

Bite-size Briefings [March ED No.4]

A series of briefings that take a "bite-size" look at international trends in different jurisdictions, drawing on Baker McKenzie's expert financial services practitioners.

Operational Resilience and Coronavirus Contingency Planning

In light of the outbreak of the coronavirus, this edition takes a bite-size look at matters such as business continuity planning and operational resilience by financial institutions across a number of the major international financial centres, namely Germany, Hong Kong, Japan, Singapore, the United Kingdom and the United States. It also reports on the degree of flexibility afforded by financial regulators in those jurisdictions. It is noticeable that those countries in Asia Pacific have had greater exposure to previous pandemics and were affected by the current outbreak earlier than Europe and America, where regulators and firms have only recently needed to act.



Germany

The German banking and financial services regulator, BaFin, issued a [statement](#) on 4 March 2020 to the effect that it takes the current risk situation caused by the coronavirus very seriously and is in intensive discussions with banks and financial services companies on possible responses and emergency plans. BaFin is monitoring the situation continuously.

In Germany, banks and financial services firms have extensive risk management obligations under the Banking Act, which are complemented by BaFin's Circular "Minimum Requirements on Risk Management" ([MaRisk](#)). MaRisk also requires banks and financial services firms to have contingency plans, which typically include emergency plans in case of a pandemic. Most banks have separated their management teams in critical areas and made sure these teams work from different locations so they do not meet physically.

BaFin frequently asked questions

BaFin has also published FAQs that address a number of basic questions relevant to the current situation.

- BaFin has stated that using capital buffers in connection with potentially negative developments, including for the purpose of granting further loans to their customers, is acceptable — even if this means that a bank is in breach of its capital requirements. Banks are still required to report to BaFin and explain the reasons for not meeting capital requirements.
- In times of crisis, banks are permitted to dispense with liquidity buffer requirements. However, this is subject to meeting their information obligations towards the regulator.

- On the other hand, BaFin plans to implement CRR II / CRD V (the EU "Banking Package") on time, unless there is action at EU level to postpone the implementation date.
- One area of relaxation on operational rules relates to the general prohibition of "out of office trading" in the MaRisk. BaFin has explicitly allowed banks to operate outside this rule where traders work from the home. Banks are reminded, however, to implement suitable replacement procedures in a timely manner.
- Where banks grant credits, they need certain documentation, including the latest financial information from the borrower. BaFin has stated that 2018 financial statements are acceptable where, due to the current situation, borrowers have not been able to adopt the 2019 financial statements and/or statutory periods for the adoption of financial statements have been relaxed.
- BaFin has dispensed with on-site audits by auditors for the time being but points out that this applies only for the "peak period" and only in connection with fighting the coronavirus. Documents in connection with audits must still be made available on a "remote basis". If this is not possible either, it is permissible to postpone the completion of an audit without incurring sanctions and, moreover it is unnecessary to formally notify BaFin. In fact, BaFin has suspended its own on-site audits and is not currently requiring further onsite audits.

SSM flexibility

Concurrently, the European Central Bank has granted similar flexibility for Single Supervisory Mechanism (SSM) supervised institutions. On 20 March 2020, the ECB announced relaxations in the prudential treatment of loans backed by public support measures and activated capital and operational relief measures previously announced, such as flexibility in applying the guidance on non-performing loans, extending remediation periods for detected deficiencies by 6 months, and accelerating certain releases of full Pillar 2 (P2G) buffers as foreseen under CRD V. The ECB expects these measures to afford relief of approximately €120 billion in regulatory CET1 capital, which could lead to additional loans to households of €1.8 trillion.

BaFin has implemented and will continue to implement relaxations of certain supervisory rules, which means to some extent less supervisory control. Nonetheless, BaFin trusts that banks will use these freedoms responsibly.



Hong Kong

Since the coronavirus outbreak, Hong Kong financial regulators and financial institutions have been proactive in monitoring the evolving situation and the implications on the financial markets. It is important for financial institutions to have in place measures to ensure continuity and sustainability. The *Appendix to the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission ("SFC")* requires SFC-licensed institutions to ensure the implementation of an effective business continuity plan (BCP) appropriate to the size of the firm. The Hong Kong Monetary Authority (HKMA) oversees a similar requirement pursuant to its *Supervisory Manual* for all Authorised Institutions (AIs).

