Centre for International Governance Innovation

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Brexit: The International Legal Implications | Paper No. 4 — November 2017

Brexit and Financial Services

Navigating through the Complexity of Exit Scenarios

Maziar Peihani

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CIGI Masthead

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Centre for International Governance Innovation

67 Erb Street West
Waterloo, ON, Canada N2L 6C2
www.cigionline.org

British Institute of International and Comparative Law

Charles Clore House
17 Russell Square, London WC1B 5JP
www.biicl.org

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About the Series

Brexit: The International Legal Implications is a series examining the political, economic, social and legal storm that was unleashed by the United Kingdom's June 2016 referendum vote and the government's response to it. After decades of strengthening European integration and independence, the giving of notice under article 50 of the Treaty of the European Union forces the UK government and the European Union to address the complex challenge of unravelling the many threads that bind them, and to chart a new course of separation and autonomy. A consequence of European integration is that aspects of UK foreign affairs have become largely the purview of Brussels, but Brexit necessitates a deep understanding of its international law implications on both sides of the English Channel, in order to chart the stormy seas of negotiating and advancing beyond separation. The paper series features international law practitioners and academics from the United Kingdom, Canada, the United States and Europe, explaining the challenges that need to be addressed in the diverse fields of trade, financial services, insolvency, intellectual property, environment and human rights.

The project leaders are Oonagh E. Fitzgerald, director of the International Law Research Program at the Centre for International Governance Innovation (CIGI); and Eva Lein, a professor at the University of Lausanne and senior research fellow at the British Institute of International and Comparative Law (BIICL). The series will be published as a book entitled *Complexity's Embrace: The International Law Implications of Brexit* in spring 2018.

About the Author

Maziar Peihani is a post-doctoral fellow with CIGI's International Law Research Program (ILRP). His research at CIGI is focused on international financial law and regulation, including sovereign debt resolution, international banking regulation, cross-border bank resolution and governance of climate change-related financial risks. Prior to joining CIGI, Maziar was the inaugural post-doctoral fellow in the Centre for Banking and Finance Law at the National University of Singapore, a graduate research assistant at InterPARES Trust at the University of British Columbia (UBC) and a teaching assistant for various law courses at UBC.

Maziar is a recipient of the David L. Vaughan, Q.C. Memorial Scholarship in Corporate Law (2011). In 2007-08, he was a visiting graduate student in the Centre for Commercial Law Studies at Queen Mary University of London, where he completed the banking law course with distinction. Maziar's research has appeared in the *Harvard International Law Journal*, *Canadian Foreign Policy Journal*, *Annual Review of Insolvency Law*, and *Banking and Finance Law Journal*. He has a Ph.D. in law from UBC, as well as an LL.M. and an LL.B. from Iran.

About the International Law Research Program

The International Law Research Program (ILRP) at CIGI is an integrated multidisciplinary research program that provides leading academics, government and private sector legal experts, as well as students from Canada and abroad, with the opportunity to contribute to advancements in international law.

The ILRP strives to be the world's leading international law research program, with recognized impact on how international law is brought to bear on significant global issues. The program's mission is to connect knowledge, policy and practice to build the international law framework — the globalized rule of law — to support international governance of the future. Its founding belief is that better international governance, including a strengthened international law framework, can improve the lives of people everywhere, increase prosperity, ensure global sustainability, address inequality, safeguard human rights and promote a more secure world.

The ILRP focuses on the areas of international law that are most important to global innovation, prosperity and sustainability: international economic law, international intellectual property law and international environmental law. In its research, the ILRP is attentive to the emerging interactions among international and transnational law, Indigenous law and constitutional law.

Acronyms and Abbreviations

AIFMD	Alternative Investment Fund Managers Directive
CCPs	central counterparties
CETA	Comprehensive Economic and Trade Agreement
CJEU	Court of Justice of the European Union
CRD IV	Capital Requirements Directive IV
EEA	European Economic Area
EFTA	European Free Trade Association
ESA	European Supervisory Authorities
EUSFTA	EU-Singapore Free Trade Agreement
GATS	General Agreement on Trade in Services
IMF	International Monetary Fund
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
UCITS	Undertakings for the Collective Investment in Transferable Securities
WTO	World Trade Organization

Executive Summary

Since the Leave vote in the June 2016 referendum, the UK government has emphasized that Brexit means Brexit, and the United Kingdom is determined to leave the European Union. The future of the UK-EU relationship is now engulfed in uncertainty and speculation. This uncertainty is most conspicuous with respect to financial services, a highly integrated industry that remains crucial to the economic well-being of both jurisdictions. This paper examines the three primary scenarios that may govern future relations between the United Kingdom and the European Union in the realm of financial services: EEA membership, third-country equivalence and a bespoke agreement. In addition to examining the opportunities, challenges and feasibility of each option, the paper reflects upon outstanding transition issues. The paper posits that it is in both parties' interest to find a workable solution that could help maintain valuable elements of the Single Market, such as passporting. However, it also warns that the United Kingdom's Brexit vision, as it currently stands, is founded on unrealistic and irreconcilable objectives, which risks driving the United Kingdom's economy off the cliff.

Introduction

Brexit is certainly one of the most remarkable events in recent European history, marking the first time that an EU member state has decided to leave the bloc. In addition to important implications for European integration, Brexit has created significant uncertainty about a vast range of issues, including the rules that govern the United Kingdom's trade with the European Union and the rest of the world, the rights of EU workers in the United Kingdom and vice versa, and the resilience of the UK economy in coming years. Such uncertainty is perhaps most profound with respect to financial services, a globally oriented industry greatly reliant on unfettered access to European markets and infrastructure. EU financial exports account for 39 percent of the total EU financial services gross value added, with 22 percent of such trade occurring within the European Union. The United Kingdom is greatly involved in the intra-EU trade flows.[1] For example, it accounts for 78 percent of foreign exchange trading, 74 percent of interest rate derivatives and 50 percent of fund management in Europe.[2] Once the United Kingdom has left the European Union, the financial intermediaries who have chosen London as their European base will lose their passports to conduct cross-border business.

The key question that therefore arises is how to govern future relations between the United Kingdom and the European Union in the realm of financial services. This paper discusses three primary scenarios that may govern the parties' future relationship: EEA membership, third-country equivalence and a bespoke agreement. The paper assesses each option, the opportunities and challenges they present, and the key legal and regulatory issues to which they give rise. It is argued that the EEA membership offers the greatest access to the Single Market, posing the least disruption to the smooth functioning of financial intermediation across Europe. At the same time, however, it poses the greatest political challenge for the UK government, which has opted for a Brexit vision that focuses on gaining back full control of immigration and staving off the jurisdiction of the Court of Justice of the European Union (CJEU).

The discussion on equivalence suggests that it is a relatively new regime only available under certain EU legislations. Not only does equivalence exclude important areas of financial activity, but its assessment and determination is a process administered by the European Commission, which can be influenced by politics. The commission can grant access on a partial or provisional basis and withdraw it altogether. Moreover, maintaining equivalence can be challenging as the two regimes will inevitably grow more divergent over time. Finally, the paper discusses the concept of a bespoke arrangement and the agreements that the European Union has concluded with third countries such as Switzerland and Canada. It suggests that the existing arrangements do not offer good models for post-Brexit negotiations as they do not match the United Kingdom's trade profile, take significant time to conclude and offer relatively narrow access to the Single Market. The paper also

1 PwC, *Planning for Brexit: Operational impacts on wholesale banking and capital markets in Europe* (2017) at 2, online: <www.afme.eu/globalassets/downloads/publications/afme-pwc-planning-for-brexit.pdf>.

