The Weekly Report from Brussels, provided by the European Affairs team at the City of London, provides an update on key developments relating to financial services in the EU.

8 December 2017

Welcome to the Weekly Report from Brussels, prepared by the City of London Corporation European Affairs team.

This week includes:

More information about the work of the City of London Corporation European Affairs team can be found **here.**

Sufficient progress reached in first phase of Brexit negotiations

On 8 December, following months of intense negotiations in Brussels, it was announced that 'sufficient progress' had been made on the first phase of Brexit talks (i.e. issues pertaining to the UK's withdrawal from the EU), allowing discussions on the future trading relationship to begin next year. In its **recommendation** to the European Council's Article 50 Taskforce, the European Commission concluded that progress on the three central withdrawal issues – the UK's financial settlement, citizens' rights, and the Irish border – had been made. The

Commission's recommendation follows the publication of a **joint report** agreed by the EU and UK negotiators which addresses the progress made during the first phase of Brexit talks.

Latest developments

Financial settlement

While headline figures are understandably absent from the agreed text, the report provides details of the methodology that will be used to calculate the ultimate financial settlement. The methodology takes into account the UK's participation in the EU's annual budgets through to 2020; arrangements for the UK's continued participation in the **programmes** of the EU's current Multiannual Financial Framework (e.g. Horizon2020 or Erasmus+); and other activities and commitments agreed by the UK with EU bodies such as the European Central Bank (ECB), European Investment Bank (EIB) and the European Development Fund (EDF).

The report also alludes to the notion that the UK is willing to assist financially in the relocation of EU Agencies based in London.

Citizens' rights

On citizens' rights, negotiators on both sides having been working to provide 'reciprocal protection for EU and UK citizens; to enable the effective exercise of rights derived from EU law and based on past life choices, where those citizens have exercised free movement rights' by the point at which the UK leaves the EU. The report provides details on the rights of residence and work of EU citizens, and those of their partners and dependants, potentially impacted by the Withdrawal Agreement (WA).

The agreement also commits to ensure that 'administrative procedures for applications for status will be transparent, smooth and streamlined' requiring no more administration than is 'strictly necessary and proportionate'. Other issues relating to security checks, social security coordination, healthcare, and the recognition of professional qualifications under the WA have also been addressed. The joint report concludes that, on citizens' rights, 'appropriate mechanisms' must be established in order to ensure the consistent interpretation and application of those rights. It goes on to state that, as the Court of Justice of the European Union (CJEU) is the 'ultimate arbiter of the interpretation of Union law' under which citizens' rights were enshrined during the UK's membership of the EU, 'UK courts shall therefore have due regard to relevant decisions of the CJEU' after Brexit.

Irish border

It was imperative for negotiators on both sides that the peace and prosperity achieved by the 1998 Good Friday/Belfast Agreement is protected within any Withdrawal Agreement despite the 'unique challenges' posed by Brexit. The report notes that the UK 'respects Ireland's ongoing membership of the EU and all of the corresponding rights and obligations that entails, in particular Ireland's place in the Internal Market and the Customs Union' while also detailing the UK's 'commitment to preserving the integrity of its internal market and Northern Ireland's place within it' – squaring this circle, of course, was one of the major obstacles which prevented a deal being made earlier in the week.

To move past this, the UK has agreed that, in the event of a 'no-deal' Brexit, it will 'maintain full alignment with those rules of the Internal Market and the Customs Union which, now or in the future, support North-South cooperation, the all-island economy and the protection of the 1998 Agreement'. The text states that the UK 'will ensure that no new regulatory barriers develop between Northern Ireland and the rest of the United Kingdom, unless, consistent with the 1998 Agreement, the Northern Ireland Executive and Assembly agree that distinct arrangements are appropriate for Northern Ireland'.

It remains to be seen how this agreement, or indeed a borderless arrangement, can work in practice given the UK government's stated intention to withdraw from both the EU Single Market and Customs Union, or how it will play out politically in the UK. That said, initial soundings from Theresa May's senior cabinet colleagues have been supportive. However, given the fragility of the Prime Minister's working majority in the UK Parliament, the agreed text on this particular issue will continue to pose political problems in the UK.

Other issues

While the three above-mentioned issues were critical in securing 'sufficient progress' on the first phase of the Brexit negotiations, there are of course other subjects which remain pertinent to the Brexit debate. These include, inter alia, ongoing cooperation in areas such as security, nuclear energy (and **Euratom**), civil and commercial matters and continuity in the availability of goods placed on the market under EU law before Brexit.

