

# What Brexit means for business

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## Introduction

The idea of creating a guide to the possible implications of Brexit came into being before the date for the Brexit referendum was set and the referendum campaign had begun. Now that the countdown to the June 23 vote is well underway, this has become a much more topical and current issue for everyone in the UK and I think that many more UK businesses are now engaged in active study and planning for Brexit scenarios.

This report does not aim to make a case for or against Brexit. Insurance is about identifying, preparing for and mitigating against risk and in the pages to follow we examine the likely impact of Brexit on businesses and what steps they ought to be considering in the short and medium term to manage such an eventuality.

At QBE, our planning for Brexit is at an advanced stage and our aim is to continue to support our customers without interruption. What is clear is that Risk Managers have a critical role to play during Brexit planning. The experts we spoke to told us that “most people are ... seeing this as a risk to their business, so they are putting it to the emerging risks committee within their organisations.” Risk management teams can expect to be working on the front line alongside directors and boards to model and plan for Brexit scenarios. Our aim in writing this paper is to support you in that task.

Whilst we cannot map out every implication within every business sector in the UK, we can provide a guide to how to create your own ‘impact map’, and also give some clarity around the multiple different possible outcomes that a Brexit vote might create.

This paper was based on a series of interviews with experts in a variety of fields; from law, accountancy, regulation, insurance and economics, and it is their views that you will find summarised below. Of course, there can be no certainty about what will actually happen if there is a vote for Brexit, and the opinions within this document should be taken for what they are – expressions by an informed commentator of a likely outcome, rather than concrete advice based on a certainty.

We hope you find this a useful guide and that it contributes towards your Brexit thinking and planning. The one thing we cannot guide you towards is how to vote – this we leave to your own personal (and business) conscience.

Richard Pryce

Chief Executive Officer, QBE European Operations

<sup>1</sup> Andy Moore, Insurance Practice Partner, PwC



## Timetable for departure

The UK will vote on June 23rd 2016 in a referendum to decide whether to remain in the European Union, and this process is already having an impact on the UK economy and markets. At present the polls predict an extremely close result, and there is an even chance that the UK will vote to leave the EU, a decision known as Brexit.

If this was to occur, the UK would be required to give the EU notice of its intention to leave the Union, and a two-year notice period would be triggered. There is no template for what would happen next and the UK and EU would have to use the two years to negotiate the terms of exit, most specifically to agree which of the many treaties, court rulings, agreements and laws binding us together would remain in force.

During this two-year period, every single expert that we interviewed for this report expected that the considerable degree of uncertainty caused by the process of working out what an exit means would lead to volatility in financial markets and a likely shrinkage in the UK economy.

It was also very generally agreed by our experts that a vote for Brexit will lead to a change of Prime Minister, leaving the UK unable to negotiate with the EU until that election is concluded, and thus taking two to five months negotiation time out of the EU notice period. There would also be a good chance of it triggering a second Scottish vote for independence. In fact Dr Gregor Irwin, former Chief Economist of the Foreign and Commonwealth Office and now Chief Economist of Global Counsel, believes "there is a very good chance that the UK would break up" if Brexit were to occur.

All of this will contribute to the levels of uncertainty, and will increase the already high level of difficulty of negotiating a positive exit with the EU.

David Kendall of the British Insurance Lawyers Association suggests that "I think it is highly unlikely the relationship will be sorted out in two years. It is highly complex and will take many years to resolve, and throughout that whole time any business owner will face high levels of uncertainty when it comes to planning." Meanwhile, Sean McGovern, Chief Risk Officer & General Counsel of Lloyd's, sounds a further serious note of alarm, having commented recently that "The Governor of the Bank of England has warned of financial instability, higher interest rates and capital flight in the event of a vote to leave. If we believe what we read in the newspapers the Bank of England is already building up its foreign exchange reserves."

A further complicating factor is the political issues surrounding negotiations for exit. The EU has a vested interest in making the UK exit negotiations difficult for the UK - they will have a close eye on preventing any other EU members from thinking this is an easy way to access EU markets without taking the parts of membership they don't want. In addition any exit treaty will require ratification by other EU members, and this has historically been difficult to achieve on even straightforward issues. Dr Irwin commented "it's a process which is far from



certain and politically fraught, and we should not expect that anyone will do the UK any favours." He concluded that "it is the politics more than the economics that will determine the outcome of the negotiations that have to happen."

Thus there can be no doubt that the two years following a vote for Brexit could be a worrying time for UK businesses. With that said, in real terms, there will be very little actual change during that time. Whilst the future might be uncertain, for the two years of the notice period UK businesses will be able to continue to do business as they have for the last forty years, trading with European partners and selling goods and services into the region. In a specific reference to insurance policyholders, but one which holds true across all areas of business, lawyers Clyde & Co reminded us that "life carries on after a Brexit vote. We will remain a member of the EU, and policyholders can renew their policy knowing that it can be serviced right through to extinction."

It is from 2018 onwards that UK businesses will have to plan for change, and the two-year notice-period buffer gives them time to do this. It is from then on that the real structural change will come and the rest of this document looks at what might come next.

