UK COVID-19 Considerations for Authorised Firms

April 6, 2020

In the wake of the coronavirus (COVID-19) pandemic the Financial Conduct Authority (FCA) has issued various statements emphasising the importance of business continuity arrangements for UK authorised firms. Responding appropriately to the unprecedented disruption caused by the coronavirus (COVID-19) crisis poses significant challenges for senior managers. In this note, we focus on the steps UK authorised firms can take to ensure their responses to the coronavirus (COVID-19) crisis are consistent with the FCA's expectations, thus mitigating the risk of enforcement action resulting from coronavirus (COVID-19) related regulatory compliance shortcomings. Also, we summarise a few of the key announcements and measures introduced by the FCA in recent weeks that are relevant to authorised firms.

FCA general information for authorised firms on coronavirus (COVID-19)

In a **statement of 4 March 2020,** the FCA emphasised the importance of authorised firms having contingency plans in place to deal with major events. The FCA explained that it would be actively reviewing contingency plans for a range of firms in conjunction with the Bank of England, including assessments of operational risks, the ability of firms to continue to operate effectively and the steps firms are taking to support their customers. The FCA also made clear that firms are expected to take all reasonable steps to meet their regulatory obligations. For example, the FCA expects firms to be able to enter orders and transactions into systems promptly, give staff access to appropriate compliance support and use recorded lines when trading. The FCA has no objection to firms operating from backup sites or with staff working from home. The FCA also explained that it is working with firms and trade associations to resolve any particular issues they may have, and will continue an active dialogue with firms, institutions and industry bodies in the coming weeks.

On 17 March 2020, the FCA published a **new webpage** containing information for firms with respect to the coronavirus (COVID-19) crisis, reiterating that it remains focused on business continuity plans for authorised firms and that it will expect authorised firms to take all reasonable steps to continue meeting their regulatory obligations. Although the FCA accepts that in the current climate, certain regulatory requirements may not always be met, firms are still expected to maintain appropriate records and conduct any necessary reporting. Firms should be prepared to discuss with the FCA any concerns that their regulatory obligations may not be met.

Coronavirus (COVID-19) and all reasonable steps

The requirement for authorised firms to take all reasonable steps to comply with their regulatory obligations during times of crisis, such as the one posed by the current coronavirus (COVID-19) pandemic, is not new. There is a section (albeit brief) of the General Provisions part of the FCA Handbook (GEN) which is devoted to regulatory compliance in times of emergency. It provides that there may be circumstances in which firms are unable to comply with a particular rule in the FCA Handbook because of an emergency. GEN 1.3.2R provides relief for firms that are unable to comply because of an emergency which: (i) makes it impracticable for the firm to comply with a particular rule in the FCA Handbook; (ii) could not have been avoided by the firm taking all reasonable steps; and (iii) is outside the control of the firm.

When conditions (i) to (iii) apply, a firm will not be in contravention of the relevant rule to the extent that, in consequence of the emergency, compliance with that rule is impracticable. An action is considered impracticable for the purposes of GEN 1.3.2R if it would involve the firm going to unreasonable lengths. The relief applies only for so long as the consequences of the emergency continue and provided that the firm can 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 (if relevant).

Firms facing disruption should proactively engage with the FCA and, if relying on GEN 1.3.2R in relation to non-compliance, must notify the FCA as soon as practicable. Firms should also be mindful of their overarching disclosure obligation under Principle 11 of the FCA's Principles for Businesses to deal with the FCA in an open and cooperative way and to disclose anything relating to the firm which the FCA would reasonably expect notice.

There is no doubt that the coronavirus (COVID-19) pandemic is an emergency. It has produced widespread economic dislocation and forced all but a few essential workers to work from home. Major stock exchanges have been in freefall to the point that trading has been temporarily suspended on multiple occasions. Given the consequences of the coronavirus (COVID-19) pandemic, the main question facing authorised firms is what amounts to taking all reasonable steps?

Clearly, the answer will differ depending on the nature of a particular firm's activities and its organisational structure. Although there is no "one size fits all" set of measures, the starting point for each firm should be their business continuity arrangements.

