COVID-19: UK Regulators Adopt Regulatory and Operational Relief Measures to Support Financial Services Firms

March 23, 2020

The Bank of England (the “Bank”), the Prudential Regulation Authority (the “PRA”) and the Financial Conduct Authority (the “FCA”) have announced a number of policies to mitigate the challenges faced by the UK financial services sector as a result of the coronavirus (“COVID-19”) outbreak and to clear the ground for firms to focus on leading the economic fight against the crisis.

This memorandum provides an overview of the policies adopted to date. We anticipate further measures and plan to update this memorandum as the situation evolves.

The regulators’ unanimous stance is that firms must strive to maintain business continuity and compliance. However, they are clearly sensitive to the burdens firms are facing as a result of the outbreak. Global and UK banks are more financially resilient since the financial crisis, but unlike the financial crisis, the COVID-19 crisis is directly endangering multiple sectors of the real economy, especially small and medium-sized enterprises (“SMEs”). Whereas operational resilience has also been a policy focus in the post-financial crisis period, many firms’ business continuity plans will not have contemplated the scale of disruption caused including significant numbers of the staff of institutions across the industry having to work from home whilst dealing with significant upheaval in their personal lives. The adopted measures, which cover a range of policy areas such as regulatory capital, bank stress tests, IFRS 9, responding to distressed consumers and market trading and reporting, are aimed at allowing firms to prioritise:

- maintaining critical operations and providing economic support;
- safety and soundness;
- customer service and protection; and
- market abuse risk management.

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I. Implementing the regulators’ policies – general principles

The UK regulators’ general approach to regulation is forward-looking and judgement-based. They anticipate that the COVID-19 crisis will be temporary and that the sector is in a good place to withstand the economic shock. Therefore, where firms can use available flexibilities including the measures discussed in this memorandum, they are expected to do so in order to continue to provide services to support businesses and households. Notwithstanding, firms cannot abandon risk management and compliance altogether and must still manage their financial resilience and their liquidity. The balancing act may be difficult in some cases. We would suggest that the key principles for firms include the following:

☑ the regulators intend for capital relief measures to be used to provide credit to the economy and absorb possible losses, and not to increase distributions to shareholders or variable remuneration. Decisions to make distributions will be subject to scrutiny;

☑ firms must continue to do what is objectively practicable and appropriately tailor their risk and conduct of business practices to the circumstances. As such circumstances can be expected to evolve, scenario analysis, planning and testing, and keeping updated on official guidance and requirements, may prove vital;

☑ governance arrangements must remain robust and should be put on a crisis management footing. Senior managers can expect to be held to account for the firm’s decisions;

☑ firms should reflect the regulators’ priorities and utilize the flexibilities available in their dealings with customers and counterparties. Firms should communicate effectively and sensitively with customers and deal with counterparties honestly, professionally and pragmatically, bearing in mind the unprecedented uncertainty and upheaval currently experienced across society;

☑ firms’ behaviour towards their staff will also be subject to scrutiny. Firms should prioritise the health, safety and wellbeing of staff in line with government guidance and ensure that staff are adequately supported;

☑ firms should keep in touch with the regulator through appropriate channels and in line with appropriate procedures for regulatory communications in this period; and

☑ firms should ensure adequate record-keeping and appropriate documentation of decision-making.

II. Key policies

A. Regulatory relief

i. Banks, building societies and investment firms (“banks”)

1. Countercyclical capital buffer (“CCyB”) released

In order to reduce the risk that the supply of credit to the real economy will be constrained by regulatory capital requirements, on March 11, 2020, the Bank’s Financial Policy Committee (“FPC”) reduced the UK CCyB rate to 0% of exposures to UK borrowers with immediate effect. The rate, which was previously 1%, had been due to reach 2% by December 2020. The FPC expects to maintain the 0% rate for at least 12 months, so that any subsequent increase would not take effect until March 2022, at the earliest. The release of the CCyB is expected to support up to £190 billion of bank lending to business (equivalent to 13 times banks’ net lending to businesses in 2019).

