

A PRACTITIONER'S GUIDE TO BREXIT

exploring its consequences
and alternatives to EU membership

1.0	Introduction	03
2.0	Importance of the Single Market for financial and related professional services	04
3.0	Alternative EU scenarios	10
4.0	Withdrawal process from the EU	14
5.0	Access to the Single Market in Financial Services	16
6.0	The UK's post-Brexit trading arrangements with other countries	20
7.0	Background/ summary of existing TheCityUK EU work	22

TheCityUK

TheCityUK represents the UK-based financial and related professional services industry. We lobby on its behalf, producing evidence of its importance to the wider national economy. At home in the UK, in the EU and internationally, we seek to influence policy to drive competitiveness, creating jobs and lasting economic growth

Financial and related professional services are the UK's biggest exporting industry. We make a £67bn contribution to the balance of trade, helping to offset the trade in goods deficit. TheCityUK creates market access for its members through an extensive programme of work on trade and investment policy. To achieve this, we work closely with governments and the European Commission to represent member views and help deliver the best outcomes in international trade & investment negotiations. Allied to this, we have a country-focused programme to build relationships and to help open markets where our members see significant opportunities. We also have a strong focus on ways of influencing and delivering regulatory coherence through dialogue with regulators, governments & industry bodies internationally.

1.0 INTRODUCTION

A referendum on the UK's membership of the European Union will be held on 23 June. The options will be either to 'Remain' or 'Leave'.

TheCityUK knows from its our own research that the public want to hear from business leaders on this matter. While it is not our place to tell people how to vote, we have a role in explaining the consequences of the referendum outcomes and helping them to reach an informed decision. As an industry that employs nearly 2.2 million people across the country and contributes more tax than any other sector, financial and related professional services must and will play its role.

This is a practitioner's guide to Brexit – exploring its consequences and alternatives to EU membership. It is our latest contribution to the debate on the UK's EU membership and the importance of access to the Single Market. Whatever the effects of leaving the EU on the UK economy as a whole, our analysis shows that leaving the EU could risk damaging UK financial services through uncertainty, reduced market access and a loss of influence over the conditions of trade. The actual process of renegotiating access to the Single Market and negotiating simultaneous free trade agreements with other trade partners would be a resource and time-intensive exercise. These are some of the important practical questions that should be considered by businesses in their strategic and contingency planning, and taken note of more widely in the EU referendum debate.

2.0 IMPORTANCE OF THE SINGLE MARKET FOR FINANCIAL AND RELATED PROFESSIONAL SERVICES

The UK is the leading global financial centre and the financial heart of the European Union. Links between the UK and other Member States are fundamental to the prosperity of the whole region. Its pre-eminence as a global financial centre is underpinned by being a member of the EU. Access to the Single Market has been an important factor in strengthening its position over the last three decades.

For the UK economy, the structural importance of the financial and related professional services industry is a reflection of the UK's position as the world's leading exporter of these services. The industry accounts directly for 11.8% of UK GDP, employs nearly 2.2 million people and is the nation's largest tax paying sector – contributing £66bn in 2014/2015. As Europe's financial centre, London is a national asset, but the benefits of the industry spread beyond the capital and the South East. With two-thirds of its employees working outside London, the industry has helped to raise living standards by spreading high productivity and high value-added employment around the country in centres such as Edinburgh, Glasgow, Belfast, Cardiff, Manchester, Birmingham and Leeds. In turn, these centres strengthen and maintain the UK's international competitiveness.


The creation and development of the EU's Single Market over the last 20 years has reinforced London's long-established position as the world's leading international finance centre. Its pre-eminence, expertise and experience has helped in the framing of the EU's Single Market in financial services, particularly in wholesale markets and has meant that the UK has had considerable influence on the EU's regulatory approach, as well as a leading role in global regulatory discussions and developments.

At £72bn in 2014, the UK's financial and related professional services' trade surplus was larger than the combined surplus of all other net exporting industries in the UK. Despite the fact that the European Single Market in services has not yet been completed, the UK has reaped great benefit from its ability to access the Single Market, in particular through financial and other services' trade and investment. The EU is the most important destination for UK exports of financial services, generating a trade surplus for the UK of £18.5bn. The UK's trade surplus with the EU in financial services (and its simultaneous deficit in goods) could be notable features in influencing the attitudes of negotiators in any post-Brexit discussions, the outcome of which cannot be predicted.

2.2
MILLION



NEARLY 2.2 MILLION PEOPLE WORK ACROSS THE UK IN FINANCIAL AND RELATED PROFESSIONAL SERVICES. TWO-THIRDS ARE EMPLOYED OUTSIDE LONDON



11.8%

FINANCIAL AND RELATED PROFESSIONAL SERVICES CONTRIBUTED £190BN TO THE UK ECONOMY IN 2014. THIS REPRESENTED 11.8% OF UK ECONOMIC OUTPUT

EU membership has benefited the UK by creating the conditions to both expand UK exports and attract foreign direct investment (FDI), particularly in financial, business and other services. Through its membership of the EU, the UK serves as the gateway to a Single Market of 500 million people, the world's largest consumer market. Between 2004 and 2014, £581bn was invested into the UK by foreign businesses, putting it in a prime position as a leading country in attracting FDI. More than half of this total came from outside the EU, with access to the Single Market being a major motivator for investment decisions.

Currently, 250 foreign banks operate in London (more than in Paris, Frankfurt or New York) and over 200 foreign law firms have offices in London and across the UK. If these firms were to reconsider their location in the event of a possible Brexit, or relocate some of their staff or business, the potential impact on the UK economy could be considerable, reducing domestic employment and tax receipts and leading to a faltering of the UK's economy.

Of course, the UK is not just a leading international centre for banks and financial institutions. It is also the world's leading hub for the supply of a broad range of related professional services, such as legal, accountancy, advisory and maritime services.

