

None.

6 Financial services: Trade in over-the-counter derivatives (EMIR REFIT)

Committee's assessment	Legally and politically important
Committee's decision	Cleared from scrutiny; drawn to the attention of the Treasury Committee
Document details	Proposal for a Regulation on the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories
Legal base	Article 114 TFEU; ordinary legislative procedure; QMV
Department	Treasury
Document Numbers	(38703), 8890/17 + ADDs 1—3, COM(17) 208

Summary and Committee's conclusions

6.1 Over-the-counter (OTC) derivatives play a major role in financial markets. They include many types of relatively straightforward currency or interest rate hedges (used by many non-financial businesses to manage the risk of exchange or interest rate fluctuations). However, there are also highly-complex transactions credit default swaps– usually entered into by larger financial institutions—which aim to protect one counterparty in a contract against a default by the other. The latter derivatives in particular were one of the drivers of the 2008 financial crisis, when unsustainable exposures to such poorly-understood financial flows contributed to the collapse of Lehman Brothers in September 2008, which in turn weakened American insurance group AIG to the point where it needed an unprecedented bail-out from the US Government in September that same month.

6.2 As a result, as part of a wider international effort,[8] the EU enacted legislation in 2012 to tighten up supervision of the market for OTC derivatives and bring greater transparency to the market to identify build-ups of risk. These rules are set out in the European Market Infrastructure Regulation, known usually by its acronym EMIR.[9] This legislation requires many derivatives trades that involve an EU-based counterparty to be 'cleared' by a regulated Central Counterparty (CCP), which steps in to fulfil the obligations of a counterparty which defaults on the contract so that there is no chain reaction of bankruptcies.[10] In addition, derivatives trades need to be reported to a trade repository to give regulators insight into the market. UK is a leading global centre for the clearing

8 The EU's regulatory action on derivatives was driven by the G20's 2009 Pittsburgh Declaration, which also committed many other countries—including the US, Australia, China and Russia—to take action to address the financial stability risks posed by derivatives. However, these countries have often taken a different legal approach to the issue.

9 EMIR is contained in Regulation 648/2012.

10 The effect of the clearing obligation is to concentrate default risk with the CCP, rather than with the individual counterparties. That in turn requires strict prudential and governance requirements for CCPs, since a collapse of a Central Counterparty could have devastating effects on financial stability.

industry, with its three major Central Counterparties—in particular LCH.Clearnet, owned by the London Stock Exchange—handling 75 per cent of centrally-cleared euro-denominated interest rate derivatives.[11]

6.3 In May 2017, the European Commission proposed substantial changes to EMIR with respect to the clearing and reporting obligations incumbent on counterparties in derivatives trades. In particular, its review of the existing 2012 Regulation had found that some of the requirements were disproportionate for non-financial institutions that enter into derivatives trades (for example companies using currency swaps). It therefore proposed amendments (colloquially known as "EMIR REFIT"), which would—broadly speaking—reduce the administrative burden imposed by the Regulation on certain financial market participants not considered a risk to overall financial stability.[12] These changes would, however, need to be agreed jointly by the European Parliament and the EU's national governments under the ordinary legislative procedure. (In parallel, the Commission also proposed changes to the way CCPs active within the EU are supervised by public regulators, including those CCPs based outside of the Union. We will be considering the state of play on those proposals separately in the near future, as agreement on them has also been reached and they are particularly relevant to the British clearing industry after Brexit.)

6.4 After nearly two years of negotiations, the Economic Secretary to the Treasury (John Glen MP) informed us on 19 March 2019 that the Parliament and the Member States had reached agreement on the "EMIR REFIT" amending legislation.[13] The new Regulation will exempt more (smaller) financial counterparties and non-financial counterparties from certain clearing and reporting obligation.[14] An existing exemption from the clearing requirement for pension schemes will also remain in place for a further two years.[15] The Commission would also have the power to suspend the clearing obligation for specific types of derivatives in "exceptional situations", for example where the only CCP offering the requisite clearing service ceases trading. EMIR REFIT will also introduce a new legal obligation on clearing brokers to provide services on "fair, reasonable, non-discriminatory and transparent commercial terms" ("FRAND"), by requiring transparency on fees as well as "unbiased and rational contractual arrangements".[16]

6.5 Under article 2 of the amending Regulation, the changes to the clearing and reporting obligations under EMIR will mostly be in effect from spring 2020, provided formal adoption takes place before the summer of 2019. The major exceptions would be the provisions relating to conflicts of interest between trading and clearing units of CCPs,[17] and new requirements on the verification and transfer of data held by trade repositories[18]

11 Commission Impact Assessment SWD(2017) 246, p. 48.

12 See for more information on the substance of the original European Commission proposal our Report of 22 November 2017.

13 See Council document 6913/19 (dated 1 March 2019).

14 For example, the Minister explains that derivatives transactions between counterparties in the same corporate group, where at least one counterparty is a non-financial institution, should be exempted from having to be reported to a trade repository under EMIR.

15 The exemption for pension schemes is meant to protect savers' retirement income from being eroded by the cost of their pension fund having to clear their transactions, as this requires posting of collateral. The two years plus one year construction is a compromise, as France and the European Parliament wanted to limit the exemption while the UK, the Netherlands and Denmark favoured extending it further.

16 Council of the EU press release, "Capital markets union: deal on updated rules for financial derivative products and clearing" (5 February 2019).

17 See the new Article 4(3a) of EMIR.

18 See the ne Article 78(9) and (10) of EMIR.

(which would instead become applicable in early 2021). The European Commission will need to adopt a series of regulatory and implementing technical standards to give full effect to the changes, for example on data standards, the segregation of client collateral from the assets of the Central Counterparty, and transfers of information held by trade repositories.[19]

6.6 The new rules will also eventually form the regulatory baseline for 'equivalence', the legal mechanism by which the Commission can assess whether a non-EU country has a comparable supervisory approach to derivatives trades as EMIR (and under which it can grant market access rights comparable to those enjoyed by CCPs and trade repositories based in the EU itself). This is the route by which British Central Counterparties will need to access the European market after the UK leaves the EU Single Market.[20]

6.7 The UK notified the European Council of its intention to withdraw from the EU under Article 50 TEU on 29 March 2017. The extent to which the changes brought about by "EMIR REFIT" will apply directly in the UK as a matter of EU law is dependent on the next steps in the Brexit process, and in particular on the date the UK actually ceases to be a Member State and on whether the House of Commons ratifies the draft Withdrawal Agreement published in November 2018:

- during any further extension of the Article 50 period, the UK would remain a full Member State of the EU and therefore be required to apply EU law in accordance with the Treaties. For an additional extension of the Article 50 period to overlap with the entry into force of EMIR REFIT, it would need to be for at least a year or more beyond spring 2019; and

- even if the Article 50 period is not extended further (or for too short a period of time to overlap with the gradual entry into force of "EMIR REFIT" in 2020), the draft Withdrawal Agreement on the UK's exit from the EU envisages a transitional period after the UK has formally ceased to be an EU Member State.[21] During this period, which could last until the end of 2022,[22] it would remain subject to European law as if it were still a Member State.[23] This, again, could overlap with the date the new derivatives regulations take effect.

6.8 In any scenario where the UK is still subject to EU law when the "EMIR REFIT" legislation takes effect, the new rules would apply to the UK financial services industry in its entirety from its entry into force until EU law ceased to have supremacy.[24] The Economic Secretary, in his latest update on the proposal, does not refer to the implications of the new legislation for the UK during either the transitional period or an extended Article 50

19 Regulatory technical standards in EU law take the form of Delegated Acts, which can be vetoed by either the European Parliament or a Qualified Majority of Member States. Implementing technical standards take the form of Implementing Acts, which must be actively approved by a Qualified Majority of Member States (but over which the European Parliament has no say).

20 Under EMIR, CCPs and trade repositories based in an EU Member State have automatic 'passporting' rights to operate in any EU country from their home base. Non-EU CCPs and repositories have to qualify following an equivalence assessment.

21 The final day of the UK's EU membership could also be different if a different date is inserted into the Withdrawal Agreement by mutual consent.

22 Under the Withdrawal Agreement, the transition would initially last until 31 December 2020. However, it could be extended by up to two years by mutual agreement between the UK and the EU.

23 See Articles 126 and 132 of the Withdrawal Agreement.

24 This would occur either when the UK's EU membership ends and the Withdrawal Agreement has not been ratified, or on the final day of the transitional period if the Agreement is ratified.

period. His letter does, however, note that the Government is "broadly supportive" of the compromise text that has emerged.[25] With the European Parliament due to approve the legislation at its final Plenary Session before the EU elections in April 2019, it is expected the changes to EMIR will be formally voted on by the Member States in the Council in the coming months. The Minister has therefore requested the Committee to clear the proposal from scrutiny, to enable the Government to "vote in favour […] should a vote take place prior to the UK's departure from the EU".

6.9 In a 'no deal' scenario, where the Article 50 period is not extended further and the Withdrawal Agreement is not ratified, "EMIR REFIT" would not apply in the UK directly as a matter of EU law. However, the Treasury is seeking powers under the Financial Services (Implementation of Legislation) Bill to implement the new rules in domestic law by means of regulations in a 'no deal' scenario to ensure the competitiveness of the UK's financial services sector. To preserve EU market access for British CCPs in this scenario, the Government would need to obtain 'equivalence' under EMIR (see paragraph 6).

6.10 We have set out our assessment of the new EMIR Regulation for the UK in various Brexit scenarios in more detail in our conclusions below.

Our conclusions

6.11 **We thank the Economic Secretary for this latest update on the negotiations to revise the clearing and reporting obligations for derivatives trades incumbent on financial and non-financial institutions under EMIR. Given the UK's pre-eminent position in the global clearing industry, and its close economic links with the EU, it is likely to have significant repercussions for the British financial services industry irrespective of the UK's decision to leave the European Union.**

6.12 **We note in this respect that, while the UK is now due to formally leave the EU on 12 April 2019 (or at an even later date, if the Article 50 period were to be extended further), the draft Withdrawal Agreement which the Government negotiated would establish a transitional period after the formal date of 'EU exit'. During this time, the UK would stay in the Customs Union and Single Market (avoiding immediate economic dislocation and providing time for the two sides to begin negotiating a new trade agreement). However, EU legislation would continue to apply in the UK as if it were still a Member State. That would extend to European laws agreed after UK withdrawal, provided they take effect during the transition. Similarly, if the Article 50 period is extended again by mutual agreement between the UK and the EU, the UK would remain a full Member State until the end of that extension, and be subject to the supremacy and direct effect of EU law for its duration.**

6.13 **Given that the EMIR REFIT legislation is due to be adopted in spring 2019 and take effect in stages (with the bulk of the changes having force of law from early 2020), it is therefore clearly a possibility that this new European legislation will apply directly to British CCPs, trade repositories and their customers until the UK had fully left the Single Market. We therefore welcome the Treasury's assessment that the final agreement on the Regulation is acceptable to the Government.**

25 The compromise agreement on EMIR REFIT was endorsed by the Member States' Permanent Representatives to the EU (COREPER) on 6 March 2019.