# What departure would mean

The EU began life as an enhanced Free Trade Agreement. It was set up to help reduce tariffs and encourage business dealings between European trading partners, and the most significant parts of our relationship continue to be based around this area. Key arrangements for business that come from the EU include:

- The existence of a single market, there are no tariffs or other barriers limiting the export of goods and services to any country in the EU
- The freedom to provide services and freedom of establishment
- The existence of 'passporting' which allows financial services, including insurance (in which the UK is the EU's leading player) to be bought and sold (broadly) without restriction across the EU
- Visa-free migration of people within the EU
- Access to EU Free Trade Agreements, which reduce trade tariffs with 53 non-EU countries around the world.

These four key accords have created many business opportunities for the UK over the last forty years, and are, of course, supplemented with an immense supporting machinery, including the European Commission, the European Court of Justice, The European Central Bank, the European Parliament and the European Investment Bank, to name but a few. After a Brexit vote the UK government would have to use all its political skills and judgement to decide which of these agreements it was determined to retain, and which it was prepared to lose, and it would be down to the EU to accept or block these proposals.

So what could the UK government aim to put in place of EU membership? There are three models that the UK could target, although it is widely agreed that the third model (the Canadian model) is the most likely for the government to choose. Which of these is chosen will shape what happens next.

## The Norwegian Model

Norway is a member of the European Economic Area, but not the EU. This means that Norway has full access to the single market, but must adopt EU standards and regulations with little influence over these, and is unable to impose immigration restrictions. It also means that Norway must contribute towards the EU budget.

There seems very little positivity towards this state of being, even from the Norwegians themselves. In fact a Norwegian Minister once said: "if you want to run Europe, you must be in Europe. If you want to be run by Europe, feel free to join Norway."

## The Swiss Model

Switzerland has had some success in building a two-way deal with the EU, which essentially allows it to access certain selected parts of the European market in return for accepting EU legislation in relevant areas as well as making contributions to the EU budget. This is known as the 'Swiss Model' and it is one which has worked well in some ways, but been problematic in others. So, while Switzerland has gained some access to the financial services marketplace in Europe, it is currently locked in dispute with the EU over the free migration of people – a dispute, ironically triggered by a referendum in Switzerland a few years ago. Without a vote or influence within the EU, it has proved difficult for Switzerland to get its view heard in these sorts of disputes. Dr Gregor Irwin comments that "with something like the Swiss model, or a British version of the Swiss model, how insurance would be treated is far from clear. The transition would be messy."

## The Canadian Model

An entirely different approach would be to strip the relationship with the EU back to its trade-based roots. Canada is in the process of ratifying the most far-reaching trade deal with Europe that has ever been created, and it is possible that the UK could aim to replicate this sort of relationship. Such an agreement would not necessarily allow the continued passporting of financial services, however, and it would certainly mean the end of visa-free migration across Europe. But only this radical model would give the UK control over immigration and free it from the dictates of the European Court of Justice.

All these models struggle to reconcile the central issue of regulatory control. "The problem for companies just now who might be looking at Brexit and thinking 'well maybe the regulatory environment will be a little bit more relaxed because we won't have all this Brussels regulation', well if you've got access to the single market the UK will have the obligation to sign up to EU legislation, but you will have no influence over that legislation."<sup>2</sup>

Using these three models as a base we will now look at how Brexit might long-term impact the risks and opportunities available to your business.

<sup>2</sup> Dr Gregor Irwin, Chief Economist, Global Counsel

# How Brexit could impact your business

It is easy to underestimate the all-pervasive influence of the EU on the UK economy. This is true within insurance too. Sean McGovern of Lloyd's puts it succinctly: "We say it often enough, hear it often enough, we trade in it every single day without a second thought. Let's face it. We take the existence of the European Single Market for granted." It is hard to imagine our working lives without it.

So how can UK businesses best prepare for the possible disappearance of this long-term partnership? How can they organise for such a wide range of scenarios, and what will the impact be on their risks? The rest of this paper looks at how to plan for the future, and gives guidance on navigating through uncertain times. We start with a summary, business area, by business area, supplied to us by experts in each field, of the business impacts of Brexit in the areas of:

- people and staffing
- taxation
- business accounting
- regulation
- business planning and costs
- import/export (or international trade)
- insurance.

## People and staffing issues

### Recruitment challenges

The free movement of labour across the EU has been in place for over forty years now. Many UK businesses rely on large numbers of EU workers in their labour force, and this is true of both skilled and unskilled workforces, from accountants to agricultural workers.

Andy Moore, partner at PwC told us "My business certainly couldn't function without being able to recruit outside the UK. In order to get the best and brightest we recruit from a Worldwide talent pool." Even in much smaller businesses this is also the case. IPT tax planning experts FiscalReps told us that "we have over 40 employees in the UK, 50% of whom are non-nationals without visas or work permits, employed for their language skills."

To give an idea of the scale of the movement that the visa-free situation has created, here are a few eye-watering statistics. There are over 1.5 million British citizens living in other countries in the EU, over half a million European students studying in the UK, and to pick the largest migrant nationality of all, over a million Poles living in the UK<sup>3</sup> Net migration from the EU to UK has more than doubled since 2012.