The UK economy gains a range of benefits from the free movement of workers into and out of the UK, including a boost to consumption and, indirectly, to tax revenues and service-sector employment brought about by the migration of skilled personnel. Financial and related professional services firms get considerable benefit from the flexibility and freedom to attract and employ the brightest talent from across the EU and the world and to foster careers and strengthen internal networks by being able to deploy staff in the rest of the EU and further overseas. Taken together, this delivers a major competitive advantage for UK-based firms. In the event of a Brexit, with the UK setting its own immigration policy, a UK government could maintain the free flow of professionals with relatively few curbs, or it could introduce greater restrictions. This could pose a risk to high-value businesses of a clampdown on their international access to highly-skilled workers, affecting the overall competitiveness of the UK and the country's current role as a destination for talent and enterprise.



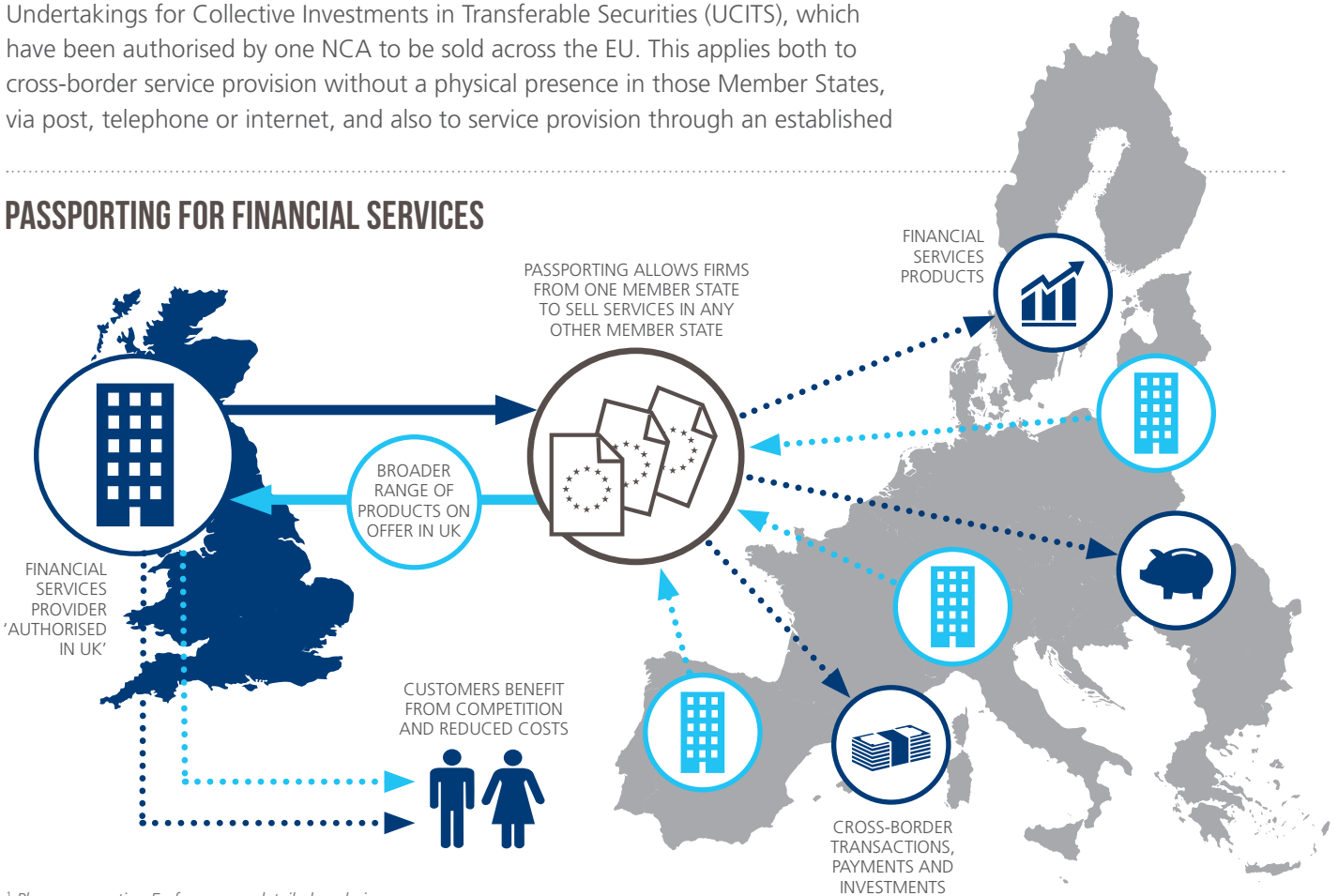
£72BN

AT £72BN IN 2014, THE UK'S FINANCIAL AND RELATED PROFESSIONAL SERVICES' TRADE SURPLUS WAS LARGER THAN THE COMBINED SURPLUS OF ALL OTHER NET EXPORTING INDUSTRIES IN THE UK

The special importance of passporting for financial services

Passporting is a major benefit of EU membership as it enables UK businesses to benefit from a range of passports allowing them to do business with or sell services to continental clients. It offers those businesses authorised in the UK, of whatever national origin, the ability to offer services remotely in the 27 other EU Member States and to some degree in the three European Economic Area (EEA) Member States¹; and businesses from other Member States to offer services on the same terms in the UK. It has been crucial in maintaining the strength of London as the EU's financial centre. These passports enable service providers which are authorised in one EU Member State to offer services in the rest of the EU without seeking separate authorisation from other Member States' National Competent Authorities (NCAs). It also allows for a range of products, most notably Undertakings for Collective Investments in Transferable Securities (UCITS), which have been authorised by one NCA to be sold across the EU. This applies both to cross-border service provision without a physical presence in those Member States, via post, telephone or internet, and also to service provision through an established

PASSPORTING FOR FINANCIAL SERVICES



¹ Please see section 5a for a more detailed analysis.

branch office in them. These arrangements have encouraged cross-border business by financial services firms, and are also important for the broader economy because they enable businesses to operate internationally by facilitating cross-border transactions, payments and investments. UK businesses and consumers have both benefitted from utilising services that are passported from other EU Member States to the UK.