6.14 **However, we note with concern that the REFIT amendments delegate responsibility to the European Commission for a number of technical standards to give full effect to the regulatory changes for the derivatives trade: during any transition, when the UK is no longer a Member State but still subject to EU law, those will be discussed and approved without the input of the Treasury, the Bank of England or the Financial Conduct Authority. The Government would also not have a vote if the new suspension mechanism for the clearing and reporting obligation were to be triggered during the transitional period, since such a suspension must be approved as an Implementing Act by a qualified majority of EU Member States only. During any further extension of the Article 50 period, the UK would remain a full Member State with the attendant representational and voting rights it currently enjoys in the Council of Ministers and associated bodies.**

6.15 **Even after EU law ceases to apply directly in the UK—for example, beyond the end of the transition, or in a 'no deal' scenario where the Withdrawal Agreement is not ratified—the amendments to the EMIR Regulation would remain important. Once it leaves the Single Market, British CCPs and trade repositories will lose their automatic right to operate throughout the EU. Instead, to continue servicing EU-based customers, a number of conditions need to be fulfilled:**

- **the European Commission must have in place an 'equivalence' decision, recognising the UK's regulatory regime for derivatives trading as equivalent to EMIR;**[26]
- **the individual UK-based CCP or trade repository has successfully applied for registration with the European Securities & Markets Authority (ESMA); and**
- **the UK's domestic regulators have established cooperation arrangements with ESMA on exchange of information and coordination of supervisory activities.**

6.16 **Whether in the short-term (a no-deal scenario) or the medium-term (ratification of the Withdrawal Agreement), 'equivalence' will become the mechanism by which UK-based CCPs and trade repositories can access the European market from their British base. We therefore welcome the EU's decision in December 2018 to pre-emptively grant the UK equivalence for Central Counterparties under the current version of EMIR, to avoid significant market disruption in April 2019 if the 'no deal' scenario occurs.**[27] **While the Commission has adopted further regulatory measures to facilitate the novation of uncleared**[28] **transactions from the UK to an EU counterparty if the Withdrawal Agreement is not ratified,**[29] **the Bank of England still has concerns**

26 In addition, the UK would also need to prove that its systems to combat money-laundering was equivalent to the EU's Anti-Money Laundering Directive.

27 See the Official Journal of 19 December 2018. The UK's individual CCPs were registered with ESMA in February 2019, enabling them to continue operating beyond Brexit day in the absence of a transitional period. The necessary cooperation agreement between ESMA and the Bank of England was signed on 4 February 2019.

28 This means the derivatives trade in question was not subject to the clearing obligation under EMIR because of the lower risk of the counterparties for Europe's financial stability, although it may still have been reportable to a trade repository.

29 The flexibility to novate uncleared derivatives contracts from the UK to an EU counterparty for a limited amount of time after Brexit is set out in Commission Regulations C(2018)9122 and C(2018)9118. These are still being scrutinised by the Member States before they take effect.

about the ability of £20 trillion of uncleared derivatives to be managed in a 'no deal' eventuality for contracts not novated in time.[30] We also note there is no contingency equivalence decision in place for UK-based trade repositories.[31]

6.17 **Moreover, under a *separate* proposal amending the provisions of EMIR relating to the supervision of Central Counterparties themselves, obtaining UK-wide equivalence and CCP-specific recognition from outside the Single Market will become more difficult. Under those changes, which we will discuss more extensively in forthcoming Report, equivalence could require the Bank of England to effectively accept and enforce decisions made by ESMA in relation to British CCPs without its input. In addition, the EU is introducing a 'location policy' with the explicit aim of having a legal mechanism to push the UK's largest Central Counterparty to relocate activities to the European Union after Brexit, as a means of keeping it within EMIR's regulatory orbit.**

6.18 **It is a cause of concern therefore that the EU's equivalence decision for UK CCPs in a 'no deal' scenario is explicitly time-limited and will expire in March 2020. If the Government wants to secure continued equivalence *beyond* that date, or after the end of the transitional period if the Withdrawal Agreement is ratified, it would need to stay functionally aligned with EMIR—including not only the amendments described in this chapter, but also a stricter equivalence process for systemically-important CCPs referred to above—indefinitely. If an agreement on equivalence under EMIR is not found after the UK leaves the Single Market (or if the 'no deal' contingency measure is allowed to expire), British businesses would no longer be able to provide clearing and repository services in any EU Member State from their London base. Given the potential economic repercussions, the EU will need to be mindful of the disruption that would be triggered by shutting out British CCPs from its market.**

6.19 **Similarly, however, any domestic policy choices in the UK with respect to clearing and reporting services for trade in derivatives would need to be balanced against the potential consequences for the ability to export such services to the EU. We note in this respect that the Treasury has pushed for the introduction of the Financial Services (Implementation of Legislation) Bill, which would give it the power to implement the changes that would be made by EMIR REFIT—and various other EU financial services proposals—by means of a statutory instrument in a 'no deal' scenario (i.e. when there would be no EU legal obligation to apply the new Regulation). It would be able to make regulations to do so, including "with any adjustments the Treasury consider appropriate" so long as they do not constitute a "major" deviation from the EU legislation they are meant to implement.[32]**

6.20 **In its Explanatory Memorandum on the Bill, the Government describes it as a "no deal" measure which will "minimise disruption" to the UK regulatory regime for financial services following exit from the EU without a Withdrawal Agreement in**

30 See for more information the minutes of the Financial Policy Committee of the Bank of England of 5 March 2019, p. 6.

31 There are currently 8 trade repositories active in the EU. Four are UK-based (DTCC, UnaVista, CME and ICE TVEL), while the other three are from Poland, Luxembourg and Sweden. DTCC opened an Irish subsidiary in March 2019. The same month, a fifth UK-based trade repository registered with ESMA—Bloomberg's UK trade repository—withdrew its registration with ESMA. There is currently no equivalence decision for trade repositories in place with any non-EU country.

32 The regulation-making powers under the Financial Services Bill expire two years after the UK's exit from the EU without a Withdrawal Agreement. It is a possibility that further regulation-making powers in this area are created before that deadline.

place.[33] **We caution the House to consider carefully how the Government may use the powers that would be delegated to it under the Bill, given that unspecified 'adjustments' could be made to EU law, and the test of whether any such changes are 'major'—and therefore not allowed—would be subjective and difficult to measure in practice. We also reiterate our concern that the Government's reliance on equivalence with EU law to access Europe's market for financial services after Brexit could also constrain the UK's regulatory autonomy in the longer term, with potentially unforeseen consequences.**

6.21 **We are content to now clear the EMIR REFIT proposal from scrutiny, in view of its imminent adoption by the Council and the Government's support for the new legislation. However, as described above, there are many outstanding issues created by Brexit with respect to the impact EU financial services legislation will have in the UK beyond 'exit day'. We therefore draw these developments to the attention of the House, and of the Treasury Committee in particular.**

Full details of the documents

Proposal to amend Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories: (38703), 8890/17 + ADDs 1–3, COM(17) 208.

Background

6.22 An over-the-counter (OTC) derivative is privately negotiated, and not traded on an exchange.[34] They account for almost 95% of the derivatives market. The size of the market is enormous: in the first half of 2018, the notional outstanding amount of OTC derivatives was nearly $595 trillion trillion (£460 trillion).[35] However, the financial crisis highlighted deficiencies within the market, with major implications for financial stability. The first deficiency was counterparty credit risk: the default of a major participant in the OTC market can have systemic implications, requiring Government intervention.[36] The second was transparency, as neither market participants nor regulators had sufficient oversight of exposures in the OTC market, causing unwillingness to trade in stressed markets and restricting liquidity.

33 However, in our view, the Financial Services Bill cannot properly be described as a 'no deal' preparation. None of the EU legislation for which the Treasury is seeking implementing powers under the Bill will actually be in force for months, if not years, after the scheduled 'exit day' on 12 April 2019. Indeed, many have not even been formally adopted by the European Parliament and Council. The amendments to EMIR under the REFIT Regulation, for example, will not be fully in effect until spring 2021 at the earliest. We accept that the regulation-making powers sought by the Treasury to implement EMIR REFIT and other EU financial services proposals in a 'no deal' scenario may make sense from an administrative perspective.

34 A derivative is a financial contract that derives its value from the performance of an underlying asset or entity, such as a currency, interest rate or commodity. They can be used as a hedge, for example against exchange rate fluctuations, or speculatively, for example to bet that a company will default on its debt obligations.

35 BIS, "Global OTC derivatives market" (accessed 19 February 2019).

36 AIG was the subject of a US Government bail-out totalling $180 billion. It had sold a large amount of OTC derivatives called credit default swaps (CDS), which insure the buyer against some other loan (for example a mortgage) defaulting. AIG had not set aside sufficient capital to cover claims against it under the CDS when the other loans started to fail.

6.23 To address these issues, in 2009 G20 leaders agreed the Pittsburgh Declaration.[37] It stipulated that all standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms and cleared through central counterparties, by the end of 2012 at the latest. Central counterparties (CCPs) act as a safety mechanism in the OTC market, placing themselves in the middle of every sale: they effectively become the buyer to every seller and the seller to every buyer, reducing risks of chain reactions or financial instability if either the buyer or the seller of the derivatives contract cannot fulfil their obligations. As a result, the risks of the derivatives market are concentrated in the CCPs. The G20 also called for use of non-centrally cleared contracts to be discouraged by making them subject to higher capital requirements. Leaders also agreed that all OTC derivative contracts should be reported to trade repositories, to give regulators a more comprehensive and transparent overview of the market and the build-up of financial stability risks.

