

**REPORT TO: PENSION SUB-COMMITTEE OF THE POLICY & RESOURCES COMMITTEE
& PENSION BOARD – 5 SEPTEMBER 2016**

REPORT ON: POTENTIAL IMPACT OF BREXIT

REPORT BY: EXECUTIVE DIRECTOR OF CORPORATE SERVICES

REPORT NO: 286-2016

1 PURPOSE OF REPORT

This report provides comment of the potential impact of the European Union Referendum Result from key service providers to the fund.

2 RECOMMENDATIONS

The Sub-Committee are asked to note the content of the report.

3 BACKGROUND

On 23 June the United Kingdom (UK) voted in a national referendum to leave the European Union (EU). This has resulted in uncertainty both for investors and for the wider financial services industry across the UK, Europe and the world.

4 SUMMARY

The following summarises key headline events and areas of potential impact to current pension fund operations in the aftermath of the initial period after the referendum result:

Investment / Economic Focus

The following summarises recent events and trends as well as potential outcomes from Investment Managers:

- **Sterling most impacted to date** - initial 10% fall followed by further volatility.
- **UK equities volatile but resilient to date** - cushioned by Foreign Exchange adjustment. Large Capitalised best performing.
- **Potential short-term economic shock to UK** - estimated 0.2% contraction in month following vote. Mild recession likely.
- **UK AAA rating downgraded by Standards & Poor**
- **Interest rates cut by 0.25% by Bank of England on 4 August** - plus £70bn bond buying programme announced.
- **Further reduction expected before year end** - however negative rates unlikely.
- **Gilt yields hit record lows, credit spreads fall**
- **Concerns around commercial property valuations**
- **Uncertainty around when Article 50 will be triggered**
- **Continued political uncertainty** - (UK, Europe and US) expected to drive volatility in risk assets

Custodial Comment

The following are potential areas of change from Northern Trust:

- **Regulatory change arising from Brexit** – although long-term changes for financial services in the UK are considered unlikely, the UK will likely need to maintain equivalence” with EU legislation to continue taking advantage of the European Single Market.
- **Provision of regulated financial services between the UK and EU** - services between the UK to the EU will become more complicated unless a UK-EU agreement on market access can be reached.
- **Future access to EU markets** – this will be dependant on future treaty agreements reached between the UK and EU and “passporting” services across borders without individual licences.
- **Implications for data privacy between the UK and EU** - From 2018, a firm with its lead entity in the UK may need to consider relocating it to an alternative EU location if “passporting” does not extend to accommodate.
- **Implications for post-trade operations** - European Markets Infrastructure Regulation (EMIR) will continue to apply to EU-based counterparties, and other mandatory clearing deadlines will take effect prior to the UK departure from the EU.
- **Managing and marketing UK funds** - A number of possible implications from Brexit could affect the UK’s fund servicing sector and impact its ability to provide asset servicing solutions to UK fund managers. For example, if the UK leaves the EU without any agreement for future relationships, any UK-based/managed Undertakings for Collective Investments in Transferable Securities (UCITS) and alternative investment funds (AIFMs) would be affected.

Actuarial Considerations

Our actuaries have seen the numerous articles in relation to the link between gilt yields and the discount rates used to value liabilities which some actuaries use (particularly in the private sector), but do not feel that the impacts warned of will have any effect on funding levels as their funding methodology considers a number of measures beyond gilt yields.

Their key consideration is that if Brexit results higher UK inflation it will have negative impact for both liabilities and global investment returns.

5 CONCLUSION

All of the comments and views noted are “potential”. The key point to note is that “no one knows” in areas from regulation, legislation and the effects on the global economy. One certainty is that the uncertainty will continue to affect financial market volatility and investor behaviour which in turn could have detrimental impact in the short term to investment performance.

6 FINANCIAL IMPLICATIONS

There are no financial implications.

7 POLICY IMPLICATIONS

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

There are no major issues.

8 CONSULTATIONS

The Chief Executive and Head of Democratic and Legal Services have been consulted in the preparation of this report.

9 BACKGROUND PAPERS

None

**MARJORY M STEWART
EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

26 AUGUST 2016

