PEOPLE & ORGANIZATIONS

One Year On: A Tale Of 3 Brexits

OVERVIEW

On June 23, 2016, the United Kingdom voted to leave the European Union. The result sent sterling crashing to a 31-year low against the dollar, prompted Conservative Prime Minister David Cameron to resign, and brought Prime Minister Theresa May to power.

One year on and so much more has changed. In the spring, May decided to call a snap election for June – aimed at strengthening the government's Brexit negotiating position. This has only increased uncertainty: The Conservative Party did badly at the ballot box and will seek to cling on to power in a minority government.

Some have argued that May's failure to secure a majority has put the government's previous "hard Brexit" position at risk, indicating that the British people might prefer a partial exit from the EU, its trade agreements and regulations.

To stay in power, May has sought the support of Northern Ireland's Democratic Unionist Party (DUP). This could also complicate the government's negotiating stance. While the DUP campaigned in favor of Brexit during the referendum, the Party doesn't want the return of a hard border between Northern Ireland (part of the U.K.) and the Republic of Ireland (an EU member state). It wants to retain close trade and customs links with the EU single market, but also insists that the UK be able to enter into its own free trade agreements, two positions which the EU negotiators may see as incompatible.

Meanwhile, the EU's position has not changed since the outcome of the referendum. EU member states have made clear that the single market and its "four freedoms" of movement are sacred. The integrity of the "four freedoms" and the unity of the remaining 27 member states (EU27) will define their approach in the negotiations. The negotiations will therefore be framed as 27 vs one.

The EU27 regret the U.K.'s decision to quit, but they have accepted it and would like to move on as soon as possible as there many other important (and difficult) challenges. They will not seek to deliberately "punish" the U.K. – as they would also stand to lose from such an approach – however, they will not accept any outcome that would infringe upon the "four freedoms".

The EU has been carefully preparing for the Brexit negotiations for the last nine months. Arguably the most important negotiations the EU has ever conducted, this importance is reflected by the very senior and experienced chief negotiators appointed by the EU institutions.

The EU Council of Ministers formally nominated the Commission as EU negotiator and also published the detailed negotiating directives for the talks. They will guide the Commission for the first phase of the negotiations and will be updated as talks with the U.K. – which began this week – progress.

So far, they have agreed on dates, organization and priorities. Both parties emphasized the importance of the sequencing of the negotiations. The first step will cover the most pressing issues: citizens' rights and a single financial settlement. The second step will see the discussion on the future partnership.

The clock has been ticking on Brexit since the U.K. triggered Article 50 – the official mechanism by which an EU member state secedes from the Union – this March. Although the Article 50 negotiations formally last two years, in reality both sides have only around 16 months until October 2018 to negotiate the terms of the U.K.'s exit and / or to ensure a transitional arrangement is in place. EU member states, the U.K. and EU parliaments will need sufficient time to ratify and approve the deal before the two-year deadline is reached in March 2019. The Article 50 agreement should set out the terms of the divorce, an outline of the future partnership and possibly transitional measures.

It is as yet unclear what form Brexit will ultimately take – hard, soft, or cliff-edge — or what those different forms actually mean.

Here, we examine what each version of Brexit looks like, and the possible implications for businesses. There's also a glossary of the key concepts of the negotiations.

IN DEPTH

From the Brexit referendum to the 2016 U.S. election and the rise of Emmanuel Macron in France – the geopolitical landscape has substantially shifted over the last year.

Perhaps unsurprisingly, Aon's 2017 Global Risk Management Survey saw the return of "political uncertainty" into the top 10 risks for businesses. Thanks to the unstable outcome of the U.K. election and, with the interests of the 27 remaining members of the EU at stake, political uncertainty has reached levels not seen since the immediate aftermath of the Brexit referendum.

As Tapan Datta, Head of Asset Allocation, Aon Hewitt, said in a recent CNBC interview: "If you had a funnel of doubt before this election about the range of possible outcomes around Brexit, that's just widened."

While the clock is ticking towards the U.K.'s exit in March 2019, there remain many unknowns.

"Businesses should view Brexit as a strategic risk – and an opportunity – to be managed as a 'thematic review' by assessing scenarios," says Eddie McLaughlin, Chief Commercial Officer EMEA, Aon Risk Solutions.

Three broad scenarios for the U.K.'s exit are possible:

Soft Brexit

- *The U.K. leaves the EU, but maintains good-to-full access to the single market and remains within the customs union.*
- *The "four freedoms" continue to apply to the U.K.*
- *The U.K. would remain subject to the European Court of Justice.*
- *EU citizens living in the U.K. are granted full citizenships rights, and vice versa.*
- *The UK will most likely have to continue to contribute to the EU budget.*

This scenario has also been described as "open Brexit" – and is sometimes known as "The Norway Model", for its resemblance to that country's relationship with the EU. A soft Brexit has the fewest obvious and immediate implications for businesses headquartered in the U.K. or operating in Europe. The main difference to the U.K.-EU relationship would be that the U.K. would no longer have any say in how Brussels formulates its regulations. On top of this, a soft Brexit will nevertheless include a financial settlement or so-called "divorce payment", as well as require the U.K. to continue contributing to the EU budget and the EU to approve future U.K. bilateral trade deals.

Navigating a soft Brexit transition successfully will require good communication. Businesses will have to build bilateral relationships with Brussels to have their voice heard, but internal and stakeholder communication will also be important.

