



# Implications of the leaving the EU single market

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## Key points

- The most important choice the UK has made in leaving the EU is signaling that it does not intend to seek continued inclusion in the EU single market in some form. This means that the UK will become a 'third country' with respect to the EU. This places the UK outside the EU single market, but with defined rights to trade in and with it. This choice has important implications for most UK economic sectors, including banking.
- One of the ways continued participation in the single market can potentially be secured is through membership of the European Economic Area (EEA). EEA membership would mean continued participation in the EU but at a potentially high cost in UK influence over its own rules.
- Third country status may ensure a high level of UK autonomy in setting rules for banking, but potentially restrict trade in banking services (and in the trade in goods and services for many other UK industries) between the EU and the UK in a highly disruptive way.
- However, there are a range of ways in which the EU and UK could in principle reduce this disruption. Implementing these would require a high degree of cooperation and good-will between the two, and flexibility on the part of the UK..

## What is the EU single market?

The EU Member States have always seen being in the single market as part of a package of rights and obligations for members.

Being a member state of the European Union automatically makes a country part of the EU single market. This market has a single external border for customs and tariffs and goods and services can be traded between the member countries of the single market with relative freedom. In many areas a single set of EU rules and standards apply to goods and services, an approach designed to both harmonise standards at a high level and facilitate trade. The EU single market is much more developed than a free trade area; at its heart are a harmonised set of rules designed to enable a very high level of economic integration among members (see Box 1: The single market and business: a single 'regulated space').

The EU Member States have always seen being in the single market as part of a package of rights and obligations for members. These include agreeing and enforcing a single set of rules in many areas. They also include the 'four freedoms' written into the European Treaties: the freedom of

movement for people, capital, goods and services. In return for benefiting from these rights, countries in the single market are expected to guarantee them to all others, including the right of EU citizens to move freely around the EU to live and work. In the final instance, these rights can be protected and enforced through the judgements of the European Court of Justice.

## Box 1: The single market and business: a 'single regulated space'.

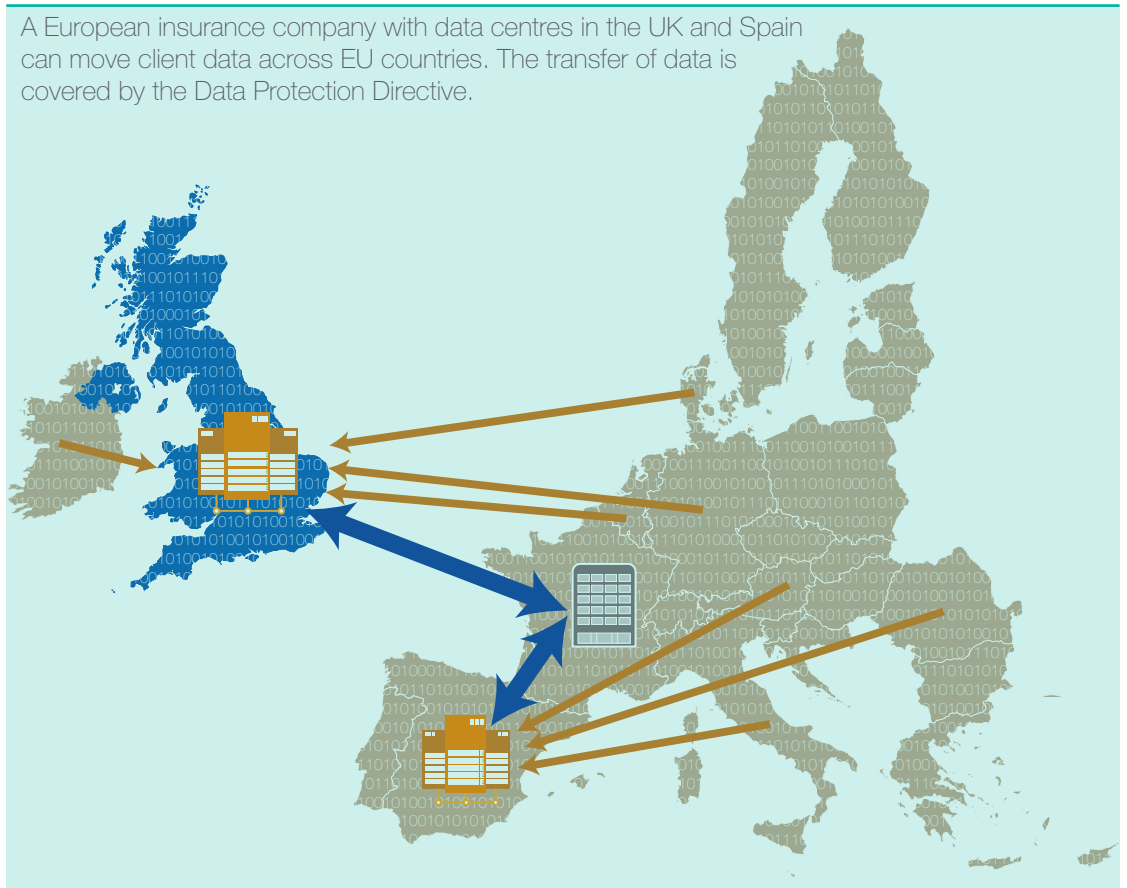
One way of thinking about the single market in many areas is as a 'single regulated space'. While EU Member States regulate their own markets in almost all areas, they often do so on the basis of a shared 'rulebook'. This shared rulebook is the foundation of the treatment that EU-based companies receive when they trade with or in other EU Member States. So, for example:

