COVID-19 from the Perspective of a Regulated Financial Service Provider

Matheson

Central Bank Communications to date on Covid-19

On 4 March 2020, the Central Bank of Ireland ("Central Bank") issued this communication on COVID-19. It gives two clear messages:

(1) That the Central Bank **"expect[s] regulated firms to have appropriate contingency plans in place to be able to deal with major operational events"**; and

(2) That the Central Bank is **"working with the financial sector to ensure that firms are responding effectively to the evolving situation."**

On 13 March, The Governor of the Central Bank ("Governor Makhlouf") explained that **"Our focus is on ensuring monetary and financial stability and that the financial system operates in the best interests of consumers and the wider economy. We are engaged with the financial sector to ensure that firms are responding effectively to the evolving situation."**

On 18 March, the Central Bank released a further statement indicating that it had decided **"to release a capital buffer that banks are required to hold in order to support the continued provision of credit to households and businesses, by the banking system, during this challenging time. This buffer, the Countercyclical Capital Buffer (CCyB), is a time-varying capital requirement and will be reduced from 1% to 0% no later than 2 April 2020"**.

On 20 March 2020, the Central Bank issued an updated statement on the COVID-19 pandemic. The Central Bank met with the Banking & Payments Federation Ireland (BPFI) and five retail banks. The Central Bank and the BPFI agreed that there is no impediment to the banks introducing a 3-month Covid-19 payment break for those affected by the pandemic. Additionally, Governor Makhlouf re-emphasised the need to protect consumers **"particularly those who may experience financial difficulties at this time"**.

We understand that some Regulated Financial Service Providers ("RFSPs") have received direct communications from their supervisory teams with regard to Covid-19 specific matters.

The Central Bank has cancelled all non-essential meetings this week and Central Bank staff are working from home.

Communicating with the Central Bank

We recommend that all RFSPs keep in contact with their supervisory desk teams at the Central Bank on their plans in response to the crisis. Communication is going to be key during this period.

RFSPs also need to bear in mind what might be "notifiable events" at this time.

RFSPs are required to obtain the Central Bank's prior approval before introducing a material change to their business. Material change is intentionally not defined by the Central Bank and the Central Bank adopts a broad interpretation of a 'material change'. RFSPs should keep this in mind as matters evolve with their businesses.

PCF Roles

RFSPs should have temporary contingency plans for key PCFs impacted by the crisis in the event that they were to fall ill. RFSPs should identify who would assume which roles and look to put in place regular briefings with the relevant PCFs and those whom they are paired with, so as to ensure they can take over if needed. We would recommend that the chosen alternates complete the Central Bank's Individual Questionnaire (IQ) in advance, therefore, having the relevant information ready to file with the Central Bank should this become necessary.

The Central Bank's Fitness and Probity Regulations permit a person to perform a PCF role on a temporary basis **"under an arrangement agreed in writing with the Bank in advance of the person in question assuming such responsibility"** (Regulation 11). In its Fitness and Probity Guidance, the Central Bank states that it **"expects that Regulation 11 will only be used in the most exceptional of circumstances"**. These are undoubtedly exceptional circumstances. It is unclear as yet whether the Central Bank will waive the requirement to have the arrangement agreed in writing.

PCF 42 – Chief Operational Officer may possibly become the Central Bank's key PCF for this crisis. We might also see a requirement introduced to nominate one individual with specific responsibility for the RFSP's crisis response.

Given the increasing emphasis being placed on Individual Accountability, and, particularly, in respect of those in senior management, we expect that the Central Bank will look to see that those in senior management roles have acted appropriately during this crisis. Clearly, such issues as communication with teams on operational matters, particularly as they pertain to the crisis, oversight of remote working teams and reporting into boards and committees will be important[1].

Outsourcing/ Service Arrangements

RFSPs should immediately engage with any of its Outsourcing Service Providers ("OSPs") to establish their ability to continue to provide the outsourced service at this time – this should form part of its own BCP testing.

RFSPs should seek details in respect of the outcomes of the OSP's own BCP testing.

RFSPs should consider its ability to take the performance of that service back in-house in the event that it is required and, if that is not possible, to consider an alternate back up.

RFSPs need to consider whether any new proposed arrangement with an OSP amounts to an outsourcing arrangement that should be notified to the Central Bank and whether such arrangement would constitute a 'material change' to their business triggering the obligation to obtain prior approval from the Central Bank.

RFSPs are aware of the Central Bank's continued focus on outsourcing arrangements. In particular, in Discussion Paper 8, one of the three headings under which it considered deficiencies in outsourcing was Business Continuity Management ("BCM"). It also identified what its minimum supervisory expectations are in this regard. Where RFSPs need to engage with OSPs as part of its response to this crisis, these requirements should be carefully considered.

