

# Brexit Task Force: September 2016 Update


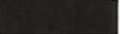
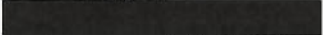
**For Discussion**

**Brexit Task Force**

## Contents

<b>Summary.....</b>	<b>3</b>
<b>1. Introduction.....</b>	<b>5</b>
<b>2. Political and Market Developments.....</b>	<b>6</b>
2.1 Political Developments.....	6
2.2 UK Economic and Property Market Developments.....	7
2.3 Financial Market Impact.....	10
<b>3. Impact on Irish Economy.....</b>	<b>17</b>
3.1 Irish Macroeconomic Impact and Forecasts.....	17
3.2 Property Market Impact.....	18
<b>4. Authorisations.....</b>	<b>20</b>
<b>5. Banking.....</b>	<b>22</b>
5.1 Referendum Impact.....	22
5.2 Ongoing Actions.....	22
<b>6. Insurance.....</b>	<b>24</b>
6.1 Queries on Authorisations.....	24
6.2 Update on the Impact on and Preparedness of Entities.....	24
6.3 Potential Impact on Irish Consumers.....	25
6.4 Group Supervision and Solvency II Equivalence.....	26
<b>7. Markets Directorate Firms.....</b>	<b>27</b>
7.1 Investment Firms.....	28
6.2 Funds and Fund Service Providers.....	29
7.3 Primary and Secondary Markets.....	31
<b>8. Financial Market Infrastructure.....</b>	<b>34</b>
<b>9. Regulatory Policy and Equivalence Assessments.....</b>	<b>35</b>
<b>10. Conclusions / Assessment.....</b>	<b>38</b>
<b>Annex 1.....</b>	<b>39</b>

## Summary

- At a political level, UK, EU and Irish institutions are putting arrangements in place for the work of negotiation of a withdrawal agreement. The EU has acknowledged that the triggering of Article 50 is a matter for the UK. Prime Minister May has stated that the UK will take its time before triggering Article 50 and that it will not be prior to the end of 2016.
- In the aftermath of the referendum uncertainty indicators in the UK picked up and business and household confidence indicators fell sharply. The Bank of England in its August inflation report noted that the short to medium term outlook had weakened markedly and forecasts were revised down significantly. More recently, financial markets have rebounded, sentiment and hard data releases have surprised on the upside and the Bank of England has taken a slightly more optimistic tone for the *near-term* outlook.
- UK commercial property funds were adversely affected in the immediate aftermath of the referendum and many listed UK REITs saw their share prices drop substantially. A number of UK CRE funds were forced to halt redemptions in the days following the referendum.
- For the euro area only modest downward revisions to GDP projections were announced by the ECB in September in comparison to the June exercise. These were of the order of -0.1 percentage points for both 2017 and 2018, partly related to the uncertainties following the referendum, while risks to the outlook remain tilted to the downside.
- In financial markets, initial turbulence was reflected in lower asset prices and increased volatility. Sterling fell sharply, to 30 year lows against the dollar, and remains close to its post-vote lows as at mid-September.
- Overall, the bout of financial market volatility did not persist, particularly compared to other recent episodes of market turbulence, and many asset prices have recovered their values. This reflects market re-pricing after the initial shock, some positive data releases in the UK and euro area and expectations relating to monetary policy. Equity prices for some European banks with high NPLs and/or high UK exposures remain well below pre-referendum levels although debt and CDS markets were not much affected.
-   
The share prices of Irish banks have been affected differently with Bank of Ireland,   
 down 25 per cent since the referendum. The AIB share price is back to around the levels of 23 June. Debt valuations and CDS spreads recovered quickly for both.
- The referendum result has negatively affected the outlook for the Irish economy. Sentiment and hard data releases point to a mixed picture so far but the short and medium term impact is likely to be negative as outlined in previous Reports. Revisions to the Bank's Q3 macroeconomic forecasts accounted for Brexit-related effects with 0.2 per cent and 0.6 per cent shaved off the projected GDP growth rates for 2016 and 2017, respectively. Within IEA, new modelling techniques have been developed and new results will be available in the next Quarterly Bulletin.



- There has been a marked increase in queries received in the Central Bank, across all supervised sectors, relating to possible applications for authorisations. These have largely been exploratory and the predominant trend across all sectors is that firms are considering all available options in light of the current uncertainty. Some companies will wait to see what relationship the UK financial services industry will have in the future before considering further actions, while other companies are expected to apply for authorisations as a contingency against no longer being able to do business from the UK.
- The Central Bank has made clear that it is committed to providing a clear, open and transparent authorisation process while ensuring a rigorous assessment of the applicable regulatory standards.
- In the short-term there would also be implications for commercial real estate, particularly the Dublin office sector where demand-supply imbalances have already been evident in recent years. Since the referendum Irish listed REITS have generally performed strongly while estate agents are reporting an increase in the number of enquiries from potential occupiers looking at the feasibility of locating operations in Dublin.
- The ultimate outcome of the UK's equivalency status as determined by the EU following the negotiations will be a crucial factor in determining authorisation levels. An initial analysis is provided in the report regarding potential areas of divergence that may develop between the UK and the EU's regulatory framework in the future.

- [REDACTED]

- In the insurance sector, the main item of note since the referendum has been an increase in London market companies requesting meetings to discuss possible applications for authorisations. [REDACTED]

- The key risks for the Markets Directorate following the referendum remain largely unchanged compared to the analysis provided for previous reports and largely relate to the implications for staffing and ongoing supervision in the event of an increase in applications for authorisations. Enquiries already received indicate that the most significant migrations are expected to occur with respect to funds and fund service providers. [REDACTED]

- [REDACTED]

## 1. Introduction<sup>1</sup>

Following the Brexit referendum, the Central Bank's Financial Stability Committee (FSC) requested that a Task Force on Brexit implications be established on a permanent basis to monitor and assess developments in this area. In addition to providing expert assessment, the Task Force will facilitate information sharing across Divisions and allow the Bank to take an integrated approach in dealing with any challenges which may arise. The Task Force will meet at a minimum on a quarterly basis and a report from each meeting will be presented to the FSC.

This first Report of the Central Bank's Brexit Task Force follows the first meeting of the group on 7 September. It provides an update on political, economic and financial market developments since the referendum, risks arising for firms supervised by the Bank and issues arising for the Bank itself including with respect to authorisations. The layout of the report is as follows. Section two provides an update on political developments, the UK economy and property market and financial market effects since the referendum. Section three discusses the potential impact of a Brexit for the Irish economy and property market. In Section four, information relating to queries received by the Central Bank in relation to potential applications for authorisations is presented. Sections five to eight provide an overview of latest developments in relation to firms supervised by the Credit Institutions, Insurance and Markets Directorates, respectively. Issues relating to financial market infrastructures are discussed in Section eight and a discussion of implications for regulatory policy is provided in Section nine. Concluding remarks are provided in Section ten.

---

<sup>1</sup> The following Divisions are represented on the Brexit Task Force: BSSD, CPD, FMD, FSD, IEA, IFFS, INSA, ORD, Risk, PPG, PSSD, PPG, RES, SMSD. The Chair and Secretariat are provided by FSD.



## Political and Market Developments

This section provides an overview of latest developments relating to the UK, European and Irish political environment; the UK economy and property market; and financial market effects since the referendum.

### 2.1 Political Developments

The vote by the UK to leave the EU is resulting in heightened levels of uncertainty with regard to when the UK will trigger Article 50 of the Treaty of Lisbon and what type of new arrangements will emerge. Once Article 50 is triggered, the UK and the EU will enter into formal negotiation of a withdrawal agreement. The negotiation is expected to take two years and is intended to provide a framework defining the future relationship of the exiting state with the EU. There is no guide as to what negotiations might cover. Given interconnectedness between a Member State and EU institutions, it is plausible that the two-year negotiation period concludes with a broad framework for a future relationship without specifying details of that relationship. It is also a possibility that the two years will elapse without a formal agreement. The two year time frame can be extended if both parties agree.

Prime Minister May outlined some views in relation to the UK withdrawal from the EU during an official meeting with Donald Tusk on 8th September. The official line from that meeting is; (i) the UK will take its time before triggering Article 50 and (ii) there will be no triggering of Article 50 prior to the end of 2016. During a statement to the House of Commons on Brexit, the Prime Minister outlined that a negotiation will focus on a British model and not some pre-existing model such as the Norwegian or Swiss approach.

In the aftermath of the UK referendum outcome there has also been a number of developments at EU level. The informal meeting of 27 Heads of State on 29 June 2016 agreed that the triggering of Article 50 is a matter for the UK. Once the UK trigger Article 50, it then falls to the remaining members of the European Council (i.e. excluding the UK) to agree (unanimously) on guidelines for the negotiation between the EU and the UK of an agreement setting out arrangements for the latter's withdrawal. The HoSG statement also noted that 'access to the single market requires acceptance of all four freedoms'.

The EU institutions are putting arrangements in place for the work of negotiation. Within the EU Council Secretariat, former chef de cabinet to Herman Von Rompuy, Didier Seeuws, has been tasked to head a Council Secretariat Task Force. Meanwhile, the European Commission has set up a Task Force for the preparation and conduct of the negotiations with the United Kingdom under Article 50 with the appointment of former Financial Services Commissioner, Michel Barnier, and former Deputy DG in DG Trade Sabine Weyand as its Chief Negotiator and Deputy Chief Negotiator respectively.

In order to address the challenges arising for Ireland from the UK referendum outcome, a number of new structures across Government have been put in place. Firstly, a new Cabinet Committee on

Brexit, chaired by the Taoiseach, with Ministers supported by Secretaries General, has been established to oversee the overall Government response, including both the economic impact and the negotiations at EU level and with the administrations in London and Belfast. Secondly, there has been a number of structural changes across government departments, including the Department of the Taoiseach and the Department of Foreign Affairs, to account for the intensification and prioritisation of work in this area. In the Department of Finance, a new Brexit unit has been established within the EU and International Division, and additionally the Department of Finance staff complement has been strengthened in the Permanent Representation in Brussels. Finally, there will also be a broader public consultation - including on an inclusive all-island basis - and an ongoing engagement with other parties in the Oireachtas, as well as with the Brexit Stakeholder Group which has already been meeting for some time now.

