

BREXIT

A briefing note for BCCI members

February 2016



1. UK referendum

UK Prime Minister David Cameron has announced a referendum to be held on 23 June 2016 on whether or not Britain should remain in the European Union. If the referendum result is for the UK to remain in the EU (an “in” vote) then the current situation remains (subject to the various changes negotiated by the UK government with the EU in February 2016). This briefing note covers the probable withdrawal process, and the possible new EU relationship scenarios, that would follow the referendum result being that the UK is to leave the EU (an “out” vote, commonly referred to as “Brexit”).

2. Withdrawal process

If the Referendum result is in favour of Brexit (i.e. the UK leaving the EU), there is no formal procedure under UK law for the government to follow in initiating the process for withdrawal. Extricating the UK from the EU would involve a consideration both of the process under the EU Treaties and of the domestic legislation that would need to be passed to disengage from the EU.

2.1 EU process

- **Article 50 of the Treaty of the European Union:** the process for a member state to withdraw from the EU is set out in Article 50 of the Treaty of the European Union (Article 50). The withdrawal process is triggered by a notification from a member state to the European Council of its intention to leave; this notification is irrevocable. Following a withdrawal notification, there is a two-year time period for negotiations to be carried out in accordance with guidelines issued by the European Council (on which the UK would no longer be represented). The European Commission will represent the EU in these negotiations.
- **Approval by a qualified majority of the European Council:** a withdrawal agreement must be approved by a qualified majority of the European Council (excluding the withdrawing member state).
- **The consent of the European Parliament:** the consent of the European Parliament is required.
- **Timing:** withdrawal takes effect on the earlier of the date of conclusion of a withdrawal agreement or the date 2 years after the initial notification to the European Council (unless the European Council, acting unanimously, and the withdrawing member state agree to extend the timetable).
- **Purpose:** the purpose of the withdrawal agreement is specifically to set out the arrangements needed for withdrawal of a state “taking account of the framework for its future relationship with the Union”. So while deciding on the steps needed to unravel the huge range of budgetary, legal, political and other obligations that exist between the EU, its institutions and the UK, the agreement may also reflect aspects of their relationship going forward. Where rights and obligations are being terminated, transitional arrangements may be needed to avoid unnecessary disruption of existing arrangements.

BREXIT

A briefing note for BCCI members

February 2016



2.2 UK process

- **Amendments to UK law:** UK legislation would also need to be passed to make necessary amendments to UK law, starting with the repeal of the provisions of the European Communities Act 1972 by virtue of which the obligations under the EU treaties are binding in the UK and the UK government has power to make payments in accordance with its EU obligations.
- **Preservation of elements of EU law:** a large number of savings provisions and transitional arrangements are likely to be needed to preserve those parts of EU law, or legislation made under it, that the UK would need to preserve in force in order to avoid regulatory gaps.

3. Legal implications of withdrawal

- **Inapplicability of EU law:** the result of withdrawing from the EU Treaties in accordance with Article 50 is that they would no longer apply to the UK. The EU courts and other relevant institutions would no longer have jurisdiction over the member state and UK citizens would no longer have the rights of EU citizens. The provisions of EU directives, directly effective decisions and regulations, and rulings of the Court of Justice of the EU, would also cease to apply, unless their effect was specifically preserved by UK national law.
- **Retention of elements of EU law:** UK law is heavily derived from EU law in many areas and the way in which EU law provisions have been implemented into UK law is very complex, often involving a combination of amendments to existing primary legislation, new primary legislation, secondary legislation and other rules, such as the rules of the Financial Conduct Authority and Prudential Regulation Authority in relation to financial services. For at least a transitional period, provisions derived from EU law would probably be retained and directly effective EU regulations deemed to continue. However, it would still be necessary to ensure that these laws function properly in the new situation. For example, where EU institutions have direct administrative powers, these would need to be replaced by alternative arrangements and the scope and meaning of legislation or rules referring to the EU may need to be clarified.
- **Effect on private business:** businesses and individuals will need to consider their own private contractual or other arrangements to ensure that they still operate as intended in the changed circumstances, or whether they need to take steps to change anything as a result of the different political climate and any consequential commercial impacts on their affairs. See further point 6 below.
- **EU Administration:** from an administrative point of view, the UK would no longer be entitled to participate in the EU institutions, courts and other agencies such as European Supervisory Authorities in relation to financial services (specifically, the European Banking Authority, European Securities and Markets Authority and European Insurance and Occupational Pensions Authority). There are also a large number of EU technical working groups and other bodies in which the UK currently participates which it may have to leave following withdrawal.

BREXIT

A briefing note for BCCI members

February 2016



- **EU agencies based in the UK:** EU agencies based in the UK, such as the European Medicines Agency and the European Banking Authority, would presumably be relocated to an alternative EU location and the position of the many organisations and projects supported by EU funding would be uncertain.

