SAMMAN

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Four months after the referendum: it's decision time

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Four months after the United Kingdom voted to leave the European Union, its political leaders have a vague realisation that it is no longer possible to elude the choice that has been expressed. Can they gain more time? Could a possible vote in the British Parliament following the decision by the High Court in London on 3 November change the deal? The state of weakness and uncertainty in which the referendum of 23 June left Europe has shown that it is useless to try to maintain a precarious equilibrium over the longterm, as has already been demonstrated. Donald Trump's election to the US Presidency intensifies even more the instability of the historical period we are living. The time has come for everyone to make the first structuring choices. In Birmingham on Sunday 2 October, Theresa May, the British Prime Minister, put an end to three months of silence. Meanwhile, the European institutions have begun to construct different scenarios.

What options are open on the eve of negotiations on the United Kingdom's exit and its future relationship with the European Union?

This note completes the previous one published by Cabinet SAMMAN the day after the UK's vote to leave the European Union (*"Brexit, the day after : what now"*) and proposes (1) an analysis of the initial direction taken by the UK, (2) an overview of the main obstacles and options which exist for each party, particularly the three European institutions and (3) a forward-looking view of the choices open to stakeholders in Europe's financial and digital sectors, as part of changes to the 'Third Party' paradigm.

Summary

- ❖ **The British Prime Minister specifies the date of the start of negotiations and wipes out the City's banks and investment companies' hopes of retaining their European passports;**

- ❖ **The UK's exit negotiations must be finished before the European elections in 2019;**

- ❖ **The main challenge for EU Member States during negotiations with the UK will be to reach agreement between themselves to avoid an 'everyone for themselves' scenario;**

- ❖ **As 'guardian' of the European project and with the right of veto, the European Parliament will be the most difficult actor to win over in any EU-UK agreement;**

- ❖ **The recent appointment of representatives to the European institutions will influence the EU's political strategies during the negotiations;**

- ❖ **France and Germany will only begin negotiations with the UK once their general elections are over (end of 2017);**

- ❖ **Regardless of the outcome of the negotiations, the current structure of European financial legislation will not enable guarantees to be given to City stakeholders on permanent access to the European Single Market. The EU may redefine its 'Third Party' approach to forearm itself against competition from a powerful 'off-shore' financial centre on its borders;**

- ❖ **International investment companies and banking groups in the City will have to choose whether to relocate or repatriate their activities to the continent, notably to France and Germany, in order to continue to have free access to the European Single Market within a stable framework and to continue to influence future discussions on financial regulation within the EU.**

- ❖ **The UK's reduced influence within the European institutions resulting from the referendum also means the loss of one of the champions of the digital industry, which will be reflected in a hardening of measures adopted within future 'packages' (telecommunications, copyright, e-privacy, etc.).**

I. The UK's choice

British Prime Minister, Theresa May's opening speech at the Conservative Party conference in Birmingham on Sunday 2 October ended three months of silence as to which direction the UK would take following the referendum of 23 June. Against the backdrop of the abysmal collapse of the pound, a fall in major international groups' profits in Britain, and the rising cost of basic commodities, May definitively wiped out the hopes of the City and, more generally, the 'remainers', to push back the UK's exit from the EU into the distant future. By stating that she wanted to trigger Article 50 of the EU Treaty before the end of March 2017, she set the theoretical cut-off date for the UK's exit for March 2019. The Prime Minister also gave another signal, that of an EU exit according to the terms used during the campaign by Brexit supporters: sovereignty, independence and a return to democracy: '*as we leave the European Union and take control of our own destiny*' and a clear message to the City that '*the world works well for a privileged few, but not for them* (i.e. those who voted for Brexit).

The date when Article 50 is triggered is a key strategic decision for the UK. For some, it is even the only lever which the UK has left against the EU. Once Article 50 has been triggered, the countdown will begin, the worst-case scenario being that of an exit without an agreement with the EU, leaving the UK isolated against 27 Member States, subject to rules of international trade which are much less favourable and protective than those set out by the EU.

