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STRATEGICRISK FORUM PREPARING FOR BREXIT

Brexit: the biggest current risk to business

StrategicRISK editor in chief Mike Jones warns that companies should 'ignore the Brexit scenario at their peril'

Exploring the risks around the possibility of the UK leaving the European Union was the overarching theme of StrategicRISK's Brexit Forum, sponsored by QBE.

More than 70 leading risk and insurance professionals attended the event held in April. Delegates heard from expert keynotes and got involved with a series of interactive workshops which offered practical advice aimed at helping create a workable Brexit risk strategy.

Speakers included Mark Littlewood, director general, Institute of Economic Affairs who gave a macro overview of Brexit and the implications if the UK left the EU and Richard Pryce, chief executive officer, QBE European Operations who considered what Brexit might mean for risk management and insurance.

Swati Dhingra, lecturer in economics, London School of Economics and co-author of Life After BREXIT, a report from LSE's Centre for Economic Performance looked at the potential economic impact of Brexit and the Forum concluded with Lord Tim Clement-Jones CBE, London managing partner of DLA Piper who tackled the thorny issue of legal and regulatory change post Brexit.

Opening the event, StrategicRISK editor in chief Mike Jones said: "I genuinely believe that the prospect of the UK leaving the European Union represents the biggest current risk to business – not only for companies based in the UK but also for those elsewhere in Europe and perhaps even beyond the continent as well."

He emphasised that the Forum was not "about the rights and wrongs of Britain's continued EU membership" or "political rhetoric or dogma" but would instead consider and evaluate the potential risks should Brexit occur to help companies prepare effectively.

"At the moment predicting the outcome of the referendum is impossible so the risk is very real," Jones said.

He warned that the referendum might be a binary choice of Remain or Leave but the reality was "incredibly complicated" and that both campaigns had been disingenuous and had left people – risk professionals included – poorly informed.

"Europe is going through its most turbulent period for more than 70 years – economically, politically and societally – along with almost everything in between," Jones said, highlighting that "rightly or wrongly" migration was "at the very centre of the argument".

An uncertain outcome meant Brexit risks were "all too real" and, as such, companies should "ignore the Brexit scenario at their peril".

He criticised firms adopting a "wait and see" attitude and others who shied away from discussing the issue for fear of being seen as siding with one political faction or another.

"Nobody thinks that by discussing mitigation or insurance strategies around terrorism risks means you advocate terrorism – so why should Brexit be any different?" Jones said.

"Let's face it, there is plenty to discuss around Brexit risk. If you think the vote itself is complex, the risks Brexit might entail are myriad.

"Nobody knows for certain what the implications of the UK leaving the European Union would be in precise detail but that should not preclude us from considering the possibilities." **SR**

THE ONLY CERTAINTY IS UNCERTAINTY

The EU referendum is likely to cause prolonged uncertainty, regardless of the outcome, Mark Littlewood, director general at the Institute of Economic Affairs said.

He started off his keynote presentation by stressing that the referendum is entirely consultative. "Formally and technically the referendum triggers nothing, whether we vote to remain or whether we vote to leave."

In case of a Brexit, therefore, the first question that arises would be when the British government would enact its rights under Article 50, which refers to the procedures when a member state decides to withdraw from the union. Once the Article is triggered, the UK will have two years to negotiate a new agreement with the EU. If it fails to do so within this time, it would need a unanimous vote by the other 27 members of the EU to prolong that period.

Littlewood warned delegates that, regardless of the outcome of the referendum, it is very likely we will enter a period of prolonged uncertainty, even if there is a narrow remain vote.

"At the moment, it is most likely the outcome will be a narrow vote to remain. I think that comes with substantial uncertainty. If there was a narrow remain vote, this stays as a live and uncertain political issue and that is because the governing party in the UK, the Conservative Party, are split right down through the middle on this," he said.

"I think the only way the uncertainty and the discussion around Britain's relationship with the EU is going to go away, is if there is a colossal vote to remain. If we see on June 23 a 2:1 majority to remain, then I think this question disappears for a generation or more."

