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CLEAR THINKING FOR FINANCIAL SERVICES

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Brexit – possible scenarios and impacts

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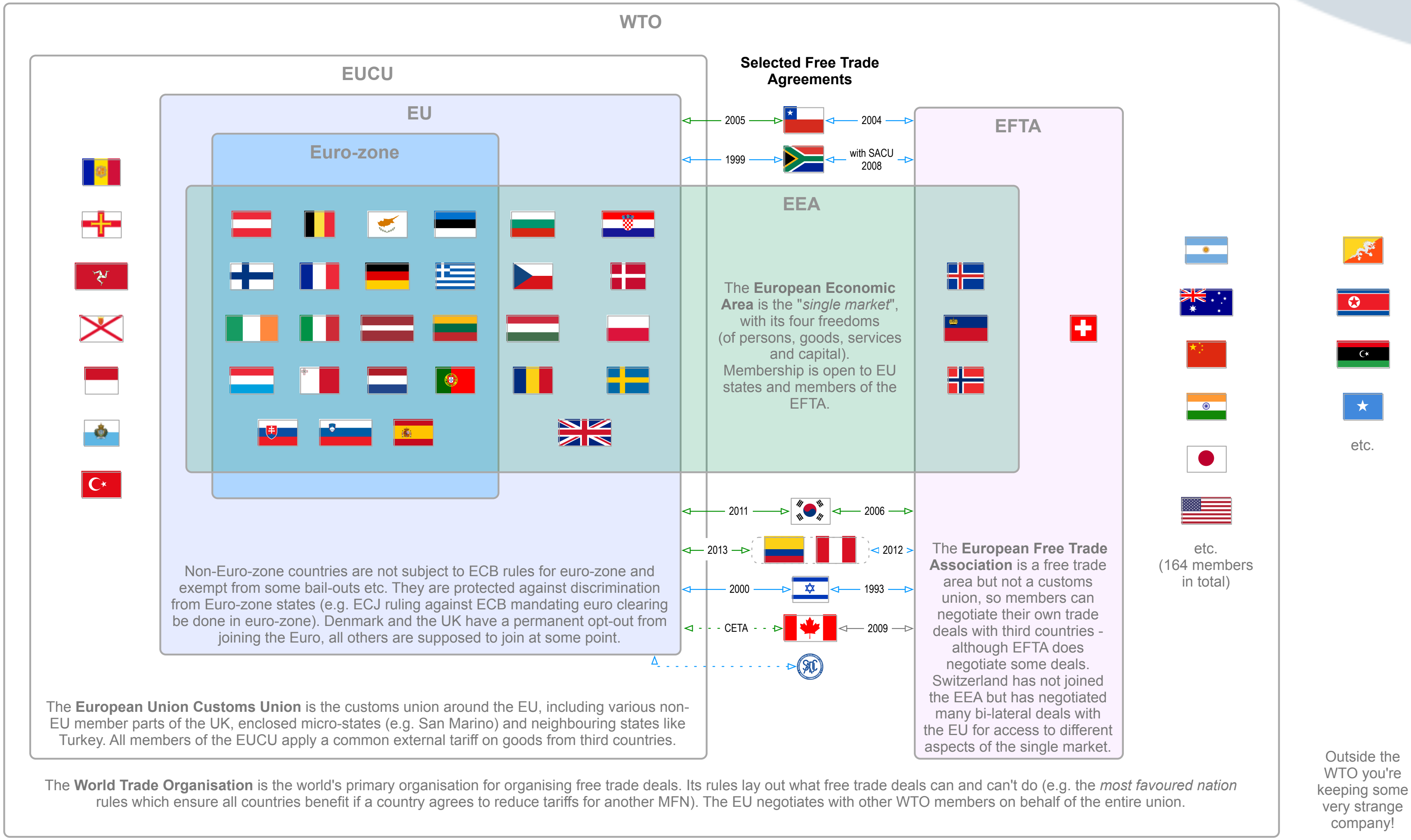

Trade agreements key: green include financial services, blue include services, grey are goods only.
Dotted lines indicate free trade agreements awaiting ratification.