4. A new relationship with the EU: Opt-out options

There is no comparable example of a country leaving the EU and the UK government has not given any public indication of the nature of the post-withdrawal relationship that the UK might seek to have with the EU. A number of different models of relationship with the EU are commonly discussed in this context although rather than following any of the existing models set out below, it seems most likely that the UK would need to form a new kind of relationship with the EU and other countries based on elements of some or all of those existing models set out below. Set out below are possible opt-out alternatives for the UK following Brexit:

4.1 European Economic Area membership

- **Members:** the European Economic Area (“**EEA**”) comprises:
 - (i) the EU;
 - (ii) Norway;
 - (iii) Iceland; and
 - (iv) Liechtenstein.

Norway, Iceland and Liechtenstein are, together with Switzerland, the members of the European Free Trade Association (“**EFTA**”), which administers the EEA and also free trade agreements with a number of other countries worldwide. The EFTA Surveillance Authority and EFTA Court oversee and enforce proper implementation of the EEA obligations.
- **The EEA Agreement:**
 - Parties: the EU and Norway, Iceland and Liechtenstein.
 - Purpose: (i) the extension of the EU single market and free movement of goods, services, people and capital; (ii) laws on competition, state aid, consumer protection and environmental for the non-EU EEA states; (iii) a number of other areas of co-operation, including R&D, enterprise and education, tourism and culture.
 - Areas not covered: agriculture and fisheries, the common trade policy on trade with third countries, foreign and security policy or justice and home affairs.
- **EU law:** the non-EU EEA member states are required to adopt much of EU law.
- **EU budget:** the non-EU EEA member states are required to contribute to the EU budget.
- **EU voting rights:** despite being required to adopt much of EU law and to contribute to the EU budget, the non-EU EEA member states do not have voting power or formal access to the decision-making process. They do not have representatives in the European Parliament. They do, however, have some influence through participation in expert groups and committees of the European Commission. This enables them to participate in the preparatory work of the Commission, but not in the negotiations by which the final terms of EU legislation are decided.

BREXIT

A briefing note for BCCI members

February 2016



4.2 An EU relationship based on the current Swiss model

- **Bilateral agreements with the EU:** after EEA membership was rejected by the Swiss electorate, Switzerland instead took the route of agreeing specific bilateral agreements with the EU in areas in which it wanted access to the single market, and has now concluded over 120 separate agreements. The Swiss agreements provide for the free movement of goods (but importantly do not cover the free movement of services) by removing tariffs, but Swiss goods must still meet EU regulatory requirements and are not assumed to comply with them (as is the case with goods coming from EEA member states). Switzerland is not required to adopt relevant EU legislation but instead will typically copy it domestically as its laws will need to be considered to be "equivalent" to those of the EU in order for the agreements to function. The Swiss agreements with the EU are constructed so that if it breaches any one agreement, the EU could in theory terminate all of the agreements.
- **Financial contribution to the EU:** the Swiss financial contribution to the EU is much lower than that of the non-EU EEA member states but it is still required to make a contribution.
- **Free movement of people:** Switzerland was also required to sign up to the free movement of people and is in the Schengen area.
- **Long term arrangements:** the complexity of having to put in place such a large number of agreements that continuously need to be updated has led the EU to conclude that the Swiss model is not viable in the longer term and it has stated that a framework agreement (along the lines of the EEA Agreement) will be required to be agreed in the future with Switzerland.

4.3 A "Customs union" relationship with the EU based on the current Turkish model

- **Tariff free access to EU:** Turkey is part of a customs union with the EU which allows for tariff free access without quotas to the internal market for goods, but importantly not for services. It has to a large extent control of its own trade policy and does not have to allow for the free movement of EU persons.
- **Common tariff with the rest of the EU for third country goods:** Turkey is required, however, to adopt a common tariff with the rest of the EU for third country goods and is restricted in its ability to conclude agreements with other countries without consent of the EU. The requirement to impose a common tariff for non-customs union imports means that where the EU agrees a free trade agreement with a third country, Turkey is forced to follow suit in reducing or dropping tariffs, even though it cannot itself derive any benefit from the trade agreement.
- **Harmonisation of certain laws:** Turkey is required to harmonise its laws with those of the EU in relation to competition, intellectual property and consumer protection.
- **No free movement of EU persons:** Turkey is not required to permit the free movement of EU persons.

BREXIT

A briefing note for BCCI members

February 2016



4.4 A Free Trade Agreement with the EU:

- **Standalone free trade agreements with the EU:** a number of countries have standalone free trade agreements with the EU, most recently Singapore, Canada and a number of African and South American countries. A significant agreement will be the Transatlantic Trade and Investment Partnership (“TTIP”) which the EU is currently negotiating with the US. The UK may negotiate a similar free trade agreement with the EU based on these recent examples.