But will the UK really have the choice of pushing back the start date of the negotiations? No, not only for reasons of internal politics but also to retain a certain level of control over negotiations with its European partners. Signature of the exit agreement must take place before the European legislative elections in May 2019. In our first note on the subject, we stressed that the **European Parliament would be a keystone in the negotiations, given that, in line with the European**

treaties, it holds the right of veto over the final agreement. The UK, the Council and the Commission, therefore, must not only negotiate an agreement which is satisfactory to the Member States but must also convince a majority of Members of the European Parliament, many of whom see themselves, since the referendum of 23 June, as the 'guardians' of the European political project. Moreover, asking the British people to return to the ballot boxes in 2019 to elect European Members of Parliament without having responded to the wish of the majority to leave the EU would be a political aberration by the British Government.

On the other side, the College of European Commissioners and its President, who will participate actively in the negotiations, will be replaced in the autumn of 2019 in a continuation of the European elections. It is therefore important for the UK that negotiations on exiting the EU are led from start to finish by the same representatives and that a negative decision is not adopted at the end of negotiations by a 'new' Parliament, the political colour of which is completely unpredictable at the current time.

Finally, uncertainties over the direction the UK will take on its proposals for access to the Single European Market for companies based in the UK, particularly US and Asian multinationals, pushed some of them – in the immediate aftermath of the referendum - to draw up contingency plans and plans to relocate within the EU. The first directions given by Theresa May in October have now put an end to some uncertainties and have enabled strategies to be developed on the basis of a clearer time-frame.

March 2017 thus appears to be a 'deadline' which the UK will find difficult to postpone, with the risk of suffering the uncertainties of political changes over the next two years. But why wait until then? Undoubtedly to give the UK and its main economic stakeholders the time to begin the negotiation of bilateral agreements with countries in the Commonwealth, to test certain scenarios and to prepare alliances, which has triggered a reaction from EU bodies.

II. The European Union's initial choices and political decisions

After divergent statements were made on the position to take towards the UK in the immediate aftermath of the vote, the leaders of Europe's most influential Member States (Germany, France, Italy) and the Presidents of the Council and the European Commission agreed, during the last meetings of the 27, on a joint position which can be summarised as: 'no negotiations with the UK before Article 50 is triggered' and 'no UK-EU free trade without the free movement of people'.

The European Commission has made it clear to the UK that any bilateral trade negotiations which it may initiate with third countries (the USA, Japan, etc.) are contrary to the EU's basic texts, which give exclusive competency over trade policy to the Commission. Some third countries (and not insignificant ones), such as the United States and Japan, have, moreover, reacted by stating that they want to wait until the end of the UK-EU negotiations before entering into bilateral discussions.

The European institutions, Parliament, Council and Commission each took time in September and October to establish the initials bases of future negotiations.

In our first note, we presented the stages of the UK's withdrawal procedure, as set out in the Treaty on European Union (TEU). We gave an outline of the role of each of the European institutions in this **unprecedented process**. By means of reminder, the agreement must be concluded by the Council, which will draft the main outline of the EU's position and will ask the European Commission to lead day-to-day discussions with the UK, before taking over to address the most complex and political aspects. The European Parliament should adopt a general framework and establish the lines not to be crossed, and could threaten to activate its right to veto if it finds the initial elements of the negotiations unsatisfactory or if the Council and the Commission fail to show sufficient transparency.

