The UK/EU Referendum – Issues and Implications

30 June 2016

CLIFFORD CHANCE

The referendum

- On 23 June 2016, the UK electorate voted to leave the European Union.
- EU rules and regulations apply equally after the referendum as before until the UK has formally withdrawn from the EU.

- There will be no immediate legal consequences as the referendum was advisory rather than mandatory.
- However, the leave vote will have a significant impact on corporates, banks and investors. Steps should be taken to deal with the economic fallout of the vote and to prepare for the UK's eventual exit.

The EU's exit clause: Article 50, TEU

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.

2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament.

3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.

4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it.

The process for exiting the EU

Under Article 50 of the Treaty on the European Union, the UK must notify the European Council of its intention to withdraw.

Article 50 provides for a two year period to negotiate a withdrawal agreement. This can be extended by mutual agreement if an agreement is not reached.

The UK will remain a member of the EU during the negotiation period and EU law will continue to apply to the UK. During this period, the exact same rights and obligations apply in relation to business within the EU, including obligations to take steps to implement EU regulations.

The UK is under no obligation or time-limit for triggering the Article 50 process. However, prominent EU leaders have indicated that they will not engage in formal or informal negotiations until Article 50 has been invoked.

Two years is an ambitious target. Previous negotiations have taken anything between three (Greenland voted to leave in 1982, withdrawing in 1985) and over eight years (Switzerland negotiated its bilateral agreements with the EU between 1992 and 2004).

It is not certain whether the withdrawal agreement would be the final agreement between the UK and the EU. The consensus amongst commentators is that it would be, and that it would take a long time to reach that agreement with the UK being “in” until it was “out.” It is possible that the UK could leave under a skeletal withdrawal agreement and negotiate a more comprehensive agreement over a longer period of time.

Withdrawal timeline

Certain | **Possible**

July – December 2017
UK Presidency of Council of EU (unless Article 50 has been triggered)

April 2017
French Presidential Elections

August 2017
German Federal Elections

2015 | 2016 | 2017 | 2018

17 December 2015
EU Referendum Act became law

10 November 2015 David Cameron set out the UK's negotiating objectives

23 June
Referendum

5 May 2016
Scottish elections, local elections in England, Mayoral election in London.

July 2016 – July 2018
Possible Article 50 negotiation

2018
Possible Brexit

2018 onwards
- Possible full treaty change
- If the UK voted to remain in 2016/17 it would have a full veto and be in a strong position to revisit any negotiating objectives it felt needed more work

The UK's 'February settlement' (no longer available as this settlement was conditional on a "remain" vote)

- Jobs and growth. Complete Internal Market, conclude further trade agreements
- Safeguards for non-euro members
- Controls on migration – "emergency break"
- Further powers for national parliaments – "red card"

Alternatives to EU membership

EEA and EFTA membership (the Norwegian model)

Bilateral agreements and EFTA (the Swiss model)

Reliance on the UK's World Trade Organisation membership

Customs union

Free trade agreement with the EU

Alternatives to EU membership

Yes | No | Partial

	Access to the EU Internal Market	Freedom to set own external trade policy	European Council Commission Parliament [1]	Court of Justice of the European Union [2]	Social and employment policy	Common Agricultural Policy	Contribute to the EU budget	Justice and Home affairs	Schengen area	Charter of Fundamental Rights	Free to regulate own Financial Sector	Membership of the euro
1 (UK) **Status Quo or variation**	Yes	Partial	Yes	Yes	Yes	Yes	Yes	Partial [6]	No	Partial [8]	No	No
2 EU Minus	Yes	Partial	Yes	Yes	No	Yes	Yes	Partial [7]	No	Partial [9]	No	No
3 EU Plus	Yes	Partial	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes
4 (Norway) **EEA + EFTA**	Partial [3]	Yes	No	No	No	No	Yes	No	No	No	Partial [9]	No
5 (Swiss) **Bilateral agreements + EFTA**	Partial [4]	Yes	No	No	No	No	Yes	No	Yes	No	Yes	No
6 (Turkey) **Customs Union**	Partial [5]	Partial	No	No	No	No	No	No	No	No	Yes	No
7 UK/EU FTA	No	Yes	No	No	No	No	No	No	No	No	Yes	No
8 WTO	No	Yes	No	No	No	No	No	No	No	No	Yes	No

1 Membership of and voting rights on the European Council, Council of the European Union, the Commission and Parliament.
2 Nomination of a judge to both the Court of Justice of the European Union and the General Court of the European Union.
3 The EEA agreement provides for access to the EU's Internal Market although at present it does not offer full access to the Internal Market in financial services.
4 Bilateral Agreements and EFTA, page 35, *Britain and the EU,* Clifford Chance, August 2015.
5 Access to the EU Internal Market for goods without the need for Rules of Origin.
6 The UK has the right to opt in / out of certain measures.
7 The UK would have a right to opt in / out as it saw fit.
8 The UK has a protocol that clarifies that the CFR does not create rights in UK courts.
9 The UK would retain a protocol that clarifies that the CFR does not create rights in UK courts.