Recent SFC and HKMA guidance

On 5 February 2020, the SFC in a *statement* reminded the market that licensed corporations, applicants and other market participants are generally expected to make all reasonable efforts to maintain "business as usual" in respect of regulatory obligations,

including meeting deadlines. These market players should promptly communicate with the SFC if they encounter specific difficulties arising from the coronavirus situation.

The HKMA has also issued a **letter** on the temporary relief measures that authorised institutions (AIs) are encouraged to implement to mitigate the financial impact of the coronavirus outbreak on their customers. The HKMA has advised the banking industry to take a proactive approach and adopt a sympathetic stance in dealing with customers facing financial stress due to the coronavirus situation. AIs should, to the extent permitted by prudent risk management principles, consider requests for temporary relief arrangements favorably and ensure that staff are aware of such policies. In particular, the HKMA has welcomed initiatives such as principal moratorium for mortgages, fee reductions for credit card borrowing and restructuring of repayment schedules for corporate loans. It has also reduced the Base Rate and the applicable Countercyclical Capital **Buffer** for Hong Kong.

Best practices

At the outbreak of Severe Acute Respiratory Syndrome (SARS) in Hong Kong in 2003, regulators in Hong Kong including the HKMA and SFC issued guidance and recommendations. Financial institutions have been proactively reinforcing preventive measures and contingency procedures and testing the effectiveness of recovery equipment and facilities. The "best practices" suggested by the HKMA and SFC are broadly similar and are summarised as follows:

Activation of BCP:

- Determine the bare-minimum services that should continue to be provided to customers in a worst-case scenario
- Make relevant staff arrangements such as work from home, and for each critical operation area, identify a small team of skeleton staff and send them to work in an alternative location
- Make alternative internal plans to ensure continuity of services such as making arrangements with head offices and overseas offices to cover certain activities (e.g., dealing room activities) in case of need
- Check with critical suppliers and major outside service providers to ensure their capability to continue to provide services in contingency situations.

Information technology, capability and cybersecurity:

- Encourage customers and staff to use telephone or online facilities
- Ensure mobile computing equipment and computer networks including any telephone recording systems can support "work from home" and "split operations" for a prolonged period
- Review system capacity to cater for the potential upsurge in transaction volume *via* electronic channels
- Ensure adequate back-up facilities, mobile computing/communication devices and network bandwidth
- Ensure that the additional cyber-security risks (e.g., scams, phishing and ransomware attacks) are properly managed.

Communications with customers and counter-parties:

- Clearly communicate with customers and counter-parties on any limitation or interruption to the service offerings and the alternative arrangements that are available to them.

There are also best practices around the work environment, monitoring and reporting of infection cases.

Actions to consider

As the situation develops and the impact of the outbreak evolves, financial institutions should ensure ongoing compliance by assessing how their business could be disrupted by coronavirus and activating their BCP. They will need to evaluate staff arrangements and the working environment, which may involve implementing temporary closures of offices, work from home and other alternative arrangements. They should evaluate technology needs and the ability to support increased demand as well as address potential cybersecurity risks. It is necessary to evaluate existing contracts and arrangements with customers, suppliers and service providers, with a view to implementing alternative arrangements to ensure continuity and, where appropriate, consider force majeure provisions to suspend or terminate relationships and implement back-up plans.

Firms should continue to communicate with customers and counter-parties on the developments, assess any practical difficulties in complying with regulatory deadlines (e.g., filing deadlines), and communicate with regulators. Clearly, it is important that firms keep abreast of the latest developments and monitor any further guidance issued by the SFC, the HKMA or other relevant authorities. Failure to do so has the potential to create not only regulatory gap risk but also client-derived complaints and litigation.



