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Brexit Industry Insights

Automotive

September 2019

With the UK's default to leave the EU without a deal, the automotive sector continues to be vulnerable to disruption. This sector is faced with simultaneously navigating global structural change whilst mitigating the impacts of Brexit – including supply chain friction, regulatory divergence, loss of access to talent and uncertain continuity of existing third country free trade agreements (FTAs). The most successful firms will be those in the sector sufficiently agile to adapt to the changing environment and alive to the opportunities these changes present.

Brexit and the Automotive sector

The automotive industry is a vital part of the UK economy, generating 12% of total exports and a turnover of £82 billion. The industry indirectly employs over 800,000 people across the UK[1].

However, 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 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.

What does this mean for business?

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

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. With the industry's recent push towards the principals of connectivity, autonomy, sharing and electrification (CASE), the automotive sector is in the process of reviewing its supply chains in order to develop new partnerships and source new components:

- **Tariffs** – In the event of a no-deal Brexit, the EU will treat UK exports the same as those from third countries under its Most Favoured Nation obligations as defined by the EU's World Trade Organisation (WTO) commitments. With 53% of UK assembled car exports and 69% of British built components exported to the EU, a 10% tariff on exports is projected to cost £1.8 billion[2].

  Furthermore, in the case of imports into the UK from the EU, the UK government has published its draft temporary Tariff Schedule that would apply for a period of 12 months in a no-deal scenario[3].

1. https://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Motor-Industry-Facts-May-2019-V2.pdf
2. ibid
3. https://www.gov.uk/government/publications/temporary-rates-of-customs-duty-on-imports-after-eu-exit/mfn-and-tariff-quota-rates-of-customs-duty-on-imports-if-the-uk-leaves-the-eu-with-no-deal
4. https://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Motor-Industry-Facts-May-2019-V2.pdf

Assuming the rates are adopted by the new government, the temporary tariff schedule has set the rate for finished cars at 10%, equivalent to the rate the EU currently applies to finished cars coming from third countries. With 68% of cars registered and 80% of imported components coming from the EU, it is projected to cost £2.7 billion[4].

With this additional duty applied, exporting finished cars from the UK and EU will have decreased economic viability in a sector already faced with low margin on sales.

Although the UK's temporary tariff schedule has set the rate applied to most car parts at 0%, which would help to ease the additional tariff costs arising in the supply chain, imports into the EU would be subject to third country rates. With part-finished goods crossing the UK-EU border multiple times, the UK's temporary tariff is only a partial solution. Tariffs will also apply to finished goods moving between the UK and EU.

- **Loss of existing EU FTAs:** Car manufacturers are also 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 not be complete by 31 October 2019[5]. 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 65%, 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%[6]. Therefore even with the rolling-over of these FTAs, 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.

- **Customs Compliance:** In addition to tariffs, companies and their suppliers will also need to contend with additional customs procedures including customs declarations, 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. Furthermore, beyond Tier 1 suppliers there are a number of businesses who 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 border delays will add friction to currently seamless flows, and many components suppliers face extremely high penalties for failure to deliver on a timely basis. Businesses have stockpiled parts where feasible. Whilst some automotive businesses rescheduled factory closures in preparation for a 29 March exit date, the same scheduling changes are not possible for 31 October.

- **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.

Focus on: Rules of Origin

Rules of Origin are designed to stop goods being artificially routed through countries with favourable trade agreements to access beneficial terms that wouldn't otherwise apply.

Imagine, hypothetically, that a UK business wishes to sell product to the US, and that the tariff rate in the US for that product is 25%. However, the UK has a trade agreement with Ruritania that sets the tariffs at 0%, and the US has a trade agreement with Ruritania that sets the tariff at 5%. What would stop the UK business shipping its product to the US via Ruritania, and reducing the tariff charge by 20%?

The answer is Rules of Origin. Broadly, they require that a minimum amount of additional work has been undertaken in each country whose trade agreements are intended to apply. The rules that determine whether sufficient work has been undertaken vary from treaty to treaty and from product to product. Common methods include a determination of where the components that make up a product come from, an assessment of the value added to the end product in each country, or whether the additional work in each country has caused the product concerned to change its customs commodity code.