What would happen to these people? It is highly likely that even if the UK's final arrangement with the EU sees the end of visa-free migration; there will an exception made for those who are already in-country. Lawyers Clyde & Co believe "people from other EU countries living in the UK or UK nationals living abroad, will not be made to go home."

But in the longer term, the government can "choose to align EU immigration with the [existing] non-EU points system<sup>4</sup>." In this case the balance of migration will skew heavily towards the skilled workers who have the points to get a visa, and away from unskilled workers, who mostly won't. So while our accountants will still very likely be able to recruit qualified talent from across Europe, albeit with an increased level of paperwork and administration required, UK businesses that rely on large pools of unskilled migrant workers may find themselves with some large gaps to fill, and potentially raised labour costs.

As lawyers Clyde & Co neatly summarised: "if the labour market becomes ever tighter and the ability to employ a range of people, be they low-paid, unskilled, or skilled is reduced, and there are restrictions around that, it is only going to increase costs... You're just restricting the labour market."

### Employment law

*In writing this section, we relied in large part on an interview given by Heidi Watson of Clyde & Co, to whom we are most grateful.*

Heidi Watson points out that "a lot of our employment laws are derived from Europe, including really big ones like our discrimination laws and entitlement to maternity pay<sup>5</sup>". The question then arises whether we can expect that all of these laws will be repealed in a Brexit situation. Interestingly, "UK Governments historically dragged their feet in implementing discrimination and family friendly laws until forced to do so by the EU". So some might assume that the UK will want to find a way to extricate itself from them.

“It is very difficult to be prepared for something which is so uncertain, but the thing that people can be prepared for is the volatility that will ensue.”

**Andy Moore, PwC**

<sup>3</sup> Sources: Dr Gregor Irwin, Capital Economics, Lloyd's of London

<sup>4</sup> BREXIT: the impact on the UK and the EU, March 2015, Global Counsel

<sup>5</sup> Heidi Watson, Clyde & Co



In spite of this, Heidi believes “it is highly unlikely that we are going to see a sudden repealing of employment rights. There are some which are just now way too engrained in our society, rights which we British are proud of and now identify with, discrimination and family friendly rights being really good examples of that” In fact, the UK is now leading the way in Europe over some family friendly policies such as shared parental leave. So don’t expect to see a wholesale repeal of **employment regulation** upon a Brexit.

There are some other areas, however, where Heidi does believe Brexit may bring some changes in employment laws. These include **Working Time regulations**. “The UK has always had an opt-out on the maximum working week and it has been under pressure from the EU ever since then to give that up. A Conservative Government would likely be delighted to see an end to the maximum working week, and some of the caselaw we have seen develop from Europe around the taking of holiday when sick may be attacked by a future UK Government.” Giving **agency workers** employment protection was, according to Heidi “really unpopular with the UK Government, who fought strongly for some limitations including a delay of 12 weeks before full protection is in place” In her view, it is possible that a Conservative Government might seek to repeal this law, which has always been seen as a fetter on the ability of business to access a flexible source of labour. If we do not see immediate changes, it is possible that over time these laws could be eroded to fit with a future UK working model. And finally, the European Union has been keen to implement restrictions on **bankers’ bonuses** following the financial crisis. Given the strength of the UK financial services sector, there was intense pressure from the UK against the imposition of the bankers’ bonus cap. If the UK were outside the restrictions of the EU, this would appear to be an immediate target to disappear post-Brexit. Having said that, as usual with employment laws, they are intensely political so it is almost impossible to predict the future direction of regulation which will be influenced considerably by the government of the day.

## Health and safety law

In terms of the implications in respect of health and safety, Clyde & Co believe this would be minimal with few regulations repealed. Since the Piper Alpha disaster in 1988, the UK has been at the leading edge globally on health and safety issues and regulation. Indeed, following the Macondo incident in the Gulf of Mexico the US government report cited the UK health and safety regime as the gold standard.

As a result of the above, the UK already has in place a robust and sophisticated health and safety regulatory regime which has not necessarily been triggered by intervention from the EU by way of directive. That is not to say that there has been no impact from EU regulations, the offshore safety directive which led to changes in the safety case regulations is a good case in point.

**In conclusion**, plan for people change. Ask your HR team to look at how and from where they recruit your labour force to understand if your labour costs could rise, and whilst you can look forward to some relief from EU employment legislation, don’t expect a roll-back of equality rights.

## Regulation

All our experts shared the same clear view about the impact of Brexit on regulation. Clyde & Co put it most bluntly. “We are very much mistaken if we think that regulation is going to be reduced by a Brexit.” The reasons for this are twofold

1. For the UK to maintain access to EU markets in the most highly regulated industries (e.g. financial services) it will need to demonstrate that it continues to regulate in the way that Europe requires. For financial services firms this means that Europe-wide structures such as Solvency II and UCITS are almost certain to remain in place whatever happens. In fact, Capital Economics points out that countries such as Bermuda and Switzerland have gone to “great lengths” to replicate Solvency II and UCITS in order to persuade the EU to allow them to access Europe’s financial services marketplace.
2. Secondly, rolling back legislation is costly and often raises more questions than it resolves. None of our commentators believed the UK government would have any interest in setting up a programme to roll back regulation within financial markets, for example.

