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Brexit

On 13 March 2017, the UK Parliament passed the European Union (Notification of Withdrawal) Bill which confirmed the results of the 23 June 2016 UK referendum. The bill received Royal Assent and became an Act of Parliament on 16 March 2017. Just under two weeks later, on 29 March 2017, Theresa May officially triggered the process for withdrawing the UK from the EU with a letter ('Article 50 letter') delivered to President Donald Tusk by UK envoy Tim Barrow. The next day, the UK government tabled a White Paper on the design and implementation of legislation (commonly referred to as the Great Repeal Bill) which will repeal the European Communities Act 1972 and, at the same time, convert the body of existing European law (the 'aquis') into UK law (where it is practical and appropriate to do so). In turn, on 31 March 2017 the European Council circulated draft guidelines to government ministers representing the 27 member states remaining in the EU ('EU27'). Once finalised and adopted on 29 April 2017, they will inform the EU27's approach to the UK/EU27 Brexit negotiations. The final week of March 2017 was undeniably historic as will be the two-year process the withdrawal letter triggered.

The prime minister's Article 50 letter confirms the objectives detailed in her 19 January 2017 Lancaster House speech, and reiterates that:

- The UK is leaving the EU, but not leaving Europe.
- Legal certainty and clarity is a priority.
- The UK will be seeking a comprehensive agreement governing the future terms of the UK/EU27 partnership, which takes in economic and security cooperation, in parallel with an agreement on withdrawal.
- If the UK leaves the EU without a partnership agreement, it would trade on the basis of World Trade Organization (WTO) rules (i.e. no deal is better for Britain than a bad deal).

Mrs May's Article 50 letter also suggests that the discussions between the UK and EU27 be guided by several key principles, the implications of which are:

- The UK is not seeking membership in the single market (which would also allow the UK to pursue the new trade deals as signalled in the Lancaster House speech).
- An early agreement on the rights of UK citizens residing in any of the EU27 member states, and the rights of citizens from EU27 member states residing in the UK.
- Implementation periods be included in the new arrangements, in the interests of avoiding cliff-edge effects.
- The need to avoid a return to a hard border between Ireland and Northern Ireland, that nothing is done to jeopardise the peace process in Northern Ireland, and that the Belfast Agreement should continue to be upheld.

Mrs May also stated that the UK will negotiate as one country and that when it comes to the repatriation of powers back to the UK, it is expected that the outcome of an internal (UK) consultation process would be a significant increase in the decision-making power of the devolved administrations in Scotland, Wales and Northern Ireland.

The draft guidelines circulated by the European Council on the framework that will define the EU27's negotiations with the UK are subject to revision before they are finalised and may yet be influenced by the 6 April 2017 European Parliament resolution on Brexit red lines. Nonetheless, the draft guidelines:

- Confirm that, on the date of withdrawal, the EU treaties will cease to apply to the UK and its overseas countries and territories associated with the Union, and to the territories for whose external relations the UK is responsible. However, in regard to Gibraltar, a caveat has been included that no agreement between the UK and the EU may apply to the territory of Gibraltar without an agreement between the UK and Spain. (Fabian Picardo, chief minister of Gibraltar, discussed this caveat in the second quarter of the 2 April Andrew Marr show, and Spain's foreign minister suggested it was only included to defend the interests of its citizens who live near, and work in, the territory).
- Make some provision for a phased approach to negotiations (rather than a parallel one) whereby the first phase would focus on an orderly withdrawal, and only once sufficient progress has been made would negotiations proceed to the second phase to arrive at an overall understanding on the framework for a future relationship.
- Suggest that the negotiations will seek to determine transitional arrangements and provide for bridges towards a foreseeable relationship.
- State that an agreement for an orderly withdrawal includes a single financial settlement (i.e. the 'divorce bill' for which estimates range from £20 billion to £60 billion).
- Suggest that, with regard to the relationship between the UK and the Republic of Ireland, 'flexible and imaginative solutions' to avoid a hard border be examined.

In this changing environment and where negotiations are likely to be volatile and characterised by unhelpful positioning – as perhaps foreshadowed by the discussion around Gibraltar and Spain's Foreign Minister's remarks that while Spain did not want to see Scotland leave the UK it would not necessarily veto a Scottish application for EU membership – **ADM will focus on**

conveying the facts as they become available, and identifying the documents that are often referred to in the press but are not always easy to locate.

We will be updating this Brexit information section with these facts together with our understanding of how key documents are structured, relate to each other and might inform the negotiations between the UK and the remaining 27 member states in the EU.

Each entry in our Brexit section is hyperlinked to the web-based resources we used to develop the entry. Currently we do not charge for the information provided, and hope readers find the materials helpful. If you would like to get in touch to discuss how we might help you with your Brexit strategy and plans, do please feel free to contact us.

We also remind readers that **commentary provided by ADM does not constitute legal advice.**

Our Brexit section is organised into the following subsections:

1. Key UK Players

2. Key EU Players

3. Article 50 – key facts

4. EU trade facts, WTO and other bilateral agreements

5. Other trade models

6. Financial services – evolving policy and advocacy from the UK

7. Financial services – passporting and equivalence

The discussion in each subsection includes hyperlinks to many of the source articles that provided a basis for the material presented. We have sought to use articles from an array of sources to reflect a spectrum of political opinion. However, as factual reports produced by governmental bodies can be presented in a biased fashion, further links are provided to aid readers who might be looking for more transparency and detail.

Brexit will inevitably introduce a whole new set of acronyms. The following is a list of those that are in general use:

EEA: European Economic Area (Iceland, Liechtenstein and Norway, plus the 28 EU member states)

EFTA: European Free Trade Area (Iceland, Liechtenstein, Norway and Switzerland)

EU: European Union (28 EU member states including the UK)

EU27: European Union (the 27 member states that will remain after the UK's departure)

TEU: Treaty on European Union

TFEU: Treaty on the Functioning of the European Union

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Key UK players

Theresa May: Mrs May became leader of the Conservative Party on 11 July 2016 and Prime Minister of the UK on 13 July 2016. She has set up a cabinet committee on Brexit which will function as the key decision-making body on the Brexit process for the UK (Politico and Financial Times). (Cabinet committees are set up and appointed by the prime minister and their decisions are binding on the government as a whole). A full list of the ministerial appointments made in July 2016 is available on the Cabinet Office's website. Further biographical information on Mrs May is available on the PM's constituency website.

Boris Johnson: On 13 July 2016, Boris Johnson, was appointed Foreign Secretary, and as Secretary of State for Foreign and Commonwealth affairs he has responsibility for the work of the Foreign & Commonwealth Office, with particular focus on: policy unit, honours, intelligence policy and cyber-security. There are a number of biographies of Boris Johnson, including a detailed one available on Wikipedia.

David Davis: On 13 July 2016, David Davis was appointed Secretary of State for Exiting the European Union. He has responsibility for the work of the Department for Exiting the European Union, including: policy work to support the UK's negotiations to leave the European Union and to establish the future relationship between the EU and the UK; working very closely with the UK's devolved administrations, Parliament, and a wide range of other interested parties on what the approach to those negotiations should be; conducting the negotiations in support of the prime minister including supporting bilateral discussions on EU exit with other European countries; and as head of exit negotiations, leading and coordinating cross-government work to seize the opportunities and ensure a smooth process of exit on the best possible terms. Further biographical information is available on David Davis's constituency website.