- When a UK-based car manufacturer has a new model tested in the UK for conformity with UK safety standards, those UK safety standards are harmonised with those of the rest of the EU. By agreement, the consequent 'certificate of conformity' is valid anywhere in the EU. Companies based outside the EU must have their products tested again by an EU authority, or by an authority recognised by the EU, before they sell them into the single market.
- An EU insurance company can establish a data processing centre in the UK and, because the EU and the UK are both covered by the EU data protection rules, the company can move personal client data between the two operations freely (provided it complies with EU data protection rules in doing so). Moving EU client data outside of the EU is subject to strict and burdensome additional safeguards, unless the EU has signed a special data protection agreement with the country in question outside of the EU. (The ability to transfer data across national borders is a critical tool for many industries in the UK in addition to banking).
- A UK-based bank covered by the EU 'passporting' system can use its authorisation in the UK to sell products and services in other EU markets or to establish branches there with minimal additional authorisation. The passporting system is not available to banks located outside of the single market.

Being outside of the single market does not necessarily mean losing access to the single market to sell goods and services – in fact, it often does not. But in almost all instances it brings additional requirements and costs to trading into the single market, or limitations on a business's ability to operate between a country inside and a country outside the single market in other ways. In the case of services, however, being outside the single market will often mean that access to the single market from a location outside the single market is not available.