Next steps

The joint report agreed by the Brexit negotiators will be presented to the European Council for adoption at the forthcoming Euro Summit on 14-15 December. Further, the report states that the UK's agreement to the text is conditional on the 'overall agreement under Article 50 on the UK's withdrawal, taking into account the framework for the future relationship, including an agreement as early as possible in 2018 on transitional arrangements'.

ECON Committee holds exchange of views with the European Fiscal Board

Background

The Economic and Monetary Affairs (ECON) Committee held an exchange of views with European Fiscal Board (EFB) member Massimo Bordignon, who was intervening on behalf of Chairman Niels Thygesen.

Mr Bordignon introduced the EFB as a new institution, established at the end of 2016, which only began working during March of this year. He provided a brief summary of the EFB's **first annual report**, published on 15 November. The report builds on the mandate of the EFB and 'reviews the way the EU fiscal framework has been implemented, highlighting imperfections and scope for improvement'. It has focussed on the complete surveillance cycle from 2015-2017.

The EFB is also mandated to cooperate with the Council and the report therefore also contains an exchange of best practice. Further, it offers advice to the European Commission as to the best fiscal stance for the euro area both retroactively and prospectively.

Mr Bordignon commented on the challenges that have faced fiscal policy makers in the aftermath of the financial crisis. Despite some recovery, there remains a strong legacy as seen in factors such as particularly low levels of inflation. The EFB's 'basic consideration' was to determine whether the best approach was one which relaxed rules in the interests of stability of public finances, or one which insisted on more rigid application of the rules although risking undermining fragile recovery.

Conclusions of first annual report

The EFB found that the Stability and Growth Pact (SGP) had been applied with flexibility and discretion. It was concluded that whilst there were 'imperfections', there had been 'no gross errors' in the SGP's application. Although not perfect, the approach had provided some support to the euro area recovery, yet country-by-country fiscal stance was suboptimal. Cases of imperfections included not having always used consistent indicators to assess compliance across time and countries, excessive deficit procedures for certain Member States, and that, whilst it was recognised that debt reduction was necessary in some cases, no procedure was launched.

The Commission adopted a broadly neutral aggregate fiscal stance during 2016. The period was characterised by fragile recovery in the face of risks of significant down sides and some countries retained high levels of debt. Monetary policies had therefore been constrained.

The Economic and Monetary Union (EMU) is characterised by common monetary policy but nationalised fiscal policy. Resource constraints meant the EFB did not look at the independent fiscal activity of any individual country, yet still advanced one suggestion to the Member State level. The EFB took the view that the 'comply or explain' process was the most apt and successful for ensuring compliance.

Proposals for SGP

The EFB advocated rules aimed at reducing asymmetry. Mr Bordignon opined that 'sanctions do not work' and that 'enforcement is more incentive compatible'. The EFB gave preference to safeguarding the efficacy of EU funds 'more than wanting to sanction sovereign countries' and contended that sanctions could be substituted with 'some kind of conditionality'.

Further, the EFB sought a 'radical simplification of rules' in order to prevent hampering transparency and predictability with undue complexity. Mr Bordignon acknowledged this was a 'long running suggestion that will require treaty change'.

The report also supported a euro area stabilisation function. The governance framework of the euro area was seen as incomplete and Mr Bordignon contended that a 'central fiscal capacity would make the euro area more resilient' and called for more defined proposals in this area.

Committee reactions

MEP comments focussed in particular on the conclusion that fiscal stance at euro area was broadly appropriate however not at the country level. Whilst the EFB were calling for more symmetric rules, MEPs such as Paul Tang (S&D, Netherlands) pointed out that previous Commission recommendations to Member States had been ignored. There was therefore concern that there must be a way to address both the enforcement of the rules as well as centralisation of fiscal capacity to ensure stability for the euro area.

Economic and Financial Affairs Council

The Economic and Financial Affairs (ECOFIN) Council met on 5 December with an agenda that included items such as publishing of an EU list of non-cooperative jurisdictions; e-commerce proposals; taxation in the digital economy; and reducing risk in the banking industry. Notably, the Council also formally closed an excessive deficit procedure for the United Kingdom.

EU list of non-cooperative jurisdictions

The **list** was adopted by EU Finance Ministers with the intention of preventing tax fraud and evasion and was produced in a coordinated effort with the Organisation for Economic Co-operation and Development (OECD). The list follows the screening of third-country jurisdictions against criteria agreed by the Council in November 2016 and sets our measures envisaged with regard to jurisdictions on the list.