EEA and EFTA membership (the Norwegian model)

- The UK would seek to join the European Economic Area.
- This would give the UK considerable access to the internal market, allowing trading (including the provision of financial services) into and within the single market without restrictions or tariffs.
- The UK would not be party to the EU's external trade agreements.
- The UK would be required to make significant financial contributions to the EU, comply with many EU laws and continue to allow free movement of persons.
- The UK would no longer participate in EU policymaking and would be excluded from the European Supervisory Authorities (a key legislative institution in relation to financial services).
- This model presents the closest relationship to the status quo. However, based on the referendum, it would be the most objectionable to the British public as it would require the UK to continue to allow free movement of persons.

Bilateral agreements and EFTA (the Swiss model)

- The UK would seek to enter into bilateral agreements with the EU to obtain access to specific sectors of the internal market (rather than the market as a whole).
- The bilateral agreements between the EU and Switzerland do not provide for Swiss access to the EU internal market in financial services. It is likely that the UK's access would be similarly constrained.
- The UK would be required to make financial contributions to the EU, comply with certain EU laws and accept some EU rules on freedom of persons.
- The UK would not participate formally in drafting EU laws.
- Negotiating the agreements would be a difficult and time-consuming process. It is unlikely that this process would conclude before the expiry of the two-year Article 50 negotiation period.

Customs union

- A customs union would allow the UK to export goods to the EU without having to comply with customs restrictions or tariffs.
- This model is currently in place between the EU and Turkey. However, if the UK customs union were to mirror that of Turkey, UK financial institutions (including UK subsidiaries of US holding companies) would not be able to provide financial and professional services into the EU on the same terms as EU member state firms.
- It is unlikely that the EU passporting regime would be available. UK firms would therefore be required to seek separate licensing in each EU member state to provide certain financial services.
- The UK would not be required to make financial contributions to the EU, nor would it be bound by the majority of EU law.