Andy Moore, partner at PwC told us: “we have already implemented a regulatory framework for most things, particularly in financial services and in reality it is going to cost more for us to undo it and to come up with something that is different than to keep it.”

Instead, much political energy will be focused on ensuring continued access to European markets in regulated areas. Sean McGovern, Chief Risk Officer & General Counsel of Lloyd’s, explained: “the objective is to ensure that Lloyd’s can continue to provide our market with access to the EU. Whilst there will be more work to do in the event of a vote to leave, we are confident that this objective can be achieved and that we will be able to provide ways to allow business to continue to be written on both a cross-border and a branch basis.”

**In conclusion**, expect very little change in the regulatory environment, particularly in financial services, including insurance. More likely, is that the UK will wish to demonstrate its continued commitment to Europe regulatory regimes in order to continue to get access to this valuable sector, where the UK is a recognised European and global leader.

## Taxation implications

*In writing this section, we relied on advice given by Ian Smith, Head of Tax for QBE European Operations, and Mike Stalley, Chief Executive of indirect tax experts FiscalReps, to both of whom we are most grateful.*

Severing the linkages which exist between the EU and the UK will likely result in a surprisingly small number of likely changes to taxation in the UK, as shown below.

### VAT and other indirect taxes

Over the last 40-odd years of EU membership, UK tax law and the EU’s impact on the UK taxation system have interacted to quite a complex degree. There has always been a tension between the desire of member states to develop their own tax systems and the EU desire to create a level playing field, and that is most obvious in indirect taxation, particularly VAT and excise duty.

As Ian Smith told us: “on exiting the EU, the UK would no longer be constrained by the EU VAT rules, including a directive which harmonises the approach to VAT across the EU.” (There are similar controls around excise duties and other indirect taxes including Insurance Premium Tax, IPT).

Post-Brexit we would be able to set our own VAT rate, and would be able to depart from some of the tax measures in the EU which the UK government dislikes. There are also a number of court cases going through the EU Court of Justice to do with indirect taxes, and those judgements, when they reach different conclusions to legislation in member states, often require member states to amend legislation to come into line with that judgement (for example in how multinationals account for VAT and costs as they occur and how they spread them out across different countries). Put simply after a Brexit the UK government

and courts would be able to determine what would be exempt from VAT and what would not.

Other indirect taxes likely to be affected by this renewed UK sovereignty include the tax charge on the raising of capital. At present the EU Capital Directive prohibits member states from taxing the raising of capital, something the UK government wishes to change.

Currently the UK is also locking horns with the EU over the imposition of Financial Transactions Tax, which the UK believes is anti-competitive as far as the City of London is concerned. It is highly unlikely this would be implemented in the UK upon Brexit.

### Insurance Premium Tax (IPT)

Mike Stalley of FiscalReps told us “Insurance Premium Tax rates are increasing globally.” Ian Smith also commented that “the UK IPT rate has been low compared to the rest of the EU for some time, and while we remain within the EU we will feel pressure to trend upwards towards the EU average. Outside the EU there may be less pressure to join the level playing field, and this could provide benefits for UK insurers that would be passed on to clients.”

### Direct Taxes (corporation and income tax)

According to Ian Smith “the direct taxes would see less activity on a Brexit as they are already set at a UK level.

Income tax is already very much left by the EU to its member states, who each deal with it as they see fit. No change should be expected to income tax as a direct result of Brexit, and the same applies to corporation tax. However, we would no longer be required to amend tax laws where EU directives and court judgements are inconsistent with UK law, and this might prevent some of the regular changes that currently occur across industries.

### State Aid Rules

The EU State Aid Rules direct that a government cannot give financial or tax advantages in a way that distorts competition. According to Ian “one area where State Aid has already been controversial, for example the UK’s recent tax deal with Google.”

Once outside the EU we could conceivably provide very specific targeted tax benefits to certain sectors without the fear of an EU reprimand. But we would also lose our right to complain if the EU did something that impacted one of the sectors that we were trying to protect. It is therefore reasonably likely that the desire to maintain some form of free trade zone with the EU would ensure that the State Aid Rules will continue to be respected..

**In conclusion**, the impacts on our tax system of Brexit are lower than might be expected. Any changes that might occur also need to be balanced against what the final settlement with the EU looks like. If, after Brexit, we remain closely tied to European markets, any UK government will see it as being in its best interest to run taxation rules in parallel with European taxation regulation.



## Accounting and business incorporation requirements

*In writing this section, we relied on an interview given by Andy Moore, Insurance Practice Partner at PwC, to whom we are most grateful.*

Taking the easy question first, the outlook post-Brexit for day-to-day business reporting and accounting is very straightforward.

All reporting and accounting standards are already set at a global, not an EU level – the International Financial Reporting Standards, or IFRS. Andy Moore, Partner at PwC confirmed that “from an accounting perspective I see there being very little impact. The accounting standards that we use in the UK have been broadly harmonised with International Financial Reporting Standards.” These reporting structures will not come under pressure for change.

However, in terms of business structures and incorporation, particularly for multinational businesses, the questions are much larger, and they are seismic in nature for the multinational financial services businesses, which make up a large part of the UK services economy.

