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The signal from the noise

Brexit: What do I do now?



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Focusing on the signal amid the noise

Businesses spent a lot of 2016 trying to work out what the implications of Brexit were. Even as we struggled with that, we then had a seismic change in the US political landscape. While the Dutch election has largely preserved the established status quo, we are all anxiously watching the French, UK and German elections in 2017 to see what the general mood is across Europe and in the UK. Never have we lived in an era where the juxtaposition of geo-politics and business has been so pronounced.

While it is too early to tell what the impact of President Trump will be, we are starting to see the shape of Brexit emerge from the mist. In my conversations with you, our clients, and with my colleagues across the PwC network there are some common themes emerging.

Prime Minister May's speech on January 17th was a game changer – the endless

2016 parlour game of “will she, won't she” was finally concluded and the overarching rhetoric is “no deal is better than a bad deal”, a sentiment which seems to be echoed in Brussels.

There is still no end to the noise in the system – endless data, updates, news articles and commentary. My brief to our Brexit team was “bring some clarity, and help our clients distinguish the signal from the noise”. We hope this document helps you to navigate your journey.

We have been inundated with clients wanting to get real insights about the implications of Brexit. This publication attempts to help you with your thinking. However, there is no substitute for tailored advice and face-to-face conversations with our experts. We are ready to work with you to quantify the risk and impact of Brexit on your organisation. Please reach out to me, your regular PwC or Law Square contact or the appropriate member of the Brexit team whose contact information appears on page 12, 13 and 14.

Axel Smits
Chairman and Senior Partner
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Overview

With the triggering of Article 50, it is time to make sense of Brexit: what it means for Belgium and what it means for you.

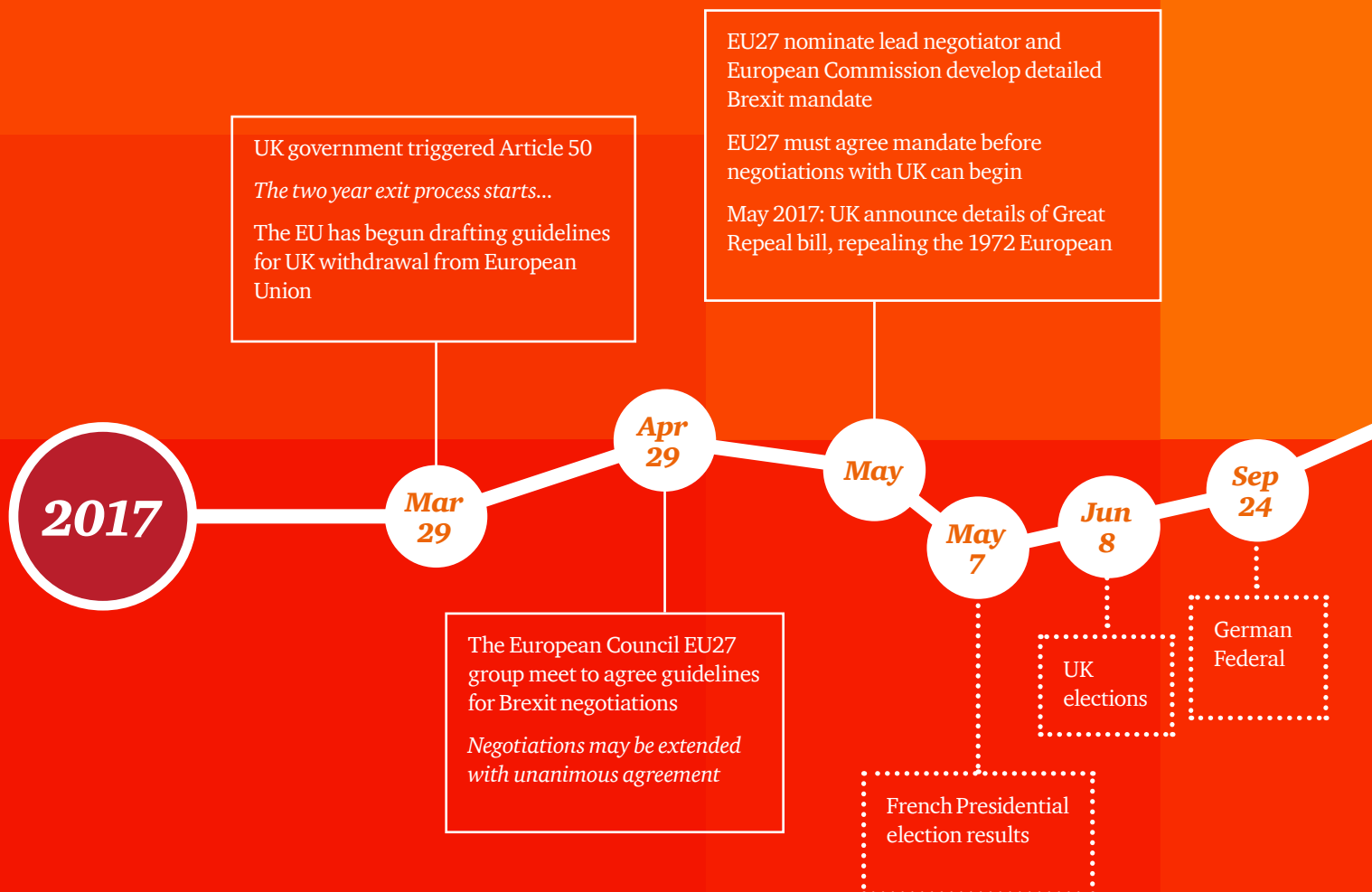
There is an enormous amount of information out there and it is difficult to know what to focus on. In this booklet, we want to help you understand the current situation and provide you with some sensible parameters for your post Brexit scenario planning.