Japan

The Financial Services Agency of Japan (JFSA) and financial institutions have been proactively monitoring the evolving situation and market implications of coronavirus. It is important for financial institutions to have in place relevant measures to ensure continuity and sustainability. In line with the policy and guidance of the national Headquarters for Novel Coronavirus Disease Control, the JFSA has issued its own guidance and recommendations for financial institutions with respect to preventive measures and contingency procedures. We discuss below the regulatory expectations as well as the key risks that financial institutions face and the steps they should take.

Regulatory standards and best practice

With respect to customers, the JFSA has recommended that firms support customers, in cooperation with relevant parties, by providing sufficient business consultations with customers and being flexible in handling requests in relation to new lending and/or the amendment of terms and conditions of existing loan agreements. When customers potentially infected with COVID-19 are quarantined in facilities, and they need financial services, firms should offer flexibility in catering to their needs.

Support by JFSA

The JFSA has added a new [subpage](#) to its website to provide one-stop access to COVID-19-related information. The JFSA has established a free telephone consultation service to respond to COVID-19 enquiries from consumers. It has also announced that COVID-19-affected corporations may extend the filing due dates of their annual securities reports, internal control reports, quarterly securities reports, and securities reports. This applies where it is not otherwise possible, for example, when a firm has to

suspend the auditing of its subsidiaries in the People's Republic of China due to the effects of COVID-19.

Actions to consider

As the situation develops and the impact of the outbreak continues to evolve, financial institutions should ensure they are compliant by monitoring the situation, including further instructions from JFSA and from relevant regulators in foreign jurisdictions in circumstances where a financial institution has branches or subsidiaries. Firms should also assess the potential impact and disruption to their business from coronavirus through testing business continuity plans by:

- Determining the minimum services to be provided to customers in a worst case scenario
- Checking with critical suppliers and major third-party service providers to ensure their capability to continue to provide services in contingency situations
- Establishing a clear command, control and communication structure (including a command centre for information sharing, corporate decision making and revising arrangements) to effectively monitor the above
- Evaluating staff arrangements and the working environment and, if need be, temporarily closing offices and implementing work from home and/or alternative arrangements
- Assessing technology needs and the ability to support increased demand
- Evaluating existing contracts and arrangements with customers, suppliers and service providers, with a view to considering or implementing alternative arrangements to ensure continuity and, where appropriate, reviewing force majeure provisions to suspend or terminate relationships with the substitution of a back-up plan

Continuing to communicate with customers and counter-parties on developments as they occur, including clear communication with customers and counter-parties on any limitation or interruption to services and any alternative arrangements



Singapore

Following the raising of the Disease Outbreak Response System Condition (DORSCON) alert level from Yellow to Orange, the Monetary Authority of Singapore (MAS) has issued updated **advice** to financial institutions on their business continuity plans in support of their staff and customers and to ensure security standards. These measures are in addition to those recommended by the Ministry of Health and the Ministry of Manpower in their general advisory to employers and workplaces on continued operations while minimising the risk of community contagion from COVID-19.

In addition to financial institutions as employers stepping up their business continuity plans to prepare for widespread community transmission, MAS requires them to continue to maintain effective internal controls across their operations should, for example, split team arrangements be implemented. Additionally, they need to anticipate, and be prepared to manage, any increase in demand for certain financial services, such as cash withdrawals or online financial services and inform customers promptly of the availability of services and operating hours.

According to **MAS**, notwithstanding the deepening of the crisis, the Singapore Dollar money market and foreign exchange market will continue to function normally in the face of heightened volatility across global markets.

Support for businesses

With regard to recent measures taken by banks and insurers to support staff and customers, MAS **welcomes** those that are aligned with the guidelines on corporate debt restructuring by the Association of Banks in Singapore, such as moratoriums on repayments, extended payment terms for trade finance facilities, and additional financing for working capital. Firms are encouraged to work with corporates and individuals affected by short-term cash flow constraints while remaining within the bounds of prudential risk assessments.

MAS has cautioned firms about the increased risk of cyber threats and scams, which take advantage of the COVID-19 situation. These range from conducting email scams, phishing and ransomware attacks to scammers impersonating contact tracing officials and requesting financial information.