In more specific terms, passporting inter alia means that a UK firm can be appointed to run a European fund without having to incur the costs of setting up a local office; a UK investment manager can be appointed to run an investment mandate for continental institutions; or continental corporations can make use of UK market infrastructure to access global markets. All of this means that businesses are able to operate in the ecosystem of financial services providers and supporting sectors described above. The passporting regime is beneficial for consumers too, as it expands the range of products to which they have access and broadens markets by fostering competition and reducing costs.

If UK-based firms were to lose the benefit of the passporting regime, they would be unable to automatically supply services in the EU from the UK on a cross-border basis. UK-based firms would also lose protection against discrimination as the passports guarantee incoming firms will be able to do business on the same terms as local ones. There is no such protection for third country firms that are allowed to operate in a Member State's market. This means that UK-based firms (including subsidiaries of non-EU businesses which have set up offices in the UK to access the Single Market) would face regulatory and prudential barriers which can impact the viability of their businesses. Additionally, existing branches in other EU Member States may need to become locally established subsidiaries to continue to provide services (with the associated capital implications) or cease operations.

EU-based firms would also need to apply for separate UK authorisation to do business in the UK either remotely or through a UK office. This would lead to an increase in the cost of doing business for UK and EU-based businesses. It would affect the competitiveness of the UK's regulatory and tax regimes. An analysis (below) of the existing arrangements between the EU and non-EU countries shows that no country outside the EU enjoys full passporting rights into the EU. If the UK were to leave the EU, an entirely new and bespoke arrangement would need to be established for the UK to preserve fully its current EU passporting rights. There would be no certainty of achieving this. In the event of such an agreement, the EU would expect 'equivalence' of standards from the UK. This implies that the UK would effectively still have to comply with EU regulatory standards and would thus have limited scope to set its own standards.

The UK as Europe's financial centre

The UK's position at the heart of Europe's financial markets, including euro-denominated markets, is dependent on the legal freedoms made available by Single Market legislation.

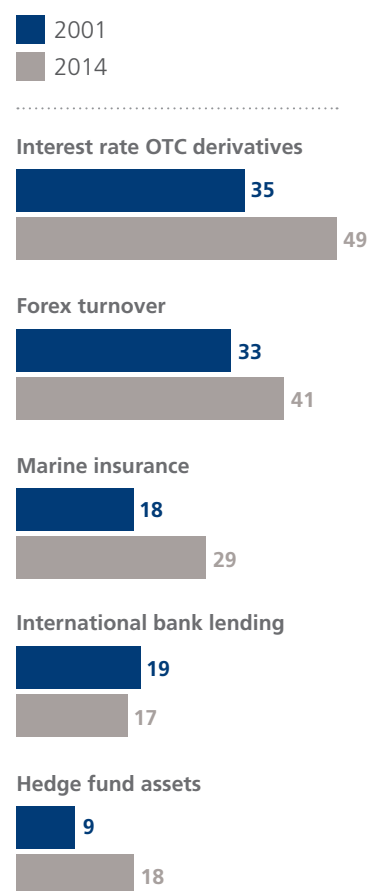
In the UK, the structure of the financial services landscape has changed substantially over the years, with market participants basing their location choice on economic, legal and regulatory factors. Before the start of the Single Market programme, London tended to be dominated by large British-owned banks and US and Japanese firms which were focused largely on business within the UK and outside Europe. Business in Europe remained spread across a number of centres with no real focus for financial activity.

The gradual introduction of the Single Market programme changed all this. Firms from other Member States were enabled by the new legal framework to establish branches freely in the UK, while firms incorporated in the UK enjoyed the same rights in the rest of the EU. At the same time, firms were gradually empowered to sell services across borders in the EU. This led to London becoming the de-facto financial centre for many EU Member States:

- Average daily turnover in the UK in euro-denominated over-the-counter (OTC) interest rate derivatives totalled \$928bn in April 2013, accounting for 69% of all such trading worldwide. Trading in the UK in euro denominated OTC interest rate derivatives increased six-fold over the past decade.
- Euro-denominated assets of UK-based banks totalled around £1.3 trillion at end of 2015. Approximately 40% of foreign currency denominated loans and deposits in the UK are in euros.
- The UK is a major location for the management of UCITS-compliant funds. London also accounts for around 90% of European prime brokerage.
- The London Market is the world's leading market for internationally traded insurance and reinsurance. Customers in EU countries account for around 17% of premium income of companies on the London Market and 16% of Lloyd's premium income.
- All major euro area banks have important branches in London, and UK banks are leading players in financial markets of the euro area. Out of 155 foreign banks authorised to take deposits through a branch in the UK, 75 are from the EU. EU banks in the UK hold over £1.1 trillion in assets or 17% of total bank assets in the UK. If the UK were not part of the EU, some of the activities of these banks would probably be diverted to other European financial centres or could disappear altogether as markets suffer decreased ability to intermediate financial transactions effectively.

UK share of global financial markets

% share



Source: Various sources; TheCityUK estimates

The UK has become an attractive destination for overseas companies from elsewhere in the EU operating in retail financial services, including Santander, NAB, Handelsbanken and Triodos in banking, and Allianz and Axa in insurance. There was also considerable growth in the presence of non-EU financial services firms, especially, but not uniquely, from the US, with half of all European headquarters of non-EU firms being based in the UK. While there were many reasons why these firms chose to base themselves in the UK, use the UK as gateway to the EU or set up branches, the fact that they no longer had to establish bases in individual Member States (with associated capital implications), but could service all their clients, cross-border, out of London played an important role for many. UK-headquartered firms now account for only a limited proportion of EU-related business done out of London and the City relies for its critical mass on the EU-, US-, Swiss- and Chinese-owned firms, along with others from the rest of the world that are located in the UK through UK subsidiaries. They too are able to buy and sell services freely across the EU and would find it legally more difficult, or in some instances impossible, if attempting to do so from their home countries.

