Institut für deutsches und internationales Recht des Spar-, Giro- und Kreditwesens

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Center for German and international Law of Financial Services

Univ.-Prof. Dr. Peter O. Mülbert, Univ.-Prof. Dr. Dr. h.c. Uwe H. Schneider,
Univ.-Prof. Dr. Dirk A. Verse M.Jur. (Oxford)

Market Access for Financial Services after Brexit

HENNING BERGER / NIKOLAI BADENHOOP

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Anschrift:	Institut für deutsches und internationales Kreditrecht an der Johannes Gutenberg-Universität Mainz
Sitz:	Wallstraße 11, 55122 Mainz
Tel.:	06131 / 39 31709
Fax:	06131 / 39 31718
Internet:	www.institut-kreditrecht.de

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* Dr. Henning Berger is Rechtsanwalt and Partner of White & Case LLP in Berlin. Nikolai Badenhoop, LL.M. (King's College London), is a PhD Candidate at Humboldt University of Berlin.

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A. Introduction and Summary

On 29 March 2019 the UK will exit the EU unless the two-year period under Article 50(3) TEU is extended. Whether or not extended, this exit could cause considerable market disruptions and damages especially for financial services. However, a 'cliff edge' scenario may be avoided by a transitional arrangement and a comprehensive Free Trade Agreement (FTA) as a framework for the future economic relationship between the EU and the UK. Designing a future framework for financial services does, however, pose serious political as well as legal challenges.

This article provides an analysis of the legal outset and challenges for the future framework with regard to two areas of great practical importance: cross-border commercial banking and clearing services. The analysis is conducted in two main steps. The first part of the article (B.) determines the effects of a no deal scenario, commonly referred to as hard Brexit, by comparing market access under EU passporting rules to market access under third country rules and considering limits to the latter under GATS. The second part of the article (C.) analyses how a bespoke EU-UK market access regime might look like with regard to the main FTA models currently being discussed, in consideration of boundaries set by GATS as well as – at least on a political level – the EEA Agreement.

In summary this article shows the following:

The current EU passporting regime for commercial banking and clearing services will no longer be applicable between the EU and the UK post-Brexit. Unless an EU-UK FTA provides otherwise, financial institutions licensed in the UK or an EU Member State will be treated like third country institutions in the respective other territory and therefore only have restricted market access (no deal scenario). Under the guidance of supervisory authorities in the EU and the UK, banks have already started licensing procedures for subsidiaries and branches to prepare for this scenario. Cross-border clearing services between the UK and the EU will also require authorisation by the competent authorities; under the EMIR II proposal, Euro-denominated clearing in the UK may only be allowed under the direct supervision of ESMA. Third country provisions in the EU and the UK can be modified within the boundaries set by international law, especially by GATS. In principle, this entails that all third countries have to be granted the same market access.

However, the political aim of the EU and the UK is to agree on an FTA for their future relationship, which may come into force after a transitional period. Such an FTA has to respect legal limits set by international law, especially GATS, and legal-political boundaries arising from the EEA Agreement. As to the degree of financial market integration, there are five models ranging from an FTA without specific rules on financial services ('bare bones deal'), an FTA with few specific rules on financial services ('CETA model'), an FTA granting market access via an equivalence regime ('equivalence plus'), an FTA granting full market access based on regulatory alignment ('alignment model') to an FTA granting full market access based on regulatory alignment and non-alignment ('bold and ambitious').

The first two models for regulating financial services under an EU-UK FTA would grant market access on the same level as GATS or only slightly above the level secured by GATS. While this would allow financial institutions to set up licensed subsidiaries and – if permitted under national law – branches under third country rules, the costs and organisational burdens for EU-UK cross-border financial services would noticeably increase. The 'equivalence plus' model would allow to maintain highly integrated financial markets, without being too complex from a legal and political perspective. The last two FTA models aim at full market access equal to the current passporting regime, while requiring less or even no regulatory harmonisation and equivalence. Though these models could provide the highest possible integration and economic benefits for the financial services industry, they would require strong political goodwill on all sides and need to overcome significant legal obstacles.

B. Market Access in a No Deal Scenario: From Passporting to Third Country Rules

At the moment, market access for financial services between the UK and the other Member States of the EU is regulated by EU law with uniform effect in all Member States (I.). If the EU and the UK cannot agree on their future relationship until Brexit day (no deal scenario), market access will be determined by third country rules in force in the UK and the EU (II.). Such rules can be changed unilaterally as long as they remain within the boundaries set by the international framework of GATS (III.).

I. Market Access under Current EU Law

Current market access for cross-border commercial banking and clearing services is based on EU primary law, especially on the fundamental freedom to provide services,[1] the freedom of establishment[2] and the free movement of capital.[3] At the level of EU secondary law, market access for banking services is regulated by the Capital Requirements Directive (CRD IV)[4] and the Capital Requirements Regulation (CRR)[5] giving EU-based banks (including EU-licensed subsidiaries of third country banks) passporting rights, whilst banks based in and operating from third countries do not have such rights. Clearing within the EU and cross-border clearing with third countries are both governed by the European Market Infrastructure Regulation (EMIR).[6] Particularly interesting in the present context is the recent proposal by the EU Commission for an EMIR amendment regarding clearing services provided from third countries (EMIR II).

1. Commercial Banking Services under CRD IV/CRR

a) Licensing Requirement for Credit Institutions

Europe has a tradition of universal banks combining both commercial and investment banking.[7] The EU defines both activities by reference to the institutions carrying them out, i.e. credit institutions and investment firms.[8] A credit institution means ‘an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account’.[9] An investment firm means ‘any legal person whose regular occupation or business is the provision of one

[1] Art. 56 – 62 TFEU.

[2] Art. 49 – 55 TFEU.

[3] Art. 63 – 66 TFEU. The free movement of capital is the only freedom constituting the single market which is also granted to third countries.

[4] 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 L176/338.

[5] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L176/1.

[6] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1.

[7] High-level Expert Group chaired by Erkki Liikanen, *Report on reforming the structure of the EU banking sector*, Brussels 2 October 2012, <http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf> accessed 16 January 2018.

[8] Commercial banking services within the EU are mainly regulated by CRD IV and CRR. While CRD IV sets out the fundamental regulatory framework for banking operations and access to them, CRR governs capital adequacy and liquidity requirements. As a directive, CRD IV needs to be transposed into national law, while CRR is a directly applicable regulation pursuant to Art. 288 TFEU. Since 3 January 2018, investment banking services are mainly regulated by MiFID II (Directive 2014/65/EU [2014] OJ L173/349) and MiFIR (Regulation (EU) No 600/2014 [2014] OJ L173/84).

[9] Art. 3(1) no.1 CRD IV, Art. 4(1) no.1 CRR.

or more investment services to third parties and/or the performance of one or more investment activities on a professional basis' excluding credit institutions.[10]

According to Article 8(1) CRD IV, credit institutions need an authorisation (banking licence) before commencing their activities. In the Euro area, banking licences are granted by the European Central Bank (ECB) which heads the Single Supervisory Mechanism (SSM) established by the Banking Union.[11] Within the SSM, the ECB has the power to directly supervise all banks deemed "significant" and indirect supervisory powers over all other banks.[12] In EU Member States outside the Euro area, banking licences are granted by the national banking supervisors.

Some requirements for obtaining a licence are mandatory under EU law, such as the obligation to provide a programme of operations and structural organisation,[13] to have a certain initial capital,[14] to fulfil quantitative and qualitative requirements for members of the management body[15] and that the business be directed effectively from the head office which should be the place where the institution is registered.[16] Member States may set additional requirements by 'gold-plating' EU secondary law and require an additional or more specific licence for particular transactions or businesses.[17] However, in order to prevent protectionism, Member States are not allowed to refuse a banking licence on the grounds that the domestic market's economic needs are exhausted.[18] While Member States are free to allow non-credit institutions to grant credits without requiring a licence, only authorised credit institutions may take deposits.[19] Germany, France and Italy require licences for both taking deposits and granting credits.[20] The UK instead requires a licence for taking deposits but not for granting loans.[21]

b) Passporting for EU-licensed Banks

Once a credit institution has been authorised in one EU Member State under CRD IV, it generally has unrestricted access to other EU Member States.[22] This is commonly referred to as the 'banking passport' and entails the possibility of performing EU-wide cross-border banking services from the bank's home Member State[23] or by establishing a branch in another Member State.[24] For the performance of intra-EU cross-border banking services, this is granted by the fundamental freedom to provide services as held by the ECJ in *Parodi*[25] even before the passporting regime was codified in

[10] Art. 3(1) no.2 CRD IV, Art. 4(1) no.2 CRR, Art. 4(1) no.1 Directive 2004/39/EC.

[11] Art. 4(1)(a) Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation) [2013] OJ L287/63. For a detailed analysis Henning Berger, 'Rechtsanwendung durch die EZB im Single Supervisory Mechanism (SSM)' (2016) Wertpapiermitteilungen 2325, 2361.

[12] Art. 6(1),(4),(5),(6) SSM Regulation.

[13] Art. 10 CRD IV.

[14] Art. 12 CRD IV.

[15] Art. 13(1), 91(1) CRD IV.

[16] Art. 13(2) CRD IV.

[17] For examples of gold-plating provisions in banking regulation Elke Gurlit, 'Instrumente makroprudenzieller Bankenaufsicht - unter besonderer Berücksichtigung zusätzlicher Kapitalanforderungen – Teil II' (2015) Wertpapiermitteilungen 1257, 1260 et seq.; Henning Berger, 'Rechtsanwendung durch die EZB im Single Supervisory Mechanism (SSM) – Teil I' (2016) Wertpapiermitteilungen 2325, 2332 et seq.

[18] Art. 11 CRD IV.

[19] Art. 9 CRD IV.

[20] Sec. 32(1), 1(1) no. 1 and 2 German Banking Act (Kreditwesengesetz); Art. L511-10, L511-1(1), L511-5 French Banking Act (Code monétaire et financier); Art. 14(1), 10(1),(2) Italian Banking Act (Testo Unico Bancario).

[21] Sec. 19(1) Financial Services and Markets Act 2000, Sec. 2(a) Financial Services and Markets Act 2000 (PRA-regulated Activities) Order 2013.

[22] Art. 33 CRD IV.

[23] Art. 33, 39 CRD IV.

[24] Art. 33, 35-38 CRD IV.

