House of Commons

European Scrutiny Committee

Twenty-sixth Report of Session 2017–19

Documents considered by the Committee on 2 May 2018

HC 301-xxv

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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 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:

- **EU-UK fisheries relations during and after withdrawal period**
- **Application of new EU waste rules during implementation period**
- **Government support for EU chemical agency's remit—an agency of which it intends to seek associate membership post-Brexit**
- **Immigration—Adapting EU visa policy to new migration and security challenges**

Given the uncertainty as to the UK's future immigration policy on EU citizens, as well as the likelihood that it will affect EU policy towards UK citizens who wish to travel to the EU after any transitional/implementation period, we cannot exclude the possibility that UK citizens may, in the future, require a visa to travel to the EU. Any changes to EU visa policy may therefore have direct implications for UK citizens.

We ask the Government what assessment it has made of the costs and benefits of a reciprocal visa regime for UK travellers to the EU and EU travellers to the UK post-exit, particularly in terms of the impact on tourism and trade.

As the Government does not intend to publish its Immigration White Paper until the end of the year, we seek an assurance that it will inform Parliament promptly of any options put forward in the future partnership negotiations with the EU which may affect the immigration status of EU citizens in the UK and UK nationals in the EU27.

Summary

Multi-annual plan for fishing in the Western Waters

The Commission has proposed a framework for management of fisheries in the Western Waters (including all seas around the UK except the North Sea). The Committee notes that this would apply during the post-Brexit implementation period and asks the Government if it will press for swift adoption while the UK retains voting rights. The Committee also asks if the Government will pro-actively engage with other Member States informally on the adoption of detailed rules to be applied during 2020. These could otherwise be devised during the period April-July 2019 without significant UK involvement but applying to

UK waters. Finally, the Committee notes that the model established under this proposal could—if aligned with the North Sea Plan—form the basis for the the future EU-UK fisheries relationship.

Not cleared; further information requested; drawn to the attention of the Environment, Food and Rural Affairs Committee

Military mobility

The Committee has considered a new European Commission 'action plan' on military mobility. This document provides more detail about possible EU policy initiatives to facilitate the movement of troops and military equipment, although it makes no concrete policy commitments while further analytical work is underway. In the next few years, it may lead to new EU legislation to remove customs and regulatory hurdles to military mobility, as well as the provision of EU funding for dual-use transport infrastructure.

Cleared from scrutiny; drawn to the attention of the Defence and Foreign Affairs Committees

Reform of the electoral law of the EU

Before the Referendum, the previous Committee recommended a Reasoned Opinion in 2016 on this proposal initiated by the EP to reform aspects of the law governing EP elections. As the UK will not now be participating in EP elections, the proposal will have no practical impact on the UK.

The proposal can only be adopted by unanimity, after the EP's consent has been obtained and Member States have approved it according to their own constitutional requirements. For the UK, that means an Act of Parliament must be passed in accordance with Section 7(2)(b) of the EU Act 2011(the 2011 Act) to enable the UK to approve final adoption of the proposal.

The Government wrote in haste during the Easter recess to notify the Committee that the UK wished to vote in support of a modified proposal at a Council meeting of 17 April. It is our understanding that this would be in relation to a decision to send the proposal to the EP for its consent. But the Government reports in a second letter that no agreement was reached at that meeting and the Council may try to agree the proposal quickly by way of Council written procedure before the end of the month (though the latest informal information from officials received on 2 May is that agreement has still not been reached). The Government therefore asks for clearance or a scrutiny waiver.

The Committee recognises that although the Government has not updated the Committee frequently, it has made a genuine effort to do so fully now. Given this and Brexit, the Committee now clears the proposal. It asks for updates on the remaining stages of the process towards final adoption of this proposal and for the Government to be more careful to identify the application of the 2011 Act in future.

Cleared from scrutiny; further information requested.

Application of new EU waste rules during implementation period

The Minister has confirmed the UK's support for the compromise deal reached on the revision to EU waste policy, including ambitious new recycling targets, and has also confirmed that the UK will transpose this legislation into UK law. The transposition deadline will be mid-2020, and so will fall within the post-Brexit implementation period. The Committee looks forward to seeing the Government's transposition plans in the context of the wider Resources and Waste Strategy later this year.

Cleared from scrutiny (by Resolution of the House on 08/03/2016); drawn to the attention of the Environment, Food and Rural Affairs, the Environmental Audit, the Housing, Communities and Local Government, the Welsh Affairs, the Scottish Affairs and the Northern Irish Affairs Committees

Persistent Organic Pollutants

The Commission's proposal seeks only to recast existing legislation, the role of which is to implement international obligations. The Committee considered the most interesting aspect to be the proposal to extend the remit of the European Chemicals Agency to include this legislation, an extension supported by the Government. This is relevant in the context of the Prime Minister's proposal that the UK seek associate membership of the Agency post-Brexit. The Committee asks the Government to what extent the uncertainty over UK associate membership of the Agency will impact on the UK's input into negotiation of this proposal.

Not cleared; further information requested; drawn to the attention of the Environmental Audit Committee

Adapting EU visa policy to new migration and security challenges

The Commission has proposed an overhaul of EU visa policy to reflect the new migration and security challenges confronting the EU. The Government says that the changes will have "no direct impact" on the UK as they concern parts of the Schengen rule book which do not apply to the UK. The Committee accepts that there will be no implications while the UK remains a member of the EU but says that this may not be the case once the UK leaves the EU (and any transitional/implementation period extending the application of EU free movement rules has expired). EU visa policy operates on the basis of reciprocity, meaning that if the UK were to introduce a requirement for the nationals of one or more EU Member States to obtain a visa to visit the UK post-exit, the EU would likely reciprocate by imposing a visa requirement on UK nationals travelling to the EU. As the Government does not intend to publish its Immigration White Paper setting out future arrangements for immigration to the UK post-exit until the end of the year, the Committee cannot exclude the possibility that UK citizens may, in the future, require a visa to travel to the EU. It asks the Government what assessment it has made of the costs and benefits of a reciprocal visa regime for UK travellers to the EU and EU travellers to the UK post-exit. It also seeks an assurance that Parliament will be promptly informed of any options put forward by the Government in the future partnership negotiations which may affect the immigration status of EU citizens in the UK and UK nationals in the EU27.

Not cleared from scrutiny; further information requested; drawn to the attention of the Home Affairs Committee and the Committee on Exiting the European Union.

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: Non-performing loans: debt management and out-of-court collateral recovery [(a) Proposed Directive (NC), (b) Proposed Regulation (NC), (c) Report (C)]

Defence Committee: Military Mobility in the EU [Communication (C)]

Exiting the European Union Committee: Adapting EU visa policy to new migration and security challenges [(a) Communication (C), (b) Proposed Regulation (NC)]

Environment, Food and Rural Affairs Committee: EU legislation on waste [Proposed Directives (C)]; Fisheries Agreement with Morocco [Proposed Decision (C)]; Multi Annual Plan for fishing in Western Waters [Proposed Regulation (NC)]

Environmental Audit Committee: EU legislation on waste [Proposed Directives (C)]; Persistent Organic Pollutants [Proposed Regulation (NC)]

Foreign Affairs Committee: Fisheries Agreement with Morocco [Proposed Decision (C)]; Military Mobility in the EU [Communication (C)]

Home Affairs Committee: Adapting EU visa policy to new migration and security challenges [(a) Communication (C), (b) Proposed Regulation (NC)]

Housing, Communities and Local Government Committee: EU legislation on waste [Proposed Directives (C)]

Northern Ireland Affairs Committee: EU legislation on waste [Proposed Directives (C)]

Scottish Affairs Committee: EU legislation on waste [Proposed Directives (C)]

Treasury Committee: Asset management: cross-border distribution of funds within the Single Market [(a) Proposed Directive (NC), (b) Proposed Regulation (NC)]; Non-performing loans: debt management and out-of-court collateral recovery [(a) Proposed Directive (NC), (b) Proposed Regulation (NC), (c) Report (C)]; Financial Services: long-term EU regulatory plans [Communications (C)]

Welsh Affairs Committee: EU legislation on waste [Proposed Directives (C)]

1 Persistent Organic Pollutants

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Environmental Audit Committee
Document details	Proposal for Regulation of the European Parliament and of the Council on persistent organic pollutants (recast)
Legal base	Article 192(1) TFEU, QMV, Ordinary legislative procedure
Department	Environment, Food and Rural Affairs
Document Number	(39594), 7470/18 + ADD 1, COM(18) 144

Summary and Committee's conclusions

1.1 Persistent organic pollutants (POPs) resist environmental degradation for long periods due to their toxic properties with the effect that they bioaccumulate in animals and humans and in terrestrial and aquatic ecosystems. Examples of POPs include pesticides such as DDT and polychlorinated biphenyls (PCBs).[1]

1.2 As POPs become widely distributed geographically, it is a global issue and countries around the world have agreed under the Stockholm Convention[2] to restrict the usage of POPs. The Convention is implemented into EU law through the POPs Regulation.[3] The UK is a party to the Convention in its own right and as an EU Member State.

1.3 The Commission proposes a recast of the Regulation with three objectives:

- to align the provisions for adoption of detailed implementing rules with changes introduced under the Lisbon Treaty—and, in particular, to stipulate which rules are subject to implementing acts[4] and which to delegated acts;[5]
- to involve the European Chemicals Agency (ECHA) in supporting the scientific, technical and reporting aspects of the Regulation—this includes providing advice on substances that are being considered by the Stockholm Convention for bans and restrictions and compiling, registering and disseminating information provided by Member States on the implementation of the agreement; and
- to simplify the reporting provisions.

1 Now largely banned, PCBs continue to occur in the environment through the disposal of old electrical equipment.
2 The Stockholm Convention on Persistent Organic Pollutants.
3 Regulation (EC) No 850/2004.
4 The adoption of an implementing act by the Commission is subject to its scrutiny (to varying degrees of stringency) by a committee of the representatives of the Member States chaired by the Commission itself.
5 The main characteristic of the delegated act procedure is that the Council or the European Parliament may block the adoption of the proposed subordinate legislation by the Commission. Under the Interinstitutional Agreement on Better Law-Making of 13 April 2016, the Commission agreed to gather, prior to the adoption of delegated acts, all necessary expertise, including through the consultation of Member States' experts and through public consultations.

1.4 The position of the Parliamentary Under Secretary of State for the Environment (Dr Thérèse Coffey) is set out below. In summary, the Minister has possible concerns regarding the introduction of delegated acts. The Minister welcomes the use of the ECHA to assist in the implementation of the Regulation as it brings the POPs regime into alignment with the REACH Regulation,[6] which will help prevent conflicting decisions for the same substances and align timelines at the international and EU levels. Finally, the Minister welcomes the proposals to simplify reporting but stresses that the impact of these changes on the UK will depend on the precise relationship between the UK and the EU and ECHA post-Brexit.

1.5 It is possible that the recast Regulation will enter into force prior to the end of the post-Brexit implementation period on 31 December 2020. As a result, the Regulation could be directly applicable in the UK until the end of that period.

1.6 **We consider two issues of particular interest to the UK in the context of its withdrawal from the European Union. These we preface with an acknowledgement that the Regulation implements international obligations, which will apply in any event to the UK, so considerations moving forward relate primarily to how those obligations are implemented and applied rather than whether they apply.**

1.7 **Most interesting is the proposal to extend the remit of the European Chemicals Agency to this Regulation. This is relevant in the context of the Prime Minister's proposal that the UK seek associate membership of the Agency post-Brexit. To date, the EU has made no public acknowledgement of whether it will accept the Prime Minister's proposition and what conditions it would apply. We ask the Government to what extent the uncertainty over the UK associate membership of ECHA will impact on its input into negotiation of this proposal. The Minister acknowledges that the impact of the simplification of reporting requirements are dependent on the withdrawal negotiations.**

1.8 **Of secondary interest, but nevertheless relevant, are the proposals on the introduction of delegated acts. Such "tertiary legislation" is the type of legislation that we have identified as that which might be proposed, negotiated, adopted and applied during the implementation period without formal involvement of the UK in their adoption. We signal this only as an example of where the issue might arise: it is a wider implication of the implementation period and is not specific to this document.**

1.9 **We retain this proposal under scrutiny and look forward to any comment on the issues raised above in addition to an update on the progress of negotiations and any view on the proposed areas where implementing acts—as opposed to delegated acts—would be required. We would welcome a response within 20 working days. We draw the document to the attention of the Environmental Audit Committee as that Committee has taken a particular interest in chemicals regulation post-Brexit.**

Full details of the documents

Proposal for Regulation of the European Parliament and of the Council on persistent organic pollutants (recast): (39594), 7470/18 + ADD 1, COM(18) 144.

6 Regulation (EC) No 1907/2006 on the Registration, Evaluation, Authorisation and Restriction of Chemicals.

The Minister's Explanatory Memorandum of 12 April 2018[7]

1.10 The Minister indicates possible concerns regarding the introduction of delegated acts and the ability for Member States to scrutinise and participate in decision making on the setting of thresholds and the nomination of POPs under the Stockholm Convention. It is not clear exactly, says the Minister, how the Commission will manage the approval of use of POPs in closed site systems nor how they will set waste thresholds for POPs in products. She believes that clarification over the ECHA's role will be key. This includes whether there will be a requirement to use committees such as the Risk Assessment Committee and the Committee for Socio Economic Analysis to set maximum limits for POPs content within an article. The POPs element of the article above the maximum limit must be destroyed, usually at high temperature. The Government will therefore seek this clarification regarding the application of delegated acts during the negotiations.

1.11 The Minister welcomes the use of ECHA to assist in the implementation of the regulation as it brings the POPs regime into alignment with the REACH Regulation. This, she says, will help prevent conflicting decisions for the same substances and align timelines at the international and EU level. The UK is supportive of strengthening the role of the ECHA, and will be seeking further clarification regarding its role in relation to the POPs Review Committee (POPRC) and reporting to ensure there are no additional resource impacts.

1.12 The UK also supports streamlining reporting, digitalisation, and encouraging the use of the Information Platform for Chemical Monitoring (IPCheM). While there is no longer a requirement for triennial reports, a requirement is proposed to keep up to date data uploaded on the IPCHeM platform, allowing the ECHA to provide six-monthly reports to the Commission. The IPCHeM brings together chemical monitoring data under a new platform, established in 2015. It also brings the general EU reporting in line with the requirements under the Stockholm Convention, including requests for information for POPRC and the reporting for the convention under Article 13. The UK will seek clarification regarding the information and reporting requirements and standards which will be set by the ECHA going forward to align with the portal. Until the UK clarifies its relationship with the EU and the ECHA the precise impact of these changes once the UK has left the EU remains unclear.

Previous Committee Reports

None.

7 Explanatory Memorandum dated 12 April 2018.

2 Multi Annual Plan for fishing in Western Waters

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Environment, Food and Rural Affairs Committee
Document details	Proposal for a Regulation of the European Parliament and of the Council establishing a multiannual plan for fish stocks in the western waters and adjacent waters, and for fisheries exploiting those stocks, amending Regulation (EU) 2016/1139 establishing a multiannual plan for the Baltic Sea and repealing Regulations (EC) No 811/2004, (EC) No 2166/2005, (EC) No 388/2006, (EC) 509/2007 and (EC) 1300/2008
Legal base	Article 43(2) TFEU, QMV, Ordinary legislative procedure
Department	Environment, Food and Rural Affairs
Document Number	(39598), 7245/1/18 + ADDs 1–2, COM(18) 149

Summary and Committee's conclusions

2.1 Multi-annual plans (MAPs) set a management framework establishing rules and criteria under which Total Allowable Catches (TACs) and other management measures are adopted. Under the reformed Common Fisheries Policy (CFP), MAPs should cover multiple stocks where those stocks are jointly exploited (i.e. a mixed fishery). On that basis, the Commission has proposed this new MAP incorporating Western Waters stocks into a single management plan. The Government says that the MAP will provide a valuable framework for future cooperation between the UK and the EU.

2.2 The fisheries of the Western Waters and adjacent areas are described by the Commission as "highly complex". They involve vessels from at least seven coastal Member States, using a wide variety of different fishing gears to target a wide range of different fish and shellfish species. The area extends from waters close to the Faroe Islands in the north to waters off the west coast of Africa in the south. It includes all of the waters around the UK except the North Sea.

2.3 The core of the Western Waters MAP is the setting of fishing ranges that are consistent with maximum sustainable yield (MSY) across the main demersal stocks (such as cod, haddock, whiting, hake, plaice, sole and nethrops). This is backed up by powers to introduce conservation measures where science indicates that these are needed to recover a stock to a sustainable condition. The MAP relies on scientific advice provided by ICES (International Council for the Exploration of the Seas),

2.4 The plan also covers implementation of the landing obligation ("discard ban") and technical measures for all stocks and the fisheries exploiting those stocks in the Western

Waters. Under the regionalised approach, affected Member States in the north and south western waters respectively may work together to draw up "joint recommendations" to implement the discard ban and apply technical measures. Those joint recommendations are subsequently adopted by the Commission.

2.5 The Minister for Agriculture, Fisheries and Food (George Eustice) explains that officials are currently examining the proposal in detail and will produce a comprehensive analysis which will be used to inform the UK's response. Regarding Brexit, the Minister is clear that the UK will continue to have a strong interest in the overall status and effective long-term management of these stocks when it leaves the EU. He considers that the science-based framework established under the MAP will be valuable for future cooperation between the UK and the EU, although he emphasises that it is too early to assess the specific role that the MAP might play.

2.6 The Minister highlights the Commission's ambition—shared by the European Parliament—to agree the MAP by January 2019, but the Minister feels that this may not be achievable.

2.7 **We appreciate that the Department is still considering the implications of this complex proposal and we look forward to further information on the potential impact, as well as any evolution in the Government approach, once the analysis is complete. A key issue will be the degree of flexibility to respond to emergency situations or where an approach adopted based on international scientific (ICES) advice is shown to be misaligned with actual catch levels, thus potentially creating problems in mixed fisheries subject to the discard ban.**

2.8 **We note the Minister's view that the MAP will provide a valuable framework for cooperation between the UK and the EU. This aligns with the approach to negotiation of the North Sea MAP, which we cleared from scrutiny at our meeting of 31 January 2018.[8] Indeed, we see strong parallels between the Commission's approach to the Western Waters MAP and the final agreement on the North Sea MAP. Looking towards the future EU-UK fisheries agreement, we would welcome the Minister's comment on the importance of ensuring as much consistency as possible between the respective MAPs in terms of approach.**

2.9 **On the timetable, the Minister expresses scepticism that agreement can be reached by January 2019. From a UK perspective, though, we would hope that the UK will push for formal agreement by the end of March 2019, while the UK still has a vote in the Council. Such formal agreement would certainly require political agreement by January 2019 at the latest. We ask the Minister to confirm the UK's intentions regarding the timetable and also confirm that the Regulation will enter into force upon adoption, will be immediately effective and will therefore apply during the post-Brexit implementation period.**

2.10 **The deadlines for regional cooperation set out in the proposal would mean that a joint recommendation for technical and discard measures to be applied in 2020 would need to be submitted no later than 1 July 2019. Assuming the possibility that the Regulation will have entered into force by that date, we ask the Minister whether the UK would be keen to see measures in place under this Plan in 2020 and, if so,**

8 Twelfth Report HC 301–xii (2017–19), chapter 12 (31 January 2018).

what appetite there might be to begin exploratory discussions about such measures while the UK remains a Member State. We note that, if the UK is not pro-active in this respect, it is feasible that a joint recommendation proposing measures applicable in UK waters could be proposed and agreed after the UK's withdrawal, but nevertheless apply to the UK during 2020.

2.11 **We retain the proposal under scrutiny and draw it to the attention of the Environment, Food and Rural Affairs Committee given that Committee's interest in the future EU-UK fisheries relationship.**

Full details of the documents

Proposal for a Regulation of the European Parliament and of the Council establishing a multiannual plan for fish stocks in the western waters and adjacent waters, and for fisheries exploiting those stocks, amending Regulation (EU) 2016/1139 establishing a multiannual plan for the Baltic Sea and repealing Regulations (EC) No 811/2004, (EC) No 2166/2005, (EC) No 388/2006, (EC) 509/2007 and (EC) 1300/2008: (39598), 7245/1/18 + ADDs 1–2, COM(18) 149.

The Commission's proposal

2.12 The purpose of this MAP is to deliver a multi-species approach to fisheries management in specific sea basins in Western Waters (International Council for the Exploration of the Sea (ICES) subareas 5b, 6, 7, 8, 9, 10; and Fishery Committee for the Central Eastern Atlantic (CECAF) zones 34.1.1, 34.1.2 and 34.2.0). A map identifying the ICES areas is in Annex B of the Government's EM.

2.13 The objective of the draft MAP is two-fold:

- to ensure that stocks are exploited in a sustainable way based on the principles of maximum sustainable yield (MSY), the ecosystem approach and the precautionary principle; and
- to provide assurance and economic stability for fishermen, by minimising quota changes each year.

2.14 The draft MAP includes provisions on:

- the setting of targets based on fishing mortality ranges around MSY as advised by ICES—allowing for adaptations in case of changes in the scientific advice, while at the same time preserving a high level of predictability;
- conservation reference points—expressed in tonnes of spawning stock biomass or abundance in numbers and determined by ICES (appropriate action should be taken when scientific advice states that a stock is under threat);
- safeguard measures—remedial action should be taken when stocks fall below conservation reference points or (in the absence of advice on spawning stock biomass or abundance), where scientific advice states that a stock is under threat;
- technical measures;

- fishing opportunities, including the possibility to limit the opportunities available to recreational fisheries;
- provisions linked to the landing obligation ("discard ban");
- access to waters and resources; and
- management of stocks of common interest.

The Minister's Explanatory Memorandum of 17 April 2018[9]

2.15 The Minister notes that officials are currently examining the proposal in detail and will produce a comprehensive analysis which will be used to inform the UK's response. He considers that the MAP will help achieve UK policy objectives for sustainable management of fisheries across a range of stocks and summarises the approach in the following terms:

> "The UK supports use of MSY ranges where these are appropriate as a tool to balance sustainable fishing opportunities in mixed fisheries. However, we also recognise a need to adjust total allowable catches or find pragmatic solutions for bycatch stocks where there is unavoidable fishing mortality in order to make the landing obligation work."