When the Euro was created as a common currency and the UK did not join it, some had supposed that financial services providers would migrate to centres within the Eurozone. This did not happen, in large part because the Single Market meant that the Eurozone could continue to be serviced in Euro-denominated business cross-border from the UK. Since the introduction of the Euro, the UK's position in many global wholesale financial markets has at least been stable, and in some cases has strengthened. The UK's global share of foreign exchange turnover rose from 33% to 41%; interest rate OTC derivatives turnover rose from 35% to 49%; hedge fund assets doubled from 9% to 18%; and international insurance premiums edged up from 18% to 29%.

It is a mistake to suppose that the business of firms headquartered in the Eurozone is restricted to the Eurozone, given that a substantial proportion is carried on in the UK. The fact that so many Eurozone firms have substantial businesses in London means that a large part of the Eurozone financial system operates, in terms of both jurisdiction and physical location, in the UK through branches and subsidiaries. This also means that the EU Single Supervisory Mechanism (SSM), rather than the UK supervisory authorities such as the UK Prudential Regulatory Authority (PRA), is the home supervisor for all the banking business undertaken in London by Eurozone banks, a measure of the degree of deep integration of UK financial markets in the wider EU market.

If the UK left the EU, it could not be assumed that EU regulators would remain content for large EU financial services businesses to continue to maintain present levels of assets and business in London if UK markets were subject to a different regulatory regime. They could potentially adopt a more wary attitude to the UK as an offshore financial centre outside the EU.



**£1.1
TRILLION**

**EU BANKS IN THE
UK HOLD OVER
£1.1 TRILLION IN
ASSETS OR 17%
OF TOTAL BANK
ASSETS IN THE UK**

3.0 ALTERNATIVE EU SCENARIOS

TheCityUK has previously examined alternative scenarios to full EU membership in *A Legal Assessment of the UK's relationship with the EU*, an analysis undertaken by Clifford Chance. None of the scenarios that envisaged the UK leaving the EU and seeking to adopt the access arrangements currently available to other non-EU countries was deemed as attractive as current full EU membership. The report highlighted the significant risk which leaving the EU posed to the UK's future economic well-being and the ability of business to grow and compete in world markets. Given the size of the UK's economy, however, a bespoke UK scenario of a completely different form might be feasible, possibly including a combination of elements from the different scenarios set out in the table below, plus other features.

The following table is not an exhaustive list of the options that have been discussed to date, excluding for example the option of reinvigorating the Commonwealth² which would face substantial challenges.

	Access to the Single Market	Formal voting rights on EU legislation	Ability to set own trade policy	Contribution to EU budget	Free movement of people	Passporting
EEA + EFTA (Norway)	Yes	No, but informal consultation on new legislation	Yes	Yes	Yes	Partial
Bilateral agreements + EFTA (Switzerland)	Partial	No	Yes	Partial	Yes	No
Customs Union (Turkey)	Access to the EU internal market for goods	No	Partial	No	No	No
FTA	No	No	Yes	No	No	No
Bespoke UK solution³	?*	?*	?*	?*	?*	?*

*Depending on the outcome of the negotiations.

² The Commonwealth option has been debated by some as an alternative to EU membership. But it is worth noting that it has been some 50 years since the Commonwealth last functioned seriously as a trading system. Some of the Commonwealth's 53 members are EU Member States (Malta and Cyprus) while others (Africa and the Caribbean) are covered by EU association agreements (ACP). Others again are or are intended to be the subject of specific EU Free Trade Agreements (FTAs) (Canada, Singapore, India, Australia, New Zealand). Given this degree of variability it is hard to envisage a post-Brexit UK preferential trading arrangement on a single set of terms with all these very diverse countries, especially as most of them are focusing on their own regional arrangements.

³ A bespoke solution might perhaps include a combination of elements from the different scenarios set out in the table above, plus other features such as a more advanced form of passporting rights than available under the EFTA and EEA options; but its precise content would be subject to negotiation with the rest of the EU and is inevitably speculative.

Access to the Single Market: This paper has already set out why the UK broadly benefits from the unique access to the Single Market that comes from being an EU Member State. But the Single Market is more than a traditional free trade area focusing simply on the removal of tariff barriers and trade quotas. It also encompasses the freedom of movement for goods, services, people and capital and aims to eliminate non-tariff barriers, even though (particularly for some services) these objectives remain a work in progress.

The Single Market is characterised by regulatory harmonisation, backed by case law adjudicated in the Court of Justice of the European Union (CJEU), although market outcomes vary reflecting the approach to harmonisation and the type and degree of regulation required to achieve Treaty objectives. While the Single Market in Financial Services is relatively well-advanced, the Single Market in related professional services is much less integrated and many national barriers remain.

Formal voting rights on and influence over EU legislation:

Whilst it is true that on some occasions decisions taken by the Council of Ministers by Qualified Majority Voting (QMV) have seen the UK being outvoted (for example on remuneration or short-selling) the UK has a proven track record of influencing EU decisions by being at the negotiating table. The UK has played an important role in setting and shaping the EU's previous and current financial services priorities, such as the development of the Single Market, especially in Financial Services, Capital Markets Union (CMU) and the current EU initiative calling for evidence on the cumulative impact of financial regulation – a function which, if outside the EU, it could find far harder to fulfil and on which it at best could expect to be consulted informally.

If the UK left the EU it would still be materially affected by EU legislation as the EU normally requires non-EU Member States to be subject to requirements equivalent to those in the EU if they wish to access the Single Market. Inability to influence those requirements would be a serious disadvantage, especially as these often determine the extent to which the benefits from open markets can be harnessed. Given the degree to which the UK benefits from access to EU financial services markets, it would be damaging if the EU, absent UK influence, embarked on more protectionist or isolationist courses impeding international transactions. There are major changes planned for the EU that will affect the UK either directly or indirectly, including proposals made in the Five Presidents' Report, the draft proposal on a European Deposit Insurance Scheme (EDIS) and completing Europe's Economic and Monetary Union (EMU).

THE EU IS THE UK'S BIGGEST MARKET FOR EXPORTS OF FINANCIAL SERVICES, GENERATING A TRADE SURPLUS OF £19.9BILLION – OVER A THIRD OF THE UK'S TRADE SURPLUS IN FINANCIAL SERVICES IN 2013.



