

# Comments on Jean-Victor Louis

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## Abstract

*Should the UK indeed leave the EU, there is a fair chance that the dynamics of EMU-deepening could change, including the Banking Union. Of course, there is no guarantee for that. But a heavyweight with the tendency of decelerating progress will disappear.*

*After a 'No-Deal-Brexit' any directly enforceable right to establishment for British financial institutions under EU law would be dependent on secondary EU legislation. This should not be too high a hurdle given that secondary legislation allows for the establishment of financial institutions owned by third country nationals of third country enterprises.*

*A specific issue concerns Clearing Houses. It would be preferable if at least those of them providing services of systemic relevance would be established within the Euro area. However, there is need for a transitory arrangement. An ESMA-decision would be advisable in order to guarantee the smooth transition of clearing services into the post Brexit era.*

## Introductory Remarks

These comments are brief, for the simple reason that I fully concur with Jean-Victor Louis' analysis, be it the identification of the most salient issues or be it his respective observations. Some complementary aspects shall nevertheless be added.

Given that, at the time of writing, still no agreement under Article 50 TEU could be reached, my working hypothesis is that there will be no such agreement and that the UK would on 31 October 2019, find itself as a third country without specific treaty arrangement with the EU ('no deal Brexit');<sup>1</sup> but that it would, with some adjustments of its WTO-commitments, remain a WTO-member, and that, consequently, its trade relations

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1 COM (2018) 556 final/2, Communication from the Commission, Preparing for the withdrawal of the United Kingdom from the European Union 30 March 2019, p 4.

with the EU and its members would thus be regulated by WTO law.<sup>2</sup> Governing the business of financial service providers and thus closely EMU-related is the General Agreement on Trade in Services (GATS), including the Understanding on commitments in financial services, together with country specific schedules.<sup>3</sup> The latter would have to be adjusted at the occasion of the UK leaving the EU, which might equally take some time.

The envisaged alternative scenario:<sup>4</sup> that there would be a transition period until 1 January 2021 for negotiating the future relations between the EU and the UK, would make a smooth transition into such relations much more likely.

As always, the legislator, in this case, the EU and the UK could by concluding an agreement under Article 50 TEU render most (but not all) of the following irrelevant from one day to another.

### *1. On the Dynamics of EMU-participation and EMU-reform*

At a very general level we may ask: Will the dynamics of EMU-participation change once the UK would have left? Legally, there is not much to say. Protocol 15 will be abrogated. That Protocol provides, side by side with Protocol 17 on Denmark, for an exemption from the general obligation to participate in the 3<sup>rd</sup> stage of the EMU. It is well known that the Council's decision to end derogation could, once the convergence criteria are met, be taken by qualified majority, theoretically even against the will of the Member State in question. This obligation is now to be found in Article 140 TFEU. Nevertheless, some of the younger Member States like Poland used to point at the UK when it comes to debates on the obligation to join the EMU. Once the UK will have gone, Denmark remains the only Member State without such an obligation. This might result in an in-

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2 Compare more in detail, stressing the numerous complicated problems which are, also under WTO law, being caused by Brexit: Christoph Herrmann, 'Brexit and the WTO: challenges and solutions for the United Kingdom (and the European Union)', in ECB Legal Conference 2017. Shaping a new legal order for Europe: a tale of crises and opportunities (2017), 165–179.

3 Compare the Understanding on commitments in financial services: [https://www.wto.org/english/tratop\\_e/serv\\_e/21-fin\\_e.htm](https://www.wto.org/english/tratop_e/serv_e/21-fin_e.htm) and the current EU schedule on specific commitments: [https://docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_S009-itsDP.aspx?language=E&CatalogueIdList=31391](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-itsDP.aspx?language=E&CatalogueIdList=31391) or [http://i-tip.wto.org/services/GATS\\_Detail.aspx?id=23178&sector\\_path=0000700044](http://i-tip.wto.org/services/GATS_Detail.aspx?id=23178&sector_path=0000700044) (accessed September 2018).