6.24 In response to this G20 agreement, the EU adopted the European Market Infrastructure Regulation (commonly referred to as EMIR) in 2012.[38] EMIR:

- ensures that information on all EU derivative transactions is reported to a recognised trade repository (the "reporting obligation"). This data is made accessible to supervisory authorities, including the European Securities and Markets Authority (ESMA), to give policy makers and supervisors a clear overview of activity in financial markets;
- requires standard derivative contracts to be cleared through CCPs (the "clearing obligation"). The process of clearing insulates both the buyer and seller of a derivative from the risk that the other counterparty will default, concentrating the risk in the CCP; and
- establishes stringent organisational, business conduct and prudential requirements for CCPs. EMIR ensures that counterparties to an OTC derivatives contract exchange margin (collateral) for trades that are not cleared through CCPs, making it more expensive.

6.25 The UK plays a central role in clearing derivatives globally, as well as in the implementation of EMIR for the EU and the Eurozone. The Bank for International Settlements has stated that the UK is the single largest venue for OTC derivatives activity. Globally, UK-based CCPs account for almost half of all clearing of interest rate derivatives (which account for 80 per cent of all OTC transactions). For euro-denominated interest rate derivatives the UK is an even larger centre, clearing 75 per cent of all such transactions.[39] There are four UK-based CCPs recognised under EMIR.[40]

Proposed amendments to EMIR

6.26 In November 2016, the Commission published a report of its review of the application of EMIR, as part of its "regulatory fitness" (REFIT) process of evaluating EU legislation.[41]

37 See G20 Leaders Statement: The Pittsburgh Summit Sept 24–25 2009

38 Regulation 648/2012.

39 See Bank of England 'Over-the-counter (OTC) derivatives, central clearing and financial stability'.

40 CME Clearing Europe, ICE Clear Europe Limited, LCH. Clearnet Limited and LME Clear Limited. There are 17 CCPs authorised across the EU as a whole.

41 See COM(2016) 857: Report under Article 85(1) of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories.

6.27 This review concluded that there was general support for the core objectives of EMIR of promoting transparency and standardisation in derivatives markets and reducing systemic risk through its core requirements. It also proposed a new legislative framework for the recovery and resolution of CCPs at risk of collapse, aiming to clarify lines of responsibility and measures to mitigate any spill-over effects in the "unlikely situation" that an EU-based central counterparty had insufficient liquidity to meet its obligations. We have considered this proposal elsewhere.[42] In addition, the Commission identified a number of areas where EMIR could be adjusted, in order to increase the efficiency of its requirements and reduce "disproportionate costs and burdens" on businesses.[43] It said that it was considering a number of amendments to EMIR with respect to the obligations for counterparties.

6.28 In May 2017, the Commission translated its review findings into a draft Regulation to amend EMIR with respect to the obligations that EU law imposes on Central Counterparties, trade repositories and those who use them (colloquially referred to as 'EMIR REFIT').[44] The primary objectives of the proposal were to:

- change the definitions of small financial counterparties (SFCs) and non-financial counterparties (NFCs) and how the clearing obligation applies to them, reducing or removing that obligation for those counterparties which do not pose a systemic risk;
- extend the exemption for pension funds from central clearing requirements;[45]
- streamline the reporting obligation, including removal of the obligation to report historical trades (back-loading); and
- introduce a mechanism allowing the Commission to temporarily suspend the clearing obligation in extraordinary circumstances.[46]

6.29 The Rt Hon. Stephen Barclay MP, then Economic Secretary to the Treasury, submitted an Explanatory Memorandum on the Commission proposal on 3 July 2017 (four months after the Government formally notified the European Council of its intention to withdraw from the EU under Article 50 TEU).[47] In it, he noted that the Government supported the Commission proposal, but would use its examination by the Council to ensure that EMIR would remain consistent with the implementation of the 2009 Pittsburgh agreement[48] across G20 partners, and that application of the Regulation between EU Member States would not lead to regulatory arbitrage and competitive distortions. With respect to the

42 See COM(2016) 856. Our predecessors considered the Recovery and Resolution Regulation in their Reports of 11 January and 29 March 2017. Negotiations on this proposal are on-going in the Council and the European Parliament, conducted separately from the EMIR package as it is not concerned with authorisation and supervision of CCPs per se. The proposal remains under scrutiny in anticipation of further information from the Government.

43 Our predecessors considered the report in January 2017. See: (38314) 14828/16: Twenty-fifth Report HC 71–xxiii (2016–17), chapter 16 (11 January 2017). It remains under scrutiny.

44 See COM(2017) 208.

45 Pension funds are exempted from the clearing obligation because they do not typically hold the necessary cash or liquid assets to fulfil the margin requirements imposed by EMIR. To impose the clearing obligation would necessitate the diversion of their invested funds, ultimately reducing the income they can provide for their customers in retirement.

46 The Commission argues that suspension of the clearing obligation may be necessary, for example if the CCP clearing the biggest portion of a certain OTC derivatives class has exited that market.

47 Explanatory Memorandum submitted by HM Treasury (3 July 2017).

48 See paragraph 0.23.

timetable for implementation of the REFIT proposal in the context of the UK's withdrawal from the EU, the Minister told us at the time that the Presidency and the Commission are seeking "swift agreement on the proposal so that certain provisions come into force by summer 2018".

6.30 In parallel to the 'REFIT' proposal, the Commission and the European Central Bank also tabled separate draft legislation on the supervision of CCPs by public regulators. One of the core objectives of those proposals was to apply stricter regulation of non-EU Central Counterparties active on the European market. Under this separate legislation, the EU could require–as a last resort–that a CCP relocate to an EU Member State if its functioning was considered essential to the European economy. Those proposals, which are primarily targeted at London's clearing industry after Brexit, remain under scrutiny, and we have considered them separately in a different chapter of this Report.

The legislative process for 'EMIR REFIT'

6.31 The previous Economic Secretary (the Rt Hon. Stephen Barclay MP) announced in December 2017 that the Estonian Presidency was seeking a common position among the EU's national governments, as the basis for negotiations with the European Parliament on the final substance of the EMIR REFIT proposal, by the end of 2017. In July 2018, the new Economic Secretary (John Glen MP) sent us a letter confirming belatedly that the Member States' Permanent Representatives in Brussels (COREPER) had indeed adopted such a 'mandate for negotiations'[49] on 19 December 2017.

6.32 In terms of the substance of the Member States' position, the Minister noted that the thrust of the Commission proposal–the removal of certain clearing and reporting obligations for certain non-systemically important companies–had been maintained. In addition, the Government secured the removal of two of the more contentious elements of the proposal (on Securitisation Special Purpose Entities[50] and exchange-traded derivatives)[51] from the legal text. Instead, these would made subject to a review by the European Commission at an (unspecified) point in the future.[52]

49 The Minister's letter refers to the mandate as a 'general approach'. This is not strictly correct, as 'general approaches' are adopted by Ministers, not their permanent representatives, and as such are subject to the scrutiny reserve (which applies to formal decisions taken by the Council of the EU). 'Mandates for negotiations' adopted by COREPER are not subject to the scrutiny reserve.

50 An SSPE is a corporation trust or other entity established specifically to carry out a securitisation or securitisations, for example of mortgage loans, legally isolating the obligations of the SSPE from those of the originator institution (like a bank). Under EMIR, many SSPEs are exempt from the clearing and margining requirements where they engage in derivatives transactions. The original Commission proposal would reclassify them as "financial counterparties", meaning they would be fully within the scope of those requirements. The financial services industry had expressed concerns that posting margin would require SSPEs to hold more cash or be restructured, with compliance functions delegated to a third party. The UK Government's position is that SSPEs, even if categorised as a financial counterparty under EMIR, should nonetheless not be subject to the clearing obligation.

51 Exchange-traded derivatives (ETDs) are not traded over-the-counter, but, as the name implies, via a regulated exchange. The Markets in Financial Instruments Regulation (MiFIR) requires every ETD in the EU to be cleared by a CCP, and to be reported by both counterparties to a Trade Repository. The REFIT proposal by the Commission would introduce single-sided reporting by the CCP for exchange-traded derivatives (ETDs), removing that responsibility from the counterparties themselves. The UK Government believed the Commission proposal would mainly result in burden relief for clearing members, who are least likely to need it given their size and sophisticated compliance machinery. Some Member States were pushing for ETDs to be removed from the scope of EMIR altogether and refer to MIFIR, while others had expressed concern about the lack of legal clarity resulting from the difference between "positions" (under MiFIR) and transactions (under EMIR).

52 The Committee wrote to the previous Economic Secretary on 18 December 2017, asking to "receive a copy of the mandate as soon as it becomes available, accompanied by an explanation of the Government's position on it".

6.33 The Minister's letter also noted that the Member States had suggested a number of other technical changes to the wording of the Regulation, for example to clarify that in case of insolvency of a CCP its own estate would be handled under national–not European–legislation, while the fate of its clients' assets would be subject to EMIR.[53] A proposal by the UK to exempt bundled transactions (so-called portfolio compression) from the clearing obligation was not accepted, although the European Commission will report on this issue in 2021.

6.34 The European Parliament's Economic & Monetary Affairs Committee (ECON) approved its position on the EMIR REFIT proposal at its meeting in May 2018, which was endorsed with amendments by the Parliament's Plenary on 12 June. MEPs largely accepted the original Commission proposal. It also wanted to negotiate amendments to EMIR with the Member States which–according to the Parliament's own summary–would also give the European Securities and Markets Authority (ESMA) the power to develop draft technical regulatory standards specifying the conditions under which commercial terms for clearing services are considered to be "fair, reasonable, non-discriminatory and transparent", to counter the possibility of conflicts of interest between a CCP's trading and clearing units.[54]

Developments since July 2018

6.35 Trilogue negotiations between the European Parliament and the Member States on the final substance of EMIR REFIT began in July 2018. Although the Treasury told us at the time that "conclusion of this file is likely to be delayed until September 2018", negotiations proved to be far more protracted than that.[55] On 5 February 2019, the Parliament and Council announced that they had finally reached an informal agreement on the EMIR REFIT proposal.

6.36 The Economic Secretary to the Treasury (John Glen MP) informed us of this development by letter dated 19 March 2019. The finalised legal text is to be put to EU Finance Ministers for formal adoption in the coming months, possibly as early as April 2019. As the UK's membership of the EU has now been extended until at least 12 April 2019, the Government may still have a vote in the Council of Ministers when the new rules are formally approved.

53 In the Member States' proposal, references to the insolvency estate of a failed clearing member itself were removed, so that the amended version of EMIR would focus solely on the assets and positions in client accounts (which, under the new Regulation, could be "ported or liquidated with greater certainty"). A separate legislative proposal on the recovery and resolution of failing CCPs–to mirror a similar legal framework for banks—remains under scrutiny.

