House of Commons

European Scrutiny Committee

Thirty-third Report of Session 2019–21

Documents considered by the Committee on 16 December 2020

Report, together with formal minutes

Ordered by The House of Commons to be printed 16 December 2020

HC 229-xxix
Published on 18 December 2020
by authority of the House of Commons

Notes

Numbering of documents

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

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

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

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

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

Abbreviations used in the headnotes and footnotes

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

Euros

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

Further information

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

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

Staff

The current staff of the Committee are Ravi Abhayaratne (Committee Operations Assistant), Joanne Dee (Deputy Counsel for European Legislation), Alistair Dillon and Leigh Gibson (Clerk Advisers), Nat Ireton and Apostolos Kostoulas (Committee Operations Officers), Luanne Middleton (Second Clerk), Daniel Moeller (Committee Operations Manager), Jessica Mulley (Clerk), Foeke Noppert (Clerk Adviser), Indira Rao (Counsel for European Legislation), Paula Saunderson (Committee Operations Assistant), Sibel Taner (Second Clerk), Emily Unwin (Deputy Counsel for European Legislation) George Wilson (Clerk Adviser), Beatrice Woods (Committee Operations Officer).

Contacts

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

Contents

1 Evaluation of the EU State aid rulebook: possible implications for the UK[1]

This EU document is politically important because:

- it evaluates the functioning of large parts of the EU's rulebook on State aid (subsidy control), and sets out the direction of travel for future reform of those rules; and
- the future development of EU policy in this area is likely to remain relevant for the UK despite its exit from the EU, given the close economic links between the two. Moreover, EU State aid rules, including future changes, will continue to apply directly in the UK to some extent under the Protocol on Ireland/Northern Ireland in the Withdrawal Agreement.

Action

- Draw the Commission's recent evaluation of the EU State aid rulebook to the attention of the Business, Energy and Industrial Strategy Committee, the Committee on the Future Relationship with the EU, the Northern Ireland Affairs Committee and the Treasury Committee

Overview

1.1 In October 2020, the European Commission published a "fitness check" (evaluation) of a number of elements of the EU's "State aid" rulebook. This governs how EU Member States can grant subsidies to businesses, and the cases in which they need prior approval from the Commission to do so. The evaluation concluded that EU State aid rules broadly speaking are fit for purpose, but the Commission is planning to make certain changes to "support the new political objectives of the […] European Green Deal, as well as the new [EU] Digital and Industrial Strategies". As such, it appears the Commission wants to make it easier for EU countries to subsidise businesses with activities in or relevant to those sectors. Specific proposals for such changes will follow in the course of 2021.

1.2 The UK of course left the European Union on 31 January 2020. As such, EU law—including on State aid—will cease to apply, broadly speaking, from the end of the post-Brexit transition period on 31 December this year.[2] However, the Committee is of the opinion that there are a number of reasons why EU State aid law, and future changes thereto, will remain relevant for the UK even as a non-Member State. We discuss these further in paragraphs 16 to 35 below, but in summary they are:

1 Fitness Check of the 2012 State aid modernisation package, railways guidelines and short-term export credit insurance; COM number: 12593/20 + ADDs 1–5; SWD(2020) 257; Legal base: Not applicable; Department: Business, Energy and Industrial Strategy; Devolved Administrations: Consulted; ESC number: 41641.

2 The Government has made regulations which will dis-apply EU State aid rules that would otherwise become part of retained EU law (except insofar as it is required to maintain them for the purposes of the Northern Ireland Protocol, as discussed elsewhere in this chapter). In the absence of a new regime, for which no legislation has been introduced, this means for example that existing transparency rules requiring the publication of details about individual subsidy beneficiaries exceeding certain amounts on a public website will disappear from 1 January 2021 for subsidies not within the scope of the Protocol.

- first, from 1 January 2021, EU State aid rules—and therefore the European Commission's powers—will continue to apply under Article 10 of the Northern Ireland Protocol (NIP) to any UK subsidies which "affect" trade in goods and electricity "between Northern Ireland and the [EU]". Following discussions with the Government, the EU on 8 December announced its intention to issue a unilateral declaration seeking to assuage concerns about the scope of that provision and the powers it gives the Commission to continue to intervene in UK subsidy policy;

- secondly, as part of the EU-UK negotiations on a free trade agreement, the EU is seeking additional binding commitments on the UK's new domestic State aid policy after the transition period ends, which would apply to subsidies not already within the scope of the Protocol (and therefore subject to EU law in any event). The Government has to date resisted such proposals, and this issue appears to be a key stumbling block for a UK-EU trade agreement;

- thirdly, even in the absence of an EU-UK subsidy control agreement, the EU is likely to seek to 'export' the application of its State aid regime on a unilateral basis by limiting the market access of beneficiaries of financial support from "third country" governments. For example, the European Commission is preparing legislation for a new "level playing field" mechanism that would allow the EU to take action against companies that are in receipt of subsidies from non-EU Governments and active within the EU market; and

- lastly, the UK also has a direct economic interest in future developments in EU State aid policy more generally, given that the extent to which EU Member States can subsidise their domestic industries will have an impact on the competitiveness of British businesses that compete with them on the UK market or internationally.

1.3 The Minister of State at the Department for Business, Energy and Industrial Strategy (Paul Scully MP) submitted an Explanatory Memorandum setting out the Government's position on the "fitness check" on 27 November 2020. This document summarised the outcome of the evaluation, but did not make any attempt at a substantive assessment of the potential ramifications of future changes to EU State aid law for the UK. Instead, the Minister says "the Government will consider whether it has views on revisions to individual guidelines and frameworks if and when consultations on these are undertaken".

1.4 Given the potential ramifications of EU State aid reform for the UK in the future, we have discussed the outcome of the European Commission's recent evaluation in more detail below.

The "fitness check" of EU State aid rules

1.5 EU State aid law is a subset of European competition legislation. In summary, it ordinarily prohibits governmental authorities in the EU's Member States—be they national, regional or local—from providing an implicit or explicit subsidy at public expense to individual businesses or sectors where this "distorts or threatens to distort competition" and "affects trade between Member States". Fundamentally, the aim of EU

State aid rules is to preserve a "level playing field" for all companies in the EU, without taxpayer-funded support for inefficient companies and avoiding subsidy races to attract inward investment.[3]

1.6 By default, primary EU law[4] requires all government schemes or subsidies within the EU[5] that qualify as State aid to be notified to, and approved by, the European Commission. The Commission has extensive autonomous powers to block, or demand adjustments to, such support measures it considers in breach of EU State aid law.[6] For aid already granted to businesses, subsequently ruled by the Commission to be unlawful, Member States can be ordered to recover the aid from the recipients with interest added.[7] Ultimately, in case of disputes about the permissibility of a subsidy under EU law, it is for the Court of Justice of the EU (CJEU) to decide, and there is an extensive body of case law on this subject.

1.7 However, while the EU Treaties include a presumption that State aid by default is not permitted, there are wide-ranging exemptions that allow subsidies where they are justified on the basis of "objectives of common interest". That would include, for example, financial support for companies in economically underdeveloped regions ("regional aid") or for specific public interest purposes, like the roll-out of broadband in rural areas where the work would be commercially unviable otherwise. The European Commission tests whether "common interest" threshold is met on the basis of "compatibility criteria" it has developed, as set out in non-binding guidelines. This guidance vary depending on the purpose of the subsidy in question, and specific guidelines exist setting out when State aid is considered permissible under EU law.

1.8 Moreover, to reduce the impact of EU State aid procedures on granting of non-controversial subsidies, certain types of aid are legally exempt from having to be approved in advance by the European Commission altogether. In particular, the Block General Exemption Regulation (GBER), which covers subsidies for specific purposes e.g. rural broadband and cultural institutions. Information on exempted subsidies under the GBER must still be submitted to the Commission for monitoring (and potential claw-back) purposes, and summary information on individual subsidy exceeding €500,000 must be published in the EU's "public transparency module for individual aid awards".[8] The GBER is supplemented by sector-specific block exemption regulations for the agriculture and fisheries industries.[9] There is also a De Minimis Regulation, which exempts subsidies to businesses which cumulatively stay below a threshold of €200,000 (£181,000)[10] over a

3 State aid is defined in the EU context as an intervention by the State or through State resources; the intervention gives the recipient an advantage on a selective basis; competition between the beneficiary of the intervention and its actual or potential competitors has been or may be distorted; and the intervention is likely to affect trade between Member States.

4 Articles 107 and 108 TFEU.

5 The notification requirement also applies to the UK until the end of the transition period, and potentially beyond in relation to the Northern Ireland Protocol (see section 3 below).

6 The Commission is autonomous in this respect because its State aid decisions, unlike most other types of legally-binding acts which it can adopt, do not need to be approved (and cannot be blocked) by the Member States in the Council of Ministers before they take effect.

7 Ultimately, EU countries, as well as individual businesses, can challenge the Commission's State aid decisions before the EU Court of Justice (CJEU) to test their validity. Equally, the Commission can take Member States to the Court if they fail to enforce its decisions in this area.

8 It is unclear whether the UK will maintain a transparency tool for subsidies outside the scope of EU law when the transition period ends on 31 December 2020.

9 Known as "ABER" and "FIBER" respectively.

10 Different, lower thresholds apply for businesses in the agriculture and fisheries sectors.

three-year period. The Commission was authorised to establish these exemptions on the basis of an "Enabling Regulation" approved by the EU's Member States in the Council of Ministers, most recently in 2015.[11]

1.9 In addition to these routine exemptions, the Commission can allow State aid even where these would normally breach the above rules, where necessary "to remedy a serious disturbance in the economy". The most pertinent example of this is the current "Temporary Framework" for State aid to address the Covid-19 pandemic, under which the Commission is allowing EU countries (and the UK) to provide subsidies to companies which go well beyond what would be permitted in normal times.[12] A similar approach was taken to State aid to support the stability of the banking sector after the 2008 financial crisis.

Recent and upcoming evaluations of EU State aid rules

1.10 In January 2019, the European Commission announced that it would be conducting a "fitness check" of large swathes of EU State aid law. The main objective was to evaluate the effectiveness of the EU's rulebook in this area since the last significant reforms took place in 2012 (the "State Aid Modernisation" or SAM exercise). The fitness check covered the GBER and the De Minimis Regulations, as well as nine separate guidelines on the permissibility of sector-specific State aid.[13] This evaluation was considered necessary not least because the bulk of the SAM reforms had a built-in sunset clause causing them to expire by the end of 2020, in essence to force the European Commission to make a decision as to whether changes were required.[14]

1.11 The Commission has already extended the GBER and De Minimis Regulation until the end of 2023, to give it time to reflect on the outcome of its evaluation and prepare further changes, if necessary. A first substantive change was made in September 2020, when the Commission updated its State aid guidelines in support of the EU's Emissions Trading System (ETS).[15] The following month, the Commission published the outcome of the overall fitness check. It concluded that the evaluated rules were "broadly fit for

11 The Enabling Regulation at the time of the SAM reforms was Regulation (EC) No 994/98. It was replaced in 2015 by Regulation (EU) 2015/1588.

12 At present, such exceptional State aid can be granted until 30 June 2021 although the Commission can decide to extend that period if warranted by the economic circumstances.

13 Namely those covering regional aid, research, "important projects of common European interest", the aviation and rail sectors, risk finance and export credit insurance, rescue and restructuring of failing companies, and energy & environmental aid. As discussed further in section 3 below, all of the State aid rules covered by the fitness check are listed in the Northern Ireland Protocol as continuing to apply, to a limited but currently unknown extent, in the UK beyond the end of the post-Brexit transition period.

14 When announcing the "fitness check", the Commission also said it intended to extend the validity of those rules and guidelines due to expire by the end of 2020 by two years, i.e. until the end of 2022, to "provide predictability and legal certainty". In July 2020, the Commission accordingly legislated for the extension of certain existing EU State aid rules. However, the timings are different: the GBER and De Minimis Regulation have been extended until the end of 2023, as have the "Restructuring" Guidelines (which cover subsidies for firms in financial difficulty). However, several other guidelines have only been extended by a year (i.e. until December 2021), covering regional State aid for less-developed regions, promotion of risk finance investments, subsidies for environmental protection and energy generation, and support for "important projects of common European interest". Separately, the Commission has recently proposed to extend a separate Regulation exempting State aid under a "de minimis" threshold specifically for "undertakings providing services of general economic interest" (SGEI) by three years until the end of 2023.

15 These guidelines allow EU countries to subsidise companies in meeting their emission reduction targets under EU climate change legislation to offset the risk of 'carbon leakage', i.e. relocation of activities to countries with less strict environmental rules.

purpose and hence there is no need for an overhaul".[16] However, "certain specific rules may need revision and/or updat[ing], including clarifications, further streamlining and simplification, as well as adjustments to reflect recent legislative developments, current priorities, market and technology developments".

