COMMERCIAL BANKING

THE EU REFERENDUM

A BRIEFING FOR CLIENTS

JUNE 2016

The results expressed in this document are summaries of the views of third parties. They are not representations by or on behalf of Lloyds Banking Group plc, or any of its related companies and do not necessarily represent the views of Lloyds Banking Group plc or any of its related companies.

LLOYDS BANK

WELCOME

IN THIS REPORT

SCOPE & OBJECTIVES OF THIS PAPER

The Board of Lloyds Banking Group has considered the potential implications of the EU Referendum for the Group, its customers, colleagues and shareholders, and for the broader economy. The Referendum and a vote to leave the EU are likely to cause economic uncertainty and potential volatility in the short term. With no certainty over how the UK's position outside the EU would evolve, the longer term economic impact is unclear.

The Board is mindful that the future of the UK's relationship with the EU is a matter for the UK electorate, and that for many the debate is more than just economics. Lloyds Banking Group will maintain its focus on being the best bank for customers and shareholders, and will continue to support its customers, irrespective of the Referendum outcome.

Press statement on the EU Referendum, Lloyds Banking Group, 14 April 2016

Like our UK peers, Lloyds Banking Group has been closely monitoring the developments regarding the EU Referendum, and considering how best to support our clients as the events in the run-up to the vote unfold. Requests from clients have focused on two areas – firstly, navigating the immediate implications for financial markets in general, and for Sterling foreign exchange in particular. Secondly, firms looking at the issue have been sent significant material: from law firms, banks, strategy consultants, trade bodies, and more besides. There is a huge range of third party sources available, and one of the most frequent requests is for a straighforward summary. The purpose of this note, and the bibliography that sits behind it, is to provide clients with a range of these third party sources – for them to consider in their own way.

Lloyds Banking Group holds no view on which way the British public should vote on 23rd June. It is a matter for the British electorate.

EXECUTIVE SUMMARY

David Cameron has called a referendum on the UK's membership of the EU, to be held on 23rd June 2016, fulfilling a Conservative party manifesto pledge at the last general election.

The announcement followed an EU Summit in February 2016, where a compromise deal was reached between the UK and the EU on a range of topics including competitiveness, sovereignty, economic governance, immigration and welfare.

Polling suggests that public opinion is quite evenly divided. Given the margin of error, and variables including voter turnout, the final result is currently uncertain.

The official campaign period began on 15th April and runs until the Referendum on 23rd June.

If the UK votes to leave, Article 50 of the 'Lisbon' Treaty provides the mechanism via which the UK would negotiate leaving the EU. It is unclear, however, how long this negotiation would take. Estimates range from under 2 years and up to 10 years, using EU trade negotiations with non-EU members as a proxy (e.g. China, Canada).

In the event of a vote to leave, the UK would need to renegotiate its trade relationship with the EU, and other non-EU nations with whom our trade relationships are currently provided for by EU-level agreements.

There are a number of possible models for a future relationship including EEA, bilateral agreement, customs union, free trade agreement, and WTO favoured nation status. There is much speculation on the likely outcome following a vote to leave, but little consensus.

The model of agreement on trade has resulting implications for the broader dimensions of the UK's relationship with the EU, including border controls, legislative and regulatory environment, and contribution to the EU budget.

With that context, there are three major time horizons in the run-up to the Referendum, and beyond:

1

Short-term: now to 23rd June

2

In the event of a vote to stay, the UK seeks to implement the agreements reached in Feburary

In event of a vote to leave the UK renegotiates with EU under Article 50: 2 year to 10+ year period of renegotiation and transition

3

Steady-state, post-vote to leave: UK adjusts to the 'new environment' after leaving the EU

1. BACKGROUND TO THE EU REFERENDUM

CAMERON: MANIFESTO PLEDGE AND FEBRUARY DEAL

"For too long, your voice has been ignored on Europe. We will give you a say over whether we should stay in or leave the EU, with an in-out referendum by the end of 2017" [1]

The origins of this Referendum stem from as early as the 1980s. The Labour party, at the time led by Michael Foot, promised to start negotiating to withdraw from the EEC "within the lifetime" of the following parliament if they won the General Election. They subsequently failed to secure power. In 1993, a year after the ratification of the Maastrict Treaty, Conservative party rebels failed in a campaign to hold a referendum. Referenda were, however, held on the Maastrict Treaty in Denmark and France. In 1997, Labour's election manifesto said a 'Yes' vote in a referendum was a pre-condition for Britain joining the euro.

In 1999 the UK decided not to join the European single currency. In 2005, a referendum was promised in the Labour, Conservative, and Liberal Democrat party manifestos on the proposed EU Constitution; France and the Netherlands rejected the EU Constitution in their referenda. The Constitution was replaced by the Lisbon Treaty but no UK referendum was held. In the 2010 General Election, a large number of MPs were elected to Parliament on a platform calling for a referendum.

LEAD UP TO FEBRUARY 2016 SUMMIT

A petition was signed in September 2015 by more than 100,000 people calling for a referendum on the UK's membership of the EU.

Following the petition, the motion calling for a referendum on EU membership was heavily defeated in the House of Commons. Of the 111 MPs voting for the motion, 81 were Conservative, and 19 were Labour. There was growing frustration and rebellion from these Conservative MPs regarding Europe.

After much anticipation, Prime Minister David Cameron promised in January 2013 to renegotiate Britain's position in the EU and then to give the people of the UK an "In-Out" referendum "before the end of 2017" if the Conservatives were successful in winning the 2015 General Election.

The Conservatives won a majority in the House of Commons in the 2015 General Election. David Cameron promised to hold a referendum before the end of 2017 as laid out in the Conservative Party Manifesto.

FEBRUARY 2016 SUMMIT

Initial discussions were held with EU leaders during the December 2015 EU Council Summit. This cleared the way for a potential deal at the February 2016 meeting. Leaders from all 28 EU Member States were in attendance. Final negotiations took 2 days from 18 to 19 February.