Most firms are required to have formal business continuity plans. The Systems and Controls section of the FCA Handbook (SYSC) mandates that UK banks, building societies, investment firms, fund managers and investment advisors must take reasonable steps to ensure continuity and regularity in the performance of their regulated activities. That includes employing appropriate and proportionate systems, resources and procedures. Moreover, firms that are subject to the Capital Requirements Regulation (CRR) must establish, implement and maintain an adequate business continuity policy aimed at ensuring, in the case of an interruption to their systems and procedures, that any losses are limited, the preservation of essential data and functions, and the maintenance of their regulated activities. It should be noted that even the limited number of firms that are not explicitly required to have a business continuity plan are advised in SYSC 4.1.7A to take account of the business continuity rules as though they were guidance.

The matters that a business continuity plan should address, include:

- the firm's resource requirements such as people, systems and other business critical assets, and arrangements for obtaining these resources;
- the recovery priorities for the firm's operations;
- the firm's internal and external communication arrangements for concerned parties (including the FCA, clients and the press);
- escalation and invocation plans outlining the processes for implementing the business continuity plans, together with relevant contact information;
- processes to validate the integrity of information affected by the disruption; and
- regular testing of the business continuity policy in an appropriate and proportionate manner.

Regardless of whether a firm is explicitly required to maintain a business continuity plan, it is clear that having such a plan represents an important step towards satisfying the obligation to take all reasonable steps to comply with applicable regulatory obligations during an emergency. On its own, a business continuity plan is not a panacea but it does provide a framework for making key decisions and coordinating and adapting the firm's response throughout an emergency.

Adaptation and flexibility are key, particularly in an emergency that is long lasting and with no clear end. Despite testing their business continuity arrangements, many firms may find that it becomes necessary to depart or make provision for circumstances unforeseen when the plan was originally conceived. The business continuity plan should therefore be treated as a living document, capable of being adapted to the exigencies of the situation rather than as a constraint on taking decisive action where it is deemed necessary.

The importance of sound governance and senior management decision-making during an emergency should not be overlooked. Identifying key decision-makers in the business continuity plan or elsewhere promotes organisational accountability. Documenting management decisions along with the rationale underlying those decisions provides an evidential basis for retrospectively assessing whether the firm took all reasonable steps to comply with its regulatory obligations and to mitigate the effects of the emergency. Although regulatory authorities may not agree with every decision made by the firm, they are less likely to take enforcement action against a firm that can demonstrate that its decisions were made by appropriate senior managers and following due consideration of the relevant facts, the firm's business continuity arrangements and its regulatory obligations.

The importance of business continuity, accountability and management decision-making is evident in each of the sector specific guidance notes linked to the FCA's coronavirus (COVID-19) webpage, some of which are explored in more detail below.

Insurance. The FCA has set out its specific expectations for general insurance firms and consumers in relation to travel, motor and home, and private medical insurance during the coronavirus (COVID-19) pandemic. In particular, insurance firms are expected to communicate clearly any policy exclusions that may impact the cover and use of individual policies. Insurance firms are also expected to have robust systems and controls in place, supported by business continuity plans, to operate effectively in a stressed situation. The FCA has also provided clarification in relation to suspension of products and policy renewals.

Mortgage providers and lenders. The FCA published new guidance for mortgage lenders and administrators, and small business lenders. The guidance makes clear that mortgage firms should grant customers a payment holiday for an initial period of three months, where they may experience payment difficulties as a result of coronavirus (COVID-19) and where they have indicated they wish to receive one. An example of circumstances in which a payment holiday may be appropriate is where there is or will be a reduction in household income that can be used to make mortgage or home finance payments. There should be no additional fee or charge as a result of the payment holiday.

Key workers in financial services. The FCA published guidance to help firms identify key workers at financial services firms. The guidance encourages firms to first identify the activities, services or operations that, 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 who are essential to support those functions as well as any critical outsource partners who are essential to the continued provision of services, even where these are not financial services firms. Examples of the types of roles that may be considered as providing essential services include: senior managers; individuals essential to the running of branches and providing essential customer services; individuals essential to facilitating corporate and retail lending; and individuals essential in the operation of trading venues and other critical elements of market infrastructure.