54 Technical regulatory standards would need to be adopted by the European Commission on the basis of ESMA's draft, and could be vetoed either by the Council or the European Parliament as they take the form of a Delegated Act.

55 In January 2019, ESMA warned that the delays in the adoption of the legislation meant that smaller financial counterparties and reporting entities in particular were at risk of becoming subject to superfluous legal obligations which the REFIT proposal was designed to eliminate. The Authority effectively notified the Member States' national financial regulators that they should "apply their risk-based supervisory powers in their day-to-day enforcement of EMIR in a proportionate manner".

6.37 As per the Minister's letter, the final text of "EMIR REFIT" as agreed between the two institutions:

- maintains the thrust of the Commission proposal for a new category of "small financial counterparties" which will be exempted from the obligation to clear their transactions through a CCP. In the same way, many non-financial counterparties will also have reduced clearing obligations;
- Pension schemes will remain exempt from the clearing obligation for another two years (i.e. until spring 2021), with the possibility of extending this by another two years by means of Delegated Act (i.e. the extension could be vetoed by either the Member States or the European Parliament);[56] and
- as regards the obligation to report derivatives trades to a trade repository, the new Regulation aims to "streamline existing rules" by removing the obligation to report historic data ("backloading") as well as reporting of intragroup transactions involving non-financial counterparties.

6.38 The Member States' suggested modifications with respect to CCP insolvency, Securitisation Special Purpose Entities and exchange trade derivatives (see paragraph 32 above) were also maintained in the final text. The European Parliament is expected to approve the new Regulation at its final plenary session before the European elections, in the week commencing 14 April 2019. Formal adoption by the Member States in the Council is expected to follow shortly thereafter.

6.39 Under article 2 of the amending Regulation, the changes to EMIR will mostly be in effect from spring 2020. The major exceptions are the provisions relating to conflicts of interest between trading and clearing units of CCPs,[57] and new requirements on the verification and transfer of data held by trade repositories[58] (which will become applicable by early 2021). The European Commission will also need to adopt a series of regulatory and implementing technical standards to give full effect to the changes, for example on data standards, the segregation of client collateral from the assets of the Central Counterparty, and transfers of information held by trade repositories.

6.40 The changes to EMIR described above are likely to be significant for the UK and its financial services industry irrespective of the Brexit scenario that unfolds in the coming weeks. We have set out our assessment of this in more detail in paragraphs 11 to 21 above.

Previous Committee Reports

See (38703), 8890/17 + ADDs 1–3, COM(17) 208: Second Report HC 301–ii (2017–19), chapter 20 (22 November 2017).

56 The exemption for pension schemes is meant to protect savers' retirement income from being eroded by the cost of their pension fund having to clear their transactions, as this requires posting of collateral. The two years plus two years construction is a compromise, as France and the European Parliament wanted to limit the exemption while the UK, the Netherlands and Denmark favoured extending it further.

57 See the new Article 4(3a) of EMIR.

58 See the new Article 78(9) and (10) of EMIR.

7 Prudential requirements for investment firms

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny; drawn to the attention of the Treasury Committee
Document details	(a) Proposal for a Regulation on prudential requirements for investment firms; (b) Proposal for a Directive on the prudential supervision of investment firms
Legal base	(a) Article 114 TFEU; ordinary legislative procedure; QMV; (b) Article 53 TFEU; ordinary legislative procedure; QMV
Department	Treasury
Document Numbers	(a) (39397), 16017/17 + ADD 1, COM(17) 790; (b) (39400), 16011/17 + ADD 1, COM(17) 791

Background and Committee's conclusions

7.1 As part of the Single Market, the EU has put in place a substantial body of law governing the prudential stability of the financial services sector. However, the investment services industry—for example the provision of brokerage services or portfolio management—has to date not been made subject to a specific prudential regime calibrated to ensure their financial stability, or orderly wind-down, in the event of an economic downturn or a liquidity crisis. Instead, investment firms in the EU are covered by European rules drafted for the banking industry under the Capital Requirements Directive and Regulation.[59]

7.2 Following a review of whether this approach remained appropriate for the investment services industry, the European Commission concluded that the banking rules were not "fully suited to all investment firms" because they do not "capture the actual risks faced by the majority" of such companies.[60] Therefore, in December 2017, the Commission tabled legislative proposals—a Regulation and a Directive—for a new, calibrated prudential regime for investment firms (referred to as the "Investment Firm Review" or IFR).

7.3 As summarised in our previous Reports of 28 February 2018 and 9 January 2019, the new legislation will create a new classification system for investment firms, ranging from Class 1 (systemically-important investment banks) to Class 3 (the smallest investment

59 The main difference between investment firms and banks is that the former do not take deposits or make loans, meaning there is less risk of a 'run' where customers want to withdraw their funds en masse, endangering the continued viability of the institution.

60 See Commission document SWD(2017) 481. We also elaborated the reasons for new prudential rules for the investment services industry in our Report of 28 February 2018.

firms).[61] For Class 2[62] and Class 3 firms,[63] the legislation will establish new, tailored prudential and organisational requirements, whereas Class 1 firms would remain subject to the Capital Requirements Directive for banks (as they are at present) because they "typically incur and underwrite risk" on a scale that makes them important for the EU's overall financial stability. In addition, Class 1 investment firms based within the Eurozone would be supervised directly by the European Central Bank's Single Supervisory Mechanism (SSM) rather than their national regulator.[64]

7.4 In addition, the Commission proposals also sought to modify the way in which non-EU firms could access the EU market for investment services. Driven to a large extent by the UK's withdrawal from the European Union, they would amend the provisions of the 2014 Markets in Financial Instruments Regulation (MiFIR) related to 'equivalence'. The equivalence regime currently allows the Commission, with the support of a qualified majority of Member States, to declare the regulatory regime of a 'third country' equivalent to the EU's.[65] If such a determination is made, firms from that country can provide investment services to EU-based professional and institutional clients on a cross-border basis (i.e. without the need for a legal presence in the EU itself). Equivalence decisions can be withdrawn unilaterally by the EU, with no right of appeal or other recourse for the non-EU country affected. This is the legal framework on which the UK will need to rely to provide investment services into the EU after it leaves the Single Market.[66]

7.5 Because of the UK's large financial services sector, its decision to withdraw from the EU has led to concerns that a significant volume of investment services—currently regulated directly by European law—could be provided from outside the EU's direct jurisdiction if the UK were to obtain equivalence after Brexit. The Commission's Investment Firm Review therefore sought to attach more stringent conditions before equivalence can be granted, by requiring a "detailed and granular process for the assessment" that also takes into

61 The categorisation of individual companies would be based primarily on the worth of a firm's assets, but also the specific type of investment services offered.

62 Under the original Commission proposal investment firms would fall into "class 2" if they exceed any one of a number of size thresholds, such as assets under management valued at more than €1.2 billion (£1.1 billion) or a balance sheet higher than €100 million (£88 million). Firms would also fall into this category if they administer any client assets or hold any client money. For most Class 2 firms, the new capital requirements would be calculated according to a new "K-factor approach" for measuring risks in three categories (to the firm, to its customers and to the market) from the services and activities undertaken. The necessary capital buffer would be derived from the volume of each activity.

63 For firms in Class 3, the minimum capital would be either the level of initial capital required for their authorisation in line with the new prudential regime—€75,000 (£67,000)—or a quarter of their fixed costs (overheads) for the previous year, whichever is higher. The European Banking Authority indicated that most Class 3 firms "ought to comfortably meet the new requirements based on their existing levels of own funds".

64 The transfer of supervisory responsibility to the ECB was included to address suspicions that UK investment firms, wishing to retain a foothold in the EU market after Brexit, might otherwise 'shop around' for the lightest-touch national prudential approach within the Eurozone. Although the Commission proposal would not make class 1 investment firms subject to the Single Supervisory Mechanism if they relocated from the UK to a non-Eurozone EU country, the Commission said in late 2017 that "based on anecdotal information, at this stage the indications are that the preferred locations for these firms' EU27-operations are in financial centres in Euro Area Member States (Germany, Ireland, Netherlands, Luxembourg, France)".

65 No 'third country' currently has an equivalence decision of this type under MiFIR. However, the Regulation only took effect in January 2018.

66 The UK is due to leave the Single Market after a post-Brexit transitional period which, if the Withdrawal Agreement is ratified, could last until 31 December 2022. In a 'no deal' Brexit scenario, the UK is due to leave the Single Market on 12 April 2019.

account the third country's "supervisory convergence".[67] The clear purpose was to give the Commission more leeway to make any UK request for equivalence conditional on a very close alignment with the EU's regulatory regime for investment firm after Brexit.[68] The Commission also called for close monitoring of the activities of non-EU investment firms operating in the EU which do not rely on 'equivalence', such as delegated or outsourced activities by EU-based firms to UK service providers.[69]

Parliamentary scrutiny of the Investment Firm Review

7.6 Based on an Explanatory Memorandum submitted by the Treasury in early 2018, we described the substance and potential implications of the proposal in more detail in our initial Report of 28 February 2018. We took into account the Government's request for a transitional period after the UK is due to formally leave the EU, during which it would temporarily stay in the Single Market and bound by new European law—including, potentially, the Investment Firm Review after its adoption by the EU institutions.

7.7 In its Memorandum, the Government expressed support for the new classification system and prudential and organisational requirements for the investment industry, subject to further fine-tuning of the specific capital requirements that would apply to the different classes. However, the Government has—understandably—been much more sceptical about the proposed modifications to the equivalence process for non-EU companies to provide services within the Single Market without the need for a subsidiary there, given these are aimed at making it more difficult for the UK to provide investment services into the EU while retaining domestic regulatory flexibility.

7.8 When the proposals were first published in late 2017, the Economic Secretary to the Treasury (John Glen MP) told us that the UK did not want to rely on equivalence at all to access the EU market after Brexit, instead seeking "stable, reciprocal arrangements" for trade in financial services that did not rely on equivalence.[70] However, the November 2018 Political Declaration accompanying the draft Withdrawal Agreement on the UK's exit from the EU instead commits the Commission to "start assessing equivalence […] as soon as possible after the United Kingdom's withdrawal" and to keep its "respective equivalence frameworks….. under review". This shows the Government has accepted that, for investment services and other financial sectors, UK market access into the EU after Brexit will be based on equivalence. The EU has made no specific commitments as to what

67 Article 61 of the Regulation as proposed by the Commission reads: "Where the services provided and the activities performed by third-country firms in the Union following the adoption of the [equivalence] decision (…) are likely to be of systemic importance for the Union, the [third country's] legally binding prudential and business conduct requirements (…) may only be considered to have equivalent effect to the [EU's] requirements (…) after a detailed and granular process for the assessment. For these purposes, the Commission shall also assess and take into account the supervisory convergence between the third country concerned and the Union."