The regulatory arm of the Singapore Exchange (**SGX**) has announced that it will allow listed companies with a 31 December financial year-end, up to 30 June 2020 to hold annual general meetings. The SGX has further issued **guidelines** to listed companies on holding general meetings, recommending the segregation of attendees across venues, in separate rooms connected by video-links; and reducing the size of the meeting at any one venue to below 250 people, in line with the Ministry of Health's advisory relating to social distancing **measures**. Other precautionary recommendations include temperature and health screening, the disclosure of travel history and contact detail, spacing seats at venues at least one meter apart, informing shareholders in advance of likely numbers attending, pre-registration as far as possible to give organisers an idea of numbers and providing alternative methods of participation through webcasts and the submission of questions in advance.

In view of the deteriorating global situation, the **Ministry of Health** recently announced mandatory self-isolation at home on a 14-day leave of absence (LOA) for all employees entering Singapore; meanwhile, short-term visitors from China, France, Italy, Iran, South Korea and Spain are prohibited from entering or transiting. Employers may be able to participate and be compensated in a recently announced Ministry of Manpower LOA Support **Programme**.



United Kingdom

The Bank of England (BoE), the Prudential Regulation Authority and the Financial Conduct Authority are in close contact with those key firms they directly supervise to ensure that their senior management is evaluating and planning to mitigate the risks posed and, in particular, to take steps to see that financial markets continue to function. Together with the European Securities and Markets Authority (ESMA), with respect to the EU, regulators are watching emerging trends closely. In a scenario where up to a fifth of the UK workforce could be affected at its peak, the BoE is aiming to ensure that "all necessary contingency plans are in place."

Regulators' statements

The BoE has issued a **statement** confirming that its prudential supervisors were reviewing the contingency plans of banks, insurers and FMI (e.g., trading venues and CCPs). This included assessments of operational risks and the ability of these entities to serve customers and markets using split teams and remote working. For its part, the FCA, in **guidance** (see also the FCA Coronavirus **webpage** for more resources) expects firms to have contingency plans to deal with major events including operational risk

assessments. This is consistent with the FCA's current focus on operational risk and systems and controls more generally; however, there has been relatively limited thematic guidance to the market on the regulator's expectations for dealing with pandemic scenarios. For example, with the exception of a review of the payments system in 2016, UK regulators have not carried out a market wide pandemic exercise for many years. ESMA in a similar [statement](#) has said firms should be ready to apply their contingency plans to ensure operational continuity in line with regulatory obligations.

Expectations over operational risk

UK regulators' expectations over operational risk and management of market-wide events such as the coronavirus outbreak are described in a recent consultation [paper](#) "Building Operational Resilience." Financial institutions should identify critical business services and establish related "impact tolerances" (i.e., thresholds for maximum tolerable disruption). They must test their ability to remain within these through a range of severe but plausible disruption scenarios. The process is intended to focus on the response and recovery actions firms would take to continue the delivery of an important business service in the event of disruption. The proposals note that in some circumstances, taking the systems and therefore the business service off-line might be the safest option where a tolerance level has been triggered (which, on a much larger scale, is effectively what happened when a circuit breaker was triggered on the NYSE after the S&P 500 plunged 7% on 9 March 2020). Recent market volatility and the need to perform a general operational risk assessment may cause firms to revisit whether their current impact tolerances are fit for purpose and what actions are needed in the event of a tolerance breach. The resilience of third-party service providers' systems and controls for outsourced services may also need to be reviewed in light of recent events.

Business continuity and regulatory obligations

In common with firms in other sectors of the economy, the financial sector has arranged for staff to work from home and/or from alternative back-up locations. Issues arise, in particular, around managing staff who are engaged in sales and trading activities, and who are required to operate remotely. The FCA's guidance on COVID-19 notes that all firms should take "reasonable steps to meet their regulatory obligations." Although trading activities may take place from backup sites or with staff working from home, (i) orders must be promptly entered into trading systems, (ii) staff must use recorded lines, and (iii) compliance support must be available when needed. While many firms have remote recording solutions (e.g., software applications on mobile phones), safeguards may be needed to ensure that staff only use recorded lines. ESMA has shown more flexibility; in a [statement](#), it concedes that where recording is not practicable, firms should consider what alternative steps they can take to mitigate the risks. The US Commodity Futures and Trading Commission has also provided much clearer relief for firms they regulate — see below. In the worst-case scenario, regulators may grant waivers over specific rules, but for the moment we expect regulators to take a "business as usual" approach to operational monitoring and oversight procedures. Senior management and compliance oversight and internal reporting systems need, therefore, to be tested and working as close to "normal" as possible.



