BREXIT: WHAT NEXT FOR BOARDS?

03 August 2016 | London
Legal Briefings – By **Dorothy Livingston**, **Carol Shutkever** and **Gavin Williams**

Businesses need to plan for the post-Brexit world using the best intelligence they can access. This was first published in PLC Magazine, August 2016.

The UK's vote to leave the EU has caused a shock to the currency markets, ushered in a period of unprecedented political change and prompted myriad questions for businesses. Although the shape of new arrangements will not become clear for some time, businesses need to plan for the post-Brexit world using the best intelligence they can access.

There are some practical steps that all businesses will now need to consider. But there are also some specific concerns for particular sectors, such as the financial services industry and the manufacturing sector.

KNOWN UNKNOWNS

A key point to bear in mind is that much depends on what arrangements will eventually replace the UK's membership of the EU, and how the UK will adapt EU laws that are currently directly applicable, or implement EU law, in the UK. Happily, outside of consumer contracts, English contract law is largely unaffected by EU law, and property law is even less affected.

It appears to be the government's intention that, possibly in early 2017, the UK will serve notice to leave the EU under Article 50 of the Treaty on the European Union. In the normal course, this notice will expire two years after it is served. The shape of new arrangements could range from the close EEA relationship (Norway model), through various other forms of trade relationship, to the UK having no bilateral trade arrangements beyond the World Trade Organization (WTO) (see Briefing "*Britain's relationship with Europe: what might the future look like?*", www.practicallaw.com/5-623-5405). However, the WTO model would not provide direct market access for services businesses and would leave manufacturing and agricultural businesses facing trade barriers.

On leaving the EU, the UK would cease to benefit from existing EU trade agreements third countries. The EU has around 50 international trade agreements with third countries, which apply to the UK as an EU member state, with others currently under negotiation. So, in parallel with the EU negotiations, the UK will need to negotiate with the key jurisdictions outside the EU, to establish its future trading arrangements.

PRACTICAL STEPS TO ASSESS THE RISKS OF BREXIT

While there are many unknown factors around the UK's future relationship with the EU, and the trade deals that it could negotiate with other countries, there are still steps that businesses can, and should, take at this point.

Due diligence. The first step is a systematic assessment of business areas to highlight which parts of a business are particularly exposed to risks linked to Brexit. This could include: looking at the business conducted by subsidiaries located in the UK and in different continuing member states; considering reliance on continuing EU or UK market access or authorisation under EU or UK regulations; and examining supply chains that would potentially be affected by the re-emergence of tariffs and other trade barriers either with the EU or in other jurisdictions. Post-referendum economic changes, including the fall in value of sterling, will also need to be considered.

Businesses may also wish to review existing commercial agreements to check the extent to which their performance is reliant on particular EU legislation or a lack of trade barriers. Another important consideration will be the extent to which operations rely on staff who may lose their rights of free movement when the UK leaves the EU.

Analyse the results of due diligence. Boards should receive papers, summarising the outcome of the due diligence exercise, which identify the risks to the business and the variables that arise depending on the replacement regime, as well as identifying any business opportunities. Besides being a business planning tool, these papers will enable businesses to identify issues on which they should lobby governments, either directly or through trade associations, on points where their business could be significantly affected.

Mitigating risk. Boards will need to adopt and implement strategies to address the identified risks arising from Brexit; for example, lobbying the government on key areas of concern, opening new branches or subsidiaries in the EU or UK, or amending current corporate policies and processes. Businesses might also consider whether any existing and new contracts could be futureproofed in light of the uncertainty surrounding what alternative to EU membership will arise; for example by inserting rights of termination in the event of specific regulatory change or the imposition of tariffs.

Strategic review. Brexit-related considerations will need to be incorporated into long-term planning exercises. For example, strategies for countries that have a free trade agreement with the EU may be affected by the UK no longer benefiting from that agreement and any potential benefits from new international trade agreements should be considered when more information is available.

Business projections. After considering the potential medium to long-term implications of changes emanating from a UK exit, and any potential economic impact, boards may wish to revise their business projections and financial forecasts.

Stakeholder engagement. Boards will need to maintain regular communication with staff, shareholders, customers and supply chains in order to keep them updated with any measures being taken in relation to Brexit. This may include setting up hotlines to allow staff to raise questions and discuss concerns, and collating questions and answers. Structural changes may require formal information and consultation processes to be undertaken with staff, employee representatives or trade unions before final decisions are made. These changes may also have knock-on effects in remaining member states that need to be taken into consideration.

Businesses may wish to encourage affected staff to take practical steps, for example, taking advantage of the potential for EU employees to register as UK citizens, and conversely for UK citizens to register as citizens of a remaining member state if they are eligible.