Liam Fox: On 13 July 2016, Liam Fox was appointed Secretary of State for International Trade and President of the Board of Trade. He has responsibility for the work of the Department for International Trade, including: developing, coordinating and delivering a new trade and investment policy to promote UK business across the globe; developing and negotiating free trade agreements and market access deals with non-EU countries; negotiating plurilateral trade deals (focused on specific sectors or products); providing operational support for exports; and facilitating inward and outward investment. Further biographical information is available on Liam Fox's constituency website.

Priti Patel: On 14 July 2016, Priti Patel was appointed Secretary of State for International Development. While Priti Patel is not one of the three ministers having a formal Brexit role, she sits on the Brexit cabinet committee and made it clear that the Department for International Development (DFID) will use its presence overseas to support British firms by making 'economic development' a priority of her department. However, as highlighted by Global Justice Now, the International Development Act (2002) enshrines in law the principle that aid money can only be spent on the reduction of poverty, so 'trade for aid' is unlawful unless the primary motivation is that of combating poverty. Further biographical information is available on Priti Patel's constituency website.

Hilary Benn: On 19 October 2016, Hilary Benn was elected as chair of the new Commons Select Committee on Exiting the European Union. The government has also committed to engage with Parliament on exiting the European Union, a question covered in the exchange of letters between Hilary Benn and David Davis (as published on the Select Committee's website).

Michael Gove: On 26 October 2016, Michael Gove was appointed to the new Commons Select Committee on Exiting the European Union. The appointment would appear to mark his rehabilitation following his actions in the aftermath of the referendum. There are a number of biographies of Michael Gove, including a detailed one available on Wikipedia.

Tim Barrow: On 4 January 2017, Tim Barrow was appointed as the UK's Permanent Resident to the EU (i.e. Ambassador to the EU) following the resignation of Ivan Rogers who wrote a controversial resignation letter that was leaked to the press.

Nicola Sturgeon: On 14 November 2014, Nicola Sturgeon became the leader of the Scottish Nationalist Party (SNP) and was sworn in as First Minister on 20 November 2014. In the weeks that followed the outcome of the UK referendum on Brexit, and with an eye on the possibility of holding a second referendum on Scotland's independence from the rest of the UK, Nicola Sturgeon was quick to put forward a case for Scotland staying in the EU based on the high proportion of voters in Scotland who voted 'Remain' compared to those who voted 'Leave'. On 28 March 2017, the possibility of a second referendum increased with members of the Scottish Parliament voting 69 to 59 in favour of seeking permission for a referendum before the UK leaves the EU, and this was followed by Mrs Sturgeon's 31 March 2017 letter to Mrs May requesting a Section 30 order which would allow the Scottish Parliament to legislate for a second referendum. The timing of a referendum, however, is very much in question. The UK government would need to give permission, and further to Mrs May's statements on the matter, Scottish Secretary David Mundell told the BBC that the timescale for any negotiation with Scotland on a second referendum could include 'the

Brexit process, the journey of leaving and people being able to understand what the UK's new relationship with the EU is, so they can make an informed choice if there was ever to be another referendum'.

Carwyn Jones: On 18 May 2016, Carwyn Jones, the Labour leader in the Welsh Assembly since 9 December 2009, was reappointed as First Minister of Wales. He had served as First Minister since 10 December 2009. Unlike Scotland and Northern Ireland, 'Leave' voters in Wales exceeded 'Remain' voters. He has suggested that all four parliaments in the UK should be part of the Brexit negotiations and the greatest buy-in would be achieved if the agreement was also ratified by the four parliaments – a position he reiterated in a letter to Theresa May that preceded the 25 October 2016 Joint Ministerial Committee (JMC) and repeated on BBC Radio 4's Today programme on 30 March 2017. Nonetheless there is a view that Westminster and Cardiff are closer than they were on Brexit, although this does not take into account a number of issues including the repatriation of powers from the EU directly to the devolved administrations.

Arlene Foster: Arlene Foster has been the leader of the Democratic Unionist Party (DUP) since December 2015 and served as First Minister of Northern Ireland from January 2016 until January 2017, when the deputy First Minister of Northern Ireland, Martin McGuiness, an Irish republican Sinn Féin politician resigned, triggering an election that was held on 2 March 2017. While the DUP remains the largest party, a Northern Ireland executive has yet to be formed and if the deadlock is not broken, the British government would be expected, under the power-sharing rules, to take Northern Ireland back under direct rule. Like Scotland, 'Remain' voters in Northern Ireland exceeded those who voted 'Leave'. Moreover, Northern Ireland is the only part of the UK that shares a land border with another EU member state, so how this border will be managed under Brexit is a key concern and one addressed in Mrs May's Lancaster House speech, her 29 March 2017 Article 50 letter and the 31 March 2017 European Council draft guidelines.

Sadiq Khan: On 9 May 2016, Sadiq Khan was elected Mayor of London. In the days following the outcome of the UK referendum on Brexit, Sadiq Khan called for devolution of powers to London, prompted by the number of 'Remain' voters in London exceeding those who voted 'Leave'. He reiterated this position at the January 2017 London Government Dinner where he also announced that London will write its own industrial strategy to feed into the government's UK-wide industrial strategy white paper. He also believes London should have a seat at the Brexit negotiating table and has sought to convince European politicians and business leaders that a bad Brexit deal that hurts London would hurt the EU as well.

Mark Carney: On 1 July 2013, Mark Carney joined the Bank of England as Governor and Chairman of the Monetary Policy Committee, Financial Policy Committee, and the Board of the Prudential Regulation Authority. While he will not be directly involved in the government's negotiations, comments from the Governor on the possible economic impacts of Brexit are closely monitored. It is likely that his statement to the House of Commons' Treasury Select Committee that Brexit was no longer the biggest risk to the UK's financial stability provided a helpful economic context for the government's Brexit strategy that was set out in the prime minister's Lancaster House speech. More

Key EU players

Members of the European Council: The European Council is comprised of heads of state or government of EU countries, the European Commission President, and the High Representative for Foreign Affairs and Security Policy. The European Council defines the overall political direction and priorities of the European Union, and sets the EU's policy agenda by adopting conclusions during European Council meetings, reflecting the fact that is it not one of the EU's legislating institutions. It takes most of its decisions by consensus. However, in certain specific cases outlined in the EU treaties, it decides by unanimity or by qualified majority. Brexit is one such case. Article 50.3 of the TEU **requires unanimity on the extension of any negotiation to withdraw** after two years, but only requires a **qualified majority to make a decision on the outcome of the negotiation** with the withdrawing state, after obtaining the consent of the European Parliament.

Donald Tusk: On 1 December 2014, Donald Tusk replaced the outgoing President of the European Council. As set out in Article 15.5 of the TEU, the President is elected by qualified majority by the Council for a term of two and a half years and can be appointed for a maximum of two terms i.e. a total of five years. Upon receiving the Article 50 letter, he indicated that he and the EU Commission have a strong mandate to protect the interests of the EU27, that their goal is to minimise the costs of Brexit for EU citizens, businesses and member states, and that the EU27 will be acting as one in the negotiations.