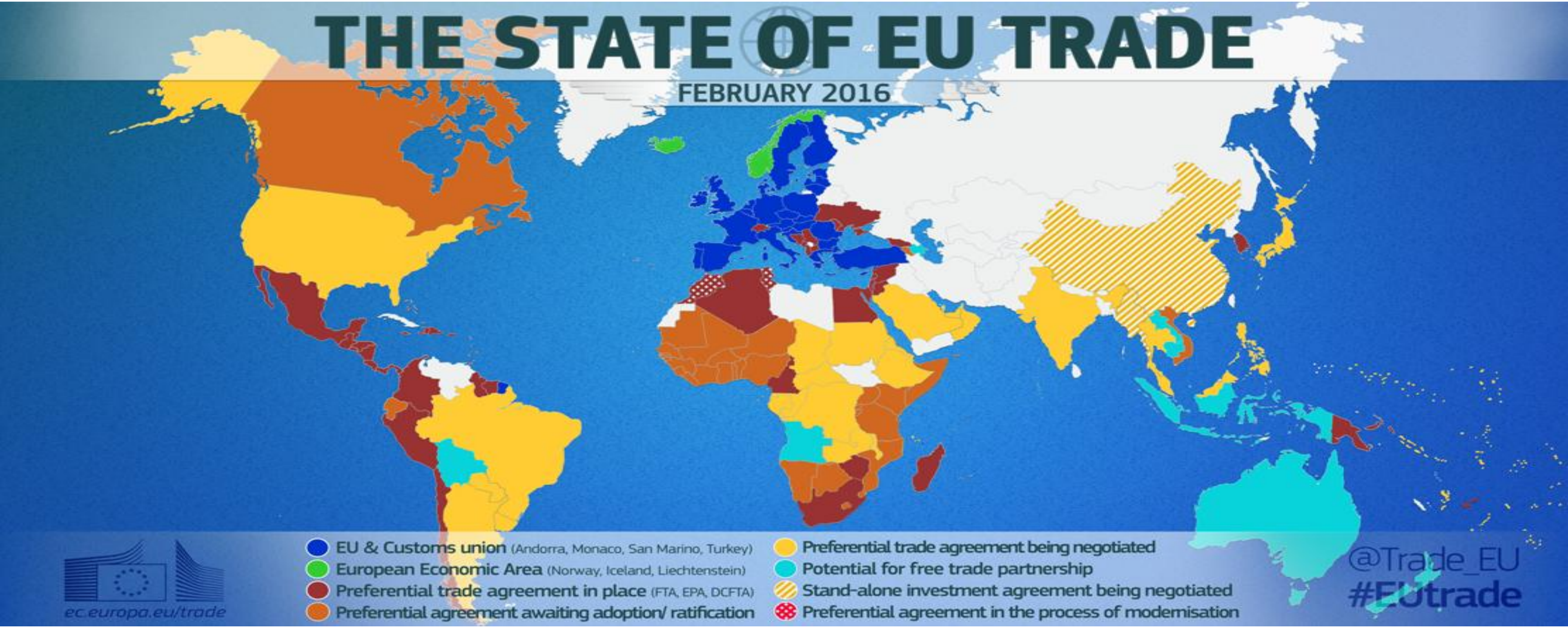
Free trade agreement with the EU

- The UK would negotiate a free trade agreement to cover goods and services.
- A comparable agreement was recently concluded between the EU and Canada after negotiations lasting 7 years.
- This agreement would remove tariffs in respect of trade in goods, as well as certain non-tariff barriers in respect of trade in goods and services.
- The UK would not be required to make financial contributions to the EU. It would not be bound by EU law but would be bound by applicable EU trading standards.

Reliance on WTO Membership

- The UK may choose not to negotiate further with the EU and to rely on its membership of the Word Trade Organisation.
- The UK would not have any preferential access to the internal market, nor would it benefit from any external EU trade agreements.
- EU tariffs and barriers would be imposed on goods and services traded between the UK and the EU.
- Under WTO rules, certain caps would apply on tariffs applicable to goods, and limits would be imposed on particular non-tariff barriers applicable to goods and services.
- The UK would no longer be required to make any financial contributions to the EU, nor would it be bound by EU laws.

Current EU trade negotiations status



Implications for UK legislation

- Once the UK has formally left the EU it will no longer be required to apply some (if not all) EU legislation. The extent to which EU legislation remains applicable will depend on which exit model the UK pursues.
- However, the UK has implemented certain EU laws through primary legislation. These will continue to be effective unless amended or repealed.
- Other EU laws have direct effect which means that they are applicable in the UK without the need for implementation. These will no longer be effective once the UK leaves the EU unless the UK introduces such laws into domestic legislation.
- The process of determining which EU laws to retain, amend or repeal will be complex and time-consuming, offering little legal certainty to the financial markets.