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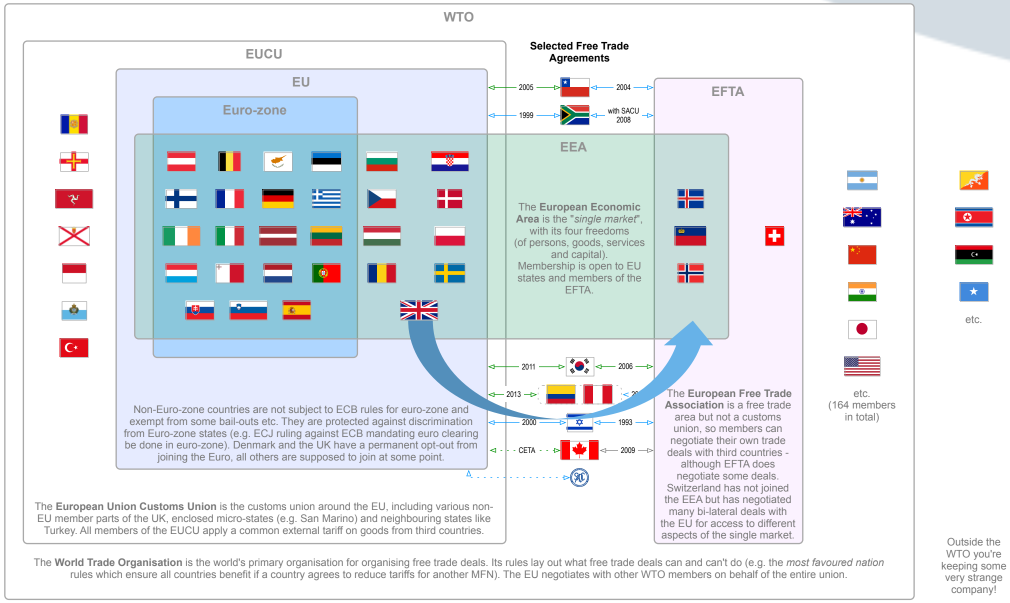
Possible “Brexit” scenarios

Continued EEA membership

The “Norway” option

		Freedoms
People	✔	EEA single market freedom
Goods	✔	EEA single market freedom
Services	✔	EEA single market freedom
Capital	✔	EEA single market freedom
Trade deals	✔	Outside the EUCU would be able to enter into independent trade deals with third countries
Financial services	✔	Most EU FS directives have “EEA relevance” and will therefore continue to apply

