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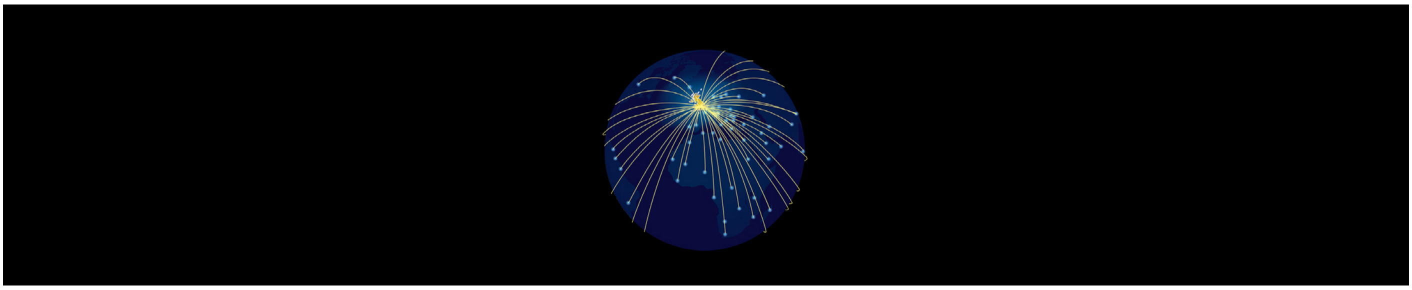

Brexit Industry Insights
Automotive

May 2020

The UK left the EU on 31 January 2020 and is currently due to exit the transition period on 1 January 2021. During this period automotive businesses are navigating global structural change and challenging supply chain demands. As the UK and EU negotiate the specific details of their future trading relationship, what is clear is the UK will be leaving the Single Market and the Customs Union at the end of the transition period. Businesses can already identify known change areas and, given the negotiating positions of the two sides, can start preparing.

The impacts of Brexit will also lead to change in the sector, which for some businesses could represent a significant departure from 'business as usual'. There are changes we know are coming for certain, and the time to act is now. The winners over the longer term will be those in the sector prepared for change and alive to the opportunities.

Coronavirus

The coronavirus pandemic has affected the world in an unprecedented way. In addition to the human toll and the disruption to millions of people's lives, the economic damage is significant and far-reaching. The virus has created a supply and demand shock to businesses globally. How the situation will unfold is as yet uncertain, but coronavirus is likely to continue to provide significant headwinds to the automotive sector for the year ahead.

What does Brexit mean for the automotive sector?

The UK's automotive industry generates 12% of total exports and a turnover of £82 billion. The industry indirectly employs over 800,000 people across the UK.[1]

The loss of the free, frictionless movement of goods between the EU and the UK, and wider consequences of Brexit could have significant impacts on the industry, including the likelihood of additional customs procedures and potential tariffs. The sector also depends upon existing EU third country FTAs benefitting from preferential access to markets outside of the EU and reduced tariffs, to which the UK may lose access post Brexit.

Some of the key implications for businesses operating in the sector are:

Supply chain

Automotive supply chains are complex and often interwoven, with a modern car often having in excess of 30,000 parts with components using different raw materials and manufacturing processes.

- **Tariffs:** The UK and the EU have set out their ambitions to negotiate a tariff-free, quota-free trade deal. However, should they fail to reach agreement on this deal, then tariffs for automotive parts will still apply at WTO most favoured nation rates. Currently, the EU's external tariff on finished cars is 10% whilst tariffs on car components range from 2.5–4.5%.

1. https://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Motor-Industry-Facts-May-2019-V2.pdf

- **Loss of existing EU FTAs:** Car manufacturers are having to look at the status of the UK's trading relationship with third countries. The UK is in the process of 'rolling over' the EU's third country agreements, but this process will may not be complete by the end of the transition period. Where these trade agreements are not able to be 'rolled over', trading with these countries will move to WTO terms.

- **Rules of Origin:** Cars, like other products, only qualify for the preferential tariffs granted under a FTA if they are able to satisfy that a certain percentage of production, often 55%, has taken place in that jurisdiction, termed the "Rules of Origin". On average, the proportion of parts actually made in the UK is less than 25%[2], though any deal between the UK and EU will cover bilateral cumulation between the two, meaning content from both sides will count towards meeting the threshold. Nevertheless, some UK exports may not qualify for the preferential tariff treatment. It is not just UK exporters who have to be concerned regarding this change – in cases where European producers are using components of UK origin, their final products may no longer satisfy the percentage required by the existing requirements set out in the EU's FTAs. A particular area of concern will be new and emerging supply chains relating to electric vehicles, where many of the components, especially batteries, are sourced outside the UK and EU (often from Asia). Furthermore, even if the thresholds can be met, there will be significant practical and administrative costs and challenges to proving this. Automotive manufactures will need to have complete visibility and data on their supply chain to be able to prove that the content requirements have been met.

- **Customs compliance:** Companies and their suppliers will need to contend with additional customs procedures which could put further strain on customs and compliance teams. Although large participants experienced in trading outside the EU may swiftly adapt to this challenge, smaller firms in their supply chain may not currently have the ability to do so. For these firms, carrying out customs procedures on goods may result in increased costs and lead times in processing goods. Beyond Tier 1 suppliers there are a number of businesses that rely on the demand from a single customer. Any decrease in demand or delays at the border could significantly impact their ability to operate.