2 *Ibid*.

questions whether the United Kingdom can obtain preferential regulatory equivalence and access in a bespoke arrangement when it is adamant to leave the Single Market and the CJEU's jurisdiction.

The paper starts with an overview of the United Kingdom's financial sector, and the freedoms and passport rights that UK financial institutions currently enjoy. It maps the passporting onto primary types of financial intermediation such as banking, insurance and asset management, and discusses how significant it is for each sector. The paper then delves into possible options that may govern future relations between the United Kingdom and the European Union. It concludes the discussion by reflecting upon the path forward, outstanding transitional issues, and the possibility of the United Kingdom leaving the European Union without a deal and therefore falling back on the World Trade Organization (WTO) rules. The paper stresses that it is in both parties' interests to find a workable solution to safeguard the valuable elements of the Single Market, such as passporting. However, it also warns that the United Kingdom's Brexit vision, as it currently stands, is founded on unrealistic and irreconcilable objectives, which risks driving the United Kingdom's economy off the cliff.

A Primer on the United Kingdom's Financial Sector, Single Market and Passporting

City of London

The United Kingdom, and the city of London in particular, has been a leading financial centre for centuries. Finance constitutes one of the most important areas of economic activity in the United Kingdom. The Office for National Statistics estimates the financial sector output to be eight percent of the United Kingdom's national output.[3] Some have argued that if relevant business services are included, this number could be as high as 12 percent.[4] The country's trade surplus in financial services was £63 billion in 2015, which is larger than the combined surpluses of the next three leading competitors, namely Luxembourg, Switzerland and the United States.[5]

The United Kingdom has one of the largest financial systems in the world. Standing at about £20 trillion, the sum of financial assets owned by UK financial institutions, excluding the Bank of England, is more than 10 times the United Kingdom's annual GDP.[6] Nearly a fifth of global banking activity is booked in the United Kingdom, and around half of the world's largest financial institutions, including banks, insurers and asset managers, have their European headquarters in the United Kingdom.[7] Four UK banks — HSBC, Barclays, RBS and Standard Chartered — have been designated as global systemically important banks.[8] The United Kingdom's insurance sector is the largest in Europe and third largest in the world.[9] In addition, the United Kingdom hosts the largest wealth management industry, as well as many of the important equity trading platforms in Europe.[10] More than half of eurozone firms raise capital in London in the form of equity or debt. Finally, the United Kingdom is also a hub for securities and derivatives trading, hosting two of the largest central counterparties (CCPs) in the world.[11]

3 Gloria Tyler, *Financial services: contribution to the UK economy* (London, UK: House of Commons Library, 2015) at 1, online: <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06193>.

4 Angus Armstrong, "EU Membership, Financial Services and Stability" (2016) 236:1 Nat'l Inst Econ Rev at 31, online: <http://journals.sagepub.com/doi/abs/10.1177/002795011623600105?journalCode=nera>.

5 TheCityUK, "Key Facts about UK Financial and Related Professional Services 2016" (March 2016) at 9, online: <www.thecityuk.com/research/key-facts-about-uk-financial-and-related-professional-services-2016>.

6 International Monetary Fund, *United Kingdom: Financial Sector Assessment Program: Financial System Stability Assessment* (Washington, DC: International Monetary Fund, 2016) at 9 [IMF], online: <www.imf.org/en/Publications/CR/Issues/2016/12/31/United-Kingdom-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-43978>.

7 *Ibid*.

8 Financial Stability Board, "2016 list of global systemically important banks (G-SIBs)" (November 2016) at 3, online: <www.fsb.org/2016/11/2016-list-of-global-systemically-important-banks-g-sibs/>.

9 IMF, *supra* note 6 at 9.

10 *Ibid*.

11 *Ibid*.

Table 1: Number of Firms with at Least One Passport under Each Directive

Directive	Outbound	Inbound
Alternative Investment Fund Managers Directive (AIFMD)	212	45
Insurance Mediation Directive	2758	5727
Markets in Financial Instruments Directive (MiFID)	2250	988
Mortgage Credit Directive	12	0
Payment Services Directive	284	115
Undertakings for the Collective Investment in Transferable Securities (UCITS) Directive	32	94
Electronic Money Directive	66	27
Capital Requirements Directive IV (CRD IV)	102	552
Solvency II Directive	220	726

Source: Financial Conduct Authority, August 2016[12]

Passporting

In addition to the freedom of movement, which is a fundamental principle of EU law, the United Kingdom, as an EU member, enjoys freedom of movement of capital, as well as freedom of financial services.[13] Free movement of capital allows UK households and firms to borrow and invest abroad and make cross-border payments.[14] The free movement of financial services has two dimensions: the freedom to provide financial services and the freedom of establishment. While both freedoms date back to the Treaty of Rome (1957),[15] a key development in the free movement of financial services came in the 1990s when the European Union introduced the passporting regime. The concept of passporting relies on mutual recognition of prudential measures by member countries, coupled with minimum EU standards. It seeks to minimize legal, regulatory and operational barriers to cross-border provision of financial services in the EEA. A firm that is authorized by a regulator in one member state is therefore allowed to carry out the same permitted activities in another member state. It can do so by either directly providing cross-border financial services, or by setting up a branch in the other member state.[16]

Passporting has been introduced through several pieces of EU legislation for various financial activities and services.[17] Table 1 shows the EU laws that provide for passporting rights in financial services. It also shows the number of inbound and outbound passports that have been issued under each piece of legislation. An outbound passport is issued by the United Kingdom's competent authorities, whereas an inbound passport is issued by an EU or EEA competent authority, which enables European firms to do business in the United Kingdom.

12 Letter from Andrew Bailey, Chief Executive Officer, Financial Conduct Authority, to Andrew Tyrie, Chairman of the House of Commons Treasury Committee (17 August 2016), online: <www.parliament.uk/documents/commons-committees/treasury/Correspondence/AJB-to-Andrew-Tyrie-Passporting.PDF>.

13 *Treaty on the Functioning of the European Union*, 25 March 1957, C 326, Title IV Free Movement of Persons, Services and Capital (entered into force 1 January 1958) [*TFEU*].

14 Bank of England, *EU membership and the Bank of England* (October 2015) at 20, online: <www.bankofengland.co.uk/publications/Documents/speeches/2015/euboe211015.pdf>.

15 *Treaty Establishing the European Economic Community*, 25 March 1957, OJ, C 224, *Title I Free Movement of Goods, Title III Free Movement of Persons, Services and Capital* (entered into force 1 January 1958) [*Treaty of Rome*].

16 Bank of England, *supra* note 14 at 24.

17 *Ibid*.

