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Brexit – an eleventh-hour trade deal

The UK and EU finalised a [Trade and Cooperation Agreement](#) one week before the end of the transition period.

The agreement in principle allows for tariff-free and quota-free trade in goods to continue, but with conditions. Many firms will face increased costs or loss of trade. Others may find opportunities.

Much remains to be agreed. Brexit is an ongoing process and trustees need to understand the effects of the changing environment on their own particular scheme and sponsor.

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Background

The UK and EU finalised a Trade and Cooperation Agreement (TCA) on 24 December 2020. The agreement has been implemented in UK law and provisionally applied in the EU, pending approval from the European Parliament.

The TCA introduces frictions to trade in goods between the UK and EU. Many firms will face increased bureaucracy and costs, when compared to the extended membership of the single market that applied during the transition period. Significant barriers to trade in services have been erected, which vary from member state to member state. The impacts on both goods and services will be very sector specific. Trustees will need to understand what they mean for sponsor covenant in their particular circumstances.

Agreement has yet to be reached between the UK and EU on major issues relating to financial services. There is, therefore, continuing uncertainty for investment managers and other financial services providers, notwithstanding preparatory adjustments and contingency plans that many had made during 2020. Trustees should consider asking questions of their providers regarding the impact of the latest developments.

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What is the Trade and Cooperation Agreement?

The TCA is the main document governing the future relationship between the UK and EU on trade and security. It sits alongside the Withdrawal Agreement, which governs the terms of departure, including the unique position of Northern Ireland.

The TCA runs to over 1,200 pages, including over 800 pages of Annexes. The dense legal text is very difficult to understand for anyone without specialist knowledge of trade agreements. The Institute for Government has published a useful [summary](#).

Businesses and individuals will need guidance from government, trade associations and others, in order to understand the implications. The last-minute nature of the agreement means that it came into effect before any substantive guidance was available from either the UK government or European Commission.

Notwithstanding its length and complexity, the TCA is essentially a framework for ongoing discussion. Implementation will be overseen by an EU/UK Partnership Council, with numerous committees and working groups to work on the detail in different areas, from Technical Barriers to Trade to Social Security Coordination.

The TCA was accompanied by several Joint Declarations on matters that remain outstanding, for example, financial services regulatory cooperation and visa/border arrangements for road hauliers.

The UK and EU have agreed level playing field commitments, relating to subsidies, labour standards and other matters. Significant divergence impacting trade or investment could result in tariffs or suspension of the agreement. The entire agreement is subject to review every five years. Such ongoing uncertainty makes the UK a potentially unstable economic environment for long term investment decisions.

What is the impact on companies trading in goods?

While most goods are free of tariffs and quotas, trade is now subject to customs procedures. These will be entirely new to firms that have not previously imported/exported outside of the EU. Very little was agreed in terms of easements.

Import processes and checks in the UK will be phased in in three stages: in January, April and June 2021. Processes and checks in EU countries may be phased in over a period, but this is not clear. Guidance on implementation from both sides is lacking. IT infrastructure at the UK border and its integration with commercial software is largely untested.

Tariff-free trade is dependent on firms proving compliance with rules of origin. This means that firms must be able to demonstrate that a minimum proportion of the components going into the product were sourced from the UK or EU. If not, tariffs will be due. Compliance with rules of origin can be costly; some firms may find it cheaper to pay tariffs. For others, such as processors and distributors of food grown elsewhere in the world, tariffs will be impossible to avoid.

Larger firms may be able to take advantage of simplified customs procedures under 'trusted trader' schemes. Much is decided at member state level, opening the possibility of future bilateral arrangements with Ireland and France, such as exist between Norway and Sweden.

Regulatory burdens will increase for many firms. While there are specific arrangements for certain sectors, in general, compliance with product standards will need to be separately certified by UK and EU bodies.

Internal trade between Great Britain and Northern Ireland is a special case, governed by the Protocol under the Withdrawal Agreement, which is overseen by a separate Joint Committee. Customs procedures are being phased in over the first three months of 2021 (and may be extended).

What is the impact on companies trading in services?

Larger impacts may be felt by firms providing services to clients in the EU. While the single market in services is less developed than that in goods, it is underpinned by three things that don't now apply to UK service providers: freedom of movement; freedom of establishment; and mutual recognition of professional qualifications.