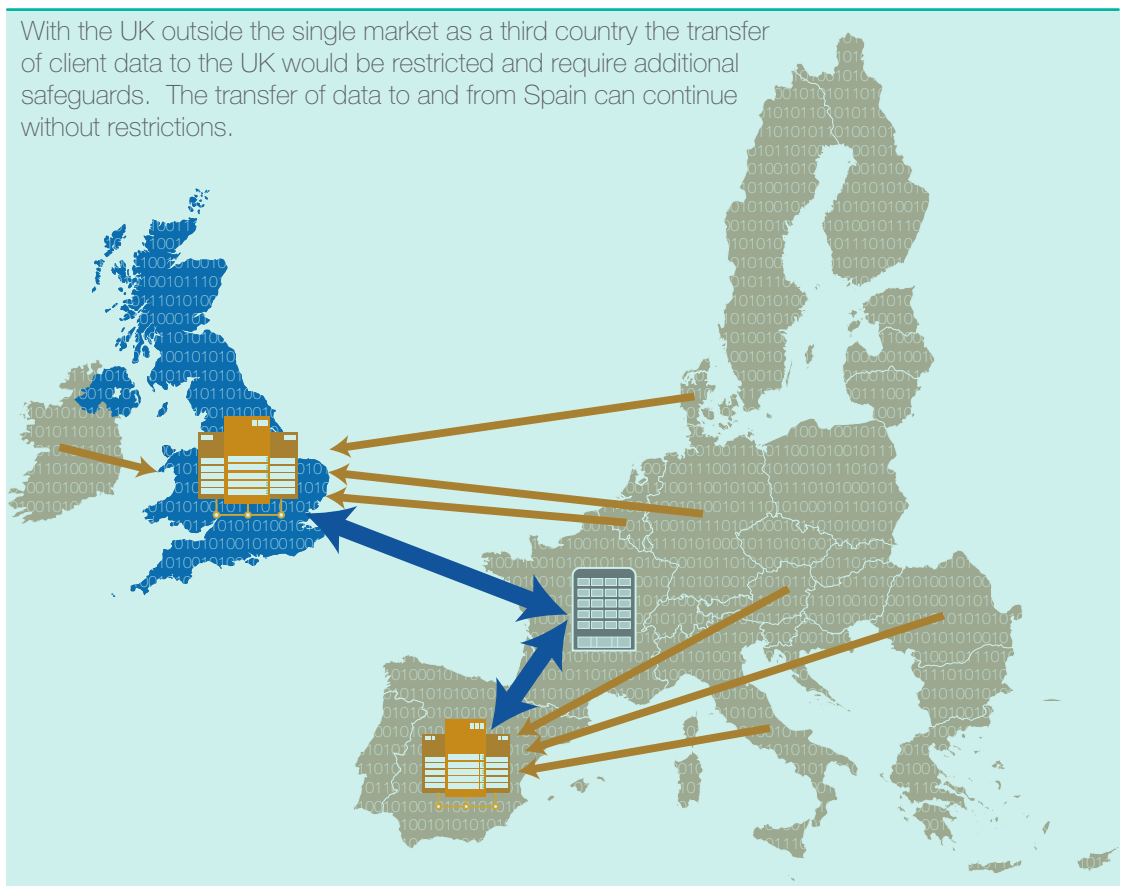
The single market and the transfer of data

A European insurance company with data centres in the UK and Spain can move client data across EU countries. The transfer of data is covered by the Data Protection Directive.



Third country status and the transfer of data

With the UK outside the single market as a third country the transfer of client data to the UK would be restricted and require additional safeguards. The transfer of data to and from Spain can continue without restrictions.



## Can the UK have access to the single market without being in the EU?

All countries can trade with the EU single market in some way. However, the rights of countries inside the single market and outside it are very different.

The basic alternative to being a part of the single market or the Customs Union, is to be outside of the single market but trading with it. This is the status of most countries in the world.

All countries can trade with the EU single market in some way. However, the rights of countries inside the single market and outside it are very different. What does leaving the EU mean for UK rights? Can those rights be preserved in any other way?

**EU and the EEA – the ‘Norway Model’:** It is possible to participate in the single market without being a member of the EU. Norway, Iceland and Lichtenstein are all members of the European Economic Area along with the EU. EEA states have many of the benefits of being in the single market, including access to the EU’s passporting system for financial services. In return they guarantee to recognise the four freedoms in the EU treaties and to make a contribution to the EU budget and incorporate important areas of EU law into their own, although they have no say over making it. ‘The Norway model’ would in principle be open to the UK, although it would depend on the willingness of both the EU and EEA states to admit the UK into the EEA group. The UK appears to have definitively ruled out this option.

**The ‘Switzerland Model’:** It is also possible to participate in the single market in some areas, but not all. Switzerland participates in the single market in some areas through its bilateral agreements with the EU. However, this kind of participation comes with important obligations. As with the EEA countries, it is expected to pay into the EU budget, incorporate EU law into its own in these areas and extend freedom of movement to EU citizens. Although it has signed a number of bilateral agreements with the EU on financial services, Switzerland does not participate in the single market for financial services. Nor does it have access to the EU passporting system for banks and other financial

services companies.

**Customs Union but not single market – the ‘Turkey Model’:** The UK could also request continued membership of the EU Customs Union, which currently covers Turkey and a number of small states such as Andorra. This would integrate the markets of the UK and the other Customs Union states for the purposes of trade in certain manufactured goods. It would mean that UK and EU exporters would not have to pay tariffs to trade these goods between the two markets, and customs formalities on this trade are minimised. However, the UK would also be required to harmonise its product standards for these goods with those of the EU and would lose the right to set its tariffs in these areas as it wished. The Customs Union does not cover trade in services, and would not create any preferential rights for UK-based services businesses in the EU unless these were separately agreed.