2.16 Turning to the UK's withdrawal from the EU, the Minister says:

> "The UK will continue to have a strong interest in the overall status and effective long term management of mixed demersal species and nephrops in Western Waters when it leaves the EU. The science based framework established under the MAP will provide a valuable framework for cooperation between the UK and the EU, where it will be important to find shared basis to agree on sustainable rates of exploitation across all commercially important species. Implementation of the proposed Western Waters MAP will be consistent with the UK's commitment to deliver sustainable management of fisheries. It is too early to assess what role MAPs could play in the longer term when the UK has left the EU."

Previous Committee Reports

None.

9 Explanatory Memorandum dated 17 April 2018.

3 Asset management: cross-border distribution of funds within the Single Market

Committee's assessment	Politically important
Committee's decision	Not cleared from scrutiny; further information requested; drawn to the attention of the Treasury Committee
Document details	(a) Proposal for a Directive 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; (b) Proposal for a Regulation on facilitating cross-border distribution of collective investment funds and amending Regulations (EU) No 345/2013 and (EU) No 346/2013
Legal base	(a) Article 53 (1) TFEU; Ordinary Legislative procedure; QMV; (b) Article 114 TFEU; ordinary legislative procedure; QMV
Department	Treasury
Document Numbers	(a) (39548), 6988/18 + ADDs 1–2, COM(18) 92; (b) (39549), 6987/18 + ADDs 1–2, COM(18) 110

Summary and Committee's conclusions

3.1 As part of its effort to create a Single Market for collective investment funds, the EU has legislated to create a number of types of funds and regulate fund managers, including **'undertakings for collective investment in transferable securities' (UCITS),**[10] funds, aimed at small investors like households, and various types of Alternative Investment Funds (AIFs) such as hedge funds and European Venture Capital Funds. EU legislation for investments funds contains the so-called 'passport', allowing funds domiciled in one Member State to be marketed to investors, including individual savers, across the entire Union.

3.2 However, use of the 'passport' for both UCITS and AIFs is subject to a number of regulatory requirements, for example relating to supervisory fees or restrictions on marketing materials. These rules are often imposed at the discretion of each individual EU Member State, and therefore vary from country to country. Partially[11] as a result of these divergent regulatory practices, and despite the existence of the EU-level regulatory frameworks for UCITS and AIFs, funds remain largely constrained to national markets

10 UCITS stands for 'undertakings for collective investment in transferable securities'.

11 The European Commission notes that other barriers to cross-border distribution of funds relate to how each EU country taxes asset management activity, and existing market structures (which can favour incumbent providers and inhibit market entry by competitors based elsewhere in the EU). See paragraph 3.26 for more information.

rather than the Single Market as a whole. EU investment funds representing 70 per cent of the total assets under management (AuM) are registered for sale *only* in their own Member State.

3.3 In 2015 the European Commission announced that—as part of its Capital Markets Union (CMU) programme to increase the supply of capital to businesses (particularly from sources other than banks)—it would seek to address regulatory barriers that prevent funds from effectively using their 'passport' under EU law to grow, compete in different national markets, and maximise economies of scale to reduce the cost of investing. It tabled a legislative initiative to that effect in March 2018, seeking to address five identified regulatory barriers by setting EU-wide harmonised standards:

- **Marketing requirements**, for example the obligation for a fund manager to submit any promotional materials aimed at potential investors in a specific Member State to the national regulator of that country for approval;
- **Regulatory fees** for 'passporting' into a Member State, which vary considerably between EU countries and may not be cost-reflective;
- **Administrative requirements**, notably the requirement (imposed by 17 Member States) for UCITS managers to maintain a physical presence in their territory even if they only market their fund to investors there on a cross-border basis; and
- **Updating 'notification' requirements**, the formal communication funds must undertake with regulators if they change their operations (including a cessation of activities in a particular EU country) in a way that could affect investors. UCITS funds have to update their 'notification' with the regulator of each EU country where they are active, rather than being able to notify only their home Member State regulator.

3.4 To reduce the disparity between the way in which Member States regulate in these areas (and therefore make it easier for investment funds to 'passport' into new national markets), the Commission proposal would impose new restrictions on the leeway national regulators would have to set their own rules.[12] The new horizontal requirements would affect marketing communications, so-called 'pre-marketing' activities, supervisory fees, and notification requirements. It would also ban Member States from requiring UCITS managers to maintain a physical presence if they 'passport' a fund into their territory. We have summarised the substance of the proposal in more detail in "Background" below.

3.5 Although the proposals have no direct link to the UK's withdrawal from the EU, the Commission has noted that Brexit "will have an impact on the EU investment fund market", as many fund managers are located in the UK and it also has a large investor base.

3.6 The Economic Secretary to the Treasury (John Glen) submitted an Explanatory Memorandum on the proposals to make cross-border distribution of UCITS and AIFMD

12 See paragraph 3.27 for more information on the Commission's use of both a Regulation and a Directive as part of this initiative.

funds easier on 23 April 2018.[13] In it, he expresses the Government's support for measures that "[remove] barriers for fund managers marketing funds across borders and provides greater consumer choice of fund products". However, the Minister adds that any legislative change should "genuinely facilitate market access and […] not impose additional and unnecessary burden on firms across the EU, which could run contrary to the overall objectives. Similarly, the introduction of new elements to the EU legislative framework for investment funds should not inadvertently result in limitations on the distribution of funds and should accommodate the diverse range of fund structures and distribution models that exist within the EU".

3.7 **The UK is a global asset management centre. Any changes to the EU's regulatory framework for investment funds (given the size of its market) are therefore likely to be of importance to the industry, irrespective of the UK's membership of the Union. As such, we consider the proposed changes to the marketing requirements for UCITS and alternative investment funds within the Single Market to be politically important. In any event, there is still considerable uncertainty about the legal and regulatory impact of Brexit on the financial services sector, and the extent to which the British asset management industry can continue to service EU-based clients when the UK leaves the Single Market.**

3.8 **Under the transitional arrangement sought by the Government for the immediate post-Brexit period, the UK would effectively stay in the Single Market until the end of 2020. If changes to the UCITS and AIF frameworks to facilitate their cross-border distribution take effect before the end of the transition, the Government and the Financial Conduct Authority would be required to transpose them into UK law, and UK-based funds would (temporarily) benefit from any changes that make their marketing within the EU easier.**

3.9 **The situation for UK funds or fund managers seeking to service the EU market after the UK leaves the Single Market depends on the outcome of the Brexit negotiations. The exit from the Single Market means that UK-registered UCITS and AIFs will automatically become non-EU alternative investment funds when marketed within the EU.**

3.10 **The impact on UCITS funds of this change may be mitigated relatively easily, as they can be redomiciled to an EU country while their effective management can be retained in the UK (as EU law already permits the portfolio management of UCITS to take place either in or outside the Union). Many UCITS funds are already domiciled in Ireland and Luxembourg but have appointed managers in the UK. However, the British Bankers Association (now UK Finance) has noted this will not necessarily be as straightforward after Brexit because marketing of portfolio management services**

13 Explanatory Memorandum submitted by HM Treasury (23 April 2018). The Memorandum was submitted with a significant delay, given that the legislative proposals were published in March. We understand this was due to an administrative error within the Department.

within the EU by third country firms is restricted under MiFID.[14] Moreover, delegation of UCITS operations to a UK entity will become subject to additional regulatory requirements that do not apply while the UK is still in the Single Market.[15]

3.11 **For UK-based AIFs (and UCITS funds that are not redomiciled to an EU country after Brexit, and therefore automatically become a non-EU AIF for the purposes of EU law) aimed at EU investors the situation will be more complicated. AIFs, unlike UCITS, are regulated at the manager rather than fund level by EU law. As a result, even if a British AIF was redomiciled to an EU country after Brexit, it would not enjoy a 'passport' to service the entire Single Market unless the manager *also* relocated to the EU. Instead, UK-based funds could only be marketed in an EU country where it has a "national private placement scheme" in place for non-EU AIFs.[16] While the AIFM Directive contains an equivalence regime which can extend the 'passport' to AIFs and AIF managers in non-EU countries where the latter apply regulation that effectively mirrors the Directive, this has not to date been activated.[17] To overcome these issues, UK AIFs or AIMFs could redomicile to the EU to keep their 'passport' (allowing them to access the entire EU investor base) and then delegate some of their functions back to the UK. However, as is the case for UCITS funds, this will become subject to restrictions that do not apply when delegation is made to EU-based entities.**

3.12 **Given the absence of operational 'third country' regimes for both UCITS and AIFs, in practice the UK asset management industry is likely to rely largely on delegation to continue servicing the EU's investor base after withdrawal from the Single Market. While this will already require some additional regulatory hurdles to be passed once the UK leaves the EU's common legal framework, the Committee notes with concern that the UK's decision to withdraw from the EU has led to calls for further restrictions on the use of delegation by EU-based investment funds. The European Commission and the European Securities & Markets Authority (ESMA) have repeatedly expressed concern about the extent to which asset management activity would take place outside the EU if the current levels of delegation to the UK persist after Brexit.[18]**

3.13 **While the recent proposals on cross-border distribution of funds do not alter the ability of non-EU entities to carry out investment management activities for EU-based funds, the Commission has already proposed separately to use Brexit as a reason to increase EU-level oversight of the overall use of delegation.[19] Any further restrictions**

14 British Bankers Association, "UK exit from the EU: an orderly transition for banking" (August 2016). For more information on third country access to the EU market for investment services under MiFID, please see our Report of 28 February 2018 on prudential requirements for investment firms (in particular paras. 8.64 to 8.85).

15 The EU-based management company cannot become a 'letter-box entity'; delegation must be notified to the domestic regulator where the fund is domiciled in advance; disclosures must be made to investors; the entity to which functions are delegated must be authorised for the purpose of asset management and subject to prudential supervision; and there must be a cooperation agreement in place between the UK's competent authority (the FCA) and the home regulator of the fund.

16 Different EEA countries have implemented the AIFMD private placement rules differently, and in some countries it is not permitted at all or restricted to professional investors only. It is also intended that in due course, the private placement regime will be closed entirely. Using private placement to market a non-EU AIF to EU-based investors also requires a cooperation agreement to be in place between the regulator of the AIF's home country and those of each Member State where it wants to operate.

17 The extension of the 'passport' to non-EU AIF managers is contained in the Directive, but the entry into force of its provisions depends on the adoption of a Delegated Act by the Commission.

18 ESMA, "ESMA issues principles on supervisory approach to relocations from the UK" (31 May 2017).

19 The increased EU oversight of delegation was proposed by the Commission as part of its reforms of the European System of Financial Supervision. See for more information our Reports of 13 December 2017 and 21 February 2018.

on delegation of asset management by EU funds overseas investment services providers, whether through new legislation or supervisory practice, would have a detrimental impact on the EU's access to asset management expertise. This is an area of concern the Committee will keep under review as the negotiations on the new European System of Financial Supervision progress.

3.14 **The UK Government is aware of the vulnerability of relying on delegation and equivalence for future trade flows of financial services with the EU, as these frameworks for market access can be altered by the Union unilaterally and therefore do not offer the same guarantee of continuity as the Single Market. It is seeking a post-Brexit financial services trade agreement that preserves preferential market access based on intensive (but non-binding) regulatory cooperation to ensure similar supervisory outcomes. However, the Treasury has not published a draft legal text on the workings of this system in practice. Moreover, the 27 remaining Member States[20] and the EU's Chief Negotiator[21] have not accepted the basic premise of the Government's offer, instead insisting that UK services providers will have to access the EU market based on "host state" rules. For asset management that will mean delegating functions back to the UK where permitted by EU law or using the NPPR scheme for marketing of non-EU AIFs on a country-by-country basis (both subject to an additional layer of supervision by the competent authority of an EU Member State).**

3.15 **In view of the possibility that the UCITS and AIFM Directives (as amended by the recent Commission proposals) will have to be applied in the UK under the post-Brexit transitional arrangement, and given the continued uncertainty about the extent of regulatory alignment under any future UK-EU financial services agreement (for example if the UK sought an 'equivalence' arrangement under the AIFMD), we retain the proposals under scrutiny and draw them to the attention of the Treasury Committee. We also repeat our call to the Treasury for publication of its detailed proposals for how its proposed UK-EU financial services agreement would be operationalised in legal terms, including the functioning of its dispute resolution body, so that we can assess the potential impact the envisaged arrangement would have on the UK's regulatory autonomy after Brexit.**

Full details of the documents

(a) Proposal for a Directive 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: (39548), 6988/18 + ADDs 1–2, COM(18) 92; (b) Proposal for a Regulation on facilitating cross-border distribution of collective investment funds and amending Regulations (EU) No 345/2013 and (EU) No 346/2013: (39549), 6987/18 + ADDs 1–2, COM(18) 110.

20 On 23 March 2018, the European Council at 27 noted that the future UK-EU trade agreement would contain a section on services "with the aim of allowing market access to provide services under host state rules, including as regards right of establishment for providers, to an extent consistent with the fact that the UK will become a third country and the Union and the UK will no longer share a common regulatory, supervisory, enforcement and judiciary framework".

21 On 23 April 2018, Michel Barnier said in a speech that the UK's decision to leave the Single Market meant that, under a future UK-EU trade agreement "companies from the other party have the right of establishment and market access to provide services under host state rules".

Background

3.16 Investment funds are investment products created with the sole purpose of gathering investors' capital, and investing that capital collectively through a portfolio of financial instruments such as stocks, bonds and other securities. Funds play a crucial role in facilitating the accumulation of personal savings, whether for major investments or for retirement. They are also important because they make institutional and personal savings available as loans to companies and projects which contribute to growth and jobs.

3.17 As part of its effort to create a barrier-free Single Market for collective investment funds, the EU has legislated to create a number of types of funds and regulate fund managers, namely:

- The **Directive on 'undertakings for collective investment in transferable securities'** (**UCITS**), the main European framework for collective investment funds. This category accounts for 75 per cent of all collective investments by small investors in the EU;[22]
- The **Alternative Investment Fund Managers Directive** (**AIFMD**), which regulates the activities of asset managers of non-UCITS such as hedge funds, private equity funds and other institutional funds (collectively called 'alternative investment funds' or AIFs, aimed primarily at professional investors);
- Three Regulations establishing a framework for specific types of AIFs with particular purposes, namely **European Venture Capital Funds** (**EuVECA**) that invest in start-ups; **European Social Entrepreneurship Funds** (**EuSEF**) which back social enterprises; and **European Long-Term Investment Funds** (**ELTIFs**) for investment in long-term projects, such as infrastructure development; and
- A **Regulation on money market funds** (**MMF**). MMFs are investment vehicles where households, corporate treasurers or insurance companies can obtain a relatively safe and short-term investment for surplus cash. They are an important source of short-term financing for financial institutions, corporates and governments.

3.18 Investment fund ownership in the EU is heavily concentrated within institutional investors such as insurance companies, pension funds, and monetary financial institutions. By the end of 2016 they collectively held two-thirds of the investments in investment funds. Households accounted for a quarter of all investments in funds, making them the second largest holder of investment funds. Total assets under management (AuM) in UCITS grew from €3,403 billion at the end of 2001 to €8,704 billion by June 2017. Assets managed in AIFs grew from €4,075 billion at the end of 2014 to €5,606 billion by June 2017.

3.19 The UK asset management industry is estimated to represent approximately 1 per cent of GDP. In 2016, UK asset managers generated fees amounting to £7.3 billion in gross exports (£6.2 billion in net terms, once UK asset management service imports are subtracted). UK authorised asset managers will often establish (or domicile) their

22 The first UCITS Directive, adopted in 1985, introduced the concept of the 'passport' for financial services in the EU. Once a UCITS fund had been authorised by the competent authorities of its home country, it could be marketed all over the EU subject to notifying its intention to the competent authorities of the host Member State. The current, fifth, UCITS Directive was adopted in 2014.

international investment fund ranges in specialised international hubs to serve their non-UK clients. Figures included by the European Commission in the impact assessment for its proposal indicate there are approximately 2,000 UCITS funds and 700 AIFs domiciled in the UK. However, it is unclear for how many UCITS domiciled elsewhere in the EU the portfolio management is effectively carried out from the UK.

Capital Markets Union and barriers to cross-border investment

3.20 Increasing the ability of both retail and institutional investors to access funds based in other EU countries is one of the key objectives of the Commission's 2015 Capital Markets Union (CMU) Action Plan. The CMU consists of numerous EU-level policy measures intended to increase the supply of capital to businesses (particularly from sources other than banks) and unlock more yield for savers by addressing fragmentation in the capital markets and removing regulatory barriers to the efficient financing of the EU's economy.

3.21 As part of the analysis underpinning the original 2015 CMU work programme, the Commission noted that EU legislation—while allowing asset managers of both UCITS and AIFs to 'passport' their investment funds across the EU based on their home state authorisation—still face barriers when doing so. It therefore announced further work to encourage greater cross-border distribution of funds, enabling asset managers to compete within the EU's various national markets. This would then, in turn, to allow funds to grow and allocate capital more efficiently across the EU.

3.22 The European Commission carried out a public consultation on cross-border distribution of funds in 2016, and in June 2017 announced its findings.[23] It concluded that variations between Member States' regulatory approach to investment funds—in particular with respect to marketing requirements, regulatory fees, and disclosure requirements—represented "a significant barrier to efficient cross-border fund distribution". It found that differences in taxation[24] and market structures (e.g. domestic markets being dominated by banks and insurers offering 'in-house' funds)[25] also posed obstacles to a more integrated single market for investment funds.

3.23 As a result of this fragmentation along national lines investments funds in the EU mostly do not take advantage of the 'passport' to grow in multiple Member State markets:

- EU investment funds representing 70 per cent of the total assets under management (AuM) are registered for sale *only* in their own Member State;
- only a third (37 per cent) of UCITS funds and 3 per cent of alternative investment funds are registered to be marketed in more than three Member States; and

23 https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017–3132069_en .

24 For example, investment funds often have restricted coverage under double tax treaties, "due to their tax status in the territory where they are domiciled or because they cannot demonstrate that their investors meet particular residence or nationality requirements". Other tax issues identified by the Commission were diverging national tax reporting requirements—in particular reporting on investor income tax—and tax discrimination of non-domestic investment funds, which discourages (retail) investors from investing cross-border.

25 The Commission noted that "the closed architecture of distribution and intermediation channels" can also pose a significant barrier for cross-border distribution. In many EU countries, banks and insurance companies are the biggest distributors of retail investment funds, offering in some cases predominantly in-house funds. Consequently, financial advice might be biased when financial advisors also act as sellers of financial products. Such advisors are also unlikely to consider cross-border funds from other distributors (on an equal footing).

- although the EU market is smaller than that of the US in terms of AuM, there are almost four times more EU funds. It follows that the average EU fund is significantly smaller than US counterparts, with—in the Commission's words—a "consequentially negative impact" when it comes to benefitting from economies of scale and minimising fees paid by investors.

Regulatory barriers identified by the Commission

3.24 To create a more efficient EU-wide internal market for investment funds, the Commission said it would seek to address the regulatory barriers identified as part of its analysis and consultation exercise. By October 2017, the Commission had decided that any meaningful reduction in the regulatory barriers to the cross-border distribution of funds would require legislative action at EU-level. It announced a proposal would be presented in the first quarter of 2018. The specific barriers the initiative would seek to address were:

- **Marketing requirements**. When EU funds are marketed cross-border to investors in another EU Member State, they are required to comply with the host Member State's national marketing requirements, which can vary considerably from country to country (sometimes including the need to seek prior approval from the national regulatory of the host country);

- **Regulatory fees**. Twenty-one Member States require the payment of regulatory fees when funds are marketed to investors in their territory on a cross-border basis. The level of fees levied by host Member State on asset managers varies considerably, both in absolute amount and how they are calculated [see Annex 8];

- **Administrative requirements**. Seventeen Member States require UCITS managers to have a (costly) physical presence in their territory even if they only market their fund to investors there on a cross-border basis. This local facility is then responsible for payments to unit-holders and certain other tasks (which again can vary by country);

- **Notification requirements**. Before a fund manager can use 'passport' into another EU country under the UCITS and AIFM Directives, it is required to notify the competent authority of the home Member State of its intention to do so. UCITS fund managers in particular have expressed concern about the difficulties in updating their fund 'notifications' when there are changes to their operations or practices,[26] as for UCITS this process is managed by the host Member State and so requires action in every Member State where the fund is active;

- With respect to **notification requirements for AIFs**, fund managers have noted that the requirement under AIMFD to modify their earlier notifications when there are material changes can "create difficulties" with respect to time limits for doing so; the definition of 'material change'; and the permissibility of marketing activities while the changes are being considered by the regulator.

26 Updates to the fund's regulatory documentation are necessary for example when there are changes to fund rules, the investment prospectus, periodic reports or key investor information documents. See e.g. article 17(8) of Directive 2009/65/EC.

> Moreover, Member States have different—and in some cases no—processes for 'de-notification' for when an asset manager wishes to stop marketing its fund in that country.

3.25 The Commission also said the problems related to taxation of investment funds and market structures were considered "out of scope" of this particular policy initiative, as they would respectively require a different legal basis (matters of tax being subject to a unanimity requirement among all Member States, compared to the qualified majority for Single Market issues) or because work is already underway at EU-level to make the market structures for distribution and intermediation channels for investment funds more efficient.[27]

The Commission proposal

3.26 In March 2018 the Commission adopted its proposals on facilitating cross-border distribution of collective investment funds. The specific aim of the proposed legislation is twofold:

- Address new rules to national regulators and ESMA with respect to cross-border marketing of investment funds, and any regulatory fees levied by those authorities. The new rules are contained in a directly-applicable Regulation, which would deliver "maximum harmonisation avoiding divergences and thus ensuring greater regulatory convergence";
- Introduce limited changes to the UCITS and AIFM Directives and the EuVECA and EuSEF Regulations to align them with these new, overarching rules.