He therefore concluded: "A narrow vote to remain, the most likely of a spread of outcomes, is not one that will reduce uncertainty. Any vote to leave puts a whole load of uncertainty on the table, and the only way uncertainty will be removed altogether, is a crushing result for remain and that looks like the least likely outcome on June 23." **SR**

'Don't let Brexit be your Millennium Bug'

Richard Pryce, chief executive, QBE European Operations told delegates to make sure they were prepared for all possibilities

Businesses and risk professionals were given a stark warning on making sure they were prepared for the possibility of the UK's withdrawal from the European Union.

In his keynote speech at the StrategicRISK Brexit event, Richard Pryce, chief executive officer, QBE European Operations told delegates: "Don't let Brexit be your Millennium Bug – don't put off your planning until it's too late."

Earlier, Pryce considered some of the practical potential consequences of Brexit and how best to ready companies for the possible changes which a vote for Brexit might bring.

Basing some of the fundamental aspects of his speech on QBE's recent Brexit research, Pryce cited three "stand out" changes that would be critical for business.

"The first is the impact caused by the potential loss of free trade with the EU, as well as our exclusion from the 53 trade agreements that the EU has negotiated globally," Pryce said.

"Much of the success of the UK is based upon our ability to execute global trade. If your business trades in goods or services outside the UK, your export/import costs are very likely to rise as a result of the loss or curtailment of free trade."

Supply chains were also at risk and "any change post Brexit may add a level of complexity (both cost and availability) to understanding supply chains".

Staff availability was the second key point.

"Wherever your business is located in the UK, you are likely to benefit from the international nature of the UK workforce," Pryce said.

"Almost everyone that QBE spoke to, when studying the effects of Brexit, highlighted the likely difficulty of recruiting staff, should the free movement of workers within the EU be ended."

The third key risk area was the "macro impact on the UK economy".

"Even those who believe a British exit from the EU would be a positive development admit that there would be some choppy economic waters to negotiate during the exit transition," Pryce said.

"Markets hate uncertainty, and Brexit would bring that. Is our economy really resilient enough?"

Turning his focus to insurance, Pryce said that a vote for Brexit would have at least two different but equally important effects for insurers and reinsurers.

The ability to "passport" and provide financial services to customers in another EU Member State was a crucial development for insurance businesses, and one that made the London market so important to the global insurance industry. This was at risk.

The implications around Solvency II were also a concern.

"We wouldn't necessarily expect to see a change to the Solvency II environment for UK regulated entities in the event of Brexit," Pryce said. "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." **SR**

FACTORING IN THE REAL ECONOMIC COST OF EU MEMBERSHIP

Swati Dhingra, lecturer in economics at LSE, considers the real economic price of leaving the EU

A Brexit is likely to result in a decrease in GDP between 1.28% and 2.61%, Swati Dhingra, lecturer in economics at the London School of Economics and author of Life after Brexit, told delegates at the event.

Putting some hard numbers on the expected economic impact of a Brexit, Dhingra discussed the economic costs and benefits of Brexit.

To assess the impact a Brexit would have on UK GDP, Dhingra looked at two extreme outcomes: a Norway-style deal where the UK would still be extremely well integrated with the EU market, remaining part of the European Economic Association, with free trade in goods and services, but perhaps some regulatory divergence. The pessimistic scenario is where the UK would just be a member of the World Trade Organisation, which would mean an increase in trade and tariff barriers.

The research showed that in the optimistic scenario, UK GDP would drop by 1.28%, compared to a drop of 2.61% in the pessimistic scenario. Dhingra also discussed other research which showed that leaving the EU and joining the European Free Trade Area (EFTA) would reduce the UK's overall trade by 12.6%.

In terms of immigration and foreign direct investment (FDI), Dhingra discussed research which has shown the UK benefits from EU membership in both of these areas. Immigrants from the EU contribute around £15bn to the UK's fiscal deficit, she said, while a Brexit would lead to a 28% reduction in FDI in the UK.