At present it is possible for a UK financial services business to have a single headquarters in Europe, to report to a single regulator, and to conduct business in every other country in Europe via branches. This is known as the hub-and-spoke model, and according to Andy Moore of PwC “it is liked by companies for its efficiency, and the fact that it allows them to keep all their capital reserves in the centre”, rather than allocated and held in individual countries. It is made possible by the EU’s passporting regime, which is based in turn on the rights of Freedom of Establishment (FoE) and Freedom of Services Act (FoS), which guarantees the right to provide business services on a cross-border basis to everyone within the European Economic Area (EEA).

Should the UK exit the EU, only the least favoured future option (the Norwegian Model, in which we remain members of the European Economic Area) would allow the maintenance of passporting. As a result of the likely loss of passporting, many international companies who use the UK as their headquarters, as well as many UK businesses who trade across Europe, would need to completely change their corporate structures, including rethinking their countries of incorporation, places of reporting for tax and regulation, and the location of their headquarters. This is a drastic change, and the implications of it need to be considered by every international business in the UK.

Of course, a further impact of this would be felt by EU suppliers of manufacturing materials to domestic businesses. If you are a UK manufacturer, reliant on European parts, post-Brexit you cannot assume that your supplier will be able to continue to import freely into the UK, and certainly not at the same cost, as Andy Moore told us. “People need to understand not just the direct impacts, but the indirect impacts, so not just what

are your customers and suppliers, but beyond that first level, then looking at onward impacts. So you might have a supplier who is UK-based, but they may source some of the underlying components of what they make from the EU. So it might not be a first order effect, but it might be a second-order effect. People can’t plan simplistically and must look through the whole chain.”

**In conclusion,** every company in the UK needs to plan for Brexit by getting a clear picture of where its supply chains come from, and what would happen to them post-exit. International companies also need to work through a plan for incorporation which will allow them to trade internationally post-Brexit, no matter which model the UK adopts. Scenario planning is critical in this area.

## The effects of removing EU Free Trade Agreements

No area is more contentious than that of the EU and its Free Trade Agreements. The EU itself began life as a free trade zone, and as The Economist said recently “The trickiest issue for a post-Brexit Britain would be how to maintain full access to the EU’s single market, the world’s biggest.”<sup>6</sup> Why is it so critical? Because at present the EU takes almost half of Britain’s exports<sup>7</sup>.

Further, the EU itself has negotiated a string of no less than 53 Free Trade Agreements with non-EU countries to help EU companies trade with countries outside the EU. If it left the EU, Britain would no longer be party to these deals and would have to try to replicate them, something described by The Economist as “a huge challenge given its lack of trade negotiators and the length of time even simple trade talks take.”<sup>8</sup>

So “the worst-case Brexit scenario would be one in which the United Kingdom failed to negotiate a free trade agreement with the European Union<sup>9</sup>.” If it transpired, British exports to the European Union would face the latter’s common external tariff (sometimes called the ‘World Trade Organisation option’). Britain would be subject to the same tariff as the European Union charges other non-member countries, without any discrimination against the United Kingdom, and this would broadly mean a tariff of 4% on average on all goods shipped within the EEA<sup>10</sup>.

For British business, there are huge concerns about losing their tariff-free access to Europe. But this is often misconstrued as meaning that we could not trade with Europe. In fact, as Capital Economics put it: “the worst-case scenario, in which Britain faces tariffs under ‘most-favoured nation’ rules, is certainly no disaster. Exporters would face some additional costs, such as complying with the European Union’s rules of origin, if they were outside the single market. However, these factors would be an inconvenience rather than a major barrier to trade.”

<sup>6</sup> The Economist The Brexit Delusion 27 February 2016.

<sup>7</sup> Capital Economics and Woodford Investment Management The Economic Impact of Brexit February 2015

<sup>8</sup> The Economist The Brexit Delusion 27 February 2016.

<sup>9</sup> The Economist The Brexit Delusion 27 February 2016.

<sup>10</sup> There are some variants on this number, for example, according to Capital Economics, car parts are subject to a higher level of tariff, of up to 10%.

And, on a global stage, as Sean McGovern points out: “those who want Britain to leave the EU argue that, once Britain loses the restrictions imposed by EU membership, it will be able to negotiate better agreements than those reached by the European Commission.” Capital Economics point out that “Switzerland ... has had more success establishing free trade agreements than the European Union.” They also point out that Switzerland, free to negotiate alone and with its own priorities at heart, has achieved a Free Trade Agreement with China, something the EU has yet to deliver.

It was suggested by several of our experts that Britain could even benefit from the situation by introducing a unilateral free trade policy, a radical solution that, it should be said, has not yet been suggested by any politician.

**In conclusion**, the loss of free trade access to the EU is a worrying concept, let alone the wider implications of no longer being part of the EU's 53 global FTAs. Whether it is a disaster or an economic inconvenience, divides opinion, but what is certain is that consumer costs will rise if free trade access is lost.

