The UK Referendum will take place on Thursday 23 June. A vote to exit the EU would result in market volatility and on-going uncertainty during the lengthy period in which exit arrangements are negotiated. Although it is not yet clear what form the UK’s post-Brexit relationship with the EU might take, many companies with a presence in the UK have begun contingency planning. In this note we cover the issues that corporates should be thinking about now, and assess the likely impact of Brexit on different aspects of business.

Identify which aspects of your business would be most affected by Brexit

Consider putting in place a team, reporting to senior management, to assess the potential impact of Brexit on your business, and including Brexit on the agenda of upcoming board meetings. Because of uncertainty over the post-Brexit regime, detailed long-term planning is not yet feasible. But knowing where the issues may lie would give you a head-start on planning as the picture became clearer, and inform your communication strategy. We have outlined some of the potential implications on the next page, grading their impact from high to low.

Your position on Brexit

Consider whether to take a stance on Brexit and, if you do, whether you will comment actively or just contribute your views to relevant industry bodies. If there is a vote to exit, you may also want to consider participating in initiatives to help shape the post-exit regime.

If you are not registered with the Electoral Commission as a ‘permitted participant’, UK election laws impose a £10,000 spending cap during the referendum period (beginning on 15 April) on activities that might support a vote one way or the other. The spending cap is £700,000 if registered. Where activities are carried out jointly, the combined expenditure of all parties is attributable to each party. Expenditure should be monitored – you will need to register if it is likely that you will exceed the £10,000 cap. It is a criminal offence for a company to incur more than £10,000 of relevant expenditure without registering, and for an individual to authorise that spending. The rules are detailed and you may need expert advice.

Employee communications

If there is a vote to leave the EU, employees based in the UK and elsewhere in Europe may be concerned about what Brexit means for them. Consider whether you will take a proactive or reactive approach to employee communication and whether it is appropriate for you to communicate relevant messages even before the vote takes place. It makes sense to prepare your communications in advance, working out what comfort you can give on operations, relocations and jobs, and deciding on the best channel of communication (eg email, intranet, video or face-to-face).

Other communications and media

Consider how you would respond to stakeholder enquiries or press coverage, and appointing a spokesperson and internal PR manager to run this process.

Annual report and AGM

Consider the timing of your next annual report and whether it may need to address Brexit, and the date of your next AGM. Are shareholders likely to ask questions about your stance on Brexit or about the impact on your business?

Exchange rate volatility

Uncertainty around Brexit is already impacting exchange rates. Sterling, and possibly euro, rates are likely to continue to be volatile in the run up to and immediately after a vote to exit, and may remain so during exit negotiations. Check your exposure to forex risks, including revenues, payment obligations, funding requirements and location of funds. For example, do you have significant unhedged dollar denominated debt but largely sterling revenues?
Implications for business

High impact

Imports and exports

Trade and single market access is a key element of the UK’s relationship with the EU – the EU takes almost half the UK’s exports. How this relationship is redefined following any vote to leave will be one of the main areas of focus, with future trading relationships dependent entirely on the nature of any agreements reached. In the medium-term this would result in significant uncertainty for UK businesses.

An EU/UK trade agreement may not overcome tariff barriers, and the other models proposed also have drawbacks. For example, a Norwegian model would require the UK to continue to observe many of the EU’s regulations, and a Swiss model would provide access to the single market for the UK’s goods, but not its services.

Brexit would also leave UK businesses without the benefit of the 53 free trade deals which the EU has obtained. While some of these agreements may be replicated bilaterally by the UK, this would undoubtedly take time. Whether the UK could obtain deals as favourable as those granted to the EU also remains highly uncertain.

In the short to medium-term, fluctuations in exchange rates may also impact UK trade.

EU funding

Businesses that benefit (directly or indirectly) from EU grants or subsidies, for example for research, may find that it is difficult to obtain funding for new projects following a vote to leave the EU. Transitional arrangements for ongoing projects would have to be agreed, and the UK would need to decide what it would continue to fund post-Brexit, at which point it would no longer be constrained by the EU state aid regime.

Employees

Depending on the post-Brexit model, it might become more difficult to recruit, retain or move employees from the UK to the EU and vice versa, which could give rise to skills gaps, an inability to service customers in relevant countries and a loss of talent. In the worst case scenario, UK nationals currently based in the EU, and EU nationals currently employed in the UK, could have to return to their home countries (potentially on short notice, although that is unlikely).

There may be an impact on EU-wide recognition of qualifications, which could present another barrier to staff mobility. This may extend beyond the EU if recognition of qualifications, or the ability to operate in particular countries, derives from free trade agreements entered into by the EU rather than the UK.