**Third Country – WTO and/or bilateral trade agreement:** The basic alternative to being a part of the single market or the EU Customs Union is to be outside of the single market but trading with it. This is the status of most countries in the world and is often referred to in EU law and practice as being a ‘third country’. Third countries can access the single market in many ways. Some of this access is guaranteed and protected by World Trade Organisation (WTO) rules or bilateral agreements signed with the EU. However, businesses based in third countries do not have the rights of businesses based inside the single market to be recognised as covered by a single enforceable set of EU standards, and this can materially affect how they are treated.

## The third country alternative for the UK

For more information on passporting and why it matters for UK banks and the EU customers of UK banks see the Brexit Quick Brief #3 “What is ‘passporting’ and why does it matter?”

As noted above, the basic alternative to leaving both the EU and the EEA is for the UK to become a ‘third country’ with respect to the EU and the EEA. A third country can trade with the EU single market on the same terms that the EU extends to all other WTO members.

However, third countries fall outside of the EU single rulebook for financial services, and are not covered by the EEA passporting framework for this reason. This has some important implications for how banks from third countries are regulated in the EU and how they are permitted to operate (See Box 2: In and out

of the single market in practice). While the UK would retain the right to establish banking operations of various kinds inside the EU under the EU’s general WTO commitments and the national licensing regimes of EU Member States, cross-border trade from the UK as conducted at present would become significantly more restricted. This would potentially be highly disruptive given the high current level of cross border trade in financial services between the EU and the UK.

In principle, a range of options would be open to the UK and the EU for making this kind of

The EU and the UK have used the framework of the EU single market and the single EU rulebook to develop a model of cross border trade in financial services that has never been attempted in agreements between countries with separate regulatory systems.

For more information on equivalence and the issues it raises, see the Brexit Quick Brief #4: "What is 'equivalence' and how does it work?"

basic third country status less disruptive for banking services (and the goods or services provided by many other industries) between the two markets. For example, the EU has a small number of special frameworks for third countries that might be activated for the UK that would maintain some operational rights in a limited number of areas such as investment services, mutual recognition of market infrastructure and movement of data between the two markets.

However, these frameworks have significant shortcomings. These include the fact that they do not currently exist for core banking services such as deposit-taking and lending for either retail or corporate customers.

A further possibility could be for the UK to seek to sign a Free Trade Agreement or other bilateral agreement with the EU to improve its access to and rights in the single market by agreeing a range of preferential terms for trade, and these could in principle cover banking and financial services. In order for such a Free Trade

Agreement or bilateral agreement with the EU to come close to the existing deep rights of two-way market access between the UK and the EU it would need to be broader and more ambitious than any existing trade agreement between two countries in this area. This is because the EU and the UK have used the framework of the EU single market and the single EU rulebook to develop a model of cross border trade in financial services that has never been attempted in agreements between countries with separate regulatory systems. An example that vividly illustrates the 'gap' between the EU-UK status quo and existing model for trading agreements between the EU and third countries is the recently agreed EU/Canada treaty – CETA, or Comprehensive Economic and Trade Agreement – which has very limited provision for liberalisation of financial services market access and cross border trade in financial services.