The Chair of the Central Bank's Brexit Task Force meets with the Department of Finance on a quarterly basis to share information and risk analysis.

## 2.2 UK Economic and Property Market Developments

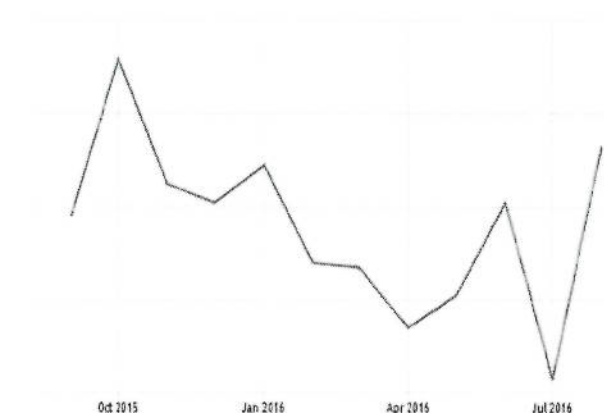
In the aftermath of the referendum large falls in sterling were recorded, uncertainty indicators in the UK picked up and business and household confidence indicators fell sharply. The Bank of England in its August inflation report noted that the short to medium term outlook had weakened markedly. It was projected that little growth in GDP would be recorded for the second half of 2016 while forecasts for 2017 and 2018 were revised down sharply by 1.5 and 1.7 percentage points, respectively, (to 0.7 per cent and 1.7 per cent). A sharp slowdown in the commercial real estate market had been recorded during H1 2016 and following the referendum there were outflows from some UK assets, notably open-ended CRE funds.

More recently financial markets and confidence indicators (Chart 2.2.1 and Chart 2.2.2) have rebounded and some data releases including retail sales have been stronger than expected. In its monetary policy statement of 15<sup>th</sup> September, the Bank of England attributed the recovery in financial markets in part to the package of monetary policy measures announced by its MPC in August. It acknowledged that indicators of near-term economic activity had surprised on the upside and that less of a slowing in UK GDP growth is now expected in H2 2016. However, no longer-term inference was drawn from the latest indicators and data and no changes were suggested to the forecasts for 2017 and 2018. The next official Bank of England forecasts will be released in November.

For the euro area only modest downward revisions to GDP projections were announced by the ECB in September in comparison to the June exercise. These were of the order of -0.1 percentage points for both 2017 and 2018, partly related to the uncertainties following the referendum, while risks to the outlook remain tilted to the downside.

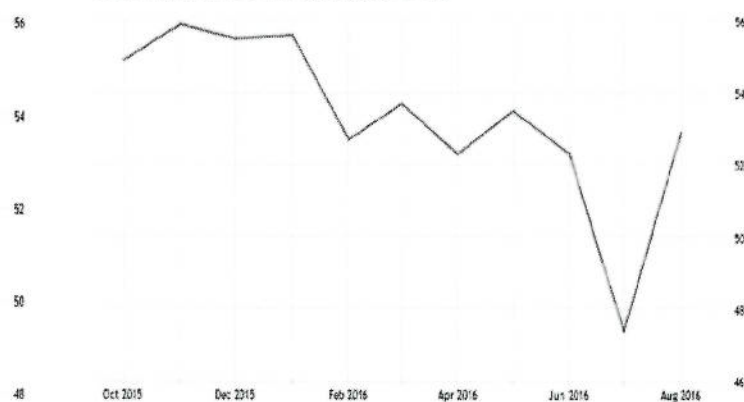


Chart 2.2.1: UK Manufacturing PMI



Source: Markit Economics  
Last observation: September 5<sup>th</sup> 2016

Chart 2.2.2: UK Services PMI



Source: Markit Economics  
Last observation: September 1<sup>st</sup> 2016

UK commercial property values had been moderating since the end of 2014 and have eased further in the months since the Brexit referendum. According to CBRE, capital values fell 0.5 per cent in August 2016 on the back of a 3.3 per cent fall in July.<sup>2</sup> Similarly, IPD data report to a 2.8 per cent drop in the month following the vote. On an annual basis CRE capital values were 0.3 per cent higher in July 2016 down from 3.8 per cent at the end of June and 9.5 per cent a year earlier, according to IPD (Chart 2.2.3). Rental values were relatively static in August (down 0.1 per cent) after a fall of 2.9 per cent in July. In terms of sectoral performance, developments in the office market are most notable. CBRE report a fall of 0.8 and 0.1 per cent in office capital and rental values respectively, for August, mainly driven by declines in the City of London.

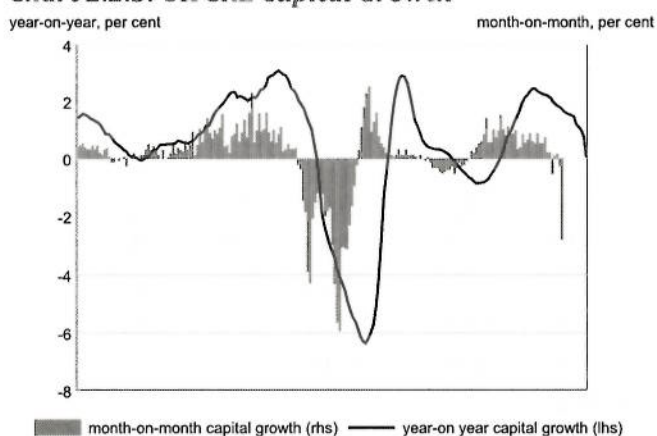
Activity in the UK CRE market is expected to remain muted in the period ahead. A recent RICS survey<sup>3</sup> reported a significant drop in confidence and investor demand for commercial property in Britain, post the Brexit vote, with London most severely affected. The survey found that the share of respondents across the UK who felt that the market was in an early downturn phase was growing. An additional finding was that 12-month capital and rental projections had moved into negative territory.

UK commercial property funds were adversely affected in the immediate aftermath of the referendum. Trading in a large portion of the UK's £25 billion commercial property fund sector was suspended, meaning investors could neither withdraw nor deposit money from the affected funds. Property funds managed by firms such as Aviva, Standard Life, Henderson Global Investors, Canada Life, Columbia Threadneedle/Ameriprise and M&G are amongst those which frozen redemptions. Other funds have lowered unit prices meaning investors looking to cash in investments would be doing so at a considerable discount.

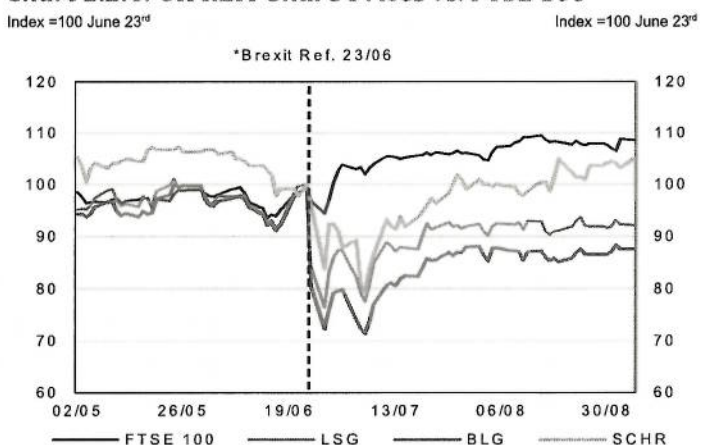
<sup>2</sup> See CBRE UK Monthly Index, August 2016.

<sup>3</sup> See RICS UK Commercial Property Market Survey, 2016Q2.



**Chart 2.2.3: UK CRE Capital Growth**

Source: IPD and Central Bank of Ireland calculations

**Chart 2.2.4: UK REIT Share Prices vs. FTSE 100**Source: Datastream and central Bank of Ireland calculations  
Notes: LSG = Land Securities Group, BLG = British Land Group and SCHR = Schroder Real Estate.  
Last observation September 5th

Many listed UK REITs saw their share prices drop substantially in the closing days of June, including Land Securities, British Land and Schroders, which declined by 24.5, 28.6 and 20.7 per cent respectively. While there has been some recovery in the weeks since, (Schroders is currently 5 per cent higher than its eve-of-vote level), Land Securities and British Land are still about 10 per cent off their pre-referendum values. Meanwhile the FTSE 100, which lost about 5 per cent of its value in the days following the Brexit decision, was almost 10 per cent higher in early September (Chart 2.2.4).

In the UK residential market, confidence dropped significantly immediately following the referendum according to the RICS Residential Market Survey. However, the August 2016 results suggest that confidence has subsequently been recovering gradually. Prices and sales volumes are now expected to rise going forward both at the three and twelve month time horizons for the country overall. For London, expectations have stabilised and prices are expected to see little change over the next twelve months.

