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Financial Regulation Unit

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COVID-19: Key considerations for regulated financial services providers

The evolving COVID-19 crisis poses a profound set of challenges for regulated financial services providers, their staff, customers and counterparties. In this briefing we highlight some of the key considerations for firms and their boards and senior management as they navigate these unprecedented challenges while maintaining operational and business resilience.

Regulators' Response to the Crisis

Earlier this month, the Central Bank set out its expectation that all regulated financial service providers should *have appropriate contingency plans in place* to ensure the continuity and resilience of their business as the situation evolves. The Central Bank has also stated that it is committed to working with the financial services sector to ensure that firms are responding effectively as the situation evolves. There have been several important statements and relief measures announced by EU authorities (see opposite) and which will, it is assumed, be factored into the Central Bank's supervisory approach.

For the duration of this crisis firms need to prioritise an *open and proactive dialogue with their supervisory contacts* at the Central Bank. Indeed, we are aware of a range of firms having daily engagements with the Central Bank on their contingency arrangements.

There is currently *no published policy of regulatory forbearance* by the Central Bank and any wholesale disapplication of elements of the current supervisory framework (e.g. around reporting obligations) is unlikely. Firms should be mindful that the Central Bank's mission continues to be the protection of the

EU Authorities Statements & Relief Measures

- EBA statement on actions to mitigate the impact of COVID-19 on the EU banking sector
- EBA provides clarity to banks and consumers on the application of the prudential framework in light of COVID-19 measures
- ESMA recommendation for financial market participants for COVID-19 impact
- EIOPA recommendations on supervisory flexibility regarding the deadline of supervisory reporting and public disclosure - COVID-19
- EIOPA statement on actions to mitigate the impact of COVID-19 on the EU insurance sector
- ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus
- FAQs on ECB supervisory measures in reaction to the coronavirus

public interest by safeguarding financial stability and by ensuring that the financial system operates in the best interests of consumers and the wider economy. That said, the Central Bank has informally indicated to some industry bodies that responsible pragmatism will be exercised in its supervisory processes where appropriate.

The crisis will no doubt pose serious challenges for many firms in achieving continuing regulatory compliance. In keeping with the Central Bank's Administrative Sanctions Guidance, the *prudent course for firms facing challenges with compliance will be early and open engagement*. Firms should be better placed in their supervisory engagement if they can demonstrate that all reasonable actions were taken to avoid a breach or otherwise mitigate its impacts, with a clear record of how the firm has prioritised the interests of its customers. An important factor to securing a sympathetic response to the firm's circumstances will be the implementation by the firm of a robust, well-tested BCP and crisis response strategy.

Governance

The board should be deeply and proactively engaged in leading and overseeing the firm's crisis management response.

Some key board considerations will include:

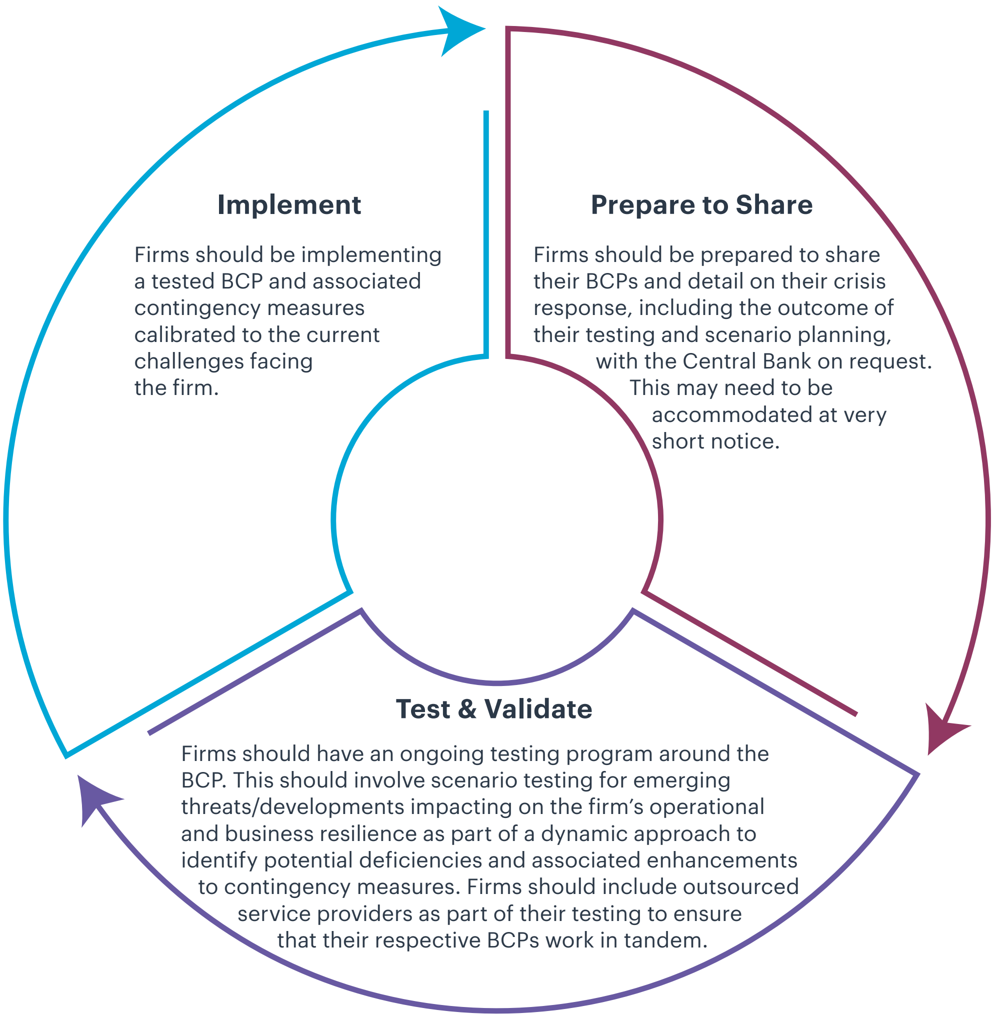
- Ensure the effective implementation of a robust and well tested business continuity plan with accountable ownership across senior management.
- Implement a dedicated crisis response team led by the CEO or COO subject to the direction and oversight of the board and its risk committee.
- Keep in regular dialogue with the executive team and heads of internal control functions on key developments and be available to convene at short notice through remote means.
- Maintain clear reporting and escalation arrangements to ensure that the board has timely and comprehensive management information for effective decision making.
- Apply scrutiny around financial resilience. The outbreak continues to have severe adverse financial and economic impacts and firms need to continue meeting regulatory capital requirements. Key will be managing the risks of any shortfall in own funds and available liquidity.
- For firms in scope of BRRD in particular, regard needs to be had to any impacts and revisions required to existing recovery plans.