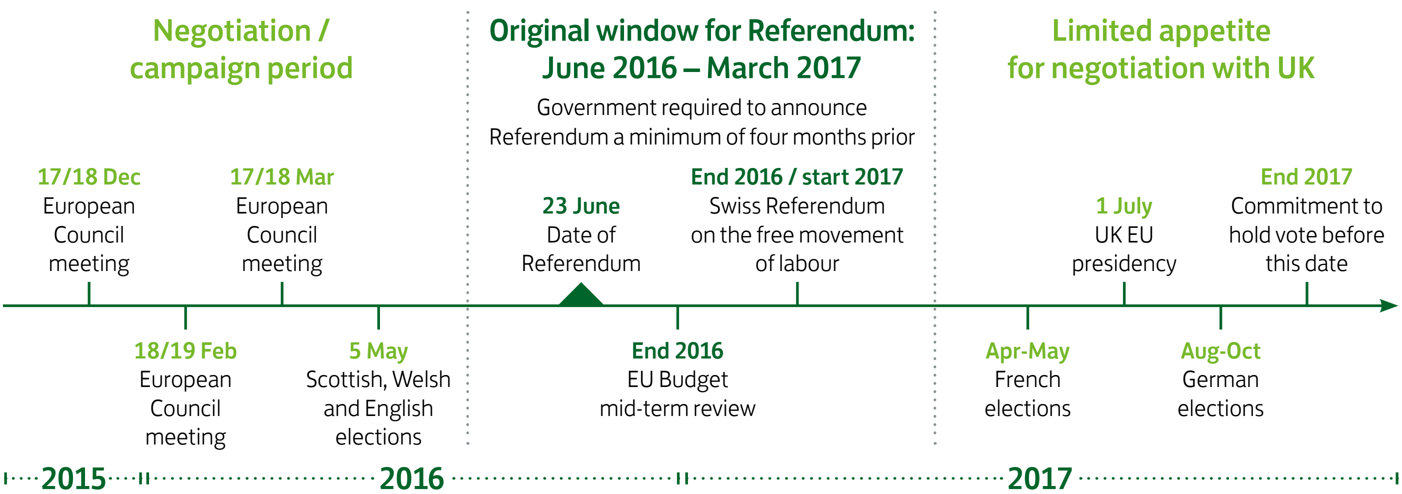
On the next page is a summary of the key requests, and subsequent settlements. Further sources providing more background on this topic are referenced in the biblography at the end of the paper.

TIMING OF THE REFERENDUM

The day after EU summit, David Cameron announced that the Referendum would be held on the 23rd June 2016.

"On Monday I will commence the process set out under our Referendum Act. And I will go to Parliament and propose that the British people decide our future in Europe through an in-out referendum on Thursday, the 23rd of June. The choice is in your hands."
Prime Minister, David Cameron [2]

The Government was required to give a minimum of four months between announcing the Referendum and holding the vote.



Source: 1 Conservative Party, The Conservative Party Manifesto 2015
2 HM Government, PM statement following Cabinet meeting on EU settlement, 20th February 2015

SUMMARY OF COMPROMISE REACHED AT EU SUMMIT, FEBRUARY 2016

Topic	UK Request	EU Compromise
Economic Governance	Any changes the eurozone decides to make, such as the creation of a banking union, must be voluntary for non-euro countries, never compulsory.	Measures to further deepen economic and monetary union will be voluntary for Member States whose currency is not the euro. Union law on the banking union giving the ECB or other EU bodies authority over credit institutions is applicable only to credit institutions located in euro currency Member States or in Member States that have concluded with the ECB a close cooperation agreement on prudential supervision.
	The EU has more than one currency. There should be no discrimination and no disadvantage for any business on the basis of the currency of their country.	Discrimination based on the official currency of the Member State is prohibited.
	Just as financial stability and supervision has become a key area of competence for eurozone institutions like the ECB, so financial stability and supervision is a key area of competence for national institutions like the Bank of England for non-euro members.	These acts shall respect the competencies, rights and obligations of the non-euro Member States. The single rulebook is to be applied by all credit institutions, in order to ensure a level playing field within the internal market.
	Taxpayers in non-euro countries should never be financially liable for operations to support the eurozone as a currency.	Emergency and crisis measures designed to safeguard the financial stability of the euro area will not entail budgetary responsibility for non-euro Member States, or for those not participating in the banking union. Where the general budget of the Union supports costs that derive from the emergency and crisis measures referred to above, appropriate mechanisms will be established to ensure full reimbursement.
	Any issues that affect all Member States must be discussed and decided by all Member States.	The informal meetings of the ministers of the euro Member States shall respect the powers of the Council as an institution upon which the Treaties confer legislative functions and within which Member States coordinate their economic policies. In accordance with the Treaties, all members of the Council participate in its deliberations, even where not all members have the right to vote. Informal discussions by a group of Member States shall respect the powers of the Council, as well as the prerogatives of the other EU institutions.

Source: Prime Minister Letter to the President of the European Council Donald Tusk
European Council, A New Settlement for the United Kingdom Within the European Union

Topic	UK Request	EU Compromise
Competitiveness	The EU should do more to fulfil its commitment to the free flow of capital, goods and service.	To secure the essential objective of establishing an internal market in which the free movement of goods, persons, services and capital is ensured, and to generate growth and jobs, the EU must enhance competitiveness, as set out in the Declaration of the European Council on competitiveness.
	The United Kingdom would like to see a target to cut the total regulatory burden on business.	The relevant EU institutions and Member States will make all efforts to fully implement and strengthen the internal market, as well as to adapt it to keep pace with the changing environment. At the same time, the relevant EU institutions and the Member States will take concrete steps towards better regulation, which is a key driver to deliver the above mentioned objectives.
Sovereignty	End Britain's obligation to work towards an "ever closer union."	It is recognised that the United Kingdom is not committed to further political integration into the European Union. This will be incorporated into the Treaties at the time of their next revision so as to make it clear that the references to ever closer union do not apply to the United Kingdom.
	Enhance the role of national parliaments, by proposing a new arrangement where groups of national parliaments, acting together, can stop unwanted legislative proposals. The EU's commitments to subsidiarity must be fully implemented. The ambition should be "Europe where necessary, national where possible."	Where reasoned opinions on the non-compliance of a draft Union legislative act with the principle of subsidiarity represent more than 55% of the national Parliaments' votes, the Council Presidency will include the item on the Council agenda for a comprehensive discussion on these opinions. Following such discussion the Council will discontinue the consideration of the draft in question unless it is amended to accommodate the concerns expressed.
Immigration & Welfare	Ensure that when new countries are admitted to the EU in the future, free movement will not apply to those new members until their economies have converged much more closely with existing Member States. People coming to Britain from the EU must live here and contribute for four years before they qualify for in-work benefits or social housing. We should end the practice of sending child benefit overseas.	The Council would authorise that Member State to limit the access of newly arriving EU workers to non-contributory in-work benefits for a total period of up to four years from the commencement of employment. The Commission will propose to amend legislation such that Member States have the option to index child benefits being paid into a Member State other than that where the worker resides. This to apply only to new claims. However, from 1st January 2020, all Member States may extend indexation to existing claims.