1.12 In particular, the Commission appears to be envisaging clearer alignment of State aid rules to make it easier for Member States to provide subsidies that contribute to the EU's top-level political priorities (its Green, Digital and Industrial Strategies), saying that "State aid can, and should, contribute to the[se] […] Strategies". To achieve this, it wants to introduce changes "in the short term" to the GBER and many of the sector-specific guidelines, while "adaptations to the De Minimis Regulation" and the guidelines on aviation and failing businesses are only necessary "in the medium term".[17] The Commission has also concluded that the specific guidelines on subsidies for the railway sector are "outdated and need a complete overhaul".

1.13 Any legislative changes to the General Block Exemption and De Minimis Regulations would not normally require the approval of the EU Member States, as they have already provided the necessary authorisation under the aforementioned Enabling Regulation.[18] Similarly, the Commission can make changes to the State aid guidelines, as non-legislative tools, at its own discretion. It is nonetheless consulting national governments and other stakeholders before making any changes.

Timetable for amendments to the EU State aid rulebook

1.14 The Commission Work Programme for 2021 indicates that the revision of the rules for State aid to under-developed regions (the "Regional Aid Guidelines") will be published in the first quarter of 2021, based on a draft put out for consultation in mid-2020.[19] This will be followed by new guidance on subsidies for environmental protection and energy projects, risk finance support,[20] scientific research, and "important projects of common European interest" by the end of that year. Amendments to the General Block Exemption Regulation—including the sector-specific versions for the agriculture and fisheries industries—are also expected to be made towards the end of 2021 "in light of the Green Deal".

1.15 In the second quarter of next year, the Commission is also due to present a legislative proposal for a "Level Playing Field" mechanism, a new legal tool that would allow the EU in essence to extend the application of its State aid rules to companies active on the European

16 The evaluation focussed on substantive, not procedural, rules around State aid. In essence, that means the Commission looked at the rules determining whether a particular public subsidy is compatible with the EU's internal market or not.

17 The Commission notes in particular that the de minimis threshold—where subsidies to an individual company totaling €200,000 or less over a three-year period are exempt from Commission approval—may need to be increased, for example to take into account inflation.

18 The exception would be if the Commission were to seek changes that go beyond what the Enabling Regulation already authorises it to do.

19 The key changes proposed, compared to the existing regional aid guidelines, are set out in these explanatory notes. They cover legal consistency with the GBER; the permissibility of aid for the production of synthetic fibres; and the selection of regions eligible to receive this type of State aid; subsidies for larger companies.

20 The risk finance guidelines set the conditions under which EU countries can use "financial instruments and fiscal measures" to improve access by SMEs and mid-caps to capital. The evaluation found they should be updated to "reflect regulatory, technological and market developments" and support the economic recovery. In the UK, such programmes have included for example the "Enterprise Investment Scheme".

market and which are in receipt of subsidies from non-EU governments.[21] In addition, the Commission has announced that it will carry out further evaluations of its State aid guidance for broadband roll-out and "services of general economic interest"—such as the provision of healthcare or housing—in 2021, presumably with a view to making any changes it considers necessary the following year. The timetable for any changes to the De Minimis Regulation and the State aid guidelines on railways, aviation and restructuring of failing businesses is unclear at this stage.

Continued relevance of EU State aid law to the UK

1.16 The UK of course left the European Union on 31 January 2020 and EU law will cease to apply, generally speaking, at the end of the post-Brexit transition period on 31 December.[22]

1.17 In particular, the State Aid (Revocations and Amendments) (EU Exit) Regulations 2020, approved by Parliament in December 2020,[23] will prevent EU State aid rules from becoming retained EU law from 1 January 2021 (except with respect to their continued application under the Northern Ireland Protocol, as we discuss below). These regulations will, notably, remove any restrictions under domestic law that this body of EU law, if "retained", would have placed on public authorities when deciding whether to provide subsidies to specific beneficiaries.[24] It also removes the existing transparency requirements found in EU law, meaning that individual larger subsidies granted from 1 January 2021 would not need to be published online in the way they must be at present.

1.18 The Government intends to legislate at some point in the future for a new, bespoke UK subsidy control regime, but has not yet presented draft legislation to that effect.[25] Its preparations in this regard have explicitly been linked to the outcome of the UK's trade negotiations with the EU, especially on a "level playing field" (see below). Ministers told the House of Lords in May 2020 that the new subsidy control regime is being developed 'in tandem' with the trade negotiations with the EU,[26] a point they repeated in the Commons as recently as November 2020. In the interim, the Government has said it will apply the WTO Agreement on Subsidies and Countervailing Measures when the EU rules cease to apply (which is much less detailed than the EU's State aid rule book, and notably only applies to subsidies that affect trade in goods, but not services). The Government have

21 This Committee published a report on the Level Playing Field mechanism in July 2020, and it is also discussed further below.

22 That includes EU State aid rules, and the enforcement powers it foresees for the European Commission and the Court of Justice. This means, for example, that the Government has sought (and obtained) Commission approval for various coronavirus-related support schemes for businesses.

23 The Lords also debated a "motion to regret" the envisaged disapplication of EU State aid rules, which called on the Government to "delay implementation of the regulations until […] the primary legislation detailing how the United Kingdom's new subsidy regime will operate after the end of the transition period has received Royal Assent".

24 This is a significant change compared to the Government's plans under the previous Prime Minister, when it tabled draft regulations to transfer the European Commission's State aid functions to the Competition & Markets Authority. See the draft State Aid (EU Exit) Regulations 2019, which would have largely retained substantive EU State aid law—including transparency requirements—and in effect transferred the powers of the Commission to the CMA. The regulations were withdrawn in February 2020.

25 In November 2020, the Government said that it intended "to publish a consultation in coming months on whether we should go further than [WTO] international commitments [on subsidy control]. This will include consulting on whether any further legislation should be put in place". Similarly, in its Command Paper of December 2020 the Government referred to the fact that the UK is "free to design its own independent subsidy regime".

26 Letter from Paul Scully MP, Minister for Small Business, to the House of Lords EU Internal Market Sub-Committee (15 May 2020).

said that, "in terms of the certainty that businesses require", it "will publish guidance as soon as possible on the international commitments that will apply in the UK on 1 January 2021". This guidance does not appear to have been published as of 16 December.

1.19 However, for various reasons this Committee considers that the EU's subsidy control regime is likely to remain relevant for the UK even beyond the end of the transition period and notwithstanding the regulations removing EU State aid law from the UK statute book.

Infringement procedures for State aid granted before 31 December 2020

1.20 First, under the Withdrawal Agreement (WA), the UK could still face legal challenges for any government support granted on or before 31 December 2020. The Agreement allows the European Commission to bring infringement proceedings against the Government before the Court of Justice (CJEU) for a failure to fulfil its legal obligations under EU law before that date for four years after the transition period ends (i.e. until 31 December 2024).[27] That will include any alleged breaches of EU State aid law committed by the UK before the end of this year. Any State aid cases against the UK that were pending before the CJEU as at the end of the transition period will also continue to judgment.

1.21 This legacy power for the EU to enforce its State aid rules in the UK may be particularly relevant for subsidies provided by the Government under the "Temporary Framework" for State aid in the context of the Covid-19 pandemic, where enormous amounts of public aid have been disbursed with relatively little up-front scrutiny.[28] Private legal challenges have already been launched against subsidies provided by certain EU Member States to support specific businesses through the pandemic under that Framework with the Commission's approval[29] However, any changes made by the European Commission to EU State aid rules made as a result of the aforementioned evaluation, which will only take effect in 2021 or later, will not be directly relevant in a legal sense to UK subsidies already granted before the end of the transition period.

EU State aid law under the Protocol on Ireland/Northern Ireland

1.22 Second, the UK and EU agreed on a specific Protocol on Ireland/Northern Ireland ("the Protocol") in the Withdrawal Agreement to avoid the need for any new customs or regulatory infrastructure on the border with EU Member State Ireland.[30]

1.23 Of particular relevance to this note is that Article 10 of the Protocol provides that EU State aid rules as listed in an Annex[31] will continue to "apply to the United Kingdom [...] in respect of measures which affect that trade between Northern Ireland and the Union which is subject to this Protocol". That Annex includes all Regulations and guidelines recently reviewed by the Commission, including those evaluated as part of the "fitness check". In practice, this will require the UK to continue to seek European Commission

27 See Article 87 WA. However, any such legal cases brought after the end of the transition would be on the basis of EU State aid law as it applied at the time of the alleged infringement; there would be no retroactive application of new EU rules to previous UK subsidies granted during or before the transition period.

28 See for more information the European Scrutiny Committee's Report of 7 May 2020.

29 See for example Case T-657/20, Ryanair v. Commission, in which the airline is challenging the Commission's decision to approve a subsidy by the Finnish Government to its national flag carrier Finnair.

30 The Protocol means Northern Ireland will in many respects be treated as if it were in the EU's Customs Union and its Single Market for goods, with certain exceptions and adaptations. Under the Protocol this arrangement will take effect on 1 January 2021 and last until at least 31 December 2026, and potentially beyond.

31 Annex 5 to the Protocol.

approval for subsidies within the scope of the Protocol insofar as they are not already exempt under the GBER and De Minimis Regulations.[32] The Commission will have the same powers that it enjoys within the EU to block or require changes to such subsidies, ultimately subject to the jurisdiction of the Court of Justice.[33]

1.24 Moreover, the substance of the EU State aid rules that will apply under Article 10 is dynamic. That means that any references to the EU State aid Regulations and the guidelines included in the Protocol are automatically required to be read as referring to those "Union acts as amended or replaced" in the future. In other words, EU State aid law as it applies under the Protocol will evolve in line with the rules applicable within the EU itself. This makes the Commission's future follow-up to the "fitness check" of this area of EU policy especially relevant in this context, as the changes the Commission is planning to make in 2021 and beyond to its State aid rulebook would automatically take effect under the Protocol as well.

1.25 However, the precise scope of Article 10, i.e. the *range* of subsidies to which EU State aid law will continue to apply, is interpreted differently by the Government and the EU. Commentators have pointed out Article 10 is expressed to apply to the UK (as opposed to Northern Ireland) and that subsidies granted to businesses in Great Britain (as opposed to Northern Ireland) as well as subsidies in respect of the supply of services may affect trade in goods between Northern Ireland and the EU. The Government, by contrast, wants to limit the extent to which Article 10 will also allow the EU to exercise its powers in such cases.

1.26 To counter this, the Government had sought powers under the Internal Market Bill to unilaterally modify or dis-apply Article 10 of the Protocol in UK domestic law, to prevent such 'reach back'. Ministers dropped the relevant clauses from the Bill in early December after the EU agreed to issue a declaration on how it interprets this aspect of the Protocol. This states that "an effect on trade between Northern Ireland and the [EU]" in goods—the trigger for the continued application of EU State aid law under the Protocol—cannot be "merely hypothetical, presumed, or without a genuine and direct link to Northern Ireland". Instead, the EU's powers would apply only where a "measure" (a subsidy scheme or individual subsidy) "is liable to have such an effect on trade between Northern Ireland and the [EU], based on the real foreseeable effects of the measure".

1.27 The practical impact of that EU declaration is unclear at this stage. While the Government argues that the "concern" that "the EU's state aid provisions should apply in [Great Britain] in circumstances when there is no link or only a trivial one to commercial operations taking place in [Northern Ireland] […] has now been addressed", the basis for this claim is not immediately apparent. First, the EU's statement does not—and indeed, could not—modify the substance of the Protocol. Moreover, in terms of its substance, the statement does not even explicitly purport to limit the scope of Article 10 only to UK subsidies which have a measurable, demonstrable impact on trade in goods

32 Agricultural subsidies for Northern Irish farmers are exempted from this arrangement, provided the UK and EU, in their Joint Committee under the WA, have agreed on a "maximum overall annual level of support" for these beneficiaries. See Article 10(2) of the Protocol in conjunction with Annex 6 thereof.

33 In addition, subject to proposed changes in the Internal Markets Bill, section 7A of the European Union (Withdrawal) Act 2018 allows undertakings to challenge a UK subsidy which they believe constitutes impermissible State aid under the Protocol. As the Act gives direct effect to the rights and obligations created by the Withdrawal Agreement, including Article 10 of the Protocol, the court would be able to quash the support measure on that basis This was a requirement imposed by the Withdrawal Agreement itself, in Article 4.

between Northern Ireland and the EU: it only requires a subsidy to be "liable" to have a "foreseeable" impact. In this sense, the EU appears to have simply restated the existing case law of the CJEU on the limits of EU State aid law, which would have been binding on the Commission when exercising its powers to intervene in UK subsidy policy under the Protocol in any event. As such, this development certainly does not preclude the possibility of legal disputes between the UK and the European Commission in the future about whether the latter has standing to intervene in the UK in respect of a particular subsidy pursuant to Article 10 of the Protocol.