"There is an inescapable trade-off between membership of the EU, market access to the EU and how much you give up in economic sovereignty by essentially incorporating many of these EU regulations that go with being a member. But that is essentially what the EU is, it's a club. You pay a membership fee and then you have to abide by certain rules and regulations," Dhingra concluded.

"In terms of what might happen if Britain were to exit, one of the big factors is that the UK is not going to be able to challenge many of these regulations at the European Court of Justice. It's also not going to have a voice in what future trade liberalisation looks like, and those are also costs which one must factor in." **SR**

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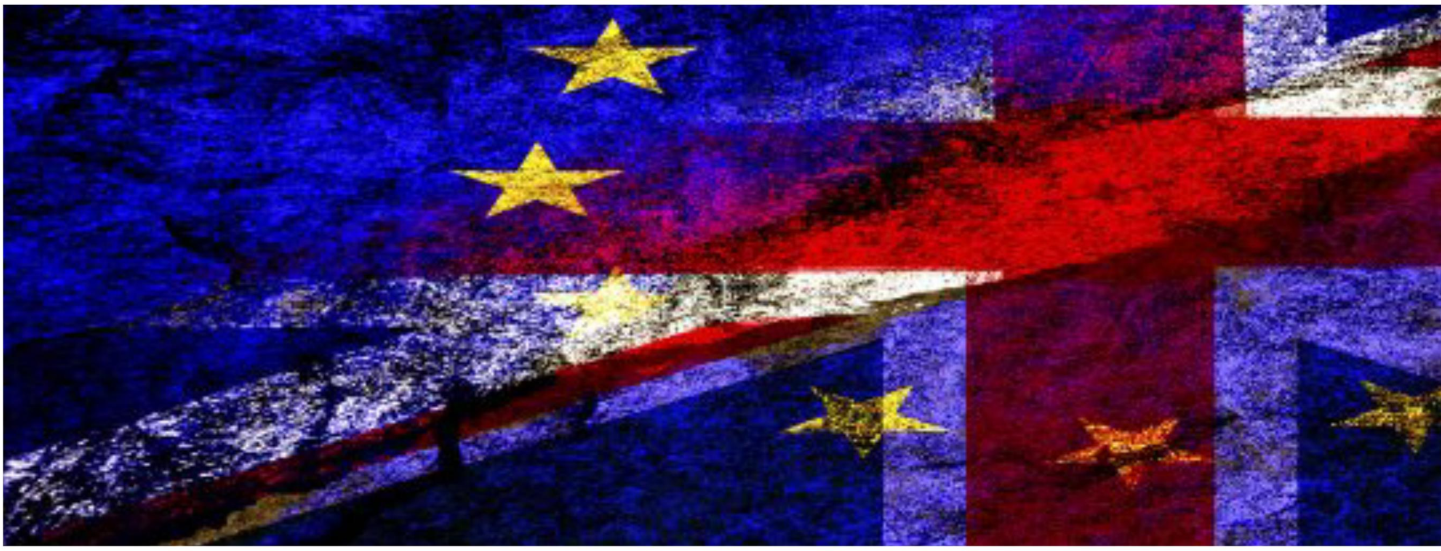


Brexit legal impact 'will be huge'

DLA Piper London managing partner Lord Tim Clement-Jones CBE warns delegates that few of the consequences will be 'entirely predictable".

The legal impact and consequences for business of the referendum to decide Britain's future in the European Union "will be huge and few of them entirely predictable", according to a leading legal expert.

In his keynote speech at StrategicRISK's Brexit Forum, Lord Tim Clement-Jones CBE, London managing partner of DLA Piper, said legal change was likely "no matter the result of the poll" either with the UK departing from the EU or staying with renegotiated terms.

However, precisely what those changes will be is as yet unclear.

"In evaluating the impact of Brexit, a range of scenarios need to be considered which could drastically alter conditions for institutional and corporate stakeholders," Lord Clement-Jones told delegates.

Greenland is the only other country to leave the EU but with its tiny population its departure more than 30 years ago could not be compared to what might happen to the UK. As a result, Lord Clement-Jones, said we were "to a large extent in unknown territory".