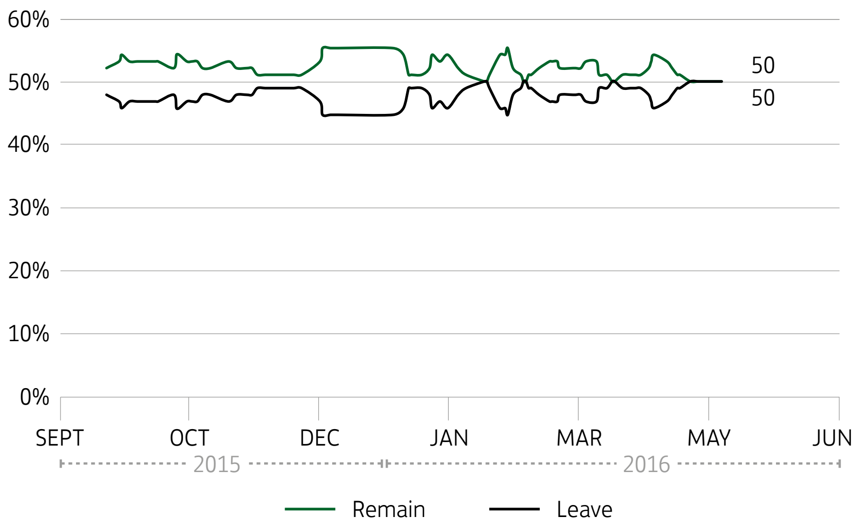
Source: Prime Minister Letter to the President of the European Council Donald Tusk
European Council, A New Settlement for the United Kingdom Within the European Union

2. POLLING: VIEWS OF VOTERS

The May 2015 general election arguably caused one of the greatest upsets since the advent of mass polling facilitated by the internet. Few watching the BBC's election night coverage on the evening of 7th May 2015 will forget Paddy Ashdown's derision of the exit polls, and his pledge to 'eat his hat' in the event that the exit polls proved accurate. With that in mind, it feels prudent to remember that polling is an indicative not exact science. Extensive research and commentary has been published on what the polls for the EU Referendum may or may not tell us. Current polls suggest that the gap between 'Leave' and 'Remain' looks marginal, and well within the swing of 'undecideds'.

Many, including Lynton Crosby (quoted overleaf), believe that voter turnout, rather than campaign activity targeting undecided voters, will determine the outcome. We have reproduced a few exhibits on polling here, and have further insight in the appendix. However, there are many other sources available, and the data included here will inevitably be superseded by the time this paper is released.

CURRENT UK VOTING INTENTION POLL OF POLLS

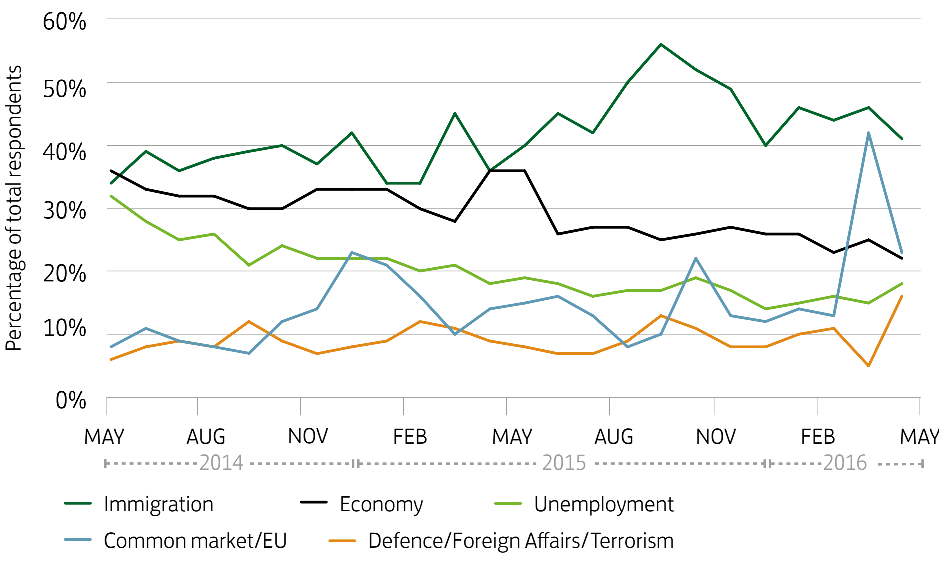


Source: www.WhatUKThinks.org/EU National Centre for Social Research, May 2016

The Poll of Polls by the National Centre for Social Research shows a tightness in the polls, with 50% in favour of remain, and 50% opting for leave.

The National Centre for Social Research Poll of Polls is based on the average share of the vote for Leave and Remain in the six most recent polls of voting intentions in the EU Referendum.

MOST IMPORTANT/OTHER ISSUES FACING BRITAIN TODAY

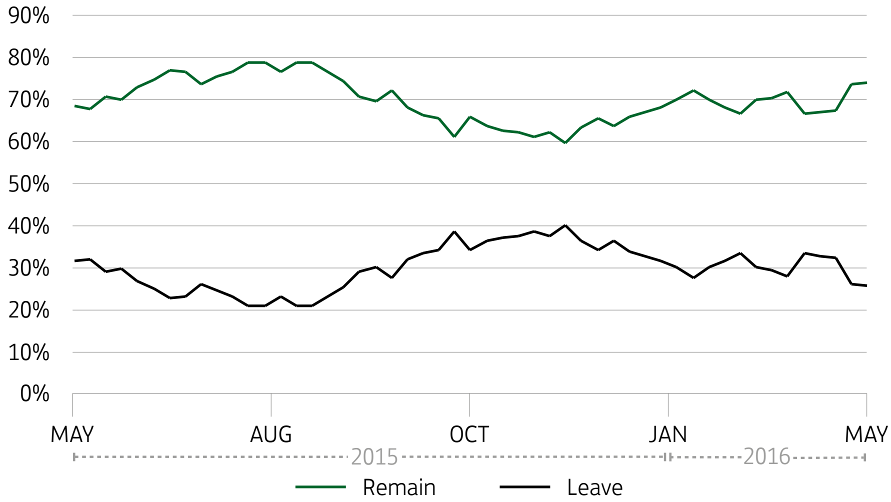


Source: Economist/Ipsos MORI Issues Index, April 2015

The most significant issue identified by the poll is immigration. The Common market/EU and defence/foreign affairs/terrorism are more important issues at the latest poll than they were in April 2015. The economy is a less important issue at the latest poll than it was in May 2015.