In response, the PRA has stressed that banks should not use released regulatory capital to increase dividends, bonuses or other distributions, and must ensure that any plans for dividends, share buybacks or bonus pool changes are subject to sound and transparent governance. Accordingly, banks are expected to:

- identify a senior manager to lead the effective discussion, oversight and scrutiny of dividend and share buyback proposals relating to the reduction of the CCyB rate, and to discuss these matters with the PRA if called upon to do so;
• task the Chair of the remuneration committee Senior Management Function (SMF12) or senior manager responsible for overseeing the development and implementation of the bank’s remuneration policies and practices, as applicable, to take reasonable steps to ensure that any proposals to amend bonus pools directly or indirectly as a result of the reduction in the CCyB rate are appropriately discussed, recorded and, if necessary, challenged by the remuneration committee and board as a whole. Decisions relating to the bonus pools must remain consistent with the maintenance of a sound capital base, incentivise and reward prudent risk management and accurately reflect firm, business unit and individual performance; and

• task the relevant senior managers to engage with the PRA and/or make relevant board minutes and other records available to the PRA, as requested.

Endorsing the message that buffers are designed to be usable, the PRA encourages the use of capital and liquidity buffers, as necessary, to continue to support the real economy, clarifying that the use of the PRA buffer or the combined buffer requirement under the Capital Requirements Directive ("CRD") is not a regulatory breach. Furthermore, the PRA buffer is confidential and a breach does not result in automatic distribution restrictions. At the same time, banks are reminded that they can only make distributions within the limits of the maximum distributable amount under CRD if they draw down on their CRD combined buffer. The PRA considers this to be consistent with the function of the buffers.

2. Internal Ratings Based ("IRB") models

Banks using the IRB framework that are implementing the European Banking Authority roadmap of regulatory products, which aims at improving the consistency of credit risk modelling across the sector (the “EBA roadmap”), should note that implementation of the aspects of the EBA roadmap related to the Definition of Default, Probability of Default and Loss Given Default estimation will be delayed by one year to January 1, 2022. The move to ‘hybrid’ IRB models will also be delayed until the same date. Banks using the standardised approach to credit risk will also benefit from a delay (presumably also until January 1, 2022, although not expressly specified in the regulators’ guidance) to the application of relevant changes the definition of default.

3. IFRS 9 credit loss provisioning

Given the sudden onset of the virus, the PRA expects there to be little forward-looking information available to allow banks to generate reasonable and supportable forecasts on the impact of COVID-19 on borrowers in the expected credit loss estimate. It therefore regards the generation of reliable and detailed forecasts as “very challenging” currently. If banks believe that such forecasts can be made, however, they should reflect that the economic shock is temporary and fully take into account the significant economic support measures announced by the UK and global fiscal and monetary authorities, including repayment holidays granted to borrowers. The PRA’s expectation is that a borrower’s eligibility for the government’s policy on mortgage repayment holidays should not, all other things being equal, automatically be a sufficient condition to move a participating borrower into Stage 2 provisioning.

Further guidance is clearly warranted. Helpfully, the PRA has confirmed that it is still considering the potential interaction of COVID-19 with IFRS 9, including through discussion with other authorities domestically and internationally, and expects to provide further guidance shortly.

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1 See https://www.bis.org/publ/bcbs_nl22.htm
2 Comprising the CCyB, capital conservation buffer, systemic buffer and G-SII buffer (for globally systemic banks), as applicable.
3 See https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2019/cp2119
**ii. Insurers**

As a result of the material fall in government bond yields, the PRA considers that movements in risk free rates since December 31, 2019 have now met the threshold for a material change in risk profile for the purposes of SS6/16 on the maintenance of the transitional measures on technical provisions (“TMTP”) under Solvency II. It “invites” applications from insurers to recalculate TMTP as at March 31, 2020 (expecting that firms will be able to demonstrate that a material change in risk profile has occurred). This, in its view, will support market functioning.

**iii. Investment services**

1. **Market abuse prevention**

Market abuse enforcement remains a risk for firms in this period. In light of alternative site and remote working arrangements, the measures firms are expected to take to prevent market abuse could include enhanced monitoring or retrospective reviews. Firms will do well to seek appropriate advice, and discuss their plans and concerns with respect to market abuse prevention and detection with the FCA.

2. **Telephone taping**

Firms should continue to record calls, but the FCA accepts that it may not be possible in some cases. Firms should make the FCA aware if they are unable to meet these requirements. The FCA expects firms to consider what steps they could take to mitigate risks such as enhanced monitoring, or retrospective review once the situation has been resolved.

