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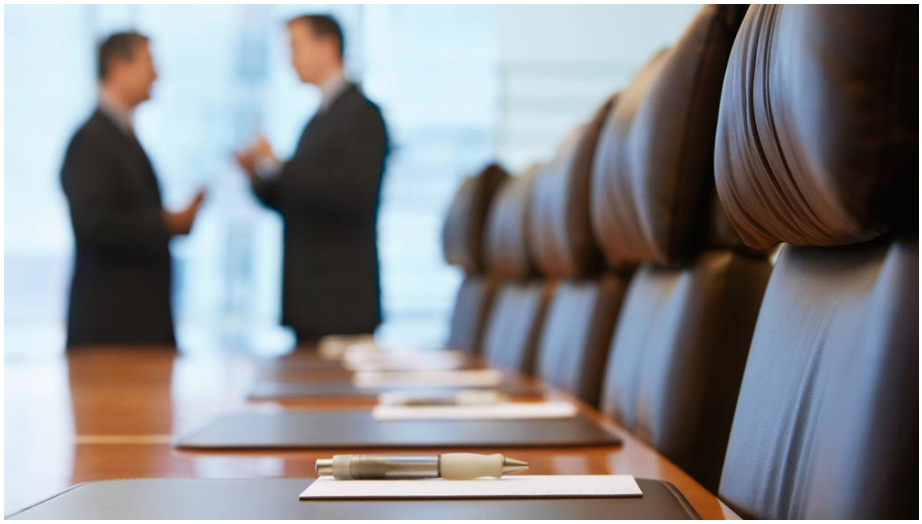

RISK & INNOVATION

Brexit In The Boardroom: Questions Senior Leaders Are Asking

OVERVIEW

After the initial shock of the UK's historic vote to leave the European Union, there was a period of uncertainty that had an immediate impact on financial markets and the value of the British pound, and dominated headlines around the world. With the appointment of Theresa May as Britain's new Prime Minister on July 13, some two months earlier than expected, a clearer sense of what happens next is likely to start to emerge over the coming weeks.

Exiting the EU will have considerable implications for people, politics and business in UK, the EU, and beyond. Many of the long-term consequences of Brexit will only become apparent as the new Prime Minister begins to resolve the political unknowns, negotiations with the EU begin, and the regulatory environment shifts over the months and years to come.

In the shorter term, however, it is important for senior business leaders to evaluate and prepare for the likely implications of Brexit on their business. How will the Brexit vote influence board room conversations in the coming weeks? Read on to discover how senior management can assess the implications of Brexit on their organization's risk management, talent, retirement and healthcare strategies.

IN DEPTH

As the world's sixth largest economy (fifth before Brexit hit the value of the pound), a downturn in the UK will have significant implications for the broader European and global economies. The International Monetary Fund (IMF) had hoped to upgrade a previous 3.2 percent global growth forecast but now says that's unlikely.

Official data showing the economic impact of Brexit to the UK will not be published until August, but there are already some indications. Consumer confidence is reportedly down and the IMF has forecast the UK economy will shrink over the next three years by 1.5 percent to 4.5 percent.

If confidence falls in the UK and in Europe, and demand for goods and services falls, this can also begin to affect other countries. This is why, says Tapan Datta, Global Head of Asset Allocation, Aon Hewitt, "The shape of Brexit is important. Capital markets don't quite know what access to the single market will look like" for UK-based businesses.

The US is an important example of how far the impact of Brexit will reach. Brexit has contributed to the rising dollar, as investors have sought a safe haven. This is likely to hit US exports. In turn, markets could fall further, stocks decline, and volatility rise. Some are even talking about a 60 percent chance that the US economy will enter recession in the next 12 months.

For senior business leaders looking to sustain long-term profitability and growth, such uncertainty is worrying. What risks does Brexit pose?

How Will Brexit Impact Retirement & Investments?

The immediate shock of Brexit has led to an increase in market volatility. What will the long-term impact be? Should plan sponsors and trustees get used to lower returns and increased volatility? How can pension plans be structured to better manage market risks?

While much remains unknown, the uncertainty in markets looks set to continue, which is likely to affect pension investments. "We are now expecting lower returns in coming years and significantly higher volatility," says Andy Cox, CEO, EMEA Retirement & Investment, Aon. "That means the potential downside position will now be significantly worse than anyone had contemplated, most were prepared for, and possibly some are able to sustain."

It's imperative for senior management to understand the financial position of pension plans and risk exposure. The risk of needing to pay more in contributions should be factored in to any financial planning. Regulatory capital positions will be important and could directly affect a company's ability to operate.

For individuals, it very much depends on the type of plan they have. With increased market volatility, "Those close to retirement may need to reassess their retirement expectations," warns Cox. "Someone retiring the week following the EU Referendum might expect their retirement income for the rest of their life to be 10% less than they had anticipated."

How Will Brexit Alter Risk Profiles?

Any major political development has the potential to impact corporate trading or operating positions, which is why after the Brexit vote, "it is critical for senior leaders to take this moment to reassess their businesses' risk profile overall," says Andrew Tunnicliffe, CEO, Aon Risk Solutions UK. How will Brexit affect confidence in the overall economy? Will the short-term market volatility we're seeing translate into the long term? Could uncertainty in the capital and currency markets lead to further protectionism?

While the UK's actual departure from the EU could take more than two years, senior leaders should take the time to "prioritize where they may see the greatest impact and ensure they are structured for resilience and future growth," Tunnicliffe advises. This assessment in itself is challenging. At present speculation abounds – "this is a complex scenario," says Tunnicliffe.