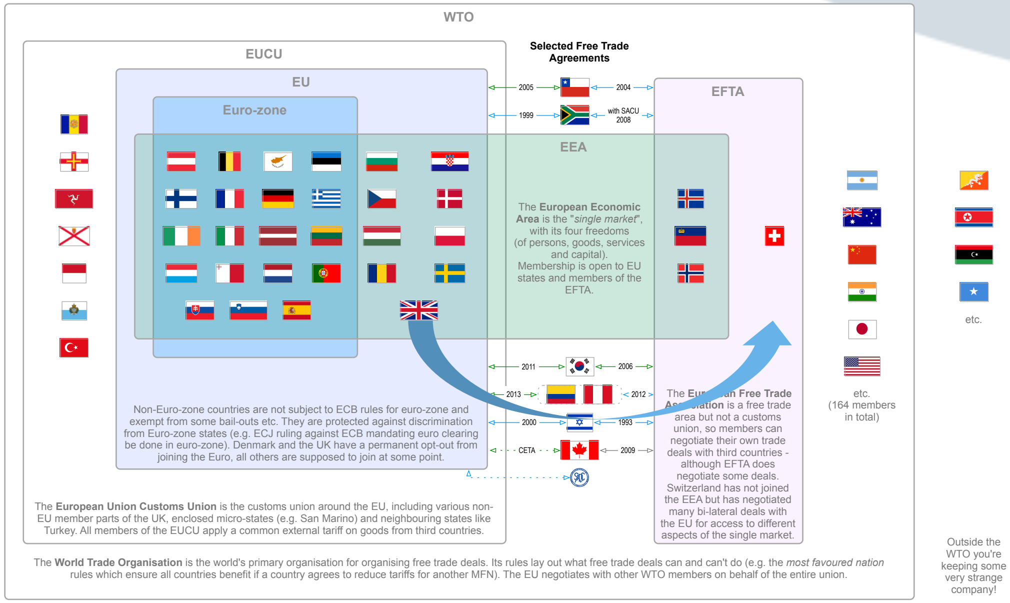


Impact: Under this option the UK would remain part of the single market. Most EU financial services directives/regulations are within the scope of the EEA agreement and would therefore continue to apply to the UK, and as now the UK would have to adapt UK law to implement EU directives. Passporting rights would in most cases be retained. The UK would have significantly less influence on the regulation; non-EU EEA states have input during the initial stages of EU legislation but not in the key “decision making” process, and we would have no influence via the EU Council or European Parliament and no veto. We may lose some protections from discrimination by Euro authorities which only protect other non-Euro EU states. Would lose access to EU trade deals with third countries and need to re-negotiate these.
Probability: Would require us to re-join EFTA, which no large state has done since it was founded in 1960, and negotiate continued membership of the EEA. All EFTA and EU members, plus the European Parliament would have a veto. Probably sufficiently acceptable to Scotland and Northern Ireland that the UK would indeed remain the UK. Very difficult to negotiate successfully in two years – if Article 50 is triggered without this being ”pre-agreed” or a longer timeframe for negotiations being agreed before triggering Article 50 there is a risk of aiming for this but ending up outside the EEA.

EFTA but not EEA membership

The “Swiss” option

Freedoms		
People	?	Not required, but likely to be price of some form of access to EU mkt
Goods	✔	Would require negotiation with EU
Services	?	Subject to individual agreement in different areas
Capital	✔	Would almost certainly continue
Trade deals	✔	Outside the EUCU would be able to enter into independent trade deals with third countries
Financial services	✘	All access to EU market lost except where 3rd country rights explicitly exist (e.g. AIFMD)



Impact: Under this option the UK would leave the EEA single market, and would need to negotiate bi-lateral access with the EU in the same way as Switzerland. Most EU financial services directives/regulations would no longer apply unless we individually agreed to adopt them, and we would therefore be a “third country”. For those directives/regs that do not allow this (e.g. UCITS) all rights would be lost and businesses that need access to the EU market would need to re-domicile. The UK would have almost no influence on EU regulation but would be able to chose whether to implement it in order to get “third country equivalence” where available. Would lose access to EU trade deals with third countries and need to re-negotiate these. May be able to benefit from existing EFTA trade agreements, although these generally do not cover financial services.

Probability: Would require us to re-join EFTA, which no large state has done since it was founded in 1960. All EFTA members would have a veto. May not be acceptable to Scotland or Northern Ireland. Negotiations would be needed on a myriad individual areas to define the scope of our access (the Swiss have 100s of agreements), which is almost inconceivable to complete in two years. Unrealistic that we could end up here if we only have two years to negotiate after invoking Article 50 – might end up with worse options in the interim.

