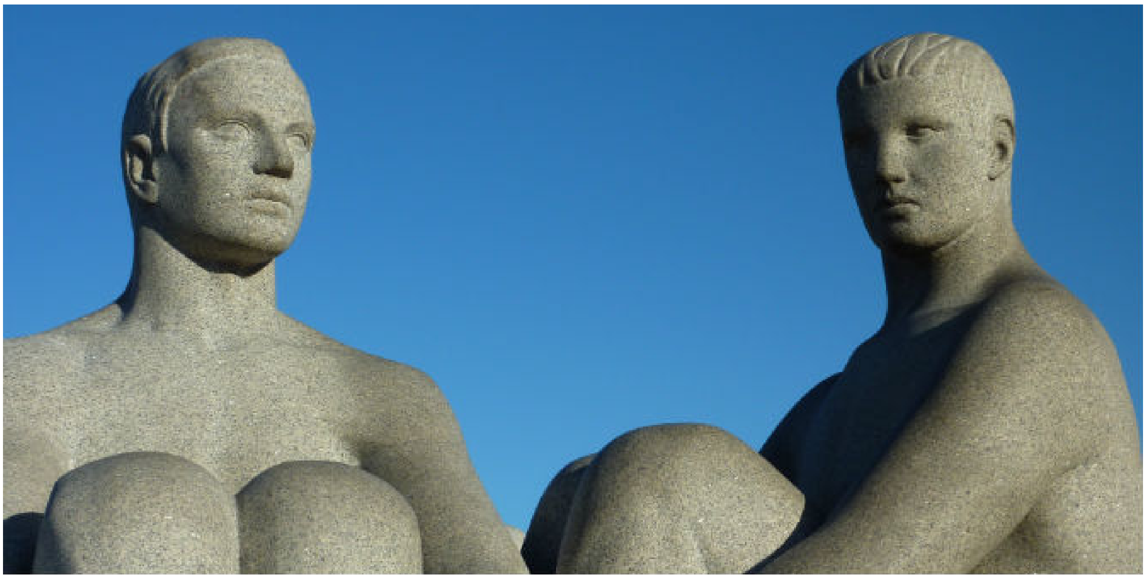
Why won't the UK get a good Brexit deal on financial services? One word: Norway

When it comes to financial services, the UK will not be able to negotiate better access than Norway currently enjoys, writes ***Morten Kinander (Norwegian Business School)****. It is simply not in the EU's interest to create a parallel equivalence regime for Britain. That is why the 'Norway' (EEA) model should not be ruled out. Claims that it would turn the UK into a 'rule-taker rather than a rule-maker' are an oversimplification.*

As seems to become clearer as time passes, there might not be too many alternatives for the UK's financial sector if the UK wishes to gain access to the single market post-Brexit. In fact, the EU recently rejected many of the solutions that the UK still clings to when it finally granted Norway permanent access to the markets. Judging from that experience, the EEA solution presents itself as the least unrealistic of the UK's options.

There has been considerable debate concerning the choice of model for the UK's access to the EU's financial markets after Brexit. Depending on whether it ends up being a hard or a soft Brexit, the choice is basically between two models, if the UK wishes continued access to the EU's financial markets: 'equivalence' or 'passporting'. While the first rides on the back of the hard line, the second requires a soft Brexit with EEA membership. Hard Brexit necessitates some form of a bespoke arrangement, while a soft one is an 'off-the-rack' solution with fittings. Equivalence means that you get access based on having the same kind of rules, while passporting means that you get a licence due to being subjected to the same regulator and supervisor. The first is a shaky privilege; the second is a long-standing right. This we all know. The problem lies elsewhere, namely, achieving predictable access without secession of sovereignty. And this is where the EU probably will not give in – simply because it cannot give in.



Sculpture by Gustav Vigeland at the Vigelandsanlegget, Frogner-Parken, Oslo. Photo: Truus, Bob & Jan too! via a CC-BY-NC 2.0 licence

There are really no existing financial industries that rely on equivalence. Granted, it is used, by US clearing houses for example, but only in a piecemeal fashion, and to the extent that specific rules allow for it. To turn this model into a working, permanent arrangement would require granting special status to the UK with increased rights compared to those granted to EU Member States. Crucially, it also requires the EU to change its mind, after recently having rejected a similar proposal from Norway (an EEA State), which, for both constitutional and political reasons, had problems in accepting that an organisation that they are not a member of can have supervisory powers in its jurisdiction. Sounds familiar?

