BREXIT UPDATE: AN EMBATTLED PM AND AN EXASPERATED EU BEING ASKED FOR AN EXTENSION

BY MAN FRM OPRISK

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This update contains three different sections which can be treated as a pick 'n' mix depending on your interests:

1. Westminster: An update on what is going on in Parliament and the decisions being made on how the Brexit process will progress;
2. Asset Management: Any updates in the period from regulators, government bodies, etc, that have direct impacts on the asset-management industry – including GBP/USD movements;
3. Beyond Westminster: Any updates in the period from wider business groups and the like on the impact of Brexit, including companies that have announced movement of operations and/or job losses in the UK.

BREXIT COUNTDOWN: 14 DAYS TO GO…

Summary:

It has been an action-packed couple of weeks in Westminster, with a series of votes taking place to determine what exactly parliament *does* want from Brexit. Hint: the answer still appears to be … nobody knows. The second 'meaningful vote' was held on 12 March as promised – unsurprisingly, the UK government was, once again, defeated. The defeat was by a lesser margin than the previous historic largest government defeat in history – this one only ranks as the fourth-largest defeat. UK Prime Minister Theresa May kept to her promise of further votes on the prospect of no-deal and an extension. Parliament took control of the UK government's no-deal motion and on 13 March voted to avoid a no-deal in any scenario. The following day, it voted with the government for either a short extension and her deal or a longer extension. May seemed to miss an opportunity following the no-deal vote that would have allowed her to take back control of the process, in our view. Rather than allow the vote on an extension – where May has no control over what amendments will be voted on – she could have announced that there would be an extension. This would have put the UK government back in control of any extension request in particular on how long it would be for. May has now reverted to her main strategy of trying to scare the Eurosceptic members of her party into backing her deal out of fear of the 'risk' of a softer Brexit or no Brexit at all. These members are being given a third opportunity to fall in line with a third 'meaningful vote' expected in advance of the EU summit on 20-21 March. Meanwhile, the EU (who would have to unanimously approve any extension) remains exasperated at the lack of clarity on what the UK actually wants – something it will need to decide on should it wish to request an extension and the deal has been defeated (see Westminster section). Businesses and business organisations continue to warn of the dangers of a no-deal Brexit. In one positive outcome, retailers have reported being able to negotiate lower rental rates in the wake of the uncertainty surrounding Brexit (see Beyond Westminster Section). The Financial Conduct Authority ('FCA') continues to advise asset-management firms to prepare for a no-deal Brexit and has issued some guidance on this. Redemptions from UK-regulated funds continue on a large-scale basis, with more than USD1 billion believed to have been redeemed in January and February 2019 alone (see Asset Management Section).

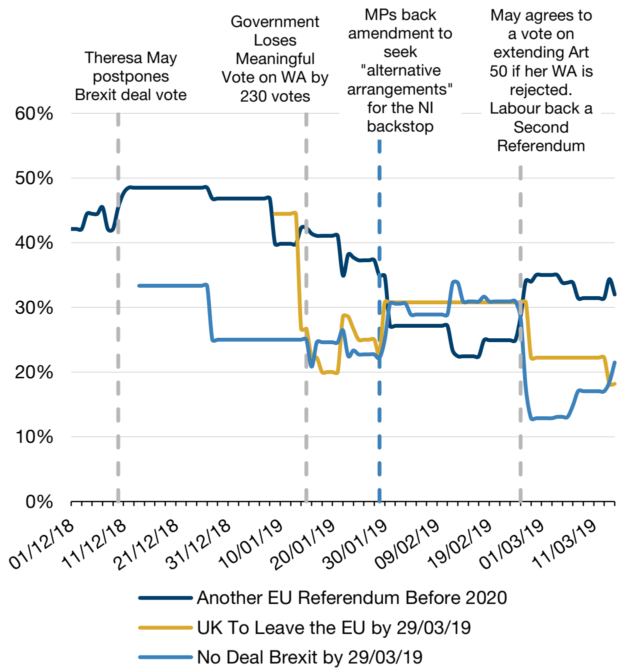
The quote of the week comes from the Guardian's Jon Henley on 12 March:

"Yes, it's Brexit's crunchiest crunch time yet. Maybe. With barely a fortnight to go, we still have no clue."

WESTMINSTER:

Latest Implied Odds From Betting Markets:

Figure 1. Implied Probabilities of Brexit Outcomes



Source: Man FRM; As of 15 March. Man FRM calculates the implied probabilities of Brexit outcomes using prevailing odds as priced by UK bookmakers, which are collated on a daily basis. The graph presents the implied probabilities of Brexit outcomes averaged across all UK bookmakers for which data is available, over time. This data analysis is based upon information obtained from third-party sources not affiliated with Man FRM. Man FRM cannot guarantee the accuracy of this data and it should not be relied upon by investors.