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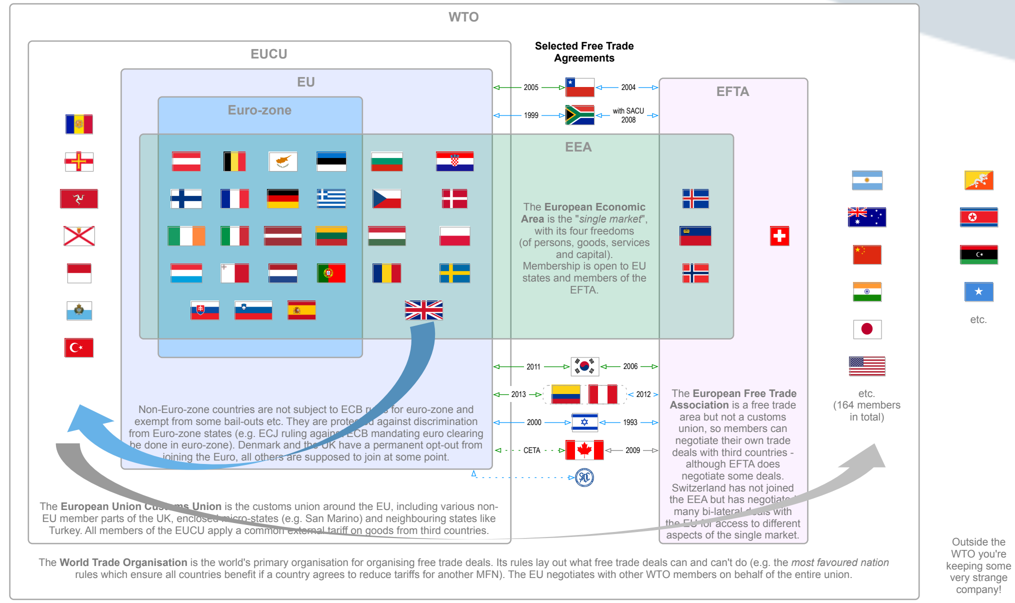
(Interim) EUCU membership

Keeping goods flowing

	Freedoms	
People	✘	Outside the single market
Goods	?	Outside the single market, but trade rules retained
Services	✘	Outside the single market
Capital	✔	Would almost certainly continue
Trade deals	✘	Inside the EUCU so would have to apply EU trade deal tariffs on third country goods.
Financial services	✘	All access to EU market lost except where 3rd country rights explicitly exist (e.g. AIFMD)



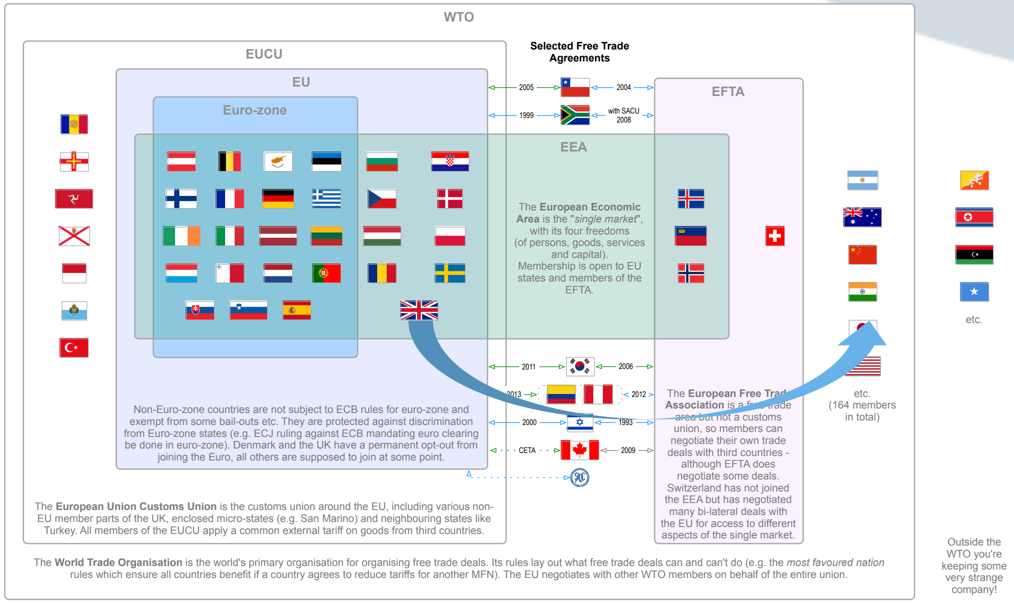
Impact: Under this option the UK would leave the EU and the EEA single market, but remain a member of the EUCU – presumably as an interim step en-route to WTO membership. This would retain the mechanics of trade in goods and external tariffs currently managed by the EUCU, and might therefore allow more certainty for physical goods imported/exported from/to third countries while individual deals are negotiated. However would be outside the EEA single market so trade with the rest of the EU would be uncertain and subject to negotiation. For the purposes of EU financial regulation UK would count as a "third country" and therefore aspects requiring access to EU market where EU rules do not allow for 3rd country equivalence for passporting would be at risk.