3.27 The Commission has also noted that the UK's withdrawal from the EU "will have an impact on the EU investment fund market", as many fund managers are located in the UK and it also has a large investor base. Consequently, the UK's exit will make the Single Market for investment funds smaller (even allowing for some restructuring and relocation of fund managers to remain within the EU), which "accentuate[s] the need to ensure that the Single Market for funds operates as effectively and efficiently as possible".[28]

3.28 The initiative consists of two linked[29] legislative texts: a Regulation with the new harmonised rules for cross-border distribution of investment funds in the EU, and consequential amendments to the EuVECA and EuSEF regulations;[30] and a Directive to make consequential changes to the UCITS and the AIFM Directives.[31]

27 Roadmap IA.
28 See Commission Impact Assessment, p. 32.
29 The initiative is split into two separate legal proposals because it is aimed, in part, at amemding existing EU legislation which is laid down in both Directives and Regulations, which are typically amended by a similar instrument.
30 See Commission document COM(2018) 110.
31 See Commission document COM(2018) 92.

Details of the proposals

3.29 The proposed Regulation on cross-border distribution of funds contains new horizontal requirements on marketing communications, 'pre-marketing', supervisory fees and transparency for all investment fund activity regulated by EU law. These new requirements can, broadly, be summarised as follows:

Marketing and pre-marketing

- There would be harmonised standards for **marketing communications** from UCITS funds and AIFs. They must be clearly identifiable as such; present the risks and rewards of purchasing units or shares of AIFs and UCITS in an equally prominent manner; and be "fair, clear and not misleading";[32]

- Where a Member State requires systematic **notification of UCITS or AIFs' marketing communications aimed at retail investors to the financial regulator** to ensure their compliance with national law, the Regulation would set a deadline for a decision either way of 10 working days.[33] The new rules would also prevent EU countries from making marketing materials subject to prior approval;[34]

- The proposed Regulation would introduce a legal definition of, and restrictions on, "**pre-marketing**" for AIFs (but not UCITS funds).[35] This would provide a clear legal basis for AIF managers to test investors' appetite for upcoming investment opportunities without triggering any notification requirement (which is currently the case in some Member States);[36]

Supervisory fees

- Any **supervisory fees or charges** levied by a financial regulator for services performed pursuant to the UCITS and AIFM Directives must be "proportionate to supervisory tasks carried out". This is because twenty-one Member States—including the UK—charge a fee when funds (whether UCITS or AIF) market to retail investors in their jurisdiction using the 'passport' created by EU law;[37]

Transparency of national rules

- National financial regulators would face new **transparency requirements** about all applicable national rules governing marketing for AIFs and UCITS" and about any related supervisory fees or charges in "a language customary in the

32 This new provision is broadly based on Article 77 of the UCITS Directive, and effectively extends the scope of application to the AIFM Directive.

33 The new requirements with respect to marketing communications aimed at retail investors would only apply to AIFs where a Member State has allowed such funds to market units or shares to retail investors in their territories.

34 At present, Belgium, Italy, France, Greece, Bulgaria, Finland, and Spain carry out 'ex-ante' checks on marketing materials.

35 The Commission argues that pre-marketing "should be limited to professional investors in order not to endanger retail investor protection". See Commission Impact Assessment SWD(2018) 54, p. 36.

36 If a professional investor ultimately invests in an AIF managed by the AIF manager that under the pre-marketing, this will be legally considered the result of marketing.

37 For an overview of the regulatory fees charged by Member State for 'passported' investment funds, see page 139 of the European Commission's impact assessment (SWD(2018) 54).

sphere of international finance". The European Securities & Markets Authority (ESMA) would also collate and publish this information centrally for all EU Member States;

Physical presence of the investment fund manager

- The Regulation would remove the ability of individual Member States to require UCITS managers to maintain a **physical presence** to deal with their retail investors in that territory (i.e. for making payments or providing information).[38] While the substantive obligations on the funds vis-à-vis retail investors would remain unchanged, they would be allowed to fulfil them across the EU from their headquarters via "electronic or other means of distance communication". The same would apply to AIF managers where they are allowed to target retail investors in a specific EU country;

Notification requirements

- The procedures and requirements for **updating notifications for cross-border passports** would be harmonised for UCITS. As is the case for AIFs, the national regulator of the home Member State (rather than the host Member State, as at present) would assess the changes. The proposal would also require the regulator to decide whether any changes to a fund's particulars would render it non-compliant with the relevant EU and national legislation within 10 working days; and

- For UCITS and AIF managers to decide to stop their marketing activities in a Member State (and therefore exit that market), a single **'denotification' procedure** is introduced. Asset managers would be allowed to 'de-notify' only if a maximum of 10 investors who hold no more than one per cent of assets under management have invested in that fund in that Member State; a repurchase offer is made to all investors; and the intention to 'denotify' is made public in advance.

Overview of the AIFMD passport for non-EU investment firms

3.30 The Single Market treatment of UK-based AIFs (including UCITS) after Brexit under the AIFM Directive, in the absence of any overriding UK-EU trade agreement, is shown in the table below. As can be seen, until the UK is granted equivalence, funds or fund managers domiciled there would have to rely on the national rules for private placement of each EU country where they wish to operate.

38 A few Member States also require these local facilities to perform additional tasks, like handling complaints or serving as a local distributor or being the legal representative (including dealing with the national competent authority).

	EU-based AIF	Non-EU based AIF in 'equivalent' country	Non-EU based AIF in other countries
EU manager	Passport. Fund can be marketed throughout the EU	Passport. Fund can be marketed throughout the EU[1]	No passport; reliance on NPPR
Non-EU manager in 'equivalent' country	Passport. Fund can be marketed throughout the EU[39]	Passport. Fund can be marketed throughout the EU[3]9	No passport; reliance on NPPR
Non-EU manager in other countries	No passport; reliance on NPPR	No passport; reliance on NPPR	No passport; reliance on NPPR

Previous Committee Reports

None. These are new proposals for legislation.

39 The 'passport' for non-EU AIFs or AIFMs is not yet available as the European Commission has yet to propose a Delegated Act to that effect.

4 Non-performing loans: debt management and out-of-court collateral recovery

Committee's assessment	Politically important
Committee's decision	(a)—(b) Not cleared from scrutiny; further information requested; drawn to the attention of the Treasury Committee and the Business, Energy & Industrial Strategy Committee; (c) Cleared from scrutiny
Document details	(a) Proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral; (b) Proposal for a Regulation on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures; (c) Second Progress Report on the Reduction of Non-Performing Loans in Europe
Legal base	(a) Articles 53 and 114 TFEU; ordinary legislative procedure; QMV; (b) Article 114 TFEU; ordinary legislative procedure; QMV; (c)—
Department	Treasury
Document Number	(a) (39588), 7403/18 + ADDs 1–4, COM(18) 135; (b) (39604), 7407/18 + ADDs 1–2, COM(18) 134; (c) (39592), 7410/18 + ADD 1, COM(2018) 133

Summary and Committee's conclusions

4.1 In several EU countries, banks still have high levels of "bad debt" on their balance sheets. These "non-performing loans" (NPLs) are unlikely to ever be repaid in full, and limit banks' ability to engage in new lending (as well as posing a risk to financial stability). Although stocks of non-performing loans are decreasing, nine EU countries[40]—not including the UK—still have NPL ratios of more than 10 per cent in their banking sector.[41]

4.2 In the summer of 2017 the Member States asked the European Commission to propose a number of policy initiatives to reduce the stock of non-performing loans (NPLs) on the balance sheets of European banks.[42] In January 2018 the European Commission set out the status of its preparations in a first 'progress report',[43] followed in March 2018 by concrete proposals for a Directive and a Regulation which would:

40 Bulgaria, Croatia, Cyprus, Greece, Hungary, Ireland, Italy, Portugal and Slovenia. The UK, along with Luxembourg, Sweden and Finland, has one of the lowest levels of NPLs in the EU.

41 The overall stock of bad loans across the EU—amounting to €950 billion (£842 billion)—is also still higher than it was before the financial crisis.

42 Action plan to tackle non-performing loans in Europe (Council conclusions, 11 July 2017).

43 See our Report of 28 February 2018 for more information on the first NPL progress report.

- require all Member States to ensure banks have out-of-court access to collateral against secured business loans, through a so-called "accelerated extrajudicial collateral enforcement procedure" (AECE);
- create a more efficient secondary market for loan agreements by setting standardised rules for specialist debt management and debt collection companies (referred to as 'credit servicers' in the proposal), which purchase non-performing loans or seek to enforce them on a bank's behalf, and allowing them to operate throughout the EU based on the licence of a single Member State; and
- amend the 2014 Capital Requirements Regulation to introduce minimum loss coverage for banks' non-performing exposures (the "prudential backstop").

4.3 We have considered the detail of both proposals, which were accompanied by a second 'progress report', in "Background" below. In April 2018 the Economic Secretary to the Treasury (John Glen) told us that the Government "is satisfied that, in their current form, the proposed policy solutions to the NPL problem are targeted at specific problem areas—broad measures aimed at reducing aggregate levels of NPLs in the EU would be disproportionate".[44]

4.4 **The Commission's recent proposals on out-of-court recovery of collateral where businesses fail to repay bank loans and the regulation of debt management companies should be seen in the context of wider efforts within the EU to reduce the prevalence of non-performing loans in a sub-set of Member States. This new legislation is due to take effect on 1 January 2021.**[45]

4.5 **Despite the UK's low rate of NPLs, and its decision to exit the European Union, it is not yet clear what impact these proposals may have on the regulation of the British banking and debt management industries. As we have noted in relation to other recent EU financial services proposals,**[46] **the Government has secured a provisional agreement that the UK will stay part of the EU's economic and regulatory structures—and therefore subject to Single Market law—until the end of 2020. This would provide additional time for the formal negotiation on, and ratification of, a post-Brexit UK-EU trade agreement and for the completion of the UK's domestic preparations for economic life outside of the Customs Union and Single Market.**

4.6 **However, Ministers have repeatedly refused to rule out the possibility of an extension of that transitional arrangement beyond December 2020. The Government's view is that the length of the transition "should be determined simply by how long it will take to prepare and implement the new processes and new systems that will underpin the future partnership".47 Under the current terms of the transition, any extension would imply the Treasury would be legally required to implement the Commission's NPL proposals (any amendments introduced by the Council and the Parliament notwithstanding).**

44 Explanatory Memorandum submitted by HM Treasury (16 April 2018).

45 This is because the Directive as currently drafted requires Member States to transpose the Directive into national law by 31 December 2020. Those provisions are to apply in domestic law from 1 January 2021.

46 See for example our Report of 2 May 2018 on a new EU Crowdfunding Regulation.

47 HM Government, "Draft text for discussion: Implementation Period" (accessed 20 April 2018).

4.7 **As the Directive and the Regulation may have legal effect in the UK, there are some issues of substance that we believe will require careful consideration during the legislative process.**

4.8 **Firstly, the issue of recovery of collateral by banks from business borrowers is highly topical, given the recent controversy over Royal Bank of Scotland's treatment of its business customers in arrears.48 We understand the Treasury is undertaking further analytical work to assess the potential impact the requirement to establish an out-of-court procedure for collateral recovery would have on UK law (taking into account the fact that the exact legal provisions are still subject to change). Any new EU rules on out-of-court debt enforcement of secured commercial loans should contain robust protections for borrowers, so that businesses do not see their assets appropriated by banks unnecessarily, or—where enforcement of any collateral is appropriate—for less than their true value.**

4.9 **Secondly, the proposed EU-wide regulatory approach to 'credit servicers' has implications for consumers and businesses alike because it appears to open up the UK's market for debt management to overseas companies. The Government's sale of Northern Rock's loan-book of distressed mortgages to a private equity firm in 2015 sparked concerns about the protection available to borrowers whose loans were sold.[49] Similar issues could arise if the new EU 'passport' for credit servicers would allow a bank to have its loan agreements managed more easily by a third party that may not even have a domestic presence, or be subject to the supervision of a UK-based regulator like the Financial Conduct Authority. In this regard, we would like the Minister to write to us as soon as possible to clarify:**

- **Whether credit servicing companies as defined in the proposed Directive already have cross-border access to the UK market without supervision by the Financial Conduct Authority (or whether the introduction of a Single Market 'passport' for such activities would, for the first time, allow debt management activities to be conducted in the UK subject to supervision by an overseas regulator); and**
- **If Member States could still require credit servicers based in another EU country to establish a physical presence in their territory before providing services there based on the authorisation of another Member State's competent authority.**

4.10 **After the UK leaves the Single Market, credit servicing companies based in the EU would no longer have a right to 'passport' their activities into the UK domestic market (and vice versa for British debt management agencies). At that point, UK-based credit servicers would only be able to operate within the Single Market if they establish a separate legal entity in an EU country, subject to authorisation and supervision by that country's domestic regulator.50 Similarly, once the UK is a 'third country' vis-à-vis the Single Market, British firms would not be able to purchase loan agreements**

48 See for more information https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2017/rbs-global-restructuring-group-s166-report-17–19/.

49 https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2015/northern-rock-correspondence-15–16/.

50 There is no provision in the proposed Directive for the recognition of a third country's regulatory approach to debt management as 'equivalent' to the EU's.

from EU banks unless they appointed a legal representative within the EU (and this representative must, in turn, engage an EU-based bank or credit servicing company to actually manage the loans).

4.11 **In anticipation of further information from the Treasury about developments in the legislative process in the coming months, we retain both legislative proposals under scrutiny and draw them to the attention of the Treasury Committee. We also consider that the Directive on credit servicing and out-of-court enforcement of collateral may be of interest to the Business, Energy & Industrial Strategy Committee in view of its scrutiny of Government policy that affects businesses and consumers. We are content to clear the second NPL progress report from scrutiny.**

Full details of the documents

(a) Proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral: (39588), 7403/18 + ADD 1–4, COM(18) 135; (b) Proposal for a Regulation on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures: (39604), 7407/18 + ADD 1–2, COM(18) 134; (c) Communication from the European Commission—Second Progress Report on the Reduction of Non-Performing Loans in Europe: (39592), 7410/18, COM(18) 133.

Background

4.12 In several EU countries, national banking sectors continue to hold unsustainably high levels of "bad debt": non-performing loans (NPLs) that are unlikely to ever be repaid in full. These constitute a drag on bank capital and resources, hindering new lending to fuel the economy, as well as potentially posing a risk to financial stability if banks cannot absorb the losses incurred on loans that will never be repaid.

4.13 In June 2017 EU Finance Ministers explicitly called for a package of measures, at both EU and national level, to help reduce overall stocks of NPLs and to ensure banks have sufficient capital to deal with the financial consequences of bad loans.[51] This Council 'Action Plan' outlined the need for a number of policy initiatives, including:

- new statutory prudential requirements for banks to ensure they 'provision' for the possibility of new loans not being repaid;
- EU legislation to improve the ability of secured creditors of recovering value from a debtor's collateral in case the borrower defaults on their loan;
- support for EU countries wanting to establish a national Asset Management Company (AMCs) to purchase NPLs from banks without breaching EU banking or state aid legislation; and
- regulatory guidance to banks on ways of reducing their stocks of bad loans, and on the governance of banks' lending practices (including for example borrower affordability assessments and monitoring of outstanding loans).

4.14 A progress report published by the Commission in January 2018 set out at high level the specific policy initiatives it intended to propose to fulfill the requirements of the

51 Action plan to tackle non-performing loans in Europe (Council conclusions, 11 July 2017).

Council Action Plan.[52] In addition to guidance and support for both banks and regulators, these included legislative proposals to facilitate a secondary markets where banks could sell 'bad' loans to new creditors; a new prudential requirement for banks to cover the risk of new loans becoming distressed ('provisioning'); and the availability of out-of-court collateral recovery mechanisms for banks if borrowers fail to repay secured loans. At the time, the Economic Secretary to the Treasury (John Glen) told us that the proposed policies are "unlikely to affect the UK" as it has "very low levels of NPLs". However, the Government supports the EU's efforts to reduce stocks of bad loans, as long as the new policies do not trigger "additional economic or market risk" and "address specific problem areas and [will] not solely be aimed at reducing aggregate NPL levels across the EU as a whole".[53]

4.15 When we considered the Commission progress report in February 2018, we concluded that—the UK's exit from the EU *and* its low stock of bad loans notwithstanding—it was not yet possible to assess the potential implications of the proposed NPL initiatives for the UK, particularly as regards the legislation being prepared by the Commission, because the Government had provisionally agreed with the EU that the UK would stay part of the Single Market—including EU financial services legislation—until at least the end of 2020. Depending on the timetable for the adoption of the Commission's proposals by the Member States and the European Parliament, the new capital requirements and statutory out-of-court recovery mechanism could therefore apply to the British banking sector, if they were to take effect while Single Market legislation is still binding on the UK.

The Commission proposals

4.16 The European Commission published two legislative proposals to address non-performing loans in the EU banking sector on 18 March 2018, accompanied by a second progress report on related non-regulatory measures.

4.17 The proposed legislation consists of:

- a Directive to improve banks' access to accelerated recovery of collateral against secured loans, and to create a more efficient secondary market for NPLs by setting standardised EU-wide rules for the specialist companies that purchase non-performing loans or seek to enforce them on a bank's behalf; and
- a Regulation to amend the 2014 Capital Requirements Regulation as regards minimum loss coverage for banks' non-performing exposures (the "prudential backstop").

Directive on credit servicers, credit purchasers and the recovery of collateral

4.18 The objective of the Directive is to prevent excessive future build-up of NPLs on banks' balance sheets. Fundamentally, it aims to do so in two separate ways:

- by encouraging the development of an EU-wide secondary market for non-performing loans, by setting common standards for the "proper conduct and

52 See our Report of 28 February 2018 for more information on the NPL progress report.
53 Explanatory Memorandum submitted by HM Treasury (1 February 2018).

supervision" of **credit servicing companies**, specialist firms with the "necessary risk appetite and expertise" employed by banks to seek repayment of non-performing consumer and commercial loans; and

- by requiring each EU country to establish an "**accelerated extrajudicial collateral enforcement procedure**" (AECE), a faster way for banks to salvage bad business loans by recovering the collateral against which they are secured rather than through existing insolvency and debt recovery legislation.

4.19 The Economic Secretary to the Treasury (John Glen) submitted an Explanatory Memorandum on the proposals on 16 April 2018.[54] We have described the substance of the proposed legislation, and the Government's views thereon, in more detail below.

Credit servicing companies

4.20 The bulk of the proposed Directive is focused on the development of a more efficient secondary market for non-performing loans, which relies on banks being able to sell NPLs to specialist credit purchasers (who would then become the creditor, removing the loan from the bank's balance sheet) or outsource management of the debt recovery process to a credit servicing company. The latter can carry out tasks such as monitoring the performance of loan agreements, communicating with the borrower, and enforcing or renegotiating the creditor's rights. Banks make use of this secondary market where they themselves are unable to effectively manage bad loans.

4.21 The proposal would create a common set of rules that third party credit servicers need to abide by in order to operate, to ensure their proper conduct and supervision across the Union, while allowing greater competition among servicers in harmonising the market access across Member States. This will lower the cost of entry for potential loan purchasers by increasing the accessibility and reducing the costs of credit servicing. More purchasers on the market should, everything else being equal, ease the way for a more competitive market with a larger number of buyers, leading to higher demand and higher transaction prices.

4.22 The harmonised standards for credit servicing companies (i.e. debt management agencies) would be:

- they would need to obtain authorisation from a domestic regulator before they can carry out their activities, which in turn would be dependent on meeting requirements relating to their conduct and organisation. For example, its management staff or owners could not have been found guilty of crimes relating to financial services or harassment;

- authorisation would be available only to natural persons who hold the nationality of an EU Member State, or to legal persons "formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union";

- companies without regulatory authorisation would not be permitted to carry out credit servicing activities as defined in the Directive; and

54 Explanatory Memorandum submitted by HM Treasury (16 April 2018).

- authorised credit servicing companies would need an "appropriate policy" to ensure the "fair and diligent treatment" of borrowers whose loan agreements it services, including referring them to "debt advice or social services" where necessary.

4.23 Where a credit servicing company obtains authorisation to operate from the national regulator of any EU country, it would be able to:

- market its services to EU-based credit institutions in respect of any type of loan agreement (i.e. both consumer and commercial lending); and
- provide its services in any EU country without needing to apply for regulatory permissions from that country's national regulator (the so-called 'passport').[55]

4.24 The supervision of credit servicing companies would primarily be the responsibility of the regulator that authorised its operations, even where it provides services in another EU country. The draft Directive would allow the authorities of 'host' Member States to "conduct checks, inspections and investigations in respect of credit servicing activities provided within their territory by a credit servicer authorised in [another] Member State" at their own initiative. However, they could not bar a company authorised elsewhere in the EU from operating, unless its 'home' regulator withdraws its licence. It is unclear if Member States could require a credit servicing company authorised in another EU country from establishing a physical presence in their territory.

4.25 The proposed legislation does not contain any mechanism for the operation of non-EU credit servicing companies in the EU, for example by way of a decision recognising a third country's regulatory regime as 'equivalent' to the rules laid down in the Directive.[56]

4.26 The Economic Secretary's Explanatory Memorandum on the proposed rules for credit servicers states that the Government "is satisfied that, in their current form, the proposed policy solutions to the NPL problem are targeted at specific problem areas—broad measures aimed at reducing aggregate levels of NPLs in the EU would be disproportionate".

Credit purchasing

4.27 The proposal also contains several provisions relating to credit purchasing, where a company buys a loan book from a bank and becomes the creditor vis-à-vis the borrower. It would sets out minimum disclosure requirements by the bank towards the prospective buyer of a loan agreement, as well as requiring the sale to be notified to the financial regulator.

4.28 Credit purchasers based outside the European Union would need to appoint a designated representative within the EU before they could purchase a credit agreement involving an EU-based borrower. This representative, in turn, would have to engage an EU bank or credit servicing company to manage loan agreements with consumers. That requirement does not apply to commercial loans, or where the purchasing company

55 'Passporting' into another Member State under the Directive would be subject to the debt management company having informed its domestic regulator of its intention do so in advance (after which this information would be communicated to the regulators of the other Member States in question).

56 Article 4 of the Directive requires credit servicing companies to apply for authorisation in an EU Member State before commencing operations, and article 5 restricts such applications to EU-based natural and legal persons.

is based in the EU. Credit purchasers or their representatives would also have various obligations to relay information on their activities to their 'home' regulator within the European Union.

