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BREXIT UPDATE

A HALLOWEEN BREXIT: TRICK OR TREAT?

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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 a direct impact 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: 199 DAYS TO GO …

Summary:

In the lead up to the EU summit on 10 April, common consensus in the media was that despite UK Prime Minister Theresa May's request for a short extension, a year's extension (with conditions attached) would be offered. In the end, in the face of fierce opposition from French President Emmanuel Macron to a short extension, the new Brexit deadline is 31 October, 2019 – six months away. The UK will also have to take part in the European Parliament elections if the Withdrawal Agreement hasn't been ratified by 22 May, or face being booted out of the EU – deal or no-deal – at the beginning of June. The PM will, in all likelihood, have a further attempt at getting her Withdrawal Agreement through parliament before the May date. Additionally, just to add to the feeling of groundhog day, there continue to be calls to try and force her to go back to the EU to add a time limit to the Irish backstop contained in the agreement. Six months is a short amount of time, particularly when you take into account the Easter and summer recesses in parliament. Even if support increased for a second referendum, there would most likely not be time to hold one. Equally, trying to hold a leadership contest and general election in that period would be tight – assuming that during this time, MPs remembered they were supposed to be sorting out Brexit too. The timeline is also incredibly awkward for May. The current parliamentary session is due to end in the summer, which means two things: firstly, that the government will need to agree the legislative agenda for the next parliamentary session (including or not including the Withdrawal Agreement in this agenda will be a contentious issue); and secondly, the confidence and supply agreement with Northern Ireland's Democratic Unionist Party ('DUP') – that currently gives the government its tenuous majority – will need to be renewed. If this agreement is not renewed – and given the government's support for the Withdrawal Agreement and the DUP's opposition, it is by no means certain it would be – then the government loses its majority and a general election may be forced. This is leading to speculation that to avoid this, the government may extend the parliamentary session until the end of October. For now, parliament is in recess for Easter and the debate will pick up again in a couple of weeks. As discussed in the 'What Happens Next?' section, all eyes will be on whether the extension will mean more or less support for the deal (**see Westminster section**). Predictions of reduced UK GDP in the event of a no-deal Brexit were released by the IMF, while the Financial Times looks at how much UK companies have spent on Brexit contingencies (**see Beyond Westminster section**). Governor of the Bank of England Mark Carney offered some words of reassurance about preparedness for Brexit; however, outflows from UK funds continue unabated (**see Asset Management section**).

The quote of the moment comes from Donald Tusk following the EU summit that granted the UK an extension to the Article 50 Withdrawal Process:

"This extension is flexible as I expected, and a little bit shorter than I expected, but it's still enough to find the best possible solution. Please do not waste this time."

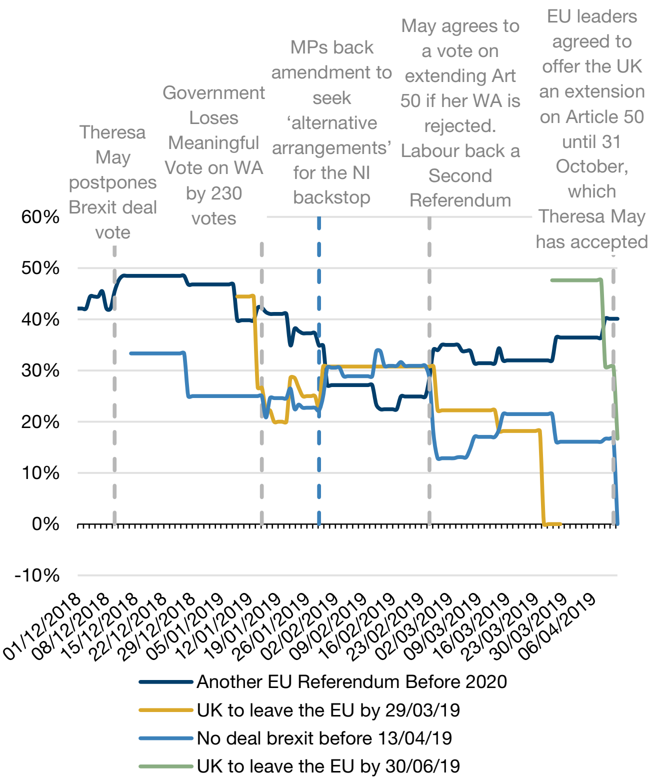
In later comments to Polish media, he also went on to say:

"Our wish and hope is the UK will be ready with a final solution at the end of October – but I'm too old to exclude another scenario."

WESTMINSTER:

Latest Implied Odds From Betting Markets:

Figure 1. Implied Probabilities of Brexit Outcomes



Source: Man FRM; As of 12 April. 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?