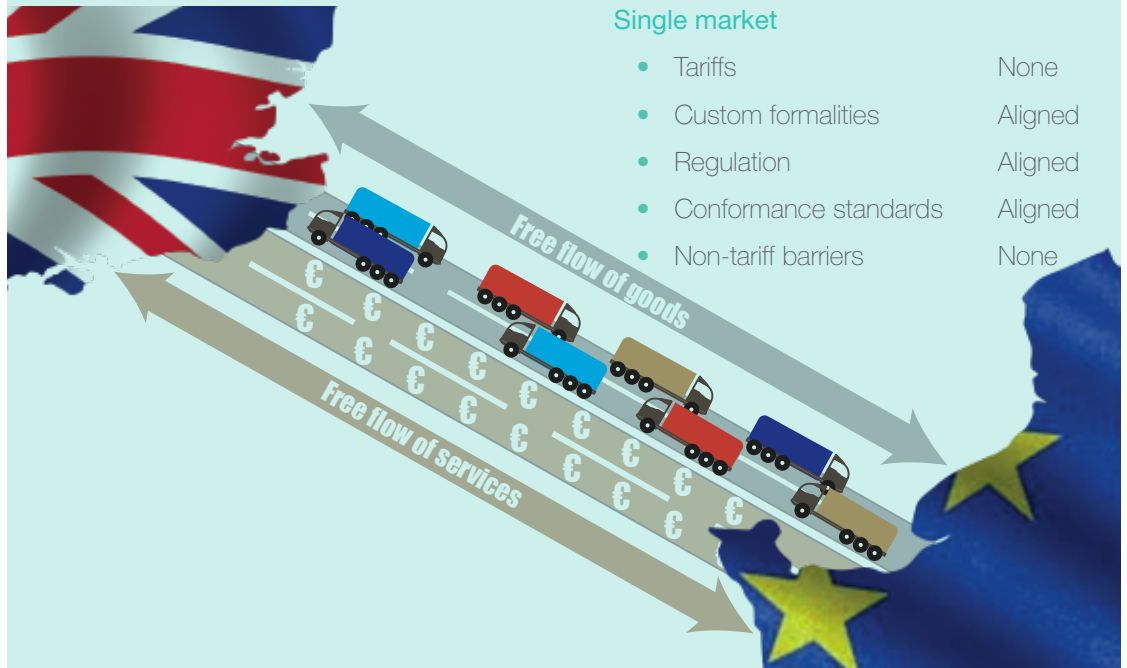
## Box 2: In and out of the single market in practice

In many cases the distinction between being part of and inside the single market and trading with it from the outside is not between having and losing market access entirely, but in different treatment for a country's products and services in the EU market. For example, a UK-based bank may wish to open a branch in Ireland to serve customers there. It can do this both if the UK is in or outside of the EEA or the EU single market. However, in each case the treatment of that branch will vary.

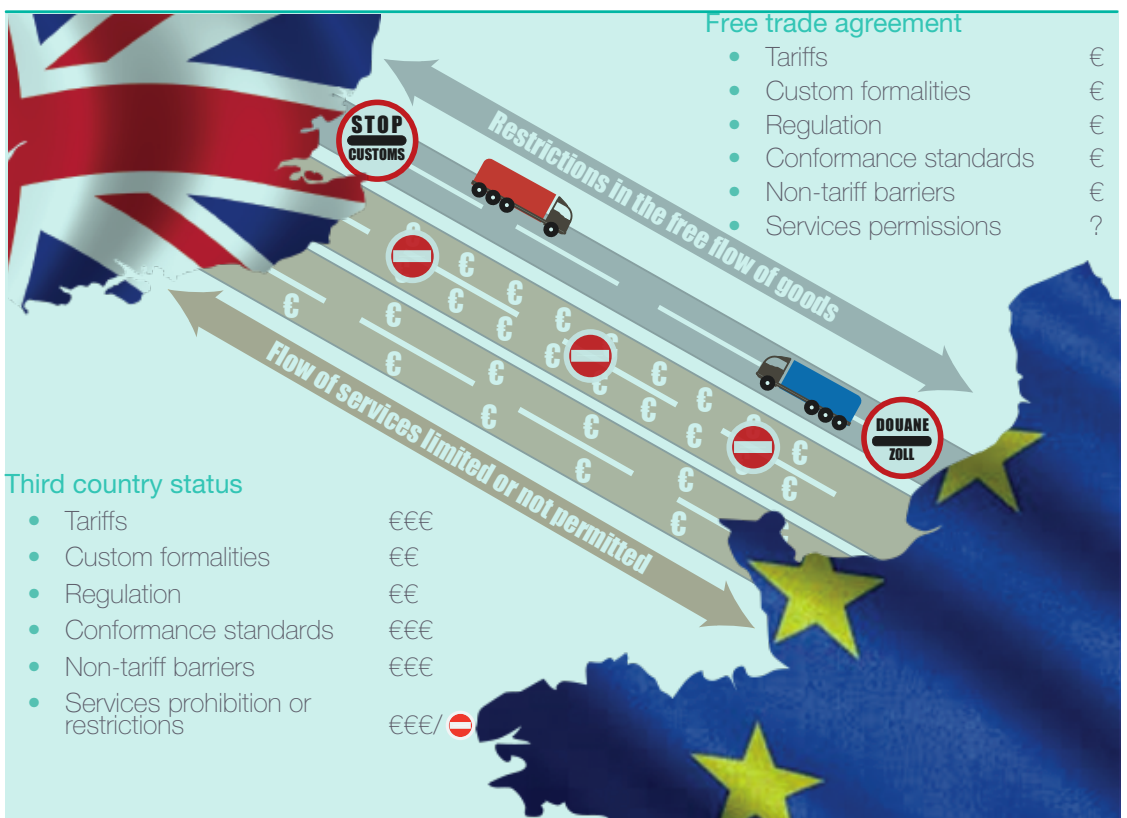
If the UK were a member of the EEA and covered by the single EU rulebook for financial services and a passport, the Irish authorities would be required to recognise its UK authorisation as giving it rights to operate in the Irish market on terms very similar to an Irish bank. However, if the UK were a third country, the same branch could still operate in Ireland, but on a very different and more burdensome basis. The Irish regulator would authorise and supervise it and could in principle impose additional material requirements on it, including higher capital levels or more onerous requirements in its reporting to Irish authorities. In principle, the Irish authorities could even require that the branch be converted into a fully-licensed subsidiary, especially if it was providing retail banking services. A demand that a banking operation convert from a branch to a subsidiary to preserve market presence in an EU country typically results in the loss of scale efficiencies, duplication and substantial additional costs.