We outline two possible outcomes of the negotiations based on the information available to us right now.

We describe what actions you should be taking now, regardless of what sector you are in.

Finally, we outline how we can help you and your business be prepared for the inevitable changes that will come.

If you need any further information or would like to have a conversation with any one of our industry experts, please do get in touch through contact information appeared on page 14.





Initial "divorce agreement" or basic principles of Brexit to be agreed between EU

Dec

2018

Mar

UK deadline for agreeing

Oct

Negotiations to be completed by this date to allow for ratification by UK and EU

2019

Mar

The UK leaving the EU must be ratified by EU27, the European Council and the European

Apr

Brexit is completed

Triggering Article 50: A London & Brussels Perspective

The world's eyes are on London and Brussels. The British Prime Minister has now triggered Article 50 of the Lisbon Treaty to formally withdraw from the European Union. What happens next will shape the future EU-UK relationship.

The start of 2017 has been the most eventful and meaningful time since the EU referendum result last year. Prime Minister May's speech at Lancaster House on January 17 saw the UK outline its roadmap for Brexit.

The speech attempted to frame how the UK views its future EU relationship. It was also intended to provide some much needed certainty about the nature of Britain's future trading relationship with Europe.

Next came parliamentary approval of the European Union (Notification of Withdrawal) Bill. The draft act formalised the beginning of the exit process. It experienced challenges through the House of Lords, but it passed unamended. Following this, the Prime Minister triggered Article 50 on March 29.

Article 50 provides for a two year period of negotiation unless Member States unanimously agree to extend it. However, negotiations may have to complete within an even tighter timeframe, possibly 15 to 18 months.

Any 'EU-UK Exit Agreement' will require a dual approval and ratification process. European Heads of State in the European Council and Member State elected representatives in the European Parliament will need to approve the agreement.

Brussels has indicated that once negotiations start, the EU will prioritise reaching agreement on the nature of the UK's exit. Specifically, the EU wants to see agreement on four issues:

- The size of the UK's exit bill for outstanding EU budget commitments
- The rights of EU citizens and the UK's obligations towards them
- The transfer of EU agencies out of the UK (including the EBA and EMA)
- Territorial issues including Northern Ireland, Gibraltar, and the UK's sovereign status in Cyprus

It appears that the EU will only begin negotiations around the more critical issue of the future trading relationship once agreement or progress is made on these issues. The UK believe that negotiations on exit and the future relationship should occur in parallel and not sequentially.