- May arrived at the EU summit to present the case for a short extension to the Article 50 Withdrawal Agreement until 30 June, 2019. Comments from various EU members had already indicated the EU was not going to be willing to grant a short extension. Indeed, initial signs had indicated potentially a year-long delay with some flexibility. After May presented, she returned to the UK embassy while the remaining EU leaders had a dinner to discuss what would be granted. In the end, the extension was longer than May had requested, but shorter than had been expected – a delay of six months to 31 October, 2019.

- Whilst most EU leaders appear to have been willing to grant the year-long extension, there was strong opposition to it from France's President Emmanuel Macron, who argued for a much shorter extension. Macron's chief concern appears to be the UK being part of EU decisions whilst trying to leave the EU, and a fear that the UK could hold the EU hostage over negotiations by threatening to block or hold up key EU legislation. Comments from hardline Brexiteers such as Jacob Rees-Mogg advocating such an approach are unlikely to have helped in this instance.

- The final extension has some flexibility and protections in it from both sides:
  - Firstly, the UK can exit this extension earlier than 31 October should the Withdrawal Agreement be passed. Note that the EU has remained adamant that this agreement will not be re-opened even in the event of a new PM.
  - Secondly, if the UK is still in the EU at the start of the new European Parliament, it will need to take part in the elections, something that has predictably outraged hardline Brexiteers. If the UK does not take part in the elections, it will be forced to leave the EU on 1 June, 2019 with or without a deal.

- Talks have continued between the Labour and Conservative parties to try and find a compromise to move forward with Brexit. No progress has been made to date and the talks will carry on over the next few weeks, including over the Easter break. Labour has been repeatedly saying that as there has been no shift in the government's position – a position that appears to be at odds with Labour's position of a customs union – a compromise is still out of reach. In the first sign of a subtle shift in the government's positon, May told parliament last week that the two sides are not as far apart in terms of a customs union as the language being used to describe the arrangements would suggest.

- Discussions and rumours continue to abound on how long May has left in the PM role. She had promised that she would leave the position if parliament backed her deal – which it did not. Given May defeated a motion of no-confidence in December 2018, she cannot be challenged again until December 2019 under current rules. So, while members of her party may continue calling for her to go, there is no legal mechanism for them to force this at this stage. The beauty parade for the next Conservative leader continues anyway: discussions are being held about the prospects of several potential replacements, including Michael Gove (Environment Secretary), Boris Johnson (ex-Foreign Secretary), Jeremy Hunt (current Foreign Secretary), Dominic Raab (ex-Brexit Secretary) and Sajid Javid (Home Secretary).

- In May's own press conference following the summit, she indicated that she still believes she can get her deal through Parliament before 22 May in order to avoid having to take part in the European elections.

- The Irish Prime Minister Leo Varadkar has weighed in on the topic of a customs union. He stated that the UK should not be a silent partner in any future customs union with the EU and should have a say in any future trade policy.

What Happens Next?

- Labour and Conservatives will continue cross-party talks to find a compromise over the Easter recess. May has hinted that if they cannot agree an approach, then a small number of options may be put to a vote in Parliament.

- It is likely that May will have another attempt to pass at least the Withdrawal Agreement in parliament before 22 May in an attempt to avoid taking part in the European elections. It is difficult at this stage to predict whether this would scrape through. On one hand, there may be fears from hardline

- Brexiteers that the longer the process drags on, the potential for a second referendum or confirmatory referendum increases. One of the outcomes for this could be the end of Brexit altogether. This may push some to vote for her deal on the premise that any Brexit is better than no Brexit. On the other hand, opposition to some technical points in this deal have become religiously entrenched, with some parties who may prefer to frustrate the process in the hope that it will lead to a no-deal Brexit at a later point or that the EU may decide to renegotiate the Withdrawal Agreement if a new PM was in place (an option that is incredibly unlikely, in our opinion).
- The current parliamentary session is due to end in the summer. At this point, parliament would need to be re-opened with a new Queen's speech which sets out the legislative agenda for parliament over the upcoming session. This puts May in a bit of a bind: the government currently relies on the DUP for its majority, and as such, the DUP would have to approve the speech. However, if passing the Withdrawal Act forms part of the legislative agenda, the DUP has said it will not support it. The confidence and supply agreement with the DUP is also due to be reviewed at the end of this parliamentary session. If it is not renewed, the government would no longer have a majority and this could trigger a general election. This leaves May with three options: 1) Get the Withdrawal Act passed before the end of this session; 2) Extend the current session until the 31 October deadline to avoid the necessity of the Queen's speech; or 3) Determine either to leave without a deal or to revoke Article 50.
- In the end, six months is not a long time. Constitutional experts have previously stated that it would take at least six months to organise a referendum – if the decision was made to do this, a further extension would almost certainly be required. If May chooses to step down or the confidence and supply arrangement with the DUP is not renewed and a general election is triggered, this would subsume much of the time available to the Brexit deadline. As discussed in previous updates, it is also hard to see either Labour or the Conservatives gaining a majority in the house that would be strong enough to pass any legislation through. In our opinion, the only way the October deadline will be the end of this is that either a deal is passed or the EU decides a no-deal is acceptable – any other avenues would require a definitive plan and a further extension. There is, of course, the option of revocation and remaining in the EU. However, it is unlikely anyone in parliament would take this course of action without a mandate either from a general election or a second referendum.

