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COMPLIANCE AND COVID-19

Moving to a new normal

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COVID-19 has created unprecedented business and regulatory disruption in a condensed period. There are massive changes to how financial institutions operate, what regulators and supervisors expect, in addition to significant economic impacts on society, businesses and individuals. The pandemic's effects have triggered extensive government action including the largest ever peacetime stimulus package in the US — the Coronavirus Aid, Relief and Economic Security (CARES) Act.

Compliance, like other functions at most financial institutions, are now fully engaged in managing the day-to-day firefighting. However, in periods of disruption, new risks can appear quickly, and existing risks can materialize into real problems as control structures no longer operate optimally. Compliance teams need to quickly pivot and consider the risks and challenges created by these rapid and radical changes. It is imperative for Compliance to perform a frequent and dynamic (non-formalistic) risk assessment in order to quickly understand the new circumstances and address the risks in a holistic way. This process involves a deliberate assessment of risks based on changes in the environment (for example, business, technological and regulatory) and a nimble way for the Compliance program to manage the changing risks through expedited actions (for example, seeking relief from regulators, updating policies and controls, and escalating issues).

While it is challenging during a crisis to pull together teams and relevant information for informed and structured conversations about new and emerging risks, it is ultimately more costly to rely on ad hoc decision-making in rapidly changing circumstances that, with the benefit of hindsight, do not look well considered.

PERFORMING A FREQUENT AND DYNAMIC RISK ASSESSMENT

With the changing regulatory and business environment, Compliance needs to focus on setting up its own dynamic process for identifying emerging and intensifying risks. This process needs to consider:

1. Actions and guidance from regulators and the government; and
2. Business strategy and the organization's crisis response

These dimensions are similar to what is normally considered in a compliance risk assessment but must be executed with more urgency and less bureaucracy. Similarly, the decisions coming out of the risk assessment must be implemented in real time in order to optimize the response.

Staying on top of key regulatory changes is a very important part of this process. As an example, regulators have urged heightened vigilance against malicious and fraudulent activity, noting increases in imposter scams, investor and product scams, and insider trading by corporate insiders[1]. Compliance teams need to consider what program updates can be made quickly to address regulatory concerns and changes.

1 Financial Crimes Enforcement Network (FinCEN): https://www.fincen.gov/news/news-releases/financial-crimes-enforcement-network-fincen-encourages-financial-institutions

Compliance also needs to consider risks created indirectly through broader regulatory and government actions, including those created by regulatory guidance on exercising forbearance and protecting clients in financial distress, and the flow of funds from government stimulus to different types of customers. As an example, Compliance will likely need to provide input on the framework for exercising forbearance and may need to monitor how the financial institution executes on the framework with its customers in practice.

It is also critical to stay close to the business during this time, which includes a “seat at the table” on response teams and committees, as well as continuing to advise on business decisions and emerging risks. As an example, Compliance needs to consider the risks created by:

- Traders, bankers, relationship managers, and other critical employees working from home;
- Extreme market volatility and its impact on different types of clients; and
- Limitations of firm systems to support clients and the control infrastructure effectively

To make sure that Compliance stays informed of material changes and emerging risks, it may be appropriate to create additional channels for fast communication on key risks, such as frequent virtual conferences with frontline, operations and technology key team members to get a quick pulse on what is happening.

Exhibit 1. Example Dynamic Risk Assessment Agenda

Inputs

Emerging risks
Market and peer changes
Regulatory actions
Business and technology changes
Key Risk Indicators
Key Performance Indicators

Proposed actions

- Update policies
- Create additional controls
- Seek regulatory relief
- Flex Compliance resources
- Escalate to senior management and Board
- Increase awareness

By assessing the compliance risk environment with a frequent (at least every 2 weeks) cadence during this tumultuous period, Compliance can quickly identify and make changes to existing policies and controls (revise Personal Account Dealing (PAD) holding periods to protect employees who need additional funds to meet their expenses), as well as, implement new ones (review health care worker accounts to ensure fair treatment). We suggest building this exercise onto existing Compliance team meetings, allowing additional time for substantive discussions and the consideration of critical documents and metrics. Each team member should be prepared to discuss relevant inputs (business, market, technology, regulatory changes) and proposed outputs (new controls, regulatory engagement, or training required) within their areas of responsibility. Actions should be focused on near term impact and diligently tracked.

SHIFTING ACTIVITIES AND FOCUS TO SUPPORT A NEW NORMAL

As part of initial reactions to the pandemic, Compliance may have extended non-critical internal deadlines (internal training requirements). Now armed with the results of its dynamic risk assessments, Compliance needs to think through how to optimally deploy its resources to manage risks in this new environment.

In general, we would expect an interim shift away from traditional controls testing and towards increased monitoring and surveillance. Electronic communications surveillance is likely to be heightened given the move towards digital communication channels more broadly. Some teams that perform non-critical functions may have capacity to be redeployed to more risk-driven activities. As resources are shifted, it's important to take a step back at regular checkpoints and conduct a review of the changes made to adapt to the new normal, adjusting the action plan as needed.

It is equally important to improve reporting to senior management and the board during this period. While Compliance may have already pivoted to providing additional ad hoc information focused on key regulatory changes and identifying needs for regulatory relief to these groups, it is critical to review key management reports and metrics, with an eye towards escalating the risks that matter given the new environment. This involves leveraging the results of the more dynamic risk assessment and revising metrics. For example, Key Risk Indicators (KRIs) may require greater focus on conduct and customer protection, and Key Performance Indicators (KPIs) may require a greater focus on backlogs and Compliance operations and staffing dislocations caused by COVID-19.

REFOCUSING THE MEDIUM-TERM COMPLIANCE STRATEGY

In adapting to a new normal, it is critical to review and refocus the overall Compliance strategy. It will be important to work with business teams to understand changes in business strategy and risk profile, to make sure that Compliance continues to focus on managing key Compliance risks. Given the expansion of remote working, certain plans (for example, further upgrades to electronic communications surveillance, workflow tools) may be accelerated, while others may be deprioritized.

There may also be opportunities to drive greater efficiency and effectiveness. For example, the current remote working environment may provide opportunities for changes in location strategy.

MANAGING COMPLIANCE IN A NEW REMOTE WORKING ENVIRONMENT

While Compliance has adapted its own team quickly to determine its critical functions (Control room) and how to conduct activities which normally are not performed offsite (trade surveillance, transaction monitoring), a new normal requires Compliance to make sure its workforce has the appropriate tools and access needed to perform key duties identified through the dynamic risk assessment and maintains connectivity to each other and the business, as co-location is not an option. Productivity management is critical for key areas (transaction monitoring) where backlogs are high risk, and it is important to overcommunicate with Compliance teams to make sure they feel productive and that they are contributing, and also find ways to foster a sense of community and maintain employee morale.

During these uncertain times, it is critical to be practical and focus on what matters. Compliance will be called upon to make decisions quickly and will need to be flexible in the way it deploys its team and works together with the business. Deploying a frequent and dynamic risk assessment can greatly assist with the ability to respond. Clear and rapid pathways for communication and escalation are also critical as this becomes a new normal. While regulators have provided relief in many areas to financial institutions during this period, it is essential that Compliance continues to frame its interactions with the business in a manner that supports the firm's overall culture of compliance. By adapting quickly and planning for the new and emerging risks and challenges, Compliance teams can help mitigate risk and support business strategy for organizations to successfully navigate this crisis.

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