[25] C-222/95, *Parodi* [1997] ECR I-3899.

secondary law. The free establishment of branches in another Member State[26] is an expression of the fundamental freedom of establishment.[27]

The major benefit of the passporting system is that EU-licensed banks do not need an additional licence in each Member State they operate in via cross-border services or host state branches[28]. Besides certain notification requirements, the bank does not need to fulfil additional prudential or regulatory requirements related to the operation of a branch in a host Member State. In contrast, if a bank decides to undertake banking business in another Member State via a legally independent subsidiary[29], the latter is nothing less than a full-fledged bank which needs a proper licence and has to fulfil all prudential and regulatory requirements under CRD IV, CRR and national law. Operating via a branch under the passporting system and not via a licensed subsidiary is economically advantageous, especially because - unlike a subsidiary – it does not have to fulfil all capital and liquidity requirements on its own.

c) Treatment of Third Country Banks

In contrast, banks operating from third countries do not benefit from the passporting regime. Under EU primary law, they are outside the scope of application of the freedom of establishment and the freedom to provide services.[30] CRD IV does not contain any third country recognition regime and does not mandate specific equivalence decisions for commercial banking,[31] as can be found especially in the field of securities and markets.[32] However, the EU follows an open-market approach by granting third countries market access in principle.[33] In order to carry out banking activities in the EU, third country banks have two options. Either they operate via a licensed subsidiary (fully fledged bank) domiciled in an EU Member State, which is allowed to participate in the passporting system, or – where permitted by national law – they operate via a licensed branch, which does not benefit from the passporting system.[34]

2. Clearing Services under EMIR

The second example of post-Brexit regulation of EU-UK cross-border banking services concerns clearing services for derivatives. After the global financial crisis, the EU extended the obligation to clear centrally from regulated markets to derivative transactions on over-the-counter (OTC) markets by introducing EMIR.[35] Clearing is done by a central counterparty (CCP) interposing itself between two

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[26] Art. 17 sentence 1 CRD IV.

[27] Art. 35 (1) CRD IV. Christian Ohler, 'Finanzmarktregulierung und -aufsicht' in: Hatje/Müller-Graff (eds.), *Enzyklopädie Europarecht*, vol. 5, Ruffert (ed.), *Europäisches Sektorales Wirtschaftsrecht*, § 10 n. 61.

[28] A 'branch' under CRD IV/CRR means 'a place of business which forms a legally dependent part of an institution and which carries out directly all or some of the transactions inherent in the business of institutions', Art. 3(1) no.16 CRD IV, Art. 4(1) no.17 CRR.

[29] Art. 3(1) no.15 CRD IV, Art. 4(1) no.16 CRR.

[30] They only benefit from the free movement of capital under Art. 63(1) TFEU.

[31] A good overview over equivalence rules in financial services is provided by European Parliament Economic Governance Support Unit from DG Internal Policies, Briefing of 12 July 2017 'Third-country equivalence in EU banking legislation' PE 587.369.

[32] See for a detailed analysis Eddy Wymeersch, 'Brexit and the Equivalence of Regulation and Supervision' (2017) EBI Working Paper 15/2017, 4 et seq.

[33] Peter Böckli and others, 'The consequences of Brexit for companies and company law' (2017) University of Cambridge Legal Studies Research Paper 22/2017, 16.

[34] Recital 23 CRD IV states that '(b)ranches of credit institutions authorised in third countries should not enjoy the freedom to provide services or the freedom of establishment in Member States other than those in which they are established'. See also André Prüm, 'Brexit: Options for Banks from the UK to Access the EU Market' (2017) Europäische Zeitschrift für Wirtschaftsrecht 988, 992.

[35] Art. 4 EMIR. For detailed analysis Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, OUP 2014), 576 et seq.

counterparties of a contract becoming the buyer to every seller and the seller to every buyer.[36] Clearing under EMIR means 'the process of establishing positions, including the calculation of net obligations, and ensuring that financial instruments, cash, or both, are available to secure the exposures arising from those positions'.[37] Cross-border clearing between the EU and the UK is of great practical importance because, as of now, approximately 75% of all Euro-denominated derivatives are cleared in London.[38]

a) Authorisation to Clear EU-wide

In order to clear derivatives as a CCP on the OTC market, a legal person needs an authorisation by the national competent authority (NCA) of the Member State where it is established.[39] The European Securities Markets Authority (ESMA)[40] and NCAs of other Member States are (only) indirectly involved in the authorisation process via a college of supervisors, which rules on the application.[41] Once it has been authorised, a CCP can clear obligations arising throughout the entire EU territory.[42] To this extent the CCP-authorisation can be described as a European passport for clearing business. Member States can adopt or continue to apply additional requirements, but only with regard to CCPs established in their own territory.[43]

In July 2011, the ECB tried to restrict clearing of Euro-denominated derivatives physically to the Euro area in its Eurosystem Oversight Policy Framework[44] which was successfully contested by the UK in *United Kingdom v ECB* (T-496/11). Without entering into further questions of substantive law, the EU General Court decided that the ECB did not have the competence to require CCPs to be located within the Euro area.[45] It interpreted Article 127(2) TFEU and Article 22 of the ECB's Statute in a narrow way stating that the ECB's competences with regard to 'payment and clearing systems' do not cover all clearing systems relating to transactions in securities.[46] As a consequence, any CCP authorised in an EU Member State can clear Euro-denominated derivatives without restrictions even if it is established and supervised in a Member State having a different currency than the Euro.

b) Equivalence Regime for Third Country CCPs

CCPs which are established in a third country can gain access to the EU clearing market if they are recognised by ESMA.[47] ESMA's centralised competence to recognise third country CCPs derives from the global nature of financial markets.[48] Currently, ESMA has recognised 32 CCPs from third

[36] Art. 2 point (1) EMIR.
[37] Art. 2 point (3) EMIR.
[38] Philip Staford and Rochelle Toplensky, 'EU outlines 3 options for London's clearing business' *Financial Times* (London, 4 May 2017).
[39] Art. 14(1), Art. 17 (1) EMIR.
[40] ESMA was established after the financial crisis in order to harmonise securities regulation and supervision in the EU by Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC [2010] OJ L.331/84.
[41] Art. 17(4), 18, 19 EMIR.
[42] Art. 14(2) EMIR.
[43] Art. 14(5) EMIR.
[44] ECB Eurosystem Oversight Policy Framework of 5 July 2011, <www.ecb.europa.eu/pub/pdf/other/eurosystemoversightpolicyframework2011en.pdf> accessed 16 January 2018.
[45] Case T-496/11, *United Kingdom of Great Britain and Northern Ireland v European Central Bank*, ECLI:EU:T:2015:133.
[46] Case T-496/11, *United Kingdom of Great Britain and Northern Ireland v European Central Bank*, ECLI:EU:T:2015:133, paras 97-99.
[47] Art. 25(1) EMIR.
[48] Recital 59 EMIR.

countries.[49] Recognised third country CCPs are not subject to ESMA's direct supervision or enforcement.[50] Non-binding cooperation arrangements ensure that ESMA and the competent third country authorities exchange supervisory information.[51]

Under EMIR, the third country recognition is subject to four conditions.[52] First, the EU Commission needs to have adopted an implementing act determining that the relevant third country has an equivalent legal and supervisory framework for CCPs, that they are effectively supervised on an ongoing basis and that this third country has an equivalent recognition regime of third country CCPs.[53] Second, the CCP must be authorised in the country of its origin and be subject to effective supervision and enforcement which ensures full compliance with the prudential requirements of that third country.[54] Third, ESMA needs to have established a cooperation arrangement with the third country on the basis that its legal and supervisory frameworks are deemed equivalent.[55] Such arrangements have to specify at least the information mechanisms, especially those for prompt notification in case of legal infringements, and coordination procedures regarding supervisory activities, including on-site inspections.[56] Fourth, the third country needs to have systems for anti-money-laundering and combating the financing of terrorism which are equivalent to those of the EU.[57]

c) Commission's EMIR II Proposal

The current regime for third country CCPs might be modified before Brexit happens in March 2019. On 13 June 2017, the EU Commission issued a proposal amending EMIR's third country recognition regime (EMIR II proposal).[58] This proposal aims to introduce new requirements for CCPs established both within and outside the EU and to strengthen the role of ESMA.[59] London-based CCPs have described this as a direct threat to their business.[60]

With regard to CCPs established in the EU, the EMIR II proposal envisages a stronger role for ESMA in the authorisation procedure. The NCAs would still be competent to supervise clearing services, but they would assess the completeness of the application for authorisation in consultation with ESMA.[61] In certain supervisory decisions, ESMA's consent would become necessary before the NCAs can adopt the decision.[62] This includes decisions on CCP authorisation, withdrawal of authorisation and

[49] ESMA, 'List of third-country central counterparties recognised to offer services and activities in the Union' last updated 9 October 2017 < www.esma.europa.eu/sites/default/files/library/third-country_ccps_recognised_under_emir.pdf> accessed 16 January 2018.

[50] See the cooperation arrangements, e.g. Art. 2(1),(4) MoU between ESMA and Swiss Financial Market Authority, Swiss National Bank of 30.11.2015; Art. 2(1),(4) MoU between ESMA and the U.S. Commodity Futures Trading Commission of 2.6.2016.

[51] Art. 25(7)(a)-(d) EMIR; e.g. Art. 3(4),(5) MoU between ESMA and Swiss Financial Market Authority, Swiss National Bank of 30.11.2015; Art. 3(4),(5) MoU between ESMA and the U.S. Commodity Futures Trading Commission of 2.6.2016.

[52] For a detailed analysis Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, OUP 2014) 618 et seq.

[53] Art. 25(2)(a), (6) EMIR, Art. 5 Regulation (EU) No 182/2011 [2011] OJ L55/13.

[54] Art. 25(2)(b) EMIR.

[55] Art. 25(2)(c), (7) EMIR.

[56] Art. 25(7)(a) to (d) EMIR.

[57] Art. 25(2)(d) EMIR.

[58] European Commission, 'Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs' of 13 June 2017, COM(2017) 331 final, 2017/0136 (COD).

[59] See also Eddy Wymeersch, 'Brexit and the Equivalence of Regulation and Supervision' (2017) EBI Working Paper 15/2017, 23–25.

[60] London Stock Exchange Group, Response to the European Commission EMIR II proposal (Part II – Supervision of EU and third-country CCPs) in official feedback process, reference F 7438, 30 October 2017.

[61] Art. 17(3) EMIR II proposal.