The *inability of directors to meet in person should not impede normal corporate governance*. Indeed, the rapid pace of events and the need for timely decision making should increase the frequency of dialogue between directors. Irish law accommodates this by allowing for board meetings to be held by teleconference, video conference or by other electronic communication. Firms should check their constitutional documents to ensure sufficient flexibility is included to facilitate holding meetings by remote means and, if necessary, effect a change to the constitution.

Irish law also allows for a resolution signed by all the directors of a company instead of a physical board meeting (provided this hasn't been disapplied in the company's constitution). These written board resolutions can be circulated electronically, which provides a real time means of documenting key board decisions.

Business continuity

Firms are subject to business continuity obligations under sectoral regulations depending on their licence type (e.g. pursuant to the Capital Requirements Regulation for credit institutions). The expectation is for firms to take necessary measures to continue their business operations in compliance with their regulatory obligations.



Staff and remote working

With large scale remote working now in place across the financial services sectors, firms should be mindful of challenges and risks presented:

- Ensure that senior managers can continue to exercise effective monitoring and supervision of their teams.
- Have a communication strategy for staff. They need to be informed of the overall BCP measures in place and planned and are clear on what is expected of them.
- Training may be required for any revisions on how staff should be performing their roles.
- Risk and compliance monitoring by the second line of defence will need to be adaptable and effective in a remote working environment. A critical issue is the preservation of an effective and properly resourced internal control framework.
- Record keeping obligations such as the MiFID II requirements on telephone recording still apply. ESMA has stated, given the exceptional circumstances created by the COVID-19 outbreak, that where firms are unable to record voice communications in relation to orders and client interactions, firms should take alternative steps to mitigate the risks related to the lack of recording (here). This "best endeavours" style approach could involve taking written notes of relevant calls instead.
- Any staff deemed essential for remaining either onsite or at any back-up facility will need to be assured around their continuing safety.
- Consider how the firm's information security obligations will be met and the control enhancements to address any risks/adverse impacts when applied in a large scale remote working environment.
- Consider and apply appropriate measures for enhanced vigilance to address the potential vulnerabilities to cyber threats due to remote working arrangements (see the Central Bank's guidance on IT and cyber security risks here).

KEY MAN RISK

Firms' contingency arrangements should address the risk of key personnel becoming unavailable at very short notice. Preparatory measures should be considered for pre-approval controlled function (PCF) holders and other key staff. These may include having identified successors as part of an overall key staff succession plan who are suitably experienced and competent and have sufficient bandwidth to take on the particular role at short notice. A prudent measure for key staff would include maintaining handover notes to ensure the smoothest possible transition of functions to their successors if necessary.

The Central Bank does permit the appointment of a temporary officer in exceptional circumstances to perform a PCF role without that individual having to complete the usual fitness and probity approval process. However, it is still necessary to obtain the Central Bank's prior agreement to the temporary officer appointment. Accordingly, it would be prudent to engage with the Central Bank to ensure that this can be achieved promptly in the absence of any express forbearance measures. It should also be noted that the firm must be satisfied on reasonable grounds that the proposed appointee meets the fitness and probity standards for the role and has agreed to abide by the Central Bank's fitness and probity standards.