The latest poll was conducted at a base size of 996 British adults between 8th and 19th April 2016. Respondents were asked to choose their most important issue, and then other issues they thought were important.

WHAT THE BOOKMAKERS ARE SAYING



Source: Oddschecker, May 2016

Bookmakers are pricing in a 74% chance of Remain and 26% of Leave in the latest data.

PRESS COMMENTARY ON TURNOUT

> This [the decrease in the Remain camp's margin] reinforces my previous observation that, currently, the outcome of the Referendum will hinge on which side can better turnout their supporters rather than which side can better persuade the small number of voters not locked into supporting either side.[3]

SIR LYNTON CROSBY, QUOTED IN THE DAILY TELEGRAPH
Conservative party strategist

> People who want to withdraw from the EU are more likely to vote in the June Referendum.[5]

THE INDEPENDENT

> The decision over whether the UK remains inside the European Union could depend on whether young people shake off their apathy and vote in sufficient numbers.[4]

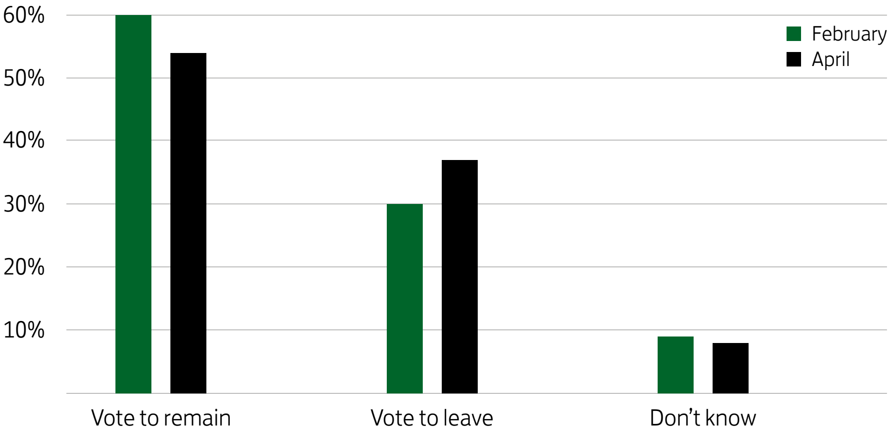
THE GUARDIAN

Source:
3 The Telegraph, EU Referendum: It now remains for the In campaign to mobilise their vote
4 The Guardian, EU Referendum: Poll shows young voters could hold key in June vote
5 Independent, EU Referendum: Brexit voters more likely to turn out in force, poll finds

3. INDICATORS OF BUSINESS SENTIMENT

BRITISH CHAMBERS OF COMMERCE EU SURVEY

Voting intentions of UK Businesses



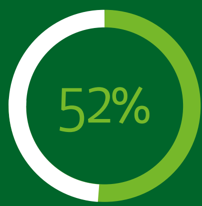
Source data: British Chambers of Commerce EU Survey, May 2016

> The BCC's detailed findings indicate that 54.1% of business people polled would vote to Remain, down from 60% in February 2016, and 37% would vote to Leave – up from 30% on the BCC's previous survey.

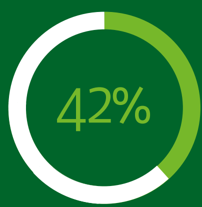
FEDERATION OF SMALL BUSINESSES (FSB)

Top issues are EU governance (75%), free movement of people (70%) and cost of EU membership (69%)

FSB has adopted a NEUTRAL position



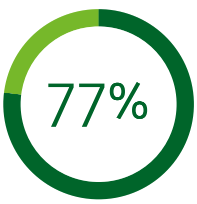
Did not feel informed



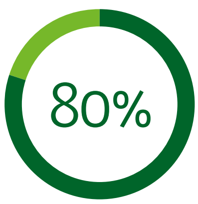
Undecided on
how to vote

Source: Federation of Small Businesses Snap Poll, March 2016

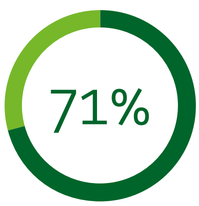
CONFEDERATION OF BRITISH INDUSTRY MEMBER SURVEY (2016)



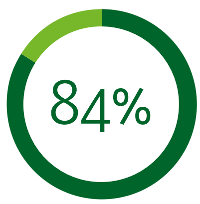
REMAIN
in best interests
of economy



REMAIN
in best interests
of their business



SMEs favour
REMAIN



Larger firms favour
REMAIN

Source: Confederation of British Industry Member Survey, March 2016

4. THE CAMPAIGNS

OVERVIEW OF CAMPAIGN GROUPS

The Electoral Commission confirmed on 13th April the two lead campaigns for the EU Referendum. Vote Leave, backed by Boris Johnson and Michael Gove, was nominated in favour of Grassroots Out, supported by Nigel Farage.

	Britain Stronger in Europe	Vote Leave
Objective	Remain	Leave – focus on financial implications
Official Leader	Stuart Rose – Conservative Peer	Matthew Elliott
Key Supporters	David Cameron – Prime Minister Karren Brady – Entrepreneur George Osborne – Chancellor of the Exchequer Jeremy Corbyn – Leader of the Opposition	Boris Johnson – Former Mayor of London Iain Duncan Smith – Conservative MP Priti Patel – Conservative MP Douglas Carswell – UKIP MP