Ability to set own trade policy: In the case of Brexit, unless or until alternative arrangements were to be found, the UK would likely revert to having non-preferential trade relations with markets round the world, based simply on the general rules in the WTO agreements. In principle, the WTO arrangements apply as much to financial services as to any other sector; but in practice the existence of the 'prudential carve-out' enshrined in the Annex to the General Agreement on Trade in Services (GATS) gives WTO members a wide degree of freedom to discriminate against foreign financial services suppliers for justified prudential reasons. This limits the extent to which the WTO rules guarantee non-discriminatory market access and national treatment for financial services suppliers. Nor would the UK any longer be entitled to retain the preferential benefits of some 50 trade and association agreements that it had enjoyed as a member of the EU, although the UK's network of bilateral investment treaties are still and would remain in force.

Contribution to the EU budget: Access to the Single Market in Services, even if only partial as in the case of Switzerland, would likely require the UK to make contributions to the EU budget. In the case of Norway for instance, the analysis in *A Legal Assessment of the UK's relationship with the EU* has shown that the Norwegian per capita contribution to the EU is about €100 per year, compared to the current UK per capita contribution of €180 per year. Switzerland follows a schedule of payments to specific programmes and to new members. In 2014 the Swiss Federation reported that it contributed approximately €439 million to the EU budget.

Free movement of workers: Free movement of workers within the EU enables businesses in the UK and any other Member States to draw from a deeper pool of talent when there are particular skills shortages. Similarly, free movement gives UK citizens the right to work in the rest of the EU, subject to meeting professional qualification requirements, offering greater career development opportunities. While migration is politically contentious, free movement of workers gives the UK as a whole a range of benefits and enables greater dynamism within the economy.

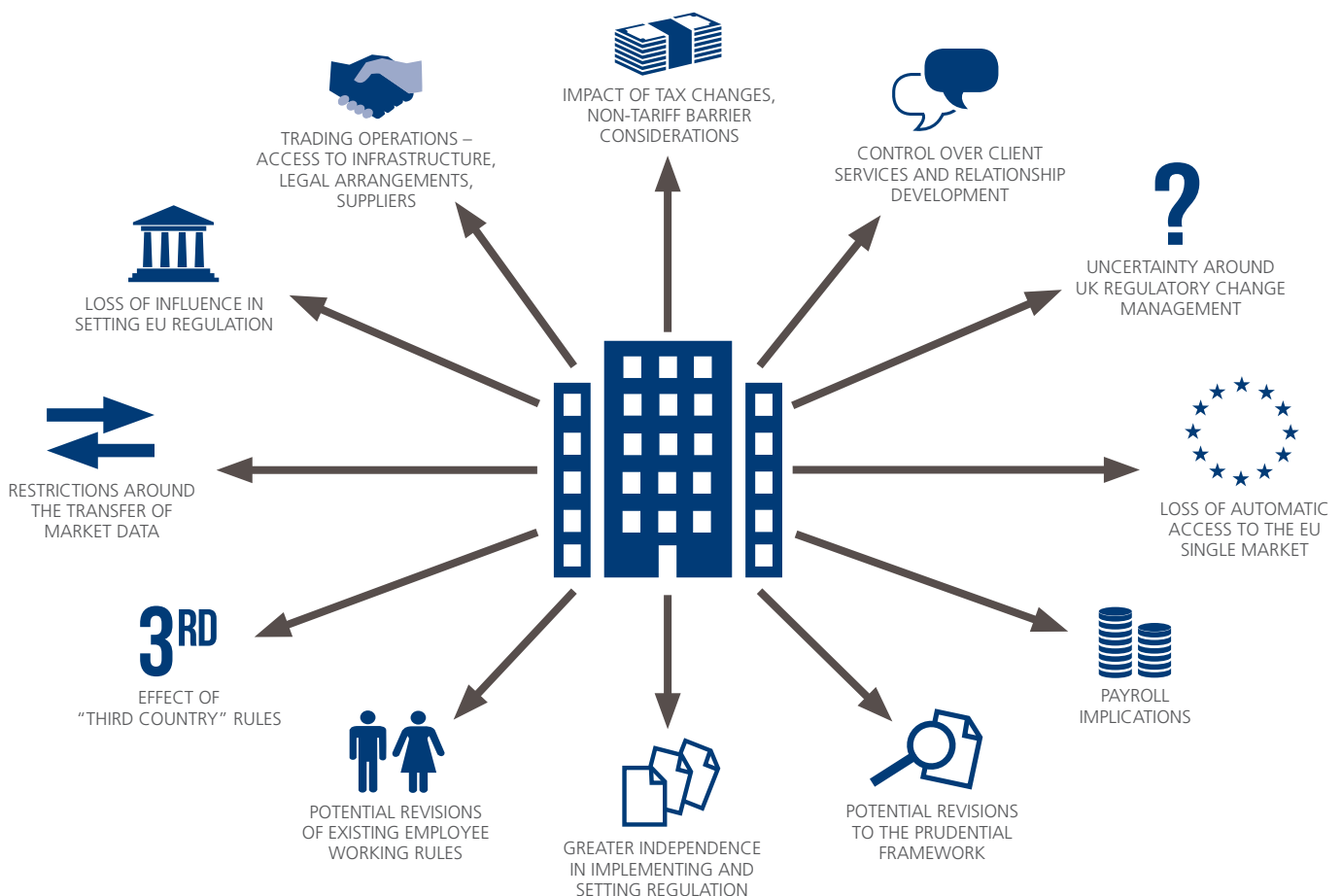
Passporting: The importance of passporting and how it has helped UK businesses meet growing EU demand for financial services over the past two decades has already been noted. None of the current alternatives to EU membership, including EEA membership, would give UK-based firms full passporting rights. Nor would they necessarily allow EU financial services businesses currently operating in the UK to remain doing so without renegotiating their terms of access to the UK market. Their home country authorities would be able to impose restrictions on their firms' activities.