Didier Seeuws: On 24 June 2016, Didier Seeuws was appointed by President Donald Tusk to coordinate negotiations with Britain on its exit from the European Union. As head of the European Council Task Force (or Special Task Force) on the UK, it is understood that Seeuws will coordinate the politically sensitive aspects of the Brexit negotiation. (Reported by EFE, The Guardian and Reuters.) An Open Europe blog credits him with drafting the European Council draft guidelines.

Jean-Claude Juncker: On 15 July 2014, Jean-Claude Juncker was confirmed by the European Parliament as President of the European Commission from 1 November 2014 for a five-year term (ending 31 October 2019) in accordance with Article 17 sub-paragraphs 3 and 7 of the Treaty on the

Functioning of the European Union (TFEU). At a meeting in Malta on 30 March 2017, he threatened to campaign for the independence of Ohio and Austin, Texas if Donald Trump continues to encourage EU countries to follow the UK's example and leave the EU.

Michel Barnier: On 27 July 2016, Michel Barnier was appointed as chief negotiator in charge of leading the European Commission task force for the preparation and conduct of negotiations with the UK under Article 50.3 of the Treaty on European Union (TEU). He started work on 1 October 2016, reporting directly to the President of the European Commission, **Jean-Claude Juncker,** who had appointed him. He was tasked, in the initial months, with preparing the ground internally for the work ahead. Once the Article 50 process is triggered, he will make the necessary contacts with the UK authorities and all other EU and member state interlocutors. In February 2017, he was reported as estimating that the UK's exit would cost it over £50 billion. He has also written in the *Financial Times* on how he believes the EU and UK need to work together, which Politico has attempted to decipher.

It is now understood that the European Council, which is the EU institution representing the governments of the remaining member states, will focus on the politics surrounding the negotiation and that the Commission will be responsible for providing technical expertise. Moreover, while it has also been reported that Michel Barnier has assembled a team of approximately 30 staffers, some with notable political instincts as well as technical skills, to coordinate the EU's position, it may be that he has little room to manoeuvre.

Guy Verhofstadt: On 8 September 2016, Guy Verhofstadt was appointed as the European Parliament's chief negotiator on Brexit. Although the European Parliament has no formal role in the exit negotiations, once an agreement is reached on the conditions for the UK's departure from the EU, it will have to be approved by the European Parliament. Guy Verhofstadt, the former Belgian prime minister, a Member of the European Parliament (MEP) and leader of the Alliance of Liberals and Democrats for Europe Group (ALDE), is a confirmed federalist. His appointment was controversial, however, as the European Conservatives and Reformists (ECR) pointed out that the 751 MEPs were not given the opportunity to vote on it. Speaking at Chatham House, days before the Article 50 letter was delivered to Donald Tusk, Guy Verhofstadt indicated that those in the UK who wish to maintain personal links with the EU can do so.

Angela Merkel: On 22 November 2005, Angela Merkel, a member of the Christian Democratic Union of Germany (CDU), was sworn in as Chancellor of Germany. She has been Chancellor ever since, and in March 2014, became the longest-serving incumbent head of government in the European Union, and has been called its de facto leader. Mrs May met Mrs Merkel on 20 July 2016, and Mrs Merkel was reported to be supportive of Mrs May's decision to wait until 2017 before starting the formal process of leaving the EU. Mrs Merkel is facing elections in the second half of 2017.

Francois Hollande: Key dates for the French Presidential elections are 23 April 2017 (first round) and 7 May 2017 (run-off, if required). The current president, Francois Hollande, declined to run for a second term in the face of low popularity ratings. Given France’s role in the EU, the candidate assuming the office of President of the French Republic will have a key role in influencing how the EU27 engage with the UK over Brexit.

Article 50 – Key facts

Article 50 of the Treaty on European Union (TEU): This Article sets out, in broad terms, the process and timeline the UK and EU will need to adhere to in the negotiation of a **withdrawal agreement**. While reference to this Article has appeared in a number of press stories and briefings, of particular interest are the briefings prepared for the UK and European parliaments.

Moreover, with reference to Mrs May's Lancaster House speech and Article 50 letter – and her stated aim of reaching an agreement on the future partnership between the UK and EU27 by the conclusion of the two-year Article 50 process – it is worth noting that **Article 50.2 states that the arrangements for withdrawal shall take into account the withdrawing country's future relationship with the Union** – a fact that the European Council has acknowledged in their draft guidelines and reflected in their proposal for a phased negotiation.

Article 50 is reproduced below:

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.

Article 238.3 Treaty on the Functioning of the European Union (TFEU): Article 238.3 TFEU, which is cross referenced in Article 50 TEU, is reproduced below:

3. As from 1 November 2014 and subject to the provisions laid down in the Protocol on transitional provisions, in cases where, under the Treaties, not all the members of the Council participate in voting, a qualified majority shall be defined as follows:

(a) A qualified majority shall be defined as at least 55% of the members of the Council representing the participating Member States, comprising at least 65% of the population of these States.

A blocking minority must include at least the minimum number of Council members representing more than 35% of the population of the participating Member States, plus one member, failing which the qualified majority shall be deemed attained.

(b) By way of derogation from point (a), where the Council does not act on a proposal from the Commission or from the High Representative of the Union for Foreign Affairs and Security Policy, the qualified majority shall be defined as at least 72% of the members of the Council representing the participating Member States, comprising at least 65% of the population of these States.

The largest EU states by population: Outside of the UK, the five largest EU member states by population are: Germany, France, Italy, Spain and Poland followed by Romania, the Netherlands, Belgium, Greece, the Czech Republic, Portugal, Hungary, Sweden, Austria, Finland, Slovakia, Ireland, Croatia, Lithuania, Slovenia, Latvia, Estonia, Cyprus, Luxembourg and Malta.

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EU trade facts, WTO and other bilateral agreements

Withdrawal, UK/EU27 trade, and transitional agreements: Article 50 of the TFEU sets out, in broad terms, the process and timeline the UK and EU27 will need to adhere to in the negotiation of a **withdrawal agreement**. And while Article 50 also states that it should take into account the withdrawing country's future relationship with remaining EU member states, it is silent on the process or scope for agreeing a **new UK and EU27 trade agreement**, and does not offer any mechanism to deal with the possible cliff-edge effects associated with moving the UK's current relationship with the EU to a new and different relationship. Nonetheless, the latter issue is considered – to varying degrees – in both Mrs May's Article 50 letter and the European Council's draft guidelines.

The Article 50 letter suggests that a new comprehensive agreement could be reached within two years, but also states that both sides would benefit from implementation periods to adjust to the new arrangements in a smooth and orderly fashion. In contrast, the European Council's draft guidelines do not anticipate that a full agreement can be reached in two years. Nonetheless, it does suggest – subject to sufficient progress being made on (i) the divorce bill and (ii) clarity and legal certainty for affected citizens, businesses, stakeholders and international partners – that an overall understanding on the framework for the future relationship could be identified and that the negotiations may seek to determine transitional arrangements to provide bridges towards the foreseeable framework for the future relationship. Neither document considers an extension – at some time in the future – to the Article 50 two-year timeline for the purposes of reaching a trade deal.

In the remainder of this subsection (and those that follow) we set out a number of considerations that arise from the EU treaties that will inform the upcoming negotiations and which are reflected in:

- The UK's stated goals as set out in the Article 50 letter and Lancaster House speech: to leave

the single market and secure a new comprehensive agreement (taking in both economic and security cooperation) that would allow the UK to establish its own WTO tariffs and reach trade agreements with the EU27 countries outside of the Union.
- How the European Council's requirement that clarity and legal certainty be provided to international partners (as well as citizens and businesses) manifests itself in relation to the WTO.