3. **Reporting**

Firms facing difficulties in submitting “regulatory data” should maintain appropriate records during this period and submit the data as soon as possible. Firms should not unnecessarily delay these submissions. It is not clear whether this guidance applies to transaction reporting, but given recent FCA focus in this area, firms should contact the FCA to discuss issues about all types of reporting as soon as possible.

4. **Systematic internaliser tick sizes**

In line with the European Securities and Markets Authority’s guidance to national regulators regarding upcoming changes to the tick size regime for systematic internalisers, required by the EU Investment Firms Regulation, the FCA will not prioritise supervision of the new requirements at this time.

**iv. Consumer credit**

Firms should show greater flexibility to customers in persistent credit card debt. Given the challenges at present, customers should be given more time until October 1, 2020 to respond to firms’ communications about persistent debt. This means that firms would not be obliged by FCA rules to suspend the cards of non-responders before then. This applies equally to customers who have already received communications from their provider and those that are yet to receive them.

**v. Mortgages and home finance**

1. **Repayment holidays**

Where a customer indicates, explicitly or through information provided to the firm, that they may potentially experience payment difficulties in the current circumstances and require a payment holiday, a firm should, as applicable, ask whether the customer may be interested in a payment holiday and grant their request for a payment holiday for 3 monthly payment periods. There is no expectation that the firm investigate the circumstances surrounding a request for a holiday. There is also no requirement to assess affordability in extending payment holidays. Firms should ensure that there is no additional fee or charge (other than

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5 This is arguably an evolution of its initial stance (see [https://www.fca.org.uk/news/statements/covid-19-coronavirus](https://www.fca.org.uk/news/statements/covid-19-coronavirus)).

additional interest) as a result of the payment holiday and the payment holiday does not have a negative impact on the customer’s credit score.

2. Repossessions

Firms should not commence or continue repossession proceedings against customers at this time given, especially, government advice on social distancing and self-isolation. This applies irrespective of the stage that repossession proceedings have reached and to any step taken in pursuit of repossession. Where a possession order has already been obtained, firms should refrain from enforcing it.

B. Operational relief

i. Banks, insurers and financial markets infrastructure

The Bank and PRA are reviewing their regulatory change proposals and intend to postpone non-critical work, where appropriate, in order to alleviate the burden on firms during the current situation. Steps taken in this regard include:

- **2020 annual stress test.** The Bank’s 2020 annual stress test for the eight major UK banks and building societies has been cancelled.

- **Biennial Exploratory Scenario (“BES”).** The Bank has paused publication of the results of the 2019 BES on liquidity until further notice. The Bank intends to announce the way forward for the 2021 BES exercise on climate-related risks in the summer.

- **Supervisory programmes.** Bank and PRA supervisors will postpone non-critical data requests, on-site visits and deadlines, where appropriate. In doing so, the PRA will have regard to the flexibility provided under CRR and Solvency II.

- **Operational resilience policy development.** The deadline for responses to ongoing consultations on operational resilience and outsourcing will be extended to October 1, 2020. The FCA has taken the same step for its consultation (see below).

- **Senior Management Function applications.** The PRA will review its approach for considering and processing applications with a view to reducing the burdens involved during current events.

ii. The FCA is taking similar steps

1. **Supervisory programmes and regulatory change**

The FCA will only continue with a small number of regulatory changes and is also looking to delay or postpone regulatory and supervisory activity. It has extended the closing date for responses to open consultations and scaled back its programme of routine business meetings, so that it only contacts firms on business-critical requests and responses to the current situation.

2. **Customer protection**

The FCA supports firms taking steps outside their usual business practices to help their customers but firms should notify the FCA. Firms are still expected to deal with complaints promptly where possible; and where not possible, firms should contact the FCA. Firms should continue to help vulnerable consumers access their banking services – online or over the phone – and should also remind consumers to be aware of fraud and protect their personal data.

III. Other matters

A. Relief in case of emergency

The PRA’s and FCA’s rulebooks provide relief from enforcement if a firm is unable to comply with a particular rule made by the relevant regulator and such non-compliance is the result of an emergency that makes compliance impracticable, could not have been

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7 Rule 2.2 of the General Provisions Part of the PRA rulebook and General Provisions sourcebook (GEN) 1.3 of the FCA handbook
avoided by the firm taking all reasonable steps, and is outside the firm’s control.

The firm must be able to demonstrate that it is taking all practicable steps to deal with those consequences, to comply with the rule, and to mitigate losses and potential losses to its clients. It must notify the relevant regulator as soon as practicable of the emergency and of the steps it is taking, and proposes to take, to deal with the consequences of the emergency.