4 COM(2018) 556 final/2, at p 4.

creased pressure on the others to respect their obligation including Sweden. However, in times of differentiation and disintegration, also the contrary might be true. For we have to realise that exerting pressure on a Member State might in the near future even more easily result in initiatives to trigger Article 50 TEU. Therefore, the resulting perspective is ambiguous.

The second point is closely related: will the dynamics of EMU-deepening change, including the Banking Union? We might remember that the UK has a reputation of watering down draft initiatives sometimes to a point where the original idea had almost been lost, only to in the end block the remains anyway. The most famous example in recent years was the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, including the so-called Fiscal Compact. Earlier, both a treaty amendment and secondary legislation had been envisaged. It had been mainly the UK blocking these solutions, which led to the famous escape from EU law to international law.<sup>5</sup> After Brexit we could expect that the fiscal compact could be integrated into the Treaties, possibly even by secondary legislation,<sup>6</sup> considering that its watered-down final version comes very close to the respective obligation under the six pack. However, it remains to be seen whether this incorporation will happen. Brexit could thus turn out as revitalising the Community method also in the field of EMU. However, we cannot rule out that the poison of intergovernmentalism has already done its work and that nothing would happen. What I would, at any event, not expect is that the remaining Member States would, at the occasion of integrating the matter into EU law, revitalise the more ambitious first drafts of the fiscal compact rules.

Similar, but, as far as details are concerned, different examples can be found in pieces of secondary legislation, namely banking union legislation, where the UK had strongly influenced the outcome, not the least by arguing that it would otherwise face disadvantages as a nonparticipating member, and sometimes by even pointing to possible later EMU accession, which would be more likely if the UK's ideas would be reflected. Also here, the remaining Member States could take or accept fresh initiatives,

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5 Compare Paul Craig, *The Stability, Coordination and Governance Treaty: Principle, Politics and Pragmatism*, *ELRev* (2012) 231, 232 f.

6 In fact, this is the core of the Commission proposal COM(2017) 824 final from 6 December 2017, to enact, mainly on the basis of Article 126 (14) TFEU, a Council directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States.

once the heavy stumbling block is no longer there.<sup>7</sup> However, we can only speculate whether that will happen.

## II. *On the Importance of Commercial Presence on 31 October 2019*

My third point is related to the freedom of establishment and the strategic options of British financial service providers, mainly credit institutions during the transitory period to Brexit. A first assumption is that the single licence to do business by way of providing services (in the sense of Articles 56 et seqq. TFEU) would disappear in the case of a no deal Brexit.<sup>8</sup> Another assumption is that the EU commitments under the GATS would in principle remain unchanged, and thus also be applicable to the UK as a third country.<sup>9</sup>

Would it, under such circumstances, be better for British banks to move or to establish subsidiaries before or after the lapse of the (prolonged) two year period? Again, all of that may be irrelevant from one day to the other once an arrangement between the EU and the UK is reached.

WTO-commitments of the EU regarding financial services would, under the assumption that they will, without any substantive change, be applied to UK financial service providers after the leave of the EU, not include the right to “actively” provide services within the EU without any establishment – the so-called “presence of natural persons” in WTO-terminology.<sup>10</sup> Thus, UK service providers would need to obtain a licence in one of the 27

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7 Compare, in this regard, COM (2017)291 final, Reflection paper on the deepening of the economic and monetary union, p 19; COM(2017) 592 final, Communication on completing the Banking Union, both with further references.

8 Generally, compare COM(2018) 556 final/2, at p 14 et seq.; as well as the ‘Notice to stakeholders’ issued by the European Commission, 8 February 2018: ‘Withdrawal of the United Kingdom and EU Rules in the Field of Banking and Payment Services’.

9 This assumption is not self-evident, but, it is argued, likely. To a certain extent this would probably also depend on reciprocity: that the UK in turn would, in the absence of a specific trade agreement with the EU, treat EU Member States’ financial institutions as third countries’ institutions, and to apply the standards it used to apply as an EU vis-à-vis third countries.