Article 26.2 on the Functioning of the European Union (TFEU) states that:

> The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the Treaties.

Trade in goods and services is covered under Articles 28 to 37 of the TFEU. Article 28 clearly states that **the Union shall operate as a customs union**, Article 29 covers the treatment applies to goods from third countries and Article 31 states that common customs tariff duties are fixed by the Council on a proposal from the Commission. As such, member states lack any capacity to independently forge trade agreements on, for example, tariff levels with countries outside of the EU.

The prohibition on restrictions on the freedom to provide services within the Union is covered under Articles 56 to 62 of the TFEU, and the prohibition on restrictions on the movement of capital within the Union is covered under Articles 63 to 66 of the TFEU, with **Article 64 covering the movement of capital between member states and third countries**. Article 64.2 states:

> Whilst endeavouring to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible and without prejudice to the other Chapters of the Treaties, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt the measures on the movement of capital to or from third countries involving direct investment – including investment in real estate – establishment, the provision of financial services or the admission of securities to capital markets.

EU-only trade agreements versus 'mixed trade' agreements: Article 216 of the TFEU concerns the EU's mandate to conclude agreements on behalf of member states. It states:

1. The Union may conclude an agreement with one or more third countries or international organisations where the Treaties so provide or where the conclusion of an agreement is necessary in order to achieve, within the framework of the Union's policies, one of the objectives referred to in the Treaties, or is provided for in a legally binding Union act or is likely to affect common rules or alter their scope.
2. Agreements concluded by the Union are binding upon the institutions of the Union and its Member States.

The division of competences between the EU and member states are set out in Articles 3 and 4 of the TFEU, so where the EU negotiates and concludes an international agreement, it has either exclusive competence (as specified under Article 3) or competence which is shared with member states (as specified under Article 4). Where it has exclusive competence, the EU alone has the power to negotiate and conclude the agreement. However, where its competence is shared with member states, the **mixed agreement is concluded both by the EU and by the member states**, and member states must give their consent.

Article 3 of the TFEU states:

1. The Union shall have exclusive competence in the following areas: (a) customs union; (b) the establishing of the competition rules necessary for the functioning of the internal market; (c) monetary policy for the Member States whose currency is the euro; (d) the conservation of marine biological resources under the common fisheries policy; (e) common commercial policy.
2. The Union shall also have exclusive competence for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence, or in so far as its conclusion may affect common rules or alter their scope.

Article 4 of the TFEU states:

1. The Union shall share competence with the Member States where the Treaties confer on it a competence which does not relate to the areas referred to in Articles 3 and 6.
2. Shared competence between the Union and the Member States applies in the following principal areas:

   (a) internal market

   (b) social policy, for the aspects defined in this Treaty

   (c) economic, social and territorial cohesion

   (d) agriculture and fisheries, excluding the conservation of marine biological resources

   (e) environment

   (f) consumer protection

   (g) transport

   (h) trans-European networks

   (i) energy

   (j) freedom, security and justice

   (k) common safety concerns in public health matters, for the aspects defined in this Treaty

3. In the areas of research, technological development and space, the Union shall have competence to carry out activities, in particular to define and implement programmes; however, the exercise of that competence shall not result in Member States being prevented from exercising theirs.

4. In the areas of development cooperation and humanitarian aid, the Union shall have competence to carry out activities and conduct a common policy; however, the exercise of that competence shall not result in Member States being prevented from exercising theirs.

Status of World Trade Organization (WTO) Agreements: In 1994, the European Court of Justice (ECJ) rejected the European Commission's contention that it had across-the-board competence to conclude the WTO Agreements in its own name. In short, the Court stated that while the Commission's exclusive competence under the common commercial policy applies to the trade in goods – the core provisions of the WTO Agreements – other areas covered by the WTO Agreements relating to services were outside the Commission's competence or were areas where the EC's competence was shared with the Member States. This decision has potentially significant implications for Brexit.

LawyersforBritain.com argues that this ECJ decision means the UK will automatically assume rights and responsibilities in respect of 100% of its relationship with other members under the WTO Agreements. The group also argues that trade relations between the UK and the EU27 will cease to be governed by the EU treaties, and will automatically be governed by the framework of the WTO Agreements in the event that an agreement between the UK and the remaining EU member states is not reached within two years of Article 50 of the Treaty of the European Union being triggered.

While other commentators have suggested the UK will have to 'regularise' its position with regard to WTO membership, LawyersforBritain.com have also noted that UK does not need to leave or reapply given that it is a founding member of the WTO as laid down by Article XI(1) of the Agreement establishing the WTO which states that:

> 'The contracting parties to GATT 1947 as of the date of entry into force of this Agreement, and the European Communities, which accept this Agreement and the Multilateral Trade Agreements and for which Schedules of Concessions and Commitments are annexed to GATT 1994 and for which Schedules of Specific Commitments are annexed to GATS shall become original Members of the WTO.'

The understanding that the UK is a member of the WTO in its own right was confirmed as part of the evidence obtained by the House of Lords EU Committee and reflected in an exclusive interview Roberto Azevêdo, Director General of the WTO, gave to Sky News, on 26 October 2016, where he: (i) clarified that while the UK will need to renegotiate the terms of its WTO membership, the process is relatively straightforward, (ii) confirmed that there will be no discontinuity in the UK's membership, and (iii) stated that he will be working intensely to ensure that this transition is fast and is smooth. (These remarks were in contrast to the comments he made in the run-up to the referendum.)

Experts providing evidence to the House of Lords EU Committee (para 172–188) also identified **two options for amending WTO schedules**: rectification (i.e. rearrangements that do not alter the scope of a concession) and modification (i.e. a substantive change in a concession). While experts providing evidence to the House of Lords indicated that moving from an EU to a UK schedule is largely technical, the UK will have to negotiate with the EU to separate out its tariff rate quotas (TRQs) and levels of subsidies from those currently shared between the 28 EU member states. The House of Lords EU Committee was informed that once this has been agreed, the UK would have to present its schedules to other WTO members. It is at this stage that other WTO members might take the view that the changes amount to a modification in the terms of trade (from the perspective of exporting countries) for the UK and the EU, particularly where it is possible that tariffs between the UK and EU27 might be imposed.

Status of (other) bilateral trade agreements: Two schools of thought have emerged. The first is of the view that once the UK leaves, the continuation of bilateral mixed trade agreements would depend on both the EU and the third-country trading partner (as argued by the EU Law Analysis) particularly as non-EU countries take the view that it is in their interests to request renegotiations either with the UK alone or with both the EU and the UK. The second points to the Principle of Continuity in the Vienna Convention, which would militate against any finding of automatic termination or renegotiation (and which has been highlighted by EU Referendum.com). With reference to the latter, EU Law Analysis cites the Second Chapter, Division A, Section I, subsection I, Article 6 of the Report of the International Law Commission which states:

> In consequence, the treaty obligation, once assumed by or on behalf of the State, is not affected, in respect of its international validity or operative force, by any of the following circumstances: (a) That there has been a change of government or regime in any State party to the treaty; (b) That some particular organ of the State (whether executive, administrative, legislative or judicial) is responsible for any breach of the treaty; (c) That a diminution in the assets of the State, or territorial changes affecting the extent of the area of the State by loss or transfer of territory (but not affecting its existence or identity as a State), have occurred, unless the treaty itself specifically relates to the particular assets or territory concerned. In all such cases, the treaty obligation remains internationally valid, and the State will incur responsibility for any failure to carry it out.