Scenario planning

A potential Brexit raises many practical questions that should be considered by firms in their necessary strategic and contingency planning and more widely in the EU referendum debate.

In considering these scenarios, firms should analyse how they will be impacted by key factors, such as the ones set out above. Other important issues include: their legal entities, which jurisdiction governs different contracts, staff mobility, third country regimes, the implications of a potential new data protection regime, tax considerations and how to deal with the regulatory uncertainty following a vote to leave the EU.

WHAT SHOULD FIRMS CONSIDER IN THEIR BREXIT CONTINGENCY PLANNING?



4.0 WITHDRAWAL PROCESS FROM THE EU

If the UK voted for Brexit in the EU membership referendum, it is most likely that this would trigger the process set out in Art 50 Treaty on the European Union (TEU)⁴.

ART 50 TEU

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.
3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.
4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it.

A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.

5. If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure referred to in Article 49.

⁴ Other options, such as simply repealing the European Communities Act, have also been discussed elsewhere but will not be considered in this paper. It has also been suggested that the negotiation process could start prior to invoking Art 50 TEU or without invoking Art 50 at all. It is far from clear whether the Council would agree to this approach.

Firstly, the UK would invoke this article and initiate a procedure according to which a Member State notifies the European Council of its intention to leave the European Union. The notification would then trigger the start the negotiation of a withdrawal agreement between the UK and the EU. This would automatically result in the UK ceasing to be a Member State of the EU in two years from the date of notification, unless the UK and the remaining Member States (voting unanimously) agree to extend that time limit. The withdrawal agreement would have to be approved by the Council, acting by qualified majority, after obtaining the consent of the European Parliament.

Secondly, the UK would then have to negotiate its future new relationship with the EU. This could be any of the scenarios set out above, or a different, bespoke solution. Art 50 (2) asks the Union to 'negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for it future relationship with the Union', suggesting that the negotiation of the withdrawal agreement and the agreement setting out the new terms of the relationship between the UK and the EU would be closely linked.

However, it is not clear how the arrangements envisaged in Art 50 TEU would work in practice, not least because there is no precedent. Although Article 50 foresees a withdrawal agreement that would also take into account the departing state's future relationship with the EU, it does not oblige the EU to negotiate a future relationship agreement. It also does not specify whether there would be a single agreement covering both and the framework for the future relationship or two separate agreements. Furthermore, the withdrawal agreement and any future relationship agreement might well be subject to different voting arrangements: the withdrawal agreement under Article 50 would be approved by a qualified majority in the Council, while a future relationship agreement might well require unanimity among EU Member States and ratification by all of them. While the UK and the EU might envisage a single policy package covering both withdrawal and the future relationship, different parts of the package could be subject to different rules, under a Treaty Article that has never been used before.

Thirdly, on the UK's departure, the EU would also have to amend its own treaties to reflect the UK's leaving the Union. This would include reallocating voting rights among the remaining Member States and revising budgetary contributions.

5.0 ACCESS TO THE SINGLE MARKET IN FINANCIAL SERVICES

This section considers the implications for access to the Single Market in Financial Services of three distinct existing scenarios that would be more likely to be considered if the UK had to renegotiate its relationship with the EU after a Brexit vote. Access to the Single Market by financial services providers does of course not just depend on financial services legislation which is discussed in this section; data protection and other initiatives currently being discussed as part of the Digital Single Market strategy being important examples in this context. This section only considers options that are of most relevance from the perspective of financial and related professional services and does not address scenarios such as a customs union, which would not cover services. The most relevant scenarios are: (a) EEA membership, (b) a series of bilateral agreements under EFTA membership and (c) a new generation FTA.

a) EEA (Norway)

The EEA establishes an internal market between the EU's 28 Member States and Iceland, Lichtenstein and Norway. If the UK left the EU but wished to benefit from the arrangements set out under the current EEA agreement, it would have to negotiate membership of the European Free Trade Association (EFTA) first. In doing so, the UK would have to negotiate with EFTA and with EEA members (all EU Member States are also EEA Member States) to join these organisations.

Detailed explanations of what EEA and EFTA membership entails have been given elsewhere⁵, including the potential difficulty of maintaining current UK opt-outs from certain pieces of legislation, such as that from Schengen open border arrangements that EFTA members have adopted and the UK would not want to join.

The EEA agreement theoretically provides full access to all areas of the Single Market, including passporting. Annex IX of the EEA Agreement covers financial services and the EFTA Working Group on Financial Services, which meets three times a year, is responsible for the legislation contained in this section.

EEA membership would mean that the UK would have to implement all Single Market rules in exchange for being able to access it. In principle, this also includes financial services. However the EEA agreement is currently incomplete in this respect, as the EU financial services legislation adopted since the establishment of the European Supervisory Authorities (ESAs) in 2010 (virtually the entirety of the EU's post-crisis financial regulatory measures) has yet to be incorporated into it.

⁵ Including in *A Legal Assessment of the UK's relationship with the EU*, April 2014.

Although there was political agreement in late 2014 that these measures should be incorporated in the EEA agreement, discussions are still ongoing. The EEA Joint Committee last reported on this in November 2015. Some of the constitutions of EFTA countries do not allow for the ESAs to make binding decisions on their markets, which creates an obstacle to progress. A solution proposed in October 2014 would allow for the ESAs to provide rulings that would then be enforced by a newly established EFTA surveillance authority that could implement the decisions without impinging on constitutional frameworks, but this has yet to be put into effect.

