

Brexit: what way forward less than 1 year from the Article 50 deadline

Progress made in the Brexit negotiations

Following the conclusion of the first round of Brexit talks in December 2017 with an agreement on the financial conditions of the departure of Britain from the EU, a second phase of negotiations was finalized in March 2018 with an agreement on a transition period between March 2019 and December 2020. Until the end of 2020 the UK will continue to participate in the Customs Union and the Single Market and will be subject to all existing Union regulatory, supervisory, budgetary and judicial instruments and structures. However the UK will be considered as a third country as of 30 March 2019 and thus will no longer be represented in EU institutions. Moreover, this transition deal is not fully guaranteed yet and depends on the successful conclusion of a withdrawal treaty in the next 12 months, a draft of which was published in March with several significant parts remaining to be negotiated¹.

The current situation remains challenging for industry players and their customers. The risk of a cliff edge situation is eliminated in the short term by the transition deal but still exists after 2020 if trade negotiations are not successful, since the current transition agreement does not include a sunset clause for its possible extension. Given the uncertainty of the final outcome of trade negotiations and the relatively tight timeframe, the Authorities are encouraging the industry to pursue their contingency planning, but many operational and legal issues remain to be addressed in order to ensure service continuity in all situations, including contract continuity and data transfer conditions.

EU-UK trade negotiation objectives and redlines

The negotiations on the future EU-UK trade and financial service relationships post-Brexit started in March 2018 and both sides have officially presented their initial objectives and positions. The UK and EU have both called for a continuation of a partnership as close as possible following Brexit, but have put forward strict “red lines” on which they do not wish to compromise.

The UK’s red lines include putting an end to the free movement of people, to significant budgetary contributions to the EU and to the jurisdiction of the ECJ and also recovering the ability to strike its own trade deals with foreign jurisdictions. Being a rule-taker from the EU is also ruled out.

On the EU side, red lines appear to be similarly restrictive. For the EU, the four freedoms underpinning the single market of goods, capital, services and people are indivisible and cherry-picking (opting for some rules and not others or participating on a sector-by-sector basis) should not be allowed in a Union based on the adherence of all its Member States to a common set of rules (EU acquis). The EU27 leaders noted at the March EU Council, that current UK positions “limit the depth of a future partnership” and earlier in March the EU Authorities mentioned that the only possible model in those conditions would be a free trade agreement (FTA) mainly focused on goods².

Possible scenarios for the future EU-UK trading relationships in financial services

Concerning financial services, the UK is calling for the continuation of close relations in the future between the UK and the EU based on a “bespoke” trade agreement based on regulatory and supervisory cooperation. The UK is advocating a regime allowing reciprocal access to EU and UK markets based on a joint agreement, through a structured UK-EU dialogue, on the regulatory requirements for cross-border trade in financial services, assessed according to their outcomes (i.e. potentially achieved through different regulatory requirements)³. This partnership would also involve supervisory cooperation to ensure the achievement of consistent outcomes over time and to monitor financial stability, as well as market integrity implications. Finally any divergences in terms of outcomes would need to be bilaterally managed in a predictable and proportionate way and an independent arbitration mechanism would be put in place to resolve potential disputes⁴.

EU negotiators have however so far rejected any bespoke deal on financial services on the grounds that such an approach would in effect result in “cherry picking” existing rights and obligations offered by the single market and that an ex ante recognition of equivalence goes beyond the usual scope of FTAs⁵. In the March 2018 EU guidelines for negotiation, proposals regarding trade in services are limited to allowing market access under host state rules, including regarding the right of establishment for providers, “to an extent consistent with the fact that the EU and UK will no longer share a common regulatory, supervisory, enforcement and judiciary framework”.

¹ Including the question of Ireland, the settlement of a future framework for trade and the dispute resolution mechanism that will be needed for future trade relations.

² A FTA covering all sectors and with zero tariffs on goods and also addressing services to a limited extent. Previously the EU negotiators have claimed that UK red lines, as they are stated at present, rule out all existing trade agreements negotiated by the EU Commission (i.e. EEA, Customs Union, a broad trade agreement such as the one with Switzerland...) except a free trade agreement (FTA) mostly focused on goods such as the Canada-Europe Trade Agreement (CETA).

³ While UK financial regulations will initially be equivalent to EU ones, the UK is not ready to commit to maintaining strict equivalence with EU rules over time, since it would put the country in a rule-taking position, which raises political concerns domestically.

⁴ If the ECJ is not an option for the UK after the end of the transition period, a specific process would need to be set up, provided that this is acceptable to the EU regarding the interpretation of EU law

⁵ FTAs usually have limited ambitions regarding services, when these are covered, focusing at best on a non-discriminatory approach to foreign firms wanting to establish themselves in a country compared to domestic firms, on the recognition of professional qualifications and the right for third country nationals to take temporary postings in the EU or on the definition of steps to further align regulations. The seamless provision of services on a cross-border basis (i.e. without a need for authorisation in the host country according to local rules) indeed poses specific challenges, since it requires an assessment of the equivalence of regulations by the host country, in order to ensure that cross-border services follow similar standards to domestic ones. This is particularly the case for financial services which involve risks and are highly regulated. Moreover trade in services often involves a recognition of qualifications and access of staff, at least temporarily.

Alternatives in the absence of an EU-UK agreement on financial services

If no agreement is found on financial services, EU-UK relations would have to rely on the existing third-country equivalence provisions of EU financial legislations, when these exist⁶. Current equivalence arrangements have however been repeatedly considered as insufficient for managing over the long term the type of relations that exist at present between the EU and the UK in the financial services sector. They indeed differ across EU regulations and do not cover all financial activities. They are also relatively uncertain since the EU can decide unilaterally to discontinue such arrangements at any time with a 30 day notice. In addition they are lengthy to put in place and cannot be defined ex ante since they require an in-depth equivalence assessment to be made and updated on a case-by-case basis.

In areas where third-country equivalence provisions are not available in EU legislation, there would be no real alternative for UK-based companies wanting to provide services in the EU post-Brexit than establishment in the EU and full compliance with EU rules, since the international General Agreement on Trade in Services (GATS) framework is very limited regarding services⁷.

A general improvement of EU equivalence arrangements could nevertheless be envisaged as a solution, given that most UK financial regulations should be equivalent to EU ones at the moment of Brexit, aiming for instance to make these arrangements more legally certain and predictable with more timely processes and possibly improving their coverage and consistency notably regarding wholesale financial services.

⁷ e.g. there are no market access provisions for third-country firms in particular in CRD IV/CRR (e.g. corporate lending), payments or in UCITS and these are limited to professional clients for MiFID and to reinsurance companies in Solvency II

⁸ Many observers consider that the GATS framework would be difficult to use in this context, given that it contains no specific approach to facilitate mutual recognition of regulations. There are on-going discussions to improve existing GATS rules for services (on-going talks among 23 WTO members on a Trade in Services Agreement (TiSA) to improve existing GATS rules for services) but these mainly focus on non-discriminatory establishment issues.