## 2.3 Financial Market Impact

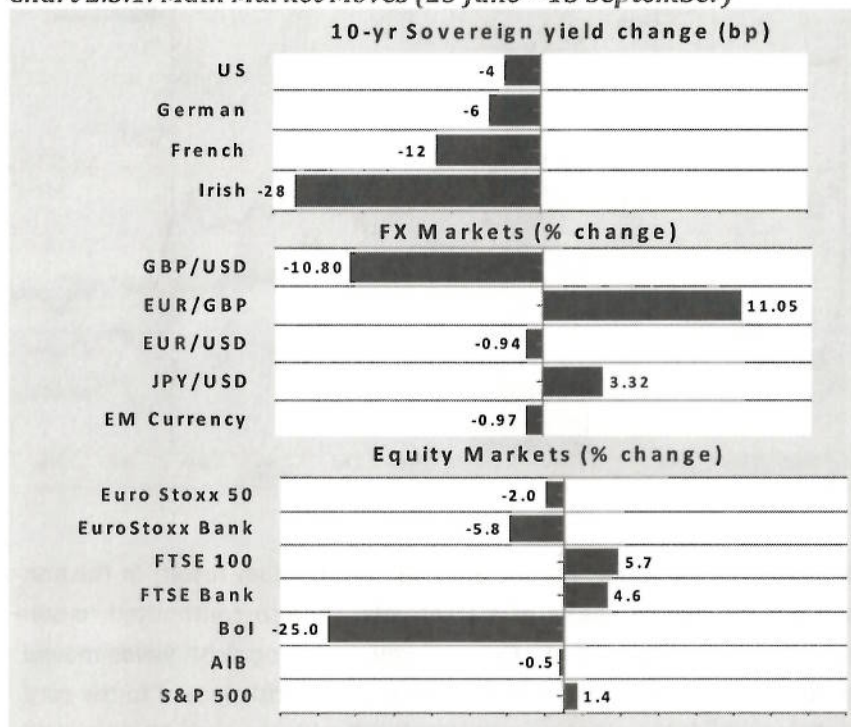
### 2.3.1 Overview

In the week leading up to the referendum, market pricing indicated that investors perceived a 'Remain' vote as the most likely outcome. The announcement therefore came as a considerable surprise to markets, despite opinion polls remaining tight, leading to large market re-positioning and a bout of significant financial market volatility. Some of the most notable initial market moves were the historic one-day depreciation in sterling, a sharp sell-off in equities, in particular the financial sector, and a flight to quality bid on risk-free sovereign bonds.

This bout of financial market volatility did not persist, particularly when compared to other recent episodes of market turbulence, including the 'taper tantrum' in 2013 and the China-induced stress in August 2015, with equity markets beginning to recover within three trading days. This swift reduction of market volatility is likely attributed to a number of factors. Firstly, the market quickly re-priced to find new post-referendum result levels. Secondly, in the weeks immediately following the announcement economic data have surprised to the upside. Both hard data and forward looking PMIs in the UK and euro area have appeared relatively resilient, albeit that more recently there has been a softening in this data in the euro area. Finally, and perhaps most importantly, continued expectations for central banks to remain in easing mode have been one of the primary supports to the market. Over the period both the Bank of England (BoE) and Bank of Japan (BoJ) eased their policy stance. Further, expectation was for the ECB to do likewise and for the FOMC to slow their interest rate hiking cycle.

Due to a combination of the above factors and on the back of low dealing activity (owing to seasonal factors), volatility fell to multi-year lows over the summer. Amid this low volatility, some asset classes have seen historic gains, with equity markets (including financial indices) recouping much of the referendum result related losses. Chart 2.3.1 provides an overview of the main market moves since the referendum date. Currently yields on euro area bonds are lower than their pre-vote levels, with the German and Irish 10-year yields 0.03% and 0.49% respectively, which is 4bps and 28bps lower than 23 June. Sterling remains close to its post-vote low against the dollar at \$1.32, c. 11% lower than 23 June. Finally, equity markets globally are close to their pre-vote levels, albeit with the European banking sector, represented by the EuroStoxx Bank Index, still c. 6% lower over the period.

Some market commentary has suggested that investors now see market volatility as set to increase in the coming months, but with this not attributable to the referendum outcome. Market commentators have highlighted two factors as contributing to this possible inflection point. Firstly, the September ECB Governing Council meeting was perceived as disappointing to markets, following the decision to maintain the present monetary policy stance and not make any adjustments to the asset purchase programmes. Secondly, commentary from FOMC members has turned more hawkish, with expectations for a rate hike by year-end increasing from its post-Brexit vote low. This has led to a sell-off in equity and bond markets over the past week.

*Chart 2.3.1: Main Market Moves (23 June – 15 September)*

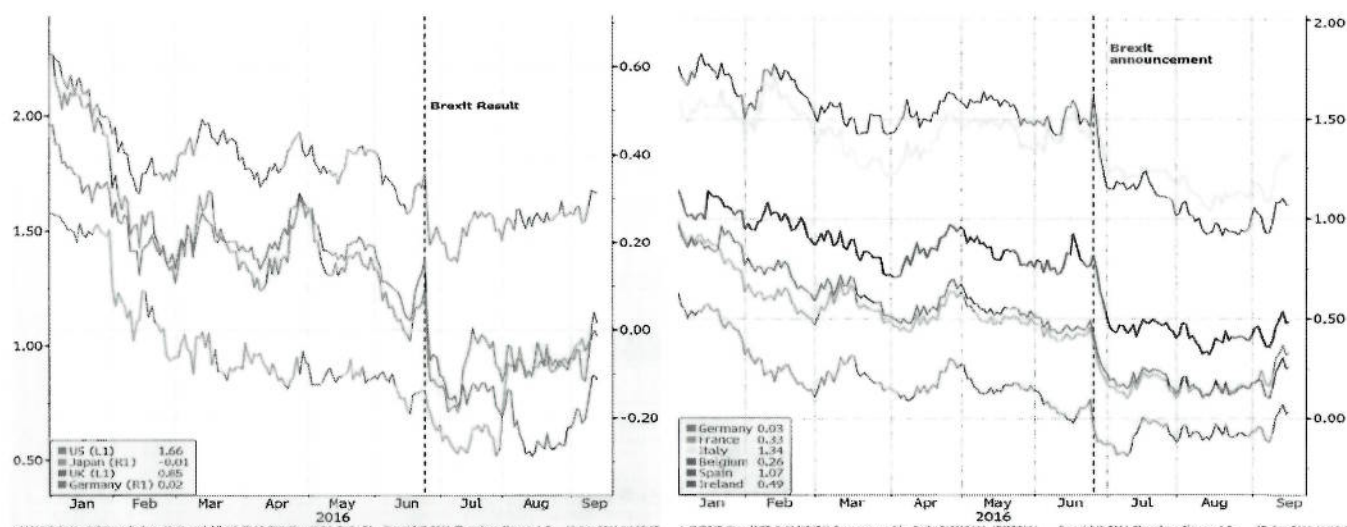
The following section discusses in more detail the impact of the referendum result on four markets – sovereign bond, foreign exchange, equity and finally a more in-depth look at the performance of the banking sector.

### 2.3.2 Sovereign Bond Market

A strong flight-to-quality bid saw G4 sovereign yields fall to historic lows in the immediate aftermath of the Brexit vote. Longer dated yields in the UK halved over a two week period, with the German 10-year bund falling into negative territory for the first time. Following this initial safe haven bid, bonds remained supported for much of this post-referendum result period, largely due to expectations for central banks to maintain or enhance their dovish policy stances. However, in recent weeks this bond rally has begun to reverse, with longer dated yields now approaching their pre-vote levels in some regions. Monetary policy action again provided much of the driver for these moves, as a number of central bank meetings failed to deliver on market expectations for further easing.

*Chart 2.3.2: G4 10-Year Sovereign Yields**Chart 2.3.3: Euro Area 10-Year Sovereign Yields*





In the euro area, core yields across the curve fell sharply after the referendum result. In the non-core, spreads initially widened but the overall easing of market volatility also contributed to non-core yield tightening from the initial post-result sell-off. Over the review period, Irish yields moved with the non-core; in the immediate aftermath of the referendum result the Irish spread to the core widened. But following the subsidence of this volatility, Irish yields fell with the Irish 10-year yield currently at 0.49% versus 0.77% pre-announcement.

However, following the meeting of the Governing Council on 08 September, at which some market commentators had expected an amendment to the current policy stance which did not materialise, bonds have begun to sell-off, with longer dated bonds now close to their pre-referendum levels. The exception to this sell-off has been the shorter end of the German curve, where scarcity concerns have anchored yields (out to 6 years) below the current deposit facility rate. The market reaction to the Governing Council meeting, along with a number of hawkish comments from members of the FOMC, in particular Chair Janet Yellen's speech at Jackson Hole, has also resulted in the reversal of a large part of the US bond rally which occurred post-Brexit.

In Japan, sovereign yields rose sharply following the BoJ's July 29 meeting, again reversing much of the post-referendum result rally. This occurred firstly as a result of markets being disappointed with the announced package, with some commentators speculating on the prospect of further stimulus being announced (even including the potential introduction of 'helicopter money' as a policy tool) in advance of the meeting. Secondly, the BoJ announced a full review of their current monetary policy package, with the results due to be released on 21 September, which led market participants to speculate on the diminishing effectiveness of monetary policy in the area. Finally in the UK, sovereign yields fell to historic lows, with the 10-year gilt nearing 0.50% over the period, down c. 90bps from their pre-vote level of 1.40%. Over the past month, however, the longer end of the curve has ticked higher, following its US and European counterparts. The short end of the curve remains relatively anchored to the policy rate, with the 2-year yield now at 0.17%.

Looking forward, as derived from market traded options, investors are currently placing a c. 25% chance of a further policy rate cut to take place in both the UK and the euro area before year-end. Conversely in the US, there is a 57% chance of an interest rate hike currently priced in over the same horizon.

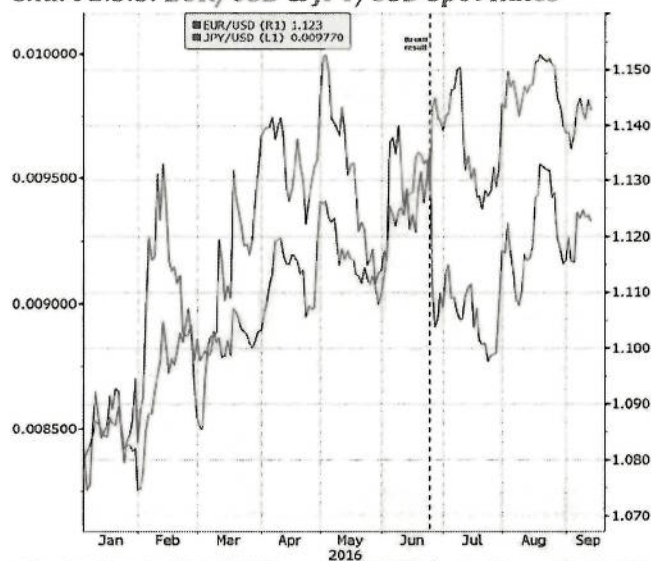
### 2.3.3. Foreign Exchange Markets

In currency markets, movements in the sterling exchange rate were the most discernible gauge of Brexit sentiment. Having appreciated strongly in the lead-up to the referendum, 24-27 June saw sterling fall to 30-year lows against the dollar (at \$1.32 vs. \$1.49 pre-vote). While other asset classes have generally rebounded from their initial post-result move, sterling remains close to its immediate post-vote low (Chart 2.3.4). This comes on the back of the BoE's easing of monetary policy stance, when on 3 August the MPC decided to cut interest rates to 25bps, increase its sovereign bond holdings (by £60bn over six months), begin a corporate sector bond buying programme (£10bn over 18-months) and implement a new Term Fund Lending scheme.