68 Separately, the Commission also proposed a reporting requirement for third country firms registered with ESMA under the equivalence regime […]. They would have to inform the Authority annually about the scale and scope of their activities; their turnover and assets; the arrangement for investor protection; and their risk management policy.

69 For example, UK investment firms could provide services in specific EU Member States via a branch (a place of business which is a part of an authorised investment firm, but which has no legal personality of its own and is not subject to separate authorisation within the EU). Under EU law, branches can provide services to retail and elective professional clients in those EU Member States which allow this. Wholesale services to professional and institutional investors can only take place on a cross-border basis after 'equivalence' has been granted, or via a fully-authorised subsidiary within the EU.

70 Indeed, until the middle of 2018, the Chancellor of the Exchequer was still insisting that equivalence should categorically not form the basis for the UK's future trading relationship with the EU in financial services.

its ‘reviews’ of this framework should lead to, and has only consented to an ambition—rather than an obligation—to conclude its assessments of the UK’s regulatory approach in the various financial sectors where equivalence is a possibility by June 2020 (*if* the House of Commons ratifies the Withdrawal Agreement).[71]

7.9 The EU Member States discussed the Investment Firm Review throughout 2018, with the most politically contentious issues being the treatment of the most important (Class 1) investment firms, and the precise conditions for granting non-EU countries access to the Single Market for investment services under ‘equivalence’. We issued our last Report on the state of play in the negotiations on 9 January 2019.

The substance of the final legislation

7.10 In early 2019, the Member States’ Permanent Representatives in Brussels (‘COREPER’) endorsed a set of amendments—a ‘General Approach’—to the Commission proposals, and asked the Romanian Presidency of the Council to discuss these with the European Parliament (which must also agree on the new legislation for it to take effect).[72] The European Parliament’s Economic & Monetary Affairs Committee (ECON) had already adopted its position on the Investment Firm Review in September 2018. Negotiations between the two institutions began in January 2019, and by letter dated 19 March 2019, the Economic Secretary informed us that the Parliament and the Member States had reached agreement on the Investment Firm Review in late February.

7.11 The final compromise on new prudential rules for investment firms operating in the EU, as summarised by the Minister, consists of the following key elements:

- for the largest, **Class 1 investment firms**, the new legislation maintains the approach taken by the Member States in their January 2019 General Approach, meaning that individual national regulators would have “more flexibility” to keep large investment firms under prudential rules meant for systemically-important banks. This, the Minister says, “preserves the [UK’s] current approach”;[73]

- with respect to pay practices in the investment industry, the rules introduce new **restrictions on variable remuneration** to discourage excessive risk-taking in pursuit of higher pay, in particular by deferring bonuses and requiring them to be partially paid out in the form of instruments like shares.[74] However, these new restrictions would not apply to investment firms with less than €300 million (£256

71 If the Withdrawal Agreement is not ratified, the EU has given no indication that it will consider any short-term equivalence decisions in relation to the UK financial services industry, other than for clearing of over-the-counter derivatives by British central counterparties under European Markets Infrastructure Regulation (EMIR) until the end of 2019.

72 The Economic Secretary wrote to us in advance of this meeting, indicating that the outstanding issues being discussed where the prudential treatment of ‘Class 1’ firms and the new framework for equivalence assessments of non-EU countries.

73 In December 2018, the Treasury told us the UK continued to advocate for a regulatory approach for Class 1 investment firms “which would not unduly impact the [Prudential Regulation Authority’s] approach to systemic investment firms’ designation and supervision”.

74 These new rules mirror parallel developments in the regulation of remuneration practices in banks under the Risk Reduction Measures package for financial stability in the banking sector.

million) in assets, or to individual employees who are paid €50,000 (£42,700) or less by way of bonus in a given year. The Minister notes with satisfaction that there will not be a bonus cap for staff in Class 2 and 3 investment firms;[75]

- on **market access for non-EU investment firms**, the final text substantially amends the 'equivalence' regime under the Markets in Financial Instruments Regulation. In particular, as originally proposed, it allows the Commission to assess whether investment services provided in the EU from outside the Union under equivalence are likely to be of systemic importance, and if so attach additional "specific operational conditions"[76] to the equivalence decision addressed to a particular country—like the UK—requiring more specific adherence to EU financial services legislation on an on-going basis;[77] and

- finally, the legislation will extend **ESMA's existing market intervention powers** to temporarily prohibit or restrict the marketing, distributing or selling of an instrument or service if it presents a risk to the EU market to non-EU firms operating under equivalence. The proposal also "outlines the actions ESMA can take in collaboration with third country supervisors, in the event it has evidence to believe that EU investors' interests and EU markets' order are being put at risk", including the withdrawal of a third country firm's registration (which would bar it from operating in the EU on a cross-border basis even if its home country is covered by an equivalence decision).

7.12 The new legislation is expected to take effect throughout the European Union by autumn 2020. Giving full effect to the rules will also require the European Commission to adopt a number of Delegated and Implementing Acts, for example on risk measurements for prudential capital; the format of information exchanges between national financial authorities; and the criteria for assessment of the potential systemic importance of non-EU investment firms operating in the EU.

7.13 The Minister's letter explains that the Government "believe that the overall agreement creates a regime that support more proportionate regulation, upholds market integrity and financial stability, and which will also benefit the industry and ultimately the wider economy". He therefore asked the Committee to clear the Investment Firm Review from scrutiny, so that the Government can vote in favour of its adoption if it is brought to the Council before the UK ceases to be a Member State.

7.14 The precise impact of the new legislation for the UK is currently unclear, even after it exits the European Union. If the Withdrawal Agreement is ratified, the Investment Firm Review would be binding on the UK as a matter of EU law from its date of application

75 By extension, the bonus cap would remain in place for Class 1 investment firms covered by the banking rules under the Capital Requirements Regulation.

76 Specifically, the Commission could require that non-EU firms operating under equivalence would have to comply with articles 20, 21, 23, 26 and 28 of the Markets in Financial Instruments Regulation, which cover requirements related to public post-trade disclosures; reporting of individual transactions to an EU-based regulator; and use of authorised exchanges or trading venues.

77 However, the European Parliament abandoned its earlier proposal that certain activities—underwriting and dealing on own account—should be excluded from the equivalence regime altogether (which would have "de facto impos[ed] a relocation requirement for [non-EU] firms" who want to provide such services to EU-based customers). In a win for the UK, these activities will therefore remain in scope of the new equivalence regime, meaning non-EU firms can in principle provide them on a cross-border basis after an equivalence determination is made. However, they would be subject to a new reporting requirement to ESMA to measure the size of such activities by 'third country' firms.

in late 2020 until the end of the post-Brexit transitional period (which could, potentially, last until 31 December 2022).[78] At the junction where both the Investment Firm Review has taken effect *and* the UK has left the Single Market (including in a 'no deal' scenario), the new legislation would not as a matter of EU law apply to British firms. However, if the Government wanted to maintain 'equivalence' to ensure cross-border market for investment firms, it would need to stay broadly aligned with the prudential requirements set out in the new EU rules. It is therefore also an important piece of legislation even for the UK as a 'third country' outside the Single Market.

7.15 The importance of the Investment Firm Review for the UK financial services industry is also underlined by the Government's decision to include it in the scope of the Financial Services (Implementation of Legislation) Bill, which is awaiting its Report stage in the House of Commons. Once passed, this Act would allow the Treasury to implement a range of new EU financial services legislation currently awaiting formal adoption by means of Statutory Instruments, in the eventuality that the UK leaves the EU without a Withdrawal Agreement—and therefore a transitional period—in place. The Economic Secretary told Parliament on 26 February 2019 that the Bill would allow for rapid implementation of the Investment Firm Review (and other new pieces of EU financial services legislation)[79] in a way that "maintains the functionality, reputation and international competitiveness of [the UK] financial sector". However, it is not strictly correct to refer to the Financial Services Bill as part of the Government's 'no deal' preparations, as the EU legislation covered by it by definition will not be in force on 'exit day' and therefore there is no risk of a legal vacuum.[80] (For example, as noted, the Investment Firm Review will not apply until autumn 2020, well beyond the current 'exit date' for the UK's withdrawal.)

Our conclusions

7.16 **We are grateful to the Economic Secretary for his overview of the final substance of the EU's Investment Firm Review. As we noted in our last report, the way the European Union regulates the investment services industry is of direct relevance to the UK given its sizeable financial services trade surplus and large-scale operations in the remaining EU Member States. The new EU rules are likely to take effect from autumn 2020. In the short-term, if the Withdrawal Agreement is ratified by the House of Commons, this means the new prudential legislation for investment firms would apply directly in the UK during the post-Brexit transitional period (and particularly if it is extended beyond its original end date of 31 December 2020 until 2022).**

7.17 **It is unclear at this stage whether the Government will have a formal vote on the final legislation in the Council of Ministers, because the date for the vote has not yet been set.[81] Once the Article 50 period ends and the UK is no longer a Member State,**

78 Initially, the transition period would last only until 31 December 2020. If the Withdrawal Agreement is ratified but the transition is not extended, the Investment Firm Review would therefore only be directly binding on the UK as a matter of EU law for a few months.

79 The full list of 'in-flight' EU financial services proposals to which the Treasury's regulation-making powers would apply are set out in the Schedule to the Bill.

80 If the EU legislation covered by the 2019 Act was already in effect on 'exit day' there would be no need for the Act, because it would have been covered by the regulation-making powers of the European Union (Withdrawal) Act 2018.

81 The European Council has foreseen the possibility of a further extension until 22 May 2019 if the Withdrawal Agreement is approved by the House of Commons. In the absence of ratification, the EU expect the Government to put forward proposals to unblock the Brexit process to avoid 'no deal' by 12 April, which could involve a further extension of the Article 50 process (including the holding of European elections in the UK).

the UK will lose its representation in the Council. Similarly, at that stage, the Treasury, Bank of England and Financial Conduct Authority will not be formally involved in the drafting or approval of any of the Delegated or Implementing Acts necessary to give full effect to the Investment Firm Review, even though they would be binding domestically until the end of any transitional period if the Withdrawal Agreement is ratified. It is concerning that no other country, including the non-EU members of the European Economic Area, must automatically accept new EU legislation on which they did not have a vote (although we accept, of course, that the Treasury has been closely involved in the EU negotiations and the Minister's reassurance that the outcome of the legislative process is acceptable to the UK Government).