10 Compare the Understanding on commitments in financial services: [https://www.wto.org/english/tratop\\_e/serv\\_e/21-fin\\_e.htm](https://www.wto.org/english/tratop_e/serv_e/21-fin_e.htm) and the current EU schedule on specific commitments: [https://docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_S009-its\\_DP.aspx?language=E&CatalogueIdList=31391](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-its_DP.aspx?language=E&CatalogueIdList=31391) or [http://i-tip.wto.org/services/GATS\\_Detail.aspx?id=23178&sector\\_path=0000700044](http://i-tip.wto.org/services/GATS_Detail.aspx?id=23178&sector_path=0000700044) (accessed September 2018).

EU Member States. Regarding such authorisation, there will be no automatism in accepting the prudential supervision arrangements that British financial service providers established with their home authorities.<sup>11</sup> By contrast, e.g. in the field of banking, the ECB would, in the case of “significant” banks, have to fully scrutinise all relevant conditions before an eventual authorisation to take up the business of a credit institution under regulation 1024/2013. However, such decisions should be taken without any discrimination, flowing from the right to national treatment under the General Agreement on Trade in Services (GATS), including the Understanding on commitments in financial services.<sup>12</sup>

Such non-discriminatory scrutiny applies already today for UK financial service providers who seek getting established in another EU Member State, i.e. through commercial presence especially by creating a new service provider or a subsidiary. As long as the UK is an EU member, however, there is a right to establishment flowing from the treaties. There doesn't seem to be a point for restricting that right resulting solely from triggering the exit procedure.<sup>13</sup> Once established, the financial service provider would later benefit from fundamental rights protection when it comes to a possible withdrawal of the existing authorisation, even after Brexit. Paradoxically, the freedom to conduct a business and the right to property<sup>14</sup> would provide firm protection for established banks even after a no deal Brexit, probably even better if compared to the rights of natural persons.

However, after the materialisation of Brexit, and in the absence of any agreement, any directly enforceable right to establishment under EU law would be dependent on secondary EU legislation.<sup>15</sup> UK banks would then be third country banks. This should not be too high a hurdle, though, given that secondary legislation allows for the establishment of financial institutions owned by third country nationals of third country enterprises.

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11 Compare also Louis' contribution.

12 Compare supra n 3.

13 Compare in this regard, even if in a totally different field, the judgment of the ECJ on the validity of a European arrest warrant: Case C-327/18 *PPU, RO*, ECLI:EU:C:2018:733.

14 Articles 16 and 17 EU Charter of Fundamental Rights.

15 This applies also to the right to establishment flowing from WTO law, given the reluctance of the ECJ to directly enforce WTO obligations according to its standing jurisprudence, starting with Case C-149/96, *Portugal vs. Council*, ECLI:EU:C:1999:574.

However, Regulation 1024/2013<sup>16</sup> establishes that the ECB, when deciding on authorisation requests, has to apply also national legislation. Should a Member State restrict the establishment of third country banks -even if this should happen mainly to reduce competition for its own banks – that could be disadvantageous for British banks. Such restriction appears rather unlikely given that Member States might feel tempted to draw advantage from offering investment opportunities, and the established bank would then benefit again from its right to establishment in any other EU Member State. Consequently, economically speaking this should not be a big issue.

There is an alternative solution to this scenario: equivalence decisions to be issued by the European Commission.<sup>17</sup> This might be done on the basis of individual scrutiny of the third country, here: the UK after a no deal Brexit. Such a decision is to be drafted for specific services and requirements and includes broad discretion for the European Commission.<sup>18</sup> Therefore, this can also be seen as a bargaining chip in the ongoing negotiations.

Even if we might assume that, given the common standards which have been developed during the last decades, the UK system should in many instances qualify as equivalent, there is no guarantee of such respective decision, nor that it would be swiftly taken by the Commission. At any event, compared to a financial service provider established within the EU, there is surely a disadvantage in legal certainty and enforceability. Hence, if British financial service providers want to be on the safe side it would be advisable to move or to create subsidiaries before the materialisation of a no deal Brexit.

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16 Article 4 Council Regulation 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ 2013/L 287/63.