Brexit may also impact absolute staffing numbers if it affects customer demand for, or your ability to provide, your product or services. There is likely to be a need to look at existing agreements with works councils and other employee representative bodies if there is a significant change in the size of the workforce as a result of Brexit.

Tax

If the UK were to leave the EU, it would probably cease to be a part of the customs union. Exports between the UK and the EU would then need to go through customs procedures. However, we would hope that the UK and the EU would enter into a free trade agreement with no or very low customs duties.

Following Brexit, the UK would sit outside the territorial scope of EU VAT. It could therefore change how VAT is charged in the UK or even replace it with an entirely different tax. Over time there could be some divergence from EU VAT, although the risk of double taxation or double non-taxation may incentivise the UK to keep its VAT system materially aligned with the EU’s. The most tangible consequence of Brexit would likely be the imposition of ‘import’ VAT when goods enter the EU from the UK and vice versa. The VAT would often be recoverable, but there may be an unwelcome cash flow cost for the period between import and recovery.

EU directives prohibit withholding taxes on intra group interest, dividends and royalty payments made within the EU. Following Brexit, EU subsidiaries would not be able to rely on the directives to make these payments to their UK holding companies free from withholding taxes. Relief under bilateral double tax treaties would be an alternative, and in many cases would eliminate withholding taxes entirely.

At some point after Brexit we may see the UK reintroduce UK tax rules that have been held contrary to EU law. The 1.5% stamp duty charge on UK shares issued into clearing systems such as Euroclear, Clearstream and DTC is one example. The UK would also have more scope to adopt competitive tax regimes that would currently be contrary to state aid rules. Conversely, we may see anti-avoidance rules applying to arrangements with UK businesses that previously would have been exempt.

For the UK, Brexit would mean the retention of sovereignty over fiscal matters. For the rest of the EU, Brexit could accelerate the harmonisation of corporate income taxes. This would not necessarily be the case; other Member States are against further harmonisation. However, the loss of a large and influential opponent could be decisive.
Medium impact

Finance

For some borrowers or issuers, uncertainty around Brexit and resulting financial market volatility may impact the availability or cost of some types of finance. However, the impact on the loan market will probably be limited, at least in the short to medium-term, and relationship-driven lending is unlikely to be significantly affected. The impact may be greater in the bond market.

Those with businesses that will be adversely affected by Brexit may find their access to finance is reduced or their borrowing costs rise (through increased margins or coupons on new transactions or step-up provisions on existing ones). In the longer term, the availability or cost of finance could be affected by the regulatory landscape post-Brexit (eg through loss of the ability to ‘passport’ prospectuses, or changes in regulatory capital rules or their application). However, much will depend on the UK’s post-Brexit relationship with the EU.

Derivatives

Volatility in the financial markets may lead to exposures in existing derivatives positions. To the extent that counterparties are required to provide collateral to support their obligations under derivatives contracts in the form of UK-linked assets (eg UK gilts), a deterioration in the value of those assets could lead to increased margin calls under the relevant collateral arrangements. Whilst consideration could be given to the possibility and desirability of hedging against or otherwise mitigating any perceived risks, in reality, it is difficult to assess the precise impact of Brexit on the value of such assets ahead of time.

Pension schemes

Any pensions impact will vary depending on the structure of the scheme and the degree to which a particular sponsor is detrimentally affected by changes to trading conditions post-Brexit. Trustees of defined benefit schemes may seek increased contingent security to mitigate funding risk where there is a strong perceived threat to the sponsor. More generally, corporates should consider whether detrimental changes could trigger any reporting or funding requirements under existing pension scheme contingent security arrangements. Trustees will also need to review investment and hedging arrangements in relation to scheme assets; for defined benefit schemes this could increase funding requirements.

Public procurement

In a contract award subject to EU procurement rules, the party awarding the contract may not usually discriminate against a tenderer just because it is from outside the EU, although EU utilities do have a limited ability to discriminate against a tenderer supplying from outside the EU. These rules are quite likely to be replaced: the European Commission has proposed a new regime under which it could impose a price adjustment measure (of up to 20%) on procurement of goods or services originating in a non-EU country if it concludes that country does not itself operate an open public procurement regime.

In practice, application of procurement rules is likely to form part of the negotiations around internal market access following a vote for Brexit. Assuming the UK wanted to maintain full access to procurement in the EU internal market for UK businesses, it is likely to need to agree to reciprocal access for EU businesses to UK processes.