Outsourcing

With outsourcing being an integral feature of most business models for regulated financial service providers, the firm's operational resilience will have an external dependency on its outsourcing service providers (OSPs), whether intra-group or third-party providers. Each firm needs to assess, monitor and manage the risk to its own operational continuity and services to customers from a failure or shortfall in service levels from its OSPs. Firms will be well aware of the Central Bank's focus in this area and its clear expectations (see our earlier briefing here). Accountability for performance of outsourced services or functions will remain with the firm.

Some practical steps and considerations to manage outsourcing risk in the current environment include:

Ensure there is a complete register of outsourcing relationships with an inventory of the business-critical dependencies which should be prioritised for an enhanced level of oversight, management and monitoring at this time.

Ensure enhanced engagement by the accountable owners within the firm of the outsourcing relationship with OSPs to understand and assess the business continuity plans and contingency measures of the OSP.

Ensuring that there are clear channels of communication and enhanced dialogue and engagement with the OSP for issues arising which in turn should be escalated to Board and senior management of the firm.

Undertake risk assessments for critical outsourcings given the dramatic change in circumstances and consider any enhanced controls and measures required to manage an adverse change in risk profile outside the firm's risk appetite.

Review the legal position for material contracts with OSPs and understand how its performance might be affected by COVID-19 (e.g. including key contractual provisions around events of default, termination and force majeure). Force majeure clauses are particularly relevant in the current crisis and, depending on their wording, may allow a party that cannot meet its obligations due to unforeseen events to suspend performance. Click here for our briefing on force majeure and COVID-19.

Review and, if necessary, update the exit strategy for the outsourced service in collaboration with the OSP to mitigate the impacts for the firm and its customers should it become necessary to repatriate the service or function to the firm or, where practicable, to another OSP.

Where there is sub-outsourcing/chain outsourcing, it is important to factor in the full outsourcing chain beyond the immediate contracted OSP and to consider the extent to which any sub-OSP is material to the operational resilience of the firm.

As a consequence of the adverse impacts of the crisis on internal resourcing, there may be a need to outsource services or functions to ensure ongoing business and operational resilience. The sectoral rules and requirements on the outsourcing process continue to apply. Click here for our briefing on the EBA Guidelines on Outsourcing. This includes prior Central Bank consent for material outsourcings. Firms should engage early with the Central Bank in such a scenario to ensure a pragmatic approach can be adopted.

Customer impacts

In releasing its Consumer Protection Outlook for 2020 earlier this month, the Central Bank emphasised that in line with its expectation that firms adopt a consumer-focused culture, it also expects firms to protect consumers from risks that may emerge from COVID-19:

"We expect regulated firms to have appropriate contingency plans in place to be able to deal with major operational events, should they occur, and we are working with the financial sector to ensure that firms are responding effectively to the evolving situation".

Key Cross Sectoral Risks 2020

- Lack of consumer-focused culture
- Irresponsible unsecured lending
- Ineffective disclosure
- Poor governance & oversight of outsourcing arrangements
- Information technology & cyber risks
- Risks from Brexit

"We also expect that all regulated firms comply with the requirements of the Central Bank's Consumer Protection Code including acting honestly and fairly in the best interest of their customers".

This was echoed in the Central Bank's public statement of 19 March 2020 (here), where it outlined that all regulated firms should be taking a consumer-focused approach in their response measures and that firms must act in their customers' best interests and in line with their responsibilities under the regulatory framework (for example under the Central Bank's Consumer Protection Code where applicable).

Clearly, firms should not expect any softening of regulatory expectations arising from the crisis and measures adopted by firms will need demonstrate that, as a core element of their culture, the interests of the customer are at the heart of their business and operations.

Some issues and steps firms should be considering, depending on the specific business model and customer type, might include:

- Is there a communications strategy so that customers have timely and clear information on an ongoing basis addressing how those customers may be impacted?
- With current isolation measures, there will be increased interaction by customers through remote means with digital infrastructure or by telephone. This may require revised procedures and practices for business which may have been usually conducted in branch or face to face.
- Firms should be alert to potential for increased incidence of complaints and have necessary resource in place to handle these in accordance with their complaint handling responsibilities.
- In light of the relief measures announced by the Irish Government for individual and SME borrowers (here), resourcing and support needs to be in place to handle increased volumes of requests and queries in a timely fashion.

How we can help

The William Fry Financial Regulation Unit is on hand to assist firms for the duration of this crisis across the full range of their legal and regulatory requirements including:

- Guiding and assisting your board and senior management on your crisis management and operational resilience measures.
- Assisting you in managing your supervisory engagement including responding to information requests from the Central Bank and advising you on how best to manage your regulatory risk.
- Reviewing key contractual arrangements with customers, counterparties and suppliers.
- Supplementing your internal resources to deal with your crisis driven legal and compliance challenges.

Contact Us

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