An "Out" or "Leave" vote should see the Prime Minister invoke Article 50 of the Treaty on the European Union and notify the European Council that the UK intends to secede from the EU.

"A controlled and negotiated process developing over a maximum of two years would follow," Lord Clement-Jones said.

Within that time, there would be a number of key issues to be resolved.

"These would include the full range of policy and legislative implications of repatriating EU competencies over vital areas such as trade, financial services, competition and state aid, environmental regulation, and even intellectual property, back to the UK," Lord Clement-Jones said.

He added that while the precise impact of a Brexit on UK law could not yet be determined without knowing the specific terms of that exit and future government decisions, there were some common themes.

Outlining a number of these, Lord Clement-Jones said that among the key legal issues for business were the impact on existing legislation, trade, contract terms and disputes, employment law and pensions, M&A, competition, tax, plus health and safety.

Similarly, although the exact nature of a Brexit would not be clear for some while what was certain was the time needed to alter some of that legislation.

Primary legislation would remain until repealed by an Act of Parliament. One option would be to "repeal or amend particular laws over time following reviews and consultations".

This would be a long-term process and could take "Ten years of Queen's Speeches", Lord Clement-Jones warned.

There were multiple potential implications for each of these, Lord Clement-Jones said before detailing what some of the most pertinent might be.

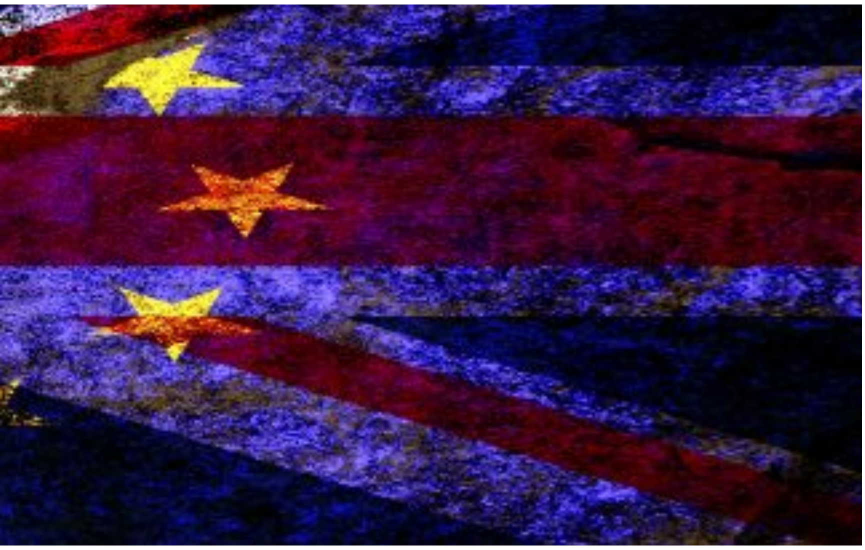
In terms of trade, the UK would be required to renegotiate existing bilateral, regional and multilateral existing EU Free Trade Agreements – and existing benefits would cease to apply until that renegotiation was complete.

Contract terms are another concern with those supporting long-term relationships and with a cross-border element at higher risk. There was a possibility, Lord Clement-Jones said, that Brexit consequences could trigger an event which could have Force Majeure implications.

Disputes, Lord Clement-Jones said, were likely in the event of a Brexit "with parties looking to terminate existing contracts". There was no clarity as yet over the approach UK courts might take to recognising and enforcing EU judgments if the European Judgments Regulation no longer applied.

Even lawyers themselves might have issues with only those qualified in remaining member states having privilege in front of EU courts.

Other significant issues for businesses include concerns around freedom of movement for workers



> "In evaluating the impact of Brexit, a range of scenarios need to be considered which could drastically alter conditions for institutional and corporate stakeholders"

– with new visa requirements for EU citizens perhaps making recruitment and retention difficult. There would also be data protection implications with the UK getting "third country" status "meaning that UK businesses operating in the EU would need to provide adequate protection for the rights of employees whose data is transferred from the EU to the UK", he said.