Chart 2.3.4: Sterling Spot Rates



Chart 2.3.5: EUR/USD & JPY/USD Spot Rates



Reaction in other currency markets has been relatively muted. Initial spill-over effects saw the euro weaken by close to 3% against the dollar in the days immediately following Brexit. However, it now currently trades at \$1.123, as at 13 September, versus \$1.136 the day before the Brexit vote. In Japan, expectations of monetary policy easing saw the yen depreciate against the dollar earlier in the review period, having gained close to 2% in the immediate aftermath of the Brexit vote on the back of safe haven bids. However, disappointment following the BoJ's announcement led to resumption in yen appreciation, albeit it has remained relatively range bound post-vote.

Looking forward, monetary policy action is again likely to dictate currency market movements. Having depreciated strongly post-Brexit vote, the continued monetary policy easing by the BoE is



likely to weigh on sterling. In the US, dollar strength will be tied to the FOMC's decision-making, with the dollar having depreciated steadily on a trade weighted basis over the year as markets expected a much slower US hiking cycle. Finally in Japan, the outcome from the 21 September review of monetary policy stance may influence the yen, although it should be noted that the BoJ's actions in recent times has had little effect on countering currency strength amid a strong safe haven bid.

### 2.3.4 Equity Markets

Equity markets in particular highlighted the multi-staged market response to the referendum. In the immediate aftermath of the announcement on Brexit, having risen in the week leading up to the vote, there was a sharp market correction with the FTSE 100, S&P 500 and Eurostoxx 50 losing c. 5.6%, 5.5% and 11.0%, respectively, over a two-day period post announcement. However, within three trading days, equity markets reached an inflection point and began a broad based recovery which continued for much of the review period (Chart 2.3.6). This was driven by a number of factors including increased expectation for accommodative stances to be adopted by central banks globally and on the back of economic data surprising to the upside.

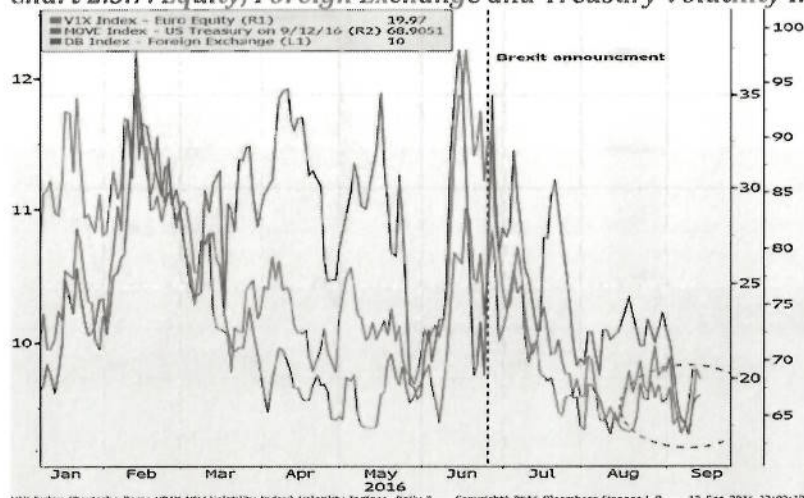
Chart 2.3.6: Global Equity Returns



However, this equity market recovery does appear relatively fragile, with losses being observed in most global equity markets in recent weeks. As indicated above, the recent more hawkish tone set by the FOMC and the market disappointment surrounding the September ECB Governing Council meeting appear to have provided a catalyst for this sell-off. Chart 2.3.7 depicts forward looking volatility measures for treasuries, foreign exchange and equity markets.<sup>4</sup> These volatility indicators highlight that investors are now pricing in an expectation for volatility to increase over the coming months.

<sup>4</sup> The VIX, Move and Treasury Index depict the market perceived volatility in each respective market over a one month period, as derived from the options market.

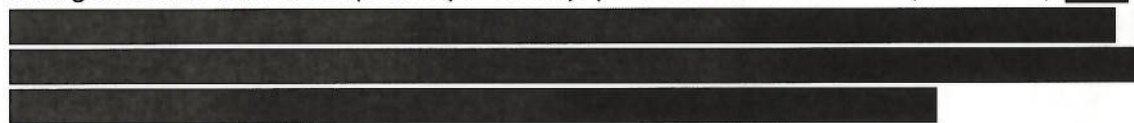


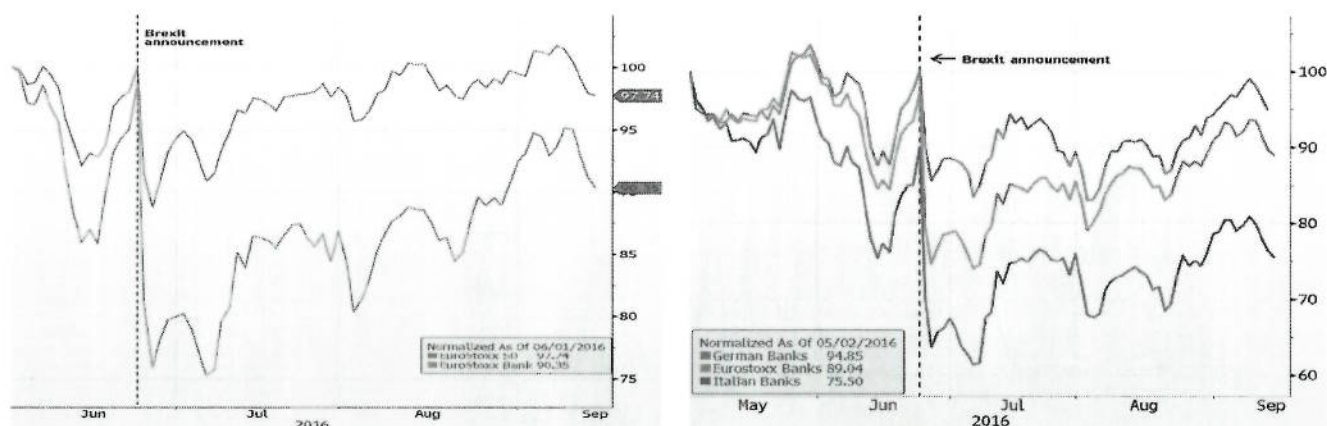
*Chart 2.3.7: Equity, Foreign Exchange and Treasury Volatility Indices*

### 2.3.5 Financial Sector

The swings in equity market valuation observed following the referendum result were amplified within the financial sector, as has been the case throughout the majority of severe bouts of stress seen since the financial crisis. UK and euro area banks were the most impacted sectors in the immediate aftermath of Brexit (Chart 2.3.8), with trading on some UK bank shares being suspended on 27 June. Throughout the post-Brexit vote recovery, however, the financial sector out-performed the overall index and was close to recouping the losses made post-vote, before the most recent downturn in risk sentiment and equity performance.

However, the performance of bank equity has not been uniform across regions, with the post-Brexit result market stress drawing light to risks in peripheral banks, in particular those with large Non-Performing Loan (NPL) books, with shares in Italy's two largest banks Intesa Sanpaolo and UniCredit, having fallen 23% and 24% respectively in the days post-Brexit announcement (Chart 2.3.9).

*Chart 2.3.8: EuroStoxx 50 v. EuroStoxx Bank**Chart 2.3.9: Euro Regional Bank Performance*



More positively, a number of market commentators have pointed to the resilience of bank debt markets post-referendum result. While equity prices tend to reflect a wide range of variables, such as future profitability and ability to make dividend pay-outs, debt markets generally reflect investor perceived credit assessment of an entity. Chart 2.3.10 depicts the performance of a euro area AT1 bond index, also known as “CoCo bonds”, relative to the EuroStoxx Bank Index. The strong performance of bank debt post-Brexit result, relative to equity performance, was highlighted as potentially being indicative of bank’s stronger capital positions and lower credit risk. CDS spreads also performed stronger than bank equities. This comes amid the announcement of the EBA stress test results on the 29 July.

*Chart 2.3.10: EuroStoxx Bank v. Euro CoCo Index*



## 2. Impact on Irish Economy

### 3.1 Irish Macroeconomic Impact and Forecasts

The Bank published its last set of macroeconomic forecasts in July (Quarterly Bulletin No. 3, 2016). These are summarised in the Table below. They also accounted for Brexit related effects, with 0.2% and 0.6% shaved off the projected GDP growth rates in 2016 and 2017, respectively, largely on account of a weaker outlook for trade and investment.

At the time of writing, revised forecasts are being finalised for the forthcoming Quarterly Bulletin (early October). These numbers will also factor in the latest set of Quarterly National Accounts (QNA) data (published 14 September) (see Table 3.1.1). These revealed a seasonally adjusted increase in GDP of 0.6 per cent (+4.1 per cent year-on-year) in the 2<sup>nd</sup> quarter. Within this, consumer spending was surprisingly weak (a fall of 0.5 per cent) with investment and imports up sharply, reflecting in part strong imports of intangible related assets.

The decline in consumption is at odds with other data notably the strong increase in employment across the economy (see below). We still expect to see a robust outturn for consumption this year although it would seem prudent to adjust growth rates marginally downwards. External developments are also weaker relative to when the last Bulletin was prepared. Both the ECB and the IMF revised world growth downwards. We did however anticipate some weakening in prospects for net exports following Brexit, so changes to the overall GDP outlook are likely to be modest (small downward revisions) to avoid double counting.

