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COVER NOTE

from:	The House of Commons of the United Kingdom
date of receipt:	14 November 2011
to:	President of the Council of the European Union
Subject:	PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on prudential requirements for credit institutions and investment firms [doc. 13284/11 EF 112 ECOFIN 531 CODEC 1284 - COM(2011) 452 final] - *Opinion*[1] *on the application of the Principles of Subsidiarity and Proportionality*

Delegations will find attached the above mentioned opinion.

Encl.: 1

[1] This opinion is available in English on the interparliamentary EU information exchange site (IPEX) at the following address: http://www.ipex.eu/IPEXL-WEB/search.do

Reasoned Opinion of the House of Commons

Submitted to the Presidents of the European Parliament, the Council and the Commission, pursuant to Article 6 of Protocol (No 2) on the Application of the Principles of Subsidiarity and Proportionality.

Draft Regulation on prudential requirements for credit institutions and investment firms[1]

Treaty framework for appraising compliance with subsidiarity

1. The principle of subsidiarity is born of the wish to ensure that decisions are taken as closely as possible to the citizens of the EU. It is defined in Article 5(2) TEU:

> "Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."

2. The EU institutions must ensure "constant respect"[2] for the principle of subsidiarity as laid down in Protocol (No 2) on the Application of the Principles of Subsidiarity and Proportionality.

3. Accordingly, the Commission must consult widely before proposing legislative acts; and such consultations are to take into account regional and local dimensions where necessary.[3]

4. By virtue of Article 5 of Protocol (No 2), any draft legislative act should contain a "detailed statement" making it possible to appraise its compliance with the principles of subsidiarity and proportionality. This statement should contain:

— some assessment of the proposal's financial impact;

— in the case of a Directive, some assessment of the proposal's implications for national and, where necessary, regional legislation; and

— qualitative and, wherever possible, quantitative substantiation of the reasons for concluding that an EU objective can be better achieved at EU level.

The detailed statement should also demonstrate an awareness of the need for any burden, whether financial or administrative, falling upon the EU, national governments, regional or local authorities, economic operators and citizens, to be minimised and to be commensurate with the objective to be achieved.

1 (33052) 13284/11: COM(11) 452.

2 Article 1 of Protocol (No 2).

3 Article 2 of Protocol (No 2).

5. By virtue of Articles 5(2) and 12(b) TEU national parliaments ensure compliance with the principle of subsidiarity in accordance with the procedure set out in Protocol (No 2), namely the reasoned opinion procedure.

Previous Protocol on the application of the principle of subsidiarity and proportionality

6. The previous Protocol on the application of the principle of subsidiarity and proportionality, attached to the Treaty of Amsterdam, provided helpful guidance on how the principle of subsidiarity was to be applied. This guidance remains a relevant indicator of compliance with subsidiarity:

> "For Community action to be justified, both aspects of the subsidiarity principle shall be met: the objectives of the proposed action cannot be sufficiently achieved by Member States' action in the framework of their national constitutional system and can therefore be better achieved by action on the part of the Community.
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> "The following guidelines should be used in examining whether the abovementioned condition is fulfilled:
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> - the issue under consideration has transnational aspects which cannot be satisfactorily regulated by action by Member States;
> - actions by Member States alone or lack of Community action would conflict with the requirements of the Treaty (such as the need to correct distortion of competition or avoid disguised restrictions on trade or strengthen economic and social cohesion) or would otherwise significantly damage Member States' interests;
> - action at Community level would produce clear benefits by reason of its scale or effects compared with action at the level of the Member States."[4]

Proposed legislation

7. The content of the proposed Regulation is set out in detail in the Committee's Report, to which this Reasoned Opinion is attached. For these purposes we set out the stated objective of the proposal and the reasons given for EU rather than Member State action.

Objective

8. The Commission's explanatory memorandum describes the objective of the proposal as follows:

> "The overarching goal of this initiative is to ensure that the effectiveness of institution capital regulation in the EU is strengthened and its adverse impacts on depositor protection and procyclicality of the financial system are contained while maintaining the competitive position of the EU banking industry."[5]

4 Article 5.

5 Para 1.1.2.

9. By contrast, however, the legal base addresses the functioning of the internal market. The legal base has also been used to distinguish the draft Regulation from the related draft Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms:[6]

> "[w]hereas the proposal for Directive [inserted by OP] governs the access to the activity of businesses and is based on Article 53 TFEU, the need to separate these rules from the rules on how these activities are carried out warrants the use of a new legal basis for the latter."[7]

Subsidiarity

10. The Commission's explanation for why the proposal is consistent with the principle of subsidiarity is set out at section 4.2 of the explanatory memorandum. We set it out here in full:

> "In accordance with the principles of subsidiarity and proportionality set out in Article 5 TFEU, the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore be better achieved by the EU. Its provisions do not go beyond what is necessary to achieve the objectives pursued. Only EU action can ensure that institutions and investment firms operating in more than one Member State are subject to the same prudential requirements and thereby ensure a level playing field, reduce regulatory complexity, avoid unwarranted compliance costs for cross-border activities, promote further integration in the EU market and contribute to the elimination of regulatory arbitrage opportunities. EU action also ensures a high level of financial stability in the EU. This is corroborated by the fact that prudential requirements set out in the proposal have been set out in EU legislation for more than 20 years.
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> "Article 288 TFEU leaves a choice between different legal instruments. A Regulation is therefore subject to the principle of subsidiarity in the same manner as other legal instruments. Subsidiarity must be balanced with other principles in the Treaties such as the fundamental freedoms. Directives 2006/48/EC and 2006/49/EC are formally directed at Member States but eventually addressed towards businesses. A Regulation creates a more level-playing field since it is directly applicable and there is no need to assess legislation in other Member States before starting a business since the rules are exactly the same. This is less burdensome for institutions. Delays with regard to the transposition of Directives can also be avoided by adopting a Regulation."