SUMMARISING THE CASE

	Remain claims that:	Leave claims that:
Economy	If the UK negotiates a bilateral trade agreement, central estimates predict each British household will be worse off by £4,300 a year per household if the UK leaves the EU. UK GDP would be 6.2% lower outside the EU after 15 years, compared with its size if it stayed in the EU. [6]	If a Free Trade Agreement is reached, and ambitious deregulation is achieved, the UK would generate 1.6% more GDP by 2030 if it left the EU in a best case scenario. [7]
Trade	The trade relationship with the EU is worth over £400bn a year. It is possible that the UK faces the EU Common External Tariff if it leaves the EU under a WTO. [8]	The percentage of UK firms that export to the EU is 6%. The EU market has been declining over the last decade for UK exporters. [10]
Immigration	Immigration has a net positive effect on the UK economy.	"EU membership stops us controlling who comes into our country, on what terms, and who can be removed." [10]
Jobs	There will be an estimated 3 – 4 million job losses if there is a vote to leave. Ongoing development of the single market could lead to an additional 790,000 jobs by 2030. [9]	The economy will grow as a result of the UK negotiating a new trade agreement with the EU. This will create more jobs for the UK. [10]
Influence	The UK needs to stay in the EU to remain involved and influence decisions in Brussels. The UK is an independent nation within Europe. [9]	The UK's membership in major international bodies such as the UN Security Council and NATO is of more impotance than the UK's membership of the EU.
Security	The UK is safer as a member of the European Union. Working with other countries in the EU ensures consistent and coordinated decisions on the security of the Union. The European Arrest Warrant aids the collaboration of security across the EU. [9]	The "free movement of people" provisions of the EU treaties, makes sensible immigration policy "impossible" and "it makes it much harder to fight terrorism and deal with criminals." [10]

Source:
6 HM Government, HM Treasury Analysis: The long-term economic impact of EU membership and the alternatives
7 Open Europe, What if there were a Brexit
8 Centre for European Reform, The Great British trade-off The impact of leaving the EU on the UK's trade and investment
9 Stronger in Europe, Why Britain is Stronger in Europe
10 Vote Leave, Briefing Room

5. WHAT HAPPENS IF BRITAIN VOTES TO LEAVE ON 23rd JUNE?

TIMELINE PRE REFERENDUM

20th February 2016: Prime Minister David Cameron announces the Referendum date.

22nd February 2016: Ministers debate the deal David Cameron has reached in Brussels and the choice facing the British people.

15th April 2016: official campaign period begins and the official Remain/Leave campaigns will be chosen.

23rd June 2016: Referendum day

TIMELINE POST REFERENDUM

If the UK votes to leave the EU in the Referendum on the 23rd June, the Prime Minister is required to invoke article 50 of the EU treaty to commence negotiations for withdrawal.

Once notice of withdrawal has been sent to the European Council, negotiations can take place on the terms of the UK's exit from the EU. The initial period for negotiation is two years although this may be extended. During this two year period the UK may still legally be a Member State of the EU. There is a possibility that negotiations are finalised before the end of two years, in which case, the UK could finalise the withdrawal.

If there is no agreement to extend the two year period, and after two years an agreement has not been finalised, the UK will cease to be a Member State with no finalised terms of withdrawal. However, there is no time limit to the negotiation period providing an extension is agreed. It is expected that the process could take several years to complete.

THE PROCESS FOR LEAVING THE EU

Any Member State can decide to leave the EU. The terms of withdrawing from the EU are set out in article 50 of the Lisbon Treaty. This is the only method of achieving lawful withdrawal from the EU under the treaty, although *in extremis*, the UK parliament could simply repeal the treaty.

To leave the EU, the Member State must notify the European Council. Upon receipt of the intention of a Member State to begin withdrawal, the European Council could then begin to negotiate the terms of exit for the outgoing Member State.

A withdrawal agreement could include rules to apply to existing situations, whilst new rules are negotiated and implemented. However, ongoing EU decision and policy making would continue to apply while the UK negotiated its terms of exit. The UK may have to adhere to EU rules until the day it exited.

The two year period of negotiation can be extended by the European Council if in agreement with the Member State.

In terms of the transition for UK legislation, EU law would still apply until the day of exit, however legislative bodies in the UK may have to decide case by case what the exit negotiations mean for UK law. [11]

WHO WOULD NEGOTIATE ON BRITAIN'S BEHALF?

David Cameron faces political pressure if the UK votes to leave. However, he has publicly said he will stay on as Prime Minister if he loses the EU Referendum.

If David Cameron were to resign, potential Conservative party candidates have been suggested such as Boris Johnson, Theresa May, or George Osborne. This is inevitably speculative – the key point to note is that a vote to exit would have major ramifications for the UK Government, and the continuity of the Government's existing leadership before the Referendum should not be assumed afterwards.

HOW LONG WOULD THE NEGOTIATION TAKE?

The short answer is, we don't know.

However, as noted above, the UK would likely remain a member of the EU for two years after a Leave vote. Negotiations could be concluded within this period but this is not a certainty.

We have few available reference points from which to assess how long the negotiation may take: no other major European nation has been through this process before. One possible proxy, however, is the trade negotiations which the EU has in train with other non-EU states (though the circumstances in this instance are rather different).

Source: 11 HM Government, The process for withdrawing from the European Union

6. ECONOMIC IMPLICATIONS OF A VOTE TO LEAVE

In the short-term, a vote to leave is likely to cause economic uncertainty and potential volatility.

In the longer term the economic costs and/or benefits are inherently uncertain. They depend both on the exact form of the UK's new relationship with the EU and also the domestic political appetite to exploit the new found freedom to deregulate and pursue trade deals with third party countries. Surveying the literature shows that most studies find a small long term impact on the economy – between +2% of GDP and -2% of GDP – only slightly bigger than typical forecast errors.

There is a wide range of views about the long term impact of a vote to leave [12], although most studies show narrow GDP impact (+/- 2%). [13]

Most longer-term studies suffer from a degree of imbalance by not looking at all offsetting benefits and costs.

TYPICAL ASSUMPTIONS OF THOSE FAVOURING LEAVE

Quick agreement is reached of a free trade agreement with the EU, tariffs are inconsequential and ignores costly 'proof of origin' rules for FTAs.

The UK retains free movement of people, and foreign direct investment is of little benefit.

Deregulation opportunity is significant, with large benefits, despite little evidence being presented.

Little or no benefit from existing EU regulation.

Assume little impact on the City, and consequent impact on the wider economy.

TYPICAL ASSUMPTIONS OF THOSE FAVOURING REMAIN

Large opportunity cost of missing out on future benefits of increased EU market integration, even though they are uncertain.

Little benefit to be gained from deregulation outside the EU, despite little evidence presented.

Tariff and non-tariff barriers will be significant constraints on UK-EU trade.

Future foreign direct investment at significant risk, which has been a large benefit to UK productivity and growth.

12 Individual summaries of the key studies of the longer term impact of the EU Referendum outcome are available in the appendix.