17 It should be added that doing business for third country financial institutions can be simplified by a number of so-called equivalence decisions to be issued by the European Commission; compare the overview at [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/recognition-non-eu-financial-frameworks-equivalence-decisions\\_en#documents](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/recognition-non-eu-financial-frameworks-equivalence-decisions_en#documents); [https://ec.europa.eu/info/sites/info/files/overview-table-equivalence-decisions\\_en.pdf](https://ec.europa.eu/info/sites/info/files/overview-table-equivalence-decisions_en.pdf) (last visited October 2018); compare also *European Parliament, Directorate General for Internal Policies, Implications of Brexit on EU Financial Services* (2017).

18 For more details compare *European Parliament* (above n 17) at pp 53 ff.

### III. On the Systemic Importance of Clearing Houses

While, generally speaking, creating establishments for financial service providers within the EU-27 is mainly a question of (continuity for) business opportunities, this might be different when it comes to the specific issue of authorising central counterparties' (CCPs) businesses;<sup>19</sup> a CCP is a 'legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer'.<sup>20</sup> Today, around 99% of the Euro denominated Union Market is being cleared by UK based CCPs – with estimated daily values of repos and open positions in interest-rate swaps of respectively € 101 billion and € 33 trillion.<sup>21</sup>

Consequently, in respect of CCPs, smooth transition might be of systemic importance for the EMU in general.<sup>22</sup>

To start with, disturbances in clearing systems might impact on the primary objective set for the ECB's monetary policy: price stability. Effects might weaken the liquidity position of credit institutions which in turn might harm the payment system. Moreover, such disturbances might impair the transmission system of the ECB's monetary policy.

Against this background there is, as the ECB has pointed out,<sup>23</sup> even a case for requiring CCPs to be located within a Euro area Member State. Already today, specific supervisory arrangements between the ECB and the Bank of England are in place, the smooth functioning of which is not be-

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19 Compare also Louis, in this volume, at p. 221 ff.

20 Article 2(1) of Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories, OJ 2012/L 201/1, last amended by Commission Delegated Regulation 2017/979, OJ 2017/L 148/1.

21 ECB/2017/18), Recommendation for a Decision of the European Parliament and of the Council amending Article 22 of the Statute of the European System of Central Banks and of the European Central Bank, OJ 2017/C 212/14, p. 15.

22 Compare, on the risk reducing purpose of regulating such business Commission Staff Working Document, Impact Assessment, Accompanying the document 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 the requirements for the recognition of third-country CCPs, SWD(2017) 246 final, 13 June 2017.

23 ECB/2017/18), Recommendation for a Decision of the European Parliament and of the Council amending Article 22 of the Statute of the European System of Central Banks and of the European Central Bank, OJ 2017/C 212/14. Compare also the respective Commission Opinion of 3 October 2017, 2017/C 340/1.

yond doubt. Consequently, even with the UK as an EU member, it would be preferable if CCPs – at least those providing services of systemic relevance – would be established within the Euro area and thus being subject to the regulatory power of the ECB. This is even more so once the UK would be a third country. For any authorisation of a CCP under Article 14 of Regulation 648/2012 would lapse after Brexit. Consequently, any such CCP would, in order to smoothly continue with its clearing activities, need an authorisation as a legal person established in the EU. Otherwise, the smooth continuation not only of the CCP's business, but moreover of the European clearing system as such would be endangered with the UK becoming a third country.

This might be somehow mitigated by the possibility for third country CCPs to get recognised for providing clearing services in the EU.<sup>24</sup> However, this is only possible on the basis of a respective decision by ESMA, interacting with the Commission, and including a certain margin of appreciation. Consequently, action is paramount in order to guarantee the smooth transition of clearing services into the post Brexit era.

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The background for this initiative is a judgment handed down by the General Court, Case T-496/11, *UK vs ECB*, ECLI:EU:T:2015:133, denying the competence of the ECB to set such a requirement.

24 Article 25 of Regulation 648/2012.

See also COM(2017) 331 final of 13.6.2017, with a proposal to amend that regulation (not yet passed).