Preparations for a No-Deal Brexit:

- The government has released civil servants that had been working on operational no-deal planning (6,000 in total) back to their original duties following on from the extension being granted. The information was originally leaked and was followed by a government statement saying sensible decisions will be made about the timing and pace of this work.

ASSET MANAGEMENT:

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

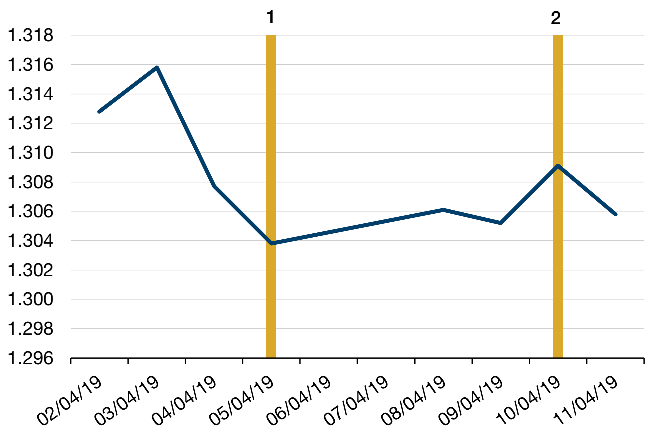
Asset Management and Financial Markets:

- Carney made some reassuring statements while on a panel discussion in Washington: "the core of the financial system is ready for Brexit… It bears no resemblance to Lehman, in terms of degree of preparation… We learned from that experience."
- Capital is being redeemed from UK stock funds for a fourth consecutive week, according to the FT. Citing data from EPFR Global, USD304.5 million was withdrawn by investors in the week ended 10 April, 2019. This puts the total withdrawal for the year at USD1 billion. Since the referendum vote in 2016, USD24.8 billion has been withdrawn.[1]
- UK investors have moved GBP62 billion of their fund investments outside of the UK since the referendum vote in 2016, according to Institutional Asset Manager, which cited Calastone's latest Fund Flow Index data. About GBP2.7 billion of this went to EU-based funds.[2]

Interest and Exchange Rates:

The period between 1 and 2 on Figure 2 represents the time from between May announcing she would ask for an extension to 30 June, through the media speculation of a delay of at least a year, to the announcement that the extension would be to 31 October.

Figure 2. GBP/USD Exchange Rate



Source: Bloomberg; as of 11 April 2019.

1. Source: https://www.ft.com/content/ba397da4-5ca2-11e9-939a-341f5ada9d40; as of 11 April.
2. Source: https://www.institutionalassetmanager.co.uk/2019/04/10/274848/brexit-drives-gbp62-billion-offshore-uk-fund-investors-flee-dublin-and-luxembourg?utm_source=MailingList&utm_medium=email&utm_campaign=Institutional+Asset+Manager+10%2F04%2F19; as of 10 April.

BEYOND WESTMINSTER:

- The International Monetary Fund released more analysis on a no-deal Brexit, predicting it could reduce Britain's GDP by 1.4% in the first year and that this could rise to a 3.5% reduction by 2021.[3]

- Bloomberg[4] reported on the current spending from some of Britain's largest companies on their Brexit contingency planning, highlighting what else could have been achieved with the same amount of capital:

  - RBS has spent GBP100-150 million – the equivalent to salaries of 2% of its workforce for a year;
  - HSBC has spent GBP137 million – the equivalent of salaries for 2,500 staff for a year;
  - AstraZeneca has spent GBP30.6 million – the equivalent of 10 clinical phase 1 trails;
  - Hiscox has spent GBP11.5 million – the equivalent of 340 flood claim payouts;
  - Babcock has spent GBP10 million – the equivalent of salaries for 223 staff for a year;
  - EasyJet has spent GBP9 million – the equivalent of earnings from 9,368 flights.

3. Source: https://www.bloomberg.com/news/articles/2019-04-09/imf-issues-yet-another-warning-as-u-k-s-brexit-battle-continues?cmpid=BBBXT041019_BIZ&utm_medium=email&utm_source=newsletter&utm_term=190410&utm_campaign=brexit; as of 9 April

4. Source: https://www.bloomberg.com/news/articles/2019-04-12/what-brexit-will-cost-some-of-britain-s-leading-companies?cmpid=BBBXT041219_BIZ&utm_medium=email&utm_source=newsletter&utm_term=190412&utm_campaign=brexit; as of 12 April.

IMPORTANT INFORMATION

19/0595/RoW/GL/I/W