1.28 The on-going negotiations between the UK and the EU on a new trade agreement are also relevant in this respect. Any arrangement relating to subsidy control as part of this overarching trade deal could supersede Article 10 of the Protocol, or supplement it.[34] Absent a bilateral arrangement, the European Commission could seek to use the EU's leverage under Article 10 of the Protocol and intervene against UK subsidies more proactively where it perceives a risk to the EU's economic interests. The role of State aid in the trade negotiations, and the UK's new economic relationship with the EU more generally, is considered further below.

Implications of EU State aid rules under the new UK-EU economic relationship

1.29 As discussed, from 1 January 2021 the European Commission will cease to have any powers to approve or block subsidies granted to businesses in the UK where these are not within the scope of the Northern Ireland Protocol.[35] There are nevertheless, and broadly speaking, three ways in which EU State aid policy as it evolves has continued economic—and therefore political—relevance for the UK beyond the end of the transition period more generally.

State aid commitments in a UK-EU trade agreement

1.30 First, as noted, State aid is one of the outstanding issues in the on-going UK-EU trade negotiations as part of the wider "level playing field" discussion.[36] The EU is seeking legally binding commitments on the future of the UK's subsidy control regime. The aim appears to be either to ensure that the UK's post-Brexit approach will mirror the EU's own State aid regime, or allow it to restrict UK market access for particular goods or services if there is divergence in this area. From the limited information that is publicly available, it appears the Government has to date resisted both approaches, although the talks are of course on-going even at this late stage.

34 Though if so, the subsequent agreement must specifically pinpoint which parts of the Protocol are superseded (Article 13(8) of the Protocol).

35 However, as noted, the Commission will retain a residual power to initiate infringement proceedings against the UK for alleged breaches of EU State aid law committed on or before 31 December 2020.

36 The EU's directives for the negotiations went so far as to say that a new UK-EU agreement should "ensure the application of Union State aid rules to and in the United Kingdom".

1.31 The benefits of any bilateral arrangement restricting State aid measures would presumably work in both directions: it would also give the UK a mechanism to address concerns about subsidies granted to EU companies.[37] This is also relevant in the context of the Commission's "fitness check" of EU State aid policy, which could result in a reduction in the limits placed on the provision of subsidies by EU Member States, allowing them to provide financial support to their businesses more freely in the context of its Green, Digital and Industrial Strategies (potentially to the detriment of British competitors).

EU approach to UK subsidies in the absence of a UK-EU agreement

1.32 Secondly, even in the absence of any legal commitments by the UK in relation to State aid, and without prejudice to the provisions of the Northern Ireland Protocol, the EU has, and is developing, certain unilateral tools to counteract the impact of what it perceives as unfair subsidies provided by UK. Notably, it could restrict UK market access for specific goods or services, for example via countervailing mechanisms to counter imports of subsidised goods under the relevant WTO rules. It has similar options at its disposal to restrict UK market access in services sectors in response to developments in Government subsidies, for example by not granting, or withdrawing, UK "equivalence" for specific financial services. Indeed, the European Commission has so far refused to grant the UK equivalence in many areas precisely because it has linked this issue to the other outstanding issues in the trade negotiations.

1.33 Moreover, the European Commission is currently pushing for an expansion of the EU's own unilateral toolbox to enforce its State aid rules in its relations with non-EU countries:

- In June 2020, it published a White Paper for a new "Level Playing Field" (LPF) mechanism. This would be a new tool allowing the EU to investigate the economic activities of companies in receipt of foreign (e.g. British) subsidies and impose redress measures to mitigate their effect on the European market. A legislative proposal for such an LPF tool is due in 2021, and the Commission's White Paper appear to have widespread support among EU countries and the European Parliament.[38]

- Similarly, in its recent Action Plan on Taxation, the Commission also suggested an overhaul of the EU's "Code of Conduct on business taxation", which sets criteria to determine if selective tax reliefs have acted as a form of State aid by affecting "the location of business activity".[39] It wants to expand the scope of the Code to ensure that EU Member States impose more effective "defensive" (retaliatory) measures on countries that do not address the EU's concerns about such allegedly distortive tax practices (e.g. the Government's intention to confer

37 In May 2020, the Government stated that "there are several complexities to developing a new domestic subsidy control regime […], particularly as we are continuing to develop our domestic policy in tandem with the EU negotiations on open and fair competition". This implies that it does consider State aid restrictions to be a matter for negotiation with the EU.

38 Notably, the White Paper refers to the Commission's preferred option of settling any disputes over a subsidy with a non-EU country via a bilateral mechanism under a trade agreement, clearly indicating the new tool could complement any bilateral arrangements in the field of subsidy control or be used in absence thereof.

39 The Code of Conduct is used to assess tax measures adopted by EU Member States themselves, and by a selected group of non-EU countries. However, it is a political tool and virtually no legal consequences flow from being listed as a 'tax haven' as a matter of EU law.

tax advantages for businesses in its proposed new free ports). While any such changes are likely to be a long way off because EU tax policy-making is very slow, it is an area of EU policy the UK should monitor closely.

1.34 As a result, the EU's approach to State aid, and consequently how it would view subsidies granted by UK under its own domestic regime from 1 January 2021, could have an impact on its relationship with the UK even if the Government did not accept any binding commitments on subsidy control as part of a wider trade agreement.

Impact of EU subsidy controls on the competitiveness of UK businesses

1.35 Lastly, the way in which the EU restricts the provision of subsidies to companies by its Member States is also relevant economically to British businesses irrespective of whether the UK and EU reach a subsidy control agreement.

1.36 More specifically, British businesses also have an interest in the extent to which their competitors in the EU can be supported financially by their governments to shore up their competitiveness both on the UK market, and internationally. This is why the way the European Commission is seeking to amend the EU State aid rule book on the back of its "fitness check" could have economic ramifications here. In particular, the changes it envisages to facilitate the use of public subsidies that support the EU's green, digital and industrial strategies could have a material impact on UK businesses in those sectors, also depending on levels of taxpayer-funded support they may be able to tap into under the UK's own new subsidy control systems.

Conclusions and action

1.37 The issue of State aid and subsidy control has been one of the most difficult issues in the UK's negotiations with the EU on a new economic relationship. However, because of the provisions on State aid already included in the Northern Ireland Protocol, this area of EU law will retain direct legal effect even after the UK leaves the Single Market on 31 December this year. This also means that Parliament should stay abreast of future developments in EU State aid policy, as changes to the European Commission's approach may directly affect the UK's available options to provide subsidies where these fall within the scope of the Protocol.

1.38 In particular, we remain to be convinced that the EU's intended unilateral declaration on the exercise of its State aid controls in the UK under Article 10 of the Northern Ireland Protocol does indeed, as the Government argues, "address" concerns that it gives the EU significant legal scope for intervention as regards subsidies for businesses located in Great Britain even beyond the end of the post-Brexit transition period. As part of our broader scrutiny of the implementation of the Protocol, we have today written to the Chancellor of the Duchy of Lancaster (Rt Hon. Michael Gove MP) to seek further clarification about the practical impact of that declaration on the EU's powers in that respect.

1.39 Beyond the issue of State aid under the Northern Ireland Protocol, whether or not there will be an agreement between the UK and the EU on subsidy control as part of a wider trade deal (and to what extent this may modify the relevant provisions of that Protocol), of course remains uncertain. However, the question of how the UK and EU approach taxpayer-funded subsidies is likely to remain salient in the longer term. This is not merely a question of the bilateral economic relationship. The revocation of EU State aid law in the UK from 1 January, except insofar as applicable under the Protocol, also raises a number of important questions of domestic policy, for example with respect to the competences of the devolved administrations and the lack of a new transparency regime for subsidies when the requirement under EU law to publicise subsidy schemes and individual subsidies falls away.

1.40 As the talks between the Government and the EU continue, we hope that this Report will inform parliamentary consideration of some of the longer-term policy issues relating to subsidy control raised by the UK's exit from the EU. We will continue to follow the negotiations between the UK and the EU, in particular the question of alignment and divergence on "level playing field" issues such as State aid, closely. When the European Commission publishes further, concrete proposals for reform of the EU's State aid rulebook, those should be considered in light of the UK's new economic relationship with the European Union and, if relevant, the outcome of the current trade negotiations. Of particular interest in this regard will be the proposal for a new EU Level Playing Field mechanism in its trade relations with non-EU countries, which we reported to the House in July this year.

1.41 In the meantime, we draw the European Commission's recent evaluation of EU State aid rules, and our assessment of their potential significance to the UK, to the attention of the Business, Energy and Industrial Strategy Committee, the Committee on the Future Relationship with the EU, the Northern Ireland Affairs Committee and the Treasury Committee.

2 Privacy and Electronic Communications[40]

This EU document is legally and politically important because:

- just like the General Data Protection Regulation (GDPR), the proposal once operative will apply to providers outside the EU if they offer electronic communications services to EU end users. This 'extraterritorial' application will impact the UK regardless of whether the proposal becomes operative during transition (which now seems very unlikely considering the Government's December update) or afterwards;
- the UK's provision of equivalent protection of personal data relating to electronic communications will form part of the Commission's data adequacy assessment. Even if a data adequacy decision is adopted, the Commission is under a duty to keep it under review and repeal, amend or suspend a decision if a third country is no longer providing adequate protection of EU citizens' data; and
- any provisions relating to national security and assisting child protection could therefore have implications for the UK, even after transition.

Action

- Write to the Minister for Media and Data, flagging our intention to pursue as part of any future scrutiny in 2020 the potential of a Regulation to still have relevance to the UK even if adopted after transition for the reasons stated above. To also highlight the omission to comment on the implications for the UK of the recent Court of Justice ruling in Privacy International case.
- Draw this update to the attention of Digital, Culture, Media and Sport Committee, the Science and Technology Committee, the Home Affairs Committee, the Justice Committee, the Joint Committee on Human Rights and the Committee on the Future Relationship with the EU.

Overview

2.1 This proposed ePrivacy Regulation was published in January 2017 to replace the current 2002 Directive on the privacy and protection of personal data relating to electronic communications (e-comms). E-comms can concern highly sensitive information about an individual. For example, medical conditions, sexual preferences, religious and political views, or commercially sensitive information about a business. Disclosure could result in personal and social harm, even economic loss.

40 Proposal for a Regulation of the European Parliament and the Council concerning the respect for private life and protection of personal data in electronic communications and repealing Directive 2002/58/EC ; Council and COM number: 5358/17 + ADDs 1–6, COM (17) 10; Legal base: Articles 16 and 114 TFEU, ordinary legislative procedure, QMV ; Dept: DCMS; Devolved Administrations: informed; ESC number: 38455.

2.2 Once adopted, the Regulation could have major implications for the way that sectors such as technology, digital advertising and publishing do business and for individual privacy. The current Directive[41] dates from 2002 and covers confidentiality of e-comms provided via traditional communications services (e.g. emails, SMS). The proposal will update the rules in the Directive to apply to 'Over the Top' services, including internet-based messaging such as What's App and Voice over Internet Protocol (e.g. Skype). It will also govern the use of cookies, other tracking technologies as well as email marketing.

2.3 The Commission had planned for the proposed Regulation to come into force at the same time as the General Data Protection Regulation (GDPR) on 25 May 2018. However, the proposal has proved very controversial, resulting in slow progress in negotiations in the Council. So far the Council has been unable to agree a General Approach.

2.4 Contentious areas during the negotiation of the proposal (including for the UK) have been:

- inconsistency and unclear overlaps with the GDPR;
- when service providers can use e-comms content and metadata in the running of their business;
- rules governing cookies and other tracking technologies;
- how the Regulation would apply to emerging technologies (Machine-to-Machine (M2M)[42] and Internet of Things (IOT));[43] and
- clarification on processing for national security purposes and (separately) for combatting online sexual abuse and exploitation of children (CSEA).

2.5 An account of the scope and content of the proposed Regulation and the Government's view of it are set out in our predecessors' previous Reports.[44]

Application after the post-exit transition period

2.6 In light of Government's update of 9 December included in this Report chapter (paragraphs 0.14–15) it now seems very unlikely that the proposed Regulation will be adopted and become applicable to the UK during transition.

2.7 However, the proposal could still have significant relevance to the UK after transition. This is because just like the General Data Protection Regulation (GDPR), the proposal as drafted and once operative will apply to providers outside the EU if they offer electronic communications services to EU end users.[45]

41 Directive 2002/58/EC (Regulation on Privacy and Electronic Communications).

42 This describes the interaction of billions of devices and machines that are connected to the internet and to each other. For example, a remote-locking system enabling you to open the door to a visitor via your smart phone if you're not at home.