What Happened Recently?

A series of votes:

- UK Attorney General Geoffrey Cox and Brexit Secretary Stephen Barclay headed back to Brussels on 5 March in order to secure a "legal add-on" to the Withdrawal Agreement regarding the backstop. This is so that Cox will be able to amend his legal advice – that the current backstop could leave the UK stuck in the customs union. This is the issue that is troubling the pro-Brexit Conservative Members of Parliament ('MPs'). This did not go down well, with both solutions presented by Cox (an extended arbitration panel and a watered-down version of the backstop) being rejected by the EU. The EU has asked the UK to come up with fresh proposals.
- A late-night dash to Brussels on 11 March by May secured some of these "legal add-ons" over the backstop (described below). The key questions then became: first, would these be enough to allow Cox to amend his legal opinion; and secondly, would it be enough to secure the votes of the DUP (the Northern Ireland MPs that prop up May's minority government) and the hard-line Eurosceptic ERG (European Research Group) members in the Conservative Party. The three legal additions are:
    - A Joint Interpretative Statement – This states that the EU could not deliberately seek to keep the UK in the backstop by failing to negotiate a new trade deal in good faith. If it did, the UK could seek arbitration and an exit from the arrangement. This document would be logged with the UN alongside the Withdrawal Agreement;
    - A Joint UK/EU statement in the non-binding political declaration – This commits both sides to developing new technologies at the border to replace the need for the backstop by December 2020;
    - A UK-only declaration – This states that there would be nothing to stop the UK launching a procedure to ultimately get out of the backstop should the EU not act in good faith and with its best endeavours to agree a free trade deal to supersede the backstop. Note that European Commission President Jean-Claude Juncker was initially opposed to this and the Irish Taoiseach (PM) Leo Varadkar said he was fine with this as it is essentially the UK talking to itself.
- In advance of the voting on 12 March, Cox informed the UK parliament that the legal additions were not enough to change his legal opinion that the UK could remain in the backstop permanently. He did acknowledge, however, that the risk had been reduced.
- The second 'meaningful vote' by the UK parliament took place on 12 March. May had widely been expected to lose this vote, with estimates ranging from an optimistic 50-vote margin to a more pessimistic 200-vote margin. Most media commentators seemed to settle in the 100- to 150-vote margin. In the end, there were 242 votes for the deal and 391 votes against the deal, so the defeat was by a margin of 149 votes.
- With May's deal defeated, she followed through on her promise of holding two further votes in parliament; one on whether parliament wanted to leave the EU with no deal and one on whether parliament wanted to apply to extend the Article 50 process.
- The no-deal vote was held on 13 March. The UK government submitted a motion to be voted on by parliament that, while trying to rule out a no-deal, also contained a caveat which said "notes that leaving without a deal remains the default in UK and EU law unless this House and the EU ratify an agreement." An amendment to this was put forward by a Conservative MP Caroline Spelman and Labour MP Yvette Cooper. Spelman (probably under pressure from the UK government) decided not to move the amendment to a vote. However, as Cooper did want to do this, the House of Commons voted on the amendment, which passed with a majority of four votes. What was unusual about this was that the amendment entirely deleted the UK government's motion and replaced it with a statement that said the House of Commons would reject a no-deal scenario in all cases – there was no caveat. When the House of Commons came to vote on the main motion, it was now the amended motion rather than the original one. Despite last-minute orders from the party for the Conservatives to oppose this motion, it passed by 321 votes to 278 – a larger majority than the vote on the amendment. A second amendment on the Malthouse Compromise was also voted on and defeated by 374 votes to 164.
- In May's speech following the defeat, she indicated two things: firstly, that the vote on an extension would go ahead as planned and secondly, that there were realistically two options for a delay – a short technical extension with a deal in place or a much longer extension for Parliament to decide what it wants.
- In further developments post the vote, it transpired that 12 ministers (including four cabinet members) risked being fired by abstaining from the vote (although it does not appear they will be). Two junior ministers resigned in order to be able to vote against the government. It has also been indicated that May will hold a third 'meaningful vote' on the second deal prior to a planned EU summit on 20-21 March. She has issued a threat to the Eurosceptic element of her party that if her deal passes, she will be able to request a short technical extension in order to implement it. However, if the deal is defeated again, she will be required to ask for a much longer extension, 'risking' either a softer Brexit or no Brexit at all. The scare tactics that have been present throughout this process are now very much back in play.
- The extension vote was held on 14 March. The government's motion was that should the deal be passed, it would apply to extend Brexit to 30 June, or to seek a longer delay if the deal does not pass. The speaker selected four amendments to this motion to be voted on:
    - The first which would be for a longer extension in order to hold a second referendum. As was widely expected at this stage, it was defeated by a margin of 249 votes. Interestingly, it seems to have been voted against by Labour and others. This would have meant a second amendment applying for an extension would not have been voted on, as opposed to objecting to a second referendum.
    - The second amendment was to control parliamentary time on 20 March in order to have indicative votes to find a majority way forward. This was defeated by a majority of two votes – 314 against and 312 for. An amendment to this amendment, which would have required an extension to 30 June in order to do this, was also defeated by a majority of three (314 against and 311 for).
    - The third amendment was from the Labour front bench, which was similar to the one that was narrowly defeated. It calls for an extension (the length of the extension was undefined in this amendment) in order for parliament to find an alternative way forward (again undefined). This was (again, as widely expected) defeated by a majority of 16, with 302 voting for and 318 voting against.