Focus on: 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 EU without a deal on 31 October 2019, type-approvals issued in the UK will no longer be valid for sales or registrations on the EU market.

5. https://www.gov.uk/guidance/uk-trade-agreements-with-non-eu-countries-in-a-no-deal-brexit
6. 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

Regulation

Although at the time of exit many EU regulations will be transposed into UK law, 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.

There may, for example, be changes to compliance requirements around reporting emissions. As European regulations are brought into UK legislation, there will be revisions within the text of these regulations to ensure they are fit for purpose in the UK. Since the new EU CO2 targets do not come into force until January 2020, they will not be copied into the UK statute book if there is a no-deal Brexit on 31 October. Despite the earlier no-deal preparation statutory instruments, there is a possible gap in the legislation if no action is taken. The government has said it may update the formulae that set specific CO2 targets to account for UK-only regulations, derogation thresholds and details on how fines are levied.

People:

The automotive industry is heavily reliant on skilled workers in specialist areas. The industry's recent push towards the principles of CASE only furthers the reliance on a talent pool of specialists. For example, the battery management area has an already limited suitable talent pool[7].

Currently, at least 10% of people employed in the UK automotive manufacturing sector are from elsewhere in the EU[8].

Under a no deal, free movement of people will end once the UK leaves the EU. EU/EEA citizens resident in the UK before 31 October 2019 will retain their rights to settlement and access to services, and they will need to apply under the EU settlement scheme by 31 December 2020. EU/EEA citizens moving to the UK after 31 October 2019 will for a transitional period be able to move to the UK to live and work as they do now. But those wishing to stay beyond December 2020 will either need to apply for European Temporary Leave to Remain by 31 December 2020 or leave the UK. The UK is expected to introduce a new immigration regime from January 2021 for all EU nationals arriving in the UK after this date.

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. Post-Brexit changes will need to be factored into existing processes to avoid delays in putting feet on the ground and/or increased costs. For example, immigration requirements for UK nationals planning to work in the EU will need to be confirmed on a country-by-country basis including expected time lines for completion of the immigration process.

Dual social security liabilities could arise for employers and mobile employees if member states do not agree to reciprocal arrangements with the UK.

In addition to potential difficulties in 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[9]. Whether the same level of funding for research and development (R&D) in the industry continues remains to beseen.

Focus on: Type approvals

European Community type-approvals (EC type-approvals) issued outside of the UK will no longer be automatically accepted for registering vehicles on the UK market.

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.

In the UK government's no-deal guidance, it is outlined that as the UK and EU technical standards will be aligned, the UK will issue provisional UK-type approvals to manufacturers that can prove they hold valid EC type-approvals. This will simplify the process for EU-based firms looking to access the UK market and ensure products can continue to be sold and registered in the UK. However there has not yet been reciprocity from the EU. Therefore UK-based firms must obtain a new EC type-approval from a competent authority in an EU jurisdiction.

7. https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/manufacturing/deloitte-uk-battery-electric-vehicles.pdf
8. https://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Motor-Industry-Facts-May-2019-V2.pdf
9. https://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-KPMG-EU-Report.pdf

What can businesses to do prepare?

- 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 – bearing in mind INCOTERMS, updated every 10 years, are due to change on 1 October 2019.
- 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.

Further reading

Official no-deal guidance for automotive

UK No-deal Technical Note:
1. Reporting CO2 emissions for new cars and vans if there's no Brexit deal
2. Vehicle type approval if there's no Brexit deal
3. The automotive sector and preparing for Brexit

UK Business Preparation Tool:
Prepare your business or organisation for Brexit

European Commission Brexit Preparedness:
Q&A for type approvals post-Brexit

- EU rules for CO2 standards for new passenger cars and new light commercial vehicles
- EU rules in the field of type-approval of motor vehicle

How can Deloitte help?

Deloitte has been supporting multiple businesses across a range of industries to understand the implications of, and prepare for, the UK's withdrawal from the EU. We have supported many clients with their Brexit planning. Our teams combine Brexit insights, industry knowledge and technical expertise to support our clients with their Brexit readiness planning – from risk assessment to applying the lessons learned to optimise for the future trading environment.

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