43 Essentially this includes any device connected to the internet and to each other e.g. wearable fitness watches, trackable dog collars.

44 Fifty first Report HC 301-I (2017–19), chapter 3 (16 January 2019); Twenty first Report, HC 301–xx (2017–19), chapter 1 (21 March 2018); Thirty first Report, HC 71–xxiv (2016–17), chapter 6 (8 February 2017); also see (38446), 5034/17: Sixteenth Report, HC 301–xiv (2017–18), chapter 3, (28 February 2018).

45 See Article 3 "Territorial scope" which extends the Regulation to providers established outside the EU.

2.8 The UK's provision of equivalent protection of personal data relating to electronic communications will form part of the Commission's data adequacy assessment.[46] Even if a data adequacy decision is adopted, the Commission is under a duty to keep it under review and repeal, amend or suspend a decision if a third country is no longer providing adequate protection of EU citizens' data.

2.9 For these reasons, the Committee has been closely monitoring developments in the negotiation of this proposal.

CJEU ruling in the Privacy International case

2.10 In our last Report of 26 March 2020, we highlighted the pending ruling of the Court of Justice of the EU (CJEU) in the Privacy International[47] case and the opinion provided by the Advocate General (AG) in January 2020. This found that bulk, indiscriminate processing of bulk communications data for national security purposes, including as required by the legislation in question (Section 94 of the Telecommunications Act 1984 read with Section 21 of the Regulation of Investigatory Powers Act 2000 "RIPA")[48] fell within the scope of the current e-Privacy Directive. We asked the Government to keep us informed of any developments in that case, including any views on the implications of the final ruling for the UK.

2.11 The CJEU delivered its ruling on 6 October, broadly confirming the opinion of the AG. Read with the joined cases concerning the compatibility of French and Belgian legislation with EU law,[49] key findings were that:

- The 2002 Directive on privacy and telecommunications (ePrivacy Directive) does apply to providers of electronic communication services ("e-comms providers") required by law to retain the data of their subscribers and to allow SIAs access to that data, even if for national security purposes (based on the CJEU'S interpretation of the scope of the Directive and the references to national security in Articles 1(3)[50] and 15(1)).[51]

46 See Article 45 of the GDPR for the wide range of factors that the Commission can take into account in its data adequacy assessment.

47 Case 623/17

48 Both legislative provisions were repealed by the Investigatory Powers Act 2016. Chapter 2 of Part 6 IPA now provides for court warrants authorising the bulk acquisition of data compared with Ministerial directions previously under s94 TCA.

49 Joined Cases C-511/18, La Quadrature du Net and Others, C-512/18, French Data Network and Others, and C-520/18, Ordre des barreaux francophones et germanophone and Others

50 Article 1(3) provides "This Directive shall not apply to activities which fall outside the scope of the Treaty establishing the European Community, such as those covered by Titles V and VI of the TEU, and in any case to activities concerning public security, defence, State security (including the economic well-being of the State when the activities relate to State security matters) and the activities of the State in areas of criminal law."

51 Article 15(1) provides "Member States may adopt legislative measures to restrict the scope of the rights and obligations provided for in Article 5, Article 6, Article 8(1), (2), (3) and (4), and Article 9 of this Directive when such restriction constitutes a necessary, appropriate and proportionate measure within a democratic society to safeguard national security (i.e. State security), defence, public security, and the prevention, investigation, detection and prosecution of criminal offences or of unauthorised use of the electronic communication system, as referred to in Article 13(1) of Directive 95/46/EC. To this end, Member States may, inter alia, adopt legislative measures providing for the retention of data for a limited period justified on the grounds laid down in this paragraph. All the measures referred to in this paragraph shall be in accordance with the general principles of Community law, including those referred to in Article 6(1) and (2) TEU."

- National legislation which requires e-comms providers systematically to provide SIAs with bulk communications data through general and indiscriminate collection of that data is incompatible with EU law (reading Article 15(1) in the light of the Charter of Fundamental Rights).[52] The CJEU dismissed the UK's argument that Article 4(2) TEU[53] ("national security" is a matter for Member States) put the issue outside the scope of EU law.

- But a Member State may legislate to allow for applications for court orders requiring e-comms providers to give SIAs access to bulk data if faced with serious "genuine and present or foreseeable" threat to national security and if time-limited, strictly necessary and only extended where the threat persists.[54]

- There are other exemptions or derogations (flowing partly from Article 15):

  - targeted and expedited retention is permissible to combat serious crime or serious threats to public security subject to effective safeguards and independent judicial or administrative review;

  - bulk retention of IP addresses[55] if limited to a strictly necessary time period; and

  - bulk retention of data relating to the civil identity of e-comms users.[56]

The Government's position and December update

2.12 In our last Report in March we highlighted the most important aspects for the House of the Government's most recent letters to us and provided our response by way of letter to the Secretary of State for Digital, Culture, Media and Sport on 26 March 2020. This included the latest letter to the EU Lords Committee, copied to this Committee, of 6 March 2020.

2.13 Given the lack of progress in the negotiations of this proposal, informal 'no progress' updates have been provided by Government officials to Committee staff since the date of our last Report. However, given the imminence of the end of the transition period, a formal update from the Government was requested.

2.14 In a brief letter of 9 December 2020, the Minister for Media and Data (Rt Hon. John Whittingdale OBE MP) writes in response to that request. In summary he tells us that:

- The Regulation has not been finalised and is still proceeding through the EU legislative process.

- So it might not now come into force before the end of the transition period and not be directly enforceable in the UK as and when it takes effect.

2.15 He then describes the only developments on the dossier since the Government's last update to the Committee in March:

52 Article 7 (right to privacy), 8 (right to data protection), 11 (right to freedom of expression without state interference) and Article 52(1) concerning limitations on those rights.

53 This EU Treaty provision states "…national security remains the sole responsibility of each Member State"

54 Detailed in the Quadrature du Net judgment, as are the derogations that follow in that paragraph of the note.

55 Related to the source of a communication.

56 No conditions on time limit are stipulated.

- The legislative file was transferred from the outgoing Croatian presidency of the Council to Germany this summer.
- Croatia had been unable to break the negotiating deadlock that had existed since the last set of major proposals were issued on 21 February 2020.
- Those proposals, which included the introduction of legitimate interests as a legal basis for processing metadata, received mixed reactions according to the progress report of the outgoing Croatian Presidency.
- In November, the German Presidency released a compromise text[57] for consideration within the Telecoms Working Group.
- Member States did not support this text[58] and the Presidency will not attempt to move towards either an informal mandate or General Approach during its term.
- The file will be handed to the Portuguese Presidency in January 2021.

2.16 The Minister finally comments that the Government will continue to monitor relevant international legislation and consider any changes UK domestic laws that are needed.

Action

2.17 Write to the Minister for Media and Data, flagging our intention to pursue as part of any future scrutiny in 2020 the potential of a Regulation to still have relevance to the UK, even if adopted after transition for the reasons stated above, and highlighting the omission to comment on the implications for the UK of the recent Court of Justice ruling in Privacy International case.

2.18 Draw this update to the attention of Digital, Culture, Media and Sport Committee, the Science and Technology Committee, the Home Affairs Committee, the Justice Committee, the Joint Committee on Human Rights and the Committee on the Future Relationship with the EU.

Letter from the Chair to the Minister for Media and Data (Rt Hon. John Whittingdale OBE MP)

Thank you for your letter of 9 December.

We note the continued lack of progress on the proposed ePrivacy Regulation and that it is unlikely to be adopted and apply to the UK before the end of the transition period.

However, your update did not address the continued relevance to the UK of a Regulation adopted after transition. In particular, we refer to the need for the UK to provide equivalent data protection of EU citizens data for the purposes of obtaining and maintaining a data adequacy decision. This is also relevant for the use of alternative international data transfer mechanisms such as standard contractual clauses under the General Data Protection Regulation (GDPR), as recently highlighted by the Schrems II ruling.

57 We had added this link to the document referred to in the Minister's letter for ease of reference.
58 As explained in the Progress Report on 23 November 2020

You will be aware of the factors that the Commission has to consider for adequacy assessments set out in Article 45 of the GDPR. In our view that would extend to the issues addressed by the current ePrivacy Directive and in time to a new Regulation replacing it. A new Regulation is likely also to extend with extraterritorial effects to UK businesses wanting to provide offer electronic communications services to EU end users.

Another consideration listed by Article 45 GDPR is "relevant legislation, both general and sectoral, concerning…. national security". With this in mind, when we last wrote to the Secretary of State in March, we requested that any update take into account the final ruling of the Court of Justice in the Privacy International case, including any implications for the UK. We consider that this is a significant omission from this current update which we intend to pursue as part of our future scrutiny in 2021.

Please note that I am also copying this letter to the Chairs of the following other Committees of the House: Digital, Culture, Media and Sport Committee, the Science and Technology Committee, the Home Affairs Committee, the Justice Committee, the Joint Committee on Human Rights and the Committee on the Future Relationship with the EU.

3 EU regulation of crypto-assets and Distributed Ledger Technology in financial services[59]

These EU documents are politically important because:

- they contain proposals for a new EU regulatory framework for the use of Distributed Ledger Technology (DLT) in financial services, including new licensing requirements for issuers and service providers in the market for crypto-assets like Bitcoin and Facebook's "Diem"; and
- it is unclear how these proposals, which are still being discussed in Brussels, could interact with the Government's own strategy for regulation and promotion of the market for crypto-assets, on which it is due to launch a consultation before the end of 2020.

Action

- Maintain a watching brief on the legislative deliberations on the EU proposals in Brussels, and in the meantime draw the Commission's proposals to the attention of the Science and Technology Committee and Treasury Committee.

Overview

3.1 Distributed Ledger Technology (DLT), the decentralised approach to recording transactions that relies heavily on electronic encryption, has many potential uses.[60] Its practical application to date has focussed primarily on the issuance of crypto-assets—financial 'tokens' that are distributed and stored using DLT—like Bitcoin, and the market is expanding rapidly. One of the more recent developments is the emergence of "stablecoins", a crypto-asset which functions as a form of payment but whose value is meant to be stabilised by being pegged to external assets, such as fiat currency.

3.2 Given the relatively novel nature and small size of the market in crypto-assets, comprehensive regulation in many jurisdictions does not specifically address the trade in tokens. Within the European Union, whose rules continue to apply in the UK until the end of the post-Brexit transition period on 31 December 2020, certain tokens might already be covered by the Markets in Financial Instruments Directive (MiFID) if they have the features of a share or bond, but many are currently unregulated under European law (although some crypto-asset exchanges do already have certain obligations under the EU's Anti-Money Laundering Directive).

59 (a) Proposal for a REGULATION on Markets in Crypto-assets, and amending Directive (EU) 2019/1937; (b) Proposal for a REGULATION on a pilot regime for market infrastructures based on distributed ledger technology; (c) Proposal for a Directive of the European Parliament and of the Council amending Directives 2006/43/EC, 2009/65/EC, 2009/138/EU, 2011/61/EU, EU/2013/36, 2014/65/EU, (EU) 2015/2366 and EU/2016/2341; Council and COM number: (a) 11053/20 + ADDs 1–3, COM(20) 593; (b) 11055/20 + ADDs 1–2, COM(20) 594; (c) 11052/20 + ADDs 1–2, COM(20) 596; Legal base: Article 114 TFEU; ordinary legislative procedure; QMV; Department: HM Treasury; Devolved Administrations: Not consulted; ESC numbers: (a) 41536; (b) 41537; (c) 41535.

60 See for more information the POST Research Briefing on Distributed Ledger Technology (6 September 2020) or the Treasury Committee's Twenty-second Report of the Session 2017–19, "Crypto-assets", HC 910 (12 September 2018).

3.3 To address this gap, in September 2020 the European Commission put forward a package of proposals to introduce the first, comprehensive EU-wide regulatory system for issuers and service providers in the market for crypto-assets.[61] The aim is essentially to "position […] Europe at the forefront of [DLT] innovation and uptake" and give the EU a competitive advantage in building a larger market for crypto-assets, while also introducing sufficient regulatory oversight to mitigate the risks to consumers and financial stability that a growing market in tokens may entail. The package of Commission proposal has two key elements:

- a draft Regulation on markets in crypto-assets (MiCAR). This would set licensing requirements for issuers and service providers in the market for tokens. Notably, it would require stablecoin issuers to be incorporated within the EU to offer their product to EU-based customers and make them subject to various organisational and prudential requirements to counter investor protection and financial stability risks.[62] Under the Regulation, a licence granted by any one EU country would allow a company to operate in the market for crypto-assets in any other Member State (the "passport"); and

- a proposal for a regulatory sandbox to allow financial services providers to test new designs for trade and settlement facilities based on DLT for transactions in crypto-securities. In summary, this would allow companies to apply for an exemption from certain requirements normally applicable to trading venues and securities settlement under EU financial services law to operate these infrastructures on a more streamlined DLT basis instead.