Risk factors may need to be noted in corporate financial reports and prospectuses and the Financial Reporting Council has issued helpful guidance on this for reports (see "*Listed companies and disclosures*" below).

THE FINANCIAL SERVICES INDUSTRY

Financial services is one of the areas that is subject to a very large amount of EU law and regulation. The following are some key areas where there will be an impact:

Market access. Currently, passporting allows UK authorised firms to carry on business in any EEA state provided that they meet the requirements of the relevant directive under which they carry out their activities. Post-Brexit, the UK might become an EEA member with continuing access to EU markets but without voting rights on financial services regulation, or the UK could be left with limited market access if it becomes a third country.

The effect on UK authorised firms of the UK becoming a third country would depend on the relevant EU market and legislation. For example, under the MiFID II Directive (2014/65/EU), member states can require third country businesses to have an authorised branch in the member state before being allowed to provide services to retail clients and certain professional clients there. Therefore, UK firms may need to set up branches in different member states. Access to other counterparties may not require a branch, but may be subject to a European Commission decision on equivalence, the outcome of which would depend on the degree to which the UK decides to replicate MiFID II provisions. Even if the UK closely mirrored the requirements, the EU's assessment process can be slow, and whether this could be fast-tracked would depend on the Brexit negotiations.

To keep full access to EU markets, some firms may need to set up subsidiaries in the EU (which comes with capital implications), and others may need to move parts of the firm's operations to the EU. EEA-based firms that currently use passporting to access UK markets would face similar issues.

Different rules apply in the insurance sector, which also has an equivalence regime that reduces the burdens on third country insurers and reinsurers trading within the EU.

Divergent regimes. The UK would need to decide to what extent it will replicate, reform or repeal existing EU financial services regulation. It seems likely that the UK would adopt the majority of current EU law, at least initially. If UK regulatory policy started to depart from EU policy, firms with cross-border interests might need to comply with two regulatory regimes, albeit that the UK could use Brexit to create a lighter touch regime.

THE MANUFACTURING SECTOR

The impact of Brexit on the manufacturing sector is also likely to be significant. There are several areas that manufacturers will need to consider.

Trade barriers and trade deals. Manufacturing businesses could be affected by the imposition of trade barriers should the UK leave the EU but not join the EEA. These barriers could include tariffs and quotas and also soft barriers to trade. In addition, they may lose current tariff-free trade deals with third countries that have trade agreements with the EU. Much will depend on what trade deal the UK is able to negotiate with the EU and with other countries. Some businesses could potentially benefit from the negotiation of more favourable trade deals within certain non-EU countries.

Product specifications. Businesses that rely on trade in products to and from the EU should monitor potential changes relating to EU product standards and the extent to which these would be retained by the UK. It is likely that EU market access as a third country business would depend on UK made products continuing to meet those specifications. Therefore, companies trading in the EU should be prepared to follow EU standards regardless of any relaxation of standards in the UK.

Workforce. UK manufacturers traditionally have a higher proportion of migrant workers in the unskilled or low-paid bracket, so businesses need to monitor negotiations regarding the status of EU migrants in the UK. Should the UK reach an agreement that excludes free movement of people, the UK might implement a form of points based system meaning that EU workers in unskilled roles may not all meet new entry requirements. Employers should keep EU employees informed of changes to their status and review the effect that restrictions on free movement could have on recruitment.

LISTED COMPANIES AND DISCLOSURES

On 12 July 2016, the Financial Reporting Council (FRC) published a statement about the need for boards to consider whether disclosures related to the Brexit vote are necessary in their annual and half-yearly reports (https://frc.org.uk/News-and-Events/FRC-Press/Press/2016/July/Reminders-for-half-yearly-and-annual-financial-rep.aspx).

The FRC says that in light of the referendum vote for the UK to leave the EU, and the consequential uncertainties in the political and economic environment, it has highlighted some matters for directors to consider when preparing their forthcoming half-yearly and annual financial reports. It says that boards must determine what disclosures, if any, are required to ensure that their financial statements, and management and strategic reports, meet the needs of investors and comply with regulatory requirements.

The FRC draws attention to the importance of high-quality narrative information that supplements the financial statements and includes the management's view of the future outlook of the business. In particular, the statement comments on the need to consider disclosures relating to: the business model; principal risks and uncertainties; market volatility; going concern basis of accounting; true and fair view; and for half yearly reports, important events that have occurred during the first six months of the financial year.

< BACK TO THE BREXIT HUB

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

DOROTHY

GAVIN WILLIAMS

LIVINGSTON
CONSULTANT,
LONDON
+44 20 7466 2061
Dorothy.Livingston@hsf.com

GLOBAL CO-HEAD OF
INFRASTRUCTURE,
LONDON
+44 20 7466 2153
gavin.williams@hsf.com

LEGAL NOTICE