In the run up to the referendum and also the aftermath of any Brexit decision, Lord Clement-Jones also predicted a short-term slowdown in the M&A activity "particularly among companies intending to acquire businesses in the UK as a stepping stone to Europe".

Insurers and other financial institutions also faced potential upheaval. Financial services businesses currently benefit from a financial services passport which allows financial institutions established in one EU member state to establish or provide services across other EU member states.

Post Brexit, Lord Clement-Jones said, UK firms which had only a UK-licensed operation would need to open a separately capitalised subsidiary in a country remaining in the EU. Insurers might also be subject to similar requirements. Perhaps most importantly, insurers would "likely have to maintain equivalence with EU regulations such as Solvency II to access EU markets".

Summing up what he described as a "breathless run through" of some of the possible legal implications of Brexit, Lord Clement-Jones had a final message for those risk professionals in the audience: to start doing some ground work now.

He said: "I do think people ought to be looking - not in massive detail - but at least scoping some of the issues that I have mentioned today because I think to suddenly find ourselves on 24 June waking up to Brexit does have huge implications for businesses.

"It is better to grab your in-house lawyers now and get them to start thinking about these things if they are not already doing so rather than doing everything in a rush post 23 June as everyone's share price gets affected by what may or may not happen."

THOUGHT LEADERSHIP

RICHARD PRYCE
chief executive officer, QBE European Operations

IMPACT COULD BE FAR REACHING

With the countdown to the June 23 vote well underway, Brexit continues to dominate the media agenda. It is front of mind for most UK businesses and while I have no interest in offering any personal opinions about Brexit, I do want to campaign for proper planning for what maybe the most significant development in a generation. At QBE, our planning for Brexit is at an advanced stage and our aim is to continue to support our customers without interruption.

In the report recently published by QBE about the implications of Brexit for business, we spoke to a series of experts in a variety of fields; from law, accountancy, regulation, insurance and economics. The impacts of Brexit could be far reaching notably affecting free trade and the availability of international staff. It may change the way we, as insurers, operate and would likely make for a more complex insurance buying environment for some of our customers.

For insurers, a vote for Brexit would have at least two different, but equally important effects. 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 insurance businesses, and one that has made the London market so important to the global insurance industry. One of the major negotiation points will be around whether passporting ceases in the event of Brexit. If this is the case insurers would need to use an existing, or establish a new legal entity within the EU in order to continue to provide ongoing services to their customers.

Another issue for insurers is the regulatory environment. 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.

In conclusion, a business which buys insurance with an international dimension needs to plan for a more complex insurance-buying environment post-Brexit, but while Brexit would be a complicating factor, insurance provision will continue to be available without significant interruption from established global insurers like QBE.

For an in-depth analysis of what Brexit means for business, including a five-point planning guide, download the QBE report here (http://bit.ly/1s73UKa)

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Boards need to be ready for short term shock

Brexit board engagement workshop highlights wide spectrum of preparedness

The preparedness of business for the possibility of the UK leaving the European Union is inextricably linked to how boards view this risk scenario.

Participants in the Brexit and the Board workshop sessions at StrategicRISK's Brexit Forum discussed a wide and varied range of experiences around this.

The Chatham House Rule was very much in force at this workshop due to the sensitivity of raising board issues publicly so the views and quotes in this particular article will not be attributed to any individuals.

Nonetheless, it is possible to report on some of the comments made and the general opinions of those risk professionals who attended.

While some of those at the workshops said their boards had identified Brexit as a potential risk "some time ago", others did not consider this risk – or at least raise it beyond the boardroom – until the referendum date was set by Prime Minister David Cameron in February this year.

Several had done nothing, with a handful of attendees saying their boards did not see the point of looking at the consequences "until there was something to evaluate". This perspective was justified through the reasoning that as there were so many possibilities the UK could pursue should it leave the EU, it was "pointless wasting time now on things which might not happen and better to deal with these if and when they do".

> **Start by concentrating on what could get you hurt and by looking at issues which might make you less competitive.**

One risk professional at the workshop memorably described Brexit risk as an "unstructured blancmange" and said it was impossible to get hold of the risks in the current (pre-referendum) situation.