From the banking perspective, the CRD IV and MiFID are particularly important. The CRD allows banks based in the United Kingdom to lend directly to corporations based anywhere in the European Union, or conduct business through the establishment of branches.[18] These branches remain under the supervisory authority of the home country, namely, the United Kingdom. Important business activities covered by the CRD IV's passport include deposit taking, lending brokering, payment services, securities issuance and portfolio management.[19] The passport under the MiFID operates similarly to the CRD IV and covers the following business activities: executing orders for clients, as well as trading on one's own account, investment advice, underwriting, foreign exchange services and portfolio management.[20] Industry reports indicate that UK banks can lose up to 20 percent of their revenue if they lose access to the European Union's passport.[21]

For the investment fund industry, including asset managers, money market funds, hedge funds, private equity and venture capital, the passport is largely introduced through the AIFMD and the UCITS.[22] Together, these directives allow investment funds to market their products in any EU member state.[23] The passport regime for investment funds is less complete than banking, and therefore of less value. While services can be offered in any EU member state, the actual marketing of funds is still subject to national regulation.[24] Nonetheless, European business is still of significance to the United Kingdom's investment fund industry. The latest study published by the Investment Association suggests that UK firms managed £1.2 trillion in assets for European clients in 2015. [25] The loss of access to the EU Single Market can therefore have significant implications for the UK investment funds industry.

For the insurance industry, the important legislation are Solvency II and the MiFID. The Insurance Mediation Directive II, which will be replaced by the Insurance Distribution Directive in February 2018, also has some significance as it governs the sale and disclosure of insurance products.[26] It has been argued that UK insurers do not use passporting as widely as the banks.[27] Open Europe, for example, estimates that 87 percent of the cross-border insurance business is conducted through subsidiaries and only 13 percent is done through branches.[28] One key reason behind this trend is that insurance firms prefer to keep risks isolated in separately capitalized subsidiaries. This business strategy is particularly common for retail insurance where a presence on the ground and local knowledge are especially important. Caution must be taken, however, in interpreting the numbers cited above. Lloyd's of London, which retains a significant share of the insurance market, relies significantly on passporting to provide underwriting services either directly

18 *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC* [2013] OJ, L 176/338, arts 33–34 [*CRD IV*]; *Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC* [2004] OJ, L 145, arts 32–34 [MiFID].

19 *CRD IV*, *supra* note 18, Annex I, List of Activities Subject to Mutual Recognition.

20 MiFID, *supra* note 18, Annex I, List of Services and Activities and Financial Instruments, s A–B.

21 For example, a recent Oliver Wyman study suggests that the UK banking sector's total revenue in 2015 was between £108 billion and £117 billion. Of this, between £23 billion and £27 billion were international and wholesale business related to the European Union. It therefore estimates that 21 percent to 23 percent of UK banks' revenue can be affected by the loss of passporting. See Oliver Wyman, *The Impact of the UK's Exit from the EU on the UK-Based Financial Services Sector* (2016) at 6, online: <www.oliverwyman.com/content/dam/oliver-wyman/global/en/2016/oct/Brexit_POV.PDF>.

22 *Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010* [2011] OJ, L 174, arts 31–32 [AIFMD]; *Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities*, OJ, L 302, art 16 [UCITS].

23 Vincenzo Scarpetta & Stephen Booth, *How the UK's financial services sector can continue thriving after Brexit*, (London, UK: Open Europe, 2016) at 23, online: <http://2ihmoy1d3v7630ar9h2rsglp.wpengine.netdna-cdn.com/wp-content/uploads/2016/10/0627_Digital_Pages-Open_Europe_Intel-Thriving_after_Brexit-V1.pdf?emailid=577bc2bcc0350c0300f8b09d&ftcamp=crm/email//nbe/Brexit/product>.

24 *Ibid* at 24.

25 The Investment Association, *Asset Management in the UK 2015–2016* (September 2016) at 16, online: <www.theinvestmentassociation.org/assets/files/research/2016/20160929-amsfullreport.pdf>.

26 *Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation* [2002] OJ, L 009; *Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast) Text with EEA relevance* [2016] OJ, L 26.

27 Dirk Schoenmaker, "The UK Financial Sector and EU Integration after Brexit: The Issue of Passporting", SSRN (October 2016) at 5, online: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2844253>.

28 Scarpetta & Booth, *supra* note 23 at 27.

or through branches in other member states. In 2015, the EU/EEA accounted for £2.9 billion, or 11 percent, of Lloyd's gross written premium.[29] As Huw Evans, director general of the Association of British Insurers, points out, the significance of this number is understood far better when it is noted that Lloyd's annual revenue in 2015 was £27 billion,[30] amounting to 64 to 69 percent of the United Kingdom's total insurance revenue.[31] Passporting is, therefore, far more important to the United Kingdom's insurance industry than is often noted in the quantitative studies on Brexit.

While there is a clear understanding that maintaining passporting rights is crucial to the United Kingdom's financial services, assessing the economic costs of losing such rights has proven difficult. Oliver Wyman estimates that a low access scenario could result in total revenue losses of about £18 to £20 billion.[32] The House of Lords' hearings on Brexit, however, suggest that it is difficult to read much into these numbers.[33] Neither the public authorities nor the financial industry seem to understand yet how passporting maps onto the business structure and the operation of financial institutions.[34] Indeed, it is difficult if not impossible to isolate various products and services and then quantify the impact of Brexit under different scenarios. While explanations can be offered on how financial institutions and markets operate, translating those explanations into impact scenarios remains difficult.[35] Consequently, the impact of Brexit on the United Kingdom's financial ecosystem remains quite unclear, especially when no coherent information is yet available on the UK government's strategy or the direction of future negotiations.

Governing the UK-EU Future Relations: A Survey of Primary Options

The key question that has arisen since the Leave vote in the June 2016 referendum is how future relations between the United Kingdom and the European Union can be governed. While there are infinite Brexit scenarios, three options seem to be most relevant when it comes to governing the future relations of both parties: an EEA membership, equivalence or a bespoke arrangement. The first option offers the greatest access to the Single Market and the least disruption to the smooth functioning of financial institutions. The second option relies on specific EU laws that allow third countries to gain access to the Single Market on a case-by-case basis. Finally, the third option is a bespoke free trade agreement, which seeks to ensure that the United Kingdom maintains access to the Single Market.

At the time of writing, the third option seems the most favourable to the British government. The prime minister's speeches and a white paper on Brexit have repeatedly called for a bold and ambitious free trade agreement.[36] In spite of this preference, the other two options remain relevant and worthy of analysis. This is particularly the case as the government's proposed bespoke arrangement

29 Michael Faulkner, "Lloyd's in talks to maintain EU licenses on Brexit", *Lloyd's List* (1 July 2016), online: <www.lloydslist.com/ll/sector/insurance/article529493.ece>.

30 House of Lords Select Committee on the European Union, Financial Affairs Sub-Committee, "Corrected oral evidence: Brexit and Financial Services in the UK" (12 October 2016) at Q 51, online: <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-financial-affairs-subcommittee/brexit-financial-services/oral/41228.html>.

31 These figures are the author's calculations based on the United Kingdom's total insurance revenue estimated by the European Parliament in December 2016. See European Parliament, *Brexit: the United-Kingdom and EU financial services*, (Briefing, PE 587.384, December 2016) at 1, online: <www.europarl.europa.eu/RegData/etudes/BRIE/2016/587384/IPOL_BRI(2016)587384_EN.pdf>.