Toomas Tõniste, minister for finance of Estonia, which currently holds the rotating Presidency of the Council of the EU, advised that the report is 'not just a one-off process' and will be regularly reviewed and updated in order to 'ensure that good tax governance becomes the new norm'.

Digital taxation

ECOFIN Ministers adopted conclusions on the EU's internal level position on **digital taxation**. Existing tax rules have been designed with the traditional economy in mind and therefore do not apply to activities that require no physical presence in the country where goods and services are sold. The conclusions therefore provide a reference for further work at EU level regarding any necessary changes to agreed concepts of international tax rules. Work is currently underway at the OECD which is analysing the differing business models of the digital economy and is preparing an interim report to the G20, scheduled for April 2018.

VAT on electronic commerce

The Council adopted **proposals** intended to assist online businesses in complying with VAT obligations and facilitating the collection of VAT from consumers buying goods and services online.

Reducing risk in the banking industry

The ECOFIN Council considered the November 2016 package of proposals aimed at reducing risk in the banking industry. In particular, there was a review of the work done on the existing proposal for a European deposition insurance scheme (EDIS) and on steps taken towards implementing the Council's July 2017 action plan on non-performing loans (NPLs) in the banking sector.

The EDIS proposal is intended to create a third 'pillar' of the EU's Banking Union by establishing an EU-level insurance scheme to strengthen the protection of bank deposits. The original Commission proposal suggested establishing EDIS in three stages however the Council noted that this has now been revised down to two phases.

The Council noted that overall NPL levels have fallen from nearly €1tn at the end of 2016 to €893bn. The Commission intends to approve a package of measures aimed at continuing this trend in spring 2018, and the Council will take stock of progress at the next meeting of the ECOFIN Council on 23 January.

The Council determined that 'progress has been achieved on the banking package, and preliminary agreement has been reached on a broad range of issues'. However, political issues persist and therefore the political discussions on the EDIS proposal were postponed, pending sufficient progress on risk reduction measures.

ECON Committee hold economic dialogue with Eurogroup President

Background

The Economic and Monetary Affairs (ECON) Committee held an economic dialogue and exchange of views with Jeroen Dijsselbloem, the outgoing President of the Eurogroup. The regular economic dialogue set by legislation but was also used as opportunity for the ECON Committee to thank Mr Dijsselbloem for his five years as President of the Eurogroup, with Committee chair Roberto Gaultieri MEP (S&D, Italy) commending his work as a 'strong, capable President'.

Economic Outlook

Mr Dijsselbloem commented that the economic outlook for the euro area was positive following the fragile recovery that began in 2013. The Eurozone was now in a solid economic expansion phase, having enjoyed 18 successive quarters of increasingly broad based growth. Confidence for the future was reflected among consumers and investors. Further, the European Commission's Autumn Forecast predicted a favourable economic outlook 'for years to come' which was praised as a ‘huge turnaround from earlier years when [the whole of the] euro area and its integrity were at risk’.

The recovery was hailed as a result of ‘difficult measures’ taken at Eurozone level and more specifically at Member State level. Structural issues in the euro area have been address but not without social and political costs. It was stated, however, that these costs were now paying off in terms of economic growth in Member States.

Greece

The outgoing President of the Eurogroup commented that ‘Greece has turned around its political and economic processes’ and noted that a European Stability Mechanism (ESM) package of short term debt measures was already in place to bring down cost of financing to Greece. Further work will commence as of January to support Greece’s recovery as well as to ensure Greece can manage its debt burden and servicing of its debt. This is intended to prepare Greece for exit of the programme in summer 2018.

Budgetary situation of the euro area

Whilst there was more work to be done, progress had been made in Greece by implementing difficult measures. This was also true of the situation in the euro area in its totality. Mr Dijsselbloem quipped that he had previously been termed ‘the most optimistic undertaker in Europe’ and commented that this optimism was being realised.

The budgetary situation of the euro area was discussed by the Eurogroup earlier this week in the context of Draft Budgetary Plans (DBPs). The Eurogroup ‘by and large concurred with the Commission view that a broadly neutral fiscal stance was appropriate for Eurozone as a whole’. There remain large differences between Member States and the group had taken the view that ‘no one size fits all in euro area’. Only a few countries have fiscal space under the Stability and Growth Package (SGP) which Mr Dijsselbloem commented should be used for investment. Six countries were considered at risk of non-compliance with the SGP rules and were encouraged to ‘do what is necessary to comply with the pact’. Further, the Commission and European Council were implored to ‘ensure even handed enforcement of the rules’.