Accelerated collateral recovery

4.29 The second part of the Directive relates to the enforcement of collateral by banks when a borrower is not making sufficient loan repayments.[57] While banks can enforce collateral under national insolvency and debt recovery frameworks, it argues that this process "can often be slow and unpredictable", keeping the banks capital tied up and preventing it from engaging in new lending. Examples of inefficiencies in the debt recovery process are 'collateral meltdown' (the simultaneous sale of collateral by all lenders leads to a sharp fall in asset prices, and therefore a lower likelihood the collateral will cover the outstanding debt), and court congestion (when the judicial system of a Member State is unable to process legal debt recovery actions expeditiously).

4.30 The proposed Directive would therefore require each Member State to establish, in law, a "more efficient" method to banks and credit purchasers to recover money from secured loans to business borrowers without recourse to legal action in court. Recovery of the collateral under this so-called "accelerated extrajudicial collateral enforcement procedure" (AECE) would take the form of a public auction, private sale, or outright appropriation of the asset by the creditor (in which case it would be free to keep the asset or sell it as it wishes). AECE be available only when agreed on in advance by means of the loan agreement between the lender and the borrower, and could not be used in relation to secured consumer credit agreements, such as residential mortgages.[58]

4.31 In order to ensure fair treatment of the business whose collateral is subject to recovery, the Directive would require the creditor to have the assets independently valuated to determine the appropriate reserve price for auction or private sale (or its value to the bank in case of appropriation). The valuer would have to be appointed by common consent of both lender and borrower,[59] and the collateral could only exceptionally be sold for less than the reserve price (and never for less than 80 per cent of the estimated value).[60] Any positive difference between the selling price[61] and the outstanding debt would revert to the borrower.

4.32 The Commission says the proposal is designed "so as to not affect preventive restructuring or insolvency proceedings and not to change the hierarchy of creditors in insolvency", as "restructuring and insolvency processes prevail over the accelerated extrajudicial collateral enforcement procedure set out with this proposal".[62] The

57 Commission Impact Assessment SWD(2018) 75.

58 For 'social considerations', it can also not be applied to the main residence of a business owner who takes out a commercial loan.

59 Where the two parties cannot agree upon the appointment of a valuer, one would be appointed by a decision of a court in the Member State in which the business borrower is established or domiciled.

60 Sale for less than the reserve price would only be possible where no buyer has been found willing to pay the full value, and there is a "threat of imminent deterioration of the asset".

61 Or the valuation, in case of appropriation of the asset.

62 Article 32 of the draft Directive provides that "where insolvency proceedings are initiated in respect of a business borrower, the realisation of collateral pursuant to national laws transposing this Directive is subject to a stay of individual enforcement actions in accordance with applicable national laws".

Minister's Explanatory Memorandum does not explain whether the UK, should it be under an obligation to transpose the Directive into domestic law, would have to make any substantial changes to existing means of extra-judicial enforcement of collateral.

Regulation on capital requirements for 'non-performing exposures'

4.33 The second legislative proposal of the March 2018 NPL package deals with banks' prudential treatment of new lending, to ensure they maintain sufficient liquidity even when loans are not fully repaid.

4.34 The proposal would amend the Capital Requirements Regulation (CRR) to create a 'prudential backstop': a requirement for banks to make "time-bound prudential deductions from own funds". This, the Commission says, would reduce financial stability risks arising from high levels of insufficiently covered NPEs, by avoiding the build-up or increase of such NPEs with spill-over potential in stressed market conditions; and ensure that institutions have sufficient loss coverage for NPEs, hence protecting their profitability, capital and funding costs in times of stress. In turn, this would ensure that stable, less pro-cyclical financing is available to households and businesses.

4.35 Concretely, the proposed amendment to the CRR would require all banks to have sufficient liquid funds to cover the incurred and expected losses on new loans once such loans become non-performing, up to a common minimum level (the 'minimum coverage requirement'), made up of provisions recognised by the applicable accounting framework. Where an institution does not meet the minimum coverage requirement, the prudential 'backstop' would apply: a bank would have to deduct the difference between the level of the actual coverage and the minimum coverage from its statutory Common Equity Tier 1 (CET1) prudential capital.[63]

4.36 Under the Commission proposal:

- The minimum coverage requirement would increase gradually depending on how long a loan has been classified as 'non-performing', to reflect the fact that the longer an exposure has been non-performing, the lower is the probability to recover the amounts due;
- There would be a harmonised, EU-wide statutory definition of "non-performing exposures" in the CRR,[64] with "strict criteria" on the conditions to discontinue the treatment of an exposure as non-performing as well as on the regulatory consequences of refinancing and other forbearance actions;
- Different coverage requirements would apply depending on whether a non-performing loan is secured or unsecured, because secured lending is generally less risky for a bank. Consequently, non-secured lending would trigger higher and

63 CET1 regulatory capital consists primarily of a bank's common stock.

64 The definition is based on the concept of NPE in Commission Implementing Regulation (EU) No 680/2014, which is already commonly applied for supervisory reporting purposes. This definition includes, among others, defaulted exposures as defined for the purposes of calculating own funds requirements for credit risk and exposures impaired pursuant to the applicable accounting framework. The amendment would also introduce strict criteria on the conditions to discontinue the treatment of an exposure as non-performing as well as on the regulatory consequences of refinancing and other forbearance actions.

timelier minimum loss coverage by the creditor bank than secured loans.[65] This is also linked to the parallel proposal for accelerated out-of-court enforcement of collateral (see above); and

- The prudential backstop would apply only to loan agreements originated or amended after 14 March 2018, the date the Commission formally adopted its proposal, as "from that date there [was] sufficient clarity how the new rule would apply" to banks. Any exposures originated before that date "should be treated accordingly to the rules in force at that date, even if they are refinanced or subject to other forbearance measures".

Previous Committee Reports

None, as these are new proposals for legislation. However, we previously considered EU policy on non-performing loans in February 2018. See: Fifteenth Report HC 301–xv (2017–19), chapter 3 (28 February 2018).

65 However, if the collateral against a secured loan has not been enforced after a number of years after the loan became non-performing, the credit protection would not be seen as effective and full coverage of the exposure amount would be deemed necessary.

5 Adapting EU visa policy to new migration and security challenges

Committee's assessment	Politically important
Committee's decision	(a) Cleared from scrutiny; (b) Not cleared from scrutiny; further information requested; drawn to the attention of the Home Affairs Committee and the Committee on Exiting the European Union
Document details	(a) Commission Communication: *Adapting the common visa policy to new challenges*; (b) Proposal for a Regulation amending the EU Visa Code
Legal base	(a)— (b) Article 77(2)(a) TFEU, ordinary legislative procedure, QMV
Department	Home Office
Document Numbers	(a) (39558), 7172/18, COM(18) 251; (b) (39559), 7173/18 + ADDs 1–3, COM(18) 252

Summary and Committee's conclusions

5.1 The EU's common visa policy is intended to facilitate legitimate travel, prevent irregular migration and safeguard public order and security within the border-free Schengen area. It is based on a set of harmonised rules which:

- determine the third countries whose nationals require a visa to travel to the Schengen area for stays of up to 90 days in any 180-day period—the EU Visa Regulation;[66]
- establish the procedures and conditions for issuing visas—the EU Visa Code (in force since 2010);[67] and
- prescribe a uniform format for visa stickers.[68]

5.2 All visa applications and decisions are entered in the Visa Information System (VIS), an EU database containing details on each visa applicant, their photograph and fingerprints.[69] Most elements of the EU's common visa policy—the EU Visa Regulation, the EU Visa Code and the Visa Information System—build on parts of the Schengen rule book which do not apply to the UK.

66 See Regulation (EC) No 539/2001 listing the third countries whose nationals must be in possession of visas when crossing the external borders and those whose nationals are exempt.
67 See Regulation (EC) 810/2009.
68 See Regulation (EC) No 1683/95 laying down a uniform format for visas.
69 The roll-out of VIS began in 2011. The System became fully operational by December 2015.

5.3 In its Communication—document (a)—the Commission calls for an overhaul of EU visa policy to reflect the new migration and security challenges confronting the EU. It proposes a number of changes to the EU Visa Code which are intended to:

- make better use of EU visa policy as a form of leverage to improve cooperation with third countries on the return and readmission of irregular migrants;
- ensure that Member States have adequate resources to process visa applications efficiently by increasing the visa fee from €60 to €80 (and from €35 to €40 for children aged between 6 and 12 years);
- improve visa application procedures by allowing travellers to apply for their visas earlier (up to six months ahead of their planned visit, rather than three) and to fill in and sign their applications electronically, and by reducing the time to reach a decision from 15 to 10 days;
- harmonise rules on the issuing of multiple-entry visas (valid for between one and five years) for trusted travellers so that they do not have to apply for a new visa every time they visit the EU; and
- promote tourism by allowing Member States to issue single-entry visas (valid only in the issuing Member State) at specific land or sea border crossing points for short stays of up to seven days under temporary seasonal schemes.[70]

5.4 These changes are set out in the proposed Regulation—document (b)—which would amend the EU Visa Code. The Commission also intends to propose changes to the Visa Information System later in the year as part of a wider package of measures to make EU information systems interoperable and ensure that all relevant information on visa applicants can be checked at the same time. It will launch a feasibility study at the end of 2018 on the possible introduction of fully automated visa application procedures and digital visas.

5.5 The Immigration Minister (Caroline Nokes) confirms that the UK does not take part in the EU Visa Code and that the changes set out in the proposed Regulation will not therefore apply to, or have any direct impact on, the UK. She says that the UK will continue to operate its own visa system and visa application procedures.

5.6 **We accept the Minister's assurance that the proposed changes to the EU Visa Code will have "no direct impact upon the UK" while the UK remains a member of the European Union. This is because UK citizens are also citizens of the European Union and are entitled to "move and reside freely" within the EU, without the need for a visa, even though the UK is outside the Schengen border-free area.[71] This will no longer be the case when the UK leaves the EU (and any transitional/implementation period extending the application of EU free movement rules has expired) as UK citizens will no longer be able to enjoy the rights associated with EU citizenship.**

5.7 **EU visa policy operates on the basis of reciprocity, meaning that if the UK were to introduce a requirement for the nationals of one or more EU Member States to obtain a visa to visit the UK post-exit, the EU would likely reciprocate by imposing a visa**

70 See the European Commission's information sheet on *A stronger, more efficient and secure EU visa policy.*

71 See Article 20 of the Treaty on the Functioning of the European Union (TFEU) which sets out the rights of EU citizens and the "conditions and limits" which determine how these rights can be exercised.

requirement on UK nationals travelling to the EU. The former Home Secretary (Amber Rudd) told the Home Affairs Committee in March that the Government expects to publish an Immigration White Paper "at the end of this year" and an Immigration Bill setting out future arrangements "at the start of next year sometime".72 She said it would be for the Prime Minister and the Secretary of State for Exiting the European Union (Mr David Davis) to determine whether the UK's immigration system for EU citizens post-exit should form part of the negotiations on the UK's future partnership with the EU, based on "proposals and alternatives" put forward by the Home Office.73

5.8 **Given this uncertainty as to the UK's future immigration policy, as well as the likelihood that it will affect EU policy towards UK citizens who wish to travel to the EU after any transitional/implementation period, we cannot exclude the possibility that UK citizens may, in the future, require a visa to travel to the EU. Any changes to EU visa policy may therefore have direct implications for UK citizens which the Minister does not address in the section of her Explanatory Memorandum dealing with policy and exit implications. We ask the Minister to tell us what assessment the Government has made of the costs and benefits of a reciprocal visa regime for UK travellers to the EU and EU travellers to the UK post-exit, particularly in terms of the impact on tourism and trade.**

5.9 **We understand that the Government wishes to flesh out much of the detail of the UK's future partnership with the EU by the autumn, before it has published its Immigration White Paper and Bill. We seek an assurance that the Government will inform Parliament promptly of any options it puts forward in the future partnership negotiations which may affect the immigration status of EU citizens in the UK and UK nationals in the EU27.**

5.10 **The Minister expresses no view on the substance of the changes proposed to the EU Visa Code. If UK nationals were to be required to obtain a visa to travel to the EU post-exit, we ask the Minister:**

- **whether harmonised EU rules on the issuing of multiple-entry visas would be beneficial for UK nationals; and**
- **whether the UK, as a country having direct ferry connections to the continent, might benefit from the proposed new rules allowing entry to a Member State for short stays of up to seven days.**[74]

5.11 **We also ask whether the Government considers it appropriate to establish a formal link between visa policy and cooperation on readmission and returns.**

5.12 **Pending further information, the proposed Regulation—document (b)—remains under scrutiny. We are content to clear the Commission Communication—document (a). We draw this chapter to the attention of the Home Affairs Committee and the Committee on Exiting the European Union.**

72 See the transcript of the then Home Secretary's evidence to the Home Affairs Committee on 28 March 2018, QQ 209 and 232.

73 Ibid, Q 210.

74 See the proposed new Article 36a.

Full details of the documents

(a) Commission Communication: *Adapting the common visa policy to new challenges*: (39558), 7172/18, COM(18) 251. (b) Proposal for a Regulation amending Regulation (EC) No 810/2009 establishing a Community Code on Visas (Visa Code): (39559), 7173/18 + ADDs 1–3, COM(18) 252.

Background

5.13 The changes to the EU Visa Code form part of a wider package of measures put forward by the Commission to manage migration to the EU more effectively and respond to the heightened security threat. The measures include two new EU information systems—an Entry/Exit System and a proposed European Travel Information and Authorisation System—to strengthen checks on third country nationals travelling to the Schengen area and a proposal to make EU border control, migration and security information systems interoperable.[75] The Commission's aim is to close information gaps, enhance internal security and prevent irregular migration by making it easier for immigration and law enforcement authorities to access relevant data held in different EU information systems.

The Commission Communication—document (a)

5.14 The Commission explains that the common visa policy is an essential part of the Schengen rule book and "one of the most valued achievements of EU integration", facilitating tourism and business within the 26 countries forming part of the border-free Schengen area. The citizens of 105 third (non-EU) countries and entities are currently required to hold a visa when travelling to a Schengen country for short stays of up to 90 days in any 180-day period. A short-stay visa issued by one Schengen country entitles its holder to travel to other countries in the Schengen area. The demand for Schengen visas has increased by 50% since 2009 (from 10.2 million to 15.2 million in 2016). During this period, visa application procedures have remained largely unchanged and, in the Commission's view, are too lengthy, cumbersome and out-of-date, operating as a brake on tourism and investment.[76] The Commission also highlights the migration challenges facing the EU and the potential to use the common visa policy as a tool to incentivise third countries to cooperate with the EU on the readmission and return of irregular migrants, including those who enter the EU legally but overstay their visa. It says that the changes it is proposing to the EU Visa Code serve a dual purpose: making it easier to process visas for legitimate travellers whilst introducing more onerous conditions for applicants from countries with a poor record of cooperation with the EU on readmission and return.

5.15 The Commission previews changes to the Visa Information System (VIS) which it will present shortly. These are intended to enhance security and facilitate more accurate background checks on visa applicants by making the Visa Information System interoperable with other EU border control, migration and security information systems. The Commission also envisages the creation within VIS of a central repository of long-stay visa and residence documents issued by Member States. It is contemplating a reduction in

75 For further information on these proposals, see our Third Report HC 71–ii (2016–17), chapter 14, (25 May 2016) on the EU Entry/Exit System; our Twenty-fifth Report HC 71–xxxiii (2016–17), chapter 12 (11 January 2017) on the European Travel Information and Authorisation System and our Sixteenth Report HC 301–xvi (2017–19), chapter 9 (28 February 2018) on interoperable information systems.

76 See the European Commission's fact sheet on changes to the common EU visa policy.

the age at which the fingerprints of child visa applicants can be taken and stored within VIS (to protect against trafficking as well as irregular migration) and the possibility of storing copies of travel documents submitted with each visa application.

The proposed Regulation—document (b)

5.16 The Commission says that the changes it is proposing focus on "streamlining and improving operational aspects of the visa procedure" and "will not fundamentally alter the [EU] Visa Code".[77] It highlights the following benefits for visa applicants:

- simpler rules on lodging a visa application: when first applying for a visa, applicants will still need to attend in person so that their fingerprints can be recorded in the Visa Information System, but subsequent applications may be made electronically;
- shorter deadlines for decisions on visa applications: decisions should be made within a maximum of 10 days (but may take up to 45 days in complex cases);
- greater flexibility to plan ahead: visa applications may be submitted up to six months in advance of travel to avoid peak season delays (it is currently only three months), but not less than 15 days before travel; and
- more flexible rules on multiple-entry visas (valid for between one and five years) for trusted travellers with a track record demonstrating their "integrity and reliability".

5.17 The Commission proposal also seeks to promote spontaneous travel by authorising Member States to introduce temporary seasonal schemes which would enable tourists to apply for a single-entry visa at specific external land or sea border crossing points. These schemes could only operate for four months of the year and would only be open to nationals of third countries which have concluded a readmission agreement with the EU. The visas issued would only be valid for a maximum of seven days in the territory of the issuing Member State and would not allow entry to other Schengen countries.

5.18 The Commission says that Member States will need additional resources to process visa applications more efficiently and proposes an increase in the visa fee from €60 (£53.05) to €80 (£70.73) for adults and from €35 (£30.95) to €40 (£35.37) for children aged 6–12 years. There would continue to be no fee for children under the age of six. The Commission notes that the last increase was in 2006 and that the higher fee remains low by international standards.[78] The Commission also proposes a new mechanism to review the visa fee every two years to take account of inflation.

5.19 Whilst most of the changes in the proposed Regulation are procedural in nature, one has a more political aspect. The Commission recognises that the existing Visa Code "was not designed for use as leverage towards individual third countries, but rather as a means of standardising visa issuing procedures and conditions".[79] It considers that:

77 See pp.1–2 of the Commission's explanatory memorandum accompanying the proposed Regulation.

78 For comparison, the Commission fact sheet gives the cost in euros of tourist visas for the US (€133), China (€125), Australia and India (€90) and New Zealand (€100). Canada (at €67) is cheaper.

79 See p.2 of the Commission's explanatory memorandum accompanying the proposed Regulation.

> "[…] the changed migration situation and increased security threat in recent years have shifted the political debate on the Schengen area, in general, and visa policy, in particular, towards a reassessment of the balance between migration and security concerns, economic considerations and general external relations."[80]

5.20 The revised EU Visa Code would include a new Article 25a authorising the Commission to introduce more stringent conditions for processing visa applications made by the nationals of third countries that are unwilling to cooperate with Member States on the return of irregular migrants. This might mean that it would take longer to process visa applications, it would be harder to obtain a multiple-entry visa or the visa fee would be doubled to €160.

5.21 The proposed Regulation is based on Article 77(2)(a) TFEU which authorises the adoption of measures concerning the common visa policy and other short-stay residence permits.

The Minister's Explanatory Memorandum of 20 April 2018

5.22 The Minister sets out the changes proposed by the Commission to the EU Visa Code. She notes that the proposal would, for the first time, establish a formal link between visa issuing procedures and a third country's cooperation on readmission, setting out the criteria against which cooperation will be measured and the action to be taken if the Commission determines that cooperation on readmission is inadequate. She also highlights the new "cascade" system for multiple-entry visas and explains how it would work:

> "Visas are issued initially for a period of 6 months. If the applicant has been issued and complied with three such visas in the previous two years then they may be issued a one-year visa. If they comply with that visa and apply for another within two years then they are next issued a 2-year visa and finally if they comply and apply again within two years then their next visa should be valid for 5 years. The validity of the visa is limited to the validity of the travel document. There are options to derogate in limited circumstances, but this is meant to be the exception rather than the rule."[81]

5.23 The Minister says that the proposed seasonal scheme for issuing visas at specific external land or sea border crossing points would "formalise a looser scheme which was permissible under the previous Visa Code".[82]

5.24 Although there is no specific timetable for agreeing the proposed changes to the EU Visa Code, the Minister notes that the Commission has called for swift progress and that the Bulgarian Presidency is keen to obtain political agreement within the Council before its term ends in June.

Previous Committee Reports

None on these documents.

80 Ibid.
81 See para 28 of the Minister's Explanatory Memorandum.
82 See para 31 of the Minister's Explanatory Memorandum.

6 Reform of the electoral law of the EU

Committee's assessment	Legally and politically important
Committee's decision	Cleared from scrutiny; further information requested
Document details	(a) European Parliament Resolution of 11 November 2015 on the reform of the electoral law of the European Union; (b) Proposal for a Council Decision adopting the provisions amending the Act concerning the election of the members of the European Parliament by direct universal suffrage ("the proposal")
Legal base	Article 223(1) TFEU; EP consent; unanimity
Department	Cabinet Office
Document Numbers	(a) (37395),—; (b) (37431),—

Summary and Committee's conclusions

6.1 This proposed Council Decision aims to harmonise certain aspects of the conduct of European Parliament (EP) elections in Member States.

6.2 The proposal was initiated by the EP and is based on Article 223(1) TFEU. This means that it must be agreed unanimously by Member States, is subject to the EP's consent and must be approved by Member States "in accordance with their own constitutional requirements". For the UK, this means approval must be obtained by an Act of Parliament before final adoption of the proposal, in accordance with Section 7 (2)(b) of the European Union Act 2011 (the 2011 Act). It is also relevant that both that requirement[83] and our own scrutiny resolution reserve[84] cannot be circumvented by the UK abstaining from any final vote in the Council. This is also true for the application of our scrutiny reserve to a decision of the Council to send the proposal to the EP for its consent—the stage in the legislative process currently under consideration.

6.3 The more significant measures in the original proposal included: common deadlines for establishing lists of candidates and electoral registers, making members of regional parliaments and legislative assemblies ineligible for election as MEPs, gender equality of candidates, proposals on electronic and postal voting, some mandatory 3–5% thresholds for winning seats, proposals relating to voting by EU mobile citizens, incorporating the "Spitzenkandidaten"[85] process to elect the Commission President and making provision

83 Section 1(7) of the 2011 Act provides that "A reference to a Minister of the Crown voting in favour of or otherwise supporting a decision is a reference to a Minister of the Crown—
(a) voting in favour of the decision in the European Council or the Council, or
(b) allowing the decision to be adopted by consensus or unanimity by the European Council or the Council.

84 Paragraph 5 of our Scrutiny Reserve Resolution of 17 November 1998 provides that "In relation to any proposal which requires adoption by unanimity, abstention shall for the purposes of paragraph1 be treated as giving agreement".

