Boards and Brexit

The key measures and immediate considerations

THE BREXIT DEBATE is currently generating more heat than light, with much finger-pointing and seemingly disingenuous comment in politics and the media. References to the possible negative consequences of the UK leaving the EU made by anyone from the Governor of the Bank of England, the IMF and the G20, to the US and French presidents, the French and German economy ministers and the UK government and Treasury have been branded as 'scaremongering' by Brexit supporters. Yet 'Bremain' proponents argue that Brexiteers have no coherent vision of a future trading model. The official 10-week campaign kicked off on 15 April with around a fifth of voters still unsure how they will vote on 23 June.

Whether they are for or against remaining in the EU, company secretaries need to seek out the facts as they apply to their organisations. This is not easy, given the often poor quality of media reporting and debate. Nevertheless, it is important to ensure that boards give proper consideration to the implications of a possible Brexit, which will vary according to sector, corporate structure and geographical spread. Boards might also consider whether they think there are risks or lost opportunities if the UK remains in the EU rather than taking a more independent path. The ICSA Bellwether survey of December 2015 shows that 71% of respondents believe that their business would be damaged by the UK leaving the EU, yet only 26% of boards said they are considering the implications of a possible Brexit. Hopefully by now the figure is much higher.

Assess the risks

If boards consider that Brexit constitutes a principal risk to their business, they will need to include it in their strategic report and also factor it into their risk and business planning. The FRC has commented, 'Companies may well be considering the risks and uncertainties of the UK's renegotiation of its EU position and potential exit. Under the Companies Act if directors consider this to be a principal risk they should disclose that to their shareholders.'

Even if the referendum decision is 'leave', the UK will still be bound by the EU treaties for around two years

Economic risks and risks specific to the business sector should be assessed. Economic risks include the potential weakening of the Pound and stock market volatility leading to financing and investment uncertainty, and sector risks may be loss of passporting rights for financial services businesses, the imposition of trade tariffs by European trading partners or the withdrawal of EU funding for regional development.

It may be necessary to consider where the business would be based or operate post-Brexit. Companies may need to relocate all or parts of their operations and look at the potential difficulties associated with employing staff from the rest of Europe or deploying UK staff to other European centres. A view will also need to be taken on how long any immediate effects of Brexit might continue, as well as on the possible future trading relationships with the remaining EU member states and the general outlook for UK business.

Businesses tend to feel uncomfortable with uncertainty because it inhibits their ability to make informed decisions on future strategy and resourcing. Whether boards prefer to remain in or exit the EU, the uncertainty around the referendum should be taken into account in their business planning. They will also need to take a view on the extent to which they are likely to be impacted by this. How long might such uncertainty last if we decide to leave the EU? If the 'leave' campaign prevails in June when will the decision to exit take effect and what might the post-Brexit environment look like?

Withdrawing from the EU

The key point to note on timing is that even if the referendum decision is 'leave', the UK will still be bound by the EU treaties for around two years. Article 50 of the Lisbon Treaty governs the process by which a member state may withdraw from the EU. It is rather sketchily drafted, perhaps because it was not expected to be used. It is triggered by the member state informing the European Council of its intention to withdraw, which sets up a two-year negotiation period on 'the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union'. The Article provides that the EU treaties continue to apply, in other words the member state is still part of the EU, until the terms for its withdrawal have been agreed or the two years have elapsed, if earlier. This two-year period can be extended, but only by a unanimous decision of the European Council (representing the other 27 member states) in agreement with the withdrawing state.

The Article also states that the agreement for withdrawal shall be concluded on behalf of the EU by the Council, acting by a qualified majority (i.e. 55% of member states representing at least 65% of the EU population) and after obtaining the consent of the European Parliament. Crucially, it adds that 'the withdrawing member state shall not participate in the discussions of the European Council or Council or in decisions concerning it', although no doubt the UK would make representations to the EU Council and other EU institutions about what it would like to achieve regarding withdrawal terms and a new framework.

Key measures to consider

There are key EU measures due to be implemented in the next few years that company secretaries should consider. Important new provisions on audit and market abuse come into force on 17 June and 3 July respectively, and the Non-Financial Reporting Directive is due to be transposed into our national law by 6 December. Other measures still working through the EU system include the Shareholders' Rights Directive Amending Directive, which the Netherlands is aiming to agree during the term of its Council Presidency which finishes on 30 June; the Data Protection Regulation; the modernisation of the Prospective Directive; and the European Network and Information Security Directive. The audit Directive will need to be implemented on a 'business as usual' basis before the referendum date (subject to certain transitional provisions). It will have been in place for a couple of years before Brexit would take effect. In addition, there are likely to be other measures that are relevant to a business's particular sector.

If Brexit does happen, the UK government will have to consider whether to retain or replace all national laws transposed from EU directives and how matters governed directly by EU regulations should be addressed (since these regulations would no longer apply on a UK withdrawal from the EU). A period of legal uncertainty would therefore ensue and the length of this is difficult to predict.

New frameworks

One thing is clear; we cannot know unless Brexit actually happens what the UK's subsequent trading relationship with the EU would look like or how long it would take to agree. Brexit supporters sometimes cite Norway and Switzerland as non-EU countries with access to the EU single market, through membership of the EEA and a Free Trade Agreement with the EU respectively. They still pay contributions to the EU and have accepted free movement of people, but have no 'seat at the table' when it comes to decision making (although the Norwegian government and companies still respond to EU consultations). To avoid having to accept free movement and paying into the EU, a bespoke 'bilateral' agreement would need to be negotiated – this is seen as the way forward by many Brexit supporters. Canada is currently seven years into such a negotiation with the EU with no deal yet finalised. Boris Johnson has said he favours the 'Canadian model'. It is difficult to imagine the EU offering access to the single market without requiring some level of free movement and financial contribution, although Brexiteers argue that this would not be the case. To George Osborne, access to the EU single market without payment or free movement would be a 'better deal' than France or Germany have and so to regard it as a possibility is 'economically illiterate'.

Boards cannot ignore the likely effects of a post-Brexit period of market uncertainty

How quickly might new trading frameworks be established if we decide to leave the Union? Brexit campaigners maintain that the rest of the EU would be keen to expedite this. Others say that some EU countries would want to give the UK a 'bloody nose' and point to warnings from France, in particular, that Brexit would bring 'consequences'. Yet, the UK's decision to leave would be likely to set off the much-reported 'contagion' among certain other EU member states with Eurosceptic tendencies, where some political parties have said they would seek to either leave or renegotiate their membership. The EU institutions would need to divert their energies into containing this as best they could, which would limit the time (and possibly the goodwill) they would have available to recommence discussions with the UK. In addition, the ongoing and serious migrant crisis is high on the EU's agenda and will occupy much of its time for the foreseeable future.

Since Brexit appears to be a real possibility, boards cannot ignore the likely effects of a post-Brexit period of market uncertainty which may continue for an unpredictable period of time. They need to form a view as best they can on the level of risk which is likely to ensue for their companies, as well as on any action they are able to take to mitigate this. Shareholders and other stakeholders have a legitimate interest in knowing that these issues have been properly addressed.

Julia Casson is director of board insight limited