Probability: Unclear that this would be allowed whilst leaving the EU, or what the mechanics for this would be. Only likely to be acceptable as an interim stage en-route to eventual WTO membership only end-state.

WTO membership

The “WTO” option

	Freedoms	
People	✘	Outside the single market
Goods	?	WTO tariff rules. Need to negotiate regulatory barriers
Services	✘	Depends on bi-lateral agreements agreed under GATS
Capital	✔	Would almost certainly continue
Trade deals	✔	In the WTO would be able to enter into agreements under WTO rules
Financial services	✘	All access to EU market lost except where 3rd country rights explicitly exist (e.g. AIFMD)

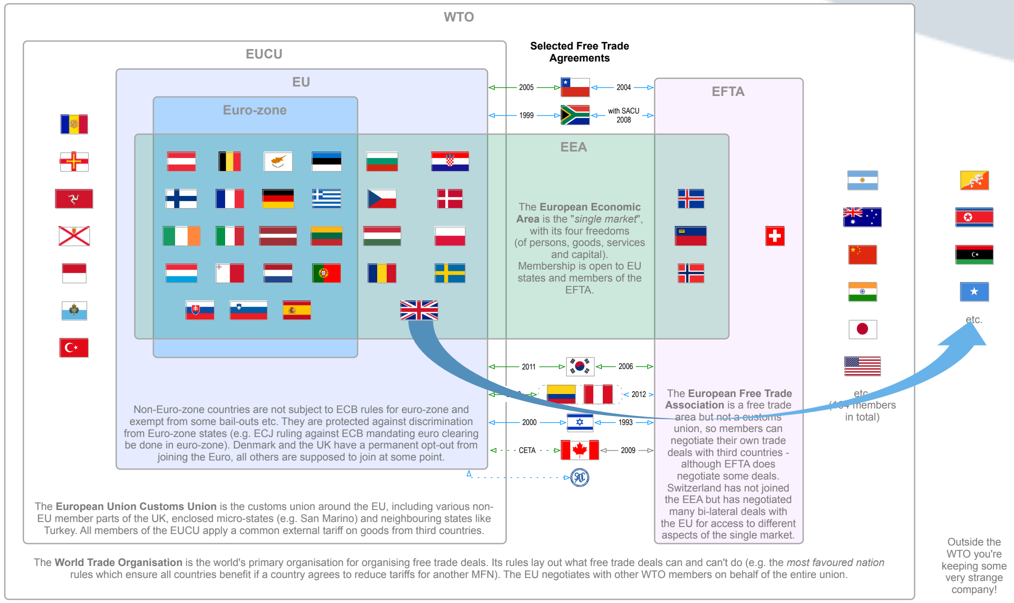


Impact: Under this option the UK would effectively “leave Europe” and seek to re-join the WTO as an independent nation. All preferential access to the European market would cease, with much financial services business needing access to the market having to re-domicile. Some directives (e.g. AIFMD) support third-country passporting but subject to strict rules and agreement by EU member states – that they would be unlikely to give easily. Goods tariffs would be controlled by WTO rules and could be negotiated, but regulatory barriers would be a bigger issue – if exports to EU were subject to customs inspection and testing regime applied to goods from WTO countries then massive disruption to supply chains and huge new port facilities to be built. **Probability:** Would require us to re-join WTO in our own right (rather than through the EU). Head of WTO indicates this isn’t a foregone conclusion as requires all WTO members to agree; but generally believed to be possible. Very unlikely to be acceptable to Scotland or Northern Ireland and could result in break-up of the UK – which has several complex variants on how that happens (to preserve EU membership Scotland would probably need England & Wales to vote to leave the UK (and the EU), with Scotland remaining in the EU as the “successor state” of the UK rather than having to re-join). Probably the only realistic option if Article 50 is triggered without agreeing more than two years to complete negotiations.