The central question coming from some boards, said one risk manager, was "how critical is it to do something now?"

Another said the attitude of their board was that time could be "spent better dealing with other more tangible or pertinent business issues" until there was some clarity over Brexit, should it happen.

There is a logic to this but most risk professionals agreed that it was also dangerous to not be prepared in some way.

Negotiations for a post-Brexit UK will take at least two years and many legal experts believe that the timescale will be significantly longer. This is where some of the main risks might lie for certain businesses which have not prepared.

There was a broad consensus among workshop attendees that a viable approach might be to develop a risk strategy for the short term, covering the immediate aftermath of a Brexit vote so that a business was prepared for the possible impact of stock market turmoil, a brake on foreign investment or a significant drop in the value of sterling. That would be followed by a more considered approach for the medium to long term which evaluates the risk around the particular route the UK takes post Brexit.

However, one risk professional summed up the views of many when he said that "some boards still needed to be convinced about doing something now on Brexit".

To counter this it was suggested that risk professionals developed their own plan or series of strategies covering some of the main foreseeable outcomes which they could present to the board should a specific scenario emerge.

These did not need to be undertaken in intricate detail as this could be extremely time consuming and unnecessary but delegates agreed that putting in place some basic strategies now "made sense".

One way to achieve this was to select a number of "pressure points" for the business which could be impacted should Brexit occur. These might include trade issues, legal and regulatory concerns or supply chain.

"Start by concentrating on what could get you hurt and by looking at issues which might make you less competitive," said one attendee.

One risk professional memorably described Brexit risk as an "unstructured blancmange" and said it was impossible to get hold of the risks in the current (pre-referendum) situation.

Another route to better board engagement on Brexit is through non-executive directors. Delegates agreed that their experience across multiple boards made them "more likely to understand some of the risks and the need to be prepared".

Interestingly, boards of companies headquartered outside of the UK and elsewhere in Europe were likely to have explored some of the possibilities around Brexit already and were inclined to be more receptive to discussing the issue of Brexit risk than some UK-based entities.

It appears from the three workshops that there is genuine interest and some considerable concern about Brexit among the UK's EU partners and this has resulted in many companies based outside the UK being at least as prepared, if not more so, than some UK companies over Brexit.

All the workshop attendees agreed that getting board engagement on Brexit risk was crucial but there were serious challenges in achieving this for many.

One summed up the key challenge quite succinctly when he said discussing Brexit at board level was the equivalent of "walking into the boardroom carrying a black swan in a sealed box and leaving it on the table".

He said: "You know when you open it there is a black swan inside but none of us can yet say what it really means.." **SR**

TOP RISK HOTSPOTS

Five other expert-led workshops were held at the Brexit Forum, each examining practical considerations for business around the risk implications of the UK leaving the European Union. These were:

- **Brexit scenario planning – Gareth Jones, Crisis Interface**

The Brexit situation demands uncertainty reduction techniques, such as scenario planning and wargames. This session looked to reduce some of the unknowns and highlighted threats and opportunities.

- **Brexit and the impact on sterling – Antonio Rami, co-founder Kantox**

Sterling suffered its biggest drop against the US dollar for seven years in the immediate aftermath of the referendum date being set. This workshop assessed how much currency volatility can be expected in the run up to the vote and beyond.

- **Brexit economic uncertainty – Swati Dhingra, lecturer in economics, London School of Economics**

The focus of this workshop was to strip away the myths and look at the facts not only about what might happen to the UK economy but also the implications for Europe and elsewhere.

- **Brexit supply chain risks - Duncan Ford, crisis and continuity management consultant, Corpress LLP**

This session examined how UK companies will be affected by Brexit in terms of dealing with suppliers in the EU and European (non UK-based) companies with suppliers in the UK.

- **Brexit political instability - George Doughty, political & trade credit risks underwriter**

A Brexit vote throws up several major political risks such as the possibility of a new UK prime minister and SNP demands for another Scottish referendum. It might even be the catalyst that breaks up the EU. This workshop looked at the most realistic outcomes and how they might affect business.