13 The largest estimated negative impact of EU membership (5% of GDP) is from a UKIP study. At the other extreme, one 2014 academic study suggests that the UK economy is 24% bigger than it would have been had we remained outside the EU since 1973, but this isn't the likely cost of leaving the EU since many of the accrued benefits would remain.

There are a wide range of views about the long term impact of a vote to leave, although most studies show fairly small GDP impact (+/- 2%)

STUDY	LEAVE GDP impact	Aspects considered:						
		Counter-factual	Short term uncertainty	Trade	Migration	Fiscal	Regulation	Investment
Institute for Study of Labour (2014)	**-24%**	Yes	No	Yes	Yes	Yes	Yes	Yes
CBI / PWC (2016) ▪ FTA ▪ WTO	 **-1.2% by 2030** **-3.5% by 2030**	Yes	Yes	Yes	Yes	Yes	Yes	Yes
CEP / LSE (2016) ▪ Optimistic (EEA – Norway model) ▪ Pessimistic (WTO)	 **-1.1%** **-3.1%**	Yes	No	Yes	Yes	Yes	Yes	Yes
NIESR (2004) ▪ No EU FTA; trade barriers only ▪ No EU FTA; trade and investment barriers	 **-0.5%** **-2.25%**	Yes	No	Yes	Yes	Yes	Yes	Yes
Institute of Economic Affairs, IEA (2001)	**-1%**	No	No	Yes	Yes	Yes	Yes	Yes
Oxford Economics (2016) ▪ 9 scenarios based on trade and politics	**-0.1% to -4% by 2030**	Yes	No	Yes	Yes	Yes	Yes	Yes
IEA: BREXIT prize winner (2014) ▪ EU FTA; 3rd country FTAs ▪ EU FTA; no 3rd country FTAs	 **+1.1%** **-2.6%**	No	No	Yes	No	Yes	Yes	Yes
Open Europe (2015) ▪ FTA aggressive de-regulation/trade ▪ FTA non aggressive de-regulation/trade	 **+1.6% by 2030** **-2.2% by 2030**	No	No	Yes	No	Yes	Yes	No
Patrick Minford / Cardiff University (2015)	**+4.1%**	Yes	No	Yes	No	Yes	Yes	No
Civitas (2004)	**+3-5% p.a**	No	No	No	No	Yes	Yes	No

Increasing benefits / reducing costs of EU exit

7. IF THE UK WERE TO LEAVE THE EU, WHAT ARE THE ALTERNATIVE MODELS?

No member state has ever left the EU. For this reason a 'Brexit' is an unknown, the nature of which cannot be predicted accurately. Law firms, economists and political commentators commonly refer to a framework, similar to what we have reproduced below, which looks at other possible scenarios, with trade agreement being the key driver which in turn defines the degree of harmonisation, or separation, between a non-EU member state, and the EU.

Predictably, there is much debate about which outcome is most likely: several of these scenarios align well to the aims of the 'Leave' campaigns, but each involves trade-offs. Fundamentally, any negotiation involves two parties, and it is unclear what terms the EU would accept in the event that Britain decides to leave.

POSSIBLE ALTERNATIVE MODELS: increasing degrees of separation from the status quo

		1. Status Quo – EU membership	2. EEA (e.g. Norway)	3. Bilateral agreements with Non-EEA nations (e.g. Switzerland)	4. Free Trade Agreement (e.g. South Africa)	5. Customs union (e.g. Turkey)	6. World Trade Organisation: Most Favoured Nation status (e.g. Australia)
Trade with EU	Freedom from external tarriffs?	Yes	Yes	Dependent on nature of the agreement (but central premise is no tarriffs)	Partial	No	EU's Common External Tarriff and substantial non-tarriff barriers
	Full access to the single market	Yes	Yes	No guarantee of full access. Swiss precedent is free trade on goods but restrictions on exports of services	No – FTA on goods but not services	No	No
Trade with Non-EU states and trade blocs	Ability to negotiate trade agreements with other non-EU nations	No	No	Yes	Yes	No	Yes
EU legislative and regulatory compliance		Full compliance required, but ability to vote on legislation	Full compliance required, but reduced ability to influence development of legislation	Uncertain, but regulatory 'level playing field' likely to be required in order to access to the free market	Yes, theoretically, but regulations must be consistent with EU to access single market	No, regulations must be consistent with EU norms or membership suspended	No – full independence
Autonomy over border controls		Free right of passage for citizens within Schengen area		Uncertain	Yes	Yes	Yes
Receipt of Common Agricultural Policy subsidies		Yes	No	No	No	No	No
Contribution to EU fiscal budget		Yes – full	Reduced contribution (83% of the full rate)	Reduced contribution e.g. Switzerland is 52% contribution of the full rate	No	No	No

8. WHAT WOULD BE THE IMPLICATIONS FOR THE UK LEGAL AND REGULATORY FRAMEWORK?

Law firms have been sharing impact analysis, thought leadership and contingency planning material on the Referendum. Links are provided to much of this analysis in section eleven of this paper. We have provided a brief summary of some of the key findings from the legal material which may prove useful (though does not constitute, and is no substitute for, formal advice from qualified legal advisors).

LEGISLATION

Three main types of legislation operate in the EU: Treaties, Regulations, and Directives.

EU Treaties are binding agreements between EU Member States. These would no longer apply if the UK was no longer a member.

Regulations are binding legal instruments which are applied directly across all EU member states. Existing Regulations may no longer apply in the UK unless specific legislation is adopted in the UK to maintain them.

Directives do not automatically pass into UK legislation, they need to be transcribed into national law by the respective parliament. In the event of a vote to leave, the domestic legislation passed as a result of Directives would continue to apply.

Case Law: In the event of a vote to leave, the UK may no longer be under obligation to apply EU jurisprudence. Even if the UK retained some EU legislation following exit negotiations, there is a possibility that the UK may not be bound by the EU Courts of Justice. However, the UK Parliament has an option to pass legislation that ensures all existing EU legislation is in effect until each piece of legislation is amended or repealed for the UK.

Intellectual Property (IP): IP laws have historically been mainly driven by the EU. In the event of a vote to leave, any EU IP law or rights may cease to apply in the UK. Any UK only rights or laws may still continue to apply.

Data Protection: The main piece of legislation governing UK data protection law is the EU 1995 Data Protection Directive. As it is a directive, a corresponding item of legislation was passed by the UK Parliament, the 1998 Data Protection Act. If the UK ceased to be a part of the EEA, there may be restrictions on passing personal data from the EEA to the UK.

