Hackney

REPORT OF THE GROUP DIRECTOR OF FINANCE AND CORPORATE RESOURCES		
Supplementary Paper: Brexit Update – Possible Implications and Funding Scenarios **Pensions Committee** **10th September 2019**	**Classification** **PUBLIC** **Ward(s) affected** **ALL**	**Enclosures** **One** **AGENDA ITEM NO.**

1. INTRODUCTION

1.1 This report sets out the potential implications of different outcomes to the UK's Brexit negotiations and, in particular, some of the implications for financial markets of a 'no-deal' Brexit. It considers the potential impact both on global financial markets and on the assets and liabilities (and therefore the funding position) of the Hackney Pension Fund.

2. RECOMMENDATIONS

2.1 The Pensions Committee is recommended to note the report, including the Hymans Robertson's advice that no fundamental changes be made to the Fund's investment strategy at this stage.

3. RELATED DECISIONS

3.1 Pensions Committee 27th June 2016 - Impact of the 2016 European Union referendum result

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

4.1 This report sets out the potential financial impact on the Hackney Pension Fund of various Brexit scenarios, and makes recommendations as to how the Fund should manage the risks associated with these scenarios. Changing economic and geopolitical conditions can have a significant impact on the ability of the fund to meet its liabilities; consideration of this report therefore forms part of the Fund's approach to the management of funding risk.

4.2 There are no specific financial implications arising from this report

5. COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE SERVICES

5.1 The Pensions Committee's Terms of Reference provide for it to to set the overall strategic objectives for the Pension Fund, having taken appropriate expert advice. Consideration of this report helps demonstrate that the Committee is keeping the

Fund's strategic objectives and its chosen approach to achieving them under review and is taking expert advice where appropriate.

6. BACKGROUND/TEXT OF THE REPORT

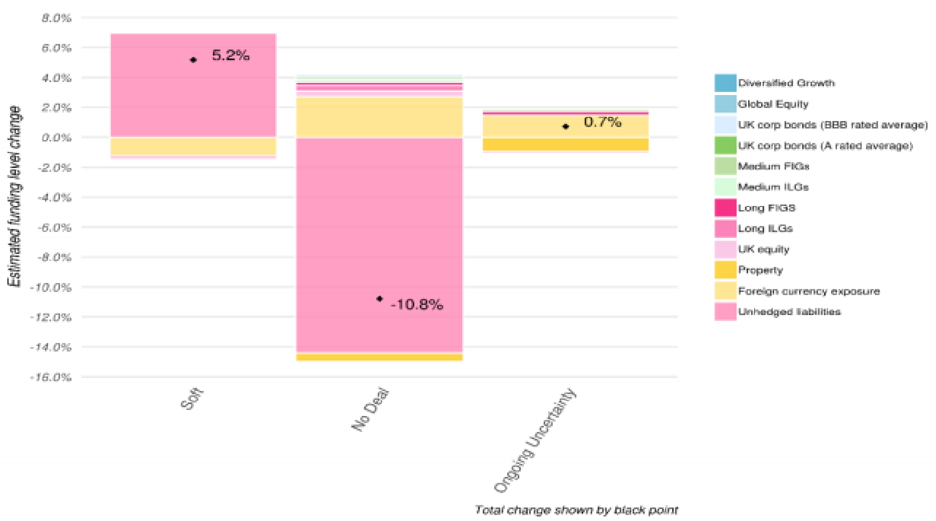
6.1 This report sets out Hymans Robertson's latest assessment (as at September 2019) of the potential Brexit outcomes on both global financial markets and the Hackney Pension Fund's assets and liabilities. Given the current uncertainty over the eventual outcome, the analysis considers 3 possible scenarios:

- Soft Brexit - one that markets generally support, and that is considered broadly supportive of the UK's current competitive position. The scenario outcome is one with an uplift to UK GDP growth, modest strengthening of sterling and the expectation of modestly faster future rate rises
- No Deal Brexit - assumes immediate disruptive elements to trade and ongoing uncertainty over the UK's competitive position. The analysis anticipates a much bigger adjustment to sterling and prolonged lower interest rates
- Ongoing Uncertainty - assumes the current impasse in parliament over the acceptance of the negotiated deal continues and the UK agrees repeated extensions to the Brexit deadline. This scenario is likely to lead to an ongoing deferral of investment which will lead to a contraction in UK GDP growth and a gradual further weakening of sterling

6.2 The analysis focuses on the relative impact rather than the absolute projection of funding levels. It does not attempt to predict which of these outcomes is the more likely, although it does note that at present the market appears to be placing more emphasis on a "soft Brexit" outcome. Instead, the analysis is intended to provide a summary of the range of outcomes that may arise, and the implications for funding. No attempt is made within the scenarios to introduce a view on the underlying details of any deal.

6.3 The analysis summarises the likely funding outcomes associated with each scenario as follows:

Chart 1 – Potential impact of Brexit on Scheme's funding level for current strategy



The analysis therefore estimates a funding gain of approximately 5.2% in the event of a soft Brexit, relative to a decrease in the funding level of approximately 10.8% in the event of a no deal Brexit. The outcomes associated with ongoing uncertainty are relatively muted, due to various positive and negative factors largely cancelling out.

6.4 The paper sets out the key risks to the funding level from an investment strategy perspective. These are:

- a fall in nominal gilt yields impacting short term funding levels and long-term returns;
- a rise in inflation expectations; and
- a fall in property values and potential fall in liquidity.

6.5 As an LGPS fund, the Hackney Fund remains open to both new members and future accrual. The Fund is therefore able to take a long term approach to funding and should avoid knee-jerk reactions to economic and geopolitical change. The report does, however, consider some approaches the Fund could take to protect against the potential downside scenarios associated with a No Deal Brexit, including where there is greater sensitivity to short term volatility. It should be noted that these approaches would worsen the position in the event of a Soft Brexit.

6.6 These approaches include:

- Considering the level of interest rate and inflation hedging from the Fund's protection assets and assessing if any changes could be made to manage shorter term funding risks
- Reducing or removing currency hedging where it is in place
- Introducing different investment strategies for long term (contribution rate focussed) and short term (balance sheet focussed) employers.

6.7 Interest rate and inflation risk could have the most significant short-term impact on the funding level. However, given the long term nature of the Fund, that contribution rates are more important than the funding balance sheet and the fact the LGPS remains open to future accrual, the paper does not propose any changes to the current interest rate and inflation hedging.

6.8 The Fund currently hedges c50% of overseas equity exposure. The paper cautions against attempting to time currency markets recognising this can be difficult. The paper recommends that the Fund to continue to have a long term overseas strategic target currency hedge ratio of at least 50% and therefore does not propose any changes. The paper also notes that in the event of a soft Brexit, it is likely that Sterling will appreciate and the currency hedged share class will therefore be expected to outperform the unhedged share class.

6.9 The report concludes that the Fund should not, at this stage, be looking to make changes to its investment strategy in response to the risks posed by a no-deal Brexit. However, it does recommend that the Fund takes steps to ensure the smooth operation of the Fund, including monitoring developments and seeking confirmation from investment managers and the custodian once the precise details of the UK's withdrawal are known that they do not anticipate any impact on trading or other operational aspects.

Ian Williams
Group Director of Finance & Resources

Report Originating Officer: Rachel Cowburn (020 8356 2630)
Financial considerations: Ian Williams (020 8356 3003)
Legal comments: Sean Eratt (020-8356 6012)

Appendices
Appendix 1 - Updated Brexit Scenarios