



COVID-19 INSIGHT FOR BANKS - KEY IMPACT FOR THE COMPLIANCE FUNCTION

All functions of the bank are affected by the current COVID-19 crisis. The compliance is no exception and even if it is probably not affected as much as risk management, the impact is important. It should not be overlooked and receive the necessary attention of the management. The compliance need to cope with an environment of weakening controls and increasing risks.

I. Weakened control framework

In order to protect their people, financial institutions have taken rigorous measure to reduce physical presence in their premises. Most of the employees work now remotely, the regulator in its communique of Sunday (!) 22 March request that only employees ensuring vital functions that are essential to maintain the critical mission should work in the Bank's premises or backup sites. According to ABBL, in general only 10 to 20% of the Bank staff are still coming to the offices. But even for the limited number of people coming to the Bank's premises, the teams have usually been split between different buildings to limit the risk and ensure business continuity, should a team member be infected.

Those elements disturb the processes, weaken the communication (especially between different departments) and the overall control framework of the Banks. All lines of defense are impacted. Often operational staff face a lot of short-term issues and are in crisis mode leading usually to put the priority

on production to the detriment of controls. This situation is naturally significantly increasing the operational risk, meaning risk of loss due human error in the operations.

II. The COVID-19 has direct negative impact on the risk level

Some new risk emerge directly linked to the COVID-19. The CRF in its note of the 02.04.2020 (<https://justice.public.lu/dam-assets/fr/organisation-justice/crf/note-covid19-1.pdf>), and following the statement of FATF, inform the professionals of new typologies of fraud, give a set of indicators and remind that continued vigilance remain essential. New operating model of CEO fraud and business email compromise (BEC) are explained. A new set of indicators is given to spot

- alleged producers and distributors of COVID-19 material;
- sale of counterfeit material;
- sale of medicine outside authorized networks.

Those new elements need to be included in the control framework, in the compliance tools and the people informed without delay and trained. It is far from easy in the current context, some institutions have difficulties and take delays in the implementation of controls regarding those new typologies of predicative offences. It is advisable if it is the case to document the issue, define an action plan, when it will be implemented and proactively take contact with the authorities.

III. Indirectly, the COVID-19 crisis increase risk of non-compliance

The **market abuse** risk is far more important. The financial markets are extremely volatile, the spreads wide and liquidity is reduced. The visibility on the impact of the crisis is very low and any information can create important price movement. People are stressed and could infringe knowingly or not rules regarding sensitive information, short selling or others. The reward to break the rule are higher due to extreme swings in price and the feeling could be that the risk is lower due to the possible disorganization. The market manipulation risk is obviously as well higher in this context of stress, lack of liquidity and lack of information.

The risk of non-compliance with **Mifid II** rules has increased as well. The requirement on the recording of telephone conversation with most of the employees working remotely will sometimes be impossible to meet. Fortunately the ESMA on the 20th March has made a public statement where it recognize that the recording of relevant conversation may not be practicable due to the exceptional circumstances. Under this exceptional scenario, the firms have to consider alternative steps to mitigate the risk linked with the non- recording like written minutes or notes subject to prior information of the client. The ESMA expects enhanced monitoring and ex post review of relevant orders and transactions. The compliance function need to identify and react quickly in that case, define the procedure if it was not foreseen and inform relevant people. The ESMA expects the firm to deploy “all possible effort” to ensure that recording of conversation is restored as soon as possible. Again, the bank should identify and document the possible issues, define the solutions and document that the firm as deployed “all possible effort”. If necessary, retro documentation of orders

should be performed and clients informed post facto. The impact of the measures taken on the compliance with several other MiFID II obligations should be checked like the obligation to inform the client the next day in case of the overall value of its portfolio or the value of one instrument for leveraged financial instruments depreciates by 10%, the suitability of the investments, the obligation to update the suitability information regularly and upon occurrence of certain events...

Other domain in the scope of the compliance function could be impacted like for example the **complaint handling**. The number of complaints will likely rise and the processes for complain handling could be disrupted. Necessary adaptations to the processes and tools should be performed if necessary to ensure timely and proper treatment and registration of complaint.

IV. Support measures of the supervisors in reaction of the COVID-19

The supervisors have taken several measures to support banks and limit the supervisory burden on their operations. The CSSF has granted a possibility to exceptionally extend the submission of various documents and of the regulatory reporting (https://www.cssf.lu/fileadmin/files/FAQ/FAQ_Covid_19_fr.pdf) and the ECB has decided to postpone by 6 months the deadline for remediation action imposed (https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320_FAQs-a4ac38e3ef.en.html). But those delays have a limited scope and even if some level of understanding can be expected by the regulator due to the exceptional circumstances, the institutions have to document the actions taken and be able to demonstrate that the priority has been put on ensuring a constant proper control framework. For example, no delay has been granted for the suspicion activity report to the CRF and at the opposite the CRF has reiterated the importance of the vigilance of the professionals in its note of the 02.04.2020.

V. Conclusion

COVID-19 outbreak is pushing financial institutions and their compliance function to develop crisis plan to respect continuously the regulatory requirements. It is advisable that the institutions analyze the

consequences of the situation on the overall control framework, document for each domain this analysis and inform the management especially if some weaknesses or delays are spotted. Action plans and deadlines should be defined and validated by the management and if relevant pro-active communication should be done with the regulator.

VI. How could BDO help you?

Should you have any questions on the above, or want to explore existing solutions for the improvement of your compliance function, tailored to your needs, please feel free to contact our FI advisory experts.

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