Given that UK-EU trading relations are expected to change, the structure of supply chains may alter, compliance burdens might increase, and the very pattern of commerce across Europe could be affected, businesses should consider the kind of cover they have in place for trade credit and political risk. In addition, it will also be critical to factor in currency fluctuations, given the recent precipitous fall in the value of the pound.

With London as a global financial center, and as many multinational organizations rely on UK-based insurers to underwrite complex risks, what is the potential impact to current provision, given the Brexit vote? "Insurance is a global industry," says Tunnicliffe, "and we do not have immediate concerns about the marketplace as it stands today. Many carriers engaged in London have operations in additional parts of the world. Given the central location of London and the deep history of the insurance market there, we expect the carrier population to carefully evaluate any market changes and ultimately support the London market going forward."

How Will Brexit Affect My Ability to Attract and Retain Top Talent?

With immigration at the heart of the referendum debate, the status of the 2.2 million EU migrant workers in the UK – and UK workers in other parts of the EU – remains far from clear. In the days following Brexit, a German jobs website reported a massive spike in requests from the UK enquiring about jobs abroad. The UK's current political, institutional and economic uncertainties are likely to continue to cause workers based in the UK to seek safety and security. How will Brexit affect talent supply in Britain and Europe? Could it affect an organization's location strategy? How can leaders manage employee uncertainty? These concerns should be top-of-mind in the board room.

Strong communication from senior leaders is vital, says Alexander Verweij, Managing Director, Head of Talent, Rewards & Performance, Aon. "The best leaders during this period of uncertainty will be those who effectively manage ambiguity and engage their talent to continue to give their best under these challenging conditions." They will seek to gauge their staff's concerns, plan how to address them, and be seen to be taking the challenge as seriously as those whose lives may be directly affected.

It's also important for leaders to be transparent with staff about any possible plans to relocate jobs or offices – while also considering the potential HR implications for their business. Although it remains unlikely that large firms will move their headquarters out of London, it may be worth considering opening offices in key EU locations in order to hedge against the risk of talent flight.

Finally, it is important for Boards to consider their organization's rewards strategy. Currency fluctuations may have a dramatic impact on UK compensation this year, while future changes to UK laws may impact pay governance. In this situation, senior management should assess how their compensation packages may change if relocating employees from the UK to other EU hubs. In addition, the broader economic climate might cause further stagnation in base salary increases and overall pay levels, so it will be important for firms to counter this in order to retain key talent.

How will Brexit impact health care?

Given that part of the Leave Campaign's argument centered on reclaiming the money the UK contributed to the EU, and promising that some of this would be redirected into the National Health Service (NHS), the debate over the implications of Brexit to health care will continue. But what does this mean for organizations operating in the UK – and beyond?

The NHS faces a predicted labor shortage of 116,000 by 2020, and it is likely that this will increase. The previous strategy of recruiting EU citizens to fill the health care talent gap will need to be revisited if part of the UK's settlement involves rejecting the free movement of labor. Similarly, anticipated funding cuts, combined with these possible staffing reductions, will likely see a reduction in the effectiveness of public healthcare provision.

This may mean an increased healthcare burden on employers, insurers and private providers. "The anticipated economic slowdown and labor force reduction could result in decreased demand for certain health and benefits products," says Richard Kirby, COO, EMEA Health & Benefits, Aon. This can lead to a significant pricing challenge as current carrier rates are based on membership numbers and breaching those numbers could trigger revised rates. "This dynamic, combined with a spike in claims that is typically seen in economic recessions, would further drive up health care costs," he warns.

Good Governance To Manage An Uncertain Future

"In today's globalized world, changes in regulatory direction in one part of the world can impact businesses and economies thousands of miles away," says Paul Hagy, Sneior Vice President and Global Corporate Treasurer, Aon. "From supply chains to shifts in employment law, market instability and exchange rates – the world is so interconnected that businesses of almost any size can be impacted by political changes far away from their usual areas of operation. This is precisely why Boards should be conducting a thorough risk and talent assessment during these times of uncertainty – if you don't know your exposures, you may be hit hard by unexpected events."

TALKING POINTS

"Until the future trade and investment relationship between the UK and the EU is settled, the uncertainty is likely to reduce investments and economic growth in the UK, and to some extent in Europe as well. They will present another headwind in a subdued global economic outlook over the next few years... It is premature to say what the long-term impact of Brexit would be. We must watch the developments carefully and prepare to adjust our strategy so that we can stay competitive." – Thatman Shanmugaratnam, Deputy Prime Minister, Singapore

"The UK's short-term labor market prospects are likely to be negatively affected by the recent referendum decision to leave the EU." – OECD Employment Outlook Report, 2016

"For a US company thinking through the implications of Brexit, resultant changes in treaty obligations, British law, and U.S. law are the major categories to monitor carefully." – Jeffrey S. Neeley, Husch Blackwell LLP

FURTHER READING

- Brexit Economic Shock Equivalent To Natural Disaster, Says OECD – The Independent, July 11, 2016
- What Is The Long-Term Impact Of Brexit On Global Markets? – Investment Week, July 8, 2016
- Brexit: Long-Term Implications For Supply Chain Leaders – Forbes, July 7, 2016
- How Will Brexit Affect Employers With EEA Workers? – Personnel Today, July 5, 2016
- Does Brexit Mean That Globalization Is Dying? Should It? – Huffington Post India, July 11, 2016
- EU Referendum: Understanding The Impact To Your Business – Aon resource hub

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