*Table 3.1.1: Growth Outlook for Ireland, Quarterly Bulletin No.3 2016*

Volume growth %	2015	2016Q1	2016Q2	2016f	2017f
Personal Consumption	4.5	5.1	1.8	4.0	2.3
Public Consumption	1.2	4.9	5.2	2.3	1.6
Investment	32.7	-3.9	21.0	12.3	6.1
Underlying Domestic Demand	4.9	3.0	1.7	4.0	2.9
Exports	34.4	3.7	3.9	6.4	4.5
Imports	26.7	2.4	9.3	8.0	4.7
GDP	26.3	3.9	4.1	4.9	3.6
GNP	18.7	12.2	4.6	4.6	3.1
BoP Current Account (% of GDP)	10.2	14.3	7.5	8.8	8.9
Unemployment rate (% of labour force)	9.4	8.4	8.6	7.9	7.2
Labour force (% annual change)	0.5	0.6	1.5	0.4	0.6
Employment (% annual change)	2.5	2.4	2.9	2.1	1.3
Inflation HICP (% annual change)	0.0	-0.3	-0.1	0.2	1.4

The other main data release was the Quarterly National Household Survey (QNHS) for the period April-June 2016. This revealed further strong broad based gains in employment with surprisingly strong labour force growth. It is likely that we will revise employment growth upwards in 2016



(growth averaged 2.7 per cent in the first half of the year) and also increase the pace of labour force growth (the labour force grew by 1.1 per cent over the same period). The strength in the latter resulted in significant revisions to the unemployment rate – the CSO revised the latter up from less than 7.8 per cent in July to 8.3 per cent. This will also necessitate an upward revision to the outlook for the unemployment rate in 2016 and 2017.

Higher frequency data developments including sentiment indicators since Brexit have been mixed. The ESRI/KBC Bank Consumer Sentiment Index declined in July following the referendum before increasing again in August. PMI data for construction, industry and services remains in positive territory (i.e. expansion).<sup>5</sup> It is too early to say whether any clear trends are emerging from these data.

There appears to be some softening in monthly manufacturing and trade data. The monthly industrial production series (which is volatile) shows that manufacturing output was up 0.9 per cent in the first 7 months of the year. However within this, the traditional (indigenous) sector contracted by 1.5 per cent (following strong gains in 2015). Similarly monthly merchandise trade data has been softer in 2016. In the year to July, exports (in nominal terms) were up 2.7 per cent with imports down 3.6 per cent. More traditional sectors (such as food) reported small increases in the value of exports. It is important to note a significant dis-connect between these data and the national accounts measures on account of contract manufacturing. Finally, Exchequer tax receipts (in the year to August) are performing well in cumulative terms (up 6.2 per cent). That said certain key tax categories - income tax and VAT receipts - have surprised on the downside. These data need to be closely monitored with some key tax months due in the latter part of the year.

Within IEA, a number of modelling developments have taken place. In particular, a GVAR (Global Vector Autoregression) model has been developed to simulate the effects of shocks to the Irish economy. The forthcoming Bulletin will detail this model in a Box – the model estimates the impact of four different shocks on the Irish economy: (i) a fall in UK GDP; (ii) a tightening of US monetary policy; (iii) an oil price increase, and; (iv) a global GDP shock. With respect to a shock to UK output (1% off UK GDP), Irish GDP responds considerably more negatively than either the US or the euro area, with cumulative losses of 0.33% and 0.32% per cent of GDP after four and eight quarters. The GVAR results are fairly similar to the estimates presented for Ireland in the last Bulletin (which were based on a Bayesian VAR model).

### 3.2 Property Market Impact

A relocation of financial or other firms from the UK to Ireland could impact on both the CRE and residential property markets here. A number of Irish estate agents are reporting an increase in the number of enquiries from potential occupiers looking at the feasibility of locating some operations in

---

<sup>5</sup> The manufacturing and services indices improved in August (following declines in July). The construction PMI fell back in August although is still positive.

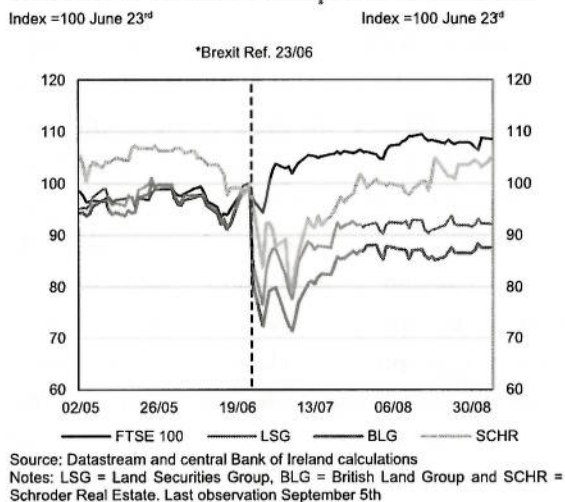
Dublin.<sup>6</sup> The Central Bank has received a considerable number of enquiries also, as outlined in Section 4.

Conversely, some outward flows might be expected from firms whose business operations are affected by potential trade restrictions. In the industrial and logistics market, occupiers that mainly trade with the UK have put some decisions on hold recently until there is more clarity on the longer-term implications of Brexit according to CBRE. The weakening of sterling has affected those involved in importing/exporting and this is likely to continue to impact activity in the sector in the period ahead.

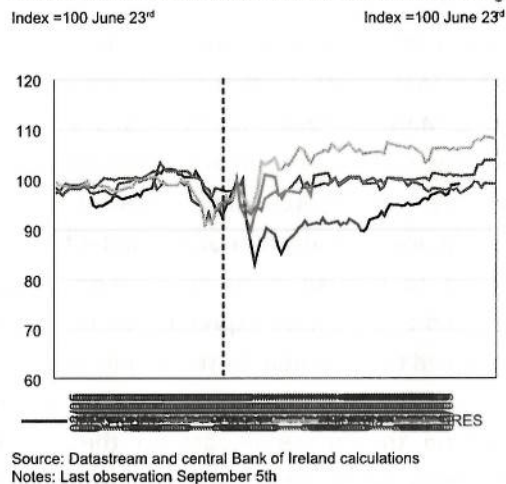
In contrast to their UK counterparts, the values of Irish-listed REITs have recovered following an initial drop in late-June. According to the latest data, Hibernia and IRES are 8 and 4 per cent, respectively, above where they were before the referendum having strongly outperformed the ISEQ in the intervening period (Chart 3.2.1). Meanwhile Green REIT remains about 1 per cent below its June 23<sup>rd</sup> value as is the ISEQ.

In terms of an impact on the Irish housing market, one of the main issues surrounding Brexit concerns supply and the ability of the market here to cope with a surge in demand for accommodation should there be a widespread relocation of UK based firms/workers here. It is likely that this would put further upward pressure on prices, at a time when there is a severe shortage of units for sale or rent.

**Chart 3.2.1: UK REIT Share prices vs. FTSE 100**



**Chart 3.2.2: Irish REIT Share Prices vs. ISEQ index**



<sup>6</sup> See CBRE Ireland Bi-Monthly Research Report, September 2016.



### 3. Authorisations

In July, the Central Bank held two Brexit roundtable discussions with trade associations and consultancy firms. [REDACTED]

[REDACTED] At the roundtables, and through the Governor's address to the Institute for International and European Affairs in August, the Central Bank made clear that it is committed to providing a clear, open and transparent authorisation process while ensuring a rigorous assessment of the applicable regulatory standards. It was also noted that where firms applying for authorisation operate business models with which the Central Bank is familiar, the process is more streamlined. Where firms seeking authorisation are outside of the typical business or regulatory models, this may present challenges in terms of resources and skill sets. Within the Central Bank's current resources, it can re-prioritise to meet short-term incremental increases on its authorisation and supervisory demands. Sustained increases will require longer term solutions. Material changes in the range of licensed entities (such as CCPs<sup>7</sup>) will require consideration from a strategic perspective. In order to meet its mandate of *Safeguarding Stability, Protecting Consumers*, the Central Bank has acknowledged that as an organisation it is important that we understand innovations in the financial services sectors, developments in financial products, the opportunities offered by them and the potential consequences for the sector.

There has been a marked increase in queries from Industry - both from firms directly and legal advisors/consultants- to discuss possible applications for authorisations across all sectors (Insurance, Banking, Markets, Payment Institutions) since the Brexit vote. To date, the focus of the queries has largely been exploratory in terms of seeking clarification on the application process and the speed at which new applications will be reviewed, with some querying the potential for a 'special' route for firms that are currently authorised under the UK regime. Some approaches from Industry indicate an intention to reverse plans to wind-down operations in Ireland and, in some cases, existing authorised entities have expressed an interest in expanding activities here. A number of firms have also flagged the potential to set up a presence for passporting purposes in Ireland. Some institutions have indicated their intention to await the outcome of the UK-EU negotiations to determine the impact on the future impact on the UK financial services industry before pursuing formal applications, while others are expected to apply for authorisations as a contingency against no longer being able to do business from the UK. The predominant trend across all sectors is that firms are considering all available options in light of the current uncertainty. The ultimate outcome of the UK's 'equivalency status' as determined by the EU following the negotiations, will be the crucial factor in determining authorisation applications levels (see Section 9).

---

<sup>7</sup> Central Counterparties



While Ireland has a number of key attributes that will help attract migrating firms (such as a familiar legislative regime, low tax rates and availability of skilled & educated staff), wider concerns about the ability of Dublin's infrastructure to cope with an influx of new entities have been well publicised. A lack of supply in the commercial and residential property sectors may present some key impediments to firms migrating to Dublin – in addition, Dublin's present transport infrastructure and related capacity constraints are not supportive of large increases in long distance commuting. Although the financial services industry is growing across other regions and urban centres, Dublin remains the preferred Irish destination for the overwhelming majority of prospective migrant entities.