85 This is a process by which European political parties designate one candidate each for the post of EU Commission President, ahead of the European elections. However a candidate can only be put forward by the European Council in accordance with the process outlined in Article 17(7) TEU.

for detailed implementing rules. However, the proposal did not include more controversial measures set out in the EP's Resolution, such as a common minimum voting age of 16 and a common voting day.

6.4 In its Explanatory Memorandum[86] which predated the Referendum, the previous Government expressed some subsidiarity concerns, saying that some aspects of the proposal were best decided at national level. Its main concern appeared to be that uniform practice for EP elections would be inconsistent with domestic electoral practices, making it difficult for the UK to hold EP and local elections at the same time, resulting in reduced turnout for EP elections.

6.5 On 13 January 2016[87] the previous Committee recommended a Reasoned Opinion on the proposed Council Decision which was subsequently approved by the House and sent to the EU institutions on 3 February.[88] Five other Reasoned Opinions were issued by national parliaments/chambers including the UK House of Lords. The former President of the EP, Martin Schulz responded on 8 April 2016[89] saying that the Reasoned Opinion had been passed to the EP's Committee on Constitutional Affairs (AFCO) for its consideration. Since then nothing has been heard from the EP.

6.6 There has been little further updating from the Government since early 2016 until this past month of April during which the Minister for the Constitution (Chloe Smith) sent us two letters. In her letter of 6 April, she says that negotiations reached a point where, following a COREPER meeting of 28 March, a proposal was to be put to the General Affairs Council on 17 April. The UK Government intended to support the proposal. She included with that letter a detailed Annex about the negotiated proposals[90] and a *limité* version of the Presidency's proposals. However, in her more recent letter of 20 April the Minister informs us that no agreement was reached at that Council meeting. Instead, agreement was to be sought before the end of the month by Council written procedure.[91] In view of that, she requests scrutiny clearance or a scrutiny waiver.

6.7 **We thank the Minister for her comprehensive and detailed letter of 6 April. Also for her subsequent letter of 20 April, updating us on the outcome of the Council meeting of 17 April. We note that the Minister has now requested scrutiny clearance or a scrutiny waiver in relation to any agreement to the proposal by the UK before the end of the month. We clarify that it is our understanding this would be an agreement to send the proposal to the European Parliament for its consent, not for its final adoption. We also note that the latest informal information from Government officials is that agreement had still not been reached as at the morning of 2 May.**

6.8 **While we are disappointed at the overall infrequency of Government updates since the proposal's introduction in 2015, we recognise that more effort has been made by the Minister and her officials to inform us in relation to these final stages**

86 Explanatory Memorandum of 4 January 2016 submitted by the then Minister for Europe, David Lidington.
87 Nineteenth Report HC 342–xviii (2015–16), chapter 1 (13 January 2016).
88 See Reasoned Opinion of the House of Commons, 3 February 2016.
89 Letter from Martin Schulz to the Speaker of House of Commons, 8 April 2016.
90 This Annex may be accessed at the end of the letter of 6 April from the Minister to Sir William Cash which has been published on the Cabinet Office website here.
91 Our clarification: Article 12 of the Council's Rules of Procedure provide for written procedure as follows: "Acts of the Council on an urgent matter may be adopted by a written vote where the Council or COREPER unanimously decides to use that procedure. In special circumstances, the President may also propose the use of that procedure; in such a case, written votes may be used where all members of the Council agree to that procedure.

of the legislative process. Unfortunately, the letter of 6 April was not sent before the Easter recess which meant that we could not report it to the House before the 17 April Council meeting. Likewise, the letter of 20 April arrived too late for us to consider at our meeting of 25 April. We were therefore unable to consider clearance or a scrutiny waiver in time for any agreement before the end of April.

6.9 **Given that the UK will not be participating in the EP elections as it is withdrawing from the EU, we now clear the proposed Council Decision from scrutiny, together with the EP's Resolution. However, we ask the Minister to keep us updated on the outcomes in the final stages of the legislative progress of the proposed Council Decision which are not clearly delineated in either of her letters. Specifically, we would like to know:**

- **when the Council unanimously agrees to send the proposal to the EP;**
- **when the EP makes its decision to consent or not consent to the Council's proposal;**
- **assuming EP consent, when approval by UK Act of Parliament has been obtained in accordance with Section 7(2)(b) of the European Union Act 2011 (the 2011 Act); and finally**
- **when the proposals are finally adopted in the Council by unanimity.**

6.10 **As a final observation, we would urge the Minister and the Government more generally to identify from the outset when a proposal is subject to the requirements of the 2011 Act. Apart from a reference in the original EM to the need for approval by Member States in accordance with their own constitutional requirements, the Government has not specifically highlighted the 2011 Act requirement for an Act of Parliament before the UK can finally approve the proposed Council Decision. This is not acceptable on a proposal of this initial importance.**

Full details of the documents

(a) European Parliament Resolution of 11 November 2015 on the reform of the electoral law of the European Union: (37395),—; (b) Proposal for a Council Decision adopting the provisions amending the Act concerning the election of the members of the European Parliament by direct universal suffrage: (37431),—.

The Minister's letter of 15 March 2018 on the statute and funding of EU political parties

6.11 In our Report of 28 March, in a chapter on a related proposal[92] the Minister provided the following short update on the current proposal, as requested in our first report on the related proposal (29 November 2017):[93]

> "These proposals are still under consideration by Member States and I will write to the Committee with further details should any firm proposals emerge. If any proposals are agreed, given that the United Kingdom will

92 Proposal for a Regulation on the European Parliament and Council amending Regulation (EU, Euratom) No 1141/2014 on the statute and funding of European political parties: 12308/17, COM (17) 481.

93 Third Report HC 301–iii (2017–19), chapter 2 (29 November 2017)—see paragraph 15.

cease to be a member of the European Union on 29 March 2019 and will therefore not be taking part in future European Parliamentary elections, in practice the proposals would not have any practical effect in the UK".

The Minister's letter of 6 April 2018

6.12 After rehearsing the scrutiny history of the proposals, the Minister updates us on the progress of the proposals:

> "Member States have been considering the European Parliament's proposals at working group level. There has been some discussion at COREPER on the proposals. It has proved difficult to achieve a consensus among Member States on the European Parliament's original proposals as many of them created difficulties for individual Member States. As such, since the European Parliament's original proposals were published it has not been clear whether Member States would be able to agree a package of proposed changes, and if so, what particular changes would command support. It has therefore not been possible to provide you with certainty on the position until now.
>
> "The current position is that the Presidency has identified areas for potential agreement among Member States. I attach a limité document from the Presidency that sets out proposed changes to the electoral law governing European Parliamentary elections, that draw upon elements of the original European Parliament proposals, and if agreed would form the basis of a Council Decision. The limité document from the Presidency is being provided in confidence to ensure that the Committee handles the information accordingly and does not publish the text.
>
> "Of course, since the European Parliament produced its proposals, the context has changed and the UK will be leaving the UK and not taking part in future European Parliamentary elections. The European Parliament has recommended to the Council the dates of 23 to 26 May 2019 for the next European Parliamentary election. Member States are considering this and the exact timing will be confirmed about a year ahead of the poll. The next scheduled European Parliamentary elections are therefore due to take place after the UK has left the EU and in practice, any proposed changes will not have any practical effect in the UK".

6.13 The Minister next lists the modifications to the EP's original proposals which have been put forward by the Presidency for agreement by Member States. More detailed outlines of these modifications are provided in an Annex[94] to the Minister's letter. They are:

- MEPs to be elected as representatives of the citizens of the Union;
- Member States in which the list system is used must set a minimum threshold (2–5% of valid votes cast) for the allocation of seats to parties for constituencies which comprise more than 35 seats;

94 This Annex may be accessed at the end of the letter of 6 April from the Minister to Sir William Cash which has been published on the Cabinet Office website here.

- the deadline for submission of candidates' nominations across Member States should be "at least three weeks" before the date of the poll;
- Member States may take the necessary measures to allow their citizens residing in third countries to vote in European Parliamentary elections;
- Member States may allow for the display on ballot papers of the name or logo of the European political party to which the national party is affiliated;
- Rules concerning the posting of electoral materials to voters in European Parliamentary elections should be the same as those applied for national elections in the Member State concerned;
- Member States may provide for the possibilities of advance voting, postal voting and electronic and internet voting at European Parliamentary elections;
- Member States shall take necessary measures to ensure that double voting in European Parliamentary elections is subject to effective, proportionate and dissuasive penalties; and
- Changes to information exchange arrangements in respect of EU nationals living in another Member State.

6.14 Next the Minister assesses the minimal impact of the proposals, if agreed:

- only two proposals concerning information exchange would require a change to UK current processes;
- the UK will have left the EU by the time (6 weeks before polling day) that Member States would be required to begin exchanging data under the proposed changes.
- the other proposals are either discretionary for Member States to implement or are not applicable for the UK or the UK already complies with what is proposed.
- in any event the UK will not be taking part in future EP elections, in practice, the package of measures will have no practical impact on the UK.
- as EP elections are a reserved matter, none of the proposals can have an impact for the devolved administrations.

6.15 On the timetable for the agreeing the proposals, the Minister tells us that:

- there is now a prospect that Member States may be able to reach agreement on the Presidency's revised proposals.
- the Presidency presented the latest draft text to COREPER on 28 March and the matter is due to be considered at the General Affairs Council meeting on 17 April.
- as the proposals will not have any practical effect in the UK, if other Member States are able to agree the package of measures, the Government is minded not to vote against the proposals.

The Minister's letter of 20 April 2018

6.16 Further to her letter of 6 April, the Minister reports on the outcome of the Council Meeting on 17 April:

> "I can confirm that the compromise text proposed by the Presidency, as set out in the *limité* document that I forwarded to you, was considered at the General Affairs Council on 17 April. At the Council, it was not possible for Member States to reach agreement on the proposed text and the Council will now try to reach agreement on this matter as soon as possible. I am advised that the Presidency hopes to adopt the proposed Council Decision quickly by written procedure before the end of April.
>
> "As I explained in that letter, since the European Parliament's original proposals were published it has not been clear whether Member States would be able to agree a package of proposed changes, and if so, what particular changes would command support. In any event, the Presidency has put forward a revised package of measures and it is this set of proposals that is now being considered by Member States. We had not anticipated that the matter would be considered as early as at the meeting on 17 April and in the event, as I have indicated, it was not possible for Member States to reach agreement at that meeting."

6.17 The Minister then reiterates the Government's view on the proposal:

- the proposal would have no practical impact on the UK as it will not be taking part in future EP elections; and
- if other Member States are able to agree the package of measures and given that agreement needs to be unanimous the Government does not wish to prevent the proposals from proceeding by blocking "adoption".

6.18 Turning to scrutiny matters, the Minister says that given there was no agreement at the 17 April meeting, the UK maintained its scrutiny reserve and did not abstain on the proposals at that time. The Minister therefore seeks a scrutiny waiver or clearance from us.

Previous Committee Reports

Twenty-sixth Report HC 342–xxv (2015–16), chapter 4 (16 March 2016); Nineteenth Report HC 342–xviii (2015–16), chapter 1 (13 January 2016).

7 EU legislation on waste

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny (by Resolution of the House on 08/03/2016); drawn to the attention of the Environment, Food and Rural Affairs, the Environmental Audit, the Housing, Communities and Local Government, the Welsh Affairs, the Scottish Affairs and the Northern Irish Affairs Committees
Document details	(a) Proposal for a Directive amending Directive 2008/98/EC; (b) Proposal for a Directive amending Directive 94/62/EC on packaging and packaging waste; (c) Proposal for a Directive amending Directive 1999/31/EC on the landfill of waste; (d) Proposal for a Directive of the European Parliament and of the Council amending Directives 2000/53/EC on end-of-life vehicles, 2006/66/EC on batteries and accumulators and waste batteries and accumulators, and 2012/19/EU on waste electrical and electronic equipment
Legal base	(a), (c) and (d) Article 192(1) TFEU, Ordinary legislative procedure, QMV; (b) Article 114 TFEU, Ordinary legislative procedure, QMV
Department	Environment, Food and Rural Affairs
Document Numbers	(a) (37377), 14975/15 + ADDs 1–3, COM(15) 595; (b) (37378), 14976/15 + ADDs 1–3. COM(15) 596; (c) (37376), 14974/15 + ADDs 1–2, COM(15) 594; (d) (37375), 14973/15 + ADDs 1–2, COM(15) 593

Summary and Committee's conclusions

7.1 The EU has a strategic objective to develop a "circular economy" whereby the maximum value and use is extracted from all raw materials, products and waste, fostering energy savings and reducing greenhouse gas emissions. As part of its strategy, the European Commission accordingly proposed in December 2015 a package of four proposals to amend six pieces of existing waste legislation.

7.2 A provisional agreement between the EU institutions was reached in December, featuring a range of recycling and landfill targets, including the target that 65% of municipal waste by weight be recycled by 2035 and that 70% of packaging waste be recycled by 2030.

7.3 When the Committee considered these documents at our meeting of 31 January 2018, we raised a number of queries, noting that the Government had yet to decide whether it would support the agreed compromise. The Parliamentary Under Secretary of State (Dr Thérèse Coffey) has responded, addressing our queries. In particular, she confirms the Government's support for the deal, following an updated analysis by officials. On a pessimistic scenario, the net social loss has reduced from £3.5 billion to £1 billion and,

on an optimistic scenario, the net social benefit might be £0.5 billion. These forecasts do not take into account further policies that might be adopted by the Government under its Resources and Waste Strategy.

7.4 It is likely that the transposition deadline will be mid-2020 and that it will therefore fall within the post-Brexit implementation period. The Minister indicates that the UK's approach to transposition will be set out in the Resources and Waste Strategy later in the year.

7.5 **We are grateful to the Minister for her helpful update, confirming UK support for the deal and confirming too that the UK intends to transpose the legislation. While we look forward to seeing the Government's transposition plans in the context of the wider Resources and Waste Strategy later this year, we require no further correspondence on the EU legislation.**

7.6 **These documents were cleared from scrutiny by resolution of the House on 8 March 2016 following the debate in European Committee A on 7 March 2016. We draw this Chapter to the attention of the Environment, Food and Rural Affairs Committee, the Environmental Audit Committee, the Communities and Local Government Committee, the Welsh Affairs Committee, the Scottish Affairs Committee and the Northern Irish Affairs Committee.**

Full details of the documents

(a) Proposal for a Directive amending Directive 2008/98/EC on waste: (37377), 14975/15 + ADDs 1–3, COM(15) 595; (b) Proposal for a Directive amending Directive 94/62/EC on packaging and packaging waste: (37378), 14976/15 + ADDs 1–3, COM(15) 596; (c) Proposal for a Directive amending Directive 1999/31/EC on the landfill of waste: (37376), 14974/15 + ADDs 1–2, COM(15) 594; (d) Proposal for a Directive amending Directives 2000/53/EC on end-of-life vehicles, 2006/66/EC on batteries and accumulators and waste batteries and accumulators, and 2012/19/EU on waste electrical and electronic equipment: (37375), 14973/15 + ADDs 1–2, COM(15) 593.

Background

7.7 The details of the Commission's original proposals were set out in the Report of 20 January 2016. The Committee considered that the proposal raised a number of important issues and recommended it for debate, which subsequently took place on 7 March 2016.

7.8 The Minister last wrote to the Committee on 24 January 2018, reporting that agreement was reached between the EU institutions on 17 December 2017. While the Government was still waiting to see the final text, it understood that mandatory targets for municipal waste recycling would be set at 55% by 2025, 60% by 2030 and 65% by 2035. Full details of the Government's understanding of the text were set out in our Report of 31 January 2018.

7.9 On Brexit, the Minister observed that, in the future, there could be changes in the UK's approach to targets to reflect the value and environmental impact of materials

collected rather than assessing them by weight alone. In terms of the transposition of this legislation into UK law during any post-Brexit transition or implementation period, the Minister was non-committal, while noting that the transposition date would be mid-2020.

7.10 Addressing the contrasting levels of ambition within the UK and between Member States, the Minister noted that the greatest challenges for England are the scale of population and levels of urbanisation, which have an impact on local authority costs, collection arrangements and participation.

7.11 When the Minister last wrote, the Government was yet to adopt a position on the outcome of negotiations.

7.12 At our meeting of 31 January, we noted the emerging approach to a post-Brexit implementation and—bearing in mind the likely mid-2020 transposition date for this legislation—set out our assumption that the UK would apply the waste package in full. We asked for confirmation from the Minister that this was a fair assumption.

7.13 On the negotiated deal, we asked the Minister to write to us once the Government had adopted a position, with an accompanying analysis of the impact and achievability. We asked the Minister to set her response in the context of the recent 25 Year Environment Plan,[95] which committed not only to meeting current targets but to setting ambitious new ones.

Letter from the Minister of 22 March 2018

7.14 The Minister explains that the Government received the final text of the proposed agreement on 8 February. The UK withheld its position at the February COREPER[96] meeting while it scrutinised the proposals and updated its analysis. The proposals were supported by the European Parliament (EP) Environment Committee on the 27 February. The Minister understands that, following an EP plenary vote on 16 April, the proposals will revert to COREPER in mid to late April, ahead of a formal Council vote in May or June 2018.

7.15 In terms of the relationship with the 25 Year Environment Plan, the Minister notes the Government's commitment to improving resource efficiency and increasing the amount and number of materials recycled. She considers that the proposals in the Circular Economy Package "align well with the 25 Year Environment Plan and what we want to achieve through the Resources and Waste Strategy".

7.16 The Minister goes on to set out the Government's position on the negotiated deal in the following terms, confirming the Government's intention to support the deal:

> "As I have noted previously the UK has raised concerns regarding the 65% by weight recycling target and this is where there has been the most substantive change in the proposals, with the target deadline being extended by a further 5 years to 2035. This target is subject to review by the Commission in 2028.

95 A Green Future: Our 25 Year Plan to Improve the Environment.
96 Committee of Permanent Representatives of the Member States

> "Since receiving the final text, officials have updated their analysis. Recognising the opportunity for a further five years to attain the 65% by weight recycling target by 2035, and the review date of 2028, on a pessimistic scenario the net social loss has reduced from £3.5bn to £1bn; with an optimistic scenario, there would be a net social benefit of £0.5bn. This analysis does not take account of the full range of policies under considering for our Resources and Waste Strategy.
>
> "Consequently, the Government intends to support the package at the final vote."

7.17 Regarding the UK's transposition of the rules, the Minister says:

> "The Department for Exiting the European Union has been clear that the implementation period should be based on the existing structure of EU rules and regulations, so that people and businesses only need to make one set of changes as we move to our future partnership. In this context the UK will set out its approach to transposition in the Resource and Waste strategy that is due for publication later this year."

Previous Committee Reports

Twelfth Report HC 301–xii (2017–19), chapter 11 (31 January 2018); First Report HC 301–i (2017–19), chapter 34 (13 November 2017); Twentieth Report HC 342–xix (2015–16), chapter 1 (20 January 2016); Sixteenth Report HC 342–xv (2015–16), chapter 2 (6 January 2016).

8 Fisheries Agreement with Morocco

Committee's assessment	Legally and politically important
Committee's decision	Cleared from scrutiny. Drawn to the attention of the Foreign Affairs, and Environment, Food and Rural Affairs Committees
Document details	Recommendation for a Council Decision authorising the Commission to open negotiations on behalf of the European Union for amendment of the fisheries Partnership Agreement and conclusion of a protocol with the Kingdom of Morocco
Legal base	Article 218 paragraphs 3 and 4, TFEU;—
Department	Environment, Food and Rural Affairs
Document Number	(39587), 7246/18 + ADD 1, COM (18) 151

Summary and Committee's conclusions

8.1 Relations between the EU and Morocco relating to fishing are governed under two pillars:

- the EU-Morocco Association Agreement and subsequent agreements made under it provide for fish and fish products to be imported into the EU at reduced or no duty subject to a tariff quota. This had been applied *de facto* to the Western Sahara; and
- a Fisheries Agreement between the EU and Morocco which has been treated as providing fishing opportunities for EU vessels in the waters of Morocco and the Western Sahara; and for payments by the EU to Morocco.

8.2 These arrangements have been challenged by the organisations representing the Western Sahara. Two CJEU Grand Chamber cases[97] have decided that the Association Agreement and the Fisheries Partnership Agreement (including its implementing Protocol) did not apply to the Western Sahara. Both cases interpreted the relevant agreements in accordance with the rules of international law which require (a) recognition that the people of Western Sahara are entitled to self-determination and (b) that obligations can only be imposed upon states (in this case Western Sahara) with their consent.

8.3 This recommendation seeks authority for the Commission to negotiate an amendment to the current Fisheries Agreement and a new Protocol implementing it, the current one expiring in July this year.

8.4 Essentially the negotiating mandate seeks to maintain the existing fishing arrangements with Morocco whereby EU ships have access to the waters of Western Sahara. The Commission is reported[98] as relying on the earlier caselaw as giving room

97 Case C-973/2006P. and Case C-266/16.

98 Politico 4 April 2018: The Commission argues that another decision by the European Court of Justice, from 2016, allows it to extend the deal south of Morocco's recognized borders. "The EU's position is that it is possible to extend this agreement to Western Sahara under certain conditions," said a Commission spokesperson.

to the EU to extend the fisheries regime to the Western Sahara. That caselaw recognises that in some circumstances international treaties can *expressly* have effect beyond the internationally recognised territory of a state party. However, this alone would not meet the other objections of the CJEU set out above. The other provisions of the negotiating mandate, as outlined below, seek to meet these objections.

8.5 The current agreement gives UK vessels a share in the quota to catch small pelagic, dimersal and highly migratory species although UK vessels have not taken advantage of this agreement for a number of years.

8.6 The Government clearly has doubts that the negotiating directives, if converted into an agreement, will meet the requirements of the CJEU.

8.7 **We share the Government's concern that the provisions in the negotiating directives intended to meet the requirements of the CJEU will not achieve this aim. No doubt any further agreement with Morocco that covers fishing opportunities in Western Sahara waters will give rise to further litigation.**

8.8 **Given that the recommendation is likely to be adopted anyway, and that this matter is likely to be litigated again, we clear it from scrutiny. We draw this Report to the attention of the Foreign Affairs Committee, and the Environment, Food and Rural Affairs Committee, for its potential legal implications.**

Full details of the documents

Recommendation for a Council Decision authorising the Commission to open negotiations on behalf of the European Union for amendment of the fisheries Partnership Agreement and conclusion of a protocol with the Kingdom of Morocco: (39587), 7246/18 + ADD 1, COM (18) 151.