7.18 **As noted, the Investment Firm Review would not apply directly in the UK by virtue of EU law in a 'no deal' scenario, or beyond the end of any transition period under the Withdrawal Agreement. However, the Treasury could still choose to implement it anyway, even if there is no EU legal obligation to do so. This, the Government has said, would be a means of ensuring the UK financial industry's "functionality, reputation and international competitiveness" after EU exit. If the Financial Services (Implementation of Legislation) Bill is passed, such changes could be made to domestic law without the need for primary legislation. Although the Bill would prohibit the Treasury from making "major" changes when implementing EU financial services legislation by means of regulations in a 'no deal' Brexit scenario, we urge the House to pay close attention to any differences introduced by the Treasury compared to the Investment Firm Review as adopted at EU-level.**

7.19 **The inclusion of the Investment Firm Review in the Bill is also relevant with respect to any attempt by the Government to obtain 'equivalence' under the Markets in Financial Instruments Regulation after Brexit. In the final legislation as adopted by the Council and Parliament, the granting of equivalence for the provision of cross-border investment services from the UK into the EU is more difficult than under current EU legislation.**[82] **The scale of the UK's investment industry means it is highly likely the European Commission would use its new powers to conduct a "granular assessment" of the potential systemic importance of investment services provided in the EU by UK firms after Brexit, and attach stricter conditionality that would tie the UK closely to European legislation in this area even as a non-Member State. The Treasury's ability to implement the EU rules domestically by means of regulations would facilitate seeking equivalence in due course, since it makes it easier to amend UK law on investment services to reflect EU legislation in this area after Brexit.**

7.20 **Overall, whether the EU grants equivalence—especially in an economically valuable area like investment services—will not merely be a technocratic exercise where regulatory regimes are compared. Given the wider state of UK-EU relations, particularly in the context of an abrupt economic rupture that a 'no deal' Brexit would trigger, it will also be inherently political. Even if the UK respects the EU's Investment Firms Review to the letter as a 'third country', there is no guarantee that it will be deemed equivalent. Moreover, even if it *is* granted, equivalence may come with conditions or time-limits, as shown by the EU's recent decision to extend its recognition**

82 Unlike for Central Counterparties for derivatives trades, the EU has not adopted a pre-emptive contingency equivalence decision for UK investment services in case of a 'no deal' Brexit.

of Switzerland's stock exchanges as equivalent for only six months.[83] **Access for UK financial services firms to the EU market is likely to be, implicitly, linked to the wider trade negotiations. These are issues the House will want to scrutinise closely as and when negotiations on the UK's future, post-Single Market economic partnership with the EU begin.**

7.21 **Given the likely impact of the EU's Investment Firm Review in the UK irrespective of Brexit, the new legislation is clearly of substantial political importance. However, in view of the imminent adoption of the proposals by the Council and the European Parliament, we are content to now clear them from scrutiny. We also draw these developments to the attention of the Treasury Committee, given its interest in the regulation of the UK's financial services industry.**

Full details of the documents

(a) Proposal for a Regulation on prudential requirements for investment firms: (39397), 16017/17 + ADD 1, COM(17) 790; (b) Proposal for a Directive on the prudential supervision of investment firms: (39400), 16011/17 + ADD 1, COM(17) 791.

Previous Committee Reports

Sixteenth Report HC 301–xvi (2017–19), chapter 8 (28 February 2018) and Fiftieth Report HC 301–xlix (2017–19), chapter 3 (9 January 2019).

83 European Commission press release, "Commission proposes to extend equivalence for Swiss share trading venues for six months" (17 December 2018).

8 Regulation of covered bonds

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny; drawn to the attention of the Treasury Committee
Document details	(a) Proposal for a Directive on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU; (b) Proposal for a Regulation amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds
Legal base	(a)Articles 53 and 114 TFEU; ordinary legislative procedure; QMV (b) Article 114 TFEU; ordinary legislative procedure; QMV
Department	Treasury
Document Numbers	(a) (39544), 7064/18 + ADDs 1–2, COM(18) 94; (b) (39555), 7066/18 + ADDs 1–2, COM(18) 93

Summary and Committee's conclusions

8.1 Covered bonds are a type of debt obligation issued by banks. They are very safe investments because they are secured against a ring-fenced pool of high-quality, low-risk assets (typically residential mortgages), which the bond holders can access directly as preferred creditors if the bank issuing the bond cannot make its contractual payments. The UK market is estimated to amount to €121 billion (£107 billion) of outstanding covered bonds, making it a relatively small player: the primary issuers in Europe are Germany and Denmark, which each had outstanding volumes of roughly €380 billion (£327 billion) in 2015.[84]

8.2 The low-risk nature of these bonds allows the issuing bank to offer a low interest rate, making them a relatively cheap way of raising capital that can then be used to finance business and consumer loans. For the same reason, EU prudential legislation (the Capital Requirements Regulation) contains certain regulatory and prudential reliefs for EU-based financial institutions, such as investment funds, banks and insurers, which purchase covered bonds issued by EU banks. However, the European Union has not to date substantively regulated or harmonised the legal aspects governing actual issuance of covered bonds themselves, such as prudential, governance or transparency requirements.

8.3 Since 2015, the EU has been engaged in the process of constructing a Capital Markets Union (CMU) where barriers to cross-border flows of capital are dismantled with the ultimate aim of providing European businesses with cheaper and more varied access to finance. This process, which has been strongly supported by the UK Government, included an assessment of the feasibility of an EU-level legal framework for the issuance of covered bonds, because of concerns that divergent national regulatory practices limited sales of

84 See Commission document SWD(2018) 50, p. 6. In 2015, the UK was the seventh largest market for covered bonds in the EU, after Germany, Denmark, the Netherlands, Spain, Sweden and Italy.

such bonds to other EU Member States or even investors outside the Single Market. The underlying logic was that a potential European legal framework would make it cheaper for EU banks to issue such bonds, in turn increasing available capital for business loans.

8.4 In March 2018, the European Commission therefore proposed an EU-level regulatory framework for covered bonds.[85] Concretely, a new Directive would set minimum harmonising standards for the issuance of all covered bonds within the European Union (such as who can issue them and how the cover pool must be designed). Products that are compliant can carry the label 'European Covered Bond' (ECB). Purchase of such an ECB by an EEA-based investment fund, bank or insurer would trigger the application of the existing regulatory or prudential reliefs (the latter of which will be subject to tighter requirements under a parallel proposal to amend the Capital Requirements Regulation) in a way that the purchase of a covered bond issued *outside* the EU would not.[86]

Parliamentary scrutiny of the Covered Bonds Directive

8.5 The Economic Secretary to the Treasury (John Glen MP) submitted an Explanatory Memorandum with the Government's views on the proposal in April 2018. The Government was broadly supportive of the proposed legislation and said it would seek "ensure that [the] proposals will enhance comparability, transparency and market stability by helping investors better understand the profile and risks of a programme as they undertake their due diligence".

8.6 The European Scrutiny Committee first considered the proposal on 25 April 2018, placing it in the particular context of the UK's withdrawal from the European Union. Because of Brexit, we noted it was especially relevant that the Commission proposal did not contain an 'equivalence' provision which would allow the EU to recognise the regulatory framework for covered bonds of a "third country" (like the UK after it leaves the Single Market) as equivalent.[87] *Were* such a mechanism to be included, bonds issued in an 'equivalent' country would trigger the same prudential and regulatory reliefs as EU-issued covered bonds.[88] In the absence of an equivalence framework, EU financial institutions investing in covered bonds issued outside the Union—for example by British banks after it leaves the Single Market—would remain entitled to the existing, more limited prudential relief with respect to their liquidity buffer. The proposal would also allow individual EU countries to prohibit banks from including non-EU assets in their cover pool.

8.7 In our previous Report on this matter, we also took note of the post-Brexit transitional period being sought by the Government. Under the text of the draft Withdrawal Agreement published in March 2018, which remained mostly unchanged in the final version published

85 The Commission confirmed such a proposal was forthcoming in its mid-term review of the Capital Markets Union, published in June 2017.

86 The amended version of the Capital Requirements Regulation would state that "preferential treatment" would be available for holders of covered bonds "as referred to" in article 2 of the new Directive, which in turn refers to " covered bonds issued by credit institutions established in the [European] Union".

87 Decisions formally recognising the regulatory framework of a non-EU country in a particular financial sector as 'equivalent' to the applicable EU rules are taken (and can be revoked) by the European Commission, with the support of a qualified majority of Member States.

88 The new Directive as proposed by the Commission would require the Commission to assess within three years of the new framework becoming operational "whether a general equivalence regime for third-country covered bond issuers and investors is necessary or appropriate". The Minister 'noted' this fact in his Explanatory Memorandum, but made no further comment on the matter.

eight months later,[89] the UK would stay in the Single Market and Customs Union until at least December 2020, even after it had formally ceased to be a Member State of the EU, to avoid disruption to trade and transport links with the remaining Member States. In return however, it would continue applying EU law, including new legislation which only took effect during the transition. In light of this, we concluded that—should the Withdrawal Agreement be ratified—the new Covered Bonds Directive could apply to the UK as if it were still a Member State (meaning it would have to be transposed into UK law in full, overriding any existing regulatory framework where the two were incompatible). By extension, UK-issued bonds would also trigger the new, more generous prudential reliefs when purchased by financial institutions in the EU (at least until the end of the transition period).

8.8 The Economic Secretary provided further updates to the Committee on progress towards adoption of the Covered Bonds Directive by letters dated 6 August, 11 October and 21 November 2018. The latest of these confirmed that Member States were expected to endorse a common position before the end of 2018, which contained several amendments to the Commission proposal for discussion with the European Parliament. As set out in more detail in our Report of 28 November 2018, the Council's amendments focussed on the eligibility requirements for the quality of assets—mortgages—included in the cover pool and liquidity buffer which bank covered bonds; the avoidance of duplicate prudential requirements under the Covered Bonds Directive and the existing Capital Requirements Regulation; and the possibility of an 'equivalence' regime granting similar prudential treatment to covered bonds issued by a non-EU country.

