Planning for the future

The Leave vote in the Brexit referendum is set to trigger a period of major uncertainty for business. There may be significant implications for employers and their workforces but the precise nature and scope of those implications remain unclear. This is because no-one knows quite what the withdrawal process will entail and what form the UK’s trading relationship with the EU will take in the future. The future of the UK in its current form has also been thrown into doubt once again, with Scotland’s First Minister indicating that she will push for a further independence referendum. This briefing summarises what we think are likely to be the key questions employers will need to address over the coming weeks and months.

We will send further regular updates as the implications become clearer, giving answers to outstanding questions as they emerge. Our team of experts is available to meet at any time, whether you would like to discuss the employment, pensions and benefits aspects of Brexit generally, or want to talk about individual topics in more detail. Please do feel free to speak to your regular contact or call or email any of us listed below.

Will anything change straightaway?

No. There are unlikely to be any immediate changes. The UK currently remains in the EU, subject to existing EU rules, and the withdrawal process is likely to take some time. Nevertheless, many employers have already been developing contingency plans, which they will now need to put into effect.

Will I need to restructure? What impact may this have?

Full access to the single market for goods and services is likely to require the UK to continue to accept the principle of free movement of persons in its current form. Given the apparent significance of immigration to the outcome of the Brexit referendum, it may be difficult politically for the UK Government to agree to a continuation of free movement in its current form. Unless matters are satisfactorily resolved, some companies (particularly those in the financial services sector) may ultimately conclude that they need to relocate aspects of their operations into an appropriate EU member state to ensure continuing full market access. If this becomes necessary, it could impact established UK workforces, and may not be straightforward to implement if the key individuals are UK nationals whose
right to live or work in the EU could be affected by Brexit.

A decision to relocate operations could give rise to significant organisational change, including in the possibility of collective redundancies. It may also mean that changes need to be made to existing contractual arrangements. For example, employees with duties in both the UK and the EU (particularly those who are working on passported financial services in the EU as well as other activities) may need to enter into carefully drawn secondment or dual contract arrangements to support and differentiate between the duties that are being performed.

Organisational change is also likely to require consultation with employee representative bodies which, in larger organisations, may include consultation with existing European Works Councils (although the continuing status of English-law governed European Works Council agreements may itself be thrown into question by Brexit).

What is the likely impact on UK pension schemes?

If the negotiations with the EU are not satisfactorily resolved, and certain operations are re-located into the EU, there could be also be consequential implications for the funding of defined benefit pension schemes. In certain circumstances, employee transfers could result in employing companies triggering debts to pension schemes under section 75 of the Pensions Act 1995, equal to those employers’ shares of the buyout deficit in their pension schemes. These debts are often material and the prospect of them may require corporate groups to negotiate with pension scheme trustees to apportion the section 75 debt liabilities or otherwise ensure that the debt is reduced or not triggered.

At the same time, a reorganisation might mean that part of the employer covenant that supports the UK pension scheme will disappear or be moved from the direct reach of the pension scheme. A weaker covenant is likely to drive up funding costs as pension scheme trustees look to reduce risk and accelerate deficit funding payments. This may require corporate groups to offer appropriate mitigation to offset the impact on the covenant, such as intra-group guarantees (potentially from entities in EU member states) or security over assets. The leverage of scheme trustees in such negotiations could be significantly increased if it is also necessary to ask them to agree to measures to reduce or apportion an employer’s section 75 debt.

What other implications are there for pension scheme funding?

We have already seen turbulence in the financial markets following the referendum. A sustained fall in asset prices would have a negative impact on scheme funding levels, and potentially affect the extent to which schemes can rely on investment outperformance in order to help remedy funding deficits over time. At the same time, as it is currently expected that the Bank of England will seek to prolong low interest rates in response to market turbulence, the discount rates used when valuing scheme liabilities may continue to be low or indeed could fall further, thereby increasing the size of those liabilities and scheme deficits. Indeed, immediately following the vote, there were reports that the combined deficit of UK defined benefit pension schemes had increased by £80 billion, reaching an overall level of £900 billion.

Market conditions and any move by banks to restructure or relocate operations could also affect the ability of pension schemes to obtain hedging for key risks, or the price at which such hedging is available. Greater foreign exchange risk and volatility could also impact on investment returns.

That said, any pressure on the UK’s credit rating that results from the Brexit vote could increase gilt yields over time, which could then lead to a substantial reduction in deficits.

A sustained period of difficult market conditions could cause financially weak or marginal employer sponsors to enter into distress in the coming months. For some employers, it may be appropriate to consider whether it is necessary to make restructuring proposals to their pension scheme trustees, in advance of any threatened insolvency, to enable the company to continue in a sustainable manner. Given the complexity of pension scheme
restructurings and the time it often takes to agree and implement them, acting sufficiently in advance could make a real difference to whether any such restructuring will be successful. Similarly, scheme trustees will need to monitor the covenants of their sponsors and assess the extent to which changed economic conditions may affect them, and draw up appropriate contingency plans.

What impact will there be on my ability to employ EU nationals in the UK, and on my ability to transfer UK nationals to operations within the EU?

It is likely that there will be some change in due course, at least for EU nationals not already within the UK.

As explained above, it is difficult to see how, politically, the UK Government would be able to accept the continuation of principles of free movement in their current form. It is also hard to see on what basis any alternative EU/UK arrangement would enable different rules to be applied to different EU member states (so that, for example, the immigration rules for a German national are different to those applicable to one of the newer member states). This is likely to mean that the UK decides to apply its immigration rules uniformly to EU nationals wishing to move to work in the UK. The administrative implications of this for both businesses and the immigration authorities are considerable.

