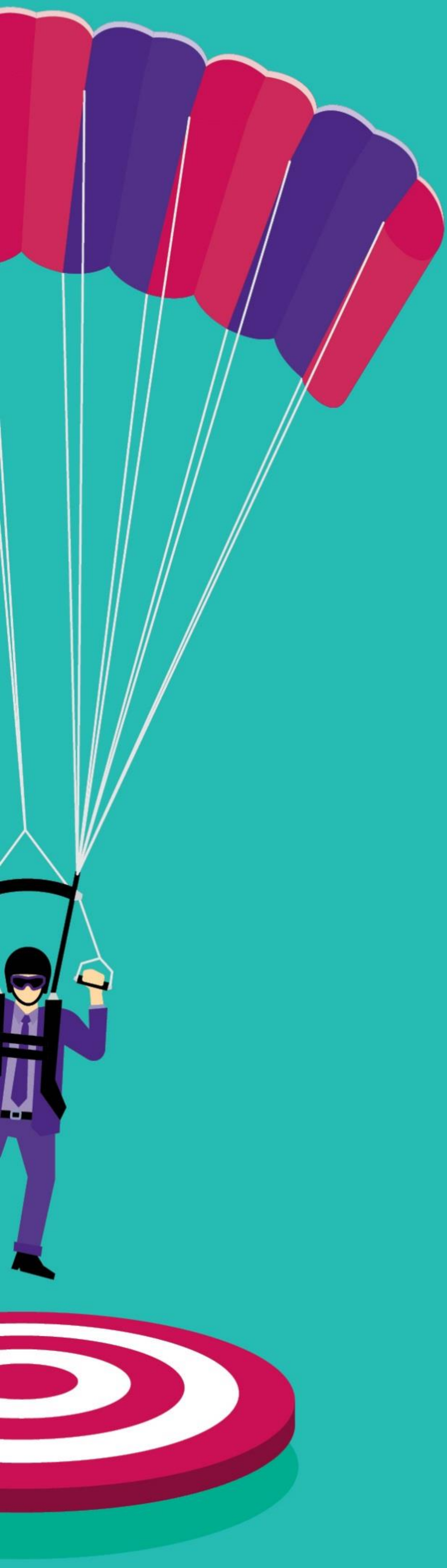

Article 50: Now what?

FAQs

KPMG International

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The *'Now what'* of Article 50

The UK Prime Minister has triggered Article 50, setting in motion the two-year process to negotiate the terms of its 'divorce' from the EU and the framework for its future relationship. This describes how the process of UK's exit from the EU, will impact on not just UK Plc but global businesses, and what step(s) to take.

So what will the Article 50 process involve?

The two-year Article 50 process covers negotiations around the exit of the UK from the EU (the 'divorce'), within the context of the framework of its future relationship (the 'remarriage'). Although undefined by the Treaty, the 'divorce' will likely focus on immediate issues — such as the rights of EU citizens living in the UK and vice versa, regulatory responsibilities, EU agencies based in the UK, cross-border security arrangements, cooperation on foreign policy, and contribution to and allocation of EU funds (i.e. the 'exit bill' that has been the focus of recent media attention).

This is a separate deal to the 'remarriage', which will define the terms of the future trading relationship between the UK and the EU — although of course, these deals cannot be discussed in complete isolation of each other. The EU Commission is pushing for sequential talks, while the UK will seek parallel negotiations.

Technically it is only the divorce that needs to be concluded in the two year period, but in practical terms, some definition of the future trading relationship is necessary for a transitional period to minimize disruption for both UK and EU business.

The divorce will have to be agreed by an enhanced qualified majority of the Council of the EU and a simplified majority of European Parliament, while the remarriage is likely to require unanimity and ratification by individual member states (including some regional Parliaments). The UK Prime Minister has also promised a vote to the UK Houses of Parliament. But regardless of whether either deal has been struck, the UK will exit the EU in March 2019 (barring an agreed extension or transitional arrangement).

So when will we know what the future EU-UK trading relationship might look like?

Once triggered, the EU will likely outline its negotiation mandate within the first 4–6 weeks, and this should also provide some clarity as to whether the EU intends to negotiate the divorce and the remarriage in parallel. However, with elections in a number of powerful EU member states coming up, in any case it is unlikely that any 'big ticket' decisions will be made before the German elections in September.

The approval processes require around six months, meaning the divorce deal, and at a minimum the future framework (and transitional period whilst the final deal is being struck), would need to be decided in 18 months to allow enough time to nut out the legalese — so by September 2018.

But clarity is not certainty. Although the terms of the deal may be set with a six month window (or longer if a transitional period is agreed) for UK and EU business to adjust to the proposed arrangement, the UK could still automatically revert to the 'cliff edge' of WTO rules in March 2019 if the EU Council, EU Parliament, EU member states, or the UK Parliament do not approve the future trading arrangement. The economics on both sides may make such a move unlikely, but in a world where economics may no longer be a driving force of politics, the optics of the divorce and future trading relationship will be considered through the lens of the continuation of European Project on one side, and the "*Brexit means Brexit*" and "*no deal is better than a bad deal*" on the other.

The 'Now what' of Article 50 (cont.)