3.4 The proposals are only drafts of EU legislation: they are now being considered by national experts representing the 27 national Governments of the EU Member States in the Council of Ministers, and by the European Parliament's Economic & Monetary Affairs Committee. The Council and the Parliament must reach agreement on the legal texts before they can become European law, and the final EU statutory framework for crypto-assets and DLT market infrastructure could therefore still differ significantly from the text presented by the Commission in September 2020.

3.5 The proposed new EU regulatory approach to DLT in financial services will not take effect until 2022 at the earliest. As such, any formal EU legislation that flows from the Commission proposals will not apply directly in and to the UK, which of course will leave the EU's Single Market on 31 December this year. However, as a relatively new area of regulatory scrutiny, the EU's approach could impact on the Government's own approach, which is due to be set out in a consultation paper before the end of 2020. To the extent that the Commission is successful in creating a competitive advantage for the EU by having common rules for its large market may need to be considered as the UK develops its own approach. Similarly, how the EU seeks to address any future financial stability risks that flow from increased stablecoin usage could also have an impact on the UK, given the interdependencies between the UK and EU's financial systems.

61 The package of crypto-asset proposals is part of the EU Digital Finance Strategy, which has one of its aims "that the EU financial services regulatory framework is innovation-friendly and does not pose obstacles to the application of new technologies".

62 Granting and monitoring such licences would be the responsibility of the national financial regulators in the 27 Member States, but the European Banking Authority (EBA) would have direct supervisory responsibilities for issuers of "significant" stablecoins.

3.6 We have considered the various elements of the European Commission's package of proposals on DLT in the financial sector further below.

Distributed Ledger Technology in the financial services sector

3.7 Distributed Ledger Technology (DLT) is a type of database, allowing for records (or ledgers), of electronic transactions to be maintained in a decentralised way. This means that, unlike traditional systems, DLT records are held by a shared or 'distributed' digital network of participants ('nodes') and not by a centralised entity. Changes to the ledger need to be validated and agreed by participants.[63] Some distributed ledgers use smart contracts that execute transactions automatically when relevant conditions are met. The ledgers in DLT systems are held independently by multiple nodes, making the information widely available and allowing errors or manipulation in transactions—for example by hackers—to be identified.[64]

3.8 DLT has a wide range of actual and potential applications, for example to digitalise supply chain management or the use of smart contract software to automate purchases of stock when the price of a good falls below a certain threshold. However, arguably its most high-profile use is in the financial services sector, where it is used for the distribution of so-called "crypto-assets" or tokens, a type of financial asset that depends primarily on DLT to function. Such tokens are, essentially, an encrypted digital representation of values or rights that can be stored and traded electronically.

3.9 Following the launch of Bitcoin in 2009, thousands of other crypto-assets have been issued. These are typically crypto-currencies, which can be used in exchange for goods or services instead of fiat money with sellers that choose to accept them (or hold them for investment purposes), or investment tokens, which provide rights related to companies in the form of ownership rights or entitlements similar to dividends. Companies can also issue utility tokens, which enable access to a specific current or prospective service or good, similar to a voucher.

3.10 A recent development is the emergency of "stablecoins", a form of crypto-currency designed to have a more stable value in reference to another currency. This is typically achieved through a pool of reserve assets (such as short-term government bonds, fiat currencies or other crypto-assets), to which buyers may in certain cases have a direct claim.[65] Perhaps the most well-known example is "Diem" (formerly "Libra"), a stablecoin developed by Facebook which will be backed by a reserve of liquid assets. Stablecoins have attracted particular regulatory attention, because by having a stable value their usage may become more widespread, with attendant implications for consumer protection and financial stability. For example, the Bank of England's Financial Policy Committee has

63 Additional security can be added by "permissioned" DLT, where only specific, identifiable users can make changes to the ledger.

64 For more information on DLT, please refer to the Parliamentary Office for Science & Technology brief, "Distributed Ledger Technology" (September 2018).

65 Theoretically, a Stablecoin could also maintain a particular value by having its supply adjusted automatically by means of an algorithm in response to fluctuations in demand. However, the European Central Bank said in August 2019 that the "idea behind algorithmic stablecoin initiatives is to adjust the supply of stablecoin units in order to maintain their price stability in the currency of reference and to guide users' expectations on its future value", but noted that this is currently "largely a theoretical possibility rather than reality".

warned that "stablecoins used in systemic payment chains should meet the standards equivalent to those expected of commercial bank money in relation to stability of value, robustness of legal claim and the ability to redeem at par in fiat".

3.11 Given the range of potential uses, the market for crypto-assets encompasses a number of different activities and different market actors that provide trading and intermediation services. Market participants include the issuer or sponsor, the entity—whose identity may or may not be known—that has "developed the technical specifications of a crypto-asset and defined its features". The resulting assets are bought and sold on trading platforms, some of which themselves operate in a decentralised way by means of "smart contract" software (which can guarantee, for example, that the funds are automatically returned to investors if an offer for investment tokens does not reach the minimum subscription target). There are also crypto-asset exchanges, entities that offer broker and dealer services—such as the sale of such assets for fiat money or vice versa—in return for commission.[66]

EU regulation of DLT in the financial sector

3.12 The European Union has the power to legislate in the field of financial services, but this competence is shared with its Member States: in other words, where the EU has not passed legislation for a specific financial sector, each individual EU country retains the flexibility to regulate that industry as it sees fit.

3.13 Although there is no specific EU legislation targeted at the use of Distributed Ledger Technology in financial services, certain crypto-assets may be covered or affected by existing EU rules. For example, since 2018 the EU's Anti-Money Laundering Directive (AMLD) has required money-laundering checks to be performed by companies that exchange crypto-currencies and fiat money.[67] Some crypto-assets—especially investment tokens—may also qualify as "financial instruments" under the EU's Markets in Financial Instruments Directive (MiFID), in which case a whole range of EU rules applies relating to the marketing and selling of such "security tokens".[68] Similarly, stablecoins could fall within the EU legal definition of "electronic money" under the E-Money Directive, in particularly if their users have a direct claim on the reserve backing its value.[69]

3.14 In 2018, the European Commission announced that it would assess the case for comprehensive EU-level regulation of crypto-assets to support the benefits of DLT in the financial sector.[70] Among the potential advantages of the technology it has identified were

66 In contrast with trading platforms, crypto-asset exchanges engage in the buying and selling of crypto-assets themselves on own account and act as the counterparty to users.

67 See Directive 2018/843/EU. The European Commission is also due to present a Report in 2022 on the implementation of the AMLD, which will—among other things—consider the need for further EU anti-money laundering legislation "with respect to virtual currencies, empowerments to set-up and maintain a central database registering users' identities and wallet addresses accessible to FIUs, as well as self-declaration forms for the use of virtual currency users".

68 Under MiFID II, "financial instruments" include transferable securities (such as shares and bonds) and various derivative contracts. In so far as a crypto-asset falls under the Directive, the Commission has noted that "a full set of EU financial rules (including the Prospectus Regulation, the Transparency Directive (TD), the Market Abuse Regulation (MAR), the Short Selling Regulation (SSR), the Central Securities Depositories Regulation (CSDR) and the Settlement Finality Directive (SFD)) are likely to apply to their issuer and/or firms conducting activities related to them".

69 Depending on the circumstances, certain crypto-assets may also qualify as bank deposits or securitisations, in which case they could also fall under the relevant existing EU legal frameworks.

70 The initiative was announced in the Commission's Fintech Action Plan of March 2018. See the European Scrutiny Committee's Report of 2 May 2018 for more information.

increased efficiency in the market leading to lower costs, as well as more opportunities for businesses to raise capital via investment or utility tokens,[71] making illiquid assets such as real or intellectual property liquid by dividing them into sellable 'tokens', and opportunities for improved data analysis by both market researchers and regulators. The Commission has also warned of the need to address potential or actual risks arising from the trade in crypto-assets related to consumer protection,[72] market integrity and manipulation,[73] and financial stability.[74] In addition, in the absence of European regulation, it argues it may be more difficult for crypto-assets markets to be scaled up in Europe, and different legal approaches by different EU Member States could lead to regulatory arbitrage.[75]

3.15 Against this backdrop, the Commission launched a public consultation on an "EU regulatory framework for crypto-assets" in December 2019, at which point the EU Member States also expressed their support for "a framework that will harness the potential opportunities that crypto-assets may offer" while cognisant of the "risks that some present" (especially the potential emergence of "global stablecoins", such as Diem, that could gain widespread use across different jurisdictions while currently mostly not covered by existing regulatory constraints). A key driver behind the Commission's proposals is to "position […] Europe at the forefront of [DLT] innovation and uptake" and avoid EU financial sectors and EU investors from being put "at a competitive disadvantage" because "the regulatory challenges related to DLT are resolved in other [non-EU] jurisdictions".

3.16 As part of the Commission's wider Digital Finance Strategy, the implications of which for the UK we set out in our Report of 19 November 2020, this preparatory work resulted in a formal legislative proposal to establish an EU Regulation on "markets in crypto-assets" in September 2020. This was accompanied by supplementary proposals for a 'regulatory sandbox' to facilitate the development of market infrastructure using DLT, and a technical amendment to the Markets in Financial Instruments Directive to clarify the legal position of certain crypto-securities under existing EU financial services legislation.[76] These are

71 The European Commission has noted that "the issuance of utility tokens can represent a cheaper and less burdensome source of funding for start-ups and early-stage companies by streamlining the capital-raising process and not diluting the ownership capital of entrepreneurs. They also have the potential to connect the token issuer with a wide initial customer base. If they were properly regulated, crypto-assets could also widen investment opportunities for investors". See Impact Assessment SWD(2020) 380.

72 In particular, consumers are at risk of losses because of fraud (given that the crypto-asset sector is not comprehensively regulated at present), failings of service providers in the market which hold customers' assets, or simply because the (high) risks of investing in crypto-assets were not properly disclosed.

73 Regulators have already observed "market abuse-style" activities in the crypto-asset markets similar to those in traditional financial markets, including false signals about the supply and demand for crypto-assets and distorted price formation and a lack of conflict-of-interest rules for trading platforms. DLT presents several new challenges in this respect, including the novelty and complexity of the technologies used as well as the low liquidity, price volatility and concentration issues.

74 For example, in its FinTech Action Plan of March 2018, the Commission said it would undertake an "assessment of the suitability of the current EU regulatory framework with regard to […] crypto-assets", with a view to making sure that "EU firms, investors and consumers can take advantage of this technical innovation within a fair and transparent framework" while ensuring that any potential risks to "financial stability, market integrity, investor and consumer protection, personal data protection and money laundering and terrorist financing-related risks" would be "appropriately addressed".

75 France, Germany and Malta have already put in place national regimes that regulate certain aspects of crypto-assets. Other Member States could also consider legislating on crypto-assets and related activities, notably Italy.

76 The international Financial Stability Board (FSB) is currently developing high-level principles for the regulation of crypto-assets, which the Commission says "will be taken into account in the EU framework". The standards are due to be completed by the end of 2021.

now being considered by the European Parliament and by the EU Member States in the Council of Ministers, which must both approve the draft rules before they can become European law.[77] We discuss all three proposals in turn below.

The proposal for an EU Regulation on Markets in Crypto-Assets (MiCAR)

3.17 The European Commission's proposal for a "Regulation on Markets in Crypto-Assets" (MiCAR) in the EU aims to "boost innovation" through the use of Distributed Ledger Technology in financial services "while preserving financial stability and protecting investors from risks". More specifically, the purpose of the proposed Regulation is to create a new regulatory framework applicable to the issuance of, and trade in, crypto-assets where not already covered by existing EU financial services legislation (see also paragraphs 33 to 37 below).[78]

3.18 The new European rules for crypto-assets currently unregulated under EU law, the Commission argues, "would provide legal clarity for users, issuers and service providers alike", and—it hopes—improve market confidence in those assets, allowing this market to grow and in doing so create "opportunities in terms of innovative digital services [and] alternative payment instruments". The Commission also sees the use of crypto-assets as a potentially significant new source of funding for EU companies, especially start-ups, by providing a clearer route to raise capital by means of "Initial Coin Offerings" and "Securities Tokens Offerings", where crypto-assets are sold to investors in return for a share in the business or a right to access a particular good or service.

3.19 To support these developments while mitigating the risks to investors and the wider financial system, the draft legislation would create various new regulatory requirements and processes for specific types of crypto-assets and services associated with them.[79] Once applicable, these would supersede any relevant domestic rules in place in individual EU Member States.

