July 2016

CLIENT BRIEFING

BREXIT: WHAT DIRECTORS SHOULD KNOW
NAVIGATING THE UNCERTAINTY OF THE UK'S "BREXIT"

WHAT WILL THE HISTORIC BREXIT VOTE MEAN FOR BUSINESSES AND INDIVIDUALS?

While the UK's vote on 23 June 2016 to leave the European Union sent shockwaves around the world, the long-term implications are yet to play out. How will the Brexit affect the markets and your company? How will the regulatory and risk environment change for organisations doing business in the UK, or with organisations operating there? Below we provide some insights on how you should be preparing your business and your workforce

Possible scenarios for EU membership alternatives

Prior to the referendum taking place, the UK Government issued a paper outlining the possible scenarios that could come to pass in terms of the future relationship between the UK and the EU.[1]

We briefly outline four possible scenarios below:

Scenario one: A tariff-free trade agreement is made between the UK and EU.

Under this scenario, the UK would have its own immigration policy and independent trade policy, as well as some access to the single market. It is believed this would have a moderate impact on the UK economy.

Scenario two: The UK becomes part of the European Economic Area (EEA).

This scenario is likely to have the lowest impact on the UK economy and trade, since EEA countries have access to the single market. EU regulations and directives would still apply in the UK, which would still contribute to the EU budget. However, it would not have an independent immigration policy.

Scenario three: The UK enters into a bilateral integration treaty with the EU.

In this scenario, the UK would enter into an agreement with the EU that is similar to agreements between Switzerland and the EU.

This would likely have a moderate impact on the UK economy, trade, and immigration.The UK would likely have some access to the single market, but no bilateral agreements providing full access of service.

Scenario four: The UK makes no access agreements and trades with the EU as a third country.

If no trade agreements are reached and only World Trade Organisation terms apply, the UK would trade with the EU in a similar way to countries like the US. This scenario would likely have the highest impact on the UK economy and the lowest possibility that the UK would be able to trade under the single market. The UK's immigration policy would also become independent.

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[1] *Alternatives to membership: possible models for the United Kingdom outside the European Union, HM Government, March, 2016, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504661/Alternatives_to_membership_possible_models_for_the_UK_outside_the_EU_Accessible.pdf*

WHAT DOES THIS MEAN FOR DIRECTORS OF NEW ZEALAND COMPANIES WITH EUROPEAN DEALINGS?

Corporate strategy imperatives: Location and regulation

Under the more likely scenarios (based on the aspirations declared by pro-Brexit politicians), global non-EU multinational companies and EU-headquartered firms with sizeable UK operations will need to rethink and possibly restructure their UK operations, given the likely additional cost and complexity associated with accessing EU markets. UK-headquartered firms with global operations, domestic firms and government bodies will all face tactical challenges, but will be less affected in the medium term. Some industries will be affected more than others, with the most significant impacts anticipated in financial services.

We remind you that if you are director of an offshore subsidiary, you remain subject to the company law and regulations of the country in which the subsidiary is incorporated. It is prudent to check whether the regulations of that foreign country prohibit non-admitted insurance and therefore requires insurance to be underwritten by a local carrier authorised to carry out business in that country. We recommend raising this issue with your broker. Global broking houses may be better equipped and positioned to handle cross-border risks.

Workforce dislocation: Market constraints, welfare and pensions

The concern about immigration that underpinned much of the vote for Brexit will most likely inspire changes to employment and labour market regulation. While the movement of key talent and human resources may be the key concern, there will also be consequences for compensation, benefits and pensions.

Negotiations will now determine the circumstances under which EU citizens will be able to enter and work in the UK and the conditions in which EU citizens already in the UK and UK citizens already in the EU, will be able to continue in their current roles. It is likely that some restrictions will be placed on EU workers within the UK labour market – in the order of two million people, who form a significant proportion of the retail, leisure and service sectors. New bilateral agreements may be required for those organisations offshoring from the UK into the EU and employment mobility constraints may influence decisions by non-UK multinational companies as to the viability of having their European headquarters in London.

If you have employees on employment contracts with your offshore subsidiary, we remind you that this triggers the employment law of that country. Certain regimes require compulsory workers compensation and this can be facilitated via an intermediary (broker), direct with the insurer, or direct with the state. We recommend seeking guidance on this from your broker.

Change in the legal and regulatory environments

After the UK leaves the EU, the Freedom of Service (FOS) Directive may no longer apply to the UK and therefore its access to the single market would have to be renegotiated during the transition period.

FOS is the right to provide business services on a cross-border basis within the EU. For insurance contracts, in particular, this means that a contract can be underwritten in an EU member country that is different from that in which the risk is located.

These contracts – which are commonly used by multinational companies as a means to secure locally admitted coverage in multiple EU countries – could be affected, depending on what the impending negotiations yield. In addition, the UK may no longer benefit from treaties between the EU and non-EU countries going forward, meaning that organisations could face new barriers when providing services outside of the EU. Also, UK judgements may no longer be enforceable in the rest of the EEA.

Your company may have a European subsidiary or joint venture that has insurance written on UK paper and is intended to apply to risks located in the wider EU, or vice versa. While we do not expect to see immediate changes to regulations, we recommend keeping alert as to the changes afoot, to ensure contractual requirements for lawful insurance are not inadvertently breached.

WHAT DOES THIS MEAN FOR THE WIDER CAPITAL MARKET?

While it is difficult to forecast with any certainty how these political events will develop and what the implications may be, we foresee the following on a one to three year outlook:

- Tough negotiating stance by the EU (UK's largest trading partner) and/or the prospect of a long, drawn out exit process will likely hamper investment activity and fuel further capital outflows out of the UK, hurting the growth prospects for the UK economy in the process.
- In a more pessimistic scenario, the uncertain political landscape may mean a sharp reduction in company capital expenditure levels, a tightening of bank lending conditions and a plunge in consumer confidence; the combination of which will act to stifle the UK economy to the extent that there is a painful recession. The risk would then be that both the political and economic negativity seen in the UK could extend out to other European countries and irretrievably dent the European project. This could be a trigger of a global recession.
- Financial market volatility is likely to continue, especially in the currency markets. Any unfavourable political developments may pose further downside risk for Sterling and potentially the Euro as well.
- Central bank policy across the world is expected to remain ultra-accommodative in a bid to further stabilise and support the global economy which has thus far seen only a tepid recovery. Rhetoric thus far focused on reassurances that central banks will act in a coordinated manner to provide liquidity to market participants as required.

FOR FURTHER INFORMATION

To find out more please contact your Marsh Client Executive.

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