8.9 On the European Parliament side, the Economic and Monetary Affairs Committee adopted its position on the covered bonds proposal on 20 November 2018. While the Parliament broadly supported the thrust of the Commission proposals, MEPs also called for a two-tier system of labels—"premium" and "ordinary"—for covered bonds depending on the quality of the assets backing them, and an equivalence mechanism to facilitate the sale of covered bonds issued outside the EU to European investors.[90] Negotiations between the Parliament and the Council on the final text of the Directive began in late 2018.

The final agreement on the Covered Bonds Directive

8.10 By letter dated 18 March 2019, the Economic Secretary informed us that the Parliament and the Member States had reached final agreement on the Covered Bonds Directive on 27 February 2019. With respect to the substance of the final legislation, the Minister notes that:

- the articles on the eligibility requirements for the cover pool (the types of high-quality assets against which covered bonds can be secured) and the liquidity

89 The key difference between the draft Withdrawal Agreements published in March and November 2018 is that the latter contained a mechanism for an extension of the transitional period, from 31 December 2020 to 31 December 2022, by mutual agreement between the UK and the EU.

90 The European Parliament Committee voted on the proposal on 20 November 2018.

buffer (the ring-fenced liquid assets in the pool that can be converted to cash quickly, ensuring that issuing banks can make their bond repayments at any given time) are "balanced";[91]

- based on the quality of assets included in the cover pool, the compromise text introduces a two-tier labelling approach (as suggested by the European Parliament), creating a label for "premium covered bonds"—where the assets meet the higher credit quality requirements of article 129 of the Capital Requirements Regulation (CRR)—and one for "ordinary covered bonds", for instruments which are backed by lower-quality assets.[92] The UK supported this approach "as it enhances transparency, allowing investors to better understand the quality of assets underlying the covered bond";

- with respect to the assets that would qualify a covered bond as "premium", there was initially a disagreement between the Parliament and Member States on the threshold for limiting exposures with a lower credit quality rating (credit quality step 3). The eventual compromise set the threshold at 8 per cent,[93] accompanied by a requirement for the European Banking Authority to monitor whether that threshold is appropriate; and

- as regards the potential duplication of prudential requirements for banks under the liquidity buffer in the Covered Bonds Directive and the Liquidity Coverage Requirement (LCR) in CRR, the Directive will allow individual Member States to dis-apply the liquidity buffer provisions altogether where the LCR requirement already applies. The legislation will specify that this approach is temporary, with a "more permanent solution" to be made by amending the Capital Requirements Regulation in the future.

8.11 The Directive and accompanying prudential Regulation are due to be formally adopted by the Council and the European Parliament in the near future, potentially in April 2019. It would take effect some 30 months later, i.e. in autumn 2021. This procedural timetable means that the Government may not be represented when the legislation is formally approved by the Council of Ministers, because it will have no right to be represented after the UK ceases to be a Member State (even if the transitional period in the Withdrawal Agreement takes effect).[94]

91 This discussion was driven by the position of countries where many counterparties may not qualify for the highest credit rating, and by extension, not for inclusion in the cover pool for covered bonds. The Member States—the UK's concerns notwithstanding—therefore supported an amendment allowing the use of derivative counterparts qualifying only for a lower credit rating ('credit quality step 3') under "specific conditions". Similarly, some Member States have called for the option of including exposures to banks with a lower credit rating and short-term exposures in the liquidity buffer (the ring-fenced liquid assets that ensure issuing banks have sufficient capacity to make covered bond repayments even if they go insolvent), although individual Member States would have the ability to exclude such assets from eligibility for the liquidity pool in their domestic legal frameworks.

92 As explained by the Minister, the asset criteria in article 129 of the CRR outline the requirements for covered bonds that are afforded a preferential prudential treatment, reflecting the risk they pose. The label for "ordinary covered bonds" will be given to other assets that do not meet CRR article 129 but meet other specific requirements.

93 The European Parliament wanted such lower-quality exposures limited to 5%, whereas the Member States in the Council had called for 10%.

94 Following the Decision of the European Council of 22 March 2019, the UK's exit date as a matter of European law has been pushed back from 29 March 2019.

8.12 In his letter, the Minister asks for the file to be cleared from scrutiny so that Government—if still able to do so—can support its adoption in the Council. He notes that "the agreement upholds the high standards of the UK covered bonds market", and it would therefore be "in the UK's interest to vote in favour of the final legislation". However, the final agreement does not contain an 'equivalence' regime as sought by the UK, which would have allowed covered bonds issued outside the EU to attract the same prudential reliefs as European ones if they originated in a country with a similar regulatory approach. However, the legislation mandates the European Commission to review whether the introduction of such a 'third country' framework would be appropriate in 2023, two years after the Covered Bonds Directive takes effect. Any legislative proposal to introduce an equivalence regime into the legislation would require further negotiations between the European Parliament and the Council.

8.13 The likely impact of the new legislation in the context of the UK's EU exit is as follows:

- if the Covered Bonds Directive falls to be implemented while the UK is still in the Single Market (i.e. UK before the end of the post-Brexit transitional period if the Withdrawal Agreement is ratified), it would have to implement the new legislation. and apply it until the end of the transition. Covered bonds issued by British banks would then trigger the same prudential and regulatory reliefs as for those issued by the EU banks It is noteworthy in this respect that the Directive is due to be implemented in late 2021, which could be within the transition period if it is extended as permitted by the Withdrawal Agreement;[95] and

- if the UK leaves the EU without a transitional period, or beyond the end of such a period if the Withdrawal Agreement is ratified, the Directive will not have force of law in the UK. The Government would be free to modify the domestic regulatory framework for covered bonds, but such bonds issued by British banks would no longer entitle EU-based financial institutions to prudential and regulatory reliefs and they could be excluded from cover pools under the remaining Member States' national legislation.

8.14 If an 'equivalence' framework were to be introduced into the Directive in the future, the Government would have to decide whether to align UK law to the EU legislation to the extent necessary to obtain an equivalence declaration from the European Commission. This would reduce the scope for changes to the UK's domestic regulations on covered bonds, unless the Government was willing to risk having the equivalence decision revoked by the EU.

8.15 It is interesting in this context that the Treasury in late 2018 published its Financial Services (Implementation of Legislation) Bill, under which it would have the power to implement the EU's new covered bonds legislation by means of Statutory Instruments in the event of a 'no deal' Brexit.[96] The Government has argued it merits being implemented swiftly in the UK, even without an EU legal obligation to do so, because the new framework

95 Article 132 of the Withdrawal Agreement allows the UK and the EU to jointly decide to extend the transition period once for a maximum period of two years, i.e. until 31 December 2022.

96 The Government will not have the power to implement the Covered Bonds Directive by regulations under the European Union (Withdrawal) Act 2018 because the EU legislation will not be in force on the day the UK is due to leave the European Union.

for covered bonds "represents an improvement on the current regime".[97] The Bill is currently awaiting its third reading in the House of Commons. Exactly what changes the Government would want to make to the UK's covered bonds regime in a 'no deal' scenario using these powers is unclear.

Our conclusions

8.16 **We thank the Economic Secretary for his latest update on the EU's new Covered Bonds Directive. It is now clear that, if the UK's Withdrawal Agreement on exiting the EU—and with it the post-Brexit transitional period—is ratified by Parliament, the new legislation could apply in the UK in full from autumn 2021 until the end of any extended transition period (which could be as late as 31 December 2022).**

8.17 **In light of this, we welcome the Minister's reassurance that the Government supports the substance of the new legislation as now agreed, and considers it compatible with the UK's existing regulatory regime. Although the Treasury initially expressed concerns about widening the eligibility requirements for the asset pool for a covered bond appear, we note that the two-tiered labelling system will allow investors to differentiate between bonds backed by different classes of assets. However, it does not appear that individual Member States—and the UK, during any transitional period—could only permit issuance of 'premium' covered bonds within the meaning of the Directive, or restrict the marketing of 'ordinary' covered bonds issued in other EU countries.**

8.18 **From previous correspondence with the Minister, it was also clear the Treasury had sought the introduction of an equivalence mechanism for covered bonds in the Directive. This would have allowed the European Commission to grant the same prudential reliefs to a 'third country' bond as will be accorded to their EU-issued counterparts, if the European Commission was of the view that that country's regulatory regime achieves the same outcomes in ensuring the safe nature of investing in covered bonds. The Government's approach was clearly linked to the Political Declaration on the future UK-EU partnership, which unequivocally states that post-Brexit trade between the two across the spectrum of financial services in general should take place on the basis of sector-by-sector equivalence as permitted by EU and UK law (rather than a system of mutual recognition initially sought by the Treasury in the earlier stages of the Brexit negotiations).**[98]

8.19 **Although we have repeatedly expressed concerns about the implications for the UK's regulatory autonomy of relying on equivalence to access the EU's much larger market for financial services after Brexit,**[99] **we note that the final Covered Bonds Directive in fact does not, the Government's efforts notwithstanding, contain such a 'third country' regime. This means that there will be no legal mechanism for**

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97 Memorandum from HM Treasury on the Financial Services (Implementation of Legislation) Bill to the Delegated Powers and Regulatory Reform Committee (accessed 27 February 2019).

98 See 'Outline of the Political Declaration Setting out the Framework for the Future Relationship Between the European Union and the United Kingdom'.

99 In particular, relying on equivalence—which is unilaterally declared and revoked—could either see the UK constrained to stay in tandem with development of EU financial services law without any say over future amendments (given that the UK exports more financial services to the EU-27 than vice versa), or risk losing market access for its financial services industry at short notice where it diverges from the EU's regulatory approach in a given area.

UK-issued covered bonds to attract the same prudential reliefs when bought by EU-based institutional investors after the UK leaves the Single Market, even if the UK voluntarily implements the Directive to the letter. This is likely to make UK covered bonds less attractive to prospective institutional investors in the European Union, since it would require a higher amount of regulatory capital. More generally, we are concerned that this development is indicative of a lack of appetite on the EU's part to introduce a wider and more stable equivalence regime to underpin its future trade in financial services with the UK. It is noteworthy in this respect that the Political Declaration on the future UK-EU partnership only commits the EU to keeping its equivalence frameworks "under review".[100] Individual EU Member States could also decide to exclude assets from eligibility in the cover pool if they are located outside the EU, which will include UK assets after it leaves the Single Market.