[62] Art. 21a(1),(5) EMIR II proposal.

access to a CCP. If an NCA does not comply, ESMA can adopt a binding decision vis-à-vis financial market participants.[63]

Third country CCPs would see a significant change under the EMIR II proposal and be classified in a two-tier system. The current third country regime would be applicable only to CCPs which are determined as not systemically important or not likely to become systemically important (Tier 1 CCPs).[64] An important modification would be that the EU Commission could subject the application of its implementing act concerning the equivalence of legal standards to the effective fulfilment of its equivalence requirements, thus creating ongoing monitoring of the third country's regulatory standards by ESMA.[65] For third country CCPs which are systemically important or likely to become (Tier 2 CCPs), the proposal introduces a new set of regulatory and supervisory requirements.[66] ESMA would determine if a third country CCP is systemically important or likely to become systemically important.[67] Once categorised as systemically important, the CCP would have to fulfil all EMIR requirements for CCPs[68] and any requirements imposed by the central banks of issue of the most relevant Union currencies cleared or to be cleared in carrying out their monetary policy task.[69] However, they could ask for a derogation if ESMA deems its home country regulation to be equivalent to EMIR ('comparable compliance').[70] Tier 2 CCPs would also have to accept ESMA's direct supervision.[71] ESMA would supervise their compliance on an ongoing basis using supervisory tools ranging from simple requests for information or general investigations to on-site inspections.[72] If ESMA were to find that a CCP has intentionally or negligently infringed specific duties under EMIR, it could impose a fine up to 10% of total annual turnover.[73] Where continuous infringements occur, ESMA could order the CCP to pay periodic penalties.[74] The decisions on fines and penalties would be subject to unlimited judicial control by the ECJ.[75] Under the proposal, a third country CCP could even be forced to relocate into and be licensed in the EU territory. This would be the case if upon ESMA`s recommendation the European Commission deemed the third country CCP to be so systemically important that the respect for EMIR and ESMA's cross-border supervision would not in itself suffice to ensure financial stability within the EU.[76]

II. The Effects of a No Deal Scenario

On Brexit day, the freedom to provide services and the freedom of establishment will cease to apply between the EU and the UK.[77] In this scenario, market access for financial services will be determined

[63] Art. 21a(7) EMIR II proposal.
[64] Art. 25(2)(e) EMIR II proposal.
[65] Art. 25(6) sentence 2, (6b) EMIR II proposal.
[66] See also Eddy Wymeersch, 'Brexit and the Equivalence of Regulation and Supervision' (2017) EBI Working Paper 15/2017, 24, who describes the proposal as constituting "an interesting innovation in the field of cross border financial activities".
[67] Decisive factors would be the CCP's nature, size and complexity, the effect of its potential failure on financial markets, the CCP's clearing membership structure and its relationship and interdependencies with other financial market infrastructures to be specified by the Commission, Art. 25(2a)(a) to (d) EMIR II proposal.
[68] Art. 25(2b)(a) EMIR II proposal.
[69] Art. 25(2b)(b) EMIR II proposal.
[70] Art. 25a EMIR II proposal.
[71] Art. 25(2b)(c) EMIR II proposal.
[72] Art. 25b, 25c, 25d, 25e EMIR II proposal.
[73] Art. 25g(1), (2) EMIR II proposal.
[74] Art. 25h(1) EMIR II proposal.
[75] Art. 25k EMIR II proposal.
[76] Art. 25(2c) EMIR II proposal.
[77] The free movement of capital will still be applicable, but not suffice to maintain market access for cross-border financial *services*.

by the respective third country rules in force on Brexit day.[78] This could have serious economic consequences for the financial industry in the UK and the EU ('cliff effect').[79] However, the negative impacts would depend to a significant degree on whether the affected institutions take sufficient measures to adapt to the changing regulatory landscape in time.[80] Furthermore, the competent authorities in the EU and the UK could also reduce the negative consequences of a no deal scenario by systematically adopting third country equivalence decisions becoming effective on Brexit day as far as provided for in EU and UK law.[81]

1. Commercial Banking

a) UK-licensed Banks

Once the UK becomes a third country under the current EU secondary law regime, banks licensed in the UK[82] will no longer be able to use passporting rights and thus will no longer be able to freely engage in cross-border banking activities under their UK licences. In this scenario, in order to continue providing substantial banking services in the EU, it would not be a realistic option to rely on making direct offers. Instead UK-licensed banks would need to establish a branch or a subsidiary in an EU Member State and obtain a banking licence from that Member State.[83] If they already have a branch in an EU27 Member State, they could convert it into a subsidiary and apply for a licence there. This subsidiary then benefits from EU passporting rights to other Member States. Alternatively they could expand existing branches set up under the passporting system if the Member State allows a third country bank branch to hold a licence. However, under the current regime, these branches would not benefit from the passporting rights and thus the banks would need a licence in each Member State where they want to offer commercial banking services via branches. De lege ferenda the EU could harmonise access for UK-licensed banks to the whole EU27 via branches by reaching a third country agreement with the UK.[84]

Both the ECB and the European Banking Authority (EBA) recently declared that EU branches or subsidiaries of UK-licensed banks in the EU27 may not act as 'empty shells' but will need significant operations and substance on the EU territory.[85] Therefore, a mere formal transfer will not fulfil current

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[78] See Eilis Ferran, 'The UK as a Third Country Actor in EU Financial Services Regulation' (2016) University of Cambridge Legal Studies Research Paper 47/2016, 3 et seq; Niamh Moloney, 'Financial Services, the EU, and Brexit: An Uncertain Future for the City?' (2016) 17 German Law Journal 75.

[79] A more optimistic view based on a political-economic analysis is developed by Wolf-Georg Ringe, 'The Irrelevance of Brexit for the European Financial Market' (2018) University of Oxford Legal Research Paper 10/2017; Wolf-Georg Ringe, 'A Brexit Deal for Financial Services' in Armour and Eidenmüller (eds), *Negotiating Brexit* (Beck, Hart and Nomos 2017) 45. In some areas, the cliff effect might be felt less where current EU secondary law regime exceptionally grants wholesale business an exemption to the need for authorisation for reverse solicitation, i.e. where the provider does not solicit business, but the consumer approaches the provider. See also Pierre Berger and Olivier van den Broeke, 'Enter Brexit: what is the impact on the financial services industry?' (2017) International Company and Commercial Law Review 209, 211.

[80] For an analysis of the options for UK-licensed banks to mitigate the negative effects of Brexit see André Prüm, 'Brexit: Options for Banks from the UK to Access the EU Market' (2017) Europäische Zeitschrift für Wirtschaftsrecht 988.

[81] See also Eddy Wymeersch, 'Brexit and the Equivalence of Regulation and Supervision' (2017) EBI Working Paper 15/2017, 38 et seq. Pointing at a newly introduced 'third country passport' in MiFID II for wholesale investment services providers established in third countries John Armour, 'Brexit and Financial Services: Bargaining in the Shadow of Equivalence' in Armour and Eidenmüller (eds), *Negotiating Brexit* (Beck, Hart and Nomos 2017) 21, 31.

[82] This includes many UK subsidiaries of third country banks, e.g. from the US or Japan, using the UK as an access point to the EU banking market pre-Brexit.

[83] See also André Prüm,'Brexit: Options for Banks from the UK to Access the EU Market' (2017) Europäische Zeitschrift für Wirtschaftsrecht 988, 989.

[84] Art. 47(3) CRD IV.

[85] EBA, 'Opinion on issues related to the departure of the United Kingdom from the European Union' 12 October 2017 (EBA/Op/2017/12), 5 et seq. <https://www.eba.europa.eu/documents/10180/1756362/EBA+Opinion+on+Brexit+Issues+%28EBA-Op-2017-12%29.pdf>

EU regulatory requirements. EBA and the ECB are not willing to grant UK-licensed banks Brexit-related exceptions from the existing regulatory framework.

Furthermore, the conversion of a branch into a subsidiary could require a transfer of assets from the UK-licensed bank to the EU subsidiary, which itself entails legal difficulties. The transfer of contracts ('repapering') will likely require counterparty consent. EBA considered this to be an issue of systemic importance.[86] Besides the conversion-specific problems and more generally, the choice of English law and jurisdiction is subject to current discussions.[87] Many banking contracts are based on English law and refer disputes to English courts. It is yet to be determined under which conditions, in a no deal scenario, English court judgments will be enforceable in EU Member States.[88]

b) EU-licensed banks

Banks licensed in an EU Member State (EU-licensed banks), many of which have significant operations in London and use it as their hub to other financial markets, would be affected by a no deal scenario as well. On Brexit day, their branches in London would become third country branches. This would entail a possible need for a UK banking licence and under certain circumstances could require them to turn a branch into a subsidiary including conversion-specific challenges similar to those faced by UK-licensed banks in the EU.[89]

However, the Bank of England has recently started a consultation on an updated approach to authorising and supervising international banks, which aims to keep the UK's financial system open to foreign institutions in the interests of the UK, EU and the global economy.[90] As part of this initiative, UK supervisors and regulators have jointly offered EU- and EEA-licensed banks to retain the status quo to a certain degree even in a hard Brexit scenario.[91] The Bank of England assured EU-licensed banks that their branches can apply for a UK licence like any other third country bank and will not have to be converted into licenced subsidiaries, as long as they do not have material UK retail deposits. It even accepts that EU-licensed banks will be supervised by their home state supervisor provided that there is a high degree of supervisory cooperation. This approach was shared by the UK Financial Conduct Authority.[92] In the same spirit, the UK Treasury announced a legislative proposal granting EU- and

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accessed 16 January 2018; ECB, 'Brexit: an ECB supervision perspective' Newsletter 15 November 2017, <https://www.bankingsupervision.europa.eu/press/publications/newsletter/2017/html/ssm.nl171115_2.en.html> accessed 16 January 2018.

[86] EBA, 'Risk Assessment of the European Banking System', 24 November 2017, 17 <https://www.eba.europa.eu/documents/10180/2037825/Risk+Assessment+Report+-+November+2017.pdf>.

[87] Giesela Rühl, 'The Effect of Brexit on the Resolution of International Disputes: Choice of Law and Jurisdiction in Civil and Commercial Matters' in Armour and Eidenmüller (eds), *Negotiating Brexit* (Beck, Hart and Nomos 2017) 61-66; Tom Snelling, 'Negotiating Brexit: Recognition and Enforcement of Judgements' in Armour and Eidenmüller (eds), *Negotiating Brexit* (Beck, Hart and Nomos 2017) 67-71; Thomas Grupp 'Entwicklungen im Umfeld einer Rechts- und Gerichtsstandswahl in Zeiten von Brexit' (2017) Europäische Zeitschrift für Wirtschaftsrecht 974; Bettina Rentsch 'Das Vereinigte Königreich als "Drittstaat" im Sinne der Rom I-VO' (2017) Europäische Zeitschrift für Wirtschaftsrecht 981.

[88] Tom Snelling, 'Negotiating Brexit: Recognition and Enforcement of Judgements' in Armour and Eidenmüller (eds), *Negotiating Brexit* (Beck, Hart and Nomos 2017) 67, 71.

[89] See above B.II.1.a).

[90] Bank of England, 'The Bank of England's approach to the authorisation and supervision of international banks, insurers and central counterparties' press release of 20 December 2017 <https://www.bankofengland.co.uk/-/media/boe/files/news/2017/december/the-boes-approach-to-the-authorisation-and-supervision-of-international-banks-insurers-and-ccps.pdf?la=en&hash=435F061FE8A7020115EADC2E1E56DFD2A9D69B4A>.

[91] Caroline Binham and Martin Arnold, 'UK City regulators turn on Brexit charm offensive' *Financial Times* (London, 20 December 2017).

[92] Financial Conduct Authority, 'FCA statement on EU withdrawal' 20 December 2017 <https://www.fca.org.uk/news/statements/fca-statement-eu-withdrawal>.

EEA-licensed financial institutions temporary market access permissions to the UK similar to current passporting rights.[93]

2. Clearing Services

a) UK-based CCPs

Of the 16 CCPs established in the EU, three of the most important CCPs are established in the UK.[94] Therefore, a hard Brexit could have serious consequences.

