

WHAT WILL TRADE LOOK LIKE AFTER BREXIT?



BREXIT

KEY NOTES



Trade on the basis of GATS would severely limit the ability of UK-based financial services firms to provide cross-border financial services to customers in EU Member States.



The extent to which the EU's commitments under TISA will go beyond GATS in terms of financial services remains unclear.



The MFN obligation will mean that the UK and the EU will not be able to treat service suppliers from the EU and the UK, respectively, any differently than service suppliers from other WTO Members. The EU's equivalence assessments would also need to be carried out in a manner consistent with the MFN principle.



Any free trade agreement, including an interim agreement, needs to comply with WTO requirements, including the substantial sector coverage requirement in relation to services. This is one of the reasons why the potential UK/EU free trade agreement is likely to take several years to negotiate.

GLOSSARY

WTO

The World Trade Organisation administers the WTO trade agreements which govern trade between nations at a global level. It is also a forum for governments to negotiate trade agreements and a place for them to settle trade disputes.

MFN

Most Favoured Nation—key WTO principle which prohibits discrimination between 'like' services and service suppliers from different WTO Members.

FTA

Free Trade Agreement, which must comply with WTO rules and be notified to the WTO.

The Understanding

The Understanding on Commitments in Financial Services contains a 'model' set of market access and national treatment commitments. The Understanding only has legal effect if WTO Members indicate in their schedules that they undertake the commitments set out in the Understanding - the EU Member States in 1999 chose to do this.

WHAT LIES AHEAD FOR FINANCIAL SERVICES?

Article 50 has been triggered and the UK and EU negotiating positions have been set out. However, it remains unclear what financial services trade between the UK and the EU will look like following the UK's exit from the EU.

The UK and the EU have set out their intentions to negotiate a free trade agreement. However, any free trade agreement, including an interim agreement, must comply with WTO requirements. If a free trade agreement is not agreed, the UK/EU relationship will be based on WTO rules, which would limit cross-border trade.

HELLO

In this guide we consider the potential impact of the WTO rules on the future relationship between the UK and the EU and what financial services trade may look like post 29 March 2019.

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AT A GLANCE



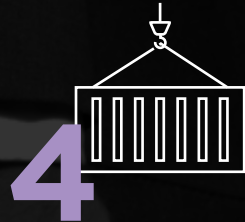
The WTO had 164 Members as at 1 January 2017



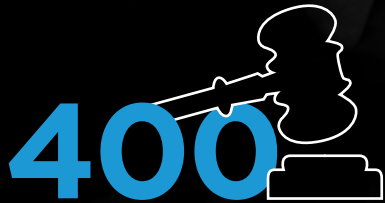
Currently 23 participants in the TiSA negotiations (including the EU)



GATS entered into force on 1 January 1995



GATS has four modes of supply including commercial presence and cross-border supply



Over 400 disputes have been brought to the WTO since 1995



The EU exported \$223 billion worth of financial services in 2015

HOW DOES THE WTO WORK?

GATS

The **General Agreement on Trade in Services** is the WTO agreement governing trade in services.

All WTO Members are members of GATS and, to varying degrees, have assumed commitments in individual service sectors.

GATS applies, in principle, to all service sectors, except “services supplied in the exercise of governmental authority” and services directly related to the exercise of air traffic rights.

GATS consists of an overall framework which sets out the principles, rules and a schedule for each WTO Member listing its specific commitments and any exemptions.

GATT

Since 1995, the updated **General Agreement on Tariffs and Trade** has become the general agreement for trade in goods.

GATT contains an overall framework which sets out the principles and rules applying to goods trade, as well as exceptions to these rules and principles.

WTO Members' tariff schedules are annexed to GATT and set out the tariffs applied by each WTO Member in relation to specific goods.

OTHERS

There are a number of other WTO agreements including:

TRIPS

Trade-Related Aspects of Intellectual Property Rights

GPA

The Government Procurement Agreement

Resolving trade disputes between WTO Members is one of the WTO's core functions and there are a number of WTO documents relating to dispute settlement, including the Dispute Settlement Understanding.