Regulation of stablecoins

3.20 The exact regulatory approach proposed by the Commission differs depending on the type of asset or service, with the most stringent standards reserved for stablecoins. Under Titles III and IV of the draft Regulation, stablecoins are singled out because they could "raise specific challenges in terms of financial stability, monetary policy transmission or monetary sovereignty" due to the "the potential large customer base […], their potential

77 The draft legislation is now being considered by national experts, and by the European Parliament's Economic & Monetary Affairs Committee. As such, the final EU statutory framework for DLT and crypto-assets could still differ significantly from the text presented by the Commission in September 2020.

78 The European Commission considered, and discarded, the option of creating a new category of financial instrument for crypto-assets under MiFID, because there was "limited support" from the EU's national regulators for such an approach. Reasons given were that "the creation of a new category would create confusion and regulatory arbitrage between existing categories" (namely where crypto-assets could already be considered a "financial instrument" without a new category), and bring "all crypto-assets that are currently unregulated under MiFID", which would lead to "cumbersome requirements [and] could drive crypto-asset projects away from the EU". See also Annex 5 of the Commission Impact Assessment.

79 The chosen approach would not address any risks related to peer-to-peer transactions in crypto-assets, but the Commission notes that individuals "expressly renounce the safeguards provided by transacting through a trusted intermediary"; any market integrity issues "are not dissimilar to those encountered in traditional securities markets, when participants engage in some over-the-counter (OTC) transactions". (i.e. outside regulated 'trading venues'); actual use of peer-to-peer remains very limited; and even these transactions would be recorded in the relevant ledger, offering traceability.

high market capitalisation, […] the potential high number of transactions, the potential interconnectedness with the financial system or the potential cross-border use of such crypto-assets".

3.21 Stablecoins are divided into two categories to in the Regulation: "asset-referenced tokens" and "e-money tokens", with the primary difference being the nature of the external asset in reference to which its value is measured.[80] For both types of stablecoins, the draft rules would in principle require an issuer to obtain authorisation—a licence—from the domestic financial regulator of an EU Member State to offer their product to EU-based customers.[81] For asset-referenced tokens, a specific new regulatory regime to that effect would be created. Issuers of e-money tokens would be included explicitly in the scope of the EU's existing E-Money Directive, with certain additional obligations to reflect the unique nature of DLT-based assets. Banks licensed in the EU would be automatically entitled to issue stablecoins, without needing specific authorisation to that effect.

3.22 The right to issue stablecoins within the EU would be dependent on continued adherence with detailed criteria set out in the Regulation. In particular, MiCAR would establish specific conduct and organisational rules for issuers of these types of crypto-assets, for example relating to prudential "own funds" and reserve assets (for asset-referenced tokens), and to the redeemability of e-money tokens in return for the fiat currency to which it is pegged.[82] In addition, issuers would be required to publish a "white paper"—essentially an investment prospectus—with details about the stablecoin, including the financial risks associated with purchasing them. These documents could form the basis for a claim for damages by buyers if the information it contains is "not complete, fair or clear or […] is misleading". It would also be unlawful to offer interest on holdings of stablecoins anywhere in the EU, to "ensure that [such] tokens are mainly used as a means of exchange and not as a store of value".

3.23 The Regulation would empower the European Banking Authority (EBA) to formally designate certain stablecoins as "significant", based for example on an assessment of their customer base, the value of transactions conducted, or the size of the reserve assets backing a stablecoin. Issuers of crypto-assets considered "significant"—which might include a "global stablecoin" like Diem—would be subject to additional regulatory obligations, including for example a remuneration policy for staff that does not encourage excessive risk-taking, a liquidity policy to ensure redemption requests can be met, and a requirement

80 E-money tokens under the Regulations are stablecoins whose value is purported to be stable by reference to a single fiat currency, whereas asset-referenced tokens reference the "value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets".

81 Under certain conditions, companies could offer stablecoins and cryptocurrencies to customers within the EU without needing prior authorisation from a regulator, namely where the assets are offered for sale only to "qualified investors" (principally financial services firms, but also private investors who accept they have sufficient "expertise, experience and knowledge" of the market to waive the investor protection rules set out in the Regulation). The concept of a "qualified investor" is defined by reference to the Prospectus Regulation and the Markets in Financial Instruments Directive.

82 The Regulation states that redemption of an e-money token must happen "in cash or by credit transfer", which appears to rule out redemption in another cryptocurrency. The draft Regulation also contains provisions on the orderly wind-down of cryptocurrency and stablecoin issuers, as well as on the proposed acquisition of stablecoin issuers by another company. The latter would need to be assessed in advance by a domestic regulator to ensure that the issuer will remain "able to comply" with the rules set out in the Regulation.

to ensure interoperability with other DLT systems. In addition, they would be subject to centralised supervision by the EBA, as part of which any "significant" stablecoin issuer would also have to pay supervisory fees to the Authority.[83]

Regulation of crypto-assets other than stablecoins

3.24 For issuers of crypto-assets other than stablecoins, like utility tokens and investment tokens that are not within the scope of existing EU financial services legislation (see below), the Commission has proposed a more light-touch regime (Title II MiCAR).

3.25 Issuers of such assets would not need a prior licence to operate in the EU, or be incorporated there. They *would* however have to publish a "white paper" with information for prospective buyers or investors.[84] The Regulation would also establish certain high-level principles for these issuers, such as an obligation to "communicate with the holders of crypto-assets in a fair, clear and not misleading manner", and give their customers a statutory two-week period to 'return' their purchase and obtain a full refund.[85]

Crypto-asset services providers

3.26 Title V of MiCAR sets out a new regulatory framework for "crypto-asset service providers", namely companies that facilitate the buying and selling of crypto-assets (such as trading platforms and brokers) within the EU. This is, in essence, a condensed version of the Market in Financial Instruments Directive (MiFID) as it applies to 'traditional' investment services and stock exchanges.

3.27 Similar to the proposed approach to issuers of stablecoins, the Regulation would require crypto-services providers to obtain authorisation from the financial regulator in an EU Member State before they could operate within the European Union.[86] To be licensed, they would need to be incorporated within the EU and comply with various high-level regulatory principles, relating for example to safekeeping of clients' assets, transparency of fees charged to customers, and prudential capital. Specific obligations would also apply to particular services like the operation of trading platforms, offering financial advice, or execution of orders in the market for crypto-assets on behalf of a third party.

Cross-cutting provisions

3.28 The draft Regulation as proposed by the Commission contains several cross-cutting provisions. Notably, on the basis of the envisaged harmonisation of conduct, prudential

83 The Commission estimates these fees will amount to approximately €2.2 million in 2022, rising to €4 million by 2027.

84 The requirements for crypto-assets other than crypto-currencies and stablecoins is subject to certain exceptions, notably where the crypto-assets are offered for free. However, the Commission has proposed that this condition would not be met where "purchasers are required to provide or to undertake to provide personal data to the issuer in exchange for those crypto-assets or where the issuer of those crypto-assets receives from the prospective holders of those crypto-assets any third party fees, commissions, monetary benefits or non-monetary benefits in exchange for those crypto-assets".

85 For utility tokens, which can be used by start-ups to raise capital for the commercialisation of a new good or service, the draft legislation also envisages that the public offer for a "service that is not yet in operation" would be limited to a year.

86 Banks and investment firms with existing licences under the relevant EU legislation governing their sectors, and that want to provide crypto-asset services, would be exempt from the requirement to seek a separate authorisation for those activities. Similarly, banks that want to issue stablecoins would not need to seek separate authorisation to do so.

and organisational standards for both stablecoin issuers and services providers, the Regulation would also create a so-called “passport”. This is a legal mechanism allowing a company authorised under MiCAR in any one EU Member State to operate throughout the entire European Union on the basis of that domestic licence.

3.29 Stablecoin issuers and crypto-asset service providers based outside the EU could not obtain a licence under the Regulation as drafted and, consequently, would be acting against the law if they continued operating within the EU under this new regulatory framework. Issuers of crypto-assets covered by the ‘light-touch’ regime (see paragraphs 18 and 19) would not need to be incorporated into the EU. The MiCAR proposal does not contain an “equivalence” regime present in certain other pieces of EU financial legislation to grant preferential market access to providers of specific financial services from non-EU countries like the UK.

3.30 The proposed Regulation is also silent on the practicalities of how the restrictions on non-EU companies offering crypto-assets or related services to EU-based customers will be enforced, given that this market by its very nature is conducted entirely digitally. Similarly, the decentralised—or “distributed”—nature of crypto-assets means that many of the ‘nodes’ of a particular token—which play an important role in maintaining the ledger—could be located outside the EU, even if the issuer is technically EU-based. It may therefore be difficult in practice to police how such products or services are marketed to investors via the internet from outside the European Union without significant resources for financial regulators.[87]

3.31 The Regulation also sets out in some detail the “market abuse” rules that should apply to the buying and selling of crypto-assets in the EU, such as insider dealing and market manipulation. These are included because the EU’s existing legislation in this area, broadly speaking, applies to financial instruments using a definition that does not cover many types of crypto-assets. MiCAR contains a list of specific powers that Member States would have to grant their domestic financial regulators to ensure effective implementation of the new rules, such as the right to suspend trading in a particular crypto-asset or to publicise the failings of a particular crypto-asset issuer or service provider to comply with the Regulation. The Commission proposal does not cover the tax implications of buying or selling crypto-assets, which remains for individual EU countries to address.[88]

87 The impact assessment accompanying the Commission proposals states that, while the chosen approach would reduce “the risks of regulatory arbitrage inside the EU level, there is a risk that a mandatory regime in the EU would increase the risk of regulatory arbitrage with third countries […] in particular if the EU regime is perceived as imposing more stringent rules than elsewhere. However, the risk of regulatory arbitrage should be weighed against the risks to consumer protection and market integrity posed by crypto-assets”.

88 There is, first, considerable uncertainty about the legal status of crypto-assets, and therefore the tax treatment of transactions that involve them. In addition, use of crypto-assets can make it easier to avoid paying tax because they are largely unregulated and the systems used are not part of the traditional financial services sector.

3.32 The Commission recognises that some disruption to the market is likely to occur when the Regulation takes effect in due course. It has therefore proposed a limited transitional regime for issuers of non-stablecoin crypto-assets[89] and service providers.[90] However, the new regulatory regime as proposed for stablecoins and cryptocurrencies would apply in full from the date the Regulation takes effect, giving them approximately 18 months to apply for a licence after the legislation is approved by the European Parliament and Council of Ministers.[91]

The pilot project on experimental DLT-based market infrastructure

3.33 The second element of the package of European Commission proposals on Distributed Ledger Technology in the financial sector would establish an experimental regulatory environment for the testing of market infrastructure based on such technology.

3.34 The proposal is aimed specifically at the development of such infrastructure for trading in crypto-assets that qualify as "financial instruments". These are, essentially, transferable crypto-securities ("security tokens") that have characteristics of shares or bonds and thus fall under the EU's Markets in Financial Instruments Directive.[92] The assessment of whether a particular crypto-asset should be classified as a financial instrument under MiFID is often not straightforward (see paragraphs 33 to 37). However, where such a determination is made by a regulator in the EU, this means that the market for such a token within its jurisdiction would be subject to the provisions of that Directive as implemented in that country and, in principle, also to a range of other existing EU rules on investment prospectuses, market abuse, short-selling and trading transparency.

3.35 For some elements of the existing regulatory approach to the lifecycle of trades in financial instruments, Distributed Ledger Technology is widely seen as offering the potential for "significant efficiencies" (in particular the trading and settlement process).[93] However, the current legal framework for these infrastructures under EU law was not drafted with crypto-assets or DLT in mind. This means, first, that EU rules effectively prevent the roll-out of DLT infrastructure in the market for crypto-securities, for example because the rules are too onerous for the small-scale operations needed to service market at

89 Crypto-assets which are not stablecoins, and which had been on the market within the EU prior to the date when MiCAR will begin to apply, will not need to conform to the Regulation. This means, for example, that issuers of existing utility tokens will not need to issue a white paper or establish a 'cooling off' period for buyers, unless already required to do so in the national jurisdiction where they operate.

90 Existing stablecoin issuers and providers of crypto-asset services that will fall within the scope of MiCAR will be able to continue operating for 18 months after the Regulation takes effect before they need to have obtained a licence on the basis of the new rules. Individual EU countries may also choose to apply unspecified "simplified procedures" when assessing applications for authorisation from existing services providers during that period.

91 The Regulation as proposed would enter into force 20 days after its publication in the EU's Official Journal (which itself follows shortly after formal adoption of the legislation by the European Parliament and the Council of Ministers), and begin applying from 18 months from that date.