- The final amendment looked to make use of a parliamentary rule that states the same motion cannot be voted on more than twice in the same parliamentary session (to agree that May cannot have a third vote on her deal). Given the deal is not a motion, it did not seem likely that this would pass. In the end, this was not moved and there was no voting.

The final vote of the night was on the government's main motion, which would guarantee some sort of extension. This was passed with a majority of 210 (412 for and 202 against).

What Happens Next?

- We believe the most likely outcome for what happens next is what has been laid out by May following on from the defeat of the UK government's no-deal motion. The third 'meaningful' debate will take place before 20 March. Whilst it remains unclear whether the fear tactics being used by May will secure enough votes to pass the deal, we believe that depending on the result of this vote, there will be one of the following two outcomes:
  - May's deal is passed: In this event, May will apply for a short extension that will end before the European Parliament elections. The extension will be a technical one to allow the terms of the deal to be implemented. It is likely the EU would agree to this extension in our view – remember, all 27 member states have to unanimously agree on an extension.
  - May's deal is defeated: Here, we believe the path forward is more hazardous. May would have to petition the EU for a significantly longer extension – possibly up to two years. This will anger the Eurosceptic members of the Conservative party. However, the main issue is whether or not the EU would agree to this – and if they do, what terms and conditions would be applied. This would mean that the UK would have to elect Members of European Parliament (MEP) to the Parliament (historically, the UK has tended to elect anti-EU MEPs) and the EU may also ask for a reason for this extension – i.e. what will the UK do with this time – a question that has yet to be answered. If all 27 members of the EU do not agree to this extension, there is a very real risk of a no-deal Brexit occurring, despite Parliament's opposition to it. The only other option at that point that would remain would be, well, to remain.

Preparations for a No-Deal Brexit:

- The US has taken an aggressive stance towards the UK in post-Brexit talks, demanding greater access to the UK market for its agricultural products and guarantees that the UK would not manipulate its currency. The US is asking for the UK to remove "unwanted barriers" related to "sanitary and physiosanitary" standards in the farming industry. There have also been provisions suggested that would allow the US to walk away from the deal if it doesn't like terms in any agreement between the UK and China.
- The Bank of England is stepping up preparations for a no-deal Brexit by requiring some UK lenders to triple holdings of more liquid assets. This is to cope with the market uncertainty that is expected in the event of a no-deal Brexit.
- French border officials at the Eurostar staged a work-to-rule protest to highlight that France is not ready for Brexit. It followed strictly the passport and customs checks that will be required causing delays of up to an hour for trains.
- Belgium's customs authority has advised Belgian companies that export to the UK to halt any shipments after Brexit day to protect against any disruption in the event of a no-deal Brexit.
- The UK government has confirmed that the UK will have replicated less than half the international agreements the EU has in place with other countries by 29 March. Forty-three out of 161 international treaties currently in place have been rolled over – this includes 11 aviation deals and five nuclear treaties.
- On 13 March (the morning after May's deal was defeated again), the UK government released two documents outlining aspects of its no-deal planning in relation to the Northern Ireland/Republic of Ireland border and proposed trade tariffs:
  - Irish Border – the UK will temporarily waive checks on all goods that cross the border. It would then seek to immediately enter talks with the EU and the Irish government to find a long-term solution;
  - Tariffs – Tariffs would be removed on 87% of imported goods in an effort to avoid price rises for consumers. Tariffs that remain on items such as agricultural goods and cars are intended to protect UK industries from cheaper imports.