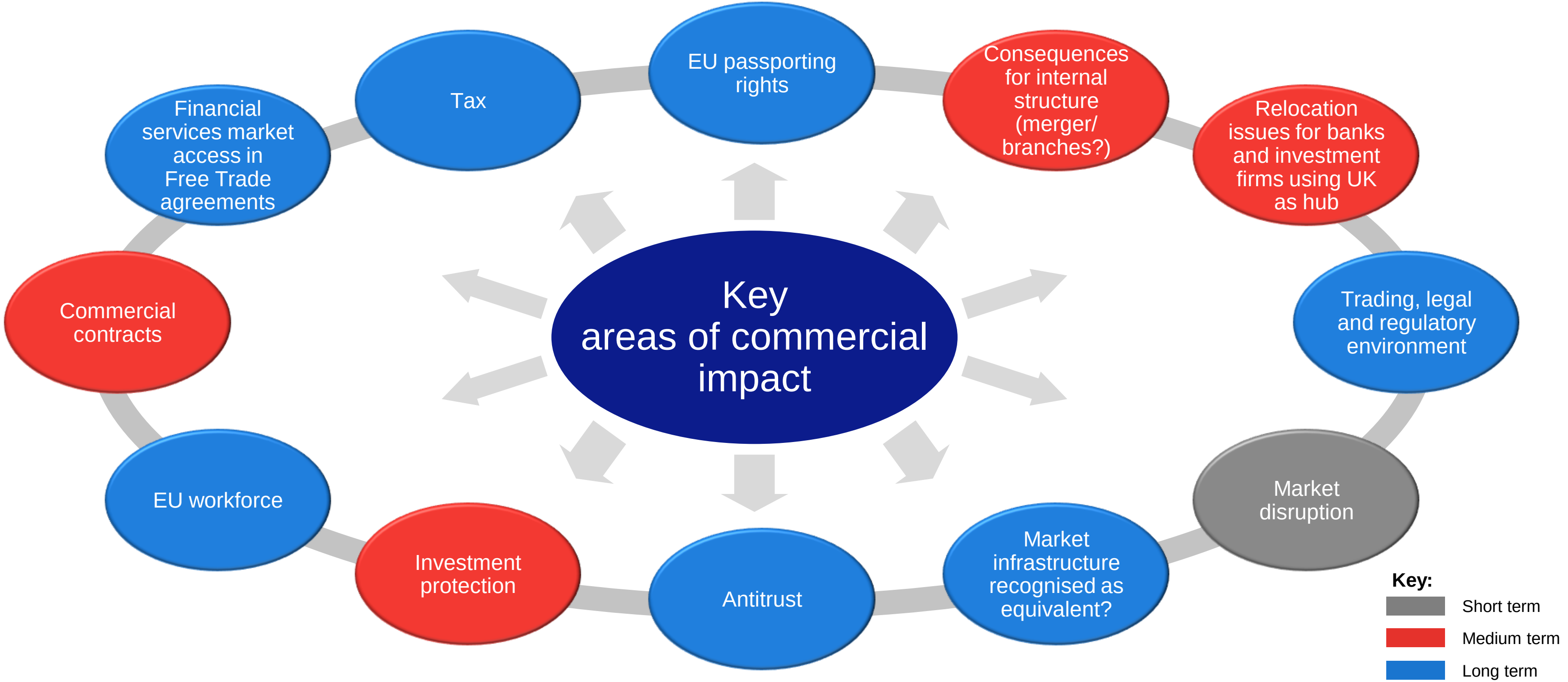
Implications for UK legislation

- The British government estimates that around 50% of UK legislation with a significant economic impact originates from EU legislation. In addition, UK law comprises thousands of EU statutory instruments and European Court of Justice precedents.
- The UK may consider enacting a law which preserves existing EU laws and regulations (effectively grandfathering them) as of the time of exit from the EU, similar to when Hong Kong gained independence from the UK.
- The EU typically promotes equivalence between member states therefore the UK would likely benefit from aligning its laws with those of the EU. Grandfathering would achieve this to an extent but EU law would diverge with the passing of new EU legislation.

The continuing effect of EU regulations on UK businesses

- The UK will need to ensure that it continues to have adequate regulation on key policy areas going forward, e.g. health and safety at work, food and product safety, consumer protection, workers' rights, managing risk within financial services.
- As EU laws evolve, the extent of divergence from UK law will become increasingly significant. Businesses that trade with the EU are likely to want one set of standards with which to comply and therefore for UK/EU standards to remain aligned.
- The financial services sector is likely to be seeking to demonstrate "equivalence" in order to exercise any rights it may have under a "third country" regime.
- However, automatically adopting new EU laws does not align with the political and social drive behind the leave vote.
- The weight of new UK legislation will place increasing demands on parliamentary time and resources, slowing down the process.
- The interests of business in the legislative process will vary by sector depending on reliance on current EU rights (e.g. the ability to share data across a UK/EU border or to recruit staff from other EU countries).
- Businesses should engage to ensure that their interests are reflected in any new policy agenda.

Key areas of commercial impact



UK Financial Services After Brexit

- Around a third of the UK financial services sector operates into or within the EU.
- Potential impact on:
  - UK banks and investment firms
  - Non-EU banks and investment firms
  - EU banks and investment firms operating in London
  - Asset managers
  - Derivatives market

Financial Services – Structural implications after Brexit

Other legal implications

It is unclear whether, and how, protection currently obtained via current EU unitary rights such as EU trademarks, EU registered designs, SPCs, PDOs or GIs will be maintained in the UK following Brexit.

Impact on data protection needs to be considered in the context of upcoming reform of EU law.

Most EU rules are implemented through UK law and it is likely they will initially remain in place, but they may diverge in the longer term. Direct EU law will need to be replaced.

Brexit may impact the right of EU nationals to continue in their present jobs in the UK and the right of UK nationals to work in the EU.

Substance of competition laws applicable in the UK and the EU is very similar; however as regards merger control, UK may lose benefit of EU's 'one-stop-shop' regime - in future some deals may need to reviewed by both UK and EU authorities.

The vote to 'leave' has created a number of short-term practical considerations for corporate treasurers, as well as potential longer term repercussions.

Imports and exports may be subject to tariffs and non-tariff barriers pushing up the price or effective cost of goods imported or exported to or from the UK.

Impact on investment protections currently provided under EU trade and investment treaties. Consideration should be given to bilateral investment treaties signed by the UK, which will remain in force.

Consideration should be given to the impact on key contracts and, in particular, how you might want to vary the terms on renewal.

Potentially significant tax consequences; for example, dividends from EU subsidiaries to UK parents may attract withholding tax post-Brexit.

Potential increasing use of arbitration as a dispute resolution forum.

Impact on documentation

- Governing law, submission to jurisdiction and enforcement of judgment clauses.
- References to EU legislation - including sanctions and other compliance representations - may need updating to refer to UK rather than EU provisions.
- Article 55 BRRD.
- Removal of EU passporting.
- Brexit "risk factor" in offering documents for ECM/DCM – does it warrant a standalone risk factor? Are there "material risks" or should we extend the "volatility" risk factor?
- Is Brexit a MAC or force majeure event itself?

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