Single market  
Free flow of goods and services

In some cases the change in rights from passporting to third country treatment is even more fundamental. For example, if the same bank wanted to provide the same banking services direct to its Irish customers from London it would be much more constrained, and in many cases prohibited from doing so.



Third country status  
Barriers to the free flow of goods and no or limited flow of services



Free trade agreement	
• Tariffs	€
• Custom formalities	€
• Regulation	€
• Conformance standards	€
• Non-tariff barriers	€
• Services permissions	?

## A key choice

The UK's decision to opt for third country status with respect to the EU has important implications for UK-based banks and for the customers that depend on the services they provide. There is a case both for being in and out of the EU single market from a UK perspective. But it must be recognised that for banking and financial services third country status will reset the freedom of cross border trade in both directions at a much lower level and potentially significantly restricts the services that can be offered to customers. EEA membership in principle

preserves many of the current operational freedoms for UK-based banks in the EU single market, and vice versa, but at a potentially high cost in UK influence over the rules the UK must implement and follow. Third country status resets those freedoms at a much lower level and significantly restricts the services that can be offered to customers. However, some of these impacts could be mitigated if the UK and the EU are ready to be ambitious and innovative in agreeing on mutually acceptable terms.

Table 1: EEA membership and third country status: The rights of UK-based banks compared

Can a UK-based bank...	UK as an EEA member	UK as a third country
...Establish a <b>licensed bank</b> ?	<b>Yes.</b> A UK-based bank can own another bank anywhere in the EU.	<b>Yes</b> , the EU is open for foreign banks seeking to establish fully-licensed subsidiaries inside the single market.
...Open a <b>bank branch</b> ?	<b>Yes</b> , the EU passporting system extends to the EEA and requires that banks authorised in one EEA state should be permitted to open a branch anywhere else in the EEA with minimal additional authorisation.	<b>Yes</b> , although branches of foreign banks in the EU are subject to close supervisory oversight and can be subject to higher regulatory requirements, especially if the EU does not recognise the 'equivalence' of the regulatory system in their home market. In some instances, the national supervisor may require the branch to convert to a subsidiary.
...Sell <b>banking services</b> from an EU branch into other EU countries?	<b>Yes</b> , the passporting system allows this.	<b>Generally, no.</b> Branches of third country banks do not have this right.
...Sell <b>banking services</b> directly from the UK?	<b>Yes</b> , the EU passporting system extends to the EEA and requires that banks authorised in one EEA state should be permitted to sell banking services anywhere in the single market, even without a local commercial presence.	In general, the direct provision of banking services from third countries into the EU is very <b>limited</b> .

## See also

BQB # 2	An orderly exit from the EU.
BQB # 3	What is 'passporting' and why does it matter?
BQB # 4	What is equivalence and how does it work?
BQB # 5	Data protection and transfer.
BQB # 6	Time to adapt – the need for transitional arrangements.
BQB # 7	The Repeal Bill explained
BQB # 8	External trade policy and a UK exit from the EU - clarifying the UK's WTO profile and beyond.