United States

In the United States, the regulatory framework for operational resilience differs significantly from regulator to regulator. As a general rule, entities that form a part of core market infrastructure (e.g., banks, markets, and executing brokers) are subject to prescriptive and comprehensive "business continuity" regimes, whereas other industry participants (funds and managers) are subject to relatively more principles-based regulations. Nearly all of the US regulators have provided some response to the COVID-

19 pandemic, with many of them directly addressing challenges that arise from a remote work environment:

Investment advisers

The Securities and Exchange Commission (SEC) issued an **order** giving investment advisers additional time to submit their annual report (i.e., Form ADV) and any amendments thereto if the advisers have been affected by the pandemic. Investment advisers also have an additional 45 days to file Form PF. This relief does require notice to clients and the SEC (along with an explanation for the delay). The SEC also issued an FAQ to clarify that advisers do not need to update **Form ADV** to disclose temporary teleworking locations as offices and will not be deemed to have **custody** if the adviser is unable to return securities that it inadvertently receives from a client because the adviser is unable to access its office location.

Securities brokers — FINRA guidance

Amid the developing turmoil, the Financial Industry Regulatory Authority (FINRA) published **Regulatory Notice 20-08**, which highlights FINRA's e-continuity rule (Rule 4370). Among other things, the guidance identifies a compliance checklist that, while applicable only to brokers, provides a useful roadmap for any US financial services business. For starters, Rule 4370(c) lists various topics that must be addressed in a member company's BCP. At a minimum, BCPs should discuss:

- Data back-up and recovery (hard copy and electronic)
- All mission-critical systems
- Financial and operational assessments
- Alternate communications between customers and the member
- Alternate communications between the member and its employees
- Alternate physical location of employees
- Critical business constituent, bank, and counter-party impact
- Regulatory reporting
- Communications with regulators
- How the member will assure customers' prompt access to their funds and securities in the event that the member determines that it is unable to continue its business

Investment advisers and brokers regulated by the CFTC/NFA

The self-regulatory organization for the US derivatives industry, the National Futures Association (NFA), has issued **guidance** that it will not discipline members that permit associated persons to temporarily work from locations that have not previously been disclosed as branch offices without a branch manager (e.g., because of remote work arrangements). Members must, however, implement and document alternative methods to adequately supervise associated person activities and meet recordkeeping requirements. The NFA also noted that swap dealers should notify the CFTC if a swap dealer implements a teleworking plan or activates its BCP where such implementation or activation is for purposes other than testing. The CFTC staff separately provided **no-action relief** to exempt swap dealers from CFTC rules requiring recording of voice trading and telephonic communications and time-stamping requirements when located in

remote, socially distanced locations and relaxed deadlines to file annual compliance reports.

US retail funds (i.e., investment companies)

The SEC has published a **statement relaxing requirements to take certain board votes in person** through 15 June 2020. The SEC recently issued an **order** further extending relief to a broad range of obligations that apply to mutual funds, unit investment trusts, business development companies, and closed-end funds. This most recent 13 March 2020 order covers in-person board voting requirements, the preparation and distribution of annual and semi-annual shareholder reports, the filing of Forms N-CEN and N-PORT, advance notice for calling or redeeming closed-end fund securities, and the timely delivery of registered fund prospectuses.

US regulators also emphasise the need to protect against cybersecurity risks and insider trading.

Financial services firms that are active in the United States should consider their business continuity plans carefully; after past crises, the SEC, in particular, has conducted examinations of financial services firms to gauge how well their operations and compliance functions responded. We should expect similar examinations in the United States after the pandemic has passed.

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