The European Commission Brexit Task Force will conduct day-to-day negotiations with the UK. Led by Michel Barnier, the task force's negotiating mandate will come from the European Council.

The European Council has convened on the 29th April in a EU27 format to adopt the negotiation guidelines on Brexit. These guidelines define the framework for negotiations under Article 50 TEU and set out the overall positions and principles that the European Union will pursue throughout the negotiations.

The European Council will remain permanently seized of the matter, and will update these guidelines in the course of the negotiations as necessary. The European Heads of State are expected to make sure the negotiations reflect their national priorities and objectives.

Brexit statements in Brussels and London have shifted from 'Soft versus Hard' to 'Orderly versus Disorderly'. An 'orderly' exit' could be one where the UK engages with the EU on the four issues. This would enable discussions on the future trading relationship to begin early in the negotiating window.

The complex nature of negotiation means that the trading relationship in the exit agreement is likely to be only high level. It would be based on a set of agreed principles. As such, any exit agreement would have to provide for a series of transitional agreements. These would help subsequent negotiations around the future trading relationship.

Were the UK and EU to fail to reach an exit agreement, this could likely result in a 'Disorderly' exit. Such a situation would see the UK simply sever all ties with the EU. World Trade Organisation rules would then regulate the EU-UK trading relationship.

The outcome of Brexit – our view

There are a range of possible outcomes to Brexit. However, we believe that the two most likely outcomes are outlined below, based on the information currently available. This will allow your organisation to start assessing its risks.

As the EU has proven throughout its history, the outcome of any negotiation is possible - depending on the prevailing political sentiment and the approach of deadlines. However, in the absence of such an agreement, Outcome 1 would be the likely outcome in our view.

Outcome 1

The UK receives Third Country Status

This would occur if the following happens:

- The EU and the UK fail to agree the terms of the divorce agreement. This disagreement could occur over the actual terms of Brexit, or even the principle of having the financial terms of agreement negotiated first.
- The freedom of movement of people becomes a sticking point. There are no free trade agreements with the EU where some element of free movement of people does not also apply. This could be a politically difficult issue for the UK government.
- Payment for access. Free trade agreements with the EU (e.g. those with Norway or Switzerland) contain clauses where those states make a contribution to the EU. Can the champions of Brexit accept continuing to make annual remittances to Brussels?
- There is not enough time to negotiate a deal.

On the basis of these four assumptions, the possibility that the UK could receive Third Country Status with regard to the EU remains a real risk.

Outcome 2

A valid Free Trade Agreement is agreed

A conventional FTA would not require the UK to accept free movement or the authority of the European Court of Justice. However, FTAs traditionally, do not do a great deal to open up services markets (a British strength) or remove non-tariff barriers to trade.

This could occur if the following happens:

- Tariffs would not apply, but the non-tariff barriers would still be in place.
- The UK agrees to continue to make a contribution to the EU.
- The UK softens its approach to freedom of movement of people for the remaining EU member states.
- The UK prioritises FTA negotiations with the EU, over other potential trading partners.

Looking at these two outcomes and considering recent statements from the UK government, we think businesses should base their model on Outcome 1 as a worst case scenario. This would not be a good outcome for Belgium or the UK. Of course, any outcome is possible with the right political sentiment.

What does Third Country Status mean?

While only one option, if the UK were to end up in Third Country Status, there are multiple rules that would apply.

In the complete absence of any agreement, the default is to move to World Trade Organisation (WTO) standards.

This means that goods moving between the UK and the EU or Belgium would be subject to tariffs at the normal EU rates, and non-tariff barriers such as customs administration charges would apply.

In the reverse, goods moving from the EU or Belgium to the UK would be subject to similar tariffs, but the rates would be based on whatever agreement the UK secures at the WTO.

The free movement of people is a separate matter. This will be determined by whatever agreement is made - with a strong belief that a deal on the Common Travel Area is possible.

Third Country Status for the UK

There has been much discussion about the potential post-Brexit scenarios for the UK.

