Hackney

REPORT OF THE GROUP DIRECTOR OF FINANCE AND CORPORATE RESOURCES		
Supplementary Paper – Impact of the 2016 European Union referendum result **Pensions Committee** **27th June 2016**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Enclosures** **Appendix 1 – Hymans Robertson's Investment Perspectives** **Appendix 2 (Exempt) – Manager responses**

1. INTRODUCTION

1.1 This reports provides an overview of the implications the 23rd June 2016 European Union (EU) referendum result may have in both economic and political terms.

2. RECOMMENDATIONS

2.1 The Pensions Committee is recommended to note the report.

3. RELATED DECISIONS

4. COMMENTS OF THE GROUP DIRECTOR OF FINANCE & CORPORATE RESOURCES

4.1 The UK electorate's vote to leave the EU is likely to impact on global financial markets across both the short and longer term. This has the potential to impact on both the assets and liabilities of the Pension Fund; the issue will require monitoring by the Committee to ensure that the Fund's investment strategy remains appropriate during a potentially long transitional period as well in the post-EU environment

5. COMMENTS OF THE DIRECTOR, LEGAL SERVICES

7.1 The referendum on EU membership was advisory rather than legally binding; no provision was contained within the referendum legislation to oblige the Government to invoke Article 50 of the EU Treaty, which will formally begin the process of withdrawal. However, the outcome is a mandate for the UK to end its membership of the EU. Although the process and timescales are currently uncertain, in the absence of evidence to the contrary it should be assumed that the long term outcome of the referendum will be the UK's withdrawal from the European Union.

6 BACKGROUND/TEXT OF THE REPORT

6.1 The EU referendum has seen a majority vote by the UK electorate in favour of leaving the EU. Though the margin of victory was small, at 51.9% to 48.1%, the result has come as a surprise to most. The result has already caused political and economic turmoil; Prime Minister David Cameron announced that he will step down in October, whilst Sterling suffered its largest fall in history with the pound reaching its lowest level against the dollar since 1985. The FTSE opened 8.7% down before rallying back to over 6,000, whilst gilt yields fell sharply; further volatility is expected over the short to medium term.

6.2 The Council's pension fund is not immune to the political and economic impact of the leave vote; this paper will provide an overview of the referendum results and the immediate aftermath in investment markets, including commentary from the Council's Fund managers. A summary of the likely wider impact on UK pension funds is also included.

7 EU REFERENDUM SUMMARY

7.2 The UK electorate has voted to leave the EU, which has been a surprise, particularly to financial markets.

7.3 The overall margin of victory of 52% to 48% masks significant regional variations, with London, Scotland and Northern Ireland all voting to remain overall, and Wales and England voting to leave.

7.4 Initial Market reaction reflects the surprise element in the decision and conditions remain volatile and fluid at this time. We expect more market swings in coming weeks reflecting the uncertainties involved

7.5 The event is generally negative for risk assets and will keep gilt and other bond yields lower than otherwise, though sterling weakness may have some impact on inflation expectations.

7.6 Over the longer term, the key question is whether and how quickly the exit process begins. As yet, there has been no decision on when Article 50 of the EU Treaty, which would formally begin a 2 year process of withdrawal ought to be invoked. A period of negotiation with the EU over the terms of the exit strategy must at some stage begin; however, significant political turmoil resulting from the vote makes the timescale impossible to predict with any certainty.

7.7 A further potential risk could arise from the significant legislative programme required to fully extract the UK from the EU and establish new trading agreements. EU membership is embedded in the devolution settlements for Scotland and Northern Ireland; it seems likely that reversing EU law in these jurisdictions will require the consent of the Scottish Parliament and Northern Ireland assembly. Scotland's First Minister, Nicola Sturgeon, has already made it clear that the SNP is likely to refuse, potentially leading to a further referendum on Scottish Independence.

7.8 A special issue of Hymans Robertson's Investment Perspectives has been appended to this report (Appendix 1); this summarises the potential impacts of the vote on UK pension funds, and sets out a suggested approach for managing these impacts.

8. INVESTMENT OUTLOOK

8.1 Much more volatility and price swings over an extended period of time can be expected – largely reflecting the uncertainty surrounding this event, which is unlikely to go away. Key uncertainties surround the impact on the European economy –

where in addition to the possibility of a period of recession in the UK, there may well be a knock to economic growth in Europe as a whole. The key concern is that the UK decision provides a slippery slope for further tensions and fragmentation within Europe and the single currency area.

8.2 Thursday's events are likely to keep pressure down on global bond yields, and there is an expectation the US will delay a further rate rise until 2017, which will prevent even the gradual upturn in yields we had earlier allowed for. For UK gilts, the impact is not clear; potentially some upward inflationary pressure will materialise from the weaker sterling, though the possibility of a Bank of England interest rate cut will work the other way.

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8.3 Some reduction in portfolio value is inevitable following Friday's set back in the markets. However, this needs to be set in the context of market movements over time; the UK equity market continues to operate within the trading range of the last 9 months.

8.4 Friday saw co-ordinated efforts to soothe markets by central banks and financial institutions, including the Bank of England (BoE), the G7 and UK regulators. Mark Carney, BoE governor, stated that the Bank would 'not hesitate to take any additional measures required' to support the functioning of markets, but warned of a period of uncertainty and adjustment whilst the economy adjusted to the new trading relationships to be put in place.

9. MANAGER RESPONSES

9.1 Responses to the vote have been provided by a number of the Fund's investment managers; these are detailed in Appendix 2

List of Appendices
Appendix 1 – Investment perspectives on the outcome of the EU Referendum
Exempt Appendix 2 – Manager responses.