Consumers. The FCA has published a webpage setting out various resources to support consumers during the coronavirus (COVID-19) pandemic. This includes advice and steps that consumers should be taking with respect to their finances.

The FCA is working in conjunction with the Bank of England and HM Treasury. The Bank of England has published a statement relating to the coronavirus (COVID-19) pandemic, confirming that it is monitoring the situation across all its functions and ensuring that contingency plans are in place. The FCA has also reiterated its continued commitment to working with other national competent authorities to ensure the orderly functioning of the global financial markets in the wake of the coronavirus (COVID-19) pandemic.

Taking into account recent FCA guidance, authorised firms in the UK should focus on maintaining business continuity during the coronavirus (COVID-19) pandemic, taking all reasonable steps to meet their regulatory obligations, and in particular:

- ensure that customers continue to be treated in a way which is fair, clear and not misleading;
- proactively consider the impact of any delays to regulatory matters and engage with the FCA early on to discuss any such risks;
- keep detailed records of decisions with respect to governance, including addressing any potential breaches of rules and related Principle 11 notifications;
- consider and liaise with key service providers to ensure they have appropriate business continuity plans in place and are equipped to provide services through the crisis with minimal disruption (consider in particular whether key service providers are located in jurisdictions with a high-incidence of coronavirus (COVID-19) and how that may affect the supply of goods and services);
- ensure that the firm's systems and controls for monitoring and recording the discharge of conduct of business obligations are effective when employees are working remotely;
- ensure employees are equipped to work remotely where possible and establish firm wide response plans to potential issues caused by employees being unable to attend the office;
- ensure that the firm's market abuse procedures effectively monitor employee trading activities in the context of remote working; and
- ensure that the firm is able to discharge its duties with respect to telephone recording, transaction recording and monitoring counterparty exposure where applicable.

FCA financial resilience expectations for FCA solo-regulated firms

On 26 March 2020, the FCA published a **press release** outlining the following expectations with respect to firms subject to regulation by the FCA only (referred to as FCA solo-regulated firms) in the light of the coronavirus (COVID-19) pandemic:

- Firms with capital and liquidity buffers are expected to use them to support business continuity. Firms are expected to plan ahead and ensure the sound management of financial resources.
- If a firm needs to exit the market, it should consider how to do this in an orderly manner while ensuring minimal harm to consumers and markets.
- Government schemes can be used to help authorised firms through this period. For more information on the government schemes, please see our earlier post "**UK Government Announces 'Unprecedented' Support for Businesses and Workers Through the Coronavirus Crisis**".
- Firms that will be unable to meet their capital requirements or their debts as they fall due, should contact their FCA supervisor to discuss their immediate financial plan.

FCA statement on senior manager responsibilities for work-related travel

On 27 March 2020, the FCA **published a statement** setting out how authorised firms should identify those individuals who need to travel to the office to ensure business continuity, and the responsibilities of senior managers in doing so, in the light of the coronavirus (COVID-19) pandemic. Each firm's designated senior manager or equivalent individual is responsible for identifying which of their employees are unable to perform their jobs from home and need to travel to the office. The FCA supports the UK government's restrictions on public travel and expects employers to take all necessary steps to facilitate their employees working from home. It considers that the number of roles requiring an ongoing physical presence in the office to maintain business continuity should be very small. For example, the following categories of staff would not be expected to travel to the office:

- financial advisers, as they can offer their services online or by phone;
- staff who can safely and securely trade shares and financial instruments from home;
- business support staff, such as those in IT where they can triage issues from home, unless they are responsible for specific equipment or technology; and
- claims management companies and those selling non-essential goods and credit.

The FCA advises firms to continue to follow the government's guidance closely and take the recommended steps.