Falling into the WTO rules is not an apocalypse... But it will not be as good as a free trade agreement.

Pascal Lamy, former WTO Director-General



KEY GATS CONCEPTS



Market access

There is no presumed right of market access in GATS and WTO Members choose which sectors they are prepared to liberalise and the time scale. WTO Members set out this information in detailed schedules.



Most Favoured Nation (MFN)

The MFN treatment obligation prohibits discrimination between 'like' services and service suppliers from different WTO Members. The principal purpose of this obligation is to ensure equality of opportunity for services and service suppliers from all WTO Members. Unless an exemption applies, a WTO Member must treat service suppliers from all other WTO Members equally.



National treatment

The national treatment obligation prohibits WTO Members from treating services and service suppliers of any other WTO Member less favourably than it treats domestic services and service suppliers. Unlike the national treatment provision in GATT, the national treatment obligation in GATS applies only to the extent that WTO Members have explicitly committed themselves to grant national treatment in respect of specific service sectors. The specific commitments to grant national treatment are often made subject to certain conditions, qualifications and limitations, which are set out in the schedules.



WHAT IS GATS?

WHAT DOES BREXIT MEAN FOR FINANCIAL SERVICES?

Cross-border supply of services

Trade in financial services on the basis of GATS would mean the loss of the current form of cross-border passporting. There are no EU-wide GATS commitments. EU Member States have their own schedules.

In relation to cross-border supply of services, EU Member States have provided very limited commitments broadly reflecting those in the Understanding to allow non-resident suppliers to supply the following services:

1 Insurance of risks relating to:



maritime shipping



commercial aviation



space launching



freight (satellites)



goods in international transit

2



reinsurance



retrocession



services auxiliary to insurance

such as consultancy, actuarial, risk assessment & claim settlement services

3



provision and transfer of financial information



financial data processing



related software by suppliers of other financial services

4



advisory and other auxiliary services



excluding intermediation, relating to banking...



...and other financial services.

EU Member States have also scheduled limitations in relation to cross-border trade commitments. For example, in Germany, “compulsory air insurance” policies can only be underwritten by a subsidiary established in the EU or by a branch established in Germany. In France, insurance of risks related to ground transport may be carried out only by insurance firms established in the EU.

Commercial presence

EU Member States offer financial service suppliers from any other WTO Member “the right to establish or expand within its territory a commercial presence” although Members can impose terms, conditions and procedures for authorisation of the establishment and expansion of a commercial presence.

EU Member States have scheduled limitations in relation to the commercial presence commitment. In France, the establishment of branches in the insurance sector is subject to a special authorisation for the representative of the branch. In Ireland, in the insurance sector, the right of establishment does not cover the creation of representative offices. In relation to banking and other financial services, in Italy, for example, representative offices of foreign intermediaries cannot carry out activities aimed at providing investment services to undertake additional commitments in relation to cross-border provision of services.

Trade in Services Agreement (TiSA)

A subset of WTO Members with an interest in service sector liberalisation are negotiating a plurilateral services agreement outside the auspices of the WTO—the Trade in Services Agreement (“TiSA”). At this stage, it is not clear whether EU Member States’ TiSA commitments will go significantly beyond GATS. In the latest draft EU TiSA schedule, a relatively small number of EU Member States have proposed to undertake additional commitments in relation to cross-border provision of services.

Did you know?

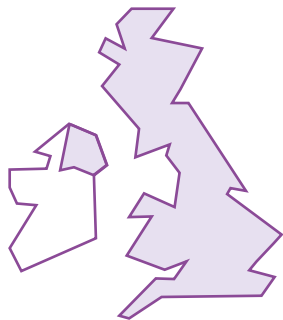
There are no EU-wide GATS commitments—across all four GATS modes of supply, EU Member States have their own individual market access and national treatment schedules. In relation to financial services, some EU Member States have committed to the provisions in the Understanding.