11. The Commission's impact assessment addresses subsidiarity in the following terms:

> "Based on the nature of problems outlined in the above analysis, several major justifications that meet the principle of subsidiarity for action at the EU level become apparent. They include a need to enhance the integration of EU internal banking market (by removing national options, discretions and possibilities to 'gold-plate'), address several market (e.g., in the area of countercyclical policy measures) and regulatory failures (e.g., capital definition and liquidity risk management rules, capital requirements for CCR) that were brought to light by the financial crisis, correct for regulatory arbitrage opportunities which are made possible by the current legislation (due to the availability of certain national options and discretions) and ensure a consistent EU approach for tackling

6 (33053) 13285/11: COM(11) 453.

7 Section 4.1.

various issues covered by the scope of this report, which would do away with the need for MS to pursue individual approaches that risk fragmenting the internal market.

"Most importantly, only a common EU-level approach could be expected to effectively provide for financial stability and tame excessive financial pro-cyclicality, as currently policies that are directed toward these key systemic aspects are either geared to national needs or are absent altogether. With respect to the latter, the crisis clearly demonstrated the ineffectiveness of the national liquidity risk supervision approaches."

Aspects of the Regulation which do not comply with the principle of subsidiarity

12. The House of Commons considers that the draft Regulation on prudential requirements for credit institutions and investment firms does not comply with either the procedural obligations imposed on the Commission by Protocol (No 2) or the principle of subsidiarity in the following respects.

i) Failure to comply with procedural obligations

13. Neither section 4.2 of the explanatory memorandum nor 3.8 of the impact assessment contains a "detailed statement" to make it possible to appraise compliance with the principle of subsidiarity (and proportionality), as required by Article 5 of Protocol No 2, TFEU.

14. The presumption in Article 5 TEU is that decisions should be taken as closely as possible to the EU citizen. A departure from this presumption should not be taken for granted but justified with sufficient detail and clarity that an EU citizen can understand the qualitative and quantitative reasons leading to a conclusion that EU action is justified.

15. The proposed Regulation differs from the Capital Requirements Directive by removing the possibility for Member States to impose stricter prudential requirements when necessary than set out in the Regulation. This is a significant change, leading to "maximum harmonisation" of minimum requirements. To discharge the obligations placed on it by Article 5 of Protocol No 2, the Commission should have prepared a detailed statement outlining the quantitative and qualitative reasons for this change: the relevant sections of the impact assessment and explanatory memorandum fall far short of the detail required.

16. The Commission's approach to the consideration of subsidiarity is matter of concern not only to the House of Commons, but to all national parliaments of EU Member States. We draw its attention to paragraph 2.3 of the Contribution of the XLVI COSAC:

"In accordance with Article 5 of Protocol 2, COSAC underlines that for national Parliaments to exercise the powers vested in them it is necessary to enable the financial effects of EU draft legislative acts to be evaluated, and, in the case of Directives, the implications for national legal systems also to be evaluated. Moreover, COSAC recalls that EU draft legislative acts should be justified on the basis of qualitative and quantitative indicators. COSAC notes that subsidiarity analyses in the Commission's explanatory memoranda have, to date, not met the requirements of Article 5."

ii) Failure to comply with principle of subsidiarity

17. Compliance of this objective with subsidiarity is appraised in the light of the guidance set out in paragraph 6 above.

18. The House of Commons considers that the objectives of the Regulation could be better achieved without precluding Member States from imposing stricter requirements. We come to this conclusion because it is clear that there continues to be a need for a flexible approach to address prudential concerns at national level. This is reflected by the introduction of Article 443 into the Regulation, in which the Commission proposes that it should be able to adopt delegated acts to impose stricter prudential requirements, for a limited period of time, for one or more sectors, regions, *or Member States*. We do not, however, find there is sufficient evidence to demonstrate that the Commission is better placed than the competent authorities of Member States to address national prudential concerns. Indeed, there is a strong argument to say that national authorities are not only better placed, but can react more quickly than the Commission can by means of delegated legislation, thereby enhancing financial stability. (Nor are we convinced that Article 443 is an appropriate use of the Commission's delegated powers under Article 290 TFEU: prudential requirements are not "non-essential" elements of the proposed Regulation.)

19. In coming to this conclusion we have considered the legal base. In our estimation the functioning of the internal market is at best a secondary objective: it is evident from the Regulation, explanatory memorandum and impact assessment that the predominant legislative objective is prudential supervision. We note that section 3.8 of the impact assessment states that fragmentation of the internal market is only a risk — we think the internal market objective can be put no higher than that. We do not think drawing a distinction between parallel proposals is a sufficient reason for a single market legal base, and we note that the two Directives that make up the Capital Requirements Directive are based on (what is now) Article 53 TFEU. We are not therefore convinced that uniformity within the internal market is sufficient reason for removing Member State discretion to require higher prudential standards in excess of the proposed Regulation.

Conclusion

20. For these reasons given above the House of Commons concludes that this proposal does not respect the principle of subsidiarity.