The upshot is that, for the time being, the EEA agreement does not cover post-crisis financial services legislation and does not allow for the use of passporting rights for services covered by any of those directives and regulations passed since then. Thus it does not allow for full access to the Single Market in Financial Services. This situation could change once such legislation was brought within the EEA agreement. However, given the volume of EU legislation, with more in prospect as the ESAs' powers and responsibilities are fully enshrined in EU law, it is difficult to foresee early change.

b) Bilateral agreements under EFTA membership (Switzerland)

If the UK chose to aim for a relationship similar to that between the EU and Switzerland, it would first need to negotiate EFTA membership. Access to the Single Market would then be negotiated through a range of individual bilateral agreements. The main difference between this option and the EEA scenario set out above is that the UK would not automatically have to transpose Single Market legislation into UK law and agreements would be negotiated on a case-by-case basis, including access to the Single Market in Financial Services. However, a large part of Single Market legislation derives from the Financial Stability Board (FSB) which the UK would normally be expected to implement in any case. It is worth noting that Switzerland currently does not have access to the Single Market in Financial Services despite the importance of financial services to the Swiss economy. Instead, Swiss firms have chosen to establish subsidiaries within the EU, and especially in the UK, in order to conduct business which needs access to the Single Market.

It should, however, be recognised that EU Member States, including the UK, have favoured a significant recasting of the EU-Switzerland arrangements. In

December 2014 the Council conclusions recorded that, 'The EU believes that an ambitious and comprehensive restructuring of the existing system of sectoral agreements would be beneficial to both the EU and Switzerland.'⁶ In this statement it also reiterated its view that the implementation of the outcome of the vote on 'Against Mass Migration' from February 2014 'threatens to undermine the core of EU-Switzerland relations'.

c) FTA

The UK could also seek to negotiate a single comprehensive economic and trade agreement (CETA) with the EU. A CETA could cover market access for goods (agriculture, foodstuffs and merchandise) and services (including financial and related professional services), with the precise scope being determined through negotiations between the UK and the EU. Judging by current and previous EU CETA negotiations, a CETA could take years to negotiate.

There is no fixed model for the content of an FTA. The EU-Canada CETA (perhaps the nearest example of a wide-ranging FTA between the EU and an advanced country) has about 40 Chapters covering:

- | | |
|--|---|
| 1. Preamble | 21. Government Procurement |
| 2. Initial Provisions and General Definitions | 22. Intellectual Property |
| 3. National Treatment and Market Access for Goods | 23. Trade and Sustainable Development |
| 4. Rules of Origin and Origin Procedures Protocol | 24. Trade and Labour |
| 5. Trade Remedies | 25. Trade and Environment |
| 6. Technical Barriers to Trade (Tbt) | 26. Regulatory Cooperation |
| 7. Sanitary and Phytosanitary Measures (SPS) | 27. Protocol on the Mutual Acceptance of the Results of Conformity Assessment |
| 8. Customs and Trade Facilitation | 28. Protocol on Good Manufacturing Practices for Pharmaceutical Products |
| 9. Subsidies | 29. Dialogues and Bilateral Cooperation on Specific Sectors |
| 10. Investment | 30. Administrative And Institutional Provisions |
| 11. Cross-Border Trade in Services | 31. Transparency |
| 12. Temporary Entry of Persons | 32. Exceptions |
| 13. Mutual Recognition of Professional Qualifications | 33. Dispute Settlement |
| 14. Domestic Regulation | 34. Final Provisions |
| 15. Financial Services | 35. Joint Declarations on specific territories, sectors and other matters |
| 16. International Maritime Transport Services | 36. Declarations on specific topics and administration |
| 17. Telecommunications | 37. Understandings on additional matters |
| 18. Electronic Commerce | |
| 19. Competition Policy | |
| 20. State Enterprises, Monopolies and Enterprises Granted Special Rights | |

⁶ Council of the European Union - Council conclusions on a homogeneous extended single market and EU relations with Non-EU Western European countries (December 2014)

- Chapter 12 (temporary entry of persons) includes appendices on EU Member States' lists of contact points; EU Member States' specific reservations and exceptions for key personnel and short-term business visitors; short term business visitors' activities; sectoral commitments on contractual services suppliers and independent professionals; and an Understanding on Spouses;
- Chapter 13 (Mutual Recognition of Professional Qualifications) includes an Annex with Guidelines for Agreements on The Mutual Recognition of Professional Qualifications; and
- Chapter 15 (Financial Services) includes Annexes on Cross-Border Trade in Financial Services; Guidance on the Prudential Carve-Out; and an Understanding on Dialogue in the Financial Services Sector. These need to be read with an additional chapter on Services and Investment, with annexes on reservations and on the specific coverage of both sides' financial services market access offers.

In such a wide-ranging negotiation with the EU, it is difficult to predict how UK-based financial and related professional services would fare. Any negotiations would be likely follow the 'nothing is agreed until everything is agreed' principle, meaning that financial and related professional services would need to take their place among all the other sectors to be negotiated, including agriculture. Past EU FTAs and CETAs with other countries have never covered right of establishment, passporting or cross-border services in any sense that would replicate the UK's current degree of full access to the EU Single Market.

While much depends on the parties involved and the negotiating objectives (and some steps could to some extent run concurrently) experience suggests that even if conditions were very favourable it would likely take a number of years before the UK-based financial and related professional services industry could be clear on the post-Brexit terms on which it would be doing business with the EU.

ANY SUCH AGREEMENT USUALLY INVOLVES A NUMBER OF STAGES:

1. Scoping study of feasibility of a potential agreement, its scope and objectives (two years, including consultations with domestic stakeholders and exploratory consultations with the other party);
2. Deploying staff resources to conduct the negotiations (at present the UK Government has very limited resources);
3. Actual negotiations (probably two years as an absolute minimum);
4. Identification of political 'landing zone' for agreement and initialling (at the end of negotiations);
5. 'Legal scrubbing' of agreement text, plus translation (into all EU languages) and signature (allow a year as a guiding principle for involvement of EU linguists/jurists);
6. A domestic political decision by both parties (in the case of the EU, a Council Decision, after consultation with the Parliament);
7. Ratification (probably by 27 Member States, if a UK-EU FTA, as it would almost certainly be a mixed agreement);
8. Preliminary pre-ratification partial implementation (e.g. of tariff changes); and
9. Post-ratification full implementation of remaining provisions (subject to any transitional periods).