Each of these institutions has now appointed a representative responsible for the negotiation process. **The choice of representative may surprise, reassure or scare those who are directly affected by the subject. These choices are, indeed, an initial indication of the approach which the institutions intend to adopt not only to future negotiations with the United Kingdom but also, and above all, to the discussions which will need to be established between the Member States themselves and between the Council and the Parliament to culminate in an agreement which is acceptable to all parties.**

In chronological order, the President of the **European Council**, Donald Tusk, first appointed **Didier Seeuws**, to prepare discussions on the United Kingdom's exit from the EU. This civil servant epitomises all the qualities required to be approved by the 27 Member States of the Union, the majority of whom, after the result of the referendum, disagreed on the strategy to adopt, each placing their national interests before those of the Union. As a Belgian diplomat, Didier Seeuws hails from a country with a politically neutral reputation and a small population. Thus, in terms of its weight in the Council, it is **not a 'politician' but a negotiator**. His specialist field is relations with the European Parliament.[1]

At the end of July, Jean-Claude Juncker, the President of the **European Commission**, appointed **Michel Barnier,** former right-wing French government Minister and former Vice-President of the European Commission responsible for financial services, to lead negotiations for the Commission. Michel Barnier is well known in European political and economic circles. He was the initiator and lead coordinator of the complete revision of Europe's financial regulations after the 2007-2008 crisis, which included the adoption of more than 40 texts by the European legislators. The decision to appoint a French negotiator, someone who is a fervent defender of the European Union and who insisted that London, Europe's leading financial player, draw upon its reserves to cover the cost of an integrated regulation, was criticised by parts of the British press and was even seen as a 'declaration of war' by some. There is, however, no basis to this claim. The appointment was the choice of the President of the Commission and Michel Barnier is neither on the same political side as, nor a close colleague of, François Hollande, the French President. One of the most important tasks during his last mandate was to negotiate with the Parliament and the Council in order to complete his legislative proposals. The toughest representatives in the Council were, notably, Wolfgang Shäuble, the German Finance Minister and, for the legislative proposal on the separation of banking activities, the French delegation.

[1] Advisor to the Permanent Representative of Belgium, responsible for relations with the European Parliament from 1998 to 2002), in 2007 he became the deputy Permanent Representative of Belgium to the EU.

Mr Barnier's appointment is strategic for three reasons and should benefit all parties. **An expert on the British financial industry and its importance to the UK,** he knows in detail the legislation applicable to this sector. **Among other things, he has managed senior civil servants in DG FISMA who will be responsible for drafting scenarios relating to banking and finance,** a crucial point in the future UK-EU negotiations. Accustomed to hard negotiations with Member States, he is also highly **appreciated by the vast majority of European Members of Parliament (in particular those in the Economic and Monetary Affairs Committee - ECON)** with whom he maintained regular dialogue during his previous mandate. **His key mission will be to convince Parliament and to find common ground and a majority, if not unanimity, between the 27 Member States of the Council on the final terms of negotiations with the UK**. It should also be noted that, in contrast to the Council's appointment of a career diplomat to represent it, the appointment of a former Vice-President of the European Commission, several times Minister in his own country, highlights the desire of the President of the Commission to see this institution play a leading role in negotiations with the UK.

The third appointment, that of Belgian Member of the European Parliament, **Guy Verhofstadt**, member of the Alde group (liberals), by a restricted body of the **European Parliament**, is unexpected. The Conference of Presidents, consisting of the President of the Parliament and a representative of each political group, usually decides on organisation of the work of the European Parliament and its relations with other institutions. This 'out-of-the-blue' appointment, without consulting the Members of Parliament (an institution where the principle of broad collegiality is, in principle, *de rigueur*), was a surprise, even within its ranks. President of the fourth biggest political group in terms of number of Members of Parliament, Guy Verhofstadt is a committed federalist who has held very entrenched positions on the outcome of the referendum and is therefore far from the unanimous choice of the European Parliament. How should his appointment be interpreted? **As a two-fold warning, initially to London: the Parliament will be the guardian of a collective project and the UK must yield to it, and, secondly, to the Council and the Commission: the European Parliament's position must be taken into account and it must be kept informed of negotiations right through to the final agreement, at the risk of the Parliament firmly opposing it.**

In addition, a collegial decision should be expected from the Parliament on the guidelines for its representative's mandate, which should be adopted as soon as the UK triggers Article 50.