On Brexit day, UK-based CCPs will become third country CCPs and therefore need ESMA's recognition in order to still access the EU clearing market under EMIR[95] as well as under the EMIR II proposal in its current form. Having incorporated existing EU law including EMIR into national law, the UK will likely fulfil the substantive equivalence requirements at the moment it becomes a third country. Nevertheless, formally it will be necessary for the EU Commission to adopt an implementing act and for ESMA to establish a coordination arrangement with the Bank of England as the UK NCA for clearing services.

If the EU adopted the EMIR II proposal in its current form prior to Brexit day, the systemically relevant UK-based CCPs would also have to accept ESMA's direct supervision provided that this will be compatible with UK law. Under certain circumstances, UK-based CCPs could even be forced to relocate into the EU in order to have market access. In this regard, it should be added that the UK as a third country will (obviously) not be able to successfully challenge EMIR II on similar grounds as it did with regard to the Eurosystem Oversight Policy Framework of the ECB in *United Kingdom v ECB* (T-496/11).[96]

b) EU-based CCPs

EU-based CCPs will probably face similar consequences in the UK. Whilst they will still be CCPs authorised within the EU and should thus fulfil the current UK recognition regime on Brexit day,[97] this regime may change at some point in the future and EU-based CCPs could lose free market access in the UK. However, in order to ensure a smooth transition, the UK regulators have offered EU- and EEA-based CCPs the same preferable treatment as for banks.[98]

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[93] The Chancellor of the Exchequer, 'Financial Services Update: Written statement - HCWS382' 20 December 2017 <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-12-20/HCWS382/>.

[94] They are LCH Ltd, LME Clear Ltd and ICE Clear Europe Ltd. See ESMA, 'List of Central Counterparties authorised to offer services and activities in the Union', last updated 11 December 2017 <www.esma.europa.eu/sites/default/files/library/ccps_authorised_under_emir.pdf>.

[95] See also Eddy Wymeersch, 'Brexit and the Equivalence of Regulation and Supervision' (2017) EBI Working Paper 15/2017, 21.

[96] See above B.I.2.a).

[97] Sec. 285(1),(3B) Financial Services and Markets Act 2000 c. 8.

[98] See above B.II.1.b). Bank of England, 'The Bank of England's approach to the authorisation and supervision of international banks, insurers and central counterparties' press release of 20 December 2017, <https://www.bankofengland.co.uk/-/media/boe/files/news/2017/december/the-boes-approach-to-the-authorisation-and-supervision-of-international-banks-insurers-and-ccps.pdf?la=en&hash=435F061FE8A7020115EADC2E1E56DFD2A9D69B4A>.

III. Limitations to Third Country Rules under GATS

The third country rules of the EU and the UK to be applied in a no deal scenario[99] can change over time. The EU Commission's EMIR II proposal[100] illustrates how regulators react to a changing market environment, especially to Brexit, and thus may change applicable third country rules. However, as the respective regulators from the EU and the UK will remain members of the Basel Committee on Banking Supervision (BCBS) and other international rule-makers, it can be expected that future third country rules in the EU and the UK will remain within the soft law set by these institutions.[101]

More importantly, post-Brexit cross-border commercial banking and clearing services between the EU and the UK will be internationally governed by the WTO's General Agreement on Trade in Services (GATS)[102] to which both the UK and the EU are parties.[103] GATS is a trade-enabling regime[104] which also sets limitations to the third country rules for financial services to be applied between the UK and the EU in a no deal scenario. As a bottom line, GATS guarantees treatment which is no less favourable than the treatment given to any other country.[105] Market access and national treatment are granted where the WTO Member State has committed to doing so in its schedule of specific commitments.[106]

1. Article II GATS Most-Favoured-Nation Treatment

Most-favoured-nation (MFN) treatment is a general obligation under Article II GATS for all WTO Member States. They must apply immediately and unconditionally to services or services suppliers of all other Members 'treatment no less favourable than that accorded to like services and services suppliers of any other country'. This grants WTO Members the right not to be treated worse than other third countries and serves to ensure that trade barriers are not discriminatory, but it is neutral as to the degree of liberalisation.[107] Given that WTO Member States aim to liberalise trade with each other, this provision de facto brings down trade barriers over time.

MFN treatment is, in principle, applicable to financial services. There are exceptions to it,[108] but they do not concern commercial banking or clearing.[109] According to Article II:2 GATS, Member States may 'maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions'.

For present purposes, MFN treatment means that neither the EU nor the UK will be allowed to grant each other's financial services providers different market access than that granted to financial services providers from other third countries. Therefore, in principle, they cannot discriminate or

[99] See above B.II.
[100] See above B.I.2.c).
[101] For a detailed analysis Niamh Moloney, 'International Financial Governance, the EU, and Brexit: The 'Agencification' of EU Financial Governance and the Implications' (2016) 17 European Business Organization Law Review 451.
[102] GATS resulted from the Uruguay Round, was agreed in Marrakesh and has been in force since January 1995.
[103] Implemented in the EU via Council Decision 94/800/EC of 22 December 1994 concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986-1994) [1994] OJ L336/190.
[104] See for detailed analysis Kern Alexander, 'The World Trade Organisation and Financial Stability: The Balance between Liberalisation and Regulation in the GATS' (2003) CFAP Working Paper Series 5/2003.
[105] Art. II:1 GATS.
[106] Art. XVI and XVII GATS.
[107] Rüdiger Wolfrum, 'Article II GATS' in Wolfrum, Stoll and Feinäugle (eds), *WTO-Trade in Services* (Leiden 2008) 73 n 5.
[108] Art II:2, II:3 GATS.
[109] The Annex on Article II Exemptions in force for the EU15 does not contain major exemptions in the financial services sector (GATS/EL/31 of 15 April 1994).

privilege each other vis-à-vis other third countries. However, this principle is subject to the exceptions provided by the Annex on Financial Services and Article V GATS, to be discussed below.[110]

2. GATS Schedules and the Understanding on Commitments in Financial Services

The GATS provides more than just MFN treatment. Each WTO Member State has a schedule of specific commitments in which it can undertake to provide market access in specific services sectors[111] and to treat services and service suppliers of other WTO Member States in specific sectors no less favourably than it treats its own national services or service suppliers in those sectors.[112] It is up to each WTO Member State to decide how it populates its schedule of specific commitments.

The EU (including the UK) has taken a liberal approach to granting market access and national treatment under the GATS. However, two points of the EU's schedule of specific commitments are important for the present analysis:

First, there is no common EU28 or EU25 GATS schedule of specific commitments at the moment.[113] The schedule currently in force dates back to 15 April 1994[114] supplemented by the important review on financial services commitments dating back to 18 November 1999.[115] This applies only to the then EU15, including the UK. Those WTO Member States who later became EU Member States, e.g. Poland and Cyprus, are committed to their own individual schedules of specific commitments,[116] which differ from, and generally are less liberal than, the EU schedule.

Second and more importantly, it should be noted that no EU Member State has granted general market access or national treatment to its financial services sector. The EU15 have bound themselves as a whole to some specific financial services commitments pursuant to the Understanding on Commitments in Financial Services.[117] For the newer EU Member States, it depends on whether they have opted into the Understanding or not. The Understanding includes only very limited obligations to grant cross-border market access for specific insurance services and transfer of financial information.[118] Banking services are instead only liberalised in so far as a WTO Member State has to allow its residents to purchase certain banking services in another Member State (consumption abroad).[119] Even though consumption abroad does not include the cross-border supply of banking services, differentiating

[110] See B.III.3. and C.I.1.
[111] Art. XVI GATS.
[112] Art. XVII GATS.
[113] Document S/C/W/273 of 9 October 2006 was certified but it has not entered into force. Document S/L/286 concluded the certification procedure, and stated that the new (EU25) schedule "shall enter into force on a date to be specified by the European Communities and its Member States", which the EU has not yet communicated to the WTO. Document S/DCS/W/EEC and Corr.1, of 2003 is no more than a working document that pulled together the various documents in which commitments could be found, but it has no legal standing in the WTO.
[114] GATS/SC/31 of 15 April 1994.
[115] GATS/SC/31/Suppl.4/Rev.1 of 18 November 1999.
[116] In the case of Poland GATS/SC/71 of 15 April 1994, supplemented on 28 July 1995, 11 April 1997 and 26 February 1998; in the case of Cyprus GATS/SC/25 of 15 April 1994, supplemented on 23 and 26 February 1998 and reviewed on 18 November 1999.
[117] Council Decision (94/800/EC) of 22 December 1994 concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986-1994) [1994] OJ L336/2 and L336/270; expressed on GATS level in GATS/SC/31/Suppl.4/Rev.1, page 2 n 1.
[118] Part B Subparagraphs 3 and 4 of the Understanding on Commitments in Financial Services. In this regime, insurance services are widely liberalised for maritime shipping, commercial aviation, space launching, freight and goods in international transit.
[119] Part B Subparagraph 4(c) Understanding on Commitments in Financial Services, Subparagraph 3(a)(v) to (xvi) GATS Annex on Financial Services [1994] OJ L336/206.

between the two is not easy given the possibilities of e-commerce and given that the place of delivery is not necessarily static in an ongoing trade relationship.[120]

Third country financial services suppliers do have the right to establish a commercial presence in the EU15 according to the Understanding.[121] The right of establishment can however be limited by terms, conditions and procedures for authorisation as long as the Member State does not circumvent its general obligation to allow the establishment of third country suppliers and acts consistently with its other GATS obligations.[122] 'Circumventing' is close to the meaning of 'avoiding' under Part B subparagraph 2 (a) Annex on Financial Services and thus is to be interpreted as showing a lack of good faith or the intent to undermine the fundamental obligations.[123]

3. Prudential Carve-out

The trade-enabling provisions in GATS are qualified by exceptions in the GATS Annex on Financial Services.[124] It allows Member States to impose measures for prudential reasons, which include the integrity and stability of the financial system and the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed.[125] Such prudential measures can deviate from GATS provisions as long as they are not (mis)used to avoid GATS commitments, i.e. as long as they are used in good faith. This prudential carve-out can restrict significantly the trade-enabling function of the GATS for financial services.

4. GATS and the No Deal Scenario

The application of the third country rules in the no deal scenario described above[126] will be in accordance with GATS. Applying the current EU third country regime for both commercial banking and clearing services in relation to the UK would be deemed compliant with GATS. The exclusion of third country branches from the passporting regime in the EU is recognised at the GATS level in the EU15 schedule of specific commitments in financial services.[127] Similarly the Commission's EMIR II proposal providing for stronger supervision of significant third country CCPs would very probably be deemed in accordance with GATS, as it serves to foster market stability under the prudential carve-out.

Though GATS does not prevent the EU and the UK from modifying their third country regimes over time, they may only do so in accordance with their specific commitments under the GATS schedules, the MFN clause and the prudential carve-out.[128] Besides, modifications of the applied policies outside the scope of the specific commitments would be allowed within the boundaries of MFN. However, if such modifications were to restrict market access, they could give rise to serious political tensions with other third countries such as the United States or Japan and are therefore rather improbable.