**Table 4.1: Overview Of Post Referendum Authorisation Developments**

Sector	Approx. number of Authorisation queries post Brexit vote	Nature of Query
[REDACTED]	[REDACTED]	<ul style="list-style-type: none"> <li>• Authorisation of new entities (including new business models)</li> <li>• [REDACTED]</li> <li>• Expansion of existing IE operations</li> </ul>
[REDACTED] [REDACTED]  [REDACTED]	[REDACTED]	<ul style="list-style-type: none"> <li>• Authorisation of new entities</li> <li>• Expansion of existing operations</li> <li>• Branch establishment (with potential to covert to full authorisation)</li> <li>• [REDACTED]</li> <li>• General queries on authorisation process and fees</li> <li>• Potential re-domiciling of Funds to IE</li> </ul>
[REDACTED]	[REDACTED]	<ul style="list-style-type: none"> <li>• Authorisation of new entities (to serve as a European hub rather than selling into the IE market)</li> <li>• General queries on authorisation process and timing</li> </ul>
[REDACTED]	[REDACTED]	<ul style="list-style-type: none"> <li>• General queries on authorisation process and timing</li> <li>• Queries re potential for a 'special route' for firms already</li> </ul>

		<ul style="list-style-type: none"><li>• authorised by PRA</li><li>• [REDACTED]</li></ul>
--	--	--

## 5. Banking

### 5.1 Referendum Impact

[REDACTED]

[REDACTED] However, the share prices of both AIB and BOI [REDACTED] were significantly impacted in the days following the vote, falling by 17.5% and 37.5% respectively [REDACTED]

[REDACTED]

### 5.2 Ongoing Actions

BSSD is monitoring different effects of the result of the Brexit vote as it relates to the Significant Institutions (SIs) and Less Significant Institutions (LSIs). [REDACTED]

[REDACTED]. For the LSIs, the Division is seeing increased levels of engagement around the area of potential authorisations and licence applications coming from international banks.

[REDACTED]

[REDACTED]

As with other sectors, a number of enquiries regarding potential authorisation applications have been received following the referendum. These are discussed in a holistic way in Section 4. In relation to the LSIs, Senior management in BSSD, the Director of Credit Institutions and senior management in the policy area of BSAD have attended a number of meetings with institutions around the possibility of establishing a presence in Ireland; expanding the current footprint of operations already licenced; reversing current plans to have their licence revoked and potentially changing the legal structure of an existing licenced entity. To date BSSD has documented contact [REDACTED] financial institutions under these broad areas. This contact, received in the ten weeks since the Brexit vote encompasses a diverse group of financial institutions parented in five different countries both within the SSM and from 3<sup>rd</sup> country jurisdictions within the EU and globally.

[REDACTED]. While engagement with the remainder of these institutions has involved initial conversations with senior management around their intentions to explore the concept of conducting banking operations in Ireland and what that would entail from an authorisation process perspective.

From a resourcing standpoint, it is clear that a significant increase in the number and type of authorisations requested by financial institutions looking to set up operations in Ireland post Brexit has the potential to provide challenges for the staff with authorisation and supervision responsibilities within the CBI. However, the CBI as part of the normal course of business assesses the skills levels and requirements to manage our supervisory delivery. [REDACTED]



## Insurance

### 6.1 Queries on Authorisations

The main item of note since the Brexit vote has been an increase in companies requesting meetings to discuss possible applications for authorisations. These firms are mainly London market companies (i.e. not Lloyds syndicates but companies that operate in the London market, often with close associations with Lloyds syndicates). Whilst some of these companies were already considering setting up an operation in Ireland even before the Brexit vote a number have cited Brexit as the reason for their enquiries. These companies are looking to set up European hubs rather than companies that sell into the Irish market

A number of meetings have also been held with legal and actuarial advisors looking for clarification on the application process and the speed at which new applications will be reviewed. [REDACTED]

Some companies will be waiting to see what relationship the UK financial services industry will have in the future before considering further actions, while other companies are expected to apply for authorisations as a contingency against no longer being able to do business from the UK. These companies are worried that a final decision will be made too late to allow action after the event and should a favourable position emerge will probably not proceed with the authorisation.

### 6.2 Update on the Impact on and Preparedness of Entities

The majority of Irish regulated entities have little or no direct business with the UK. For these companies the impact of Brexit will be limited to the impact on financial markets in general and any economic slowdown in the markets to which they sell. Under Solvency II, all companies are required to do their own stress and scenario tests as part of their ORSA process. In general these include tests on adverse movements in financial markets and new business levels greater than those expected from Brexit. Comprehensive analysis of these stress tests would not produce meaningful results as the stresses are not centrally defined and vary from company to company. Reviews of the individual reports indicate that companies have sufficient capital buffers in place to withstand the expected level of financial market movements.

As part of the initial Brexit reports, three scenarios were considered as broadly representing the future relationship between the UK and the EU in terms of the financial services industry. The impact of each scenario on companies largely depends on how they sell business into the UK. This can be done on a Freedom of Establishment basis ("FOE" which means that the company sells via a UK branch) or a Freedom of Services basis ("FOS" where no physical presence exists in the UK).

- In the base case scenario, [REDACTED], whereby trade agreements can be reached, FOS business would no longer be possible but business could continue on an FOE basis. Moving from an FOS to an FOE basis would likely incur additional running costs. There is also the possibility of increased regulation of branches in the UK which might also challenge the viability of business models.

- Under the best case scenario, an EEA style outcome, [REDACTED] there would be little impact as both FOE and FOS sales could continue.
- Under the worst case scenario, whereby no agreement can be reached and trade relations are governed by WTO rules, business models would be severely impacted as sales could only continue via a subsidiary which would be fully regulated in the UK and probably lose the tax advantages that currently exist for offshore sales.

The base and worst case scenarios conclude that selling on an FOS basis will not be available following a Brexit and [REDACTED]. However for FOE business it is only in the worst case scenario that this business is likely to be severely disrupted and [REDACTED]. However even under the base case scenario where FOE selling is allowed it is possible that there could be increased UK regulation of branches following a Brexit.

Supervisory contact is being maintained with all companies whose business model will be impacted by Brexit.

- [REDACTED]
- In the immediate aftermath of the referendum result, companies selling variable annuity business were queried on how the financial market volatility had impacted on their hedging programs. [REDACTED]
- A number of the large domestic non-life companies also sell business in the UK, mostly just to Northern Ireland, with a mix of FOS and FOE models. [REDACTED]

[REDACTED]. However future bouts of market volatility are to be expected and the impact on insurance companies will be closely monitored. For all the entities regulated here there seems little prospect of an immediate solvency concern caused by Brexit but business models could be severely impacted in the longer term

### 6.3 Potential Impact on Irish Consumers

A significant amount of premium is written by UK entities selling into Ireland.

- A small number of UK life companies selling via an Irish branch. The largest of these are [REDACTED] (mainly selling savings and pensions).
- Approximately 20 life companies selling protection business on an FOS basis (which is more price sensitive than pensions business). These companies would likely have to set up an Irish branch to continue in Ireland (potentially increasing costs) or cease trading and transfer



their business. Both cases are likely to lead to less competition in the Irish market but as the market share of these entities is low the impact is likely to be small.

- A large number of non-life companies many with very small amounts and not actively pursuing sales. The largest companies are selling on a FOE basis [REDACTED] and the exclusion of these from the Irish market would have a significant impact on competition, although it seems unlikely that they will exit the Irish market completely.

Hence it seems that the Irish insurance consumer will only suffer minor impact from Brexit as the majority of business from the UK is being sold on an FOE basis and is likely to be able to continue to do so when the UK leaves the EU. There may be a small reduction in competition in some markets if companies currently selling in Ireland on an FOS basis cease doing so.

#### **6.4 Group Supervision and Solvency II Equivalence**

The UK's PRA is currently the group supervisor (or EU sub-group supervisor) for a number of groups with subsidiaries in Ireland. The UK has also recently introduced the Solvency II regime and is not expected to change this significantly, at least in the short term. As such it is expected that its supervisory regime will be deemed equivalent for the purposes of group supervision. If this is the case then the PRA will continue as group supervisor. However, if equivalence is not granted then a new EU sub-group supervisor will be needed and in many cases this responsibility could fall on the Central Bank with a consequent increase in workload for the Insurance Supervision Directorate.



## 6. Markets Directorate Firms

The key risks following the Brexit referendum remain largely unchanged for the Markets Directorate compared to the analysis provided in the previous reports, namely that a potential increase in applications for authorisation will have implications for staffing and ongoing supervision. No noticeable increase in authorisations has yet occurred, although the various authorisations teams have reported an increase in the number of queries received, with Brexit cited as a key driver of many of these queries.

The enquiries to the Markets Directorate indicate that the most significant migrations are expected to occur with respect to funds and fund service providers. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

The predominant trend across all entity types is that firms continue to consider all options, as they may not have time to finalise plans in relation to relocation decisions upon the conclusion of the negotiations between the EU and UK. The issue of 'equivalency status'<sup>8</sup>, whereby the UK maintains close adherence to EU legislation, (deemed the 'Swiss-Plus Approach') could be an important consideration for entities looking at authorisation prospects.

Over the medium term, Markets Directorate firms will need to consider the impact on operations in particular where the firms are part of larger UK groups or where relationships and legal arrangements have been established with UK-domiciled entities. A number of firms are heavily dependent on counterparty and clearing relationships, outsourcing arrangements, and the passporting of services, all of which are likely to be affected by Brexit.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

<sup>8</sup> See section 9 for a discussion of third party equivalency

## 7.1 Investment Firms

### 7.1.2 Passporting

MiFID investment firms are able to provide services into other EU / EEA member states on a freedom of services or a freedom of establishment (branch) basis. The EBA & ESMA co-authored a report on investment firms which was published in December 2015<sup>9</sup>. This report indicates that of the circa 7,200 firms across the EU / EEA that perform MiFID services, approximately 51% of these firms are authorised in the UK. The same report indicates that almost 2,800 firms avail of a MiFID passport, with approximately 75% of those firms being UK firms.