The Explanatory Memorandum of 16 April 2018

8.9 In his Explanatory Memorandum the Minister (George Eustice) identifies the substantive items in the proposed negotiating mandate designed to reflect the judgments of the CJEU:

> "a. provision for access to the waters covered by the current Agreement and Protocol and to the waters adjacent to the non-self-governing Territory of Western Sahara.
>
> "b. support for the efforts of the United Nations Secretary-General to find a solution providing for the self-determination of the people of Western Sahara consistent with the principles and purposes of the Charter of the United Nations and inclusion of a review clause in the light of a mutually acceptable political solution being found;
>
> "c. a clause on the consequences of violations of human rights and democratic principles;

"d. mechanisms to ensure an understanding of the geographic and social distribution of the socio-economic benefits arising from the Agreement and Protocol in order to allow the EU Commission to ensure that both benefit to the people concerned;

"e. a requirement that the EU Commission assess the potential implications of the Agreement and its Protocol for sustainable development, in particular as regards the benefits for the people concerned and the exploitation of natural resources of the territories concerned;

"f. provision that the EU Commission should ensure that the people concerned by the Agreement have been adequately involved."

8.10 The Minister expresses the qualms of the Government in the following terms:

"The proposed mandate intends that a future Agreement and Protocol should extend to the waters adjacent to the Western Sahara and that the benefits of the exploitation of the resources found in those waters to be shared by the Western Sahrawi people. At this time the method of ensuring this is not clear.

"A careful assessment of the final negotiated outcome will be necessary in order to ensure it is fully in line with international law and that there has been an acceptable degree of involvement of the people of Western Sahara.

"Defra, FCO and HMRC, are watching the proposed mandate with interest, and have been consistent that the status of Western Sahara is undetermined and to be resolved through the UN process. Given insufficient time for scrutiny, the UK will abstain in this vote, and the Commission will likely be able to start negotiations for a new Agreement and Protocol—in line with international law and the ruling of the CJEU—regardless."

Previous Committee Reports

None.

9 L-type vehicle approvals

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny
Document details	(a) Report from the Commission to the European Parliament and the Council on the effects of the Euro 5 Environmental Step for L category vehicles; (b) Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 168/2013 as regards the application of the Euro 5 step to the type-approval of two- or three-wheeled vehicles and quadricycles
Legal base	(a)—(b) Article 114 TFEU; QMV; ordinary legislative procedure
Department	Transport
Document Numbers	(a) (39576), 7343/18, COM(18) 136; (b) (39575), 7344/18, COM(18) 137

Summary and Committee's conclusions

9.1 As part of its implementation of a 2013 regulation[99] on the approval and market surveillance of two- or three-wheeled vehicles and quadricycles, the Commission is required to conduct an environmental study examining the impacts of the proposed step from Euro 4 to Euro 5 emissions limits, which is due to be implemented for all new vehicle types from 1 January 2020. Based on this study, the Commission published a report[100] which found that the limits, dates and requirements set out in the Regulation were cost beneficial and technically feasible, but also recommended several areas in which the Regulation could be improved.

9.2 The Commission has therefore proposed an amending Regulation[101] which would:

- postpone plans to implement on-board monitoring of the catalyst, used in removing harmful emissions from the exhaust gas, until 2025 (due to current technical limitations);
- extend exemptions for certain on-board diagnostic (OBD) system requirements to light quadricycles and enduro and trial motorcycles (typically used for off-road motorsports) in light of the costs that manufacturers, particularly SMEs, would have to bear in installing the required technology;
- delay by two years the implementation of Euro 5 standards for light quadricycles, utility three-wheeled mopeds and enduro and trial motorbikes, as the benefits

99 Regulation 168/2013 of the European Parliament and of the Council of 15 January 2013 on the approval and market surveillance of two- or three-wheeled vehicles and quadricycles Text with EEA relevance.

100 Report from the Commission to the European Parliament and the council on the effects of the Euro 5 Environmental Step for L-category vehicles COM(2018) 136 final.

101 Proposal 7344/18 for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 168/2013 as regards the application of the Euro 5 step to the type-approval of two- or three-wheeled vehicles and quadricycles COM(2018) 137 final.

which would be achieved by implementation within the timescale set out in the Regulation are not proportionate to the costs that would be incurred by manufacturers;

- replace the current method for assessing the durability of the emissions treatment system at the time of type approval by 2025, and in the meantime impose more demanding conditions in testing to ensure greater accuracy on durability; and

- extend for a further five years the Commission's powers to propose and adopt delegated acts to adapt the legislation in light of new technical progress in the field, with the possibility of further extension thereafter. The current Regulation limits this power to an initial five year period which expired on 21 March 2018.

9.3 In the Government's Explanatory Memorandum,[102] submitted on 17 April 2018, the Parliamentary Under Secretary of State at the Department for Transport (Jesse Norman) expressed support for the proposal, on the grounds that the proposed schedule for the implementation of the Euro 5 step will remain unchanged for 95% of L-category vehicles, reducing carbon emissions and improving air quality, while the other adaptations proposed, particularly for manufacturers of light quadricycles, utility three-wheeled mopeds and enduro and trial motorbikes, will reduce the cost-burden for these operators, many of which are SMEs. The Government also supports phasing out the current method of assessing the durability of the emissions treatment system and the introduction of a more robust and realistic methodology.

9.4 **We welcome this amending Regulation, which will significantly reduce the short-term financial impacts of Regulation 168/2013 on small and medium sized businesses, allowing a more phased implementation, while ensuring that 95% of L-type vehicles will proceed to implement the Euro 5 step in January 2020 as previously agreed, reducing carbon emissions and improving air quality. The proposed changes would have the effect of making current EU Regulation of L-type vehicle approvals more proportionate to the objectives to be achieved.**

9.5 **We clear the draft Regulation from scrutiny.**

Full details of the documents

(a) Report from the Commission to the European Parliament and the Council on the effects of the Euro 5 Environmental Step for L category vehicles: (39576), 7343/18, COM(2018) 136; (b) Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 168/2013 as regards the application of the Euro 5 step to the type-approval of two- or three-wheeled vehicles and quadricycles: (39575), 7344/18, COM(2018) 137.

Previous Committee Reports

None, but see Committee reports on Regulation 168/2013 on the approval and market surveillance of two- or three-wheeled vehicles and quadricycles: Sixth Report HC 428–vi (2010–11) chapter 4 (3 November 2010); Thirty-eight Report HC 428–xxxiv (2010–11) chapter 3 (19 July 2011); Tenth report HC 86–x (2011–12) chapter 12 (17 July 2012).

102 Explanatory Memorandum from the Minister, DFT, to the Chair of the European Scrutiny Committee (17 April 2018).

10 Military Mobility in the EU

Committee's assessment	Politically important
Committee's decision	Cleared from scrutiny; further information requested; drawn to the attention of the Defence Committee and the Foreign Affairs Committee
Document details	Commission Communication: Action Plan on Military Mobility
Legal base	—
Department	Foreign and Commonwealth Office
Document Number	(39606), 7633/18, JOIN(18) 5

Summary and Committee's conclusions

10.1 As part of the new framework for 'Permanent Structured Cooperation' (PESCO) in the area of defence, twenty-four EU Member States[103] are participating in a new project to reduce barriers to the smooth movement of troops and military equipment throughout the EU. This would make military deployments both in and outside of the EU's Common Security and Defence Policy—more efficient. More information on the specific work to be undertaken as part of this intergovernmental project is expected later in 2018, after the participating countries establish the formal governance framework for PESCO in June.[104]

10.2 In recognition of the specific nature of the barriers to military mobility, some of which fall within the EU's legislative competence (customs and goods regulations) or could benefit from financial support from the EU budget (improvements to dual-use transport infrastructure), the PESCO project should be seen as part of a wider EU-level programme of work to reduce such obstacles. In March 2018, the European Commission—based on a 2017 policy paper[105] and further preparatory work undertaken by the European Defence Agency—published an 'Action Plan on Military Mobility'.[106] Its purpose is to identify "a series of operational measures to tackle physical, procedural or regulatory barriers which hamper military mobility",[107] namely:

- the development of EU military requirements which reflect the needs of the Union and its Member States, which would in turn facilitate an "effective and coordinated approach to military mobility across the EU". The Commission will ask the Foreign Affairs Council to approve a set of such requirements by mid-2018;

103 All Member States except the UK, Malta and Denmark are participants in PESCO. Out of those twenty-five countries, only Ireland is not part of the Military Mobility project.
104 See our Report of 28 March 2018 on PESCO for more information.
105 See our Report of 19 December 2017.
106 See Commission document JOIN(2018) 5.
107 European Commission, "Action Plan on military mobility: EU takes steps towards a Defence Union" (28 March 2018).

- the identification of those parts of the trans-European transport network (T-ENT) which are suitable for military transport, leading to a common list of priority projects to improve infrastructure links which may benefit from EU funding under the post-2020 Multiannual Financial Framework; and
- further analytical work to identify options to remove regulatory and procedural obstacles to the movement of troops and equipment, for example by extending existing EU legislation that simplifies the transport of dangerous goods to military convoys.

10.3 We have described the proposed actions in more detail in "Background" below. As part of a 'Community' approach, any legislative or regulatory action would in principle apply to all Member States (and not just the twenty-four countries part of the PESCO project on military mobility).

10.4 The Minister for Europe (Sir Alan Duncan) submitted an Explanatory Memorandum on the Action Plan in April 2018.[108] It reiterates the Government's support for the EU's efforts to "improve Military Mobility across Europe and to resolve common impediments", and supports the Commission's proposed actions (especially were the EU could address regulatory issues through "innovative solutions"). The Minister also emphasises the UK's view that "NATO's role is crucial in the delivery of the action plan" and that "the Alliance's requirements are effectively incorporated as part of the implementation". With respect to the extent to which the UK—after Brexit—might benefit from any EU regulatory or legislative simplifications that will ease movements of troops and military equipment, the Memorandum reiterates the Government's ambition for a "deep and special partnership on security and defence [with] unprecedented levels of practical cooperation".

10.5 **We thank the Minister for his latest Explanatory Memorandum on the EU's military mobility project. We note the Government has taken an interest in this project and supports it politically. We stand by our Report of November 2017, in which we concluded that the impact on the UK of any initiatives to facilitate military mobility within the EU is not yet clear because of the uncertainty about the shape of the post-Brexit relationship with the EU on all areas covered by the latest Action Plan (defence, customs, and transport). The Government has not published a draft legal text to operationalise its ambition for an "unprecedented" new foreign policy partnership with the EU, meaning that we cannot say with any certainty what the policy, legal and financial implications for the UK would be if it wanted to maintain close involvement in the EU's foreign policy structures when it ceases to be a Member State.**

10.6 **With respect to UK participation in any EU-led military mobility projects after Brexit, it is important to distinguish between actions undertaken by Member State governments within PESCO to remove barriers to military mobility (which will be intergovernmental and diplomatic in nature, for example by facilitating permissions for entry and exit of foreign troops), and the wider efforts led by the European Commission to address infrastructure, customs and regulatory barriers to movements of troops and equipment.**

10.7 **Participation by the UK in the PESCO project would not automatically extend to the UK the application of any regulatory or customs reliefs that may be pursued as part**

108 Explanatory Memorandum submitted by the Foreign & Commonwealth Office (19 April 2018).

of the wider 'Community' approach to military mobility, as those are likely to apply only to the members of the Single Market and the Customs Union. The Government has committed to leaving both.109 For example, the Dangerous Goods Directive—which may be extended to military convoys—applies only to transports that take place wholly within the Single Market.110 The extension of any regulatory simplifications to military transports between the UK and the EU would therefore likely be dependent on the Government applying the relevant legislation (which in turn means the impact is closely linked to the overall future trade agreement, and the extent to which it may tie the UK to continued regulatory alignment with the EU to facilitate trade in goods in particular).

10.8 **Similarly, any financial support from the EU budget for improvements to cross-border transport infrastructure (as well as the new European Defence Fund for the development of new military technology)111 will be focused primarily on EU Member States. The Government has not provided any detail about the size and scope of the financial contribution112 it would be willing to make to preserve access to specific EU funding programmes after the end of the post-Brexit financial settlement as currently agreed (which will keep the UK as a participant in EU spending programmes until 31 December 2020).113 The Government has told us with respect to continued UK involvement in the EU's Framework Programme for Research after Brexit that "all of the necessary arrangements are in place for 31 December 2020. We are confident that the UK will be ready".114 We presume the same ambition applies to agreements for other programmes in which the UK wishes to participate after the post-Brexit transitional arrangement ends, such as the European Defence Fund.**

10.9 **In light of the Government's interest in the Military Mobility project, and its unclear policy and financial implications for the UK, we draw the document to the attention of the Defence Committee and the Foreign Affairs Committee. We now clear it from scrutiny, but ask the Minister to write to us with further information on the EU 'military requirements' that will be drawn up by the European External Action Service before any formal approval of them takes place within the Foreign Affairs Council later this year.**

109 We are conscious of the fact that it remains possible that any legislative proposals relating to the Military Mobility Action Plan might still apply in the UK, if they become applicable during the Government's post-Brexit "implementation period".

110 See article 1 of Directive 2008/68/EC.

111 See our Report of 31 January 2018 for more information on the European Defence Fund.

112 The practical room for manoeuvre for the Government may be limited with respect to any future financial mechanism for involvement in specific EU funding programmes. The EU has a well-established practice of calculating the financial contribution by a third country by reference to the annual budget for the programme in question (as determined by the Member States and the European Parliament) and the GDP of the third country.

113 The current Connecting Europe Facility, the EU's investment programme for transport, energy and telecommunications infrastructure, permits use of EU funding for projects in non-EU countries only where "Where necessary in order to achieve the objectives of a given project of common interest and where their participation is duly justified". The eligibility of non-EU countries from 2021 onwards, when the next long-term EU budget takes effect, will be negotiated as part of the wider Multiannual Financial Framework.

114 Letter from Sam Gymiah to Sir William Cash dated 23 April 2018. Proposals for the next Multiannual Financial Framework are due to be published in early May 2018.

Full details of the documents

Joint Communication to the European Parliament and to the Council on the Action Plan on Military Mobility: (39606), 7633/18, JOIN(18) 5.

Background

10.10 As part of the 2016 European Defence Action Plan, the European Commission committed to "increase coherence and synergies between defence issues and other Union policies where an EU added-value exists". In November 2017 twenty-five EU Member States—all except the UK, Denmark and Malta—triggered a possibility under the EU Treaty to establish "Permanent Structured Cooperation" (PESCO) on defence matters, as a possible precursor to a 'common EU defence'.[115] PESCO requires the participating countries to make concrete commitments to improve the EU's collective defence, for example by increasing their defence budgets and by working together closely on improving and integrating their military capabilities.[116]

10.11 PESCO is structured around individual projects, participation is voluntary by the participating countries on a case-by-case basis. Involvement by non-EU Member States, such as the UK after Brexit, will be subject to separate legal arrangements which are yet to be established. In March 2018, the 25 participating Member States formally adopted the initial list of seventeen PESCO projects, which—on average—have seven participating countries each.[117]

10.12 The most popular project, in which all PESCO countries except Ireland are involved, is the one that seeks to enhance "Military Mobility" within the EU. The Netherlands, whose Government is the project lead, described its objective as follows:

> "This project will support Member States' commitment to simplify and standardise cross-border military transport procedures. It aims to enhance the speed of movement of military forces across Europe. It aims to guarantee the unhindered movement of military personnel and assets within the borders of the EU.
>
> This entails avoiding long bureaucratic procedures to move through or over EU Member States, be it via rail, road, air or sea. The project should help to reduce barriers such as legal hurdles to cross-border movement, lingering bureaucratic requirements (such as passport checks at some border crossings) and infrastructure problems, like roads and bridges that cannot accommodate large military vehicles."[118]

10.13 Because the project seeks to address regulatory hurdles to the movement of both troops and material within the EU, the 'military mobility' project—uniquely among the initial list of PESCO work-streams—partially relies on changes to wider EU policy that affect the movement of goods and people, such as customs and transport legislation. This,

115 See for more information on PESCO our previous Reports of 28 March 2018 and 19 December 2017.

116 PESCO does not affect the veto of each EU Member State over CSDP operations and other EU foreign policy measures under the Treaties, or their right to decide unilaterally whether to deploy military personnel or equipment to specific operations or missions.

117 See Council Decision 2018/340/CFSP.

118 See http://www.consilium.europa.eu/media/32079/pesco-overview-of-first-collaborative-of-projects-for-press.pdf.

in turn, means the project is reliant in part on the support of the European Commission and the European Parliament, especially where measures to facilitate military convoys require adaption of EU law or funding from the EU budget. Any resulting improvements to the mobility of forces would "enhance European security […] in the context of Common Security and Defence Policy missions and operations, as well as national and multinational activities", such as NATO operations.

10.14 In recognition of the 'Community' element of the Military Mobility project, the European Commission in November 2017 published a policy paper setting out its initial assessment of EU-level initiatives that could facilitate the movement of both military personnel and equipment within the EU. Although it acknowledges that it remains the sovereign decision of each Member State whether to allow foreign troops into its territory, the Commission argues that certain obstacles—physical, legal and regulatory in nature—could be addressed to allow EU countries to move troops and equipment "swiftly and smoothly" where they have decided to deploy them. These obstacles included gaps in Europe's physical infrastructure that can support military transport, as well as the legal and regulatory framework governing transport of both personnel and equipment (for example export and import formalities for dangerous goods).

10.15 To address these barriers, the Commission envisaged that EU legislation or non-legislative initiatives would contribute to resolving barriers to military transports, noting that these areas are "subject to legislation, procedures and investment instruments which would need to be adapted, including at EU level, to make them suitable for military uses".[119] It made a number of provisional recommendations for EU action:

- using the EU budget to invest in transport infrastructure that benefits both civilian and military traffic;
- introducing streamlined customs procedures for cross-border transports of military goods under the Union Customs Code;
- extending the applicability of the Dangerous Goods Directive to military transports to remove regulatory barriers to intra-EU movements of defence equipment; and
- harmonising procedures for cross-border movements of troops.

10.16 The Foreign Affairs Council welcomed the Commission's intentions at its meeting on 13 November 2017. In December 2017 military mobility was added to the common set of new proposals for the implementation of the EU-NATO Joint Declaration of July 2016. Furthermore, that same month the European Council invited the European Commission and the Member States to bring work forward on military mobility, both within PESCO and in the context of EU-NATO cooperation.

10.17 In September 2017, the European Defence Agency (EDA) had already established a dedicated Working Group to support the elaboration of a follow-on Action Plan on Military Mobility by spring 2018. The objectives of the working group were to identify obstacles and barriers to cross-border movement and surface transit of military personnel and assets and translate these into an Action Plan with "dedicated tasks and responsibilities

119 The Commission added, without elaborating, that "EU legislation in other areas could also be looked at for possible relevance to military mobility".

including a roadmap with timelines". The Working Group reported back to the EDA's Steering Board in February 2018, setting out the "tasks, responsibilities and ambitious timelines for improving military mobility" in four areas: legal aspects; customs; military requirements, including infrastructure-related military standards; and cross-border movement permissions, including diplomatic clearances.[120]

Military Mobility Action Plan

10.18 Based on the EDA's preparatory work, the Commission published a more detailed Military Mobility Action Plan with more concrete details about the planned next steps in March 2018. The document identifies the following initiatives to be undertaken at EU-level:

Transport infrastructure

- reaching agreement between the Member States on a collective view on the **military requirements to facilitate the transport of troops and equipment**, including defining the infrastructure needed in the EU to support military mobility (by mid-2018);
- building on a 2017 pilot exercise along the North Sea-Baltic corridor, the Member States will seek to **identify gaps in the military and dual-use transport infrastructure** across the EU by the end of 2018 and quantify the costs of the necessary improvements in 2019.[121] The intention is to use the outcome of that exercise to begin improving dual-use transport links, potentially using funding from the EU budget, from 2020 onwards by making changes to the EU legal framework for investment in transport infrastructure (including the EU's satellite navigation and earth observation programmes);[122]

Movement of military equipment

- the EU has legislation to facilitate the **transport of dangerous goods** across the territory of its Member States, but this only applies to civilian transports.[123] Based on further analytical work by the EDA and the Member States, the Commission will decide by 2020 whether further action at EU level is necessary, for example by extending the Dangerous Goods Directive to military transports;
- the Commission and Member States will assess the **impact of customs legislation on movements of military equipment**, including the need to develop an EU alternative to the existing NATO form 302 used for temporary export and re-

120 The EDA already operates the Diplomatic Clearances Technical Arrangement, which aims to harmonise procedures for overflights and landings of 16 EU Member States' military aircraft (the UK is not a signatory). The arrangement enables the signatory countries to operate without the need to submit diplomatic requests for each flight, with an annual diplomatic clearance number issued. It includes a dedicated online portal to provide basic transparency on national policies and procedures for granting diplomatic clearances for military transport aircraft.

121 Such gaps can include, for example, maximum height clearances underneath road bridges; the weight tolerance of bridges; or loading gauges on railways.

122 Currently, such funding is provided primarily from the Connecting Europe Facility. The EU budget cannot be used for transport infrastructure that is exclusively for military use.

123 For military transports, Member States apply their own national rules when authorising transports of dangerous goods by other armed forces (which "requires ad hoc authorisations and creates delays").

import of military goods.[124] The Commission will also undertake a more general assessment of the possible options for streamlining and simplifying customs and Value Added Tax (VAT) formalities affecting military operations, with any legislative proposals—if considered necessary—due by the end of 2018;

National restrictions on military transports

- via the European Defence Agency, a number of EU countries already participate in a **Diplomatic Clearance Technical Arrangement** to facilitate the military flights within the EU. The Commission and Member States will examine the possibilities for a similar arrangement for surface movements; and
- the Commission has invited the Member States to assess their current national approach to allowing "other-than-own" military assets to operate in their territory and use the resulting 'map' of national regulations to make movements easier except where there are "rational political restrictions".