No deal

The “wilderness” option

Freedoms		
People	✘	Outside the single market
Goods	✘	Outside WTO system
Services	✘	Unheard of for non-WTO members
Capital	?	Capital flight might require introduction of capital controls
Trade deals	?	No framework in which to negotiate these
Financial services	✘	Unheard of for non-WTO members



Impact: Under this option the UK would effectively “leave the world” forging its own way as an independent nation alongside North Korea, Eritrea, Yemen etc. (and even Yemen is in the process of trying to join the WTO). Would be entirely dependent on trade deals that we could negotiate, outside WTO rules we would not benefit from “most favoured nation” status ensuring we get no worse a deal than any other WTO member. We would have a very weak position. Negotiating services access would be unheard of and difficult to see the City remaining a global financial centre. Risk of significant capital flight, capital controls could not be ruled out.

Probability: Does not require anyone else’s consent for this to happen, and no one can veto it. Therefore whilst it’s very unlikely that we would set off for this destination there is a distinct risk of ending up here “by accident” once Article 50 is triggered, unless we have either pre-negotiated a destination or have agreed a more realistic time-frame to negotiate leaving the EU (say 5 or 10 years from triggering Article 50).

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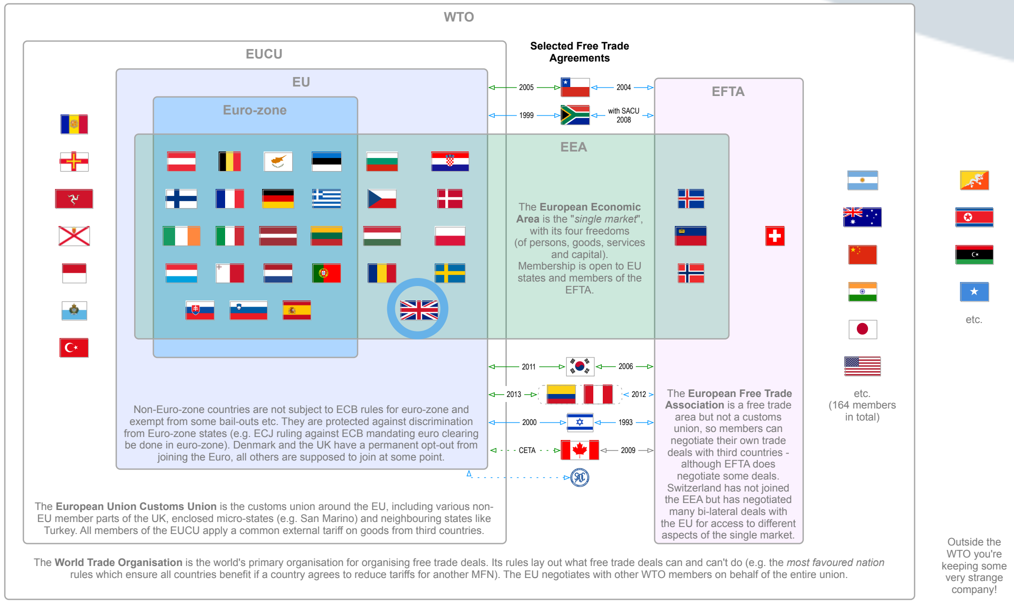
Continued EU membership

The "Status quo" option

	Freedoms	
People	✔	EEA single market freedom
Goods	✔	EEA single market freedom
Services	✔	EEA single market freedom
Capital	✔	EEA single market freedom
Trade deals	✘	Dependent on EU negotiations of new trade agreements
Financial services	✔	Would remain in the EU with full protection against discriminatory Euro-zone regulations



Impact: Under this option the UK would state that it did not intend to invoke Article 50 and therefore remain a full member of the EU. There would be no immediate changes in the UK's membership (officially the agreements obtained by David Cameron are no longer on the table). Minimal impact on Financial Services, which would continue to operate as currently. UK would continue to have significant voice in direction of future EU financial services legislation, but would have not choice but to implement it.
Probability: Difficult to see how the government could do this, without at least attempting to negotiate one of the other options. Possible that government may eventually decide that all other options are either "too difficult" or "too damaging" and then attempt to persuade public that the status quo should be maintained. Whilst UK membership of EU continues at the moment, as long as the publicly stated intention is to invoke Article 50 in the future our influence in the EU is reduced and businesses will react to the uncertainty.

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