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[120] Armin von Bogdandy and Joseph Windsor, 'Understanding on Commitments in Financial Services' in Wolfrum, Stoll and Feinäugle (eds), *WTO-Trade in Services* (Leiden 2008) 656 n 11.

[121] Part B Subparagraph 5 Understanding on Commitments in Financial Services.

[122] Part B Subparagraph 6 Understanding on Commitments in Financial Services.

[123] Armin von Bogdandy and Joseph Windsor, 'Understanding on Commitments in Financial Services' in Wolfrum, Stoll and Feinäugle (eds), *WTO-Trade in Services* (Leiden 2008) 657 n 12; Armin von Bogdandy and Joseph Windsor, 'Annex on Financial Services' in Wolfrum, Stoll and Feinäugle (eds), *WTO-Trade in Services* (Leiden 2008) 635 n 23-24.

[124] GATS Annex on Financial Services [1994] OJ L336/206.

[125] Part B Subparagraph 2(a) GATS Annex on Financial Services.

[126] See B.II.

[127] GATS/SC/31/Suppl.4/Rev.1, page 2 fn 1, here cited nearly literally substituting "Community" with "EU".

[128] See also André Prüm, 'Brexit: Options for Banks from the UK to Access the EU Market' (2017) Europäische Zeitschrift für Wirtschaftsrecht 988.

C. Financial Services under an FTA: Limitations and Models

So far, this article concentrated on the regulatory backdrop governing the no deal scenario. In this chapter, we depict the array of models for a future bilateral EU-UK regime governing market access for cross-border commercial banking and clearing services. In light of a political-legal margin for modelling an EU-UK FTA (I.), we discuss five concepts for such an FTA with regard to financial services (II.).

I. Margin for Modelling an FTA

A possible FTA faces divergent political expectations and 'red lines' in both the UK and the EU which have been reflected in the political debates taking place since the Brexit referendum. When these are considered in combination with the legal boundaries, a certain margin for modelling such an FTA emerges. This can be visualised by the following figure 1:

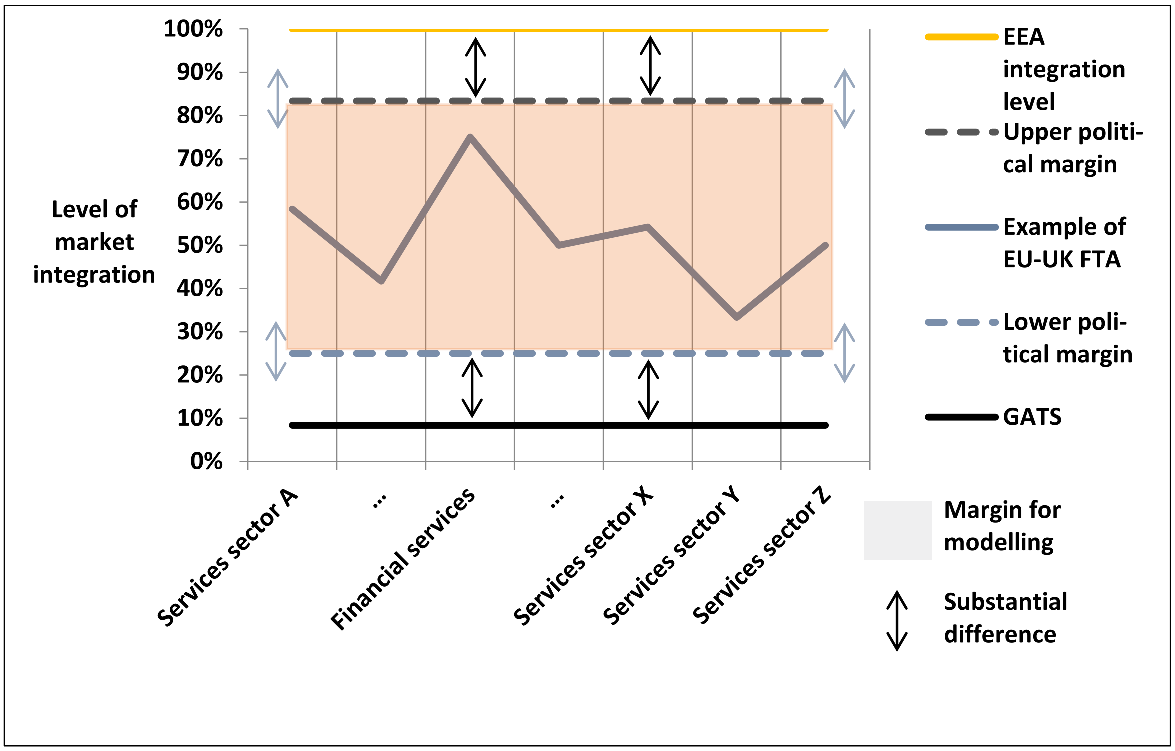

Figure 1 Margin for modelling a possible EU-UK FTA

The lower boundary of the margin consists of GATS, which is both a default regime[129] and a legal boundary[130] to the future EU-UK framework ('GATS floor'). Whilst the level of market integration in an FTA can vary between services sectors, the overall level of negotiated market access will have to be higher than the 'GATS floor'. Furthermore, an FTA between the EU and the UK hardly makes sense if it does not provide for a noticeably higher level of liberalisation than GATS. However, this does not necessarily mean that an FTA must surpass GATS in all affected sectors, especially with regard to financial services FTAs often contain only a few provisions.

[129] See above B.III.
[130] See below C.I.1.

The upper boundary of the margin is the level of integration provided for by the Agreement on the European Economic Area (EEA) ('EEA ceiling').[131] On the one hand, the UK government seems to be ruling out the possibility of remaining part of the EEA given what it perceives as the disadvantages of EEA membership compared to the current status as EU member.[132] On the other hand, the EU will not grant the UK full access to its single market unless the UK accepts EU regulations and contributes financially in the same way as EEA Member States. Otherwise, this would amount to the UK enjoying the benefits of single market participation without having the same burdens as members ('cherry-picking'). This is a red line upon which the EU and all remaining 27 Member States agree so far. Furthermore, if the UK were granted the same degree of market access as EEA Member States without their obligations, this would lead to the UK being treated better than Norway, Liechtenstein and Iceland. Therefore, from the EU perspective, any possible bilateral EU-UK FTA will probably have to grant noticeably less market access to the UK than the access granted to the EEA Member States.[133]

1. Limitations Set by GATS

A possible bilateral EU-UK agreement on market access will need to respect the boundaries set by GATS. For the present purpose, there are two important limitations. First, a bilateral framework would have to respect the provisions of the GATS Annex on Financial Services. Second, Art. V GATS requires a bilateral FTA to be a comprehensive economic integration treaty, otherwise all GATS Member States could ask for the same preferential market access (MFN treatment). These WTO rules set a margin for an EU-UK FTA.

a) Annex on Financial Services

One option for the EU and the UK to grant each other market access for commercial banking and clearing services is provided by the GATS Annex on Financial Services. Under this Annex, the EU and the UK can recognise certain prudential measures of each other's authorities.[134] It can be granted reciprocally or unilaterally.[135] This can include the recognition of commercial banking licences or the authorisation of a CCP and might be interesting if the EU and the UK cannot agree on a substantial amount of services sectors and thus cannot comply with Article V:1 GATS.

However, under this option, the EU and UK would have to give other interested WTO Member States the opportunity to show that they fulfil the requirements and if they can do so then either grant them accession to the bilateral agreement or give them adequate opportunity to negotiate a comparable agreement.[136] This may not be in the interest of the EU and/or the UK.

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[131] Agreement on the European Economic Area between the EU and Norway, Iceland and Liechtenstein [1994] OJ L1/1, which is in force since January 1994.

[132] PM Theresa May in her Florence speech on 22 September 2017: "European Economic Area membership would mean the UK having to adopt at home - automatically and in their entirety - new EU rules. Rules over which, in future, we will have little influence and no vote. Such a loss of democratic control could not work for the British people."

[133] For details see below C.I.2. A less rigid concept of the upper boundary from an economic-political view and based on an outcomes-based approach is offered by Wolf-Georg Ringe, 'The Irrelevance of Brexit for the European Financial Market' (2018) University of Oxford Legal Research Paper 10/2017.

[134] Subparagraph 3 GATS Annex on Financial Services.

[135] Subparagraph 3 lit. a) GATS Annex on Financial Services.

[136] Subparagraph 3 lit. b) GATS Annex on Financial Services. See also André Prüm, 'Brexit: Options for Banks from the UK to Access the EU Market' (2017) Europäische Zeitschrift für Wirtschaftsrecht 988, 989.

b) Article V GATS Exemption for Treaties on Economic Integration

A more robust way for the EU and the UK to grant each other wide ranging, preferential market access after Brexit is to agree on a treaty on economic integration under Article V GATS. Such a bilateral treaty must have (i) substantial sectoral coverage and (ii) be free from any kind of discrimination pursuant to Article V:1 lit. b GATS. Otherwise, other GATS Member States could claim the same preferential market access under Article II:1 GATS.

As for the first condition of substantial sectoral coverage, a wish for sector-specific deals specifically for financial services was proposed by some British politicians early after the Brexit referendum.[137] However, sector-specific deals are not permitted under GATS. The requirement of substantial sectoral coverage means that a bilateral agreement must cover a substantial number of sectors, volume of trade affected and modes of supply and that no mode of supply may be excluded a priori.[138] Whilst there is no definition of the exact qualitative and quantitative meaning of substantial, it is generally agreed that only a very limited number of sectors could be excluded.[139] GATS does not define what a service sector is. Some commentators apply the list of eleven sectors[140] of the WTO's Dispute Settlement Understanding and presume that the exclusion of more than one or two sectors would be a violation of Art. V:1 GATS.[141] For a future bilateral deal, this means that the EU and the UK would have to agree on liberalising nearly all service sectors albeit possibly to divergent degrees. An FTA liberalising only financial services would not be compatible.[142] The degree of liberalisation can differ from sector to sector and it will be sufficient if each chapter exceeds the GATS level of liberalisation. Given the current level of cross-border market integration and the economic interests of both the EU and the UK, it seems probable that the potential deal would fulfil these requirements. In principle, it could be open to challenge through WTO dispute settlement, but so far, no other FTA in services has been challenged in the WTO in spite of most of them falling short of 100% sectoral coverage.

With regard to the second condition of non-discrimination, reducing the high level of existing market access and national treatment between the EU and the UK seems contrary to the spirit of Article V:1(b) GATS, requiring a deepening of the liberalisation.[143] However, it is unlikely that another WTO Member State could challenge the terms of an EU-UK FTA through WTO dispute settlement. First, WTO dispute settlement applies only to WTO Agreements, not to the terms of agreements under Article V GATS that go beyond WTO obligations.[144] A challenge could be made to the conformity of the new UK-EU agreement in its entirety with Article V GATS, but not to the specific terms of the agreement. Second, there is no agreed standard against which WTO members could determine whether the terms of a new UK-EU trade agreement comply less with GATS rules than the current situation. EU economic integration through the Single Market and its Customs Union has never been 'approved' in the WTO. It

[137] Alex Barker and Jim Brunsden, 'May puts UK on course for sector-by-sector deals on EU trade access' *Financial Times* (London, 3 October 2016).