Companies with an interest in public procurement should monitor the public debate to see whether leading Brexit campaigners argue that Brexit will allow UK public entities and utilities to discriminate in favour of UK suppliers – if this becomes an important campaign issue, a post-Brexit UK Government may be more likely to advocate restrictions on UK/EU procurement in post-Brexit negotiations.

Intellectual property

The most immediate impact of Brexit would be on unitary, pan-European, intellectual property rights such as Community Trade Marks and Community Registered Designs. These would not cover the UK post-exit, although they would continue to cover the rest of the EU as before. It is widely expected that the UK Government would provide for right-holders who lose protection in the UK in this way to be granted an equivalent UK national registered trade mark or design right preserving their priority rights, so they should not lose out in the long run.

The position for unregistered Community Design Rights is less clear, so companies operating in fields where designs are important, including consumer goods and mobile devices, would need to consider registering design rights wherever possible. In the patents field, the UK would not be able to participate in the new European Unitary Patent or Unified Patent Court. However, ‘classic’ European patents protecting inventions in the UK would continue to be available through the European Patent Office as before.

Data protection

Personal data is permitted to flow around the EEA without specific restriction on cross-border transfers. Following Brexit, the UK might put in place a solution for the cross-border transfer of data from the EU to the UK which the European Commission recognised as adequate. In the meantime, companies that moved personal data from the EU to the UK would need to implement their own compliance mechanisms (eg standard contractual clauses approved by the Commission, or Binding Corporate Rules for intra-group transfers).
Low impact

UK-incorporated group entities

If group structures have been created for specific reasons (e.g. for tax purposes or to take advantage of EU-wide arrangements) they would, in due course, need to be reviewed to ensure they would continue to have their desired effect following Brexit. Where issues are identified, corporate relocations might form part of the solution.

Contracts

Neither a vote in favour of Brexit, nor Brexit itself, is likely to have a significant impact on existing or new contracts, save in any exceptional situations where a counterparty’s business is severely affected. Contracts will remain in force, the parties’ rights and obligations will be largely unaffected and specific Brexit-related provisions in new contracts are unlikely to be needed. Material adverse change provisions, for example in M&A and debt finance documents, are unlikely to be triggered. Brexit should not affect the approach that parties take to including English governing law clauses in their contracts or, in most cases, to including English jurisdiction clauses (save in the limited category of cases where enforcement of English judgments becomes more difficult post-Brexit).

Some contracts (e.g. IP or IT licences and distribution or franchise agreements) may contain territorial restrictions that refer to the EU. These would likely need to be amended following Brexit, as would references to EU legislation to the extent it is no longer applicable.

Insurance

Following a vote to leave the EU, we would expect regularly renewed insurance policies to be renewed on terms that cater for Brexit. Historic policies that still provided cover (e.g. occurrence-based policies) would need to be reviewed for provisions referring to the EU which, following Brexit, would exclude the UK.

Law and regulation

Following a vote to exit the EU, there would be a period of uncertainty as to the future application of EU laws in the UK. This would be clarified as part of the exit arrangements and it seems likely that the UK would retain much of the existing regime. In some areas, e.g. antitrust, there would likely be an added layer of complexity, uncertainty and cost resulting from dual-regulation or parallel investigations. But for companies whose businesses or dealings are not subject to EU-wide regulatory or passporting regimes, the impact should be limited.

Product safety

Much of the UK’s law on product safety and regulation derives from European law. A vote to leave would not trigger the unravelling of those laws overnight. However, decisions would have to be taken as to which laws to retain and whether any need to be adapted. EU product standards may well continue to apply to UK exports and imports, and the UK’s exporters may have little choice but to meet safety and design standards if they want to continue their exports into Europe.

Environment and climate change

A vote to exit the EU would not have an immediate impact on rules implementing EU environmental or climate change law. However, the transition to a purely domestic regime will be key. Much of the UK’s environmental law is EU-derived. Decisions would have to be taken over which areas of law and policy the UK Government would retain or replicate. It may, in practice, be that much of the existing law will remain in place (amended to reflect the EU break). For instance, there is a considerable amount of European law concerning the packaging and labelling of products. To continue to export products to Europe, businesses will still need to comply with these requirements even though they may not be driven by national law. Politically, there will be calls for many of these laws to be repealed and a lighter touch form of environmental regulation applied. It is likely that we would see a patchwork of EU and UK-derived law in place.

In the case of climate change driven laws, the UK has its own climate change ambitions and initiatives. This may be an area where the UK Government finds it easier to press on with its own policies, which will largely be in keeping with EU policy. Difficult questions will still arise, such as how the UK links (if at all) to the EU emissions trading scheme.