"Within an organization, the absence of relevant information about how external events – such as Brexit – impact business operations can cause additional uncertainty," explains Dan Riley, Partner, EMEA Talent Practice, Aon. "Employees want to know that, no matter what, their leaders will respond to the external changes, stabilize the company, and provide a road map that give people a feeling of confidence in the future."

Hard Brexit

- *The U.K. leaves the EU with no agreement on continued access to the single market and customs union.*
- *Access to the U.K./EU market will depend on a future trade deal to be concluded post-Brexit — this could include some transitional measures. In any case, this new access will be diminished in comparison to the single market.*
- *If there are no transitional measures, then WTO law would have to be applied until the new trade deal is agreed.*
- *The EU's "four freedoms" end for the U.K., and national borders with EU member states will harden.*
- *EU citizens living in the U.K. and U.K. citizens living in the EU are likely to be allowed to stay but would have to apply for citizenship/residence permit, to be assessed on a case-by-case*

basis.

This scenario would have an existential impact on the flow of trade and talent between the U.K. and the EU. The exact nature of the trading relationship will depend on the deal agreed. A combination of new tariffs and red tape could hinder the trade of goods and services. This, in turn, could hurt U.K. economic growth, and reduce inbound foreign investment, as well as harming the interests of EU businesses reliant on the UK market.

There are considerable implications for the ability of U.K. businesses to hire key staff if EU workers cannot easily be recruited. Businesses in the U.K. that rely on talent from the EU, and vice versa, may want to look at training programs to fill potential skills gaps. "To stabilize any employee losses, providing additional training to remaining employees will enable a smoother transition," says Riley. This is a strategy which applies across Brexit scenarios.

Pension fund liabilities could also be affected. "Our base-case scenario is a fairly hard Brexit," says Datta — although this is under review pending clarity on the outcome of the U.K. election. "Low growth would lead to low gilt yields, which drive liability discount rates – a chain reaction that would reduce the ability of pension funds to achieve improved funding levels."

Cliff-Edge Brexit

- *The U.K. leaves all institutions of the EU, the single market and the customs union without an Article 50 deal.*
- *No Article 50 deal will mean no agreement on a future trade deal and no transitional measures.*
- *Trade deals with the EU default to World Trade Organization (WTO) rules and tariffs.*
- *EU companies established in and EU citizens living in the U.K., and vice versa, are are left in legal limbo.*

Cliff-edge Brexit seems likely only if negotiations irreparably break down, or run out of time with no extension of the negotiating period and / or agreement on transitional arrangements . Prior to the election shock, May and some in her government had said they believed "no deal is better than a bad deal" – and this would be the "no deal" scenario.

The EU wants to secure the legal position for its citizens in the U.K., and has expressed a desire to be paid an "exit fee" by the U.K. to cover its financial obligations (which the EU argues the U.K. has already committed to). Neither of these issues would be resolved by a cliff-edge Brexit, so it is also something the EU wishes to avoid.

WTO rules could mean the U.K. facing new tariffs including an extra 32 percent on the price of wine, 9.8 percent on cars and 4.1 percent on liquefied natural gas.

What Next?

With uncertainty surrounding the talks, making a distinct plan for each scenario is crucial to navigating Brexit successfully.

"The biggest risk of all is doing nothing," says McLaughlin. "Businesses should use scenario planning as a tool to navigate the uncertainty and develop response and mitigation plans around risk, cause and consequence."

With France's new President Macron telling May that the door is still open for the U.K. to remain in the EU until negotiations are concluded, even the U.K.'s actual departure from the Union cannot be considered an absolute certainty (though some form of Brexit remains almost certain). Nearly a year since May insisted that "Brexit means Brexit," it's still unclear what exactly that might mean.

TALKING POINTS

"I was very happy to see that some academics and researchers in the U.K. because of Brexit are considering coming to France to work. It will be part of my program to be attractive for these kinds of people." – Emmanuel Macron, President of France

"My preoccupation is that time is passing, it is passing quicker than anyone believes because the subjects we have to deal with are extraordinarily complex." – Michel Barnier, Chief Negotiator for Brexit, EU

"The [EU] 27 hope for a softer and more realistic British approach – whether they have to talk to May Mark 2 or a new prime minister. If the British oblige, the EU could scale back some of its demands, for example on money. And then a deal would become more likely." – Charles Grant, Director, Centre for European Reform

FURTHER READING

- What Will Brexit Mean For British Trade? – The Telegraph, February 24, 2017
- May Plows Ahead With Brexit Plan Amid Doubts Over Strategy – Bloomberg, June 9, 2017
- What The DUP Will Want For Supporting Theresa May – The Financial Times, June 9, 2017
- Brexit Talks Could Collapse Over UK Divorce Bill, Says EU Negotiator – The Guardian, May 19, 2017
- 2017 Global Risk Management Survey – Aon

GLOSSARY

Customs union: The free trade bloc comprising all EU member states, with a common external tariff. Within the customs union, goods can move freely between member states with minimal border checks.

Four freedoms: The freedom of goods, capital, services and people (labor) to move freely within the EU.

Institutions of the EU: The core institutions governing the EU. These include the European Parliament, the European Council, the European Commission and the European Court of Justice.

Liability discount rate: A measurement of a pension plan's expected risk-free return in the future. The discount rate is driven by interest rates on high-grade corporate bonds.

Single market: A term used to refer to the EU as a single trading bloc.