WHAT ARE POSSIBLE IMPLICATIONS OF MFN PRINCIPLE IN GATS?

Inward passporting

'Inward passporting' refers to the ability of financial service suppliers based and authorised in an EU/EEA Member State to passport into the UK on the basis of the single market Directives. The Government has set out its intention to retain all existing EU laws and EU-derived laws (e.g. UK laws implementing EU Directives) meaning that inward passporting will still be permitted unless appropriate changes are made to the transposed EU laws.

The MFN obligation means that the UK cannot offer preferential treatment to service suppliers based in the EU in relation to inward passporting or in relation to any other aspect of trade in services. Therefore, if appropriate amendments were not made to the inward passporting legislation, the UK would be obliged to allow financial service suppliers from outside the EU to have the same rights and passport into the UK, which the UK is unlikely to wish to do.



Passporting into the EU

While the exact nature of the future UK-EU arrangements in relation to financial services remains unclear, we anticipate that the EU would advocate retaining closer ties with the UK in relation to financial services compared to other third countries.

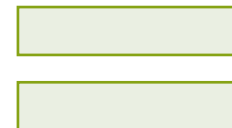
However, absent a free trade agreement between the UK and the EU, the EU can only allow cross-border financial services to be supplied into the EU on MFN terms meaning that the EU cannot grant UK service suppliers preferential treatment/access as compared to other third country service suppliers. Put in another way, if the EU did extend preferential treatment to UK service suppliers, GATS would require the EU to immediately grant service suppliers from other WTO Members the same treatment, which the EU is unlikely to wish to do.



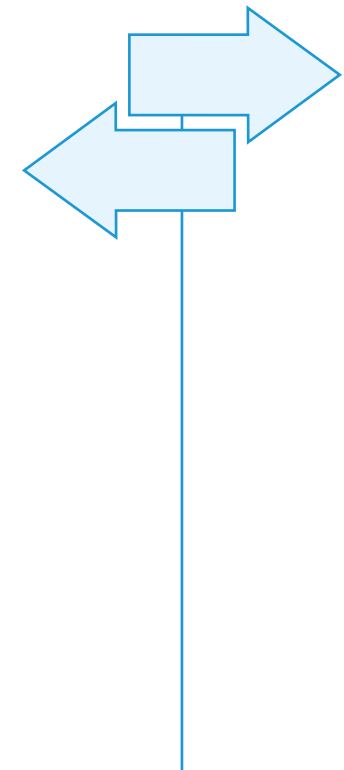
Equivalence

Some EU laws contain "third-country provisions" that empower the European Commission ("the Commission") (with involvement of other institutions) to decide on the equivalence of foreign rules and supervision for EU regulatory purposes. Whenever the Commission determines by way of an equivalence decision that a foreign regulatory, supervisory and enforcement regime is equivalent to the corresponding EU framework, that recognition usually makes it possible for authorities in the EU to rely on supervised entities' compliance with the equivalent foreign framework.

The loss of passporting rights under a WTO scenario means that financial service suppliers in the UK may need to rely on equivalence to provide financial services on a cross-border basis to EU customers. The MFN obligation means that the EU cannot accord preferential treatment to UK service suppliers. Therefore, even though the UK's laws upon exiting the EU will be virtually identical to EU law, the EU will need to ensure that it assesses any equivalence requests from the UK on the basis of the same objective criteria as equivalence requests from other WTO Members.



Around 5,500 UK firms hold at least one passport to do business in the EU/EEA.



HOW DO FREE TRADE AGREEMENTS FIT IN WITH THE WTO RULES?

Key exception to MFN

WTO Members have the right to depart from the MFN principle in order to enter into an FTA provided that, in relation to services, the FTA:

- has substantial sector coverage; and
- provides for the absence or elimination of substantially all discrimination between or among the parties at the entry into force of the agreement or on the basis of a reasonable time-frame.

The FTA should also not result in new trade barriers for other WTO Members.