6.0 THE UK'S POST-BREXIT TRADING ARRANGEMENTS WITH OTHER COUNTRIES

On leaving the EU, the UK would lose the preferential trading benefits established in over 50 EU trade agreements with over 50 non-EU countries or organisations (together covering some 35 per cent of world trade). The UK would also be excluded from the prospect of benefiting from agreements that have been concluded but are not yet in force (for example those with Canada and Singapore) or other agreements currently under negotiation (for example the Transatlantic Trade and Investment Partnership (TTIP) or free trade agreements with Australia, New Zealand, India or the ASEAN countries), together accounting for a further significant percentage of world trade. Instead, the UK would need to establish its own tariff, in readiness for trading with other countries on a WTO most-favoured-nation (MFN) basis, unless and until it could complete negotiations to reinstate preferential trade arrangements with trading partners.

Outside the EU, it would fall to the UK to seek fresh negotiations with these trading partners in the hope of regaining similar or better levels of preferential access. As with an FTA with the EU, it is difficult to predict the outcome. Any negotiation requires dedicated resources, and involves a balance of factors. In this case, the UK would be the party seeking replacements for lost preferential trade arrangements, through fresh agreements, at a moment dictated by the decision to leave the EU. Some trading partners might be reluctant to negotiate for a variety of reasons, ranging from prioritising their involvement in existing trade negotiations to extraneous political factors. They might also not feel obliged to give the UK as generous market access and national treatment as to the EU as a whole because the UK market was smaller.

There could however be compensating factors. Post-Brexit, the UK could more easily seek to focus its trade negotiations on sectors where it has inherent strengths, such as high value-added financial and related professional services. It could do so without EU-driven concessions to other Member States' national interests – for example France's regular insistence on a 'cultural exception' for audio-visual products and services. Furthermore, the UK's status as the world's fifth largest economy by GDP could well make it an attractive prospect for an up-to-date trade agreement, enhanced by the qualities that have enabled the UK to play a leading role as part of the EU: language, legal certainty, time zone and a positive approach to global trade and investment.

In a few cases, such as the Trade in Services Agreement (TiSA) negotiations, or the multilateral procedures for implementing the recent WTO Trade Facilitation Agreement, the UK, post-Brexit, could probably take quite rapid steps to become a fully integrated party. In most cases, however, a fresh UK trade negotiation would be likely to be accompanied by all the stages (from initial scoping to final

implementation) outlined above. Even in the most favourable circumstances, the scope and cost of negotiating a large number of trade agreements would be challenging. Any practical scope for doing so would depend not only on the UK's priorities and resources but also on the priorities and goodwill of the countries concerned. Some major trading partners (for example, the US) are already indicating that their interest is in regional arrangements, and that they regard it as more realistic to conduct trade relations with the UK as an EU member rather than outside the EU.

As matters now stand it is far from clear whether the UK would be equipped to undertake and manage its own full-service trade and investment policy, including conducting trade and investment negotiations. At present, the UK Government has very limited resources, in terms of experienced negotiators, given the transfer of competence in most but not all areas covered in trade and investment negotiations. True, this area of policy still needs ongoing Member State expert involvement as the Council agrees the EU's negotiating mandates and agrees, or not, the resultant trade agreements. But there would need to be significant re-skilling and upgrading of governmental capacity in the FCO and the Department for Business, Innovation and Skills if the UK were, after four decades, to return to doing so. TheCityUK's response to HM Treasury's consultation on Spending Round 2015 commented on the FCO budget and HMG's trade policy capacity:

'With the total budget for the FCO amounting to less than 0.2% of all public expenditure, we are concerned that the ring-fenced and non-discretionary elements mean that the real budget available to run the network amounts to only £700m, a figure that is just double the DFID aid budget to Ethiopia.' (Evidence, paragraph 6)

Moreover, the FCO budget is significantly smaller than the budget many comparable countries allocate to their equivalent institutions. For reference, the US State Department's budget is ten times larger than the FCO's; the French foreign ministry is 25% bigger than the FCO; and Germany spends 75% more than the UK on its equivalent of the FCO. The US Trade Representative's office has over 200 staff plus external advisers and advisory committees, not to mention the US Department of Commerce, the US International Trade Commission and US Customs, which have many trade-related responsibilities including the administration of the US tariff: the UK might need comparable resources if it were to aim at negotiating a large number of agreements in a short space of time. Financial regulators are typically also involved in such negotiations on both sides, so resources would be required there. This is not to say that UK negotiating capacity could not be expanded. But it would take time, have costs and would add to the uncertainty and business disruption that a prolonged series of fresh UK trade negotiations would entail.

7.0 BACKGROUND/ SUMMARY OF EXISTING THECITYUK EU WORK

TheCityUK has produced a series of publications on the importance of access to the Single Market for financial and related professional services, and the benefits of the UK's continued membership in a reformed EU. It has also suggested EU reform proposals for the benefit of all 28 Member States and their combined 500 million citizens. *A practitioners' guide to Brexit – exploring its consequences and alternative EU membership scenarios* draws on this evidence base which includes:

- *UK and the EU: a mutually beneficial relationship*: an overview of the ties between the financial and related professional services sectors in the UK and the rest of the EU.
- *TheCitySpeaks*: a study of the views of financial and related professional services on the EU and the UK's membership of the EU.
- *TheCityListens*: research into the public's views on the EU.
- TheCityUK and IRSG submissions to HMG's Balance of Competences Review: submissions were made to *Trade & Investment, Trade & Industry, Single Market Synopsis, Single Market: Financial Services and the Free Movement of Capital and Economic and Monetary Policy*.
- *A Legal Assessment of the UK's relationship with the EU*: research undertaken by Clifford Chance summarising the legal implications for the UK of different EU membership scenarios.
- *Analysing the case for EU membership – How does the economic evidence stack up?*: A study by Analytically Driven examining the economic benefits that accrue from Britain's membership of the EU.
- *EU Reform – A View from TheCityUK*: a paper setting out TheCityUK's high-level positioning on EU reform.
- *EU reform – detailed proposals for a more competitive Europe*: a report suggesting 25 detailed recommendations on how the EU could be made to work better for all 28 Member States.



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