[138] Footnote 1 to Art. V:1 lit. a) GATS.

[139] Thomas Cottier and Martín Molineuvo, 'Art. V GATS', in Wolfrum, Stoll and Feinäugle (eds), *WTO – Trade in Services* (Leiden 2008) 130-131 n 11 et seq.

[140] The Services Sectoral Classification List (MTN.GNS/W/120) includes business services, communication services, construction and related engineering services, distribution services, educational services, environmental services, financial services, health-related and social services, tourism and travel-related services, recreational, cultural and sporting services and transport services.

[141] Thomas Cottier and Martín Molineuvo, 'Art. V GATS', in Wolfrum, Stoll and Feinäugle (eds), *WTO – Trade in Services* (Leiden 2008) 131 n 12.

[142] See also Christoph Herrmann, 'Brexit, WTO und EU-Handelspolitik' (2017) Europäische Zeitschrift für Wirtschaftsrecht 961, 965.

[143] Thomas Cottier and Martín Molineuvo, 'Art. V GATS', in Wolfrum, Stoll and Feinäugle (eds), *WTO – Trade in Services* (Leiden 2008) 135 n 23.

[144] Art. XXIII:1 GATS.

has been examined in the Committee on Regional Trade Agreements,[145] but this Committee has not reached a conclusion on the conformity of any FTA, including the EU, with the GATT or GATS rules. Third, cutting back the level of UK-EU preferential treatment would not seem to be likely to adversely affect third country services exporters into the UK or EU markets. On the contrary, it might even improve their market access by reducing discrimination against them. There might be adverse effects for third country bank branches or subsidiaries in the UK or the EU, e.g. a US bank established in London with passporting rights losing them due to Brexit. However, their intra-EU market access rights are not guaranteed by GATS, so they could not have recourse to WTO dispute settlement in order to protect those rights.[146] An alternative course of action for them might be to refuse to agree to certify the UK's new GATS schedule in the WTO until the UK had provided them with additional concessions to make up for any loss of benefits of access to its market, such as passporting.

2. Limitations Set by the EEA Agreement

The upper boundary against which an EU-UK FTA needs to be measured is the EEA Agreement, which creates an internal market between the current 28 EU Member States and the three EEA EFTA States Iceland, Liechtenstein and Norway (EEA Internal Market).[147]

The EEA Agreement provides for the free movement of persons,[148] goods,[149] services,[150] capital[151] and the freedom of establishment.[152] It also grants full market access for certain sectors including financial services via passporting rights similar to the EU's Single Market. To this end the relevant regulatory standards between the EU and the three EEA EFTA Member States are fully harmonised. The underlying idea is that a single market requires homogenous rules and homogeneous application of these rules.[153] The EU legal acts which are relevant for the EEA are incorporated into the EEA Agreement by decision of the EEA Joint Committee and have to be implemented into the EEA EFTA Member States' national legal orders.[154] The obligation is automatic and compliance is monitored by the EEA Surveillance Authority.[155] EEA EFTA Member States do not have veto rights in the EU rule-making process. However, in prudential matters, there is a high degree of supervisory and regulatory cooperation. For example, the NCAs of EEA Member States take part in EBA and ESMA with the same rights and obligations as NCAs of EU Member States, except for the right to vote.[156] Judicial review under the EEA Agreement is provided by the EFTA Court which is, to a certain extent, bound by the ECJ. In practice, the EFTA Court generally follows the ECJ despite its possibility to distinguish cases.[157]

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145 WTO Document WT/REG39/M/5 of 27 July 2006 is the last document on the matter.

146 Art. XXIII:1 GATS.

147 Each contracting party may withdraw from the EEA Agreement provided it gives at least 12 months' notice in writing to the other contracting parties under Art. 127 EEA Agreement. It is likely that the UK will withdraw from the Agreement in the course of Brexit.

148 Art. 28-30 EEA Agreement.

149 Art. 8-27 EEA Agreement.

150 Art. 36-39 EEA Agreement.

151 Art. 40-46 EEA Agreement.

152 Art. 31-35 EEA Agreement.

153 Art. 105 et seq. EEA Agreement.

154 Art. 7, 92 et seq. EEA Agreement.

155 Art. 4 et seq., 22 et seq. Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice [1994] OJ L344/1.

156 Decision of the EEA Joint Committee No 199/2016 of 30 September 2016 amending Annex IX (Financial Services) to the EEA Agreement [2017/276] regarding EBA [2017] OJ L46/4, and Decision of the EEA Joint Committee No 201/2016 of 30 September 2016 amending Annex IX (Financial Services) to the EEA Agreement [2017/278] regarding ESMA [2017] OJ L46/22.

157 For detailed analysis Michael-James Clifton, 'EEA: Another Side to Europe' (2016) European Law Report 174, 179-181.

Another characteristic of the EEA Agreement is that the three EEA EFTA Member States contribute financially to certain tasks of the EU.[158]

As the UK government does not – at least at the moment – intend to rejoin the EEA Internal Market after Brexit by becoming an EEA EFTA Member State, the EU and the EU Member States will aim to make sure that an EU-UK FTA will not grant similar market access rights for the majority of sectors covered by the EEA Agreement without similar legal and financial obligations. Such a far reaching EU-UK FTA could be deemed a circumvention of the EEA Agreement to the detriment of the EEA EFTA Member States.

II. Financial Services and FTA Models

Considering possible degrees of market access, five main models to provide for financial services in an FTA emerge. First, there is the possibility that the EU and the UK agree an FTA, but cannot agree on specific market access rules for financial services (1.). In this scenario, cross-border financial services would be protected only by GATS. Second, the FTA includes some specific rules for financial services without granting much in the way of market access (2.). This would be comparable to the liberalisation of financial services under the EU-Canada Comprehensive Economic Trade Agreement (CETA).[159] Third, the FTA introduces an equivalence regime granting certain market access exceeding CETA (3.). Fourth, market access is granted on the basis of regulatory alignment (4.). Fifth, the parties agree on an entirely new concept based on alignment and non-alignment (5.). The last two scenarios correspond to recent UK finance industry proposals.

In the following section, the five models will be contextualised and analysed with particular emphasis on how each of them conceives continuous regulatory alignment, supervisory cooperation and possibilities of judicial review. Finally, the models are measured against the margin for modelling set out above[160]. Our analysis relies on the premise that any possible FTA will be based on reciprocity, i.e. will give the EU and the UK the same mutual access rights to each other's markets.

1. FTA without Specific Rules for Financial Services ('Bare Bones Deal')

It is possible that the parties might reach an FTA without agreeing on specific rules for financial services. Such an FTA has been referred to as a 'bare bones deal' because it would be a minimum agreement avoiding a mutually harmful hard Brexit.[161] Such a bare-bones deal would be unlikely to regulate the highly technical and difficult matter of cross-border access for financial services. In this case, EU-UK cross-border financial services would be affected in the same way as in a no deal scenario. They would only be protected by GATS and depend on the EU and the UK unilaterally granting market access to the other's financial institutions. There would be no regulatory alignment other than the non-binding standards agreed upon at the international level in the Financial Stability Board and the BCBS.[162] Supervisory cooperation or cross-border supervision would be the exception and depend on the unilateral regimes on both sides of the channel. EU and UK supervisors would execute their

[158] Art. 115-117 EEA Agreement, Protocol 38 to EEA Agreement.
[159] Comprehensive Economic and Trade Agreement between the EU and Canada, signed on 30 October 2016 [2017] OJ L11/23.
[160] See C.I.
[161] David Davis in response to MP Michael Tomlinson in the UK House of Commons, HC Deb 2 November 2017, vol 630, col 964 <https://hansard.parliament.uk/Commons/2017-11-02/debates/9FF70968-B9C1-4688-9E6F-5F548A06C878/TopicalQuestions> accessed 16 January 2018.
[162] Niamh Moloney, 'Negotiating a Financial Services Deal: Politics, Preferences, and Predictions' in Armour and Eidenmüller (eds), *Negotiating Brexit* (Beck, Hart and Nomos 2017) 35-40.

respective tasks separately. Furthermore, this regime would not provide for a common judicial review mechanism either.

The consequences for commercial banks and CCPs would be identical to the no deal scenario.[163] Should the FTA under this model lead to a more thorough integration of other sectors, the model could ultimately resemble the 'Swiss model'. The EU-Swiss regime liberalises the trade of goods in many areas[164] and, to a certain extent, the movement of persons.[165] However, there is no general agreement on the free movement of services. Only specific services are liberalised. Whilst some insurance services enjoy a limited degree of market access,[166] cross-border financial services between the EU and Switzerland are expressly excluded from liberalisation.[167]

2. FTA with Few Specific Rules for Financial Services ('CETA Model')

The second model is an FTA which includes a chapter on financial services, but only grants a low degree of cross-border market access. EU and UK financial regulation would not be aligned. Financial institutions would mainly have to rely on unilaterally granted access rights which could be unilaterally revoked as long as this complies with the prudential carve-out. This regime would not establish much cooperation between EU and UK supervisory authorities either. Such an FTA concept comes close to the regime governing cross-border financial services between the EU and Canada under CETA. Judicial review would take place respectively before UK or EU courts as long as the access rights granted would not be based on the FTA. Insofar as FTA based rights would be concerned, judicial protection would be governed by the FTA. This could be inspired by CETA and create a mixed dispute mechanism through international arbitration and a possibly multinational investment tribunal.

CETA's chapter 13 liberalises financial services more than GATS, but significantly less than the EEA Agreement. The chapter prohibits quantitative restrictions to market access for the other party's financial services providers, e.g. by number of financial institutions, value of financial services transactions or operations or number of natural persons employed.[168] The parties are also generally prevented from restricting or requiring specific types of legal entity or joint venture necessary to undertake certain businesses.[169] More importantly, there is a general obligation to ensure national treatment[170] which is explicitly extended to suppliers of cross-border financial services.[171] So, in principle, Canadian financial services providers are entitled to be treated as EU financial institutions and vice versa. CETA also explicitly obliges the parties to allow persons located in their territory to purchase a financial service from a cross-border supplier of financial services from the other party.[172] It is not clear how far this reaches because the provision does not require the parties to permit such suppliers to do business or solicit in their territory and allows the parties to define 'doing business' and

[163] See above B.II.
[164] A helpful overview provided by EP DG Internal Policies, Policy department A: Economic and scientific policy briefing paper, 'Internal Market beyond the EU: EEA and Switzerland' January 2010, PE 429.993, 10 et seq. The regime goes back to the EU-Swiss Free Trade Agreement of 1972 [1972] OJ L300/189.
[165] Agreement between the EC and Switzerland on the free movement of persons (AFMP) [2002] OJ L114/6.
[166] Agreement between the EEC and the Swiss Confederation on direct insurance other than life insurance [1991] OJ L205/3.
[167] Art. 5(1) AFMP, Art. 22(3)(ii) Annex I to AFMP.
[168] Art. 13.6(1)(a) CETA.
[169] Art. 13.6(1)(b) CETA.
[170] Art. 13.3(1), Art. 8.6 CETA.
[171] Art. 13.7(1), Art. 9.3 CETA.
[172] Art. 13.7(6) first sentence CETA.