B. Implementation of final Basel III standards (“Basel 3.1”) in the UK

The government committed, in its December 2019 Queen’s Speech, to introduce legislative proposals to enable the implementation of Basel standards in the UK, post-Brexit. On March 11, 2020, HM Treasury stated that it intended to use the Financial Services Bill 2019-21 to take powers to enable the implementation of the remainder of Basel 3.1 that will not have been incorporated into UK law (e.g., standards that have been implemented in the European Union via CRR provisions that will only apply from June 2021) by the end of the Brexit transition period. The PRA is coordinating internationally to ensure that implementation of Basel 3.1 will happen alongside other major jurisdictions but has acknowledged that the timetable may prove challenging.

C. Economic measures

Beyond the supervisory measures adopted by the regulators, the UK government and the Bank, in its capacity as monetary policy authority, have also taken significant economic measures to mitigate the crisis, which are discussed in detail in our recent alert memorandum (available here) and include the following:

- **Bank Rate cut and asset purchases.** On March 19, 2020, the Monetary Policy Committee of the Bank cut Bank Rate to 0.1% and opted to increase the Bank’s purchases of UK government and sterling non-financial investment grade corporate bonds by £200 billion.

- **Covid Corporate Finance Facility.** The Bank and HM Treasury have launched a new ‘Covid Corporate Finance Facility’, to provide funding to businesses by purchasing commercial paper issued by non-financial UK firms which are considered to make a material contribution to the UK economy. Funding will be provided on terms comparable to those prevailing in markets in the period before the COVID-19 economic shock, and will be open to firms that can demonstrate they were in sound financial health prior to the shock.

- **Term Funding Scheme.** On March 11, 2020, the Bank launched a new Term Funding Scheme with additional incentives for SMEs (“TFSME”), with the aim of transmitting the effect of the reduced Bank Rate to the real economy. Over the next year, the TFSME will offer four-year funding of at least 10% of banks’ lending to the real economy at interest rates at or close to Bank Rate. Additional funding will be made available to lenders that increase lending to SMEs. The Bank estimates that the scheme should lead to around £100 billion being provided in term funding.

- **Coronavirus Business Interruption Loan Scheme (“CBILS”).** A temporary CBILS will be launched, under which participating lenders can lend up to £5 million to support SMEs with a government-backed guarantee covering up to 80% of losses. The government will also cover the first 12 months of interest payments. HM Treasury estimates this should unlock up to £1 billion of working capital loans to support small businesses. Loans of up to £25,000 to sole traders and unincorporated enterprises can fall within the scope of FCA regulation. The FCA has issued guidance on the information and circumstances that are relevant when assessing the affordability of such loans. In the same vein as their policies discussed above, the guidance notes that the fact that the customer may, at the time of the application, be temporarily experiencing exceptional financial pressures...
does not mean that the firm is prevented from making the loan.  

D. Support for critical workers

Part of the government’s effort in reducing and slowing the spread of COVID-19 has included closing schools and other educational settings. However, the government has preempted the difficulty that parents working in key sectors that are critical to the COVID-19 response, including essential financial services, may face as a result. Schools are being asked to continue to provide care for children of such “critical workers” in certain cases to ensure parents can still continue to work.

The regulators consider that firms are best placed to decide which staff perform roles that are necessary for the firm to continue to provide essential daily financial services to consumers, or to ensure the continued functioning of markets. To help firms identify who they are, firms should first identify the activities, services or operations which, if interrupted, are likely to lead to the disruption of essential services to the real economy or financial stability. Firms should then identify the individuals that are essential to support these functions. Firms should also identify any critical outsource partners who are essential to continued provision of services, even where these are not financial services firms. The regulators have provided indicative lists of the types of roles that may be considered as providing essential services including, amongst others, individuals who are essential in the overall management of the firm and individuals who provide essential support such as finance and IT staff.

Firms should consider whether they should issue a letter to all individuals they identify as critical workers that clearly identifies them as such and that can be presented to schools on request. Such letter should include the sentence “the individual has been designated as a key worker in relation to their employment by [firm name]” and be signed by someone with appropriate authority.

The regulators recommend that that the Chief executive officer Senior Management Function (“SMF1”) (or most relevant member of the senior management team for firms without an SMF1) be made accountable for ensuring an adequate process.

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