ASSET MANAGEMENT:

Recent updates below regarding the asset management and financial services industry in relation to Brexit:

Asset Management and Financial Markets:

- The UK financial regulator, the FCA, continues to urge firms to prepare for a no-deal Brexit. It has introduced draft legislation – the Financial Services Contracts Regime – that will allow EU firms who have not applied for the temporary permissions regime to wind business down in an orderly manner. The release also includes details of firms or persons that would not be covered by a transitional provision, which allows transition to a new UK regulatory framework and, as such, need to be prepared to comply from exit day. These include:
  - Firms subject to the MIFID II transaction reporting regime, and connected persons (for example, approved reporting mechanisms);
  - Firms subject to reporting obligations under the European Market Infrastructure Regulation ('EMIR');
  - European Economic Area ('EEA') issuers that have securities trade or admitted to trading on UK markets;
  - Investments first subject to the Bank Recovery and Resolution Directive ('BRRD') and that have liabilities governed by the law of an EEA state;
  - EEA firms intending to use the market-making exemption under the Short Selling Regulation;
  - Firms intending to use credit ratings issued or endorsed by FCA-registered credit ratings agencies after exit day;
  - UK originators, sponsors or securitisation special purpose entities ('SSPEs') of securitisations they wish to be considered simple, transparent, and standardised ('STS') under the Securitisation Regulation.
- The FCA further notes issues with the sharing of data between the UK and EEA. The UK government has stated that the UK will allow the free flow of data from the UK to the EU. However,

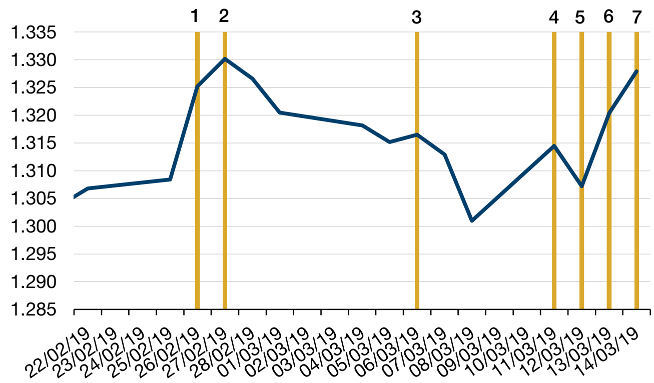
the position for transfers of personal data from the EEA to the UK has not been made clear.

- European Securities and Markets Authority confirmed on 1 March that it approved EU customers investing in the Irish market continuing to settle trades in London via Euroclear UK and Ireland. Ireland, unlike other EU member states, does not have its own depository. At the same time, DTCC (the US post-trade group) was also approved to run a derivatives trade repository in the EU – in Ireland.
- Retail investors withdrew more than GBP850 million from UK regulated fund products in January due to concerns of a no-deal Brexit, according to [Funds Europe](). Almost 70% of this came from equity funds. It also notes (quoting data from Calastone) that investors have continued to sell out of equity funds in February to the tune of a further GBP215 million. This is the highest level of redemptions since just before the 2016 US presidential election.

Interest and Exchange Rates:

- In the week ending 1 March, the benchmark 10-year gilt yield rose 16.4 basis points up to mid-day London time. This put British sovereign debt on track for the heaviest sell-off since September 2017.

Figure 2. GBP – USD FX Rate Change – 15 Days



Source: Bloomberg; Between 22 February and 14 March

1. May delays 'meaningful vote' and announces a series of votes on no-deal and an extension if the deal is defeated in the next vote. Labour comes out in support for a second referendum.
2. A series of amendments to a neutral government motion are all defeated.
3. The EU announces negotiations with Cox are not going well.
4. Cox declares the EU concessions obtained by May are not strong enough to change his legal opinion that the UK could be permanently trapped in a customs union by the backstop in the Withdrawal Agreement.
5. May loses the meaningful vote.
6. Parliament takes control of the government's motion and rules out leaving the EU without a deal in any circumstances.
7. MPs vote for the UK government's motion to extend until 30 June if her deal is rejected again and a longer extension if it is not.

BEYOND WESTMINSTER:

- 6 March – The Organisation for Economic Cooperation and Development ('OECD') warned that a no-deal Brexit may put the UK economy into recession. Even if a deal is secured, Brexit could cause annual growth to fall below 1% in 2019 for the first time since the financial crisis in 2008.
- 7 March – Toyota warned it may end manufacturing in the UK if the UK leaves the EU with no-deal or on unfavourable terms.
- 7 March – UK retailers are being able to negotiate cheaper rents in the wake of Brexit uncertainty, providing a good time for expansion, according to industry executives (including the boss of Urban Outfitters).
- 10 March – Shionogi (a Japanese pharmaceutical company that opened its European base in London five years ago) announced plans to move the base to the Netherlands. This is part of a restructuring of European business to insulate itself from any disruption caused by Brexit.
- 11 March – The International Energy Agency ('IEA') has warned that a "disorderly Brexit" could hit crude oil demand, stating that "ongoing trade disputes between major powers and a disorderly Brexit could lead to a reduction in the rate of growth of international trade and oil demand."
- 11 March - British citizens who own shares in Ryanair will be barred from buying more stock, voting on company resolutions or attending AGMs in the event of a no-deal Brexit. This is to allow the airline to abide by EU regulations that require all airlines flying under a European licence to be controlled and majority owned by EU investors.

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