Where RFSPs need to utilise services by group companies at this time, the same considerations as outlined above when outsourcing to an OSP should be applied. If this means a RFSP is moving a regulated activity to a new jurisdiction, the firm should ensure that the necessary licences to carry out the required activities in that jurisdiction are in place.

Business Continuity Planning

As per the Central Bank's statement detailed above, RFSPs are expected to have BCPs in place. This expectation is derived from various sources, depending on the nature of the RFSP. However, of general application in this context is the Central Bank's cross industry guidance in relation to information technology and cybersecurity governance and risk management by RFSPs.

In this guidance, the Central Bank stipulates that a **"documented BC plan is in place that enables the firm to maintain IT and business operations and services in the event of a disruption. For critical systems and dependent services, firms should have a level of availability commensurate with the criticality of these services and ensure that 24/7 support capabilities are in place."**

RFSPs can expect to be held to this standard by the Central Bank as this crisis unfolds.

Where deficiencies are identified with a RFSP's current BCP, these should be addressed immediately and communicated to the Central Bank.

As mentioned above, BCP assessment and testing in the context of outsourcing arrangements is vital at this time.

RFSPs can expect that the Central Bank will look for details of the testing of BCPs over the coming weeks, if not already requested. RFSPs should document these processes in order to evidence to the Central Bank that such testing has occurred. We can expect the Central Bank to asks questions such as:

- what deficiencies have been identified, what is the plan to deal with them and where is implementation at?;
- what new risks have been identified and how are they being addressed?
- if the BCP has already been implemented, when was that decision made and on what basis? and
- issues pertaining to remote working, ability to meet regulatory filing deadlines, maintaining regulatory capital requirements, compliance with authorisations on cross border matters etc. will come into sharp focus.

In the context of RFSPs who are in the midst of transactions which are dependent on court approvals, RFSPs need to consider the possibility that courts will be closed for an indefinite period and the impact that will have on these transactions.

RFSPs will also need to consider the possibility of delays in attaining regulatory approvals for various matters at this time - such as change in control approvals and authorisations etc..

Consumers

Throughout this crisis the Central Bank will look to see that consumers are protected. In the words of Governor Makhlouf, the Central Bank will focus on **"the financial system operate[ing] in the best interests of consumers and the wider economy"**.

This aligns with the observations made in the Central Bank's Behaviour and Culture Report which arose out of the financial crisis and the tracker mortgage scandal. Speaking on this, Derville Rowland stated that those who lead RFSPs must now **"set about building a culture that serves their customers, their shareholders and the wider economy."** RFSPs have been addressing this challenge for some time now but demonstrating how customers interests are being protected will be important as the Central Bank looks to RFSPs actions at this time.

One of the key ways we expect the Central Bank to do this is by seeking information on how and when RFSPs communicate with consumers and what information is provided to them.

RFSPs should consider putting in place a specific crisis related communications strategy addressing such issues as: what are the best methods of communication depending on the content of the messaging, the customer categories and the query types; ensuring consistency in messaging etc.

RFSPs will need to consider how they will react to large scale requests for forbearance in relation to consumers - fairness will be paramount in this context. Governor Mahkloul has stated that the Central Bank **"expects banks to use the positive effects of these measures to support the economy and not increase dividend distributions or variable remunerations"**.

We have already seen several communications from the Irish banks around measures which they are introducing on fees for using contactless payment and possible mortgage and loan repayment deferrals.

Insurance companies can expect to be inundated with claims requests in the areas of health, travel and business continuity. Claims handling capabilities may be challenged and turnaround times increased. Impacted RFSPs will need to communicate this with consumers in a prompt manner and will need to engage with the Central Bank, if regulatory timelines are at risk of being breached.

Where insurers propose to amend their claims handling processes to cope with a significant increase in the volume of claims received, the new processes must be effective and should be clearly documented.

Market Conduct Risk

The Central Bank has in recent times placed significant emphasis on market conduct risk (see our updates on same here), describing Conduct Risk as **"the risk the firm poses to its customers from its direct interaction with them"**. RFSPs should be cognisant of the deficiencies identified by the Central Bank in this area as they move through this crisis.

Board Governance

Board members will require regular senior management updates on the impact of the crisis on the business and what the planned responses/approaches are. This is to ensure that they can exercise adequate oversight and governance around the decisions being made.

Of critical importance is for each RFSP to check its Constitution to ensure that they do not require a minimum number of directors to be physically present at a board meeting to constitute a quorum.

Additionally, RFSPs need to check their Constitutions for any specific requirements around video or telephone attendance at board meetings.

Regulatory Forbearance

As it pertains to matters of compliance with European regulation, RFSPs can expect the Central Bank to conform with any forbearance measures proposed at a European level.