92 This proposal should therefore be seen in conjunction with the third element of the package, namely the draft amendment to the Markets in Financial Instruments Directive to clarify the legal position of security tokens under EU law. This is discussed further elsewhere in this chapter.

93 The Commission cites, for example, the possibility of allowing for "near real-time settlement" of trades (mitigating counterparty risk during the process), reducing potential cyber-risks by using a decentralised infrastructure (instead of a centralised one, which represents a single point of failure), and decreasing costs for market participants (by decreasing the need for collateral, reducing the scope for errors, and automating certain back-office processes through the use of "smart contracts" software).

its current size,[94] or because they simply do not allow for the merger of different stages of a transaction lifecycle with the use of decentralised systems and 'smart contracts' software.[95] Secondly, use of this technology to provide market infrastructures creates several new risks—notably in relation to the operation of smart contracts—which are not catered for under current EU rules at all.[96]

3.36 As such, the Commission notes, EU regulation effectively "prevents widespread testing of DLT capabilities to determine to what extent the technology is mature enough to replace or complete existing market infrastructures" for crypto-securities. The second element of its DLT package is a draft Regulation that would create an EU-wide statutory framework for a pilot project to give "existing investment firms and market players the possibility to test the use of DLT on a larger scale, by offering trading and settlement services at the same time" for such securities (rather than, as is required under EU law at present, having those functions performed by separate entities).[97]

3.37 In effect, the proposal aims to create a regulatory "sandbox", first pioneered for innovation in financial services by the UK's Financial Conduct Authority in 2015. It would allow companies in the EU to apply to their national financial regulator for temporary derogations from the existing rules to allow them—and regulators—to "gain experience on the use of distributed ledger technology in market infrastructures" without any major risks to "investor protection, market integrity and financial stability". In particular, firms could seek a licence to operate Multilateral Trading Facilities (MTFs) and Securities Settlement Systems (SSSs)—for the trading of security tokens[98] and the settlement of such trades respectively—using DLT technology. In practice, this would mean that they would be exempted from certain regulatory requirements under EU law—enumerated exhaustively in the Commission proposal—that apply to their 'traditional' counterparts. For example, a DLT MTF would be allowed to "perform some activities normally performed" by a Central Securities Depository (CSD).[99]

94 The European Commission has acknowledged, for example, that "strict MiFID rules on trading venues would not be proportionate enough to enable small-scale DLT-based trading of crypto-assets comparable to shares and bonds".

95 Although DLT could facilitate the merger of certain financial market activities (trading, clearing, settlement and custody), EU rules governing the infrastructure that currently carries out those operations follows the traditional lifecycle of a transaction and requires specific, individual entities "on grounds of stability, security and competition". For example, the Central Securities Depositories Regulation (CSDR) requires the existing of a specific, central entity to act as the depository operating the securities settlement system.

96 In particular, current EU rules do not impose any "reliability and safety requirements" on the 'smart contracts' software that is crucial to the operation of Distributed Ledger Technology. Consequently, it is also silent with respect to any resulting liability issues if the software is defective or does not accurately reflect the intent of the parties to a transactions, especially since a trade carried out by the software, once validated in the ledger, is recorded immutably.

97 The Commission gives the example of securities issued via DLT, where the ledger also serves as the recordkeeping mechanism that makes separate Central Securities Depositories superfluous. Similarly, with respect to Central Counterparties, it notes that "the majority of their functions could be performed by smart contracts on the DLT, including cash calls on network participants in times of need".

98 Security tokens, called "DLT transferable securities" in the proposal, would be defined as 'transferable securities' within the meaning of Article 4(1)(44) (a) and (b) of MiFID II "that are issued, recorded, transferred and stored using a DLT".

99 Namely initially the "recording of DLT transferable securities, the settlement of transactions in DLT transferable securities and the safekeeping of DLT transferable securities". The draft Regulation notes that this would avoid "imposing a functionally redundant overlay to the trade lifecycle of a financial instrument handled by DLT market infrastructures".

3.38 However, the ability to use this 'sandbox' would be limited only to specific financial market participants already licensed to carry out the 'traditional', non-DLT counterpart of such services (such as investment firms for MTFs, and Central Securities Depositories for SSS). To avoid risks to financial stability, the proposal also includes quantitative restrictions on the security tokens that could be handled by these systems, for example by only allowing crypto-shares for companies with a market capitalisation of less than €200 million.[100] Similarly, the draft legislation contains a requirement that operators of DLT market infrastructures must have in place that "IT […] arrangements related to the use of their DLT" that "ensure continued transparency, availability, reliability and security of their services and activities, including the reliability of smart contracts used".

3.39 As with the MiCAR proposal, a permission to operate DLT market infrastructure within the 'sandbox' granted in any one EU country would allow the licensee to carry out such operations throughout the entire European Union (the "passport").

Clarification of crypto-assets as "financial instruments" under EU law

3.40 The third and final element of the Commission's DLT package relates to the current difficulties in assessing whether crypto-assets, especially investment tokens, qualify as "financial instruments" under the EU's Markets in Financial Instruments Directive (MiFID).[101]

3.41 MiFID is the centrepiece of the EU's existing suite of securities legislation, governing the provision of investment services by banks and investment firms, as well as the operation of traditional stock exchanges and alternative trading venues. Where a financial instrument falls within its scope, this also triggers the application of a "broader set of rules" to financial instruments and firms that provide investment services and activities in relation to them.[102] Determining whether a token falls within the scope of the Directive is important, because crypto-assets which fall outside the scope of MiFID would in principle be subject to the draft new regulatory regime for crypto-assets under MiCAR.[103] By contrast, those that are within its scope are subject to the wide range of regulatory obligations set out in MiFID (as well as being potentially eligible to be traded under the proposed "sandbox" arrangements described above).

3.42 Therefore, when regulators assess whether existing EU financial regulation applies to crypto-assets, one fundamental question is "to determine whether the crypto-asset at stake is a 'financial instrument' under MiFID". However, the actual classification of a crypto-asset as a financial instrument under the Directive "requires a complex case-by-case analysis". These difficulties arise, firstly, because the market itself is complex, as "the range of crypto-assets is diverse and many of them have hybrid features" of more than one type (i.e. a product could combine the characteristics of both an investment and a utility token). Secondly, MiFID itself gives individual EU countries some discretion in

100 Similarly, the Commission has proposed to cap the total market value of DLT transferable securities recorded by a CSD operating a DLT securities settlement system, or by a DLT MTF where allowed to record such DLT transferable securities, at €2.5 billion.

101 Directive 2014/65/EU, as amended.

102 The Commission notes that these include "the Prospectus Regulation, the Transparency Directive (TD), the Market Abuse Regulation (MAR), the Short Selling Regulation (SSR), the Central Securities Depositories Regulation (CSDR) and the Settlement Finality Directive (SFD))".

103 Certain other tokens are also not covered by the draft MiCAR Regulation if they are already governed by EU financial services law, in particular where they qualify as bank deposits, structured deposits or securitisations.

interpreting what actually constitutes a "financial instrument" and, in particular, the sub-set of such instruments termed "transferable securities" (which most closely correlate to the features of investment tokens).[104] As such, there are different interpretations across the EU of these concepts, making it possible that the same crypto-asset could be considered as a financial instrument in one Member State, but not in another.[105]

3.43 Moreover, even where a crypto-asset is deemed to constitute a "financial instrument" under MiFID, there is a lack of clarity on how the existing regulatory framework for financial services applies to such assets and services related to them because it was not designed with crypto-assets in mind. This means regulators "face challenges in interpreting and applying the various requirements under EU law",[106] resulting in a lack of legal clarity, an opportunity for regulatory arbitrage for entities in the crypto-assets sector, and no effective EU "Single Market" for these products.

3.44 To partially address this situation, the Commission as part of its DLT package has proposed an amendment to MiFID.[107] This would clarify the legal treatment of "security tokens", by expanding the definition of a 'financial instrument' under the Directive to "clarify beyond any legal doubt that such instruments can be issued on a Distributed Ledger Technology".[108] While this may remove legal ambiguity about whether security tokens *can* be financial instruments under MiFID, the Commission has promised to issue further guidance in 2021 to help national regulators determine in which cases they actually *should* be considered as such.

The possible implications of the proposals for the UK

3.45 The UK of course left the European Union on 31 January 2020 and will withdraw from the EU's Single Market at the end of the post-Brexit transitional period on 31 December. The proposed new EU regulatory regime for crypto-assets will not take effect until 2022 at the very earliest, depending on progress made in the legislative deliberations in Brussels. This also means the substance of the new rules could differ substantially from the original Commission proposals, for example with respect to the role of the European Banking Authority or the scope of the regulatory sandbox for DLT market infrastructures.

3.46 Given the time needed for discussion and formal adoption of the proposals, it is clear that these new rules will not apply directly to or in the UK under the post-Brexit transition period. This point is also emphasised by the Economic Secretary to the Treasury (John Glen MP) in an Explanatory Memorandum submitted to us on 8 October 2020, setting out the Government's position on the putative EU approach. This states that "the

104 A 2019 survey by the European Securities & Markets Authority (ESMA) found that, while a majority of national financial regulators in the EU have "no specific criteria in their national legislation to identify transferable securities in addition to those set out under MiFID", the other 12 did.

105 ESMA concluded in its "Report on 'Licensing of FinTech Business models'" in 2019 that "almost all [national regulators] indicated having difficulty in determining when crypto-assets are regulated and when they are not".

106 ESMA, "Advice on 'Initial Coin Offerings and Crypto-Assets'", January 2019.

107 The proposal would also complement the "sandbox" regime for DLT-based market infrastructures (see above) by allowing for temporary exemptions for such entities from certain obligations on Multilateral Trading Facilities (MTFs) under MiFID. The remainder of the proposal relates to a separate initiative on digital resilience in the EU's financial sector, which is outside the scope of this Report and therefore not covered here.

108 The amendment itself is textually straightforward: add "including such instruments issued by means of distributed ledger technology" to the definition of "financial instrument" in point 15 of Article 4(1) of MiFID.

European Commission's proposals will have no direct implications for UK-based firms or consumers insofar as their UK business is concerned" and "there is no direct link to the UK's future relationship with the EU" in financial services.

3.47 However, by potentially legislating for access to the entire EU market, the Commission proposals could still have implications for the UK and its own crypto-asset industry.[109] Issuers and service providers based outside the EU could not obtain a licence under the MiCAR Regulation as drafted and, consequently, would be acting against the law if were to operate within the EU under this new regulatory framework. The proposal does not contain an "equivalence" regime present in certain other pieces of EU financial legislation to grant preferential market access to providers of specific financial services from non-EU countries. As a result, the Minister notes, "UK-based crypto-asset issuers and UK-based crypto-asset service providers with business interests in the EU may be impacted by Commission proposals to introduce location requirements for the majority of [such] firms". To continue serving EU-based customers, the Minister notes, UK firms "may need to establish a legal entity or registered office in an EU member state".

3.48 As a corollary, it is also relevant that one of the key drivers behind the Commission's proposals is to mitigate the risk that by leaving the regulation of crypto-assets to be "resolved in other third country jurisdictions", this could "put both the EU financial sectors and EU investors, at a competitive disadvantage". Conversely, the extent to which the EU is successful in addressing that risk by "positioning Europe at the forefront of [DLT] innovation and uptake" could also impact on the growth of this sector in other jurisdictions, like the UK.[110] Similarly, should the market for stablecoins grow sufficiently large to have a potential impact on financial stability, the EU's approach to mitigating any such risks could also impact on the UK given the interdependencies that exist between the UK and EU's financial systems.

3.49 It may also be interesting to compare the UK's eventual proposals for its approach to the regulation of the crypto-assets market, on which the Government intends to consult "before the end of 2020", to the arrangements put forward by the European Commission. In particular, interested parties may wish to assess to what extent the two are compatible, or would require companies in the market for DLT tokens to observe different regulatory—and potentially mutually exclusive—standards if they wanted to operate in both the EU and the UK.[111]

Conclusions and action

3.50 In light of the novelty of the Commission proposals in seeking to regulate the market for crypto-assets in the EU, and its potential longer-term implications for competitiveness of that sector in the UK as well as wider financial stability considerations linked to the use stablecoins, we consider these developments to be of political importance. It is, however, too early to judge the likelihood that the proposals will facilitate growth in the EU

109 Out of 198 responses to the Commission consultation on the EU's regulatory approach to crypto-assets in December 2019, 21 were by organisations or individuals in the UK.

110 The impact assessment accompanying the draft MiCAR Regulation also argues that "with a fully harmonised regime, the EU could lead by example, given the lack of comprehensive regulation on crypto-assets in third countries".