There are many arguments and models, a myriad of assumptions and potential scenarios that may play out. However, we think it comes down to four simple principles that could lead to the UK acquiring Third Country status.



“Goods move freely, so do people”

Existing free trade agreements require adherence to the four principles of the EU – the free movement of goods, services, capital and people.

We understand that the UK has no issue, and never has, with the first three.

However, the movement of people was one of the major issues in the Brexit referendum. To concede on the free movement of people - effectively meaning that there would be no immigration controls for the UK - would be seen as a reversal of the democratic will of the UK electorate.

This is unlikely to be simply an EU-UK issue. Countries such as Australia, India and China are already asking for assurances around the access rights of their nationals employed in the UK, while indicating that they are still keen to do trade deals with the UK.



“Pay to Play”

There is no free trade agreement with the EU where the external entity does not make a contribution to the EU coffers.

For example, Switzerland pays €450m per annum. On a roughly pro-rata basis, the UK would need to pay £3bn in annual contributions.

The total UK public spending in 2016-17 is expected to be €772bn.

In economic terms, this would be manageable; in political terms, it is challenging. The Leave campaign in 2016 ran advert campaigns promising an extra £350m per week to spend on public services in the UK if Brexit was voted through. Continuing to send money to Brussels may be considered a bridge too far.



“The divorce settlement”

In order to exit, the EU insists that the UK makes a settlement on their outstanding liabilities to the Union.

While there are a wide range of estimates - the Centre for European Reform says the figures are between €24.5bn and €72.8bn - the broad headings are understood.

For example, the UK has outstanding liabilities to the EU unfunded pension scheme. The EU is looking for pro rata payment for all officials. The UK may resist this and insist on no payment or payment for past UK officials.

Then there is the gap between budget commitments and what has been paid, what is termed in Brussels the “reste à liquider”.

Additionally, the divorce agreement will need to include investment commitments after 2019.



“The clock is ticking”

There simply is not enough time to agree Brexit arrangements within the two year period.

The UK government has admitted that a full suite of trade deals could take 10 years to agree.

When they left the EU, Greenland's trade deals took three years to negotiate. They mainly export fish, and the import of fishing ships and petroleum accounts for 29.3% of imports - not a lot of categories to have to negotiate trade deal under, and yet it still took three years. Greenland's total annual trade is USD\$1.6bn.

These principles are based on rational theories and an expectation that the players in the EU behave in their best national, economic and political interests. Of course, this is also based on the assumptions about the future. There is no doubt that an agreement can be reached if the political will to compromise and agree exists.

What do you need to do now?

Most companies have no plan in place to deal with the consequences of Brexit.

In our conversations with clients, the most common rationale for this low engagement with such an important matter is an overwhelming sense that the issue is too complex. Organizations feel that there are too many variables to effectively deal with.

Step 1

We don't agree with this. You should take action now...

In this paper, we have described what we believe are the two most likely outcomes. We think companies can proactively follow a simple series of steps to prepare themselves for Brexit.

This includes performing a comprehensive risk assessment and developing a set of actions to quantify the risk to their P&L and Balance Sheet risk. This way, they can assess their Brexit exposure over the medium term.

Every company and industry sector need to develop its own set of mitigating and contingency actions to address and close that gap.

Create a baseline set of assumptions

We suggest you use our model as your baseline. Use additional data to address specific issues you may have in your company or sector.

Starting with the proposition that the UK ends up with Third Country status, layer on particular aspects relevant to your organization. These may include:

- Do you import/export products from/to the UK?
- Do you have people seconded to/from the UK?
- What about EU product standard, safety measures and trademarks?
- What about market access for services from the UK to the EU and vice versa?

Ideally, each organization will be able to quickly define a set of basic assumptions to inform their Brexit planning. Everyone in the organisation needs to understand and use the same set of assumptions in all planning and strategy work.

Keeping your assumptions concise also allows for straightforward periodic reviews and simple modifications of assumptions as the Brexit landscape becomes clearer.



Step 3

Develop a set of actions to mitigate and reduce the impact

Once you have developed your detailed risk analysis, you can assess the results. This should allow you to identify the risk areas and develop suitable mitigating actions for your business taking into account the time needed for their implementation .