Furthermore, coordination between the three European institutions will be crucial, both during discussions with the UK to ensure progress is transparent and, above all, when finalising the agreement. **A tripartite inter-institutional coordination group (bringing together the Parliament, the Council and the Commission) should be rapidly established.**

What are the weak points of the 27 Member States? In terms of the Council, consultation and coordination of each of the main economic pillars (agriculture, industry, finance, etc.) will be necessary in order to **avoid an 'everyone for themselves' scenario and competition between Member States with the temptation to possibly concluding bilateral 'deals' with the UK.**

Council negotiations on Brexit and strengthening the European project will, moreover, collide with national policy agendas. Europe's political leaders' approach to the negotiations, from both the left and the right, is unclear. Some are calling for the EU to be strengthened in light of Brexit. However, the result of the national elections in France (June 2017) and Germany (October 2017) must be awaited, to see whether there is any shared ground between the heads of government and whether the support of European citizens can be obtained. Possible changes in governments should have the effect not only of political redirection but also of 'rotating' senior civil servants in the key Ministries (Economy, Finance, Industry, Agriculture, etc.) and in the French and German negotiating teams (Ministers of European/Foreign Affairs, Permanent Representatives to the EU, etc.), who may then reshuffle the cards once more or, at the very least, modify the agenda.

In many Member States, notably France, Germany, Italy, Spain, and the Netherlands, the question of Europe creates division within their various political groups. In France and Germany, candidates in the so-called 'government' parties (excluding the 'extreme left' and 'extreme right') first and foremost need to unite their political families and then get the backing of a majority of voters. Their objective, therefore, will be to avoid basic questions on strengthening Europe and to focus on a few slogans about reworking European governance. The subject will, however, be at the heart of the campaigns of parties from the Eurosceptic extreme left and extreme right, who will focus on the risks of abandoning sovereignty, the need to close the borders, the end of open economies and, thus, exit from the EU. In France and Germany, the result will be uncertain until the date of the final vote.

It is not expected, therefore, that France and Germany will fully enter into negotiations with the UK before the third quarter of 2017.

III. The strategic choices facing companies in the financial and digital sectors

In our first note on the subject, we described the various possible options for an EU-UK agreement: a partnership agreement within the European Economic Area (EEA), free trade agreements negotiated *à la carte*, etc. and their impact upon actors in the financial and digital sectors. Below, we propose an additional analysis, taking into account how the situation has since evolved.

A. What impact on the financial sector?

Should companies in the financial sector wait for the cooperation project that the UK will present in March 2017 or even the end of negotiations in 2019, or can they already begin to define their own strategies? What scenarios should London-based banks, investment companies, asset managers etc. consider?

While the successive statements by Theresa May appear to indicate that 'integrated cooperation' (along the lines of the EEA) would not be on the agenda, activating Article 50 of the TEU, ensures that the UK will leave the EU's political institutions.

Regardless of the nature of the final agreement, **future trade relations and the free movement of services, goods and people between the EU and the UK will remain precarious and will be negotiated on a point-by-point basis**. They will depend on the UK's policy decisions and those of its former European partners who will have the possibility of revising their economic relationships at any time. Currently, **there is no 'overarching' European text or agreement with a Third State in terms of finance which ensures a permanent link such as that guaranteed to Member States**

of the EU and the EEA through the European treaties under the control of the European Union Court of Justice.