The Financial Conduct Authority in the UK has indicated that it expects RFSPs to take "all reasonable steps" to meet their regulatory obligations at this time. If the Central Bank announces something similar, RFSPs should expect that, were they to commit a regulatory breach, they should expect to be rigorously challenged before any forbearance would be shown.

With regard to impending deadlines for implementation of new regulatory requirements, can RFSPs expect to see extensions granted? For example, the requirements set out in the Addendum to the Consumer Protection Code which are to be applied from 31 March. Are we likely to see the Central Bank agree to a deferral? Given that 31 March is imminent, it is difficult to see that it would, however, those RFSPs which are impacted should raise this with their supervision team as soon as possible.

At a European level, there have been a number of clear cases of regulatory forbearance in recent days. For example, the European Banking Authority ("EBA") has announced that it is deferring the EU-wide stress test exercise to 2021 to allow banks to prioritise operational continuity and in particular to ensure **"the basic needs of their customers are satisfied"**. The European Central Bank – Banking Supervision ("ECB- BS") is considering discussing postponing **"on-site inspections and extending deadlines for the implementation of remediation actions stemming from recent on-site inspections and internal model investigations"** .

Insurers are due to deliver their annual Solvency II regulatory returns to the Central Bank by 31 March. This is a significant and challenging piece of work for most insurers in normal circumstances. It will be particularly difficult now with vast numbers of teams working from home. The European Insurance and Occupational Pensions Authority ("EIOPA"), being cognisant of this, has stated that **"In order to offer operational relief in reaction to coronavirus, national competent authorities (NCAs) should be flexible regarding the timing of supervisory reporting and public disclosure regarding end 2019. EIOPA will coordinate the specifics of the approach"**. To date there has been no communication from the Central Bank on what, if any, extension it is permitting and whether it would consider for example, relaxing requirements for wet signature submissions and accepting electronic signatures instead. We recommend that RFSPs raise these issues with their desk supervisor in the Central Bank as a matter of priority.

Impact of Staff Working Remotely

While agile working practices have advanced considerably in recent times, RFSPs have rarely, if ever experienced a situation, where high percentages of staff are working remotely.

RFSPs need to quickly consider how to deal with some of these issues:

- Are the IT systems able to support the numbers relying on remote access?
- Do they have the capacity to support, for example, submission of regulatory filings on time, booking of trades etc?
- Do the necessary employees have access to recorded phone lines where needed?
- How can compliance personnel maintain oversight?
- Will cybersecurity risks become more acute?
- It is inevitable at a time like this that regulators need to make additional requests for information from RFSPs. In particular, where RFSPs are multi-jurisdictional, this can be a significant burden in already difficult circumstances. RFSPs will need to manage this as best they can and keep regulators updated regularly on expected timeframes for delivery of information. In addition, we would encourage regulators to understand the difficulties facing RFSPs at this time and to take a practical approach to these issues as they arise.

European Regulatory Communications

The following are links to communications issued by the European regulatory bodies pertaining to Covi-19 which should be considered, depending on your business:

- **EBA** statement on actions to mitigate the impact of COVID-19 on the EU banking sector – available here
- **EBA** tightens measures to mitigate spreading of the coronavirus – available here
- **ESMA** recommends action by financial market participants for COVID-19 impact – available here
- **EIOPA** statement on actions to mitigate the impact of Coronavirus/COVID-19 on the EU insurance sector - available here
- **European Commission** – COVID-19: Commission sets out European coordinated response to counter the economic impact of the Coronavirus – available here
- **ESMA** issued a decision temporarily requiring the holders of net short positions in shares traded on a European Union (EU) regulated market to notify the relevant national competent authority (NCA) if the position reaches or exceeds 0.1% of the issued share capital after the entry into force of the decision – available here. This applies to any natural or legal person, irrespective of country of residence. Therefore, to be clear, to non-EU investment firms and individuals. This does not apply to shares admitted to trading on a regulated market where the principal venue for the trading of the shares is located in a third country, market making or stabilisation activities.
- **ESMA** Public Statement – postponement of the reporting obligations related to securities financing transactions under the Securities Financing Transactions Regulation and under Markets in Financial Instruments Regulation – available here.
- **EC** Statement on temporary EU State aid relief in the context of COVID-19 – here
- **Eurogroup** statement on COVID-19 economic policy response – here Statements by the ESM and Commission on combatting COVID-19 – here & here
- **EIB** statement on measures to fight COVID-19 crisis – here
- **EC** report on functioning of the market abuse Directive – here

[1] The Bank of England, the Prudential Regulatory Authority and the Financial Conduct Authority released a Consultation Paper 'Building Operational Resilience' in December 2019. This details an approach to "operational resilience" for all RFSPs that references **"the ability of firms to prevent, adapt, respond to, recover and learn from operational disruptions."** Those in Senior Management roles may find this of interest as it provides an insight into the thinking of a regulator in this context.