### Implications for business costs

All the experts that we interviewed were in agreement that Brexit would increase business costs to some extent, and all also expected it to create some market turbulence. Economist Dr Irwin said “we can say with some degree of confidence that there will be a major movement in the markets if the UK votes to leave the EU.” In consequence, he noted that “any business that is highly leveraged will feel that impact, and any business that has currency exposure will also feel the impact.”

In addition, all experts were united in expecting Brexit to shrink GDP, which will impact demand, although no one can say how much. Dr Gregor Irwin told us “I’m an economist, but I would definitely mistrust anyone that tells you that Brexit will slow UK GDP by 1.6% and that ten years from now GDP will be 3.6% lower. That is a spurious degree of precision. I believe Brexit will slow GDP, but it is not possible to attach precise numbers to that.”

In a stark warning, Dr Irwin concluded Brexit “...is negative for sterling. It is negative for UK debt. Interest rates will go up across the credit spectrum and the yield curve. That is damaging in terms of growth and at a time when the Bank of England doesn't want to raise interest rates, it will happen anyway. So you can see that it would have a macroeconomic impact and it would last for a number of years.” He also believes “that the UK would have significantly damaged its reputation for stability.”

Some of the experts we consulted were less dark in tone, and renowned commentators Capital Economics were in fact almost bullish, stating “Although the impact of Brexit on the British economy is uncertain, we doubt that Britain's long-term economic outlook hinges on it.”



So, how can you know what cost effect to plan for? Ian Smith, Head of Tax for QBE European Operations puts it best: “our clients would be likely to experience an increase in their tax costs to the extent that they are doing business in the EU (dependent on whether we are in the EEA or not). Businesses might also expect their tax costs to increase in the UK.”

David Kendall of the British Insurance Law Association told us that “in the insurance industry, the value of assets in insurers’ balance sheets is an issue. Brexit is likely to have an impact on asset values, which is a particular area for concern.” Our experts all believed that businesses passported into Europe would need to consider the possibility that these rights will be lost.

**In conclusion**, prepare for some economic fallout from a vote for Brexit. Make business contingency plans based on an expectation of market turbulence, lower economic growth and increased cost.

# Specific insurance implications

## Effects on insurers and reinsurers

For insurers and reinsurers, a vote for Brexit would have two different, but equally important effects.

Firstly, Brexit has the potential to cause some business disruption for the insurers themselves. They are regulated businesses, many of whom have international branch networks or underwrite multi-country policies on the basis of FoS and using an EU regulatory and capital framework.

Many insurers and reinsurers located and regulated in the UK are able to distribute their products throughout the EU by using the rights of freedom of establishment and freedom to provide services from one state to another within the EEA—the concept of passporting or cross border. The ability to passport and provide financial services to customers in another Member State has been a crucial development for businesses.

In the event passporting ceases insurers and reinsurers would need to use an existing, or establish a new legal entity within the EU in order to continue to provide services to their customers. In the worst case scenario where the insurers and reinsurers affected have to establish new legal entities, most of our experts agreed that these companies would face some additional costs and disruption, for example in terms of duplicating regulatory resources and compliance in both the UK and EU.

How likely is this sort of wholesale change? It was widely believed by all our experts that maintaining passporting would be an absolute priority for the UK government under any scenario, in which case insurers would be able to continue to deliver their products and services as they do today, without restructure or rising costs.

A further aspect is the regulatory environment for insurers and reinsurers in the event of Brexit. We wouldn't necessarily expect to see a change to the Solvency II environment for UK regulated entities in the event of Brexit. However the extent to which the Solvency II regime could change and perhaps reduce capital requirements will inevitably be an unresolved issue for a time.

Our most informed expert on this topic Sean McGovern, General Counsel of Lloyd's of London, made it very clear that he believed Solvency II would not be repealed even if the UK left the EU. He said "Brexit does not offer a route to insurance regulatory nirvana. The UK regulatory system has been largely driven by domestic political and regulatory concerns since the financial crisis", not by Brussels.

Overall, there are some dramatic possibilities here, but in reality, passporting is such a major issue for the British economy, that Lloyd's and other commentators suggest the UK government will strive to maintain it within all outcomes of the Brexit vote.

## Effects on insurance buyers

In the long term, insurance buyers will undoubtedly be affected by what happens to those who provide their insurances. In the short term, they also need to consider the effect on the insurance cover itself. Here there is better news. Our experts told us that short-term policies should not immediately be impacted, including the mandatory classes of employers liability and motor insurance. In the field of motor insurance, although "there is pan-European regulation governing motor insurance ... the UK "gold-plates" the European regulations.<sup>12</sup>" You might not expect to see any price changes here as a result of Brexit, but an indirect result of a reduction in the value of sterling could be an increase in the costs of imports. This could put pressure on the price of parts which forms a significant element of the cost of vehicle repair.

There is also no rush. The two-year EU notice period will give both insurer and insured the time to amend one-year and most three-year policies on renewal, rather than require them to be reviewed and rewritten in a hurry. Similarly, for three-year insurances that do extend past any Brexit notice period, the notice period still gives the insurer and insured time to plan for and make any amendments needed.