The House of Lords EU Committee (para 153–158) have also gathered evidence on whether the UK could have access to mixed trade agreements and EU-only trade agreements once Brexit occurs, or whether the UK would have to revert to WTO rules. With regard to mixed trade agreements, the House of Lords were informed by one expert that even if the forthcoming negotiations provide the UK with the opportunity to become an individual signatory to these agreements, ‘either the EU or the third country would probably request some form of negotiation'. So even where the third country agreed to become a signatory to a free trade agreement on the same terms as when the UK was a member of the EU, 'the EU could take the very drastic step of either withdrawing or terminating these types of agreements'. As a consequence, one expert suggested that it 'might be simpler for the UK to seek to sign new bilateral agreements with these states which mirror the current agreements'.

It is perhaps instructive to note that with regard to the (yet to be ratified) EU-Canada Comprehensive Economic and Trade Agreement (CETA), the House of Lords EU Committee (para 157) was informed that it is the UK government's assessment that:

> On leaving the EU, the UK will no longer retain access to the trade preferences contained in CETA unless arrangements are put in place as part of our negotiations with the EU. This outcome will not be impacted by whether or not the existing trade deal was signed as a mixed agreement.

The status of EU trade agreements with third countries that are solely in the competence of the EU to negotiate is not widely discussed. However, the evidence gathered by the House of Lords EU Committee (para 153–154) appears to suggest that the UK's access to those third-country markets would be governed either by the WTO rules (and the agreed UK schedules) or an alternate free trade agreement that the UK would need to negotiate. (This was illustrated by the case of duties which apply to sugar arriving from Caribbean countries.)

In light of the above, of potential interest is the 2014 report requested by the EU Parliament's Committee on Economic and Monetary Affairs on how financial services are covered in EU trade agreements.

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Other trade models

In her 5 October 2016 speech to the Conservative party conference, Theresa May set out her vision for Britain which many commentators read as signalling that the government was leaning towards the UK leaving the EU single market rather than retaining some form of membership of the single market in return for a degree of free movement. These two outcomes are often referred to as a 'hard/clean' Brexit and a 'soft' Brexit – terms that provide a convenient shorthand for commentators, but have the potential to mislead by overlooking possible developments that do not fit neatly under either label.

This direction (i.e. a 'hard/clean' Brexit) was confirmed in Mrs May's 29 March 2017 Article 50 letter and her earlier 17 January 2017 Lancaster House speech where she set out a vision for a 'Global Britain' whereby the UK would: (i) seek 'a **new, comprehensive, bold and ambitious free trade agreement with the European Union**'; and (ii) have the **freedom to strike trade agreements with countries from outside the EU** as well. The former reflects the UK government's wish to 'seek the greatest possible access' to the EU without seeking access to the EU's single market (as this would require accepting the EU's four freedoms and the rules and regulations that implement them), and the latter requires that the UK no longer be bound by the EU Customs Union, which is defined by the EU's Common Commercial Policy and the Common External Tariff.

In the remainder of this section we take a closer look at the two trade models that appear to be left on the table – a comprehensive agreement like the one the EU has struck with Canada, and the WTO (these and other trade models have been frequently referred to in the press, law firm briefings and government documents) – as well as possible **future trade agreements** the UK has been discussing with non-EU countries (but which cannot be formally agreed until after the UK leaves the EU).

Canada-EU – Comprehensive Economic and Trade Agreement (CETA): To date, CETA is the most comprehensive trade agreement reached by the EU. It runs to over 2,000 pages and has taken several years to negotiate. The agreement was signed at the EU-Canada Summit on 30

October 2016 after nearly being derailed by the Belgian regional government of Wallonia. It is expected that from Spring 2017, most (but not all) parts of the agreement will apply provisionally following approval by the European Parliament, but before it is ratified by all 28 member states (including the UK) and regional governments through the relevant national ratification procedures.

Recognition that CETA could serve as a good starting point for discussions with the EU dates back to February 2016, if not before. And in December 2016, Michel Barnier indicated that a 'political agreement' between the UK and EU could be settled during the two-year period specified in Article 50, and could then be followed by negotiations for a CETA-style deal.

World Trade Organization (WTO) framework: This is a global multilateral agreement on the trade in goods and certain services between member countries. It is based on two foundation principles – 'national treatment' and 'most favoured nation' (MFN) – and is most known for two primary agreements – the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS). A helpful summary of this framework has been produced by Slaughter and May.

Under both GATT and GATS the MFN principle applies, and there is, therefore, a general prohibition on charging a lower tariff on goods originating in one WTO member than is applied to goods originating in another WTO member. Under the GATT there is an exception for custom unions and free trade agreements (and under the GATS for economic integration agreements).

National treatment applies under the GATT which means that once any relevant tariffs have been paid on goods from overseas, these goods must be treated in the same manner as goods originating domestically. Under the GATS this principle only applies if a particular WTO member has agreed to it.

Singapore and Hong Kong are two jurisdictions that rely solely on the WTO's framework and have adopted a unilateral free trade policy (i.e. they do not apply import or export tariffs).

The significance of the WTO framework cannot be overstated in the context of the Brexit negotiations. A point which the House of Lords EU Committee (para 259) acknowledged in its remarks concerning sequencing the UK's negotiations with the WTO, EU and third countries, and the need for the UK to prioritise its relationship with the EU and the WTO.

The Economists for Free Trade have published a detailed research paper by Patrick Minford and Edgar Miller who discuss the various policy options the government might pursue under the WTO framework and quantify their estimated impact. They arrive at the recommendation that the optimal strategy is for the UK to adopt WTO rules with zero import tariffs and at the same time embark on establishing free trade agreements with countries that wish to eliminate non-tariff barriers and other distortions. In relation to the City, they suggest that if EU protectionism extends to the City, it should not retaliate and should instead, pursue the agenda suggested in *A Blueprint for Brexit: The Future of Global Financial Services and Markets in the UK* – by Barnabas Reynolds for Politeia.

Mrs May reiterated her vision of a Britain that is both a European country and a country

which looks to the wider world in speeches in Davos (19 January 2017) and Philadelphia (26 January 2017). In relation to the UK's plans for a 'comprehensive, bold and ambitious free trade agreement' with a 'divorce' phase, Germany's finance minister, Wolfgang Schäuble, has remarked that these can be made to work and has also stated that Britain should be offered a reasonable deal given that the financial services offered by the City of London benefit Europe as a whole. His comments align with a previously reported appetite among some German politicians to take account of the UK's size, significance and its long membership of the European Union, and may potentially translate into a special status for the UK which bears only limited comparison to that of countries that have never belonged to the European Union.

The **remainder of this section looks at some of the bilateral trade agreements** that the UK will be seeking to quickly agree and ratify once it leaves the EU, and provides an initial view of where the UK's trade strategy potentially intersects with its plans to become the leading European, if not global, fintech hub via the UK Financial Conduct Authority's Project Innovate which includes its sandbox for fintech firms.