Jobs and Growth

Thematic discussions on jobs and growth have been taking place in the Eurogroup and included items such as tax burdens on labour, particularly on the lower part of labour market. Relieving these burdens ‘not only improves the labour market but also opportunities for people to participate and get into jobs'. This was considered an example of structural reforms that can be pursued jointly even though National Competent Authorities (NCAs) are 'in the lead'.

Deepening of Economic and Monetary Union (EMU)

The Eurogroup has prepared the Euro Summit, taking place on 14-15 December. This was done in inclusive format taking guidance from President Tusk. The group worked along three main themes.

Role of ESM

There was broad consensus that the euro area should build on its experience as regards improving the role of ESM, and this could involve a smaller role for the International Monetary Fund in the future. There was also support in the Eurogroup to retain the current ESM institutional framework that was reported to have 'installed confidence in Member States and great trust in the ESM.'

Completion of Banking Union

To ensure a solid footing for the Banking Union, Mr Dijsselbloem contended the EU must continue with financial sector reform. There had been encouraging examples of such work in Spain and Italy and it was commented that 'lessons could be drawn form such insolvency cases; learning from these could help complete the Banking Union'.

The Eurogroup intended to push on with the banking package the Commission has put forward, and work on non-performing loans (NPLs) was continuing. This work was intended to go on to allow next steps to be taken in the field of risk sharing, such as the establishment of a backstop to the Single Resolution Fund (SRF). Mr Dijsselbloem opined that the intention of President Tusk to come to 'more concrete decisions' in this area at the Euro Summit of June 2018 was feasible.

EMU fiscal framework

The Eurogroup was addressing the current fiscal framework as well as engaging in a 'lively debate' about possible new instruments in fiscal policy. There was broad consensus that the current framework has become very complex, hampering predictability. There should, therefore,be 'scope to simplify the rules'.

Discussions on new fiscal instruments were reported to be at a less advanced stage. There were presently 'at least six possible instruments that the Commission could introduce' however these would all have significant budgetary connotations. There were 'very different ideas in the Eurogroup at present as regards governance, design and funding'. The Commission proposals were described as 'very rich' and the Eurogroup committed to 'work intensely' on these debates to prepare for possible next steps in June 2018.

ECON Comments

MEPs commented largely on the Commission's proposals to develop the ESM into a European Monetary Fund and the need for clarification of the future competences of the Finance Minister who is to chair the Eurogroup. Burkhard Balz MEP (EPP, Germany), for example, was concerned about the merging of European Monetary Commissioner with the role of President of the Eurogroup as regards implications for 'institutional checks and balances'.

Mr Dijsselbloem commented that 'the ideas about the Eurozone, and what the Commission now calls 'European Minister of Finance' are very broad but also still quite vague in elements'. For example, were the European Minister of Finance to be given control of national budgets, this would raise 'huge constitutional and democratic legitimacy questions'. This wider debate was only entering preliminary stages. Mr Dijsselbloem offered his own opinion: 'thinking in terms of realpolitik, the Eurogroup will insist on having its own Chair. There is a strong sense in the Eurogroup that we should distinguish the role of the Commission and of the Eurogroup.'

In other news

- The **Eurogroup** met to discuss, inter alia, growth and jobs, draft budgetary plans, the overall budgetary situation of the euro area, the election of new Eurogroup President and the deepening of EMU.
- The European Commission **announced** it has deemed certain U.S. trading venues for derivatives as operating under an equivalent regulatory regime to those in the EU.
- The European Commission set out a **roadmap** for action and a number of concrete measures to deepen the Economic and Monetary Union.
- The **European Council** adopted creditor hierarchy, IFRS 9/large exposures rules.
- International central bankers give endorsement to the Basel III **reforms**.
- The **Committee on Internal Market and Consumer Protection** voted on services in the internal market, laying down a notification procedure for authorisation schemes.
- The **Committee on Budgetary Control** considered the EU general budget and held exchange of views with the Secretary-General of the European Commission.

Upcoming EU Institutions events and consultations

5 January: Deadline for EBA **consultation** for home-host cooperation under PSD2

5 January: Deadline for **consultation** paper on EIOPA's second set of Advice to the European Commission on specific items in the Solvency II Delegated Regulation

15 January: Deadline for ESMA **consultation** on draft guidelines on standards for trade repositories' derivative positions

22 January: Deadline for Commission **consultation** on how best to encourage sustainable investments

31 January: Deadline for EBA **consultation** on guidelines to strengthen pillar 2 framework

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City of London Research

The City of London produces regular research on EU Financial Services which can be accessed **here.**

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