In fact, the 2016 negotiations between Norway and the EU, which led to the erection of a model that might also work for the UK, throw a gloomy light on the prospects of an equivalence model for the UK. I say this in full recognition of the immense difference in bargaining power between Norway and the UK. But a large part of the reason why the prospects for such a solution for the UK are so grim has little to do with bargaining power: access to the EU's financial markets is a matter of law, not of politics. It is a question of fitting into an established legal structure that has recently been the subject of a serious overhaul of its regulatory architecture after the financial crisis. It is, in other words, a matter of constitutional rule of law thinking, as opposed to political desirability. And here the overhaul is important. The overhaul partly took the form of tighter regulation. But, more importantly, it consisted of a new model for the EU's supervision of the financial markets: a supervision of the supervisors, bearing the acronyms of EBA, ESMA, EIOPA, and ESRB (the ESAs). After 2010, the EU has, for better or for worse, designed a system that is exactly meant to prevent differentiation according to market size, with the overall message being 'ever closer integration'. In such a setting, divergence equals disintegration.

Before 2010, Norway had full access to all the relevant arenas of policy and regulation in the EU simply by virtue of its EEA membership. From 2010 onwards, following the introduction of the new supervisory architecture, with four important EU Regulations endowing the new supervisory system with more potent supranational powers, the tone changed; Norway was relegated to observer status, pending the solution to the passport issue, after requests of 'equivalence' were rejected. Norway either had to change its constitution to allow an organisation that it was not a member of to exercise control over it, or to come up with a different solution. Getting the passport depended now not only on being an EEA member, but also on accepting direct supervision by the ESAs on specifically designated areas and/or specifically defined emergency times.

The solution that was adopted builds on and expands the existing 'two-pillar system' to accommodate the new regulatory and supervisory aspect of the EU institutions, and it might even work for the UK. It operates on the assumption that, when necessary, the EU's supervisory authorities will make a rule or take a decision that will then be copied by the EFTA authorities, and made into EEA law, replacing only the name of the institutions in the provisions with the relevant EEA institution. To illustrate, if ESMA, the EU supervisory authority of securities markets, decides that the Norwegian financial regulator is failing in its duties to oversee the Norwegian market, ESMA can issue a draft decision to make it do certain things, to remedy the perceived defects. This draft will be sent to the EFTA Surveillance Authority, which, although being under no legal duty to do so, issues a corresponding, binding decision over the Norwegian financial regulator. And *voilà*, ESMA's view becomes Norwegian law. This element of non-obligation on the part of the EFTA is important, because if bound, the EFTA States would not have been constitutionally able to accept the arrangement. As it stands, it is an expression of a political will to honour the arrangement, and not a legal obligation.

As such, Norway not only gets its much-needed passports and secure access to the financial markets, it also retrieves what it lost, namely full participation in all relevant meetings where policy issues and regulation development are hammered out. This includes not only participation in the boards of the ESAs, but, crucially, in the hundreds of meetings each year where policy is hammered out and regulations drafted. Solving the constitutional issue was therefore regarded as vitally important in two respects: firstly, for the purpose of achieving passporting rights; and secondly for the attendance in these meetings. Without such attendance, influence in the drafting process would be lost, together with an understanding of why new financial regulation is being made, and how it is thought to be applied in the individual states. It will not take long for the UK to diverge from an established and unified supervisory practice without access to the background of new financial regulation by the ESAs, or to the dialogue among the national regulators as to how to apply it.

In these settings, Norway is taken seriously well beyond its weight class when it comes to areas where it has special knowledge, for example within the area of commodity derivatives. According to government officials who participate in these meetings, the discussions are based on merit, with EU technocrats being first and foremost interested in drawing the most expedient form of regulation. In other words, if you are a heavyweight in such circumstances, power comes even more generously – even without voting rights. With its stellar market knowledge, the UK could, therefore, expect to exert considerable influence in these forums, and should be careful about ditching the EEA alternative. At least, it will retain its constitutional independence, and will not be bound by the European Court of Justice. It will not even be bound by the EFTA Court, whose decisions are advisory. Commentators and political pundits alike should therefore avoid simplistic 'rule-taker, not rule-maker' talk.

This post originally appeared at the Oxford Business Law Blog. It represents the views of the author and not those of the Brexit blog, nor the LSE.

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