We are working through this three step activity with our clients. We are certain it can help you to fully understand the effect of Brexit on your organisation. We believe that by talking to our experts and learning from best practice will significantly help you Brexit proof your business.

Step 2

Analyse your business

Using the assumptions you have developed in Step 1, work through the core elements of your P&L. Ask questions like:

- How is your revenue line constructed?
- What are the impacts of the assumptions in your working model?
- What is the impact on your cost base?
- What impact will there be on your working capital requirements?

This allows you to assess the financial impact on your business and highlights where the areas of greatest risk are.

Brexit taskforce

Over the past number of months, we have been scenario planning for Brexit with industry experts, economists and clients.



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Axel is the Chairman and Senior Partner of PwC Belgium. He is a chartered tax consultant by training and - before assuming his current position - was the head of the Belgian Tax and Legal practice. Over the past two years he also facilitated PwC's EMEA Tax and Legal practice. In addition to his leadership position, Axel remains active as a client partner within our firm.



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Nancy is the Clients & Markets Leader. She is leading the M&A practice and has 20 years of experience in the field of international taxation as well as financing structures. She has a significant expertise in all tax aspects involved in acquisitions as well as corporate simplification and restructuring.



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Lionel is heading up PwC's Customs & International Trade Belgian team and has also been appointed as PwC Europe Customs Coordinator. Lionel is supporting clients cross industry in addressing the Customs & International Trade impact associated with Brexit.



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Our Brexit taskforce is ready to work with you to ensure that across every aspect of your organisation, risks are mitigated and opportunities maximised.



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Ine is the Brexit Taskforce Leader. She is the partner in charge of Law Square's tax policy, dispute resolution and litigation practice. She has been the Global Indirect Taxes Leader and the Client Relationship Partner for services provided to the EU Institutions at PwC. With her expertise in EU and Belgian policy, she is engaging with clients cross industries to help them through their Brexit challenge.



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Karin is the Managing Partner of Law Square and also heading the Corporate & Commercial Law practice of the firm. She is assisting clients regarding Brexit using her experience gained from helping numerous Belgian and international clients in the setting-up, (re)structuring and handling of their corporate and financial organisation and their commercial activities. With her team she also covers other aspects of corporate and business law, including contract law, IP, real estate matters and data privacy (GDPR).



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Jurgen is Advocaat Vennoot / Avocat Associé in Law Square's Tax Policy - Dispute Resolution & Litigation practice. He is supporting clients in addressing the customs and trade impacts associated with Brexit and in assessing the impact of Brexit on logistics services and sourcing contracts. Jurgen also covers clients' concerns about the impact of Brexit on the legal framework and on current and future disputes and litigation (e.g. before the Court of Justice of the European Union).

Our experts will help you protect your business and tap into areas of potential growth.

Please get in touch with any of our experts below or your usual PwC or Law Square contact.



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Peter is PwC's Belgian People & Organisation Consulting Leader. His background includes projects with a high-level of complexity, conducted for the Belgian, European and Middle East Market. His key areas of expertise are: people aspects of organisation transformation, change management, HR transformation and improving the ROI of your workforce.



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Claire has 20 years of experience within Indirect Tax with a specialisation in VAT and a strong focus on international trade. She is a VAT Director accredited tax consultant, specialised in VAT, both at a Belgian and European level. She has unique experience gained from spending her time partly as a consultant and partly as the global VAT Director of a Swiss based MNC for several years.



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Bart leads the Employment Law & Immigration team in Belgium. He is supporting clients cross industry in addressing the people impact associated with Brexit.



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Floris is part of PwC's technology consulting practice, with more than 25 years of experience. Based in Brussels, Floris' client work has focused mainly on governance and public sector with major programmes undertaken for European institutions, NATO and national governments, working on development aid and the digital agenda, including cyber security, e-procurement, open data and digital-by-default programmes. Next to his role as Belgian consulting lead, he oversees the cyber-practice for PwC EMEA, and for PwC's consulting work for Government and Public Services globally.

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Page 9 The clock is ticking

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