However, as David Kendall of the British Insurance Lawyers Association pointed out, long-term policies such as life insurance are a different matter. He commented, "I suspect this will impact on life insurers ... depending on [the EU] relationship we end up in post-Brexit. So if passporting was to end completely, for life insurers [it is] potentially quite a serious thing as it is a much more long-term business than annual or three-year general insurance policies."

Ultimately, "Brexit might add a layer of complexity to insurance policies, as different licensing regimes do create issues that may need to be reflected in contracts, whereas passporting is simple, tested and low cost.<sup>13</sup>" Barbara Riggs, our commentator, notes that "QBE is accustomed to changes in insurance regulation which require wholesale changes to be reflected in all policy documentation and such changes can be implemented quite rapidly if required.<sup>14</sup>"

For multinational companies seeking insurance protection across multiple international locations, it should be cheering to note the positivity with which our experts contemplated a post-EU underwriting environment, something that is perhaps due to the global nature of the London market. Barbara Riggs told us "we write plenty of insurance contracts covering risks outside the EU already." Subject to the appropriate regulatory permissions, such insurance contracts could still be written even though "a new regulatory regime would be likely to have an impact on policy provisions. We would seek to address this in the policy drafting. Not all the provisions commonly in use in multinational wordings

<sup>11</sup> Ian Smith, Head of Tax for QBE European Operations

<sup>12</sup> Barbara Riggs, Head of Policy Wordings, QBE European Operations

<sup>13</sup> Barbara Riggs, Head of Policy Wordings, QBE European Operations

<sup>14</sup> Barbara Riggs, Head of Policy Wordings, QBE European Operations



have been considered formally by the courts which creates more risk and adds a layer of complexity - for example how the cover operates in territories where the programme leader does not hold a licence. Remaining part of the EU would mitigate these issues significantly, at least in the member states.

### London as an insurance centre

A further issue that will affect business insurance and reinsurance going to other cities is the likely continuance of London as a global insurance centre. The UK is the world's third largest exporter of financial services and insurance products.

The possible loss of insurance markets to other cities proved a divisive topic among our experts who held widely varying opinions. Andy Moore of PwC was one of several experts to question the future of London as a financial services centre outside of Europe "I think the future of the City of London does become questionable. It could well lose critical mass if we end up with another EU financial hub." Most of the experts interviewed believed that such a loss of critical mass could see organisations moving people and/or companies out of the UK.

The official word from Lloyd's of London is that "in the event of a vote to leave, we would work with the UK Government and EU Institutions during any negotiations to retain market access for Lloyd's and the London Market and create as much regulatory certainty as possible." Lloyd's are clearly prepared to defend their patch, and Sean McGovern recently said "depending on the circumstances, Lloyd's will need to take steps to secure the necessary access to EU member states and through our contingency planning work we have been undertaking the necessary research and planning to enable that to happen."

### Risk management

At the beginning of this document we stated that risk management is at the heart of Brexit planning, and this is true at both a macro ('what are the overall risks for our business?') and a micro ('how does this change our business insurance requirement?') level. Having taken the rest of the document to cover the macro side of the issue, it is worth considering the micro side. How will you need to change your insurance risk profiling and planning?

It seems highly likely Brexit will complicate the task of risk management. Risk managers may have to deal more on a country-by-country level, or at the very least on a UK vs EU level. Some large international risks, reinsurances and layered insurances that have traditionally passed through the London market may now need to access the market in a different way, depending on whether it continues to be possible to passport insurance purchases into the London market.

There will also be new considerations to discuss with your broker or insurer around the legal implications of Brexit on existing insurances. For example, if there are restrictions on the availability of traditional sources of labour from the EU, how will construction employment and risk be affected by the likely changes in visa regulation? Risk managers may have to carefully consider the consequences of this, especially on large projects.

It is not possible for us to map in one document every single change to every risk on every type of insurance, but broadly, your risk profile will link to the amount of international exposure your business has, and the amount of regulation (whether health and safety or financial) that your business is exposed to, and you should use this for the starting point of planning, as well as the basis for discussions with your insurer and/or your broker. We hope this document also assists you in your planning.

### Claims

It is worth noting that none of our experts could find many significant impacts from Brexit on existing insurance claims, or on future claims from existing insurances. Andy Moore of PwC, (who have a claims consultancy practice), noted that there could be some individual impacts on long-running complex claims disputes with an international dimension, although he did point out that "one would hope that in most policies there would be a definition of where legal disputes would fall and be managed from."

Otherwise, it was the conclusion of our experts that business insurance buyers can continue to have confidence in their ability to claim on existing and future policies, whether or not the UK votes for Brexit.

**In conclusion**, as Clyde & Co told us, those who buy insurances with an international dimension need to plan for a more complex insurance-buying world post-Brexit, but whilst Brexit would be a complicating factor, insurance provision will continue to be available without significant interruption from experienced global insurers like QBE. For clients, yes "it does become ... more messy for QBE's clients because if they have UK businesses they will need a UK insurance company, if they have EU insurance businesses then they will need an EU insurer, and that applies to both commercial and retail. It is just another layer of problems."

# Preparing your business for Brexit

“...companies were more prepared for the Millennium bug than for Brexit.”