The TCA allows market access for services but makes that access subject to detailed and extensive 'reservations' or carve-outs which vary country-by-country.

Regulated occupations could be badly hit by end of mutual recognition. Lawyers can advise EU clients (subject to varying conditions in different member states) on the law in England and Wales but are barred from advising EU clients on EU law. Other UK-qualified professionals are essentially barred from practising in many EU countries.

There is a list of specified occupations that UK nationals may undertake in the EU. However, these are again subject to carve-outs and requirements that vary by member state, for example, work permits, residency and economic needs tests.

Business travel will become more complicated. Short business visits may be made visa-free for a maximum total of 90 out of each 180 days and 11 specified purposes, such as attending meetings or trade fairs. The 90-day limit includes visits for personal as well as business reasons. Businesses may, therefore, need to track employees' time spent in the EU, including on holiday.

Services are subject to Most Favoured Nation clauses; if the EU gives better rights to other countries, it must also give them to the UK (and vice versa). The EU has similar clauses in its agreements with Japan and Canada, meaning that it could not give better terms to the UK without also extending them to Japan and Canada. It is, therefore, very hard to see how EU market access for UK service providers will in future get back to what it was.

What is the impact on companies trading in financial services?

The outlook for financial services companies' operations within the EU is uncertain, as the TCA did not include financial services. The regime of passporting came to an end with the end of the transition period, as a result of which UK financial service firms that wish to do business in EU states will have to navigate the rules of each country. There has also been only very limited recognition of Equivalence by the EU, meaning a lot of business done in London, such as share trading in EU-listed companies, has had to shift to trading venues within EU states.

Whilst negotiations on the future relationship are ongoing, with a Memorandum of Understanding expected by the end of March 2021, there is widely expected to be a permanent shift in financial

service provision in Europe, with particular impact on the City of London. The changes do include the establishment of a new UK fund structure, which we can expect to hear more about in due course.

What do trustees need to do on covenant?

It is vital that trustees and sponsors have a shared understanding of the risks that the end of the transition period poses to businesses and their ability to support defined benefit (DB) schemes. Even if a sponsor does not directly trade with the EU, its suppliers might. The biggest problem might well be outside the business, wherever the weakest point in the supply chain is.

Trustees should ask questions of sponsors on the impact on their business, for example:

- Resilience to short-term disruption to imports or exports.
- Effect of regulatory compliance costs and/or tariffs on profitability.
- Effect of any restrictions on services that can be provided to EU clients.
- Impacts on any business activity in Northern Ireland.

Trustees should ensure that these and other sector-specific issues are included in their regular covenant monitoring. Advice may be needed.

What do trustees need to do on investment?

Trustees should maintain awareness of how the changes taking place impact their investments – from not just a risk and expected return perspective but also operationally. We recommend they ask their providers questions regarding the preparations they have been making for the new operating environment, for example:

- Moving of investment or operational teams to within the EU.
- Movement of assets under management.
- Establishment of new fund ranges.
- Plans responding to the latest developments in financial service provision between the UK and EU, including impact on hiring plans.

At the level of your scheme investments, it would be beneficial to understand how the deal impacts planned investment decisions, for example:

- Expectations for inflation and government debt yields, especially gilts, in near and longer term, and how these may impact your scheme.
- Equity managers holdings of European Equities within the global equity portfolio.
- Which risks have risen or fallen as a result of the deal, and how these are being managed.
- The managers' observations so far with regard to impact on costs, for example, ability to place trades in a new trading environment, or changes in transaction costs borne by the funds.

As the situation is ongoing, this dialogue will have to be maintained as the situation unfolds and a new landscape of risks and opportunities becomes clearer.

Comment

Most commentators have agreed that the TCA is a positive step and removes some of the uncertainty the UK was facing at the end of 2020. However, the trading and regulatory environment will be very different to what it was under the single market and may lead to the remodelling of supply chains.

Much detail remains to be decided between the UK and EU in the coming months and years. It is likely that Brexit debate will now fade into the background of the national conversation; reporting of ongoing sector-by-sector negotiations will move to the business pages and trade press. Trustees need to understand the effects of the evolving trading environment, particularly in respect of their scheme investments and the covenant of their sponsoring employer.

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