111 As a first step, the Financial Conduct Authority recently consulted on a measure "to bring certain cryptoassets into scope of financial promotions regulation".

market for crypto-assets, and therefore their indirect impact on the UK, not least because legislative deliberations between the European Parliament and the Council of Ministers on the final legal texts is only in its initial stages.

The Committee believes further developments in the legislative process in Brussels are likely to merit continued scrutiny in due course. In the meantime, we draw the Commission proposal to the attention of the Science and Technology Committee and the Treasury Committee, the latter in light of its inquiry into the "future of financial services".

4 Cross-border police cooperation: Ireland's participation in the Schengen Information System[112]

This Council Implementing Decision is politically important because it:

- initiates the process for Ireland to take part in the Schengen Information System ("SIS II")—an EU database supporting cross-border police cooperation—at the same time as the UK is leaving SIS II; and
- may be relevant in mitigating any loss in current operational capabilities to tackle cross-border crime on the island of Ireland as the new customs arrangements and regulatory requirements under the Protocol on Ireland/ Northern Ireland bed in.

Action

- Draw to the attention of the Northern Ireland Affairs Committee (in the context of their inquiry on Cross-border co-operation on policing, security and criminal justice after Brexit), the Home Affairs Committee and the Justice Committee.

Overview

4.1 The so-called Schengen "*acquis*"—the body of rules requiring EU countries to remove systematic checks and controls at their internal borders—was brought within the framework of the EU Treaties and became part of the EU law in May 1999. As Ireland and the UK had not signed up to the original Schengen agreements,[113] the EU Treaty incorporating the Schengen rules recognised that they would not apply in either country but also gave each the option of requesting to take part in some or all of the rules if they wished to do so. The UK and Ireland both submitted requests to take part in the police cooperation elements of the Schengen Information System, an EU database used to support cross-border police cooperation and external border security. Their requests were agreed in principle by the Council, subject to each country meeting a set of detailed legal and technical requirements, including on data protection.[114]

4.2 The Schengen Information System ("SIS II"—the second-generation system) became operational in the UK in April 2015. Since then, it has developed into an important tool for law enforcement authorities in the UK, providing real-time access via the Police National Computer to data ("alerts") on criminal suspects, missing persons, vehicles

112 Council Implementing Decision on the putting into effect of the provisions of the Schengen acquis on data protection and on the provisional putting into effect of certain provisions of the Schengen acquis in Ireland; Council number 12281/20 and 11319/20; Commission number—; Legal base Article 4 of Council Decision 2002/192/EC concerning Ireland's request to take part in some of the provisions of the Schengen acquis; Home Office; Devolved Administrations consulted; ESC number 41638.

113 See the 1990 Schengen Convention implementing the 1985 Schengen Agreement.

114 See Council Decision 2000/365/EC approving the UK's request for partial participation in the Schengen acquis and Council Decision 2002/192/EC approving Ireland's request.

and property needed for a police investigation.[115] According to the EU's IT Agency ("eu-LISA"), 91 million alerts were stored in SIS II at the end of 2019 and in the same year police forces in the UK carried out around 480 million automated searches, making the UK the third heaviest user of SIS II.[116] UK participation (and access to SIS II data) will come to an end when the post-exit transition period expires on 31 December 2020. While the Government considers that there are no legal or technical barriers to continued UK participation as a third (non-EU country), the EU has made clear that access to SIS II is contingent on applying the wider Schengen rule book and EU free movement rules—the Government has ruled out both. Instead, it intends to use Interpol channels to exchange information and to make them "as effective as possible".[117]

4.3 At the same time as the UK leaves SIS II, Ireland will for the first time be establishing its own connection to SIS II. The Council Implementing Decision (adopted on 18 November 2020) begins the process for Ireland to connect to SIS II (on 1 January 2021), receive SIS II alerts (from 4 January 2020) and become a fully operational participant in the police cooperation component of SIS II from 15 March 2021. Initially, the operation of SIS II in Ireland will be on a provisional basis (and can be reversed). It will only be made final (by means of a further Council Implementing Decision) following a process of evaluation establishing that Ireland complies fully with all the requirements necessary to ensure the proper functioning of SIS II. The entire process should be completed by the end of 2022.

4.4 In his Explanatory Memorandum of 3 December 2020, the Security Minister (Rt Hon. James Brokenshire MP) simply "takes note" of the Council Implementing Decision, observing that "having SIS II at the border will provide Ireland with real-time alerts on people accused or convicted of crimes in other EU countries". He adds that the Council Implementing Decision "does not make any specific references to the UK or the UK's use of the Schengen Information System".

Our assessment

4.5 The timing of the Council Implementing Decision is significant. It sets in motion a process for Ireland to participate in SIS II which mirrors a reverse process in the UK. The Government recognises that the UK's exit from SIS II at the end of 2020 will result in a mutual loss of capability both for the UK and the EU and, for that reason, is seeking to develop other channels for sharing information.[118] Police leaders in the UK have indicated that losing access to SIS II will have "a major operational impact" because the information it provides has become an integral part of policing systems across the EU.[119] It will take time to find alternative means of cooperation that are equally effective. Meanwhile, the impact of new customs arrangements and regulatory requirements under the Protocol on Ireland/Northern Ireland on cross-border criminality on the island of Ireland (and the wider ripple effects for the UK as a whole) remains uncertain.

115 See evidence submitted on 5 November 2020 by the National Crime Agency to the Home Affairs Committee. See also the evidence submitted by the National Police Chiefs' Council on 11 November 2020.

116 See the March 2020 publication by eu-LISA (the EU Agency for the Operational Management of Large-Scale IT Systems in the Area of Freedom, Security and Justice) on SIS II—2019 Statistics.

117 See the letter of 17 November 2020 from the Security Minister (Rt Hon. James Brokenshire MP) to the Chair of the European Scrutiny Committee.

118 See the letter of 17 November 2020 from the Security Minister (Rt Hon. James Brokenshire MP) to the Chair of the European Scrutiny Committee.

119 See the evidence submitted by the National Police Chiefs' Council to the Home Affairs Committee on 11 November 2020.

4.6 Given this broader context, it is disappointing that the Minister does not consider whether Ireland's participation in SIS II may have implications for the UK, particularly in underpinning cooperation between the Police Service of Northern Ireland and the Irish Garda in tackling cross-border crime after transition. While there will be legal constraints on the information that Ireland will be able to share with the UK, there may nonetheless be some operational benefits for the UK when it loses access to SIS II, just as there may have been for Ireland when the UK had access to SIS II.[120]

Action

4.7 Draw the Council Implementing Decision to the attention of the Northern Ireland Affairs Committee to inform its inquiry on Cross-border co-operation on policing, security and criminal justice after Brexit. Also draw to the attention of the Home Affairs Committee and the Justice Committee.

120 Article 65 of Regulation (EU) 2018/1862 on the establishment, operation and use of the Schengen Information System (SIS) in the field of police cooperation and judicial cooperation in criminal matters provides: "Data processed in SIS and the related supplementary information exchanged pursuant to this Regulation shall not be transferred or made available to third countries or to international organisations." The Regulation is expected to take effect and apply towards the end of 2021 or in 2022.

5 Documents not considered to be legally and/or politically important

Department for Business, Energy and Industrial Strategy

(41660) — COM(20) 696	Communication from the Commission to the European Parliament and the Council New Consumer Agenda Strengthening consumer resilience for sustainable recovery.
(41699) — COM(20) 740	Report from the Commission to the European Parliament and the Council Report on the functioning of the European carbon market.

Department for International Trade

(41656) 12914/20 + ADD 1 COM(20) 705	Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Implementation of EU Trade Agreements 1 January 2019—31 December 2019.

Foreign, Commonwealth and Development Office

(41608) — —	Council Implementing Regulation (EU) 2020/1536 of 22 October 2020 of implementing Regulation (EU) 2019/796 concerning restrictive measures against cyber-attacks threatening the Union or its Member States.
(41609) — —	Council Decision (CFSP) 2020/1537 of 22 October 2020 amending Decision (CFSP) 2019/797 concerning restrictive measures against cyber-attacks threatening the Union or its Member States.
(41611) — —	Council Decision (CFSP) 2020/1516 of 19 October 2020 amending Decision (CFSP) 2016/1693 concerning restrictive measures against ISIL (Da'esh) and Al-Qaeda and persons, groups, undertakings and entities associated with them.
(41646) — —	Council Implementing Regulation (EU) 2020/1649 of 6 November 2020 implementing Regulation (EU) No 36/2012 concerning restrictive measures in view of the situation in Syria.

(41647) — —	Council Implementing Decision (CFSP) 2020/1651 of 6 November 2020 implementing Decision 2013/255/CFSP concerning restrictive measures against Syria.
(41676) 13120/20 SWD(20) 400	Commission Staff Working Document Delivering on the UN's Sustainable Development Goals—A comprehensive approach.
(41683) — JOIN(20) 17	Joint Communication to the European Parliament and the Council EU Gender Action Plan (Gap) III—An Ambitious Agenda for Gender Equality and Women's Empowerment in EU External Action.

HM Treasury

(40883) 13091/19 + ADDs 1–8 COM(19) 444	Report from the Commission to the European Parliament and the Council: 30th Annual Report on the Protection of the European Union's financial interests—Fight against fraud—2018.
(40983) 14814/19 + ADD 1 COM(19) 601	Report from the Commission to the European Parliament and the Council: Ninth report from the Commission on the operation of the inspection arrangements for traditional own resources (2016–2018) Article 6(3) of Council Regulation (EC, Euratom) No 608/2014 of 26 May 2014.

Home Office

(40915) 13396/19 + ADD 1 COM(19) 497	Communication from the Commission to the European Parliament and the Council on the verification of the full application of the Schengen acquis by Croatia.

Annex

Documents drawn to the attention of select committees:

(‘SNC’ indicates that scrutiny (of the document) is not completed’; ‘SC’ indicates that scrutiny of the document is completed)

Business, Energy and Industrial Strategy Committee: Evaluation of the EU State aid rulebook: possible implications for the UK [Evaluation (SC)]

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

Committee on the Future of the European Union: Privacy and Electronic Communications [Proposed Regulation (SNC)]; Evaluation of the EU State aid rulebook: possible implications for the UK [Evaluation (SC)]

Home Affairs Committee: Cross-border police cooperation: Ireland’s participation in the Schengen Information System [Council Implementing Decision (SC)]; Privacy and Electronic Communications [Proposed Regulation (SNC)]

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

Justice Committee: Cross-border police cooperation: Ireland’s participation in the Schengen Information System [Council Implementing Decision (SC)]; Privacy and Electronic Communications [Proposed Regulation (SNC)]

Northern Ireland Affairs Committee: Cross-border police cooperation: Ireland’s participation in the Schengen Information System [Council Implementing Decision (SC)]; Evaluation of the EU State aid rulebook: possible implications for the UK [Evaluation (SC)]

Science and Technology Committee: EU regulation of crypto-assets and Distributed Ledger Technology in financial services [(a), (b) Proposed Regulations, (c) Proposed Directive (SNC)]; Privacy and Electronic Communications [Proposed Regulation (SNC)]

Treasury Committee: EU regulation of crypto-assets and Distributed Ledger Technology in financial services [(a), (b) Proposed Regulations, (c) Proposed Directive (SNC)]; Evaluation of the EU State aid rulebook: possible implications for the UK [Evaluation (SC)]

Formal Minutes

Wednesday 16 December 2020

Members present:

Sir William Cash, in the Chair

Jon Cruddas	Mrs Andrea Jenkyns
Allan Dorans	Mr David Jones
Mr Richard Drax	Anne Marie Morris
Margaret Ferrier	Greg Smith

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 5 read and agreed to.

Resolved, That the Report be the Thirty-third Report of the Committee to the House.

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

[Adjourned till Wednesday 6 January at 1.45 p.m.

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)

Tahir Ali MP (*Labour, Birmingham, Hall Green*)

Jon Cruddas MP (*Labour, Dagenham and Rainham*)

Allan Dorans MP (*Scottish National Party, Ayr Carrick and Cumnock*)

Richard Drax MP (*Conservative, South Dorset*)

Margaret Ferrier MP (*Scottish National Party, Rutherglen and Hamilton West*)

Mr Marcus Fysh MP (*Conservative, Yeovil*)

Mrs Andrea Jenkyns MP (*Conservative, Morley and Outwood*)

Mr David Jones MP (*Conservative, Clwyd West*)

Stephen Kinnock MP (*Labour, Aberavon*)

Mr David Lammy MP (*Labour, Tottenham*)

Marco Longhi MP (*Conservative, Dudley North*)

Craig Mackinley MP (*Conservative, South Thanet*)

Ann Marie Morris MP (*Conservative, Newton Abbot*)

Charlotte Nichols MP (*Labour, Warrington North*)

Greg Smith MP (*Conservative, Buckingham*)