Employment Law: UK employment law is derived in a large part from EU legislation. There are areas of UK employment law that could be affected such as protection from discrimination, law on gender equality, maternity leave, and minimum paid annual leave. The free movement principle has led to EU migrants living and working in the UK. It is unclear what will happen to these workers in the event of a vote to leave, and may be subject to the negotiations that take place.

Environmental Law: In total, there are over 300 EU acts on the environment such as waste, are conservation of flora and fauna, pollution, water, noise control, and energy. The effect of a vote to leave on environmental law is unclear.

9. POSSIBLE IMPLICATIONS FOR EU LAWS AND REGULATIONS

The applicability of EU law and regulation in the event of a vote to LEAVE is dependent on whether it derives from Treaties, Regulations, Case Law or Directives.

During any transition period (2 – 10 years under the scenarios below), the UK remains part of the EU, hence the current regulatory regime applies. But there is uncertainty around new regulatory initiatives in the pipeline, given potentially limited UK Government appetite for implementation.

Under the EEA, there is no expected material change in both financial and non-financial regulation, given the need for the UK to adhere to Single Market rules under an EEA agreement. The UK would have no direct influence over formulating /designing the rules going forward. [14]

Under an FTA the regulatory void would need to be filled; beyond that only limited regulatory changes expected given the UK's stance on financial regulation.

Status Quo	EEA		FTA
Treaties (both EU treaties and where the EU is a signatory, e.g. trade agreements).	Only EFTA free trade agreements apply.	Other treaties cease to apply.	Treaties cease to apply.
EU Regulations.	Regulations under the EEA Agreement still apply.	Regulations not under the EEA Agreement cease to apply.	Regulations cease to be part of UK law, unless specifically transposed and any associated guidance ceases to apply.
Case law of the Court of Justice of the EU (CJEU).	Case law of EFTA Court replaces that of CJEU, but it is largely aligned. CJEU case law applies so far as it has been implemented by the UK courts (but can now be overridden by UK courts and parliament).		Assumption that CJEU case law applies so far as it has been implemented by UK courts (but can now be overridden by UK courts and parliament).
EU Directives transposed into UK law.	Required to retain Directives that apply under EEA Agreement.		Directives continue to apply unless repealed but associated guidance ceases to apply.

14 The EEA Agreement sets out policy areas where EU legislation applies to EEA member states, notably all policy areas for the Single Market (including the "four freedoms", consumer protection and company law). Policy areas not covered include customs union, common trade policy, common foreign and security policy, direct and indirect taxation, economic and monetary union.

FILLING THE VOID

Current EU Directives are already transposed into UK law, but EU Regulations and guidance (which today have direct effect) would need to be implemented into UK law where it is the intention of the UK Government that they should remain in place. There could be concern around the capacity of the UK authorities to address the void left by EU Regulations swiftly given the scale of the challenge.

UK APPROACH TO CHANGES

The UK would enjoy a degree of flexibility that it does not currently have, but limited changes [15] to the UK regulatory regime could be expected as part of this process because:

1. The UK would continue to seek alignment to the Financial Stability Board (FSB) principles and guidance, with direction set by the G20 (UK is active in both fora).

2. Not unreasonable to expect continued preference of UK authorities for super-equivalence (or 'gold-plating') of rules, based on past practice.

3. Access to the Single Market from a customer, payments/settlements and funding perspective would hinge on a European Commission assessment of the UK regime's 'equivalence' to EU rules – so alignment to EU rules would be required in areas where this is considered advantageous, but there may be other areas where the UK chooses to adopt a different approach.

10. NEXT STEPS

Lloyds Bank is committed to supporting clients, and is happy to engage on these topics as far as we are able, subject to our commitment to remain impartial in the debate. For more information, please contact your relationship manager.

Source: 15 Based on: HM Treasury submission to the EU in February 2016

11. SOURCES OF FURTHER INFORMATION

We have compiled this bibliography through a combination of desk research and engagement with some of the organisations below. Much of this material has been useful to Lloyds Banking Group, as we have explored the implications of the EU Referendum for our business, and we believe it may help you and your firm also. As far as possible, we have tried to present an objective balance representing the full spectrum of opinions, though the bibliography is brief on formally partisan materials for obvious reasons. The views expressed in the material below are those of the authors only – and are included here for ease of reference only, and the Group does not endorse the views of any third parties

Author entity	Author category	Title / Link	Pages	Category	Date published
AFME	Trade Body	The UK Referendum – Challenges for Europe's Capital Markets: A legal and regulatory assessment	68	Impact Analysis	Mar – 16
Ashurst	Law Firm	Brexit: potential impact on the UK's banking industry	40	Impact Analysis	–
Ashurst	Law Firm	Brexit	28	Impact Analysis	–
Bank of England	Bank	EU Membership and the Bank of England	100	Impact Analysis	Oct – 15
BBA	Trade Body	UK banking sector believes Brexit would have "negative impact" on their business	Web Page	Poll	Mar – 16
Bertelsmann Foundation	Consulting Firm	The Impact of Brexit	16	Impact Analysis	Jan – 16
Bertelsmann Foundation	Consulting Firm	Brexit – potential economic consequences if the UK exits the EU	8	Impact Analysis	May – 15
Berwin Leighton Paisner	Law Firm	Brexit: A Practical Guide to the Potential Legal Implications	7	Impact Analysis	Feb – 16
Bloomberg	Other	Brexit Special	14	Impact Analysis	Feb – 16
British Chambers of Commerce (BCC)	Trade Body	BCC: Businesses want to be in the EU, but a reformed EU	1	Poll	Mar – 15
Canaccord	Financial Services	Six Investment Market Drivers for 2016 #5 – Brexit – UK market nightmare?	4	Thought Leadership	Jan – 16
Cardiff Business School	Academic Institution	Evaluating European Trading Arrangements	21	Thought Leadership	Nov – 15
CBI	Trade Body	EU Referendum Member Information Pack: How to prepare your organisation for the EU Referendum	36	Contingency Planning	Feb – 16
CBI	Trade Body	Choosing Our Future	17	Thought Leadership	2015
CBI (PWC written)	Trade Body	Leaving the EU: Implications for the UK Economy	79	Impact Analysis	Mar – 16