- **Just in time delivery:** The sector is heavily reliant on just in time delivery – £35 million of components are delivered daily to the UK just in time from the EU. The impact of increased customs checks will add friction to currently seamless flows, and many components suppliers face extremely high penalties for failure to deliver on a timely basis. The actual delivery of these components could also become a concern, depending on the new rules on road haulage. Even with a deal it is not expected that hauliers from the one party (UK/EU) will be able to pick up and delivery within the other. If a deal is reached, there should be provisions to allow goods to be moved from one to the other, but this may still come with new permit requirements limiting the number of hauliers eligible. Finally, without a deal things will fall back on ECMT rules, which significantly limit the number of permits available for hauliers on both sides.

- **Commercial contracts:** Contracts may need updating to manage some of the potential risks arising from Brexit or in response to Brexit related restructuring. Areas of focus include: reviewing risk allocation between parties such as which counterparty bears the risk of border delays and tariff costs; definitions of key terms; changes to pricing structure or frequency of pricing reviews; and, changes to payment terms and contract enforcement.

Regulation

At the end of the transition period many EU regulations will be transposed into UK law. However, there is potential for divergence in regulations and standards in the UK and the EU over the longer term. Divergence could have significant impacts on the industry. Monitoring the change in requirements in both the EU and the UK simultaneously is likely to increase the burden on compliance teams.

People

The automotive industry is heavily reliant on skilled workers in specialist areas. The industry's recent push towards electrification and automation only furthers the reliance on a talent pool of specialists. For example, the battery management area has an already limited suitable talent pool[3]. Currently, at least 10% of people employed in the UK automotive manufacturing sector are from elsewhere in the EU[4].

EU/EEA citizens resident in the UK before 31 December 2020 will retain their rights to settlement and access to services, and they will need to apply under the EU settlement scheme by 30 June 2021.

The UK has announced plans to introduce a new points-based immigration system from January 2021 for all new EU nationals arriving in the UK after this date. The system includes a salary threshold of £25,600, the requirement to have a job, be educated to an A-level standard, and speak English.

Multinational automotive companies often have a highly mobile international workforce and are reliant on the efficient deployment of individuals around the world including within the EU.

Dual social security liabilities could arise for employers and mobile employees depending on the final agreement between the UK and EU.

In addition to potential difficulties in

2. http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-energy-and-industrial-strategy-committee/leaving-the-eu-implications-for-the-automotive-industry/oral/73855.html
3. https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/manufacturing/deloitte-uk-battery-electric-vehicles.pdf
4. See note 1 above.

recruiting sufficiently qualified employees from the EU/EEA, there could be difficulty in the UK developing its own talent. Currently, innovation in the UK automotive sector is boosted by significant EU funding – the industry has received approximately £3.5 billion in research grants to UK business and universities[5]. Whether the same level of funding for research and development (R&D) in the industry continues remains to be seen.

In focus: Type approvals

Vehicle and component manufacturers rely on type approval to show they meet safety and environmental standards before they can place a product on the market for sale.

If the UK leaves the transition period without an agreement on type approvals, then those issued in the UK will no longer be valid for sales or registrations on the EU market.

The government has previously indicated European Community type approvals (EC type approvals) issued outside of the UK will be accepted for registering vehicles on the UK market, for a period of time, though it has since distanced itself from these types of easements.

Businesses will need to ensure they are therefore able to manage the separate type approval for both the UK and EU markets and understand the additional costs involved, if they are not included in a future FTA.

There are examples of the EU accepting mutual recognition of type approvals, for example in the EU-South Korea FTA. It includes a provision on the mutual recognition of vehicle type approvals, which establishes that a type approval issued by one party's "competent authority", confirming conformity with the relevant UN ECE Regulations, must be accepted by the other party as providing proof of conformity. However, such recognition is rare, is at the most ambitious end of an FTA negotiation and has already been ruled out of scope by the EU as part of an FTA with the UK.

What can business do to prepare?

- Perform a full analysis and impact assessment of the known changes across the key areas of your business, these include – supply chain, workforce, tax, legal and regulatory.
- Establish a project management office function that appreciates the cross-functional challenge of Brexit, and has buy in from all key areas of the business.
- Conduct a trade continuity and market access review to understand your exposure to third country trade deals; assess your International Commercial Terms (INCOTERMS) to understand who in your supply chain bears the impact of losing beneficial trade terms.
- Conduct analysis to determine the additional customs procedures your business will be required to submit and understand import and export procedures for trading with the EU as a third country.
- Take steps to stock pile components or finished goods if required and identify and coordinate with key suppliers regarding their Brexit readiness.
- Review underlying commercial contracts for parts supply, identify risks and re negotiate as necessary.
- Undertake a regulatory review to be prepared for regulatory divergence, including type approval and product standards. Ensure your business is able to continue supplying goods to both the EU and the UK on the date of withdrawal.
- Continue to monitor developments from both the UK and EU regarding trade in goods. This should include trade agreements being rolled over by the UK.
- Continuously communicate with your EU workforce to encourage status certification as early as possible. Establish a process that monitors member state changes to immigration and social security that could impact UK workers in the EU. Consider how future HR and talent recruitment strategies may need to change.
- Manage all key stakeholders to understand commitments and expectations.

This Brexit guidance is not exhaustive. Companies should routinely review the latest official updates and technical guidance as and when they are published by the UK, EU, and individual EU Member States.

5. https://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-KPMG-EU-Report.pdf

How can Deloitte help?

Deloitte is a leading voice in navigating Brexit considerations with business and government. We combine our global Brexit insights with specialist knowledge of the negotiations, developed through advising clients across multiple industries, jurisdictions and technical subject matter areas. Using our **Brexit Impact Assessment**, we apply a methodical approach to mapping the impact of external drivers of change onto an organisation's business model, providing a clear framework for identifying critical actions.

For further information please contact Deloitte Brexit Support at
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