A small proportion of EU / EEA MiFID firms are authorised in Ireland; (circa 1.5% of all EU / EEA firms, and 2.2% of firms that passport)<sup>10</sup>. These figures indicate a heavy concentration of MiFID firms in the UK and a higher propensity for UK firms to provide services on a passported basis. Although the holding of a passport is not by itself a reliable indicator of the amount of business carried out in other jurisdictions it would appear that UK firms would stand to be impacted more from a removal of access to the single market than would 'Other EU firms' be impacted by a loss of access to UK markets.

### 7.1.2 Market Risk

As noted in Section 2, the increased market volatility experienced in the aftermath of the Brexit vote has subsequently subsided. Pension asset values are in many cases directly affected by the values of UK-based investments, with the recent decline in GBP having the effect of reducing these fund values. This coupled with the lower-for-longer interest rate paradigm may have an adverse impact on pension deficits and by extension on the entities who manage pension funds. Like asset managers, income levels of these entities may come under pressure where revenue is derived from AUM.

The aforementioned increased market volatility following the vote has been attributed to having a 'scare factor' amongst investors. Although market volatility may present risks to some firms, business models of a number of other firms depend on – and benefit from – market volatility. Profitability of investment firms has generally improved in recent years, leaving the majority of firms better positioned to absorb any losses / reduced profits. Market risk will continue to be monitored by supervisors.

---

9

<sup>9</sup><https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-20+Report+on+investment+firms.pdf>

<sup>10</sup> Figures for firms that passport are not available for all jurisdictions – this may have the effect of inflating Ireland's apparent share of these firms.



### 7.1.3 Client Assets / Investor Money Supervision

The Client Assets Supervision Team has been in contact with relevant firms in relation to whether they have any concerns related to Brexit. The main impact reported to date has been the initial short-term reaction of investors. Stockbrokers reported a significant increase in trading activity immediately following the referendum as investors sought to re-balance portfolios. Trading has since levelled off, but remains at an elevated level. There have been no indications so far that firms are looking to change their clearing members. Where assets are traded in the UK, the related assets will typically also be held in the UK. If Brexit were to present any obstacles to firms maintaining assets in non-EU jurisdictions, then appropriate disclosures would have to be made to affected clients, or firms may seek to use EU-based custodians.

### 7.1.4 Strategic Planning and Preparedness

Supervisors have been in regular communication with firms about the potential impact of Brexit on their business models and [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

## 6.2 Funds and Fund Service Providers

### 7.2.1 Domicile and Distribution Issues

Brexit may result in the UCITS<sup>11</sup> and AIFM<sup>12</sup> Directives not applying to the UK. Should it be determined that the UK is not an equivalent regime, there is a risk that previously compliant UK UCITS funds would not be permitted distribute or market into EU / EEA jurisdictions. This situation would prevail unless and until the UK obtains equivalency status – trade press has already discussed the prospect of equivalent ‘UK-ITS’ that would seek to mirror EU funds. In the absence of UKITS, newly authorised funds may choose Ireland as a domicile over the UK. Fund managers could foreseeably also look to establish two sets of funds, UK-established funds which are sold exclusively into the UK and EU-established funds which are sold throughout the EU. In any case, it has been commented that the loss of a UK client base would not represent a significant loss to most funds.

<sup>11</sup> Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions

<sup>12</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers



Post-Brexit, the destinations of choice for new authorisations of funds are widely perceived to be Ireland and Luxembourg. In addition to new authorisations of funds, existing funds may seek to re-domicile to Ireland<sup>13</sup>. A typical re-domiciliation application may take 4-6 weeks depending on complexity. An increase in applications for authorisation and / or fund re-domiciliations to Ireland has previously been flagged as having direct implications for staffing arrangements of the Markets Directorate.

Alternative Investment Funds ('AIFs') domiciled within the EU can presently<sup>14</sup> appoint an AIF Manager ('AIFM') located outside the EU under the Non-EU AIFM private placement regime. UK-authorised AIFMs may therefore be able to avail of this provision, assuming equivalency is applied and met.

Delegation remains a key consideration for both UCITS and AIF fund managers as they may seek to obtain an authorisation in Ireland and then proceed to outsource / delegate certain activities back to UK-based group entities. The Central Bank would look at each such proposal on a case-by-case basis in order to assess whether the arrangement would be permissible.

Depositories of Irish-authorised funds have to either be Irish-authorised or a branch of an EU Credit Institution which holds a relevant passport.

#### 7.2.2 Market Volatility and Redemptions

There have been no discernible patterns of Irish-authorised funds implementing changes to hedging strategies in the wake of the Brexit referendum. It should be noted that currency fluctuation remains an ongoing and actively managed risk.

Following the referendum result, there were noticeable disposals of UK assets, with fears of falling property values in the UK's commercial real estate market accompanied by a sell-off in equities and fall in bond yields. While a number of UK commercial real estate funds were forced to halt redemptions in the days following the referendum, no Irish-domiciled funds reported difficulty with meeting redemption requests, and none reported taking any action to limit or suspend redemptions. The Fund Supervision Team monitors notifications of suspensions for all funds via the Online Reporting System. The team is no longer involved in the process of investigating redemptions in excess of 5% at an individual fund level as this process has been withdrawn. However, firms have been advised to report any significant or unusual issues which may arise outside of normal operating conditions to their supervisory teams.

Some additional risks have been inserted into prospectus documents. Funds continue to have limited exposures to the UK in general.

[REDACTED]

<sup>14</sup> This is a transitional arrangement, no end date for which has yet been specified.

### 7.2.3 Strategic Planning and Preparedness

A sustained downturn in markets would indirectly affect asset managers as income is primarily derived from AUM and performance fees. Some fund service provider firms charge performance fees linked to GBP fund values, and therefore as GBP has declined so too have certain fund values and related performance fees. On-going strategic planning and preparedness will continue to be monitored by supervisors.

## 7.3 Primary and Secondary Markets

### 7.3.1 Listings

Presently London hosts a number of Regulated Markets, upon which a variety of financial instruments are listed and traded. The status of Regulated Market is conferred under European legislation and could potentially be lost post-Brexit, should no agreement be reached that allows the UK to retain this authorisation type or avail of a form of equivalency. This would have implications in a number of areas.

[REDACTED]  
[REDACTED]  
[REDACTED] Thus Brexit should have limited impact in terms of affecting decisions to list or trade on particular exchanges.

Should UK regulated markets become less attractive as a by-product of Brexit, the Irish Stock Exchange may represent a viable alternative for listings. Increased volumes of prospectus listing applications are foreseeable as issuers look for a gateway into the EU. [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

The timeline for equity listing is generally much longer than for a debt listing. Queries have also been received regarding the ability of issuers to transfer their listings. Issuers of equities that were originally listed in the 1970s and 1980s may not be able to transfer these listings where the original listing occurred prior to the passing of the relevant legislation.

There have not been many queries to date about the ability of Irish issuers to sell into the UK; however issuances are not that significant in any case. [REDACTED]  
[REDACTED]

<sup>15</sup> The ISE is the competent authority for admission to listing whereas the Central Bank is the competent authority for the





### 7.3.2 Regulated Disclosures and Short Selling

If an increased number of issuers choose Ireland as their home member state for the purposes of the Prospectus and Transparency Directives ('PD', 'TD'), the volume of prospectus applications and regulated disclosures to be processed would likely increase.


The loss by UK markets of Regulated Market status under MiFID, and the failure to secure equivalency status would increase the disclosure requirements for UK obligors admitted to trading on a Regulated Market, and for UK securities admitted to trading on a Regulated Market used as a market measure or as collateral, would be increased and, therefore, such prospectus applications would be more time consuming to review.

Brexit should have minimal impact on existing processes regarding short selling of Irish shares listed in the UK. If the LSE were to remain the principal trading venue for selected Irish equities, the designation of the UK as a third country would remove these equities from the scope of the Short Selling Regulations.

If there is an increase in the number of market makers located in Ireland, then there will be a parallel increase in the volume of market maker exemption notifications received. However, if UK entities do not seek authorisation in the Union, their exemption notifications would be submitted to the competent authority of the main trading venue where they trade within the EU. This is unlikely to be Ireland. Market makers are determined on an instrument-by-instrument basis and waivers (e.g. from Short Selling Regulations) are sought at the instrument level – additional market makers could potentially mean that a large number of exemptions have to be reviewed. In addition, waivers that have already been granted have to be monitored. Echoing comments made elsewhere in this report, there would likely be a significant increase in these types of notifications if a second Regulated Market were to seek authorisation in Ireland.

### 7.3.3 Markets Integrity



 It is not anticipated that Brexit will lead to a large increase in the number of financial instruments being monitored from a market abuse perspective – unless additional trading venues were to seek authorisation in Ireland.

### 7.3.4 Transaction Reporting

Prospectus Directive and for the review of PD prospectuses which are required for an offer to the public and/or admission to trading on a regulated market. In addition to review of a PD prospectus by the Central Bank, the ISE must also ensure compliance with the listing conditions.

Data received through transaction reports indicated a smaller number of UK trades in early July; however this is not regarded as a sufficiently long timeframe to indicate whether a long term trend will emerge.

If a second Regulated Market were to be authorised in Ireland there would likely be an increase in data volumes for transaction reporting purposes; this may also be amplified by any related relocations of trading firms. If such an exchange were not the primary listing for securities however then the Central Bank may not be the “most relevant Competent Authority” – which would potentially mitigate the likelihood of increased transaction reporting volumes.

The exchange of information with the UK is a big issue for transaction reporting purposes as a large amount of data is shared with and collected from the UK. The use of UK-based Approved Reporting Mechanisms by Irish firms may also become an issue post-Brexit.

#### **7.3.5 European Markets Infrastructure Regulation**

Four of the six trade repositories of the European Union – to whom EMIR trade reporting data is submitted – are based in the UK, including the largest (EuroCCP; which is a subsidiary of DTCC). [REDACTED]

[REDACTED]



## 7. Financial Market Infrastructure

Since the UK's vote to leave the EU on the 23 June, there has been limited impact from a payments/securities settlements perspective. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

## 8. Regulatory Policy and Equivalence Assessments

The UK's vote to leave the EU will have significant implications for European financial services policy making. Much will depend on the eventual agreement struck between the UK and the EU, and in particular whether UK-based firms can 'passport into' EU Member States. Furthermore, whether the UK succeeds in negotiating entry to the European Economic Area (EEA) or is treated as a third country would have markedly different implications.