Author entity	Author category	Title / Link	Pages	Category	Date published
CCAB	Trade Body	Business in Europe: Researching Reforms for Sustainable Growth	47	Thought Leadership	Jan – 16
Centre for European Reform	Think Tank	If the UK votes to leave: The seven alternatives to EU membership	14	Contingency Planning	Jan – 16
CEP (LSE)	Academic Institution	The Consequences of Brexit for UK Trade and Living Standards	15	Impact Analysis	Mar – 16
CEP (LSE)	Academic Institution	Should We Stay or Should We Go? The economic consequences of leaving the EU	10	Impact Analysis	Mar – 15
Civitas	Trade Body	A Cost Too Far?	97	Thought Leadership	Jul – 04
Credit Agricole	Bank	UK 2016 will be dominated by Brexit	6	Impact Analysis	Jan – 16
CSFI	Trade Body	The City and Brexit	36	Poll	Apr – 15
Deloitte CFO Survey	Consulting Firm	The Deloitte CFO Survey	8	Poll	Sep – 15
Deutsche Bank	Bank	The UK & EU: Exit Emergency	41	Impact Analysis	Feb – 16
EEF	Trade Body	Six in ten EEF members want the UK to remain in the EU – just 5% support a 'Brexit'	Web Page	Poll	Feb – 16
Elsevier	Other	The macroeconomic impact of UK withdrawal from the EU	22	Impact Analysis	Jan – 04
Freshfields Bruckhaus Deringer	Law Firm	Britain and the EU – questions for your business	6	Contingency Planning	–
Freshfields Bruckhaus Deringer	Law Firm	Your Real Estate	3	Contingency Planning	–
Freshfields Bruckhaus Deringer	Law Firm	Effects on European and UK Energy Regulation	3	Impact Analysis	–
FSB (Federation of Small Business)	Trade Body	A study of FSB member's views of the UK's membership of the European Union	67	Poll	Sep – 15
Global Counsel	Consulting Firm	BREXIT: the impact on the UK and the EU	43	Impact Analysis	Jun – 15
Grant Thornton	Consulting Firm	How would a Brexit impact UK business?	Web Page	Impact Analysis	Jul – 15
Haggie Partners	Consulting Firm	Lloyd's Market Future 2016	11	Impact Analysis	Mar – 16

Author entity	Author category	Title / Link	Pages	Category	Date published
Herbert Smith Freehills	Law Firm	Brexit: Sector by sector	Web Page	Contingency Planning	Feb – 16
Herbert Smith Freehills	Law Firm	Brexit: A possible UK exit from the EU	22	Impact Analysis	Feb – 16
HM Government	Other	Alternatives to membership: Possible models for the United Kingdom outside the European Union	54	Contingency planning	Mar – 16
HM Government	Other	The best of both worlds: the United Kingdom's special status in a reformed European Union	45	Political / Lobbying	Feb – 16
House of Commons	Other	In brief: UK-EU economic relations	14	Other	Jan – 16
House of Lords EU Committee	Other	The Referendum on UK Membership of the EU: Assessing the Reform Process	31	Thought Leadership	Jul – 15
ICAS	Financial Services	The UK and the EU	10	Impact Analysis	Nov – 15
ICMA	Trade Body	Brexit: Practical implications for Capital Markets	6	Contingency Planning	Feb – 16
IEA	Trade Body	Britain Outside the European Union	140	Impact Analysis	Jan – 16
IEA	Trade Body	Better Off Out? The benefits or costs of EU membership	136	Impact Analysis	Jan – 01
IEA	Trade Body	A Blueprint for Britain: Openess not Isolation	69	Thought Leadership	Apr – 14
ING	Financial Services	The shock from Brexit	24	Impact Analysis	Jan – 16
Institute of Directors (IoD)	Trade Body	The UK's relationship with the European Union	26	Thought Leadership	2015
Invesco	Financial Services	Brexit – the pros and cons	6	Impact Analysis	Jul – 15
Ipsos Mori Captains of Industry survey	Trade Body	Key Influencer Tracking	6	Poll	–
IZA	Other	Economic Growth and Political Integration: Estimating the Benefits from Membership in the European Union	40	Impact Analysis	Apr – 14
Linklaters	Law Firm	In or out? Ready or not? The United Kingdom EU Referendum	4	Impact Analysis	Jun – 15

Author entity	Author category	Title / Link	Pages	Category	Date published
LSE	Academic Institution	Submission of evidence for inquiry in the costs and benefits of EU membership for the UK's role in the world, for the House of Commons Foreign Affairs Committee.	6	Impact Analysis	Oct – 15
Macfarlanes	Law Firm	Post-Brexit regulatory landscape – Radical departure or business as usual	4	Contingency Planning	Mar – 16
Norton Rose	Law Firm	Brexit: What are the potential consequences of a UK exit from the European Union	8	Contingency Planning	Nov – 15
Open Europe	Think Tank	What if...? The Consequences, challenges & opportunities facing Britain outside EU	116	Thought Leadership	Jan – 15
Oxford Economics	Academic Institution	Assessing the Implications of Brexit	5	Impact Analysis	Mar – 16
PLC	Law Firm	The Future of Britain in Europe	6	Impact Analysis	Jun – 15
Rathbones	Financial Services	If you leave me now: exploring the implications of Brexit for the UK economy and markets	32	Thought Leadership	Feb – 16
Rothschild	Financial Services	Market Perspective – Cyclical and secular risks – Brexit and UK Markets	12	Impact Analysis	Jan – 16
Shearman & Sterling LLP	Law Firm	Brexit: Options for and Impact of the possible alternatives to EU membership.	15	Impact Analysis	Mar – 16
Sheppard & Wedderburn	Law Firm	Brexit Analysis Bulletin	8	Impact Analysis	Feb – 16
Squire Patton Boggs	Law Firm	Brexit – What you need to know	3	Impact Analysis	Feb – 16
The City UK	Financial Services	EU Reform	36	Contingency Planning	Jun – 15
The Economist	Other	The reluctant European	23	Thought Leadership	Oct – 15
The Law Society	Law Firm	The EU and the Legal Sector	96	Thought Leadership	Oct – 15
The Law Society	Law Firm	The UK Legal Services Sector and the EU	16	Thought Leadership	Sep – 15
University of Cambridge	Academic Institution	Britain & Europe: The Political and Economic Repercussions of the Crisis	6	Impact Analysis	Jun – 15
Woodford Investment Management	Financial Services	The Economic Impact of Brexit	34	Impact Analysis	2015
YouGov for Easyjet	Other	Britain's small businesses unfazed by threat of Brexit	Web Page	Thought Leadership	Nov – 15

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