



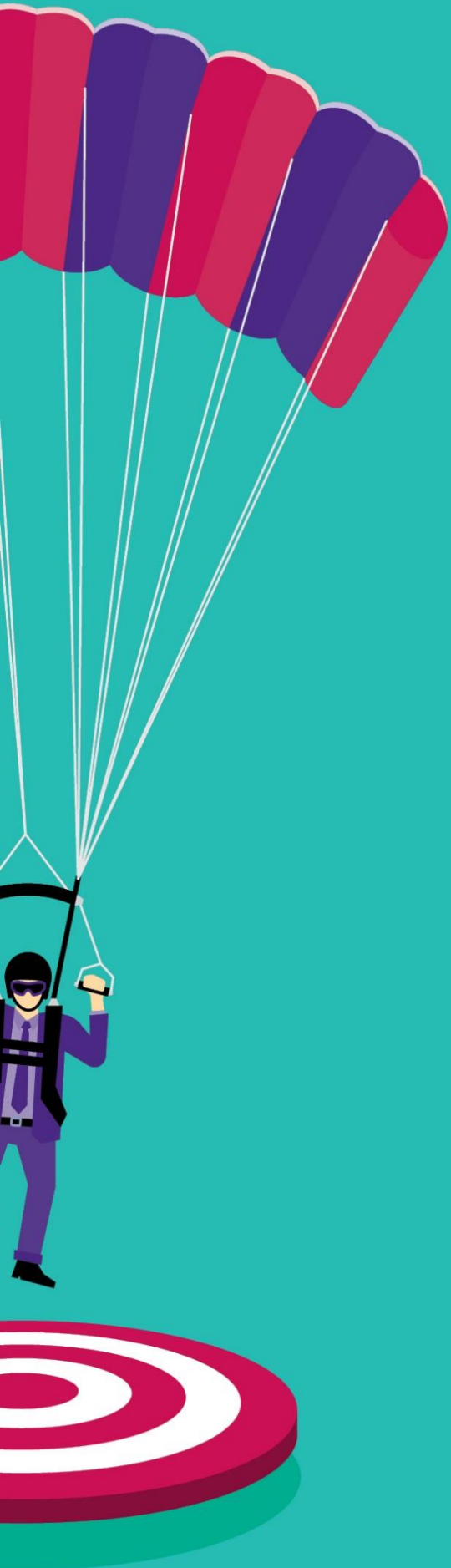
Article 50: So what? Now what?

FAQs

KPMG International

—

July 2017



The 'So what' and 'Now what' of Article 50



The UK Prime Minister triggered Article 50 in March, setting in motion the 2 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 2 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'). The 'divorce' focuses on immediate issues — such as the rights of EU citizens living in the UK and vice versa, judicial cooperation 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. Talks will be held sequentially in the first instance, but the EU and UK will progress to discussing the future arrangement once 'substantial progress' on the divorce has been made.

Technically it is only the divorce that needs to be concluded in the 2 year period, but in practical terms, some definition of the future trading relationship is necessary in order to agree 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?

Working backwards, the approval processes require around 6 months, meaning the divorce deal, the future framework and any transitional deal would need to be decided by September 2018 to allow enough time to nut out the legalese.

Negotiation rounds on the divorce have been scheduled until October 2017; if 'sufficient progress' has been made, the EU and UK will commence discussions on the future framework — leaving approximately a year to agree the parameters of the arrangement, as well as any transitional deal to bridge the gap. A speedy negotiation indeed.

But clarity is not certainty. Although the terms of the deal may be set with a 6 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*' (under a non-majority UK Government) on the other.

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



The UK is 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 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 'So what' and '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:** the UK and the EU may be releasing policy papers on key issues, but do not expect a 'blow-by-blow' commentary on the nitty gritty negotiations on Brexit - although the media hype is unlikely to die down. It could be harder to get meetings with politicians and technocrats alike, both in the UK and EU.
- 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 is rising:** 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 and commencement of negotiations, 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.
- 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. The commencement of negotiations is only one component and the rest will still require continued attention.

Contact us



Rohitesh Dhawan

Director, Global Brexit Centre of Excellence

E: rohitesh.dhawan@kpmg.co.uk

T: +44 (0) 20 7311 1352

kpmg.com/socialmedia



© 2017 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Designed by Evalueserve.

Publication name: Article 50: So what? Now What?

Publication number: 134271b-G

Publication date: July 2017