Most recent European Economic Area ('EEA') financial services Directives and Regulations contain provisions allowing firms to avail of aspects of EEA legislation subject to the existence of an equivalent third country domestic legal, regulatory and/or supervisory regime.

Depending on the specific sector and activity, favourable treatments flowing from positive equivalence decisions can carry different types of implications- for example, less onerous prudential capital charges for exposures incurred to certain entities established in a third country; recognition of market infrastructures in the third country which may be used by EEA-authorised firms; or the possibility for specific types of third country-authorised firms to establish and/or offer their services within the EEA.

In order for firms to avail of such treatment, the third country regulatory and supervisory regime must be deemed equivalent to that of the EEA. The European Commission is generally vested with the power to issue decisions on the equivalence of third countries arising within EEA financial services legislation, albeit often acting on technical advice submitted by one of the European Supervisory Authorities (ESAs).<sup>16</sup> The awarding of equivalency status can be a protracted process and is done on a per-legislation-per-jurisdiction basis.<sup>17</sup> There are no prescribed timelines for the process around the assessment of equivalency and thus the assessment of some legislation may take considerably longer than others.

There are also specific areas of EEA financial services legislation where the conduct of the equivalence assessment and the taking of a formal decision are left to the national authority (operating under ESA guidance<sup>18</sup> in some instances). A determination on whether a third country is equivalent may even be left to a firm in some situations,<sup>19</sup> subject to *ex-post* supervisory review if necessary.

<sup>16</sup> The European Supervisory Authorities comprise the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

<sup>17</sup> An overview table of equivalence decisions taken by the European Commission is maintained here: [http://ec.europa.eu/finance/general-policy/docs/global/equivalence-table\\_en.pdf](http://ec.europa.eu/finance/general-policy/docs/global/equivalence-table_en.pdf)

<sup>18</sup> See, e.g., EIOPA, *Guidelines on the Methodology for Equivalence Assessments by National Supervisory Authorities under Solvency II*.

<sup>19</sup> See, e.g., Article 349(f) of Regulation (EU) No 575/2013 ('the EU Capital Requirements Regulation').



Generally speaking, equivalence assessments conducted under EEA financial services legislation tend to be principally 'objective'<sup>20</sup> and 'outcome'<sup>21</sup> based, i.e. primarily concerned with determining whether and to what extent the third country regime shares equivalent or comparable objectives and produces equivalent or comparable outcomes to those which would result from applying the relevant EEA legislation.<sup>22</sup> This does not necessarily imply that the relevant third country framework must be written in identical terms to the EEA legislation in order to qualify as equivalent.

Where the relevant legislation is purely national and a question of third country equivalence arises, the onus will be on the national authority to satisfy itself that the relevant equivalence requirements are met, based on what is stipulated in the national legislation and under the relevant policy framework.<sup>23</sup> The approach towards equivalence assessments conducted under domestic legislation similarly focuses on identifying whether the third country regime corresponds to a level which delivers equivalent outcomes.

Table 9.1 overleaf focuses on what an initial analysis of the potential areas of divergence that may develop between the UK and the EU's regulatory framework in the future, and explains the reasons behind this categorisation. A glossary of terms can be found in Annex 1.<sup>24</sup>

<sup>20</sup> See, e.g., ESMA, *final technical advice on third country regulatory equivalence under EMIR – Australia*.


<sup>21</sup> See, e.g., EBA, *Methodology for the Assessment of Equivalence with European Regulatory and Supervisory Framework*.

<sup>22</sup> See, e.g., European Commission, *Equivalence with EU Rules and Supervision*: [http://ec.europa.eu/finance/general-policy/global/equivalence/index\\_en.htm](http://ec.europa.eu/finance/general-policy/global/equivalence/index_en.htm)

<sup>23</sup> See, e.g., Central Bank of Ireland, *Policy Statement on the Authorisation of Branches of Non-EEA Credit Institutions*.

<sup>24</sup>

Table 9.1: UK-EU regulatory divergence

Level of divergence	Rationale	Regulations
High	<ol style="list-style-type: none"> <li>1) UK has its own regime in place</li> <li>2) UK has contested these rules in the past</li> <li>3) </li> </ol>	<ul style="list-style-type: none"> <li>• Merger controls, state aid rules, antitrust laws</li> <li>• Proportionality – AIFMD</li> <li>• Commission dealing; proportionality – MiFID</li> <li>• Remuneration – CRD IV</li> <li>• Tobin tax – FTT</li> <li>• EU Structural Reform proposals</li> <li>• Short selling ban (SSR)</li> <li>• All regulations – Third country regimes (might be more accommodating to third countries)</li> </ul>
Medium	<ol style="list-style-type: none"> <li>1) Global standards agreed at G20/ Basel Committee level where the UK is an influential member. Over time there could be some divergence between UK and EU approaches (like the difference between Dodd-Frank Title VII and EMIR).</li> </ol>	<ul style="list-style-type: none"> <li>• Basel III (CRD IV)/Basel IV</li> <li>• Central Clearing of standardised OTC derivatives (EMIR)</li> <li>• Loss absorbing capacity (TLAC/MREL)</li> <li>• Recovery &amp; Resolution Planning (BRRD)</li> <li>• FRTB</li> <li>• Stress testing (EBA)</li> <li>• Recovery and Resolution of non-bank financial institutions (TBC)</li> </ul>
Low	<ol style="list-style-type: none"> <li>(1) UK regulators have tended to favour more conservative and restrictive regulation in this area, “gold plating” EU directives to keep such legislation equivalent to existing comparable UK laws (such as the Retail Distribution Review and MiFID II).</li> <li>(2) UK regulators have committed to fully implement this regulation post-Brexit.</li> <li>(3) UK needs to remain equivalent to ensure continued access to the single market.</li> </ol>	<ul style="list-style-type: none"> <li>• AIFMD</li> <li>• CSDR</li> <li>• IFR</li> <li>• IID</li> <li>• MAR</li> <li>• MCD</li> <li>• MiFID II</li> <li>• MMFs</li> <li>• PAD</li> <li>• Pan European Framework for Covered Bonds (CMU Package - TBC)</li> <li>• Pan European Venture Capital Funds Proposal (CMU package – TBC)</li> <li>• PSD II</li> <li>• PRIIPS</li> <li>• Prospectus Regulation (CMU package)</li> <li>• Transparency Directive</li> <li>• Securitisation Regulation (CMU package)</li> <li>• Solvency II</li> </ul>



		• UCITS V
--	--	-----------

## 9. Conclusions / Assessment

The result of the Brexit referendum came as a surprise to financial market participants and as a result the outcome led to large market re-positioning and a bout of significant financial market volatility. This did not persist as equity markets generally recovered and market volatility declined, supported by central bank actions in a number of countries including the UK. Nevertheless, uncertainty regarding what new arrangements will emerge between the UK and EU is still elevated. The value of sterling remains around 10 per cent weaker against the euro compared to pre-referendum levels. The short term outlook for the UK economy has deteriorated, reflected in substantial downward revisions for economic growth in 2017 and 2018. These factors will negatively affect the outlook for the Irish economy and have been reflected in downward revisions also in the Central Bank's forecasts for this year and next. Irish financial institutions will also be affected, particularly those with large UK property-related exposures given the weaker outlook for this sector.

There has been intensive engagement between supervisors and financial firms in relation to the impact of a Brexit since well before the referendum and this has been stepped up following the vote.

[REDACTED]

[REDACTED] Engagement is now more focussed on more medium-term challenges. These discussions cover, inter alia, potential effects on business models and financial performance as well as firms' preparedness for the effects of Brexit.

As anticipated in the reports discussed by the FSC and Commission before the referendum, a very important issue for the Central Bank relates to potential applications for authorisation. Enquiries have been received across all sectors since the referendum the Bank has made clear that it is committed to providing a clear, open and transparent authorisation process while ensuring a rigorous assessment of the applicable regulatory standards. Nevertheless, it is clear that considerable uncertainty prevails regarding what passporting arrangements will exist between the UK and EU financial services sectors and what will be the ultimate level of authorisation requests in this jurisdiction. It seems as if some companies are adopting a wait and see approach in this regard while others are expected to apply for authorisations as a contingency against no longer being able to do business from the UK. A significant influx or expansion of financial firms would have implications for the operations of the Central Bank, particularly if new entity types such as financial market infrastructures seek to locate here.

In the short-term there would also be implications for the commercial real estate, particularly the Dublin office sector where demand-supply imbalances have already been evident in recent years. Since the referendum, Irish listed REITS have generally performed strongly while estate agents are reporting an increase in the number of enquiries from potential occupiers looking at the feasibility of

locating operations in Dublin. This would also have implications for the banking sector given the still-high exposures to the sector and non-performing loans.

The Brexit Task Force will continue to monitor these issues and further updates will be provided in the December report.

## Annex 1

### Acronyms for Table 9.1

AIFMD: Alternative Investment Fund Managers Directive

Anti-Money Laundering Directive IV (4MLD)/Funds Transfer Regulation (FTR)

BRRD: Bank Recovery & Resolution Directive

CRD IV: Credit Requirements Directive and Regulation

CSDR: Central Securities Depositories Regulation

IFR: Interchange Fees Regulation

MAR: Market Abuse Regulation

MiFID II: Recast Markets in Financial Instruments Directive and Regulation

MCD: Mortgage Credit Directive

MMFs: Regulation on Money Market Funds (MMF)

PAD: Payment Accounts Directive

PSD II: Recast Payment Services Directive

IID: Insurance Distribution Directive

PRIIPS: Package Retail Investment and Insurance Products Regulation

SFTR: Securities Financing Transactions Regulation

SSR- Short Selling Regulation

FRTB- Fundamental Review of the Trading Book

CMU- Capital Markets Union

FTT – Financial Transaction Tax

MAR – Market Abuse Regulation