32 The low access scenario means that the United Kingdom becomes a third country without receiving equivalence or preferential access on a bilateral basis. *Ibid* at 14.

33 House of Lords European Union Committee, *Brexit: financial services* (9th Report of Session 2016–17, December 2016) at 13 [House of Lords EU Committee], online: <https://publications.parliament.uk/pa/ld201617/ldselect/ldeucom/81/81.pdf>.

34 *Ibid* at 15.

35 House of Lords Select Committee on the European Union, Financial Affairs Sub-Committee, "Corrected oral evidence: Brexit and Financial Services in the UK" (19 October 2016) at Q 58, online: <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-financial-affairs-subcommittee/brexit-financial-services/oral/41565.html>.

36 Theresa May, "Theresa May's Brexit speech in full" (Speech delivered at Lancaster House, London, UK, 17 January 2017) *The Telegraph*, online: <www.telegraph.co.uk/news/2017/01/17/theresa-mays-brexit-speech-full/>; HM Government, *The United Kingdom's exit from and new partnership with the European Union* (February 2017) at 35 [Brexit White Paper], online: <www.gov.uk/government/publications/the-united-kingdoms-exit-from-and-new-partnership-with-the-european-union-white-paper>.

has elements of both the EEA membership and equivalence. The government not only seeks to conclude a free trade agreement, but also to maintain an EEA-type access to the Single Market, and ensure the continued equivalence of legal and regulatory regimes with the European Union.[37]

It is also important to be mindful of the United Kingdom's internal politics and that Brexit preferences can change over time. The Conservative government suffered a major defeat in a snap election that was supposed to seek a "strong Brexit mandate."[38] It currently holds a thin majority in Parliament, struggling to secure political backing for its vision of Brexit.[39] The principle of parliamentary sovereignty, which was upheld by the UK Supreme Court in the *Miller* case, requires the government to consult Parliament over Brexit.[40] Parliamentary debate and scrutiny can therefore pressure the government to re-evaluate and change its Brexit strategies and objectives. The following section will therefore discuss the legal and regulatory issues that arise under the three Brexit options.

EEA Membership

The EEA refers to a single market established between EU member states on one hand and the three members of the European Free Trade Association (EFTA), namely, Iceland, Liechtenstein and Norway.[41] These countries are commonly referred to as EEA EFTA members, and their relationship with the European Union is underpinned by the EEA Agreement.[42] Switzerland, another EFTA member, has its own agreement with the European Union, which will be discussed later in this paper. The EEA Agreement grants virtually full access to the Single Market and provides for the four freedoms, namely, free movement of goods, services, capital and labour, in the same way as they are applicable within the European Union.[43] The EEA, however, is not a customs union and excludes agriculture, fisheries, common trade policy and foreign policy.

The EEA Agreement provides for the simultaneous application of EU rules on the internal market, state aid and competition within the EAA.[44] This is meant to ensure that the rules of the Single Market remain homogenous. The EU laws are imported as an annex to the EEA Agreement, and their implementation is monitored by the EFTA Surveillance Authority.[45] The decisions of the EFTA Surveillance Authority can be appealed to the EFTA Court. The EFTA Court can also hear actions against the Surveillance Authority, as well as disputes between the EFTA member states.[46] The EFTA Court takes into account the case law of the CJEU when interpreting the EEA Agreement, as well as EU treaties and laws.[47]

If the United Kingdom decides to join the EEA, disruptions to the financial sector will be minimized. UK financial institutions will continue to benefit from the passport regime by operating through branches or providing direct cross-border services. Non-EU financial institutions can also maintain their commercial presence in the United Kingdom and do not need to move their headquarters to other EU/EEA countries as the United Kingdom would remain the gateway to EU markets. In order to join the EEA, the United Kingdom needs to follow the procedures under article 108 of the EEA Agreement. Under this provision, any European state that seeks to become an EEA party should submit its application to the EEA Council, the highest decision-making authority in the EEA.[48] The terms and conditions of the accession need to be agreed upon by all contracting parties to the EEA Agreement, namely

37 Brexit White Paper, *supra* note 36 at 42–43.

38 Steven Erlanger, "Theresa May Calls for New Election in Britain, Seeking Stronger 'Brexit' Mandate", *New York Times* (18 April 2017), online: <www.nytimes.com/2017/04/18/world/europe/uk-theresa-may-general-election.html>.

39 George Parker, "British election results: May's gamble backfires", *Financial Times* (9 June 2017), online: <www.ft.com/content/d50a9332-4c89-11e7-a3f4-c742b9791d43?mhq5j=e7>.

40 *R (Miller) v Secretary of State for Exiting the European Union* [2017] UKSC 5 at paras 110, 124.

41 EFTA, "European Economic Area (EEA)/Relations with the EU", online: <www.efta.int/eea>.

42 *Agreement on the European Economic Area,* 2 May 1992, OJ, L 1 (entered into force 1 January 1994) [*EEA Agreement*].

43 *Ibid*, art 1.

44 *Ibid*, art 102.

45 *Ibid*, art 109.

46 *Ibid*, art 108.

47 *Agreement Between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice* [1994] OJ, L 344, art 3.

48 *EEA Agreement, supra* note 42, art 90. The EEA Council consists of the EFTA governments, members of the EU Council, and representatives from the European Commission and European External Action Service.

EU and EFTA member states. The agreement should then be submitted for ratification to the contracting parties under their domestic laws.[49]

However, while offering significant benefits, EEA membership comes with important costs and challenges. First, the United Kingdom is expected to make a contribution to the European Union's budget in return for access to the Single Market and other EU programs. Based on current estimates, this contribution will not significantly differ from what the United Kingdom is currently paying.[50] Second, in return for access to the Single Market, the United Kingdom needs to respect the four freedoms and submit to the jurisdiction of the EFTA Court, which closely follows the CJEU's precedent. The EEA Agreement allows member states to unilaterally adopt safeguard measures in case of "serious economic, societal or environmental difficulties."[51] As the language of article 112 indicates, however, these measures can only be adopted in exceptional circumstances and must be temporary and limited in scope. Moreover, the adoption of such measures entitles other contracting parties to take "proportionate rebalancing measures," which can mean restricting access to the Single Market.[52] Due to such restrictions, safeguard measures have been used in a limited manner. Norway, for example, has never used safeguard measures. While Liechtenstein has adopted safeguards to restrict the free movement of people, such measures have been reached by way of an agreement with the European Union, which Liechtenstein cannot amend unilaterally. More importantly, Liechtenstein's safeguards are very limited in scope and can be explained by its unique circumstances: a population of around 37,000 and a territory of around 160 square kilometres.[53] The final challenge has to do with the United Kingdom's influence over the EU rule-making process. As mentioned earlier, EU laws are transposed into the EEA legal order. Member states are expected to follow EU rules on core freedoms, state aid, competition and so on.[54] While the EFTA states can express their views on the proposed EU rules, they can have no vote on what is decided and can have only limited influence over the rule-making process.[55]

These challenges are of varying magnitude. For example, the issue of financial commitment seems to be of less concern, given that the UK government has recently expressed readiness to make some form of contribution to the EU budget in return for access to the internal market. Similarly, the United Kingdom's influence over the rule-making process can also be reinforced through greater emphasis on the EEA Agreement provisions, which seek to facilitate timely input from member states in the rule-making process.[56] Given the United Kingdom's significance as a major financial jurisdiction, it is likely that its views will have more influence over the European Union's rule-making process on financial services than other EFTA states. The second problem, however, seems to pose the greatest challenge to the viability of the EEA option. The UK prime minister expressly indicated that her country is not leaving the European Union to give up control of immigration or return to the jurisdiction of the CJEU.[57] If the United Kingdom seeks to resume full sovereignty over immigration and rule of law, EEA membership cannot be pursued as a realistic option.