A few examples illustrate this: the criteria for mutual recognition (or issuance of a passport in the case of the Directive on Alternative Investment Fund Managers (AIFMs) should be considered 'activity by activity' (trading in derivatives, asset management, payment services, etc.). This should take place not only at the time of the assessment (decision by the Commission after an opinion/assessment by ESMA for the financial markets) but must also 'at all times, be subject to specific conditions' at the risk of withdrawal of the equivalence decision (or issuance of the passport) by the European Commission. **The consequence of this situation, if the UK wants access to the EU's single financial services market, would be to connect the content of its legislation on finance in the long term to that of the EU, without being able to deviate from it** (as is the case of Switzerland for example). Moreover, **the UK would need to 'update' its regulations in line with changes in the legislation of the 27 Member States**. This condition would considerably limit the UK's freedom to relax its regulations or current level of supervision, and contradicts the stated political desire to attract global finance on the basis of regulations which are less restrictive than those of the EU.

The 'Third Country' approach, i.e. the criteria used in the concept of 'equivalence' and those of attribution of the 'passport' (in the case of the AIFMD Directive) used today by the EU in its relations with geographically-distant countries such as the US, Hong Kong, etc. **may be brought back into question**. Indeed, it appears economically unrealistic that the EU would allow a major economic competitor on its borders, with more relaxed regulations, to freely compete with its companies who are subject to higher constraints. **The EU may, therefore, review its strategy towards the openness of its internal market on a case-by-case basis in order to restrict the impact that an 'off-shore' area at the gates of the EU would have on its national champions.**

The uncertainties relating to the direction which the 27 Member States should take and the constraints which will apply to the UK should steer the choice of investment companies and banks to relocate or repatriate their activities into an EU country in order to continue to have free access to the EU's single market in a stable framework. This same approach should be taken by 'continental' companies using London as an 'international hub'.

Moreover, Brexit is weakening the lever that international banks and investment companies had through the UK on Europe's single market. Political weight within the EU of 'host' country(ies) may therefore be one of the criteria retained by major international finance groups in addition to the criteria of infrastructure, employment law, taxation, etc. This parameter should benefit France and Germany in terms of asset management and market operations.

Relocation of investment companies and banks, notably American and Asian ones, within the EU of 27 could, therefore, have a double advantage: maintaining security in terms of transactions within the EU and being able to continue to have an influence on financial market regulation policy, banking policy etc. in the post-Brexit EU.

B. What impact on the digital sector?

Since the Brexit vote, the UK, other EU Member States and the EU Commission have identified a matter of common concern and of political preponderance to everyone: **security.** Against this backdrop, should digital service providers expect security proposals to possibly affect them? What form would these proposals take? Who would be their key representatives, given that the leverage role of UK stakeholders, who typically championed the digital industry, is weakening?

Following a wave of attacks in the summer 2016, France and Germany launched discussions to hand part of the responsibility over to EU institutions for negotiating complex (and sensitive) security issues, such as authorities' access to **encrypted data** and an enhanced **exchange of information** between national authorities.[2]

The appointment of the **new UK Commissioner**, **Sir Julian King**, **to the Security Union portfolio (including cybersecurity and the fight against cybercriminality)** last September should demonstrate unity of purpose on security between the UK and the EU at large. Given his outsider status in the EU Commission, it is unsure whether he will be a key figure in Brussels and play a decisive role on issues which generally fall within the responsibility of Member States.

In the medium term, digital service providers should thus, primarily, monitor the EU Commission's proposals which, despite the uncertainty following the Brexit vote, respect the milestones set out in the Digital Single Market (DSM) strategy, launched in May 2015. The coming months will be busy, with several legislative texts already going through the ordinary legislative procedure, and with packages that could lead to the adoption of **stricter obligations for digital service providers**. To cite an example, **the telecom package launched on September 14th 2016** should lead to an extension of application of the telecommunications operators' specific obligations to 'over-the-top' (OTT) players.

Given the evolution of legislative proposals, anticipated judiciary developments on the legality of **international data transfers,** and pressure **from pro-security stakeholders**, the **EU data protection framework could undergo changes in the following years.**

[2] French and German Home Affairs Ministers, Bernard Cazeneuve and Thomas de Maizière, made a joint call for an EU approach to several security issues on 24 August 2016.

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