10.19 The Foreign Affairs Council will be asked to sign off on the EU's "military requirements" by summer 2018. The European Commission is due to present a first progress report on the implementation of the Military Mobility Action Plan by summer 2019, when the UK is expected to have formally ceased being an EU Member State. Any substantial regulatory reforms or dedicated financial support from the EU budget would follow from 2020 onwards.

Implications for the UK

10.20 Following the publication of the European Commission's initial policy paper on military mobility in autumn 2017, the Government told us that it recognises "the need to improve military mobility within Europe and to resolve common impediments across the areas outlined [by the Commission]". The Minister for Europe (Sir Alan Duncan) added at the time that "the UK will be keen to ensure that the proposed work-plan is taken forward with key stakeholders outside of the EU, particularly NATO", as otherwise "there is considerable risk of duplication and for any proposed action plan to be substantially less valuable".

10.21 While the UK is not a formal participant in PESCO or its Military Mobility project, the Government has supported its launch, as well as consistently calling for a legal framework—which is still being discussed by the participating countries—that will allow non-EU countries to request involvement in specific PESCO work-streams. This would enable the Ministry of Defence and UK industry to seek participation in individual projects after Brexit on a case-by-case basis. The UK has actively participated in the European Defence Agency's working group which provided the basis for the more recent Military Mobility Action Plan. In addition, on 13 November 2017, the Foreign Secretary supported an invitation to the Commission to "consider comprehensively the infrastructural, procedural and regulatory issues in light of the military requirements defined by Member States to facilitate mobility of personnel and assets across the EU".

124 Articles 226(3)(e) and 227(2)(e) of the Union Customs Code allow NATO form 302 to be used as Union transit document. However, some EU Member States have reported operational difficulties resulting from a lack of clarity as regards the use of form 302 for temporary export and re-import of military goods by or on behalf of the armed forces of the EU Member States.

10.22 After the latest Action Plan was published in March 2018, the Minister for Europe submitted a further Explanatory Memorandum on the Government's position on military mobility. It reiterates UK support for the project:

> "The Government agrees with the content of the Action Plan and its recommendations to undertake further work under the key headings. The UK has experienced first-hand how issues with European transport infrastructure can hinder our ability to rapidly move forces and we are also committed to exploring innovative solutions to improve regulatory issues. The EU is well-placed with its existing competences to support this work, while respecting the sovereignty of national decision-making bodies."

10.23 However, the Minister also emphasises that NATO must play a role in the delivery of the Action Plan so that "any work is fully coherent with existing NATO work strands, and that the Alliance's requirements are effectively incorporated as part of the implementation". The Minister recognises that the levers available to the EU that are not available to NATO—in particular regulatory and legislative action—may pose an obstacle to the UK's full involvement in the fruits of the Military Mobility project in the context of its withdrawal from the EU. He reiterates the Government's ambition of a "deep and special partnership on security and defence" with "unprecedented levels of practical cooperation in tackling common threats building on our shared values and interests". He concludes by saying that, while the UK remains a full member of the EU, the Government will "engage with the specific initiatives outlined in the Action Plan to assess where the government could negotiate future participation where it is mutually beneficial".

10.24 With respect to UK participation in any EU efforts to enhance military mobility after Brexit, it is important to distinguish between actions undertaken by Member State governments within PESCO to remove barriers to military mobility (which will be intergovernmental and diplomatic in nature, for example by facilitating permissions for entry and exit of foreign troops), and the wider efforts led by the European Commission to address infrastructure, customs and regulatory barriers to troop and equipment transports. Participation by the UK in the PESCO project on military mobility would not automatically extend to the UK the application of any regulatory or customs reliefs that may be pursued as part of the wider 'Community' approach to military mobility, as those are likely to apply only to the members of the Single Market and the Customs Union.

Previous Committee Reports

Seventh Report HC 301–vii (2017–19) chapter 14 (19 December 2017).

11 EU-Iraq Partnership and Cooperation Agreement

Committee's assessment	Legally and politically important
Committee's decision	Cleared from scrutiny
Document details	Council Decision on the conclusion of the Partnership and Cooperation Agreement between the EU and its Member States, of the one part, and the Republic of Iraq, of the other part
Legal base	Articles 91, 100, 207, 209 TFEU in conjunction with Article 218(6)(a) TFEU; unanimity
Department	Foreign and Commonwealth Office
Document Number	(39481), 10209/12/REV1

Summary and Committee's conclusions

11.1 The EU and its Member States signed a Partnership and Cooperation Agreement with Iraq in 2012. The objectives of this Partnership are:

- to provide an appropriate framework for the political dialogue between the Parties allowing the development of political relations;
- to promote trade and investment and harmonious economic relations between the Parties and so to foster their sustainable economic development; and
- to provide a basis for legislative, economic, social, financial and cultural cooperation.

11.2 Certain elements of the PCA have been provisionally applied since August 2012:

- Article 2: Respect for Human Rights;
- Title II: Trade and Investment;
- Title III: Areas of Cooperation;
- Title V: Institutional and General provisions.

11.3 The Titles covering (a) political dialogue and cooperation in the field of foreign and security policy and (b) justice, freedom and security have not been provisionally applied.

11.4 When we first considered it we:

- noted that the UK scrutiny reserve was lifted at short notice to enable the proposal to be sent to the European Parliament for its consent when aspects the application had been provisionally applied since 2012 and there would be little prospect of the European parliament delivering its consent for several months in any event;

- sought an assessment of the provisional application of the PCA;
- sought confirmation whether the UK was still asserting that the UK opt-in applied even though the proposal no longer contained a legal base in Title V of Part Three TFEU;
- asked whether the text indicates the extent to which competence was being exercised by the EU and the Member States respectively, and if not whether the minister (Sir Alan Duncan) was intending to take any steps to clarify this; and
- sought information on whether the UK would be taking any steps to continue the PCA bilaterally.

11.5 **In the light of the Minister's response (set out below) we now clear this matter from scrutiny. In doing so we draw the attention of the House to the fact that the Minister is taking no steps to clarify the extent to which the EU or the Member States are exercising shared[125] competence. This is the latest example of a fudge in the Government's policy that normally the EU should only exercise competence which is exclusive to it, leaving Member States to exercise shared competence.**

Full details of the documents

Council Decision on the conclusion of the Partnership and Cooperation Agreement between the EU and its Member States, of the one part, and the Republic of Iraq, of the other part: (39481), 10209/12/REV1.

The Minister's letter of 16 March 2018

11.6 In answer to a question (which was not asked by the Committee) the Minister provided further explanation as to the events leading immediately to the override of scrutiny:

> "The Committee asked why an override of scrutiny was necessary. The PCA required the consent of the European Parliament before conclusion. Committee clerks advised the FCO that scrutiny would not be necessary as European Parliament consent is a procedural matter and would not trigger a scrutiny reserve. As a result, the European External Action Service set a date to adopt a Council Decision to obtain the consent of the European Parliament. However, on receiving the draft Council Decision, the Committee clerks corrected their advice, explaining that the request for consent would in fact be caught by the scrutiny reserve. Given the short timeframe, clerks recommended an override of scrutiny. In overriding scrutiny for the consent of the European Parliament, the conclusion of the Iraq PCA was also covered."

11.7 We note here that we did not specifically ask why an override was necessary and this response does not address the context of a proposal that had been on the table for a considerable period in respect of an Agreement that had been provisionally applied for

125 Shared competence can be exercised by ether the EU or the Member States, the choice is political.

years and which the European Parliament would not provide its necessary consent for months. Furthermore, the response overlooks previous FCO practice to treat referral to the European Parliament as an event giving rise to a scrutiny override.

11.8 The Minister assesses the outcome of the provisional application of the PCA since 2012 without indicating whether it had been successful or otherwise:

> "Pending the completion of the necessary procedures for its entry into force, Article 2, and Titles II, III, and V of the Agreement have been applied provisionally, in accordance with Article 117 of the Agreement only insofar as it concerns matters falling within the Union's competence. The provisions of the PCA provide a comprehensive framework to develop and improve relations between EU member states and Iraq, in particular the measures which cover trade and investment and have the potential to support growth. As Iraq is not yet a member of the World Trade Organization, the PCA provides essential provisions for trade under World Trade Organization principles. Implementation of the PCA is ongoing, as Iraq emerges from a period of challenging economic and security constraints, which means that the country will need significant investment. Many parts of the PCA are relevant to this, such as provisions on public procurement, which can help British companies to do business in Iraq."

11.9 In relation to the UK opt-in he writes:

> "The Committee asked whether the UK still asserts that the UK opt-in is engaged despite the UK acceptance that there should be no legal base from Title V TFEU; and how the provisions of the PCA in which the opt-in is asserted will be reflected in the legal text, and whether or not the UK intends to opt-in. In light of the Philippines CJEU judgment—which clarified that readmission provisions such as those in the Iraq PCA should not be considered to be JHA content—the Government does not consider that there are obligations in the text of the Iraq PCA that trigger the UK's JHA opt-in Protocol."

11.10 In relation to transparency as to the exercise of competence he writes:

> "The Committee asked whether the text submitted to the European Parliament indicates or delimits the extent to which the EU is exercising competence; I can confirm that the text does not delimit the extent to which the EU and member states are exercising competence. I do not judge that further action, such as a minute statement, is required on this occasion to confirm that the EU is exercising exclusive competence."

11.11 In relation to relations with Iraq after Brexit he writes:

> "The Committee raised the issue of continuing the PCA on a bilateral UK-Iraq basis after the UK's exit from the EU, or after the expiry of any transitional/implementing period. DExEU has led cross-government work to assess the international agreements that will need to be replaced, or amended, as a result of the UK's exit from the EU. The priority is to

> avoid unintended changes in our relationships with third countries and international organisations. We are not seeking to re-open or renegotiate the substantive content of agreements.
>
> "We are seeking to continue the effect of the PCA with Iraq as we withdraw from the EU. The FCO is responsible for this work and officials visited Baghdad in January this year for constructive discussions with the Government of Iraq on transitioning the PCA. The UK will continue to work with Iraq to ensure continuity in the effect of our current arrangements as we exit the EU, including as we move into any agreed implementation period."

11.12 Finally, the Minister addresses future UK-EU relations in foreign and security policy in the context of Iraq:[126]

> "With regard to the Implementation Period of the EU Iraq Strategy, the precise nature of our institutional engagement with the EU in foreign and security policy remains subject to negotiation.
>
> "The UK is committed to building an enhanced partnership with the EU on security, defence and foreign policy issues. However, we are leaving the European Union and will not seek participation at these meetings on the same basis as EU members. Nevertheless, given our historic ties and shared values, it is likely that the UK and the EU will continue to pursue the same goals and will therefore want to cooperate closely on common foreign policy challenges. This will include close consultation in a range of fora. Attending the Political and Security Committee and the Foreign Affairs Council, for example, is not the only means through which we can achieve this, nor is it the only way in which the UK can continue to have influence over EU foreign policy.
>
> "It is worth underlining that there is no pre-existing model for cooperation between the EU and external partners which replicates the full scale and depth of the collaboration that currently exists between the UK and the EU. However, given that there is no legal or operational reason why such an agreement could not be reached, we want to establish an enhanced partnership that reflects the unique position of the UK."

Previous Committee Reports

Sixteenth Report HC 301–xvi (2017–19) chapter 7 (28 February 2018).

126 See our first Report (listed below) which also considered a Joint Communication by the European External Action service and the Commission on *Elements for an EU strategy on Iraq*.

12 Financial Services: long-term EU regulatory plans

Committee's assessment	Politically important
Committee's decision	(a)—(c) Cleared from scrutiny; drawn to the attention of the Treasury Committee
Document details	(a) Communication from the Commission: Action Plan on Financing Sustainable Growth; (b) Communication from the Commission: FinTech Action plan for a more competitive and innovative European financial sector; (c) Communication from the Commission: Completing the Capital Markets Union by 2019—time to accelerate delivery
Legal base	—
Department	Treasury
Document Number	(a) 39560, 7216/18, COM(18) 97; (b) 39561, 7217/18, COM(18) 109; (c) 39562, 7219/17 COM(18) 114

Summary and Committee's conclusions

12.1 In spring 2018, the European Commission published three separate policy papers on different aspects of the financial services industry and the measures—both regulatory and non-regulatory—it is considering to boost the availability of capital within the Single Market and to ensure financial services providers can contribute to the EU's wider objectives on sustainable economic growth and the 'digital economy'. The three papers, which we have described in more detail in "Background" below, are:[127]

- an action plan on **financial technology** ('**fintech**') to support digitalisation of financial services in a consumer-friendly way and without jeopardising financial stability;[128]
- a paper on the steps towards completing the **Capital Markets Union** (CMU), a programme of measures underway since 2015 to increase non-bank sources of finance for businesses across the EU;[129] and
- an action plan on "**financing sustainable growth**",[130] with the aim of reorienting investment flows in the EU towards sustainable projects with a clear environmental or social benefit.

127 The Commission also published a fourth related document, on measures to reduce stocks of non-performing loans dragging on European banks' balance sheets. We have considered this document in a separate chapter in this Report as it was accompanied by two concrete legislative proposals.

128 See Commission document COM(2018) 109, "FinTech Action plan: For a more competitive and innovative European financial sector".

129 See Commission document COM(2018) 114, "Completing the Capital Markets Union by 2019—time to accelerate delivery".

130 See Commission document COM(2018) 97, "Action Plan: Financing Sustainable Growth".

12.2 In spring 2018 the Commission also proposed legislation to accompany the Fintech Action Plan (a new Regulation on licensing of crowdfunding platforms)[131] and the Capital Markets Union (on covered bonds;[132] cross-border distribution of collective investment funds; non-performing bank loans; and assignment of claims).[133] These we have considered in more detail separately. It has confirmed that future proposals for further regulatory reform in the financial services sector are due later in 2018, including in particular:

- an 'EU sustainability taxonomy' and non-financial transparency requirements for institutional investors and asset managers as part of the Sustainable Finance Action Plan (see paragraph 12.26 below);
- a "Small Listed Companies" proposal, to make it easier for SMEs to raise capital on equity and debt markets;
- a new regulatory framework to encourage the development of EU Sovereign Bond-backed Securities (SBBS), a new type of financial instrument that consists of securitised tranches of Eurozone central government bonds;[134] and
- an amendment to the 2009 Motor Insurance Directive, which is likely to expand the scope of compulsory insurance requirements to drivers of tractors and other non-standard vehicles following an EU court judgement.[135]

12.3 The Commission is also undertaking further work to identify legal barriers to the development of innovative financial products, as well as assessing the need for EU legislation on investment disputes between EU Member States.[136] These efforts may lead to further legislative proposals further down the line, most likely after the new College of Commissioners takes office in November 2019.[137]

12.4 Although the Commission has already published a number of legislative proposals that aim, in part, to prepare the EU for the implications of the UK's withdrawal for the European financial services industry,[138] there is no direct Brexit angle to these latest policy papers. In particular, the documents do not mention any substantial changes to the EU's

131 We have considered the Crowdfunding Regulation in more detail in a separate chapter of this Report.

132 See our Report of 25 April 2018 for more information on the new Covered Bonds Directive.

133 The Committee is yet to formally consider the proposals on assignment of claims, investment funds and non-performing loans as we had not received the Government's Explanatory Memoranda on these documents as of 19 April 2018.

134 See https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018–400473_en.

135 Directive 2009/31/EC. See also the judgment of the European Court of Justice in case C-162/13 (*Vnuk*).

136 Bilateral investment treaties between Member States set varying standards of treatment outside the EU legal framework for cross-border investment within the Single Market. The Commission's view is that they are incompatible with EU law because they give rights to investors of certain EU countries and not others. The Commission is pursuing infringement proceedings in respect of several intra-EU bilateral investment treaties (BITs).

137 Given that the European Parliament is approaching the end of its current five-year term, the Commission has a limited window to propose new EU legislation if it wants it adopted before the next European elections in May 2019.

138 Brexit has been cited as a driver behind recent Commission proposals on financial supervision, a relocation requirement for clearinghouses, access to the EU market for 'third country' investment advisors, and operations of non-EU banks within the Single Market.

"equivalence" regimes in financial services,[139] which are is under review because of Brexit.[140] The outcome of that process—and to what extent it may be modified to accommodate the UK as Europe's foremost financial centre after it leaves the Single Market—is not yet clear. In addition, it has been reported that the Commission is preparing to table "emergency legislation" to avoid a legal vacuum in cross-border contracts for financial services between the UK and the EU-27 if no transitional arrangement is legally in place by 29 March 2019.[141]

12.5 **The current European Commission has pursued a wide-ranging policy agenda for financial services in recent years, primarily as part of the Capital Markets Union. The UK's decision to leave the EU has motivated further legislative change in anticipation of the Union's primary financial motor leaving its regulatory jurisdiction. It is clear from the Commission's recent papers that further legislative proposals are likely in due course on areas as varied as SME listing, transparency requirements for asset managers and investment dispute settlement between EU countries.**

12.6 **Overall, the European Scrutiny Committee currently retains twenty proposed Directives and Regulations on financial services under scrutiny as they progress through the EU's legislative machinery.[142] One of the reasons for this is the continued uncertainty about the impact new EU policy measures may have in the UK, due to the wider lack of clarity about the future economic partnership with the EU-27 following Brexit and the date when the UK will ultimately leave the Single Market (and can begin disapplying EU law).**

12.7 **At present, the latter turning point is scheduled to occur in December 2020, when the post-Brexit transitional period is due to end. However, the Government has not ruled out seeking an extension if necessary in view of progress in making domestic preparations for life outside the EU and the state of the negotiations on a new UK-EU trade agreement. As such, it is possible—and in some cases likely—that new EU financial services legislation will have to be implemented because it will take effect during the transition. However, the Government will not have a vote, or formal involvement in the wider legislative process, after the UK ceases to be a Member State.**

12.8 **The impact of EU legislation on the UK *after* it leaves the Single Market is less clear. At that point, UK financial services providers will lose their 'passports' to operate across the EU without the need for local authorisation in other Member States, and instead become "third country" operators with restricted access to the EU market for banking, investment services and asset management. Concretely, in the context of the three policy papers we have discussed in this Report, an exit from the Single Market means for example:**

139 Under some pieces of EU financial services legislation, the European Commission—with the support of a majority of Member States—can recognise a non-EU country's regulatory regime for a specific part of the industry as 'equivalent'. Such a unilateral decision by the EU triggers prudential or regulatory reliefs for EU-based firms which deal with a provider in the non-EU country in question, or grant those providers preferential market access on a cross-border basis.

140 See Commission document SWD(2017) 102, "EU equivalence decisions in financial services policy: an assessment" (February 2017). In March 2018, the EU-27 called for unspecified improvements to the equivalence framework in light of the UK's departure from the EU, echoed later in April in a draft European Parliament Report (which will be debated by the full Parliament in September).

141 Financial Times, "Brussels seeks emergency powers to prepare for hard Brexit" (18 April 2018).

142 See the Annex to this Report for more details on the proposals under scrutiny.

- **UK-based firms would still be able issue investment prospectuses—including, in the future, 'Green Bonds'—to EU-based investors, but they would have to do so under the terms of the EU Prospectus Regulation and under the supervision of the domestic regulator of an EU country. Prospectuses issued pursuant to UK law (even if it is identical to the Regulation) would only be valid if the UK obtained a formal 'equivalence' decision to that effect (see above);**[143]

- **the new Crowdfunding Regulation will not apply to UK crowdfunding platforms, which will therefore be ineligible for a 'passport' to offer their services across the Single Market from a UK base;**[144]

- **UK-based investment advisers will not be able to market their services into the EU based on their passport, and so will have to establish a new business within the European Economic Area or provide more limited services on a cross-border basis depending on the legislation of each individual EU country;**[145] **and**

- **UK asset managers will continue to be able to perform their services for EU-based investment funds under 'delegation', but the European Commission is seeking to restrict such practices where it effectively leaves the EU-based entity as a 'letterbox firm' with all substantive operations carried out in the UK.**[146]

12.9 **While no UK-EU trade agreement will fully make up for that loss of access, the Government is seeking to mitigate the impact through an unprecedented trade agreement on financial services. Although the Treasury has not published any detailed proposals, the Chancellor has said the UK wants a new arrangement where bilateral cross-border access is the default presumption. Access would be limited through ad hoc sector-specific decisions by either party if there were to be a significant divergence in regulatory approach, subject to a yet-to-be-created dispute settlement mechanism. Leaving the matter of the acceptability of this proposal to the EU-27 aside, we remain concerned that even this approach, while not placing the UK under a legal obligation to implement the EU *acquis*, could still lead to *de facto* long-term regulatory alignment with the EU rulebook to avoid the risk of a sudden loss of market access.**

12.10 **The Committee will continue to closely monitor any developments in the negotiations on a new UK-EU financial services agreement to assess the extent of, and processes governing, any continued regulatory alignment after Brexit. In light of the fluidity over the scope of the future UK-EU economic partnership, and the length of the post-Brexit transitional period, we are forced to conclude that the European Commission's long-term regulatory agenda for the financial services sector—as outlined in its recent policy papers—is relevant to the UK. Accordingly, we draw them**

143 The new Prospectus Regulation will replace the existing Prospectus Directive from July 2019. The provisions on 'third country' issuers are contained in articles 28 to 30 of the Regulation. The European Commission has recently proposed that the European Securities & Markets Authority (ESMA) should act as the central EU-wide authority for scrutinising any prospectuses submitted under this equivalence regime.

144 We have discussed the new EU crowdfunding regime in more detail elsewhere in this Report.

145 See also our Report of 28 February 2018 on prudential requirements for investment firms.

146 See for more information on Brexit and asset management our recent Report on the cross-border distribution of collective investment funds within the Single Market.

to the attention of the House, and the Treasury Committee in particular. We now clear the documents from scrutiny, as any specific legislative proposals will be subject to scrutiny in their own right.

Full details of the documents

(a) Communication from the Commission: Action Plan on Financing Sustainable Growth: (39560), 7216/18, COM(18) 97; (b) Communication from the Commission: FinTech Action plan for a more competitive and innovative European financial sector: (39561), 7217/18, COM(18) 109; (c) Communication from the Commission: Completing the Capital Markets Union by 2019—time to accelerate delivery: (39562), 7219/17 COM(18) 114.