Third-country Equivalence

Certain EU financial laws allow a third country to gain access to the Single Market, provided that its legal and regulatory frameworks are recognized as equivalent to the European Union's. This recognition enables the European Union to rely on the foreign firms' compliance with an equivalent regulatory framework, allowing them access to the Single Market. The European

49 *Ibid*, art 126.

50 Stephen Booth, "As the UK searches for a post-Brexit Plan, is the EEA a viable option?", *Open Europe* (4 August 2016) online: <http://openeurope.org.uk/intelligence/britain-and-the-eu/as-the-uk-searches-for-a-post-brexit-plan-is-the-eea-a-viable-option/>; Sam Ashworth-Hayes, "Norwegians pay about as much as Brits to access EU", *In Facts* (2 November 2016) online: <https://infacts.org/norwegians-pay-same-brits-eu-access/>.

51 *EEA Agreement*, *supra* note 42, art 112.

52 *Ibid*, art 114.

53 Booth, *supra* note 50.

54 *EEA Agreement*, *supra* note 42, part IV, c I–II.

55 Jean-Claude Piris, "If the UK votes to leave: The seven alternatives to EU membership", *Centre for European Reform* (12 January 2016) 6, online: <www.cer.eu/sites/default/files/pb_piris_brexit_12jan16.pdf>.

56 *EEA Agreement*, *supra* note 42, arts 99–100.

57 Theresa May, "Prime Minister: Britain after Brexit: A Vision of a Global Britain" (Speech delivered at the Conservative Party Conference at the ICC, Birmingham, UK, 2 October 2016), [May's Speech (October 2016)], online: <http://press.conservatives.com/post/151239411635/prime-minister-britain-after-brexit-a-vision-of>.

Commission makes the decision on whether to grant equivalence. The decision is often based on the technical advice provided by the European Supervisory Authorities (ESA), although sometimes the commission itself does all the technical work.[58] The criteria for recognition of equivalence are set out in the relevant financial legislation. Typically, equivalence provisions require the third country to demonstrate to the regulatory regime that it meets three conditions: it has legally binding requirements in place; it exercises effective supervision; and it achieves the same results as the EU corresponding regime.[59]

The equivalence determination applies legislation by legislation. The following are some of the major activities that are covered by equivalence provisions of EU financial laws:

- → provide cross-border investment services to professional clients and eligible counterparties (MiFID II/Markets in Financial Instruments Regulation [MiFIR]);
- → establish CCPs and information-gathering trade repositories (European Market Infrastructure Regulation);
- → provide access to trading venues, CCPs and benchmarks (MiFID II/MiFIR);
- → provide access to trading venues for the purposes of trading obligations for derivatives and shares;
- → provide marketing of AIFMD; and
- → provide reinsurance (Solvency II).[60]

It must be noted that no equivalence decision can be taken yet under the MiFIR and MiFID II as these two legislations will not come into force until January 2018.[61] MiFID, which is currently the applicable legislation, does not provide for any common third-country regime.[62] Another important issue that can be discerned from the above list is that the equivalence regime does not cover the full range of financial services — deposit taking, lending, primary insurance, retail asset management and payment services are excluded.[63] Further, even when equivalence is allowed under a particular legislative scheme, equivalence can be granted only partially or provisionally. For example, there are three sets of criteria for equivalence under Solvency II: capital requirements, group supervision and reinsurance.[64] A third country's regulatory regime will only be reconciled as fully equivalent when all three criteria are met. To date, only Bermuda and Switzerland have achieved full equivalence with other third countries, such as Australia, Canada and Japan, achieving only provisional or partial equivalence.[65] Finally, even when granted, equivalence can be withdrawn on short notice.[66]

The equivalence regime's limited scope and legislation-specific nature make it a far less attractive option than an EEA-type passport. If the United Kingdom decides to pursue equivalence, it must apply to the commission under the relevant

58 European Commission, "Equivalence with EU Rules and Supervision", online: <http://ec.europa.eu/finance/general-policy/global/equivalence/index_en.htm#maincontentSec4>.

59 European Commission, "Recognition of non-EU financial frameworks (equivalence decisions)", online: <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/recognition-non-eu-financial-frameworks-equivalence-decisions_en>; House of Lords EU Committee, *supra* note 33 at 17.

60 European Commission, "Equivalence Decisions Taken by the European Commission (as at 21/12/2016)", (December 2016), online: <https://ec.europa.eu/info/sites/info/files/file_import/equivalence-table_en.pdf >.

61 *Ibid*.

62 Ernst & Young, *UK/EU: Working through uncertainty: Practical considerations for financial institutions*, (2016) at 8, online: <www.ey.com/Publication/vwLUAssets/EY-UK-EU-Working-through-uncertainty/$FILE/EY-UK-EU-Working-through-uncertainty-considerations-for-Financial-Institutions.pdf>.

63 House of Lords EU Committee, *supra* note 33 at 18, 21.

64 *Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance*, [2009] OJ, L 335, arts 227, 260, 172 [Solvency II].

65 *Commission Delegated Decision (EU) 2015/1602 of 5 June 2015 on the equivalence of the solvency and prudential regime for insurance and reinsurance undertakings in force in Switzerland based on Articles 172(2), 227(4) and 260(3) of Directive 2009/138/EC of the European Parliament and of the Council*, OJ, L 248, online: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015D1602&from=EN>; *Commission Delegated Decision (EU) 2015/2290 of 12 June 2015 on the provisional equivalence of the solvency regimes in force in Australia, Bermuda, Brazil, Canada, Mexico and the United States and applicable to insurance and reinsurance undertakings with head offices in those countries*, OJ, L 323, online: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015D2290&from=EN>; *Commission Delegated Decision (EU) 2016/310 of 26 November 2015 on the equivalence of the solvency regime for insurance and reinsurance undertakings in force in Japan to the regime laid down in Directive 2009/138/EC of the European Parliament and of the Council*, OJ, L 58, online: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D0310&from=EN>.