## Dr Gregor Irwin

At present our survey found that only the largest UK businesses have begun any significant Brexit planning. One smaller business owner said “We simply aren’t right now. We have it on our Board Agenda, we have to work up a Plan A, B, C, D and E.” However, change is coming. “We are starting to see people – I wouldn’t say preparing – but they are planning for preparation.”<sup>15</sup>

What this means in practice is that “Most companies ... are starting some form of, if not project, then at least impact assessment to make sure they know once we get through the referendum and have the decision, the parts of their business that are most likely to be impacted.”<sup>16</sup>

Should this group include you? The answer is of course yes. How concerned should you be? Overall “The first rule of thumb is any business that is both subject to a reasonable amount of regulation and which trades with the rest of Europe is going to be directly impacted,” says Dr Irwin. His organisation, Global Counsel, is working with a number of clients to model their plans post-Brexit, and he suggests the following simple steps to help any business start to understand how its world could look post-Brexit.

1. **Start at the end.** Put together at least three scenarios for your firm, based on what the end point in the UK/EU relationship might look like. This should include the three models outlined in this report, together with any significant variants that will critically affect your business (e.g. the effect of the loss of passporting, the effect of a Scottish devolution)
2. Understand the impact of each scenario. What are the **primary exposures** of your business to Europe and how will these change in each situation?
3. **Look through the supply chain.** What are the secondary exposures of your business to Europe?
4. Ask yourself the question **‘how do we get there?’** How exactly will short-term volatility, reduced economic growth and a possible lack of credit impact your business, and how can you mitigate this?
5. **Look for opportunities.** All change brings opportunities, and now is the time to identify and plan for these, along with the risks.

From this, it should be possible to identify a manageable set of risks and opportunities and to evolve a plan for your business no matter what the outcome. The rest is up to you.

<sup>15</sup> Andy Moore, Insurance Practice Partner, PwC

<sup>16</sup> Andy Moore, Insurance Practice Partner, PwC

## Conclusion

In commissioning and writing this report we set out to give UK business owners a sense of what a vote for Brexit will mean for the UK business community, and in particular for QBE's business insurance buying clients. Our aim was to equip you with as many of the facts as possible and to highlight (in a highly unpredictable situation) what likely changes you might see as a result of a UK vote for Brexit.

As an insurance specialist, we have also tried to set out in some depth how Brexit might affect the UK insurance buyer, and give an overview of its impact on the marketplace as a whole

Our last objective was to give you some starting points for Brexit planning in your own business area. In the process of interviewing a group of experts on different aspects of the topic, one thing which united them all was the importance of having a risk management strategy and of looking ahead in order to be prepared for what might come. The UK is about to make a huge decision, and we look forward to working with all our clients as we navigate in partnership through the murky waters to come.



## Acknowledgements

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David Leckie, Partner, Clyde & Co

Mike Stalley, Chief Executive Officer, FiscalReps

Barbara Riggs, Head of Policy Wordings, QBE European Operations

Ian Smith, Head of Tax, QBE European Operations

## Further reading

Capital Economics and Woodford Investment Management  
The Economic Impact of Brexit February 2015

Dr Gregor Irwin [www.global-counsel.co.uk/publications/brexit-impact-uk-and-eu](http://www.global-counsel.co.uk/publications/brexit-impact-uk-and-eu)

Dr Gregor Irwin [www.global-counsel.co.uk/publications/morning-after-brexit-uncertainty-and-what-it-means-business](http://www.global-counsel.co.uk/publications/morning-after-brexit-uncertainty-and-what-it-means-business)



## About QBE

QBE is a business insurer. We understand the risks businesses face and support organisations from a diverse range of sectors in managing and mitigating their risk enabling them to realise their objectives.

An A+ rated insurer, we have the appetite and capacity to provide cover for businesses of all sizes.

Our extensive product range includes:

Accident and health (inc commercial PA and business travel)	Pharmaceutical and medical
After the event insurance	Political risk and terrorism
Commercial crime	Product guarantee and recall
Commercial combined	Product protection
Contractor all risks/EAR	Property
Energy, offshore and onshore	Reinsurance
Entertainment and leisure industry	Scheme underwriting facility
Environmental impairment liability	Specie
Financial and professional liability (Cyber Liability, Director's & Officer's, Professional Indemnity)	Surety/bonds
General liability (Employer's Liability, Public Liability, Tradesman)	Trade credit
Marine	Warranty and GAP
Motor Commercial (inc fleet, haulage, bus and coach, motor trade)	

### Risk management

Effective risk management is a feature of all successful organisations – and it's one of our key underwriting considerations. We work closely with businesses to improve their systems and processes; minimising their exposure to risk and helping to reduce the frequency and severity of any losses.

### We stand by our claims

Inevitably, claims do occur. That's when businesses really discover the value their insurance company delivers. We pride ourselves on our positive attitude and proactive approach to claims management. Our claims teams have a deserved reputation for the professional, efficient and sympathetic way they work with brokers and clients when losses are incurred.

### Local knowledge

UK underwriting offices: London, Belfast, Birmingham, Bristol, Chelmsford, Glasgow, Leeds, Manchester and Stafford.

### To find out more

For more information about QBE and how we can help your business, please visit our website **[www.QBEurope.com](http://www.QBEurope.com)**

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