FCA updates statement on short selling bans and reporting

On 31 March 2020, the FCA published an updated version of its **statement on short selling bans and reporting**. This follows the decision of the European Securities and Markets Authority (ESMA) on 16 March 2020, to temporarily amend the threshold for notifying net short positions to competent authorities under the Short Selling Regulation from 0.2% of issued share capital to 0.1%. The FCA had previously confirmed that ESMA's decision would apply in the UK and in its updated statement confirmed that the required changes to its systems have been made and that it will be in a position to receive notifications at the lower threshold from 6 April 2020. The FCA has advised firms to make best efforts to report at the lower threshold from this date. Those firms that cannot amend their systems to report at the lower threshold by this date should contact the FCA to discuss further. The new reporting obligation will apply to shares for which the FCA is the relevant national competent authority and not to exempted shares where the principal venue for the trading of the shares is located outside the European Union. The FCA has stopped short of imposing a temporary limitation or prohibition on short selling, but will keep the situation under review. For more information on the amendments to the threshold for notifying net short positions, please see our earlier post **UK Corporate Finance Update: Coronavirus (COVID-19)-Related Measures and Guidance**.

FCA Dear CEO letter to firms providing services to retail investors

On 1 April 2020, the FCA published a **Dear CEO Letter** to firms providing services to retail investors about coronavirus (COVID-19). The FCA reiterated that it expects firms to provide strong support and service to customers and small businesses during this period and that it expects firms to manage their financial resilience and actively manage their liquidity. The FCA also set out its approach to a number of key issues to help firms manage their response to the crisis:

- **Flexibility for client identity verification.** Although firms must continue to comply with their client identity verification obligations, they can be flexible with how they achieve this while non-essential travel restrictions are in place. The Money Laundering Regulations 2017 and Joint Money Laundering Steering Group guidance provide for client identity verification to be carried out remotely and give indications of appropriate safeguards and additional checks which firms can use to assist with verification. Examples of such remote client identification include: accepting scanned documentation sent by e-mail, preferably as a PDF; or asking clients to submit 'selfies' or videos.
- **Supervisory flexibility over best execution until the end of June 2020**. The FCA expects firms to continue to meet their obligations, including their obligations on client order handling, taking into account current market conditions when determining the relative importance they place on the different execution factors when meeting their obligations, and the venues or brokers they rely upon to achieve best execution. Firms should consider the use of different types of orders to execute client order and manage risk during market volatility. Following ESMA's guidance, the FCA will not take enforcement action where a firm:

  - does not publish its RTS 27 report (concerning the data to be published by execution venues on the quality of execution of transactions) by 1 April 2020, provided it is published no later than 30 June 2020; or
  - does not publish RTS 28 and Article 65(6) reports (concerning publication by investment firms of information on the identity of execution venues and on the quality of execution), provided they are published by 30 June 2020.
- **Supervisory flexibility over 10% depreciation notifications until the end of September 2020**. Firms providing portfolio management services or holding retail client accounts that include leveraged investments are currently required to inform investors where the value of their portfolio or leveraged position falls by 10% or more compared with its value in their last periodic statement, and for each subsequent 10% fall in value. The FCA will not take enforcement action until 1 October 2020, provided a firm:
  - has issued at least one notification to a retail client within a current reporting period, indicating their portfolio has decreased in value by at least 10%;
  - subsequently provides general updates through its website, other public channels (such as social media) and/or generic, non- client communications; or
  - chooses to cease providing 10% depreciation reports for any professional clients.
- **Pause on implementation of measures.** The FCA's policy statement on defined benefit pension transfer advice has been delayed and follow-up work on assessing the suitability of retirement income advice has been paused. Rules on investment pathways and platform switching provisions have already been made and have been referred to the FCA Board for further consideration.
- **Financial resilience.** For firms providing services to retail investors, the FCA clarifies that: government schemes to help firms through this period can be used to help firms plan for how they will meet debts as they fall due and help firms remain solvent in the immediate period; and government loans cannot be used to meet capital adequacy requirements as they do not meet the definition of capital. Firms therefore should ensure that they have other funding available to meet their capital adequacy requirements, if required.

The FCA will continue working with firms and consumer organisations to understand how the impact of coronavirus (COVID-19) is affecting markets and the harms that consumers may face. It will keep the measures outlined under review.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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