SAAX Group
Southern African Actuarial ConneXion

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Brexit: The cost of uncertainty

Uncertainty is something that most long-term investors would like to eliminate from their investment portfolios. In fact, one could go as far as to say that it is a word that they would like to remove from their vocabulary. Unfortunately, it is a word that is increasingly being used when describing the global economic environment.

Major events in the past decade have created significant volatility in global markets, which in turn have created significant uncertainties for long-term investors. The Global Credit Crisis, the European debt crisis, US Quantitative Easing and the 2015 China stock market crash are but a few of these events. The latest event to be added to this list is one that will have a significant impact on the UK economic landscape: Brexit.

The decision by the United Kingdom to leave the European Union brings with it a considerable amount of uncertainty as businesses and policymakers try to unravel the implications of the decision. In line with this, MBE sponsored a panel discussion at Staple Inn, hosted by the Southern African Actuarial ConneXion (SAAX) Group, to discuss the implications of the decision on financial markets, and, thereby, try to address some of the uncertainties.

The panellists were Adam Levitt (Ashurst), Dick Rae (BMO Global Asset Management) and Paul Brett (MetLife), and, as such, there was representation from the legal, life insurance and asset management business areas. Proceedings were directed by Christopher Cundy, Managing Editor of InsuranceERM.

The discussions covered a number of topics. There were, however, three talking points that took centre stage. The topics were: Regulation, the Economic impact of Brexit and possible opportunities presented by Brexit.

Solvency II: not all or nothing

After significant effort over a number of years Solvency II was finally implemented in 2016. The project to reshape the Insurance regulation for the European Union was a major undertaking and the UK was one of the biggest policy influencers.

The Solvency II implementation might not have been perfect but it was by no means a failure. The regulation went a long way in getting all the European countries onto the

Dick Rae, Paul Brett, Chris Cundy and Adam Levitt formed the panel same standard and implemented a number of requirements put forth by the PRA. It is thus highly unlikely that there will be a significant move away from Solvency II as a regulatory framework after Brexit. A significant factor contributing to this is the desire to maintain a regime that satisfies the equivalence requirement under Solvency II.

Agreeing to disagree

Recent comments from Theresa May, indicating that a Hard Brexit is likely, brings its own set of uncertainties. This is due to the fact that new trade agreements would need to be put in place, giving the UK two options to follow: it could either set up a Standard World Trade Organisation (WTO) agreement or negotiate a free trade agreement. Both options have their downsides though, as the WTO agreement does not deal explicitly with financial services and the free trade agreement is difficult to negotiate. All in all, it does not seem that the process will be resolved quickly, and providing cross border financial service will become more difficult.

Divided we shrink

Panel Discussion: more uncertainty ahead

Another major challenge insurance companies and asset managers should expect to face is a weaker economy. This is because the British economy is expected to contract and bring with it a low interest rate environment. Market volatility is also expected to increase, as can already be seen in the volatility of the sterling since the announcement.

Brexit also closes down some major expansion opportunities for companies only operating in the UK. Regulations such as the pan-European pension regulation and harmonising of sales are expected to be implemented in the near future and to have a substantial impact on the European insurance market.

The bright side

It is not all doom and gloom, however, as Brexit brings its own set of opportunities. The UK now has the opportunity to change portions of the Solvency II regulation that they did not totally agree with and new trade negotiations can result in agreements that are more beneficial to the UK. Overall, the UK can now be more nimble and adapt quickly to a changing global environment.

These are definitely interesting and uncertain times and unfortunately the path forward is still not clear. Only through increased discussion and deliberation can clarity be gained and substantial progress be made to reduce uncertainties.