66 European Parliament, "Third-country equivalence in EU banking legislation" (Briefing, PE 587.369, December 2016) at 2, online: <www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI(2016)587369_EN.pdf>.

legislative scheme. Since the United Kingdom has been an EU member so far and plans to keep a significant portion of the EU legislation through the Great Repeal Bill,[67] achieving equivalence may not be technically difficult at the point of withdrawal. Politically, however, the process for achieving equivalence may prove slow and problematic. An interesting example in this respect is the commission's landmark decision on equivalence of US central clearing arrangements.[68] Simon Gleeson from Clifford Chance notes that while technical experts found the US regime broadly equivalent within six months, it took more than 30 months of discussion at the political level to grant equivalence. Yet, some have remained relatively optimistic that politics will not interfere with equivalence decisions. For example, Cambridge law scholar Eilis Ferran draws attention to the rise of the ESA and the strong technical expertise they bring to the equivalence process.[69] In her view, such technical input can shield against political interference. While there is merit to the observation that the ESA play an important role in technical determination, it is only the commission that can make the equivalence determination. It is hard to see why the commission's decision cannot be influenced by political considerations, especially when the EU members strongly stress the importance of safeguarding political unity and that the United Kingdom should not achieve a better deal than it currently enjoys as a member of the bloc.[70] The United Kingdom's withdrawal from the European Union, coupled with its reluctance to accept the basic freedoms in return for market access, may adversely affect the prospect of achieving a favourable equivalence deal.[71]

67 See May's Speech (October 2016), *supra* note 57; Brexit White Paper, *supra* note 36 at 9.

68 See European Commission, Press Release, "European Commission adopts equivalence decision for CCPs in USA" (15 March 2016), online: <http://europa.eu/rapid/press-release_IP-16-807_en.htm>.

69 House of Lords Select Committee on the European Union, Financial Affairs Sub-Committee, "Corrected oral evidence: Brexit: Financial Services" (7 September 2016) at Q 5, online: <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-financial-affairs-subcommittee/brexit-financial-services/oral/37866.html>; Eilis Ferran, "The UK as a Third Country Actor in EU Financial Services Regulation" (2016) University of Cambridge Faculty of Law Research Paper No 47/2016 at 20.

70 Tony Barber, "The EU 27's message to Brexit Britain", *Financial Times* (12 January 2017), online: <www.ft.com/content/a6be290c-d8bd-11e6-944b-e7eb37a6aa8e?mhq5j=e7>.

71 Sara Hagemann, "Brexit – six months on: The rest of the EU", *The UK in a Changing Europe* (27 December 2016), online: <http://ukandeu.ac.uk/brexit-six-months-on-the-rest-of-the-eu/>.

Even if the United Kingdom can achieve equivalence in the short term, maintaining such equivalence may be challenging over the long run. It has yet to be seen whether the United Kingdom will choose to continue applying EU rules as a third country without any direct influence over EU regulatory design. If the country decides to break away from EU regulations, it will then find it difficult to maintain the level of equivalence required by EU law. To be sure, international standards continue to apply in both the United Kingdom and the European Union, providing some level playing field across jurisdictions. Such standards, however, lay out only minimum requirements, and considerable differences remain between jurisdictions in how they regulate and supervise financial markets. As Niamh Moloney notes, equivalence is not simply a matter of regulatory equivalence, but also how the authorities supervise firms and enforce the rules.[72] Equivalence assessments for supervision and enforcement are highly elusive. For example, a tougher or more lenient approach to enforcement on either side can easily diminish the prospect of equivalence.[73] The divergence between the UK and EU regimes is also likely to grow over time as both jurisdictions respond and adapt to fast-paced changes in their own markets. Thus, unless the United Kingdom closely follows the European Union's lead on financial regulation, losing equivalence will always be a present danger.

A Bespoke Free Trade Agreement

The third alternative to EU membership is a bespoke bilateral agreement. This option, which frequently appears in Brexit news and commentaries, seems most aligned with the UK government's Brexit priorities. In January 2017, UK Prime Minister Theresa May indicated that her government sought to pursue "a new, comprehensive, bold and ambitious free-trade agreement", with elements of Single Market arrangements in

72 Niamh Moloney, "Financial services, the EU, and Brexit: an uncertain future for the city?" (2016) 17 German LJ 75 at 79.

73 *Ibid*.

certain areas such as financial services.[74] The European Union currently has two important bilateral agreements that are relevant to financial services: the EU-Swiss agreement on insurance, and the Canada-European Union Comprehensive Economic and Trade Agreement (CETA).[75]

The EU-Swiss agreement is quite narrow in scope; it only covers direct insurance other than life insurance, with social insurance and reinsurance being excluded.[76] The agreement allows insurance firms that have been licensed by one contracting party to open a branch in the territory of another contracting party.[77] The agreement, however, does not allow insurance firms to directly provide cross-border insurance services in the territory of the contracting party.[78]

CETA, as it appears from its title, is a much broader agreement than the EU-Swiss deal. The agreement, which took more than seven years of negotiation, has been praised as the most comprehensive trade agreement with the European Union. It consists of 30 chapters, with the thirteenth chapter specifically devoted to financial services.[79] CETA seeks to liberalize trade in financial services based on the four modes contained in the General Agreement on Trade in Services (GATS): cross-border supply, consumption abroad, commercial presence and presence of natural persons. It contains the principles of national treatment and most-favoured nation treatment, which prohibit contracting parties from discriminating against each other's businesses or treating them less favourably than a third country's firm. Market access under CETA is, however, quite limited as the contracting parties are under no obligation to permit foreign financial institutions to conduct or solicit business in their territory.[80] So, the cross-border provision or consumption of financial services will be subject to the same rules that each contracting party applies in its jurisdiction.[81] Similarly, with respect to commercial presence, financial institutions should comply with the rules that apply in the host jurisdiction. In fact, article 13.6(3)(a) expressly says that "a Party may impose terms, conditions, and procedures for the authorisation of the establishment and expansion of a commercial presence" if it does not lead to discrimination.[82] As a result, a European bank that seeks to operate in Canada has to comply with all the requirements imposed by the Canadian regulator, including the rule that foreign branches cannot accept deposits of less than CDN$150,000.[83] Similarly, a Canadian bank seeking to operate in the European Union has to comply with the EU directive on the taking-up and pursuit of credit institutions' business.[84] In this respect, CETA bears resemblance to GATS, which also provides for a prudential carving-out: contracting parties can adopt all necessary regulatory and prudential measures even though they are incompatible with GATS freedoms.

As the above discussion suggests, the existing bespoke agreements do not represent good models for post-Brexit negotiations. The Swiss deal is narrow in scope, covering only a small segment of the insurance business. Its passport rights do not allow firms to directly engage in cross-border insurance business. Moreover, given that the insurance industry is not a major user of passport rights, a Swiss-type agreement would be of limited value to the United Kingdom's financial sector. CETA is also a poor policy choice, given the significant difference between the United Kingdom's and Canada's trade profiles. Trade in services is of much greater significance to the United Kingdom than to Canada, whose exports

74 "Theresa May's blueprint for Brexit: full speech transcript", *Financial Times* (17 January 2017) [Theresa May's blueprint], online: <www.ft.com/content/589da76c-dcb3-11e6-9d7c-be108f1c1dce?mhq5j=e7>.

75 *Agreement between the European Economic Community and the Swiss Confederation on direct insurance other than life insurance* [1991] OJ, L 205/4 [*EU-Swiss Agreement*], online: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A21991A0727%2801%29>; *Text of the Comprehensive Economic and Trade Agreement*, 30 October 2016, (not yet entered into force) [*CETA*], online: <www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/toc-tdm.aspx?lang=eng>.

76 *EU-Swiss Agreement*, *supra* note 75, Annex 2 at para A.

77 *Ibid,* art 11.

78 *Ibid,* art 7.1, Annex 2 at para B.3.

79 Government of Canada, "Trade Negotiations and Agreements" (October 2016), online: <www.canadainternational.gc.ca/eu-ue/policies-politiques/trade_agreements-accords_commerciaux.aspx?lang=eng>.