In September 2016, Australia and the UK announced that they will establish a bilateral trade working group that will meet twice a year from early 2017, so that the two countries will be ready to fast-track trade negotiations once the UK leaves the EU. Australia's foreign minister, Mathias Cormann, confirmed this on 19 January 2017. On the fintech side, in early 2016 the FCA signed a cooperation agreement with the Australian Securities and Investments Commission (ASIC), marking the first time that two financial regulators had agreed to provide information to one another specifically in order to make it potentially easier for fintech firms to access new markets.

During the 6 to 8 November 2016 trade mission to India, Theresa May reached an agreement with the Indian government to work on the UK–India trade relationship. This agreement reflected a view that a bilateral free trade agreement between the UK and India would be easier to conclude than the one India has been discussing with the European Union for nine years. Nonetheless, it is clear that India will be seeking a looser approach to UK work and student visas. A further trade mission, led by Philip Hammond, took place in the first week of April 2017, having as its motto 'Make in India, Finance in the UK'. The delegation included the Governer of the Bank of England (Mark Carney), the CEO of the FCA (Andrew Bailey) and over a dozen representatives from the fintech sector.

On 13 January 2017, New Zealand's prime minister stated that New Zealand will seek to agree a free trade deal with the UK as soon as possible after Brexit. Moreover, in recognition of the fact that the UK has insufficient trade negotiators, New Zealand has offered to loan staff that are expert trade negotiators to the British Civil Service, and the UK is reportedly also looking for help from Canada with which it has had 'technical exchanges'. It is perhaps worth noting that in February 2017 the Ontario Securities Commission (OSC) and the UK's FCA also signed a cooperation agreement to provide support to innovative fintech firms seeking entry into either market.

The election of Donald Trump as 45th president of the US, combined with the Republican Party retaining their majorities in the US Senate and House of Representatives, suggests that the president has the potential to make his policies laws. While in the run-up to the election key Republicans were critical of his campaign, he and Paul Ryan (Speaker of the US House of Representatives) now appear to be working together although President Trump's executive order on immigration is an example of where a possible red line was nearly crossed.

On trade, his election means a move away from multilateral trade agreements as reflected by the US's withdrawal from the Trans-Pacific Partnership (TPP) and its plans to renegotiate the North American Free Trade Agreement (NAFTA). EU-US negotiations on the Transatlantic Trade and Investment Partnership (TTIP) also appear to be on hold.

Consistent with earlier statements that the UK would not be at the back of the trade queue, at a joint news conference held during the 27 January 2017 summit between the prime minister and President Trump, the president promised a free trade deal with the UK. In advance of this meeting, it was suggested in the UK press that such a deal would look to cut tariffs and make it easier for workers to move between the two countries. It has also been observed that such a deal would give the UK leverage with Europe – particularly if it included a deal to reduce barriers between US and UK banks through a new 'passporting' system. While the 27 January 2017 summit appeared to mark a new chapter in the 'special relationship' and some experts believe the trade deal could be agreed within a two-year time frame, the prime minister will need to balance this relationship against the accepted cultural norms in the UK as well as its national interests in other arenas. Moreover, the UK will need to evaluate the possible impact of President Trump's administration's apparent appetite for rolling back financial regulation – an issue discussed in the Oliver Wyman paper *Implications of the Trump Administration for Financial Regulation* by Douglas J Elliot – and whether the US takes a step back from the international forums setting standards for financial services – as suggested by a letter to Federal Reserve Chair Janet Yellen, which she rebuffed.

China is another country with which the UK is holding talks on trade, investment, financial services and energy.

Finally, the government of Japan has also expressed its concerns regarding the uncertainty that Brexit will bring. In a letter issued in advance of the G20 Summit, it asked for the negotiations to be conducted in a transparent fashion and set out a series of detailed requests. Nonetheless, Brexit and the US withdrawal from TTIP seems to have helped to jump-start an EU/Japan trade deal which is similar in scope to CETA but, from the EU's perspective would be seen as more significant, given the relative size of Japan's economy.

It is clear that trade agreements are complex and include a significant range of possibilities (such as limited agreements on the reduction of tariffs, ones that cover services and capital, and others promoting economic integration). This complexity increases where the trade agreements cover financial services. However, as highlighted by the International Organization of Securities Commissions (IOSCO) Task Force on Cross-Border Regulation, the regulatory toolkit to achieve effective cross-border regulation (in securities markets) includes more than one approach that countries can tailor to fit the specific circumstances of the agreement being negotiated.

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Financial services – evolving policy and advocacy from the UK

While some firms have made statements to the press regarding the contingency plans they have developed in relation to Brexit (and may or may not trigger), the industry has also relied on its trade associations to develop research and communicate their evolving response to the challenges that Brexit presents.

The Association for Financial Markets in Europe (AFME): In February 2017, AFME published a report it had commissioned from PwC which, taking a granular and fact-based approach, outlined the transformation challenges that Brexit poses to banking services. Building on this, AFME issued a further report aimed at policymakers in April 2017, entitled *Implementing Brexit: practical challenges for wholesale banking in adapting to the new environment.*

The British Bankers Association (BBA): The BBA's CEO, Anthony Browne, has made a number of often quoted comments to the press including a warning that banks' 'hands are quivering over the relocate button' – a position he seemed to have distanced himself from when he spoke at the BBA's annual Mansion House dinner in November 2016, when he reportedly said: 'We should stop looking back, roll up our sleeves and look to the future.' Most recently, writing in the *Telegraph* in relation to the Great Repeal Bill and the legal challenges Brexit presents, he proposed that the legal process should be guided by three priorities: 1) complete the process in a two-year period (to ensure the UK does not fall into a legal black hole); 2) ensure that regulation is not transposed in a way that compromises the UK's negotiations to get full access to the EU market; and 3) ensure that the reforms that have been important to restoring financial stability after the 2007 crisis are not undone.

The BBA website includes an information page on Brexit but it does not include position papers like that prepared for it by the Global Counsel (an advisory group chaired by Lord Mandelson) and the law firm Clifford Chance.

TheCityUK and International Regulatory Strategy Group (IRSG): TheCityUK and the IRSG (an advisory body to both the City of London Corporation and TheCityUK) have now published three separate reports on Brexit: *The EU's third country regimes and alternatives to passporting* (23 January 2017)*, Brexit and UK-based financial and related professional services (12 January 2017),* and *UK financial and related professional services: meeting the challenges and delivering opportunities* (3 August 2016). Together these three reports help to document the City's changing position on market access which has yet to solidify, as reflected in TheCityUK's suggestion, on the one hand, that the UK and EU agree a framework for the mutual recognition of regulatory regimes, building on and going beyond the existing equivalence regime, and the IRSG's suggestion, on the other hand, that the UK consider mutual access with the EU that avoids having rights of access tied to the existing concept of equivalence. The IRSG has also published a report on Central Counterparties (CCPs) post-Brexit and the implications for banks and end-users.

Financial Services EU Task Force: Financial News reported that this task force had begun operating as a sub-group of TheCityUK. As reported by Reuters, it will focus on high-level coordination and strategic input to support detailed work by TheCityUK (and the trade associations that are members or are in dialogue with it).