Background

12.11 In March 2018, the European Commission published four policy papers with high-level proposals for future regulatory and non-regulatory initiatives affecting the EU's financial services industry:

- an action plan on **financial technology** ('**fintech**') to support digitalisation of financial services in a consumer-friendly way and without jeopardising financial stability;[147]
- a paper on the steps towards completing the **Capital Markets Union** (CMU), a programme of measures underway since 2015 to increase non-bank sources of finance for businesses across the EU;[148]
- an action plan on "**financing sustainable growth**",[149] with the aim of reorienting investment flows in the EU towards sustainable projects with a clear environmental or social benefit; and
- a 'progress report' on a 2017 Action Plan to reduce stocks of **non-performing loans** dragging on European banks' balance sheets.[150] We have considered this document in a separate chapter as it was accompanied by two concrete legislative proposals.

12.12 We have summarised the key elements of each of the remaining three policy papers below, focussing on areas where the Commission envisages or is already preparing legislative initiatives. We considered these to be important as it is not yet clear to what extent the UK and EU's markets for financial services will remain linked after Brexit, or to what extent the UK's post-Brexit regulatory framework may continue to be aligned with the Single Market *acquis*, in the long term (see "Summary and conclusions" above).

147 See Commission document COM(2018) 109, "FinTech Action plan: For a more competitive and innovative European financial sector".
148 See Commission document COM(2018) 114, "Completing the Capital Markets Union by 2019—time to accelerate delivery".
149 See Commission document COM(2018) 97, "Action Plan: Financing Sustainable Growth".
150 See Commission document COM(2018) 133, "Second Progress Report on the Reduction of Non-Performing Loans in Europe".

Fintech Action Plan

12.13 The digitalisation of financial services ("fintech") has increased significantly in recent years, primarily in the area of intermediation and distribution, such as price comparison websites for insurance and 'robo-advice' for investors, but also in other ways (for example the use of 'big data' analysis to create tailored risk profiles for customers in the insurance industry, or even entirely new products such as crypto-currencies using blockchain technology).

12.14 The European Commission has expressed its support for the use of fintech where it acts as an enabler for the EU's policy objectives in the area of financial services, such as its Consumer Financial Services Action Plan (which seeks to ensure "better access to finance and to improve financial inclusion for digitally connected citizens") and the Capital Markets Union, which has the aim of deepening and broadening the EU's capital markets" to provide businesses with a source of finance other than bank loans. Fintech is also a focus area of the 2015 'Digital Single Market' strategy, the Commission's overall programme of measures to improve access to online goods and services.[151]

12.15 Despite its potential benefits for users of financial services, the Commission and other regulatory bodies are also aware of fintech's impact on "regulatory compliance and supervision". While digital technologies can "facilitate, streamline and automate compliance and reporting and improve supervision", they also represent numerous regulatory challenges: they can disrupt established methods of protecting consumers and investors (particularly where firms operate around the 'regulatory perimeter'), pose new cyber-security risks, and can lead to the unforeseen build-up of financial instability. To allow new digital ways of providing financial services to be tested safely, the UK's Financial Conduct Authority operates a 'regulatory sandbox', called the Innovation Hub, where "innovative financial products and services" benefit from additional support from the regulator.[152]

12.16 At EU-level, there is already a well-established regulatory framework on both financial services and digital technology that affects the fintech industry. All companies are subject to the General Data Protection Regulation on handling of personal data,[153] due to take effect in May this year, and the Anti-Money Laundering Directive when handling potentially suspicious transactions.[154] Moreover, the financial services sector itself is highly regulated: EU and national law typically require firms to seek authorisation before they can offer products and services to the market, irrespective of whether they use traditional or innovative means to deliver them.

12.17 Nevertheless, the European Commission believes further policy measures—both legislative and non-legislative—are necessary at the European level to stimulate the digitalisation of financial services in a safe and sustainable way. Concretely, it wants to enable innovative financial services providers to scale up throughout the Single Market and thereby increase competition;[155] ensure new technologies are interoperable and use

151 See Commission document COM(2015) 192, "A Digital Single Market Strategy for Europe" (May 2015).
152 https://www.fca.org.uk/firms/innovate-innovation-hub.
153 Regulation (EU) 2016/679.
154 See our Report of 31 January 2018 on the latest Anti-Money Laundering Directive.
155 An initial assessment by the European Banking Authority (EBA) found substantial differences in the way individual EU countries approached supervision of fintech firms, including crowdfunding platforms.

common technical standards; and to ensure that the EU's regulatory framework provides the right balance between encouraging fintech and providing sufficient prudential and conduct oversight.

12.18 To achieve these objectives, the Commission's Action Plan lists a number of policy measures:

- a Regulation for a Single Market 'passport' for online investment via crowdfunding and peer-to-peer lending platforms, which was published in March 2018 and which we have considered in more detail in a separate Report;[156]
- an in-depth assessment by the European Supervisory Authorities of the current authorising and licensing approaches for innovative fintech business models, as well as IT security and governance requirements, which could lead to regulatory guidelines or recommendations for changes to EU financial services legislation by early 2019;
- a report on best practice across the EU for 'regulatory sandboxes' like the FCA's Innovation Hub, to allow fintech firms to make use of the flexibility afforded by EU financial services legislation to develop their products and services in cooperation with regulators;
- the establishment of an 'expert group' to assess whether there are unjustified regulatory obstacles to financial innovation in the financial services regulatory framework, with a report due by the middle of 2019;
- a public consultation on improving online access to data about companies listed on EU regulated markets, including the possibility of a "European Financial Transparency Gateway"; and
- a "comprehensive strategy" on distributed ledger technology and blockchain for all sectors of the EU economy, including their application in financial services. This will build on a new EU 'Blockchain Partnership' launched by 22 EU countries—including the UK—in April 2018.[157]

12.19 The Economic Secretary's Explanatory Memorandum on the Fintech Action Plan makes no substantive assessment of any of the elements of the Action Plan, as a separate Memorandum was submitted on the proposed Crowdfunding Regulation.[158] With respect to the Action Plan, the Minister states only:

> "This communication does not reference the UK's exit from the European Union. If legislative or other changes come about as a result of these initiatives, decisions will need to be taken in the future as to whether the UK continues to align with the EU framework for FinTech."

156 See our Report of 18 April 2018 for more information on the Crowdfunding Regulation.
157 European Commission, "European countries join Blockchain Partnership" (10 April 2018).
158 The proposed Crowdfunding Regulation, which forms part of the Action Plan, is the subject of a separate Explanatory Memorandum.

Capital Markets Union progress report

12.20 The European Commission launched its Capital Markets Union (CMU) programme in 2015,[159] followed by an interim review in 2017.[160] Its aim is to deepen capital markets across the EU, including by the removal of cross-border barriers to investment, to provide businesses with more competitive sources of finance and reduce the EU economy's reliance on bank lending. In addition to various non-regulatory measures, the CMU also generated a significant number of legislative proposals (affecting asset managers, investment advisors and banks), the implications for which the European Scrutiny Committee—particularly in the context of Brexit—has considered in detail elsewhere.[161]

12.21 In March 2018, the Commission published its latest update on progress made towards completion of the Capital Markets Union. That same month, it presented a further tranche of CMU legislative initiatives (which we have assessed separately given the need to consider their substance in detail), namely:

- measures to reduce stocks of non-performing loans on banks' balance sheets, including regulation of credit servicing companies, accelerated collateral enforcement and new capital requirements;
- an EU regulatory framework for covered bonds, a special type of asset-backed security;
- a new licensing framework for EU crowdfunding platforms, including a 'passport' to operate in any Member State without the need for domestic regulatory authorisation, as part of the Fintech Action Plan (see paragraph 0.18 above);
- amendments to the UCITS and AIFM Directives to encourage the cross-border distribution of investment funds within the Single Market; and
- a Regulation on the assignment of claims, where a creditor transfers the right to claim a debt to another person in exchange for payment, to clarify which Member State's law applies when determining who owns a claim after it has been assigned in a cross-border case within the EU.

12.22 Furthermore, as part of its CMU work programme, the Commission is also preparing further legislation on:

- the settlement of bilateral investment disputes between EU Member States;[162]
- reducing barriers faced by small firms when listing on equity and debt markets to raise capital;

159 See Commission document COM(2015) 468. The previous Committee published a Report on the CMU on 28 October 2015.

160 See Commission document COM(2017) 292.

161 With respect to previous legislative proposals as part of the CMU, see for example our Reports on EU Venture Capital Funds; the European System of Financial Supervision; and prudential requirements for investment firms. See for more information on all CMU proposals the Annex to this Report.

162 Bilateral investment treaties between Member States set varying standards of treatment outside the EU legal framework for cross-border investment within the Single Market. The Commission's view is that they are incompatible with EU law because they give rights to investors of certain EU countries and not others. The Commission is pursuing infringement proceedings in respect of several intra-EU bilateral investment treaties (BITs).

- a new regulatory framework to encourage the development of EU Sovereign Bond-backed Securities, a new type of financial instrument that consists of securitised tranches of Eurozone central government bonds;[163] and
- an amendment to bring the Motor Insurance Directive in line with a Court of Justice judgement on its scope.[164]

12.23 The Economic Secretary to the Treasury submitted an Explanatory Memorandum on the Capital Markets Union progress report on 28 March 2018. In it, the Minister reiterates that the Government is a "supporter of the CMU project" and that the policy measures—both legislative and non-legislative—identified by the Commission since 2015 are "the right actions to deliver tangible reform".[165]

Sustainable Finance Action Plan

12.24 The final financial services policy paper published by the European Commission in March 2018 focussed on social and environmental sustainability, including the effects of climate change. The Commission wants the financial system to be part of "the solution towards a greener and more sustainable economy" by "reorienting private capital to more sustainable investments". Its High-Level Expert Group (HLEG) on sustainable finance, which included 7 UK members.[166] It published its final report in January 2018, calling for measures to ensure assets are invested in "funding society's long-term needs" and to strengthen financial stability by incorporating environmental, social and governance (ESG) factors into investment decision-making.[167]

12.25 The Commission's new Sustainable Finance Action Plan builds on the HLEG's recommendations and sets out a number of initiatives to channel more investment into an "environmentally and socially sustainable economic system" in the EU;[168] ensure social and environmental costs are integrated into the risk management processes of financial services providers such as insurers and banks; and increase transparency of corporate sustainability policies to allow investors to differentiate between companies based on their social and environmental approach.

12.26 The main policy initiative announced by the Commission to achieve these objectives is a new legal framework to establish an "EU taxonomy" to classify environmentally and socially sustainable economic activities. This would identify under which conditions or criteria any given investment or financial product would contribute to the EU's sustainability objectives, and could be used to measure financial flows towards sustainable development priorities; identify assets that qualify for financing under sustainability-related EU budget instruments; set sustainability standards in EU financial services legislation (for example requirements to issue official "Green Bonds" under the

163 See https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018–400473_en.
164 Directive 2009/31/EC. See also the judgment of the European Court of Justice in case C-162/13 (*Vnuk*).
165 Explanatory Memorandum on the Capital Markets Union submitted by HM Treasury (28 March 2018).
166 http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetail&groupID=3485&NewSearch=1&NewSearch=1&Lang=EN.
167 High-level group report
168 The Commission notes the EU has an 'investment gap' of €180 billion (£x) to achieve EU climate and energy targets by 2030. According to estimates from the European Investment Bank (EIB), the overall investment gap in transport, energy and resource management infrastructure has reached a yearly figure of €270 billion.

Prospectus Regulation and the possible incorporation of climate risks into banks' and insurers' prudential requirements); and underpin corporate disclosure of sustainability policies and targets to inform investment decisions.

12.27 A legislative proposal to establish the principles and scope for the EU Sustainability Taxonomy is due in May 2018, and will focus initially on climate change-related indicators. A technical expert group will then be tasked to provide the substance of the taxonomy, focussing initially on climate change, by early 2019, allowing for subsequent incorporation of its indicators into EU law on a case-by-case basis.

12.28 As noted, the Commission has also announced a number of additional initiatives to be undertaken in the coming months and years to achieve the objectives of the Action Plan, including:

- a legislative proposal to clarify institutional investors' and asset managers' sustainability duties (also to be presented later in 2018), which would require them to integrate sustainability considerations into their investment decision-making process and increase transparency towards investors on their policies in this regard;
- new rules for prospectus issuers that would allow them to issue an investor prospectus for 'Green Bonds' if they meet the relevant sustainability criteria and transparency requirements;
- possible amendments to EU legislation on public corporate transparency with respect to sustainability reporting requirements, for example an obligation on company boards to publish a sustainability strategy and exercise due diligence when contracting suppliers;[169]
- the adoption of Delegated Acts (statutory instruments) under the Markets in Financial Instruments Directive and the Insurance Distribution Directive to incorporate sustainability considerations into investment advice, and possible similar changes to the legal framework for credit rating agencies;
- delegated Acts specifying requirements for the transparency of the methodology used by firms to create sustainability benchmarks (which are used by investors when tracking the social or environmental performance of their investments),[170] as well as a possible harmonising initiative for benchmarks on "low-carbon issuers"; and
- an assessment by the European Supervisory Authorities, and the European Securities & Markets Authority in particular, of evidence of "undue short-term pressure from capital markets on corporations" (for example with respect to portfolio turnover and equity holding periods), with a view to formulating recommendations to the European Commission on any further necessary actions to address it.

169 The Commission is consulting on the EU's legal framework for corporate reporting until July 2018.

170 Benchmark providers have been developing ESG benchmarks to capture sustainability goals, but the Commission says the lack of transparency regarding their methodologies has affected their reliability. It argues transparent and sounder sustainable indices' methodologies are needed to reduce 'greenwashing' risks.

12.29 In his Explanatory Memorandum on the Sustainable Finance Action Plan, the Economic Secretary has "broadly welcomed" the Commission's policy agenda.[171] He notes that the "UK was influential in the [High-Level Expert Group], with a third of its members drawn from UK institutions", and the aims outlined in this document are "aligned with the UK's interests in developing green finance". He calls this "an area in which the UK has significant expertise" and thus one where it "stands to benefit from any increased export potential in this market" (although he does not refer to the implications of the Government's decision to leave the Single Market in this regard, which is likely to end the ability of UK-based financial services providers to market their activities within the EU without the need to establish a separate business in one of the remaining Member States).

12.30 With respect to some of the areas where the Commission is proposing the EU should legislate, the Minister says it is important for the EU to consider the "need for the future growth of the market". He adds:

> "[…] We understand that legislative action …[on the sustainability taxonomy and the 'Green Bonds']… would take a minimum-standards approach. We are urging the Commission to conduct rigorous quantitative and qualitative analysis before deciding to legislate for changes to prudential requirements on green assets and investments. We are urging the Commission to be mindful of domestic regimes that are working well, including those across the European green finance market, and to make sure that any legislative action does not undermine those regimes."

12.31 The Minister concludes by saying that, as long as the UK remains a member of the EU, it will "continue to engage closely with the Commission as well as other stakeholders to ensure that both the debate on sustainable finance and individual policy reforms closely reflect our objectives". He also acknowledges that "some of the proposals outlined in the Sustainable Finance Action Plan if taken forward may fall during the implementation period", during which the UK will continue to apply EU law as if it were still a Member State. He makes no further assessment of the implications of that arrangement, especially in view of the fact the UK is due to lose its institutional representation and voting rights over new EU legislation on 29 March 2019.

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None. However, the Committee has considered various legislative proposals related to the CMU Action Plan and the Fintech Action Plan in its Reports of 25 April and 2 May 2018.

Annex: Current and upcoming EU legislative proposals in the area of financial services

12.32 The table below lists pending EU legislative proposals directly concerned with financial services which remain under scrutiny; those recently cleared from scrutiny; and the Commission's confirmed upcoming proposals.

171 Explanatory Memorandum submitted by HM Treasury (11 April 2018).

Sector	Proposal	Proposed	Document	Scrutiny status
Banking	Safe and Transparent Securitisation	September 2015	37128	Cleared from scrutiny on 7 December 2015. Regulation published in the Official Journal in December 2017.
Banking	European Deposit Insurance Scheme	November 2015	37332	Remains under scrutiny. Last considered on 21 February 2018.
Investment services	Investment Prospectuses	November 2015	37356	Cleared from scrutiny on 25 January 2017. Regulation published in the Official Journal in June 2017.
Supervision	Fifth Anti-Money Laundering Directive	July 2016	37927	Cleared from scrutiny on 31 January 2018. Awaiting formal adoption by the Council.
Asset management	EU Venture Capital and Social Funds	July 2016	37956	Cleared from scrutiny on 18 November 2016. Regulation published in the Official Journal in November 2017.
Banking	Risk Reduction Measures: recovery and resolution	November 2016	38300	Remains under scrutiny. Last considered on 7 March 2018.
Banking	Risk Reduction Measures: insolvency hierarchy	November 2016	38301	Cleared from scrutiny on21 February 2018. Directive published in the Official Journal in December 2017.
Banking	IFRS9 standard on bank losses	November 2016	38304	Cleared from scrutiny on 13 November 2017. Regulation published in the Official Journal in December 2017.
Banking	Insolvency Directive	November 2016	38313	Remains under scrutiny. Last considered on 31 January 2018.
Clearing	Clearinghouses: recovery and resolution	November 2016	38332	Remains under scrutiny. Last considered on 29 March 2017.
Clearing	Clearinghouses: clearing obligation and trade repositories (EMIR Refit)	May 2017	38703	Remains under scrutiny. Last considered on 22 November 2017.

Sector	Proposal	Proposed	Document	Scrutiny status
Clearing	Clearinghouses: supervision and non-EU firms under EMIR	June 2017	38840	Remains under scrutiny. Last considered on 22 November 2017.
Pensions	Pan-European Pension Product	June 2017	38875	Remains under scrutiny. Last considered on 29 November 2017.
Supervision	European System of Financial Supervision	September 2017	39052, 39503, 39055, 39056	Remains under scrutiny. Last considered on 28 February 2018.
Supervision	Location of the European Banking Authority	November 2017	39291	Cleared from scrutiny on 18 April 2018.
Banking	Non-performing loans: credit servicers and enforcement of collateral	March 2018	39588	Remains under scrutiny. To be considered by the Committee shortly.
Investment services	Securities: assignment of third party claims	March 2018	39603	Remains under scrutiny. To be considered by the Committee shortly.
Banking	Risk Reduction Measures: capital requirements	November 2016	38303, 38304	Remains under scrutiny. Last considered on 7 March 2018.
Investment services	Prudential requirements for investment firms	December 2017	39397, 39400	Remains under scrutiny. Last considered on 28 February 2018.
Asset management	Cross-border distribution of collective funds	March 2018	39548, 39549	Remains under scrutiny. To be considered by the Committee shortly.
Asset management	Covered Bonds	March 2018	39544, 39555	Remains under scrutiny. Last considered by the Committee on 25 April 2018.
Investment services	Crowdfunding Regulation	March 2018	39550, 39551	Remains under scrutiny. Last considered on 25 April 2018.
Banking	Non-performing loans: prudential backstop	March 2018	39604	Remains under scrutiny.
Payment services	Single European Payments Area: non-Eurozone countries	April 2018	39616	Remains under scrutiny. To be considered by the Committee shortly.
Insurance	Motor Insurance Directive	May 2018	-	Awaiting document.

Sector	Proposal	Proposed	Document	Scrutiny status
Investment services	Listing of SMEs on regulated markets	May 2018	-	Awaiting document.
Investment services	EU Sustainability Taxonomy	May 2018	-	Awaiting document.
Asset management	Sovereign Bond-backed Securities	Q2 2018	-	Awaiting document.
Investment services	Non-financial transparency of asset managers and institutional investors	Q2 2018	-	Awaiting document.
Investment services	Green Bonds under the Prospectus Regulation	Q2 2018	-	Awaiting document.

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

Department for Business, Energy and Industrial Strategy

(39567) 7411/18 + ADD 1 COM(18) 130	Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee Monitoring the Implementation of the European Pillar of Social Rights.

Department for Culture, Media and Sport

(39610) 7727/18 + ADD 1 COM(18) 170	Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the mid-term evaluation of the implementation of the Europe for Citizens programme 2014–2020.

Department for Education

(39596) 7515/18 COM(18) 152	Communication from the Commission to the European Parliament and the Council: Reform of the administrative structure of the European Schools.

Department for Environment, Food and Rural Affairs

(39569) — —	Basic Payment Scheme for farmers—operationally on track, but limited impact on simplification, targeting and the convergence of aid levels.

Department for International Development

(39542) 7081/18 + ADDs 1–2 COM(18) 123	Report from the Commission to the European Parliament and the Council Annual Report on the Implementation of the European Union's Instruments for Financing External Actions in 2016.

Foreign and Commonwealth Office

39651	Council Decision amending and extending Council Decision 2013/34/CFSP on a European Union military mission to contribute to the training of the Malian Armed Forces (EUTM Mali).
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39652	Proposal of the High Representative of the Union for Foreign Affairs and Security Policy to the Council for a Council Decision Amending Council Decision (CFSP) 2015/778 of 18 May 2015 on a European Union military operation in the Southern Central Mediterranean (EUNAVFOR MED Operation SOPHIA).
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HM Treasury

39432	Proposal for a Decision of the European Parliament and of the Council on the mobilisation of the European Globalisation Adjustment Fund following an application from Sweden—EGF/2017/007 SE/Ericsson.
5322/18	
COM (18) 782	
39433	Proposal for a Decision of the European Parliament and of the Council on the mobilisation of the European Globalisation Adjustment Fund following an application from Spain—EGF/2017/006 ES/Galicia apparel.
5319/18	
COM (18) 686	
(39595)	European Court of Auditors: Special report 09/2018: Public Private Partnerships in the EU: Widespread shortcomings and limited benefits.
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Home Office

39218	Report on the annual accounts of the European Institute for Gender Equality for the financial year 2016 together with the Institute's reply.
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Formal Minutes

Wednesday 2 May 2018

Members present:

Sir William Cash, in the Chair

Marcus Fysh	Michael Tomlinson
Darren Jones	David Warburton
David Jones	Dr Philippa Whitford
Andrew Lewer	

2. 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 13 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Twenty-sixth Report of the Committee to the House.

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

[Adjourned till Wednesday 9 May 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)

Douglas Chapman MP (*Scottish National Party, Dunfermline and West Fife*)

Geraint Davies MP (*Labour/Cooperative, Swansea West*)

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*)