80 Patrick Leblond, "CETA and Financial Services: What to Expect?" CIGI, CIGI Papers No 91, 12 February 2016 at 12.

81 *Ibid*.

82 *CETA*, *supra* note 75, art 13.6(3)(a).

83 Office of the Superintendent of Financial Institutions, "Guide to Foreign Bank Branching" at para 8(a), online: <www.osfi-bsif.gc.ca/Eng/fi-if/app/aag-gad/Pages/fbbguide.aspx>.

84 *Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions* (as amended) [2006] OJ, L 177, online: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32006L0048>.

to Europe consist mainly of commodities.[85] In fact, the United Kingdom runs a substantial trade deficit in goods, which it can only seek to compensate with a surplus in services.[86] In contrast to an EU or EEA membership, CETA offers very little liberalization for trade in services. This is particularly the case with respect to the freedom to provide services and the right to establishment or commercial presence, which are crucial to the United Kingdom's financial institutions.

It has been argued that the aim of a bespoke agreement should be securing EU equivalence and passporting rights for the United Kingdom's financial institutions.[87] However, to what extent Brexit negotiations can secure such an aim has yet to be seen. European leaders have repeatedly emphasized that they will not allow cherry picking with respect to the Single Market. It is unlikely that a bespoke agreement can offer passport rights that are available only to EEA members that have accepted the core freedoms and surrendered to the applications of EU law in return for market access. Similar challenges will arise with respect to equivalence. As explained previously, the EU equivalence regime, which is administered by the European Commission, is relatively new and offers limited market access. Granting a preferential equivalence status and market access to the United Kingdom will require changing EU law on equivalence and will raise questions about the consistency of the European Union's approach to third countries. Such objectives will therefore be difficult to pursue, requiring extensive negotiations, and will depend on the European Union's negotiating position as well.

85 In 2013, Canada's net export to the European Union was nearly CDN$33.2 billion. Precious stones and metals accounted for $10 billion and minerals for $4.6 billion. In contrast, exports in services were just under $14.5 billion for the same period. See Canadian Trade Commissioner Service, *Exporting to the EU: A Guide for Canadian Business* (2017) at para 1.4, online: <http://tradecommissioner.gc.ca/european-union-europeenne/market-facts-faits-sur-le-marche/0000256.aspx?lang=eng>.

86 For example, in 2014, the United Kingdom's trade deficit in goods was 6.7 percent of GDP, while its surplus in services for the same period was 4.7 percent. See Office for National Statistics, *UK Balance of Payments, The Pink Book: 2016* (2016) at para 4 "Trade", online: <www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/unitedkingdombalanceofpaymentsthepinkbook/2016#trade>.

87 House of Lords EU Committee, *supra* note 33 at 33.

The Path Forward: Concluding Observations

Many unanswered questions remain about Brexit and how it will change the United Kingdom's future relationship with the European Union and the world. The surprising results of the June election have added to this uncertainty, as the UK government did not secure a strong Brexit mandate as it had hoped.

Particularly problematic is the fact that the United Kingdom still lacks a comprehensive and realistic strategy on how to govern its future relations with the European Union.[88] The only available document is the Brexit white paper, which came out in February 2017 after significant parliamentary pressure. The white paper calls for a new strategic partnership with the European Union, including a comprehensive trade agreement, and stresses the desire to maintain the deeply integrated trade and economic relationship.[89] However, it does not specify how such objectives ought to be achieved. Nor does it assess the tradeoffs involved, particularly with respect to the free movement of people. The paper expressly indicates that the Free Movement Directive will cease to apply following Brexit and that "the migration of EU nationals will be subject to UK law."[90]

Yet, maintaining the current level of economic and financial integration on the one hand and taking back full control of immigration on the other may prove to be irreconcilable objectives. Free movement of people is a founding principle of the EU project, enshrined in the EU treaties and case law.[91] With the exception of Liechtenstein, which is a very small country, none of the European countries with access to the Single Market have managed to impose restrictions on the flow of EU/EEA citizens. Even

88 This problem has been admitted by UK government insiders as well. See e.g. Connor Murphy, "Brexit negotiations are not going well, says former top UK diplomat", *Politico* (7 August 2017), online: <www.politico.eu/article/brexit-negotiations-are-not-going-well-says-former-top-uk-diplomat/>.

89 Brexit White Paper, *supra* note 36 at 35.

90 *Ibid* at 25.

91 Camino Mortera-Martinez & Christian Odendahl, "What free movement means to Europe and why it matters to Britain", *Centre for European Reform* (January 2017) at 3, online: <www.cer.eu/sites/default/files/pb_cmm_co_freemove_19jan17.pdf>.

Switzerland, which has only partial access to the Single Market, has accepted the free movement of people.[92] It seems unrealistic to expect EU leaders to give the United Kingdom access to the Single Market without having to accept at least a mild form of free movement in return.

The lack of a Brexit strategy, combined with the daunting complexity of dismantling social and economic arrangements that were put in place over half a century ago, mean that the United Kingdom can crash out of the European Union without a deal. As set out in article 50 of the Treaty on European Union, the EU treaties will cease to apply to the United Kingdom when the withdrawal agreement comes into force, or two years from the day the article 50 notification has been made.[93] While there was initially some optimism that a deal could be achieved within two years, this outcome seems increasingly unlikely.[94] Free trade agreements are notoriously slow.[95] Consider CETA, for example, which took seven years to negotiate and has not yet come into force.[96] Indeed, CETA was relatively simple as it did not include the type of service provisions and non-trade tariff barriers that a large service economy such as the United Kingdom's needs to negotiate.[97] Significant time is also needed to agree upon important exit matters, such as the United Kingdom's exit bill, the rights of EU citizens in the United Kingdom and vice versa, and the future of EU agencies located in the United Kingdom.[98] Furthermore, it is possible that the future UK–EU agreement will be classified as a "mixed agreement" under EU law, which would then require the lengthy process of domestic ratification by all EU member states as well.[99]

To hedge against the risks of falling off the cliff, the United Kingdom needs a clear transition agreement that maintains access to the Single Market until a new partnership agreement has been put in place.[100] Yet, the prospect of a soft transitional agreement seems bleak if the UK government continues to pursue a hard Brexit strategy, stressing its determination to leave the Single Market.[101] In this regard, Michel Barnier, the European Union's lead negotiator, has noted that "the term transitional agreement only makes sense if it prepares the way for a future relationship."[102] This statement implies that the terms of the transitional deal need to be aligned with objectives and terms of the long-term agreement between the parties. If the parties cannot agree upon access to the Single Market in their post-Brexit partnership, passport rights risk disappearing altogether after the two-year limit when article 50 has been reached.[103]

If the United Kingdom leaves the European Union without a deal, its relationship with the European Union will then fall back on the WTO rules or, more specifically, on the schedules on goods and services, which set out the rights and obligations

92 *Ibid* at 6.

93 This is unless all 27 EU member states agree to extend the process. See *Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon*, 13 December 2007, OJ, C 306, art 50 (entered into force 1 December 2009), online: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:12007L/TXT>.