The task force is made of the following top officials of major financial institutions:

- Shriti Vadera (chair) – a former government minister and current chairwoman of Santander UK bank
- Douglas Flint, chairman of HSBC – to lead on commercial banking
- Norman Blackwell, chairman of Lloyds, and David Roberts, chairman of Nationwide – to lead on retail banking
- Rob Rooney, chief executive of Morgan Stanley International, and Michael Cole-Fontayn, chairman of BNY Mellon in Europe – to lead on wholesale banking
- Adrian Montague, chairman of Aviva, and John Nelson, chairman of Lloyd's of London – to lead on insurance
- Howard Davies, chairman of RBS, and John McFarlane, chairman of Barclays – to lead on cross-sectoral issues
- Liz Corley, vice-chair of Allianz Global Investors – to lead on investment management
- Gerry Grimstone, chairman of Standard Life and Mark Boleat, policy head of City of London Corporation – to lead on international advocacy

Financial Services Negotiation Forum (FSNF): This group aims to bring together senior financial services professionals from the 'Leave' and 'Remain' sides, and give a voice to smaller firms in particular, as well as to financial services companies outside London. Its goal is to provide a platform for industry practitioners and policymakers to share and debate evidence-based research and to agree a consensus on critical issues relevant to the Brexit negotiations.

On 16 January 2017, it published *Euro-clearing and Brexit: The Practitioners' View* which suggests it could be in the best interests of the EU for clearing of these products to continue outside the eurozone and that the UK should offer an enhanced collaborative arrangement (i.e. effectively shared oversight) to the European Central Bank (ECB).

Buy- and Sell-side Trade Associations inside and outside the UK: Although the work of these various associations is not always public (and is normally technical in nature) many, such as the Futures Industry Association, are also looking at the implications of Brexit for financial institutions that currently passport from the UK to the EU27 member states, and those that passport into the UK from the other EU27 member states.

It is notable that, as reported by the FT, the **Alternative Investment Management Association (AIMA) with the Alternative Credit Council (ACC)** have arrived at a position on Brexit with their respective memberships. While neither group has made their joint position papers public, AIMA's CEO has summarised – on LinkedIn – the position paper directed at the UK government. Several recommendations are made including one 'to maximise single market access for the entire financial services sector, by hardwiring into a treaty the principles of market access based on equivalence, non-discrimination and reciprocity', but not at the expense of 'retaining some flexibility for the UK to set rules for domestic and internationally facing business'.

Financial services – passporting and equivalence

Once Brexit occurs, a central concern for the financial services industry will be continued access to the EU27's financial markets from the UK as well as access to the UK's financial markets via any of the EU27 countries. As demonstrated by the evolving policy and advocacy emerging from the UK, views on how this might be achieved have now moved from focusing just on passporting. In the remainder of this section we summarise published research that has helped to inform the ongoing discussion on how access to UK and EU27 financial markets might be achieved, and provide background information on passporting and the EU's current approach to equivalence.

Importance of financial services to the UK economy: In the October 2016 study undertaken by Oliver Wyman (OW) for TheCityUK, *The Impact of the UK's Exit from the EU on the UK-based Financial Services Sector*, it was reported that the UK-based financial services industry earns approximately £200bn in revenues annually, and approximately 25% (or £40–50bn) of these revenues arise from international and wholesale business related to the EU. In the same study, OW looked at the impact which an exit from the EU – putting the UK outside of the EEA – could have on these revenues across a spectrum of regulatory outcomes relating to the degree of access that financial firms based in the UK would have to EU clients and infrastructure through:

1. Financial services passport: a provision under the relevant single market directive (or regulation) that, subject to the fulfilment of conditions specific to the directive (or regulation), entitles a firm authorised in the European Economic Area (EEA) to carry on permitted activities in any other EEA state by either exercising the right of establishment (of a branch and/or agents) or providing cross-border services.
2. Third country equivalence: a provision that exists in recent EU financial services acts that set out those cases whereby the EU may recognise that a foreign (i.e. 'third country') legal, regulatory and/or supervisory regime is equivalent to the corresponding EU framework. That

recognition, in turn, makes it possible for authorities in the EU to rely on supervised entities' compliance with the equivalent foreign framework.

In the OW report, the high-access scenario is one where the potential impact is least and is predicated on an exit that delivers: (i) the UK having full passporting and equivalence under the full scope of single market directives, and (ii) new access arrangements for those directives where a third-party regime does not currently exist.

The low-access scenario is one where the potential impact is greatest and is predicated on an exit where the UK is a third country without any recognition of regulatory equivalence and where the UK's relationship with the EU rests largely on WTO obligations.

OW's quantification of the estimated first order and ecosystem effects of the UK's exit from the EU under these two scenarios is set out in detail on page 14 of the report. In summary, under the high-access scenario revenues from EU-related activity would drop by £2bn and 3–4,000 jobs would be at risk, while under the low-access scenario revenues from EU-related activity would drop by £18–20bn and up to 31–35,000 jobs would be at risk.

However, not everyone agrees with OW's analysis.

The October 2016 report by Open Europe – starting with data supplied by the FCA to the UK Parliament Treasury Committee (and reproduced in the section on passporting below) – examined the financial services sector by sub-sector and concluded:

- In Banking (wholesale and retail), passporting works well (from the UK and into the UK) and is most important (representing approximately a fifth of the sector's annual revenue).
- In Asset Management, passporting is less important given a number of technical barriers that hinder the marketing of funds across the EU, the fact that a number of larger funds operate subsidiaries in the EU, and the propensity for EU client assets to be domiciled in Dublin and Luxembourg with management delegated to the UK.
- In Insurance, 87% of insurers operate across borders via subsidiaries rather than branches (which rely on the passport). Lloyd's of London's underwriting business is a noted exception to this although it is estimated that only 3% of the market's gross written premium is directly reliant on the passport.

In light of this analysis, Open Europe does not support TheCityUK's assertion that the City of London's success is based on full and complete access to the EU single market in financial services. Instead, Open Europe arrives at a series of specific recommendations that are premised on the UK seeking a comprehensive free trade agreement with the EU27. In summary, the key recommendations concern:

- Where the UK should be seeking retention of passporting arrangements.
- Where and how equivalence arrangements can be achieved and bolstered (e.g. with pre-emptive equivalence).
- The establishment of a UK equivalence system that offers reciprocal market access to the EU,

and infrastructure that ensures that the UK maintains its equivalence standing with non-EU states.

- Domestic reforms to ensure that London (and the UK) remains an attractive place for financial services to do business.

Both reports, however, highlight that this is not a ‘zero-sum game’ – i.e. organisations will not shift activities from the UK to the EU on a one-for-one basis. As such, the UK government will be in a position to remind EU negotiators that EU businesses will have an interest in ensuring that the agreement governing the relationship between the UK and the European Union also benefits EU companies and governments.

Politeia has also published a report – *A Blueprint for Brexit: The Future of Global Financial Services and Markets in the UK* – by Barnabas Reynolds, a partner at Shearman & Sterling LLP. Unlike the OW and Open Europe reports, the Politeia report rejects maintaining the passport on the grounds that it would require the UK to continue to be a rule-taker of EU regulation (which it describes as burdensome), in all likelihood require the UK to sign up to the authority of EU supranational bodies (EBA, ESMA or ECJ), and require some form of commitment to the EU (financial or free movement of people).