These requirements apply to both interim/transitional and final agreements.



There is no precedent for [the potential UK/EU] free trade agreement: until now, all the commercial agreements made by the EU...were written as part of a process of regulatory convergence.

Michel Barnier, EU Chief Negotiator for Brexit



Substantial sectoral coverage

The substantial sector coverage requirement in GATS means that virtually all services sectors must be covered to some extent in the FTA.

Substantial sector coverage does not mean that each service sector needs to be covered to the same extent or that the provisions in an FTA in relation to services need to be particularly detailed or far-reaching. For example, the EU-Israel Association Agreement only contains a few paragraphs covering services and reaffirms the respective parties' GATS commitments; however, as the provisions are very broad and refer to all services, the substantial sector coverage requirement is satisfied.

In relation to goods, GATT provides that an agreement must apply to substantially all trade. The need to

cover most sectors of the economy is one of the reasons why free trade agreements, including interim/transitional agreements, can take many years to negotiate.

Many media reports have referred to anticipated special arrangements between the UK and the EU in relation to specific sectors of the economy such as the automotive sector and/or the financial services sector. However, these reports are misleading because any UK-EU free trade agreement would need to cover most sectors of the economy to be WTO compatible. This is not simply a theoretical legal point—the 'Auto-Pact' between the United States and Canada, for example, was found by a WTO Panel to lack "the trade coverage required" to fall within the free trade agreement exception in GATT.



ENFORCEMENT OF RIGHTS

How will rights be enforced in a WTO scenario?

The EU single market rules currently in place in the UK are part of domestic law and have direct effect. In the UK (and in other EU Member States), businesses and individuals can use domestic courts to enforce their rights and if needed, domestic courts can refer cases to the Court of Justice of the European Union.

If the UK and the EU do not enter into a free trade agreement, any disputes concerning trade between the UK and the EU will be governed by the WTO dispute settlement procedure, which differs considerably from the current arrangements. Notably, businesses and individuals cannot themselves bring an action under the WTO dispute settlement procedures. Instead, they must lobby their governments to take action.

The EU has a procedure in the Trade Barriers Regulation, for businesses to bring WTO issues to the attention of the European Commission. The UK will also need to set up a system to assess complaints from businesses and take them forward at the WTO.

What is the WTO dispute resolution procedure?

Under the WTO dispute settlement procedure, the relevant WTO Members first enter into consultations. If those consultations are unsuccessful, a panel will be established to produce a report. The panel's report is subject to appeal.

How would rights be enforced under a UK-EU FTA?

The most common procedure for resolving trade disputes is state-to-state dispute settlement, where a state complains about violations of the free trade agreement by the other state to a joint panel. In free trade agreements containing an investment chapter, it is also possible to include a dispute settlement mechanism between investors and states, which grants an investor the right to resort to international arbitration against a state's government.



The dispute settlement system provides security and predictability to the multilateral trading system.

Jonathan T. Fried,
Former Chair of the WTO
Dispute Settlement Body



GET IN TOUCH

Our cross-practice Brexit task force is here to help you to address the challenges and opportunities you may now face.

We are helping clients to understand their risks, assess contracts and devise strategies to influence the future UK/EU relationship.



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Polly specialises in financial services law and regulation. Having spent time on secondment to the FSA's Enforcement Division, she has a close understanding of how the regulator works in practice. Since the Brexit vote, Polly has been advising financial services clients on what it means for the financial services industry.



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Marieke advises clients across a range of sectors on the legal aspects of Brexit, as well as helping clients to identify the key risks and opportunities associated with Brexit. She also advises on the WTO rules in the context of Brexit and otherwise.

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Chris has over 15 years' experience in Brussels and London advising on the EU institutions, law-making processes and trade deals. He has helped clients to devise successful strategies to influence the EU and domestic laws.

Chris heads the firm's Brexit task force and is one of the leading experts and media commentators on this subject. He advises clients across all sectors, ranging from financial services to automotive.

Getting in touch

When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

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