4.5 World Trade Organisation

- **UK member of WTO:** the UK is already a member of the WTO (although as with all the EU member states, the EU currently acts on its behalf at WTO level).
- **Most Favoured Nation:** the WTO operates on the basis that the “Most Favoured Nation” principle will be applied among its members; that is, exporters for a member country can trade with other members on the best terms offered to any other member country. The UK would benefit from this membership which is already in place, but there has been press commentary on the pros and cons of WTO membership.
- **Pros:**
 - the UK would keep control of its own trade policy;
 - no free movement of persons;
 - no contribution to the EU budget;
 - EU law would not apply in the UK.
- **Cons:**
 - UK exports to the EU would face tariffs;
 - no free movement of persons;
 - UK exporters would continue to need to meet EU product standards;
 - the WTO offers little protection to exporters on an individual basis as there is limited ability to enforce its rules.
 - the WTO arrangements are of less benefit in the area of services where the principle applies more loosely. This would be unhelpful from the perspective of the UK, which is a significant exporter of services, and particularly the heavily regulated financial services subset where the services that can be provided from outside the EU are limited.

4.6 A hybrid of the above

- It seems most likely that the UK would not follow a single precedent from those models set out above, but would form a new kind of relationship with the EU based on elements of some or all of those existing models set out above.

5. Third country arrangements

As well as negotiating a new relationship with the EU, in the event of withdrawal, the UK would simultaneously need to put in place trade arrangements with other countries with whom it currently deals on EU negotiated terms. Since the EU has exclusive competence in the area of trade policy, the EU's existing trade agreements with third countries are entered into by the EU as a block rather than by

BREXIT

A briefing note for BCCI members

February 2016



the individual member states, and so the UK would not (unless otherwise agreed) continue to participate in them on withdrawing from the EU. Any such agreements would require separate negotiations with the relevant countries.

6. Key issues for businesses

- **The withdrawal process:** withdrawal from the EU would be a complex, lengthy and uncertain process. In developing a new relationship, much would depend on the attitude that the EU and other countries take to a post-withdrawal UK and how co-operative all parties choose to be.
- **Effect on business operations and strategy:** disentangling the UK from EU law and regulation would raise many technical issues. Businesses and individuals who are affected by the UK's membership of the EU would need to consider the implications of uncertainty and potential change on their operations and strategy. Key issues include:
 - product sales or supply chains that span the EU or other countries with which the EU has trade agreements;
 - provision of services in reliance on EU passporting regimes or other forms of mutual recognition of qualifications or standards. Currently a UK authorised firm has the right to carry on business in another EEA state, with or without a branch, provided that it meets the requirements of the single market directive under which the activities will be carried out. This passporting right allows UK authorised firms free access to EU markets. Following an exit, the UK risks losing this right, the impact of which will vary depending on the relevant sector legislation, meaning either restricted EU market access for the UK, with third country status following an exit, or continued access to EU markets but without the ability to vote on financial services legislation, for example, as an EEA or European Free Trade Association member. EEA firms that are currently passported into the UK, or which would like to gain access to the UK market after the UK's exit from the EU, would face similar uncertainties;
 - sector-specific regulation, for example financial services, where the impact of a UK exit would be strongly felt. Almost the entirety of UK financial services legislation over the past ten years has EU legislation as its source. The move towards the European Single Rulebook has also meant that many EU rules are now directly applicable in the UK, but following an exit, those regulations would no longer have effect. However, it seems unlikely that a UK exit would trigger a mass overhaul or repeal of EU-based financial services legislation, especially in cases where implementation is recent and involved costly systems and operational changes (e.g. MiFID II which is due to come into force in January 2017); and
 - employment of workers from the EU in the UK, or vice versa.

BREXIT

A briefing note for BCCI members

February 2016



- **Other areas of impact:** businesses will also need to consider the impact of the UK's withdrawal on free movement of capital, data protection rules, competition and consumer policy, research and development, energy policy, environmental laws, agriculture and fisheries and regional aid.
- **Wider implications:** of less direct impact on business, but also of importance, will be the wider implications of resulting geopolitical change as well as the future relationship between the UK and the EU on criminal and civil judicial co-operation, and foreign and defence policy.

7. Next steps:

The British Chamber of Commerce for Italy is available to answer Members' concerns or queries in relation to an eventual Brexit. Further briefings will be posted to the Chamber's website as Brexit options are formulated prior to the referendum on 23 June 2016.

Martin Pugsley (Vice President)
The British Chamber of Commerce for Italy
February 2016

The Chamber's mission is to assist and encourage the development of trade and investment between the United Kingdom and Italy and to support and promote the interests of its Members' commercial activities. This is achieved by:

- Assisting and facilitating bilateral trade and investment between the United Kingdom and Italy, working closely with the British Embassy, the British Consulate and UKTI.
- Supporting and promoting the interests of our Members' commercial activities, facilitating access to the local business community and organising professional networking opportunities in major Italian cities.
- Organising professional training seminars and workshops for the benefit of Members by their peer experts, on relevant and topical business themes, including local and cross border regulations and practices.
- Offering services and business advice to our Members and the wider community, either directly or via our Members.
- Stimulating positive cultural exchange between British, Italian and other nationality Members through a selected range of social, cultural and sporting events.



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