'solicitation'.[173] Whilst UK business representatives see this as an example for market access without requiring regulatory alignment,[174] the wording casts doubt upon such a broad interpretation.

In any case, CETA provides for a vast number of exceptions.[175] Therefore, CETA does not grant passporting-like, but only restricted market access for financial services suppliers. The parties can unilaterally restrict market access or national treatment to the other party's financial institutions by adopting 'reasonable measures for prudential reasons' (prudential carve-out). This includes, for example, authorisations, notifications and ongoing supervision as long as they fulfil one of the following three prudential reasons: (i) the protection of investors, depositors or policy-holders, (ii) the maintenance of the safety, soundness and responsibility of a financial institution and (iii) the integrity and stability of the financial system.[176] A measure is very likely to be deemed reasonable if it implements or respects international standards.[177] The second reason is innovative compared to other prudential carve-outs[178] and thus explicitly opens the door to reinforced micro-prudential supervision. The treaty parties hereby stressed the importance of prudential measures and reflected political concerns of CETA reducing regulatory control of cross-border operations.

CETA establishes a Financial Services Committee in order to supervise the correct implementation of the financial services chapter, especially the prudential carve-out.[179] It consists of EU and Canadian representatives of the respective competent authorities and decides by mutual consent.[180] Besides the supervision of the parties' compliance with the provisions, the Financial Services Committee has the task to carry out a dialogue on financial services regulation in order to cooperate in developing international standards.[181] This is additional to the EU and Canadian participation in the multilateral standard-setting bodies BCBS and Financial Stability Board.

Furthermore, CETA exceeds GATS standards with regards to financial services, as it provides for a dispute settlement procedure combining classical arbitration with a new multilateral investment tribunal. General disputes on the interpretation or application of CETA's chapter on financial services can be brought to an arbitration panel of three arbitrators which can render binding awards (CETA calls them reports) in case meditation procedures have not worked.[182] With regard to investor-state disputes in the remit of financial services,[183] CETA establishes a multinational investment tribunal.[184] The tribunal has 15 members consisting of five EU nationals, five Canadian citizens and five third country nationals.[185] When the state invokes the prudential carve-out, it can refer an investor's claim to the EU-Canadian Financial Services Committee to decide on the validity of invoking the prudential carve-out.[186] CETA innovatively introduces an appeal mechanism according to which the appellate tribunal can decide on legal errors and manifest errors in the appreciation of the facts made by the first instance

[173] Art. 13.7(6) second and third sentences CETA.
[174] International Regulatory Strategy Group, 'A new basis for access to EU/UK financial services post-Brexit', report from September 2017, 46 et seq.
[175] Noting a general tendency of CETA to provide so many exceptions as to question their exceptional character Armand de Mestral 'When does the exception become the rule? Conserving regulatory space under CETA' (2015) 18 Journal of International Economic Law 641-654.
[176] Art. 13.16(1) CETA.
[177] Patrick Leblond, 'CETA and Financial Services: What to expect?' (2016) Centre for International Governance Innovation Paper 91/2016, 7.
[178] E.g. GATS Annex on Financial Services, see above B.I.3.
[179] Art. 13.18 CETA.
[180] Art. 13.18(1),(2) CETA.
[181] Art. 13.18(3)(b) CETA.
[182] Art. 13.20 CETA referring to the general procedure under Art. 29.2, 29.4, 29.6, 29.7, 29.10 CETA.
[183] Art. 13.21 CETA.
[184] Art. 8.18 et seq. CETA.
[185] Art. 8.27(2) CETA.
[186] Art. 13.21(1)(b), (3), (4) CETA.

tribunal.[187] Final awards by the CETA investment tribunal are binding and entirely enforceable under the New York Convention, i.e. also by enforcement into assets situated in third countries.[188]

3. FTA Granting Market Access via Equivalence Regime ('Equivalence Plus')

Moving a step further towards full market access, the EU and the UK could agree on an FTA spelling out specific rules for mutual access based on equivalence. This would go beyond the existing equivalence rules under EU law.[189] An equivalence regime would allow for tailored market access which could be unilaterally revoked. Market access would depend on the EU and the UK mutually recognising their regulatory standards to be equivalent. Such a regime would require a high level of cooperation between EU and UK supervisors. In terms of judicial review, the enshrinement of detailed market access rights within the FTA would require a common dispute settlement mechanism. The parties could agree to submit all disputes to the ECJ, create a mixed system of judicial review in front of UK and EU courts or create a common court similar to either the CETA or EFTA courts.

On the basis of an EU-UK FTA, the system of market access based on equivalence could be extended to commercial banking services, too. For example, the EU-UK FTA could enshrine mutual market access rights for commercial banks based on mutual recognition of banking licences as long as the regulatory regimes are substantially equivalent. This approach would reflect the current EMIR requirements for third country CCPs. Market access for commercial banking services could be extended to banks licensed and supervised in the UK without the requirement of establishment and licence in the EU if they were deemed to be subject to equivalent standards. Both EU- and UK-licensed banks would benefit from such an equivalence regime since they would not have to transform their branches located in the respectively other territory into subsidiaries.

Since the EU currently requires full regulatory uniformity in order to provide full market access, 'equivalence plus' would probably have higher chances of acceptance in the EU if it generally endorsed the approach expressed in the EMIR II proposal.[190] According to this approach, EU and UK commercial banks could be granted passporting-like access to the other market if they were recognised to fully comply with the other party's regulatory requirements and accept supervision of these standards by the other party's supervisor. This would be a middle way between the current passporting and equivalence regimes. The degree of market access would not be as high as under passporting because the market access could be unilaterally withdrawn. But it would be significantly higher than the one under the current EU secondary law third country regime. Potentially, banks would face double standards should the EU and UK standards diverge. However, banks would be free to comply with the stricter of the two regimes and thus secure access to both markets.

In addition to the general need for supervisory cooperation to handle Brexit-related changes of supervisory matters,[191] EU and UK supervisory authorities would have to closely cooperate in an 'equivalence plus' regime because their supervision would partly overlap. For example, a London branch of a significant Eurozone bank would be supervised both by the ECB and by the FCA/PRA. The FTA could create mechanisms in order to avoid the doubling of supervisory exposure. For example, the treaty could establish the principle that host supervisors are competent for supervising branches and

[187] Art. 8.28 CETA.
[188] Art. 8.41(1),(5) CETA.
[189] See above B.I.1.c), 2.
[190] See above B.I.2.c).
[191] For a thorough analysis see EBA, 'Opinion on issues related to the departure of the United Kingdom from the European Union' 12 October 2017 (EBA/Op/2017/12).

subsidiaries located in their territory. With regard to significant institutions, there could be an additional home state supervision due to their systemic importance. The FTA could also establish a college of supervisors from both the UK and the EU for the preparation of certain decisions.

Judicial review would depend on the degree of regulatory detail in the FTA. The more the equivalence regime is spelled out in the FTA, the more important becomes an international dispute settlement mechanism. If the equivalence regime mostly relies on EU secondary and UK law, judicial protection can mainly take place before EU and UK courts. However, if the equivalence regime is specified in the FTA, it will pose particular challenges since there is no precedent FTA model to inspire 'equivalence plus'. In any case, judicial protection should reflect the degree of institutional interconnectedness. The spectre of existing options includes international arbitration, a CETA-inspired multilateral court, extending the competences of the ECJ to such EU-UK specific trade disputes or creating a bespoke bilateral EU-UK court. All options lead to significant political and legal issues. As the EU considers itself to be a separate legal order and the ECJ to be its guardian, the EU will probably push for the ECJ to play a strong role. However, in light of the UK's strong resistance to the ECJ, it is unlikely that the UK will accept the ECJ as the court with sole jurisdiction for deciding on the future EU-UK relationship. A bespoke EU-UK court consisting of UK and EU judges could, however, infringe current EU law as reflected in the ECJ's opinion on the initial project for an EFTA court.[192] This initial draft aimed to establish an EFTA court consisting of ECJ judges and EEA Member States nationals. The ECJ held that such a jurisdiction was incompatible with its exclusive competence on the autonomous legal order formed by EU law.[193] This underlines the legal challenges for an FTA in terms of judicial protection.

4. FTA Granting Full Market Access Based on Alignment ('Alignment Model')

The UK and the EU could seek out new paths and choose to go further than the EEA Agreement liberalisation. This is what the UK financial services industry has recently proposed, represented by the International Regulatory Strategy Group (IRSG) and UK Finance.[194] They propose different possibilities of an FTA granting full mutual market access to EU and UK financial services providers. Whilst a part of the proposal is based on regulatory alignment,[195] another part calls for market access even without such alignment.[196] The idea behind the alignment proposal is that market access should be granted in a similar way to passporting, i.e. by permanent mutual recognition of home state authorisations. The permanent, general and automatic character of the recognition marks the difference compared to the 'equivalence plus' proposal.

'Alignment' is a term not yet used in EU legalese. It has the appeal of being a new notion and offering new concepts, but contemporarily lacks clarity.[197] The term is used in the EU-UK report on the

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[192] ECJ Opinion 1/91 of 14 December 1991, ECR I-06079.

[193] ECJ Opinion 1/91 of 14 December 1991, ECR I-06079, paras 30-36.

[194] IRSG, 'A New Basis for Access to EU/UK Financial Services Post-Brexit' 25 September 2017 (IRSG proposal) <https://www.irsg.co.uk/assets/IRSGNewBasisForAccessweb.pdf>; UK Finance, 'Supporting Europe's Economies and Citizens: a modern approach to financial services in an EU-UK Trade Agreement' 16 November 2017 (UK Finance proposal) <https://www.ukfinance.org.uk/wp-content/uploads/2017/11/EU-UK-Trade-Agreement-report-ONLINE-UPDATED.pdf>.
An FTA granting market access based on alignment was also proposed for the insurance industry, see London Market Group, 'Proposals for a Future Trading Relationship between the UK and the EU' 29 November 2017 <https://admin.londonmarketgroup.co.uk/wp-content/uploads/2017/11/LMG-Proposals-for-a-future-trading-relationship-between-the-EU-and-UK_secure.pdf>.

[195] IRSG proposal, p. 29 et seq; UK Finance proposal, p. 41 et seq.

[196] IRSG proposal, p. 4 4et seq.; UK Finance proposal, p. 36 et seq.