94 Peter Foster, "Brexit deal could be reached by October 2018, says lead EU negotiator Michel Barnier", *The Telegraph* (6 December 2016), online: <www.telegraph.co.uk/news/2016/12/06/eu-brexit-negotiator-michel-barnier-reiterate-no-cherry-picking/>; Brexit White Paper, *supra* note 36 at 65.

95 Caroline Freund & Christine McDaniel, "How Long Does It Take to Conclude a Trade Agreement With the US?", *Peterson Institute for International Economics* (21 July 2016), online: <https://piie.com/blogs/trade-investment-policy-watch/how-long-does-it-take-conclude-trade-agreement-us>.

96 Government of Canada, *supra* note 79.

97 Jon Henley & Dan Roberts, "Reality check: will it take 10 years to do a UK-EU trade deal post Brexit?" *The Guardian* (15 December 2016), online: <www.theguardian.com/politics/2016/dec/15/reality-check-will-it-take-10-years-to-do-a-uk-eu-trade-deal-post-brexit>.

98 *Ibid*.

99 Trade agreements that contain provisions that fall under member states' responsibility are often referred to as mixed agreements. In addition to the European Union, individual member states also have to ratify mixed agreements according to their national ratification procedures. See European Commission, "Trade negotiations step by step" (September 2013) at 6, online: <http://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149616.pdf>. The CJEU is soon expected to rule on the legal classification of the EU–Singapore Free Trade Agreement (EUSFTA). In an opinion published on December 21, 2016, Advocate General Eleanor Sharpston found that the EUSFTA is a mixed agreement that can only be concluded by both the European Union and member states acting jointly. See CJEU, Press Release, No 147/16, "Advocate General's Opinion in Opinion procedure 2/15" (21 December 2016), online: <http://curia.europa.eu/jcms/upload/docs/application/pdf/2016-12/cp160147en.pdf>.

100 TheCityUK, "Brexit and UK-based financial and related professional services" (January 2017) at paras 6–7, online: <www.thecityuk.com/research/brexit-and-uk-based-financial-and-related-professional-services/>; House of Commons Treasury Committee, "The UK's future economic relationship with the EU inquiry" (10 January 2017) at Qs 302–306.

101 Theresa May's blueprint, *supra* note 74.

102 Alex Barker & Jim Brunsden, "Barnier urges UK to be realistic about trade terms for Brexit", *Financial Times* (6 December 2016).

103 Jennifer Rankin, "EU's Brexit negotiator wants to stop UK getting 'soft transitional deal'", *The Guardian* (29 November 2016), online: <www.theguardian.com/world/2016/nov/29/eus-brexit-negotiator-wants-to-stop-uk-getting-soft-transitional-deal-michel-barnier-access-single-market>.

of the WTO members.[104] Currently, the United Kingdom's commitments are integrated into the EU schedules, which means that when the United Kingdom leaves the European Union, it needs to establish its own separate schedules.[105] Under the WTO rules, new schedules can only be established if other WTO members do not oppose them.[106] The UK government has indicated its plan to minimize any ground for objection by seeking to replicate the existing trade commitments that it currently shares with the European Union in the new schedules.[107] However, even if the United Kingdom supposedly succeeds at this mission, little access to the EU markets would follow. The EU Schedule Supplement on Financial Services, which has been submitted under GATS, offers little market liberalization.[108] There is no passporting, and no business activities can be pursued in the European Union unless in accordance with EU laws, as well as any other national laws and requirements that apply in the member state in question.[109] Thus, dropping back to the WTO rules will be significantly detrimental to the United Kingdom's financial sector as they by no means constitute a satisfactory substitute to what is currently available under the Single Market regime.

It is undoubtedly in both parties' interests to preserve access to the Single Market in their transitional and long-term agreements. There are currently more than 8,000 EU firms that use passporting to access UK markets.[110] As mentioned previously, continental firms raise half their equity and debt through banks based in the United Kingdom. Further, the United Kingdom accounts for three-quarters of foreign exchange and derivative activity in the European Union.[111] Thus, losing access to the United Kingdom's deep capital markets would have severe consequences for the EU economy as well. Wolf-Georg Ringe sees this significance of the United Kingdom's financial markets as an important bargaining chip. He argues that while Brexit will inevitably come, it will be more in form than in substance.[112] In his analysis, economic realities and political constellations make such an outcome inevitable.[113] Along similar lines, a group of experts at the European think tank Bruegel have called for a new "continental partnership" that would allow the United Kingdom to participate in selected common market policies and maintain access to the Single Market.[114]

These assessments and proposals certainly have merit as they recognize that the economic stakes are too high for either party to allow a disorderly Brexit. Moreover, the bulk of negotiations are to be carried out by technocrats, who are less concerned with empty political ambitions than economic realities and practical solutions. Nevertheless, it must be borne in mind that the European Union is as much a political project as an economic one, and that maintaining political unity is currently of greatest importance to EU leaders. It is unrealistic to assume that the United Kingdom can pursue a hard version of Brexit but at the same time simply copy and paste all the privileges of Single-Market membership into a tailor-made agreement. It is indeed possible that the UK government will moderate its stance regarding leaving the Single Market, staving off the jurisdiction of the CJEU and abolishing the free movement of EU citizens. However, if such statements are not just political rhetoric meant to please the "leave" campaign, but rather true objectives and priorities, then a very rocky road to Brexit lies ahead.

104 In WTO terms, "These schedules contain the commitments made by individual WTO members allowing specific foreign products or service-providers access to their markets. The schedules are integral parts of the agreements." See WTO, "WTO legal texts: Members' schedules of commitments", online: <www.wto.org/english/docs_e/legal_e/legal_e.htm#schedules>.

105 GATS, *European Communities and Their Member States: Schedule of Specific Commitments*, GATS/SC/31 (1994), online: <www.wto.org/english/tratop_e/serv_e/telecom_e/sc31.pdf>.

106 See *GATS*, 15 April 1994, 1869 UNTS 183, art XXI (entered into force 1 January 1995).

107 Julian Braithwaite, "Ensuring a smooth transition in the WTO as we leave the EU" (23 January 2017), *Foreign & Commonwealth Office* (blog), online: <https://blogs.fco.gov.uk/julianbraithwaite/2017/01/23/ensuring-a-smooth-transition-in-the-wto-as-we-leave-the-eu/#comment-78593>.

108 *GATS*, *European Communities and Their Member States: Schedule of Specific Commitments, Supplement 4 on Financial Services*, GATS/SC/31/Suppl.4/Rev.1 (1999) [*EU Schedule Supplement*].

109 *Ibid* at 2, n 1.

110 Bailey, *supra* note 17 at 3.

111 Jill Treanor, "Mark Carney: European economies face hit if cut off from City of London", *The Guardian* (30 November 2016), online: <www.theguardian.com/business/2016/nov/30/mark-carney-european-economies-face-hit-if-cut-off-from-city-of-london>.

112 Wolf-Georg Ringe, "The Irrelevance of Brexit for the European Financial Market" (2017) Oxford Legal Studies Research Paper No 10/2017 at 28, online: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2902715##>.

113 *Ibid* at 35.

114 Jean Pisani-Ferry et al, "Europe after Brexit: A proposal for a continental partnership", *Bruegel* (29 August 2016) at 6, online: <http://bruegel.org/2016/08/europe-after-brexit-a-proposal-for-a-continental-partnership/>.

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