Instead, and not unlike Open Europe, it looks to the equivalence provisions that are already in place (and detailed in Annex A of the report) and considers two options for addressing where there are gaps in the current equivalence regime (which are detailed in Annex B of the report). The first option is an ‘expanded equivalence model’ that would expand the availability of equivalence to address current gaps and require the UK and EU27 to assess their respective rules fairly (i.e. base the assessment on outcomes rather than the existence of identical laws). In the event that the first option is not achievable, the second option is the ‘financial centre model’ where these equivalence gaps are not filled and the UK redevelops its regulatory regime so that it is market friendly and removes the cost of losing the passport. The report also points out the need for careful analysis of which activities are actually cross-border activities, and the appropriate use of the ‘reverse solicitation’ exemption by which financial institutions operating in the UK can transact business with EU customers who wish to access their services, subject to the provisions of the exemption.

A closer look at passporting: On 20 September 2016, the UK Parliament’s UK Treasury Committee issued a press release concerning its publication of a 17 August 2016 letter from Andrew Bailey, the Chief Executive of the Financial Conduct Authority (FCA), that provided an overview of passports issued by UK and other EU member state competent authorities and the directives that they have been issued under. The tables below reproduce the data set out in the letter, however, like Open Europe’s report, we have also sought to group the data in the second table by sub-sector as well as ensure the outbound and inbound columns in both tables align.

An outbound passport refers to a passport issued by the UK’s FCA or Prudential Regulation Authority (PRA) to a UK firm, enabling that firm to do business in one of the other EU member states (or, where relevant, an EEA state). An inbound passport refers to a passport issued by a competent authority in one of the EU member states (or, where relevant, an EEA state) to a firm from that state that allows the firm to do business in the UK or other member states.

When reviewing the first table, it is essential to note that a firm conducting one type of activity under one directive in 30 countries (i.e. 27 EU member states plus Iceland, Liechtenstein and Norway) would need to be registered as holding 30 passports. Moreover, some directives require multiple passports for different activities and the total number of passports includes activity delivered through branches or provided from outside the member state (i.e. on a cross-border basis). Apart from underlining that passporting works in both directions, these details go some way to explaining why there are many more passports than there are firms, and why the total number of outbound passports is greater than inbound passports although the number of firms passporting from the UK is less than those passporting into the UK.

Total inbound and outbound passports

	Total	Outbound	Inbound
Total number of passports	359,953	336,421	23,532
Number of firms using passports	13,484	5,476	8,008

It is clear that a significant number of inbound and outbound passports have been issued in relation to the directives affecting banking and insurance (although it is essential to note that MiFID I is distinct from MiFID II/MiFIR which will replace it in January 2018 and includes an equivalence regime). The data also provides no detail on the effectiveness of the passport regime or the extent to which the passports, once issued, are used. As mentioned above, Open Europe's October 2016 report provides some analysis in this regard.

Total inbound and outbound passports by sub-sector and directive

	Directive	Outbound	Inbound
Banking	Capital Requirements Directive (CRD IV)	102	552
	Markets in Financial Instruments Directive (MiFID I)	2,250	988
Asset Management	Alternative Investment Services Directive (AIFMD)	212	45
	UCITS Directive	32	94
Insurance	Solvency II	220	726
	Insurance Mediation Directive	2,758	5,727

Payments and e-money	Payments and Services Directive (PSD)	284	115
	Electronic Money Directive	66	27
Other	Mortgage Credit Directive	12	0

A closer look at equivalence: As summarised by the FT, prior to the outcome of the 23 June 2016 referendum being announced, most banks were not focused on the equivalence provisions. However, since then the provisions contained in MiFID II/MiFIR and other directives and regulations have become a point of focus. These equivalence provisions currently rely on a determination ultimately made by the European Commission. On 29 September 2016 the Commission produced a summary table of their decisions to date. A closer look at selected equivalence provisions is provided below.

Markets in Financial Instruments Directive II and Markets in Financial Investments Regulation (MiFID II/MiFIR): Articles 46 and 47 of MiFIR come into effect on 3 January 2018 with the other MiFIR II/MiFIR requirements. Subject to the conditions under MiFIR Article 46.2 being met, MiFIR Article 46.1 states that:

> A third-country firm may provide investment services or perform investment activities with or without any ancillary services to eligible counterparties and to professional clients within the meaning of Section I of Annex II to Directive 2014/65/EU [i.e. MiFID II] established throughout the Union without the establishment of a branch where it is registered in the register of third-country firms kept by ESMA [The European Securities and Markets Authority] in accordance with Article 47.

In turn, MiFIR Article 47 gives the Commission the power to adopt a decision in relation to a third country stating that the legal and supervisory arrangements of that third country ensure that firms authorised in that third country comply with legally binding prudential and business conduct requirements which have equivalent effect to the requirements set out in regulations, directives and implementing measures specified under Article 47. The rules pertaining to the establishment of branches in member states where a third-country bank is seeking to provide services to retail (or elective professional clients) are set out in MiFID II Article 39.

Separately, in relation to the trading obligation provisions under MiFIR, MiFIR Article 28.1(d) also allows for recognition of third-country trading venues subject to the Commission finding (under a procedure referenced in MiFIR Article 51) that the legal and supervisory framework of the third country ensures the trading venue authorised in that third country complies with the requirements listed in MiFIR Article 28.4. The MiFIR trading obligation is also linked to the clearing obligation specified in the European Market Infrastructure Regulation (EMIR).

While the equivalence provisions in MiFIR should be helpful to the wholesale market, MiFID II/MiFIR do not allow third-country investment firms or third-country credit institutions to provide investment services to retail clients or elective professional clients. Instead, MiFID Article 39 gives member states the option of requiring these third-country firms intending to provide investment services or perform investment activities to this set of clients to establish a locally regulated retail branch in that member state. Where a member state has taken up this option, subject to a series of specified conditions, the third-country firms can seek authorisation to set up a branch.

European Market Infrastructure Regulation (EMIR): The concept of equivalence also features in EMIR in relation to the recognition of third-country central counterparties (CCPs) (Article 25) and trade repositories (Article 77). EMIR has been in effect since 4 July 2012, and is concerned with the clearing and bilateral risk management requirements for over-the-counter derivative contracts, reporting requirements for derivatives, authorisation and supervision of central counterparties as well as their obligations, and requirements for trade repositories.

Capital Requirements Directive IV and Regulation (CRD IV/CRR): CRD IV allows deposit-taking institutions to conduct services throughout the EU using their home-state authorisation. As summarised by Ashurst, these services extend to deposit-taking, lending, and participation in securities issues, as well as trading securities for customers or on own account, as well as custody services, and these are activities that overlap with MiFID II/MiFIR activities. The CRD also allows third-country banks to establish branches in the EU with the agreement of the EU authorities but does not detail how such an agreement would be reached or which services would be covered.

The concept of equivalence also finds expression in the capital calculations set out in the CRR. For instance, under well-defined conditions certain categories of exposures to entities located in countries outside the European Union can benefit from the same preferential treatment applied to EU member states' exposures in terms of capital requirements. Similarly, recognition (or lack thereof) of third-country CCPs under EMIR also has implications for the CRR capital calculations that directly inform the total capital which financial services firms (that are subject to CRD IV/CRR) must hold.

As mentioned above, a complete analysis of the equivalence regime is set out in Annexes A and B of the Politeia publication *A Blueprint for Brexit: The Future of Global Financial Services and Markets in the UK.*