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Progress? Interpreting the EU's draft Negotiating Guidelines on the UK becoming a "third country"

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The Article 50 process began on 29 March 2017 and by 31 March 2017 we had the first formal indication of the approach the EU will take to the negotiations to follow.

The EU issued its draft negotiating guidelines and sparked, to its apparent surprise, much sound and fury from the UK over potential implications of the references to Gibraltar. This followed the sound and fury, or as Boris would put it "sturm und drang", over the UK's eleven references to the importance of future co-operation on security in its own Article 50 notification letter.

All of which sets the stage for the predictable media misunderstandings and overreactions to come over the next two years as the prospect of Dover's cliff edge becoming a literal and metaphorical barrier to cross-border trade with the EU looms ever closer…

But both sides having been quick to confirm that any perceived malign intent from the references to security or to Gibraltar was misconstrued, the air is now clearing for some cool-headed analysis of what we can learn from the draft EU negotiating guidelines.

The first point to note is that the negotiating guidelines have been issued in draft. They had been the subject of discussion within the EU prior to issue, with various responses debated and individual Member States' priorities reflected. However, there had also been a range of approaches which could have been taken by the UK to triggering Article 50 so there would have been a need to reflect on the terms of the actual letter issued and the appropriate response.

The aim will be for the draft guidelines to be adopted by the EU27 leaders at a summit on April 29 so that they can be used by the European Commission as guidance for developing its more detailed negotiating mandate. The European Parliament played its part with a resolution on 5 April, supporting the approach outlined and encouraging the European Commission to be "firm" with the UK.

These are the first examples of the practical challenges which a two-year time period represents when negotiating not only with the EU's constitutional bodies but also with its 27 Member States. There will be "due process" which must be observed at each stage in order to secure a binding agreement and that will involve circling back repeatedly to the EU27.

Nevertheless, we might be somewhat encouraged by (at least one aspect of) the draft negotiating guidelines.

The UK has been keen that the future trading relationship be discussed as part of the exit negotiations. The EU had previously indicated that the withdrawal arrangements, and specifically, the exit bill must be agreed first. In the draft guidelines, the EU has indicated that it will take a phased approach so that if it considers "sufficient progress" on the withdrawal arrangements has been made then discussions on the future trading relationship can progress.

It is clear the interpretation of "sufficient" means that "progress" is firmly within the EU's control. But it also indicates an intent to be co-operative in navigating these negotiations and to allow scope for political will to design solutions – perhaps recognising the potential for an impasse to have emerged quickly if it had sought to insist that a binding agreement on the exit bill be in place before turning to the future. Despite public positionings on what should be achieved in the first phase, this small caveat may indeed leave the door open for actual progress.

The negotiating guidelines also state that the EU will give priority to an "orderly withdrawal", meaning the UK's transition to being a "third country", and acknowledge the potential for disruption in other Member States as well as the UK if that is not achieved. All of which help remind us that a win-win negotiation will live up to its name.

As our work on the IRSG report on "The EU's Third Country Regimes and Alternatives to Passporting" made clear, there are material implications for the financial services sector of the UK becoming a third country for firms operating across an EU/UK border. The EU and UK have already reached alignment on the recommended approach set out in the report by being agreed on their wish to put in place an ambitious free trade agreement. Focus now turns to the detail of what can be delivered – and when.

Two key priorities for the financial services sector, in common with many others such as aviation and pharmaceuticals, are to secure "transition" and "access". There are messages to be analysed on each.

On transition, or as the Prime Minister would say "implementation", the mood is positive but firm. Transition may be negotiated but must be time-limited and will require acceptance that EU rules and structures apply, including EU regulatory, budgetary, supervisory and enforcement structures – though it may be notable that it does not expressly refer to the four freedoms in that context.

The EU's body of law, the "acquis", will be incorporated into UK law by the Great Repeal Bill. In financial services, the UK's FCA has indicated that it does not anticipate a "bonfire of regulation" after Brexit so applying EU rules during transition may therefore not be a significant concern to that industry and this appears to be a common perspective amongst highly regulated industries. Much will depend on whether the UK politics of remaining subject to EU governance structures can be reconciled.

The guideines also refer to possible "bridges" to a foreseeable framework for the future to close the gap between exit and the new framework being in place which is something which industry would be keen to see in place. Timing of agreement on transition being reached will be key to allowing businesses to assess the likely destination landscape before implementing costly contingency plans.

By making clear that the EU does not wish there to be a "legal vacuum" there are also indications that it is understood that measures will need to be taken to allow the contracts and policies which their citizens have in place to continue to operate as intended or be dealt with in a clear, fair and predictable way post-Brexit.

On access, indications are more muted with the EU's negotiating hand held closer to its chest. "The free trade agreement should be ambitious, balanced and wide-ranging. It cannot, however, amount to participation in the Single Market or parts thereof" excluding participation based on a sector by sector approach. This is also consistent with the "substantial sectoral coverage" requirements under WTO rules.

But the recognition of a need for balance should lead to an understanding that the deal needs to work as a whole for all involved – and whilst access for the automotive industry or agriculture may be a greater priority for the EU than financial services, a balanced deal will recognise the need for accommodation the respective priorities of both sides. A "no tariff" deal may be of greater benefit to EU exports whilst the UK requires focus on "non-tariff barriers" for its exports

Its instruction, possibly aimed more widely than the UK, that there should be no separate negotiations with individual member states on matters pertaining to withdrawal is also a reminder that a number of decisions relating to access structures do remain at a member state level and sometimes with domestic regulators.

The guidelines highlight some issues which will be key to unlocking a free trade agreement which delivers access for UK and EU financial services firms, including agreeing appropriate enforcement and dispute resolution mechanisms. Given the limited role of financial services in free trade agreements to date, in part due to the operation of the prudential carve out, these issues are relatively new to that sector but innovative thought is being applied in large measure to solving them.

For the moment, as the guidelines themselves tell us "Nothing is agreed until everything is agreed." – not even their draft text...

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