[197] Concern shared by David Allen Green, 'Brexit: what regulatory alignment means and does not mean' *Financial Times* (London, 8 December 2017).

first phase of Brexit negotiations referring to a default regime which the UK is willing to implement in order to prevent a hard border between Ireland and Northern Ireland in case no agreement can be reached.[198] Whilst the exact definition of alignment remains uncertain, it most certainly means that regulatory standards have to converge to a specific degree. Even 'full alignment' as used in the default Irish border regime of the Brexit negotiations report leaves room for interpretation. The term alignment expressly differs from both the EU term of 'harmonisation' and the EEA term of 'homogeneity'[199] and therefore implies a certain regulatory freedom. In a recent parliamentary debate, UK Brexit minister David Davis described regulatory alignment as aiming "to achieve the same outcomes, but by different regulatory methods".[200] The UK industry proposals also define it as an objective-related principle which leaves freedom as to the means of implementation. At first sight, this is reminiscent of the effects of an EU directive under Article 288(3) TFEU which is binding as to the result, but leaves the choice of form and method to the Member State. However, the UK government appears to be seeking a regulatory freedom exceeding that granted by a directive.

The proposal starts from the premise that the UK regime for financial services will be fully aligned with the EU regime on Brexit day. Hence, the UK financial service industry does not see any need for changing the status quo of full mutual market access.[201] After Brexit, EU and UK prudential requirements will possibly increasingly diverge.[202] In order to assess 'sufficient alignment', the proposals ask for an outcomes-based approach focusing on the regulatory result and not the means.[203] This raises questions concerning the benchmarks for sufficient alignment, the entity which would assess ongoing alignment and the sanctioning mechanism. As to the relevant benchmarks, they can result from international regulatory standards such as those set by the BCBS.[204] In order to foster the alignment, the EU and UK could agree to inform and consult each other in advance of regulatory changes.[205] The alignment along these standards could be monitored by a common independent and supranational entity resembling the EEA Surveillance Authority[206].[207] The parties could create a Financial Services Forum whose function would be to encourage alignment through regulatory cooperation, to assess divergence and to assess possible re-alignment.[208] In addition, the UK industry proposals are optimistic and consider both the UK and the EU capable of assessing regulatory divergences. Furthermore, they place a certain responsibility on the directly affected financial services providers which shall report divergences to their supervisors.[209] Once significant divergence did occur, the proposals provide for the termination of market access to be treated as ultima ratio. Furthermore, their best case scenario would foresee sanctions only in the affected sector.[210]

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[198] Negotiators of the European Union and the United Kingdom Government, 'Joint report from the on progress during phase 1 of negotiations under Article 50 TEU on the United Kingdom's orderly withdrawal from the European Union' 8 December 2017, n 49-50 <https://ec.europa.eu/commission/sites/beta-political/files/joint_report.pdf>.

[199] Part VII Chapter 3 Section 1 EEA Agreement.

[200] David Davis in response to MP Yvette Cooper in UK House of Commons, HC Deb 5 December 2017, vol 632, col 898 <https://hansard.parliament.uk/Commons/2017-12-05/debates/900DF557-19AD-468B-B8F34D03172C3E33/EUExit Negotiations> accessed 16 January 2018.

[201] IRSG proposal, p. 30.

[202] See for possible changes on the UK side International Regulatory Strategy Group, 'The Architecture for Regulating Finance after Brexit' 8 December 2017 <https://www.irsg.co.uk/assets/The-Architecture-for-Regulating-Finance-after-Brexit.pdf>.

[203] IRSG proposal, p. 34 et seq; UK Finance proposal, p. 42 et seq.

[204] IRSG proposal, p. 36.

[205] IRSG proposal, p. 38.

[206] See above C.I.2.

[207] IRSG proposal, p. 40 et seq.

[208] IRSG proposal, p. 63 et seq.

[209] IRSG proposal, p. 40 et seq.

[210] IRSG proposal, p. 42.

As to prudential and conduct of business supervision, the UK industry proposals ask for a clear allocation of supervisory competences and a strong cooperation between supervisors, but do not formulate a concrete concept.[211] In terms of judicial review, they conceive both state-to-state and investor-state dispute settlement with binding decision powers on the interpretation of the EU-UK FTA, e.g. on the withdrawal of market access rights.[212]

5. FTA Granting Full Market Access Based on Alignment and Non-alignment – ('Bold and Ambitious')

For some parts of cross-border financial services, the UK industry proposals go even further and propose a regime granting full market access on the basis of 'non-alignment'. They make the case that in certain areas, especially the wholesale business, the EU and UK regulatory regimes do not have to converge at all in order to recognise licences mutually. The underlying idea is that regulatory standards and protection should depend on the level of financial sophistication that the two contracting parties have.[213] Whilst IRSG asks more generally for market access on a non-alignment basis in the wholesale sector,[214] UK Finance proposes a threefold graded approach to (de)regulating cross-border services.[215] Since it seeks full market access independently from regulatory convergence, this model reflects the UK Brexit rhetoric of a 'bold and ambitious' FTA.

The first layer represents the core of the non-alignment model. Cross-border commitments between qualified counterparties would be regulated only by the home state and not subject to any alignment criterion.[216] The beneficiaries of this privileged market access would be determined with regard to their financial knowledge.[217] Such qualified counterparties would be banks, large non-financial counterparties, large institutional investors, national and regional governments, and international organisations located in the territory of the other party.[218] This proposal relies not only on the capability of the financial services providers to look after themselves, but also on the mutual recognition of regulators.[219]

On the second layer, commitments of professionals would be subject to mutually recognised regulatory frameworks, but not subject to conduct of business rules (partial alignment). The UK Finance proposal defines professionals as 'entities required to be authorised or regulated, large undertakings and institutional investors'.[220]

On the third layer and corresponding to the least degree of financial sophistication, smaller commercial and retail commitments would be subject to mutually recognised regulatory frameworks and to some local conduct of business rules (full alignment).[221] The sufficient degree of alignment on the second and third layer would be assessed and sanctioned as under the alignment model.[222]

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[211] IRSG proposal, p. 69, 74 et seq; UK Finance proposal, p. 56.
[212] IRSG proposal, p. 81 et seq; UK Finance proposal, p. 77 et seq.
[213] UK Finance proposal p. 36 et seq.
[214] IRSG proposal, p. 47 et seq.
[215] UK Finance proposal, p. 36.
[216] IRSG proposal, p. 46.
[217] UK Finance proposal, p. 37.
[218] UK Finance proposal, p. 40.
[219] UK Finance proposal, p. 40.
[220] UK Finance proposal, p. 41.
[221] UK Finance proposal, p. 53.
[222] See above C.II.4.

D. Conclusive Remarks

The five models for an EU-UK FTA discussed above can be evaluated with regard to the grade of market access and regulatory convergence they provide, as shown in figure 2:

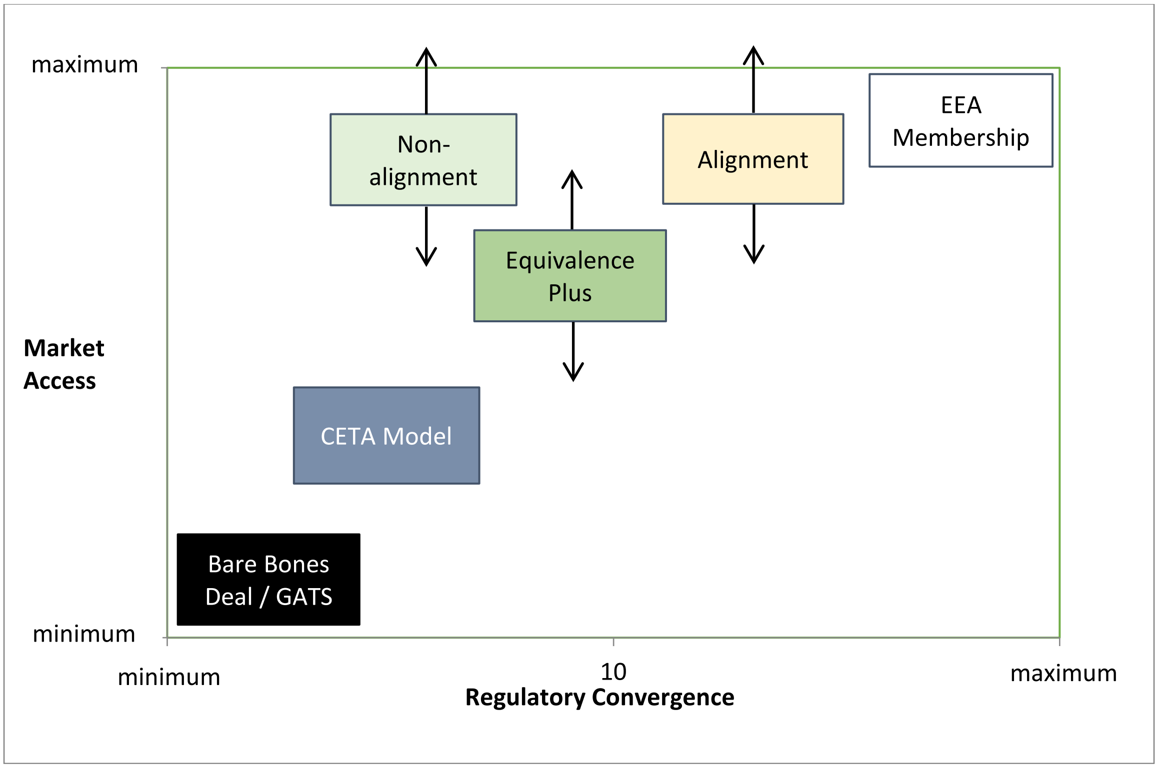

Figure 2 Market access and regulatory convergence for financial services under different FTA models

1. The figure shows that the first model (bare bones deal) would resemble the GATS regime granting no market access for cross-border financial services and requiring no regulatory alignment. On the margin for modelling scale it is therefore on the lowest level.

2. The CETA model does not grant much more market access or regulatory alignment than the first model. It is clearly above GATS but still in the lower part of the market access scale.

3. The equivalence plus model grants higher market access than GATS and CETA, but remains below the boundary set by the EEA Agreement. The equivalence plus regime would grant market access via case-by-case recognition of single institutions in exchange for their regulatory compliance with the host state regulations. This would be compatible with the margin for negotiation resulting from GATS and the EEA Agreement.

4. The alignment model is intended to grant full market access by fully recognising the licences, which equals the EU/EEA passporting system. On the market access scale, it is located on the upper boundary and may – depending on the details of its design – end up outside the margin for modelling. Since it proposes full market access without full regulatory harmonisation, it can conflict with the EEA Agreement.

5. The non-alignment model goes even further than the alignment model because it grants full market access without requiring regulatory convergence. This is probably beyond the margin for modelling because the tension with the EEA Agreement is obvious.

6. However, in view of the advantages a highly integrated financial market holds for both the EU27 and the UK, it still seems worthwhile to explore the alignment and the non-alignment models further before settling for equivalence plus or one of the first two models. Especially if the EU, the remaining EU Member States and the EEA EFTA Member States should agree that it is of vital interest to keep the current high standard of market integration with regard to financial services, they may consent to such an innovative solution.