The UK is rescinding its membership of the EU instead seeking a comprehensive Free Trade Agreement and customs arrangement. The future UK-EU arrangement could go beyond any existing trade models seen to date, as it's an unprecedented unwinding of economic and political integration. But the EU has been clear that it must be less advantageous than membership — meaning less liberalized trade.

So what is the UK seeking?

"Our new relationship should aim for the freest possible trade in goods and services between the UK and the EU. It should give UK companies the maximum freedom to trade with and operate within European markets and let European businesses do the same in the UK. This should include a new customs agreement with the EU, which will help to support our aim of trade with the EU that is as frictionless as possible."

— 'The United Kingdom's exit from and new partnership with the European Union', UK Government

Although it is rescinding its membership of the EU Single Market and Customs Union, it is clear the UK would like to retain the same (or as much as possible) liberalized trade in goods, services and capital.

And as for the UK's imperatives in the spirit of 'taking back control', it is best to look at the defined 'red lines'; namely, that the end arrangement allows for:

Full control of UK ***immigration*** | *Removal of the jurisdiction of the* ***European Court of Justice*** | *Freedom to set* ***independent trade policy*** *and removal of the* ***Common External Tariff***

It is these points that will likely define the parameters of any future arrangement between the UK and the EU. Control over immigration means membership of the Single Market becomes a question of preferential access, with mutual recognition and equivalence mechanisms as a key point of debate. Removal of the jurisdiction of the ECJ raises questions around dispute settlement and enforcement for an FTA — usually a key sticking point for comprehensive FTAs even on a good day (such as the Wallonian incident with CETA). Removal of the Common External Tariff raises questions around the practicalities of a customs arrangement.

So what are the key negotiation points?

The UK and the EU are commencing negotiations from the unique position of an integrated regulatory and customs union — i.e. zero tariffs and a common regulatory framework through agreed harmonization and mutual recognition. But by leaving the EU, the UK (or the devolved administrations of Northern Ireland, Scotland and Wales) will regain sovereignty over policy areas such as competition and mergers, state aid, environmental, employee, consumer and data protection, and sector-specific regulatory frameworks.

So the debate may stem less from how to achieve convergence with EU rules (as is a core topic in most FTAs), and more around what the acceptable level of divergence to the EU would be, while still allowing the UK to trade with the EU under preferential guaranteed terms. Although tariffs and quantitative restrictions represent an absolute cost to business, particularly for business with pan-EU28 supply chains, it is the non-tariff barriers to trade that will likely form the focus of negotiations for the UK. This includes rules of origin, product regulations and approvals, and obstacles to the establishment and provision of services.

In either case, trade facilitation (the simplification, modernization and harmonization of export and import processes) will also be important, to minimize disruption to business caused by the reimposition of borders.

The *'Now what'* of Article 50 (cont.)

The world outside the negotiating rooms in Westminster and Brussels is not substantively different than it was before Article 50 was triggered, but things will change in subtle but important ways for businesses. Whilst 'more of the same' might be in order for some businesses, others will need to consider doing things differently.

So how might things feel different for UK and Global businesses?

The days just before and after Article 50 are not substantively different. Nothing has changed in effect, and no avenues have suddenly opened or closed. Yet, expect the mood and playing field to change in the following subtle but important ways:

1. **Information from UK and EU governments could be harder to come by:** Theresa May promised that there would be no 'blow-by-blow' commentary on Brexit, so expect the spirit of those words to play out in the coming weeks and months. It could be harder to get meetings with politicians and technocrats alike, both in the UK and EU, and the 'official' release of information could be few and far between, although the media hype is unlikely to die down.

2. **The bandwidth — and behavior — of Pan-European regulators and interest groups could change:** With the certainty of timeline, European regulators and other interest groups (e.g. Business Promotion Agencies, In-bound investment facilitators) could see an increase in applications and interest from UK or global companies needing to restructure their European applications. This could make it harder to access them, longer to process applications, and more difficult to secure the interest of a company or sector.

3. **The pressure to have a plan will rise:** Now, more than ever, Management teams will be expected to have a plan in place to deal with the risks and opportunities of Brexit. Investors in particular will want comfort that Executive teams are adequately focused and resourced to deal with the issues. In short, a 'wait and see' approach will likely no longer feel sufficient for groups within and outside the organization.

Now what might you do?

Keeping in mind the specific change(s) brought about by the Trigger of Article 50, here is what you might consider doing in the coming weeks and months:

1. **Pick 1–3 sources of news and insight, and stick to those:** Expect the deluge of information, opinion and heresy to continue and uplift post-Article 50. With such a large amount of noise, it can be prudent to find a handful of sources for news and insights and stick to them to prevent information overload and paralysis. Of course, we hope and encourage you to have KPMG as one of them, and invite you to visit www.kpmg.com/brexit for our contributions. require continued attention.

2. **Embrace the idea of planning assumptions:** We are big fans of the notion of planning assumptions. These are known-knowns and known-unknowns that help reduce the overall uncertainty into manageable, yet flexible, sets of possibilities. Examples of these include; an X% reduction in the availability of EU workers, or a Y% change in the value of the Pound. From our experience of working with businesses — large and small and across every sector — we can share possible starting points for these.

3. **Do (some) more of the same:** The important work programs that many businesses have been running since the referendum result (and some, since even before) such as scenario planning, workforce planning, and government engagement should all clearly continue. Article 50 would clearly have been part of those plans, but of course only one component and the rest will still require continued attention.

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