It is nevertheless highly unlikely that there would be any change to the status of EU nationals currently in the UK while withdrawal negotiations are taking place, and Leave campaigners have repeatedly said they would not remove EU nationals who are already in the UK at the time Brexit is implemented. The same is thought to be true of UK nationals working within the EU.

Will there be fundamental changes to employment laws?

There may be some change over time but major adjustments are unlikely. European law has become a key part of the fabric of domestic employment law, both statutory and case-law, over many years. Notwithstanding the suggestion of some Brexit campaigners that a Leave vote gives an unrivalled opportunity to deregulate domestic employment laws, it is unrealistic to expect that there will be wholesale change.

Areas that could be the focus for change include more controversial recent EU developments such as the rules on agency workers, working time and aspects of holiday pay law, not least the accrual of holiday pay during periods of sickness. And, from a sector-specific perspective, the UK (having already launched a, subsequently discontinued, legal challenge to their validity) can be expected to look to disapply the rules on bonus caps within the financial services sector. There might also be a focus on aspects of more long-standing European legislation that are thought to be unduly restrictive, such as restrictions on the ability to achieve consensual harmonisation of terms and conditions following a TUPE transfer. So we may see a degree of “pick and choose” emerging.

The scope to make these and other changes will be influenced by the nature of the relationship that is negotiated between the UK and the EU. If the UK wishes to try to secure broad access to the single market, it will be expected to continue to apply EU employment rules. The EU will not permit social dumping – the last thing it wants is to allow the UK unrestricted access to the single market if it is able to apply more flexible employment laws than member states.

Will there be fundamental changes to pensions law?

As pension scheme funding is currently attracting significant political attention, major changes may indeed be forthcoming to the pensions regulatory regime. However, any such changes are not expected to be prompted by Brexit itself. Indeed, while EU requirements permeate many aspects of the pensions regulatory regime, for the most part that regime...
reflects UK political priorities and Government policy to date. There may be more flexibility to address technical difficulties or potentially onerous requirements, such as some aspects of anti-discrimination law. For more details, see our separate briefing on the pensions regulatory implications of Brexit.

Will we still be able to operate cross-border pension schemes?

Subject to any continuation of the UK in the EEA, or another form of participation in the single market, groups that have operated UK-based cross-border pension schemes for employees across the EU are likely to find that those schemes can no longer operate in EU member states. Conversely, it may be that a cross-border pension scheme that is based in an EU member state can no longer be used for UK employees. The replacement or relocation of these pension arrangements will then become necessary. As schemes are most often used in the UK for members with defined contribution benefits, it will be rare for the unwinding of cross-border arrangements to trigger UK defined benefit funding issues.

Will we still be able to operate our share plans across Europe?

Companies that have to date relied on a London listing in order to offer their share plans to employees throughout the EU are likely to find that this exemption is no longer available. Some companies will be able to rely on other exemptions to be able to continue offering share awards to employees but others will need to submit to the expense of producing a prospectus if they want to continue to operate their share plans as they do today.

What if post-vote economic uncertainty adversely affects targets for performance related pay?

Many companies may be concerned that the ability of long term incentive plans (LTIP) and other incentive arrangements to provide meaningful incentivisation to key employees will be compromised by the economic fall-out flowing from the Leave vote, and the impact this could have on the attainability of internal performance targets such as earnings per share (EPS) and return on capital employed (ROCE).

However, it will not always be straightforward to adjust performance targets for existing awards. Although plan rules do generally confer a power on remuneration committees to adjust performance conditions, they are normally restricted from doing so unless the new conditions are at least as demanding as those they replace. Institutional investor sentiment will also need to be taken into account – investors will be subject to the same economic dislocation as everyone else and may not be sympathetic to changes that are perceived to make it easier for employees to earn incentives.

Remuneration committees will also need to consider whether it is appropriate to adjust targets now – so that the targets continue to provide meaningful incentivisation for key employees but also carry the risk of needing further adjustment because of unforeseen economic fall-out – or wait until the end of the relevant performance period, when a single adjustment can be made but with the risk that in the meantime the award may have ceased to have any motivational value. Remuneration committees may find themselves approached by executives asking for performance adjustments, and need to start preparing for how they will respond.

Will we need to undertake a whole-sale employment contract/policy review?

Not immediately. But once the likely path to exit becomes clearer and the consequent implications for business are more fully understood, it is likely to be necessary to undertake a comprehensive review of all contractual terms with staff. Although it is unlikely in an employment context that Brexit will give rise to a risk of contractual unenforceability,
there may be provisions in contracts (for example, relating to the scope of restrictive covenants or mobility provisions) that require adjustment. A broader review is likely to extend to relocation and expatriate policies, immigration requirements, an analysis of the scope and application of protective covenants in connection with business change and reorganisation, as well as a wider review of how staff are remunerated and incentivised.

What are the implications of Brexit for employee data privacy?

The new EU Data Protection Regulation, commonly known as the GDPR, comes into force in 2018. This will apply directly to member states. Depending on the precise timing of withdrawal, the GDPR may not apply to the United Kingdom and, even if it does initially apply, it will then cease to do so. The GDPR introduces more stringent regulation of personal data across the EU, including making specific and explicit consent to data processing a requirement and strengthening the regulation of the transfer of personal data outside the EU.

The UK Information Commissioner has made it clear that he expects standards equivalent to the GDPR to be applied in the UK post-Brexit to enable businesses to transfer their data between the UK and the EU in the ordinary course of business. Brexit is therefore unlikely to make a material difference to how employers plan for the GDPR.

For further information on any of the issues raised in this briefing, please contact any of the contacts listed below. For further information on any other issues posed by Brexit, please see our Britain and the EU website. Your usual Freshfields contacts will be very happy to assist you in any contingency planning as you assess the impact of the vote to leave for your business.
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