8.20 **We have also taken note of the inclusion of the Covered Bonds Directive in the scope of the Financial Services (Implementation of Legislation) Bill, allowing it to be implemented by the Treasury by means of regulations in a 'no deal' Brexit scenario (in which case there would be no EU legal obligation on the UK to do so). It is unclear what changes the Government wishes to make to the UK's existing regulatory framework in this area using its powers, especially now that there is no prospect of the UK securing an 'equivalence' determination in return for applying the Directive voluntarily. We urge the House to consider any future statutory instruments carefully to ensure the Government does not use them to make substantial regulatory changes that ought to be introduced via primary legislation.**

8.21 **In view of their imminent adoption by the Council, we are content to now clear the Covered Bonds Directive and the accompanying prudential Regulation from scrutiny. We also draw these developments to the attention of the Treasury Committee.**

Full details of the documents

(a) Proposal for a Directive on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU: (39544), 7064/18 + ADDs 1–2, COM(18) 94; (b) Proposal for a Regulation amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds: (39555), 7066/18 + ADDs 1–2, COM(18) 93.

Previous Committee Reports

See (39544), 7064/18 + ADDs 1–2, COM(18) 94: Twenty-fifth Report HC 301–xxiv (2017–19), chapter 5 (25 April 2018) and Forty-sixth Report HC 301–xlv (2017–19), chapter 13 (28 November 2018).

100 We have reached similar conclusions in this Report's separate chapter on the EU's Investment Firm Review, where an existing equivalence regime on 'third country' market access for wholesale investment services has been made less, not more, accessible for the UK after Brexit.

9 Stronger EU rules on the return of illegal migrants

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny; further information requested; drawn to the attention of the Home Affairs Committee
Document details	Proposal for a Directive on common standards and procedures in Member States for returning illegally staying third country nationals (recast)
Legal base	Article 79(2)(c) TFEU, ordinary legislative procedure, QMV
Department	Home Office
Document Number	(40059), 12099/18 + ADD 1, COM(18) 634

Summary and Committee's conclusions

9.1 The European Commission's proposal for a Directive responds to a request made by EU leaders in June 2018 to "significantly step up the effective return of irregular migrants".[101] The rate of returns across the EU—that is, the proportion of return decisions leading to the effective removal of illegally staying third country nationals—has fallen from 45.8% in 2016 to 36.6% in 2017.[102] The proposal would repeal and replace the 2008 EU Return Directive (in force since December 2010) and introduce changes to make it quicker and easier for Member States to detain and remove failed asylum seekers and illegally staying third country nationals and prevent their re-entry into the EU. The main changes are described in our earlier Report agreed on14 November 2018.

9.2 The UK does not participate in the 2008 Return Directive but the Government shares the European Commission's concern that discrepancies in the way it has been interpreted and applied by Member States have hindered effective returns. In her Explanatory Memorandum of 9 October 2018, the Immigration Minister (Rt Hon. Caroline Nokes MP) indicated that the changes proposed would improve consistency and strengthen return processes in Member States lacking an effective return capability. She confirmed that the UK's Title V opt-in Protocol applied to the proposed Directive, set out the factors which would inform the Government's opt-in decision, and underlined the importance the Government attached to maintaining the UK's "sovereignty over returns procedures and management of UK borders".[103] The three-month deadline for deciding whether to opt into the proposed Directive expired on 16 January 2019.

9.3 Whilst recognising that the Government was unlikely to opt in, we noted that post-exit (or at the end of any post-exit transition period) UK nationals found to be staying illegally in an EU Member State would be subject to the amended EU return procedures (and therefore more vulnerable to detention) unless the UK negotiated a future relationship agreement with the EU giving UK nationals a special status equivalent to that of an EU

101 See the Conclusions of the European Council agreed on 28 June 2018.
102 See p.2 of the Commission's explanatory memorandum accompanying the proposed Directive.
103 See para 12 of the Minister's Explanatory Memorandum.

citizen. We requested a more detailed assessment of the safeguards and remedies that would be available to UK citizens subject to a return procedure governed by the proposed Directive.

9.4 In her letter of 18 March 2019, the Minister apologises for the delay in informing us that the Government has decided *not* to opt into the proposed Directive. She reiterates the Government's commitment to securing "an effective reciprocal partnership with the EU on illegal migration matters, including practical cooperation" as part of the UK's future relationship with the EU. Turning to the adequacy of the safeguards and remedies for UK citizens who may, post-exit, be subject to return procedures under the proposed Directive, the Minister draws our attention to the provisions of the draft EU/UK Withdrawal Agreement which protect the rights of UK nationals in the EU. She continues:

> Without a deal, the UK cannot act unilaterally to protect the rights of UK nationals in the EU; it is for this reason that we have always prioritised agreeing the Withdrawal Agreement and why the Government has written to the European Commission to explore the proposal detailed in the Costa Amendment to ring-fence the Citizens' Rights element of the Withdrawal Agreement in the event of no deal.[104] The European Commission has also published a No Deal Contingency Action Plan, which calls upon EU Member States to take a generous approach to UK nationals who are already resident in their territory.[105] This includes a call for Member States to take measures so that all UK nationals legally residing there on 29 March 2019 will continue to be considered as legal residents of that Member State without interruption; I can confirm that all Member States have provided HMG with reassurances that this will be the case and are taking legislative and administrative steps to ensure this. We will continue to work with the EU and individually with Member States on the details of their legislation and ensure that UK nationals are given detailed advice and firm reassurances as soon as possible. In addition, formal agreements guaranteeing citizens' rights have so far been reached with Switzerland, Norway, Iceland and Liechtenstein.

Our Conclusions

9.5 **The deadline for deciding whether to opt into the proposed Directive expired more than two months ago, on 16 January. We are disappointed that it has taken the Minister so long to inform us of the Government's decision *not* to opt in, not least given that she issued a** Written Ministerial Statement **and wrote to our counterparts in the House of Lords explaining the reasons for the decision on 31 January.[106] As the UK will not be bound by the proposed Directive, or be able to vote on its adoption, we are clearing it from scrutiny.**

104 See the letter of 4 March 2019 from the Secretary of State for Exiting the European Union (Rt Hon. Steve Barclay MP) to the European Chief Negotiator Taskforce on Article 50 (Michel Barnier).

105 See the Commission Communication, *Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: Implementing the Commission's Contingency Action Plan* published on 19 December 2018.

106 See Hansard HCWS1290, 31 January 2019.

9.6 **We note, however, that the Minister's letter only addresses the safeguards and remedies available to UK nationals already living and working in another Member State *on or by* exit day who would fall within the scope of Part Two of the EU/UK Withdrawal Agreement, if ratified, or if it is not, bilateral assurances given by each Member State. Our question was also intended to encompass UK nationals whose stay in an EU Member State begins *after* the UK's exit from the EU (or after the end of a post-exit transition/implementation period), who would not therefore be protected by Part Two of the draft EU/UK Withdrawal Agreement and who do not meet the requirements for lawful entry, stay or residence. We would welcome some assurance from the Minister that the procedural safeguards set out in chapter III of the proposed Directive are adequate, especially given the risk of inadvertent breaches of national immigration rules while UK nationals adjust to the loss of free movement rights after leaving the EU. We draw this chapter to the attention of the Home Affairs Committee.**

Full details of the documents

Proposal for a Directive on common standards and procedures in Member States for returning illegally staying third country nationals (recast): (40059), 12099/18 + ADD 1, COM(18) 634.

Previous Committee Reports

Fifty-third Report HC 301–lii (2017–19), chapter 8 (13 January 2019) and Forty-fourth Report HC 301–xliii (2017–19), chapter 12 (14 November 2018).

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

Department for Environment, Food and Rural Affairs

(40423) 6926/19 + ADDs 1–3, 31 & 55 COM(19) 95	Report from the Commission to the European Parliament and the Council on the implementation of the Water Framework Directive (2000/60/EC) and the Floods Directive (2007/60/EC) Second River Basin Management Plans First Flood Risk Management Plans.
(40455) 7448/19 COM(19) 140	Proposal for a Council Decision on the position to be taken on behalf of the European Union in the framework of the Convention on Future Multilateral Co-operation in the North-East Atlantic Fisheries as regards the application for accession to that Convention submitted by the United Kingdom.

Department for Transport

(40388) 6459/19 + ADD 1 COM(19) 51	Report from the Commission to the European Parliament and the Council Sixth report on monitoring development of the rail market.
(40389) 6335/19 COM(19) 34	Report from the Commission to the European Parliament and the Council on the exercise of power to adopt delegated acts conferred on the Commission under Directive 2014/90/EU of the European Parliament and of the Council of 23 July 2014 on marine equipment.
(40404) 6833/19 + ADD 1 COM(19) 84	Report from the Commission to the European Parliament and the Council on the implementation in the period from 1 January 2015 until 31 December 2016 of certain provisions of Regulation (EC) No 1071/2009 establishing common rules concerning the conditions to be complied with to pursue the occupation of road transport operator (2nd report from the Commission on the implementation by Member States of certain provisions concerning the access to the occupation of road transport operator).
(40421) 7053/19 COM(19) 120	Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Aviation Strategy for Europe: Maintaining and promoting high social standards.

Foreign and Commonwealth Office

(40467) — —	Council Implementing Regulation (EU) 2019/350 amending Council Implementing Regulation No 36/2012 concerning restrictive measures in view of the situation in Syria
(40468) — —	Council Implementing Decision (CFSP) 2019/351 amending Council Implementing Decision (CFSP) 2013/255/CFSP concerning restrictive measures against Syria

HM Treasury

(39548) 6988/18 + ADDs 1–2 COM(18) 92	Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC of the European Parliament and of the Council and Directive 2011/61/EU of the European Parliament and of the Council with regard to cross-border distribution of collective investment funds.
(39549) 6987/18 + ADDs 1–2 COM(18) 110	Proposal for a Regulation of the European Parliament and of the Council on facilitating cross-border distribution of collective investment funds and amending Regulations (EU) No 345/2013 and (EU) No 346/2013.
(40311) 5027/19 COM(18) 830	Report from the Commission on the application of Annex XI to the Staff Regulations and Article 66a thereof

Home Office

(40273) 15628/18 + ADD 1 COM(18) 785	Communication from the Commission to the European Parliament and the Council Report on the evaluation of the EU Framework for National Roma Integration Strategies up to 2020.

Formal Minutes

Wednesday 27 March 2019

Members present:

Sir William Cash, in the Chair

Martyn Day	Mr David Jones
Marcus Fysh	Andrew Lewer
Kelvin Hopkins	Michael Tomlinson

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 10 read and agreed to.

Summary agreed to.

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

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

[Adjourned till Wednesday 3 April 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*)