

Preparing for post COVID-19 in the UK:

Defining moments from the regulatory landscape



COVID-19 (C-19) has put regulators in uncharted waters. The scale and scope of the economic shocks exceeded regulatory assumptions. The new ways of working call for revisions to existing regulatory expectations. This is supported by our recent dialog with UK-based regulators which also points to changes of emphasis and timing.

While the immediate regulatory response has been to postpone timelines and free up resources, preparing for the eventual aftermath of C-19 will likely call for more, not less, regulatory oversight. This should entail heightened focus on commercial banking conduct, stress testing scope, and operational resilience.

Prioritizing for recovery and growth requires clarity over the regulatory horizon. We outline five areas of regulatory change that may place firms under greater scrutiny post C-19.

Unintended consequences from amending regulatory timeline

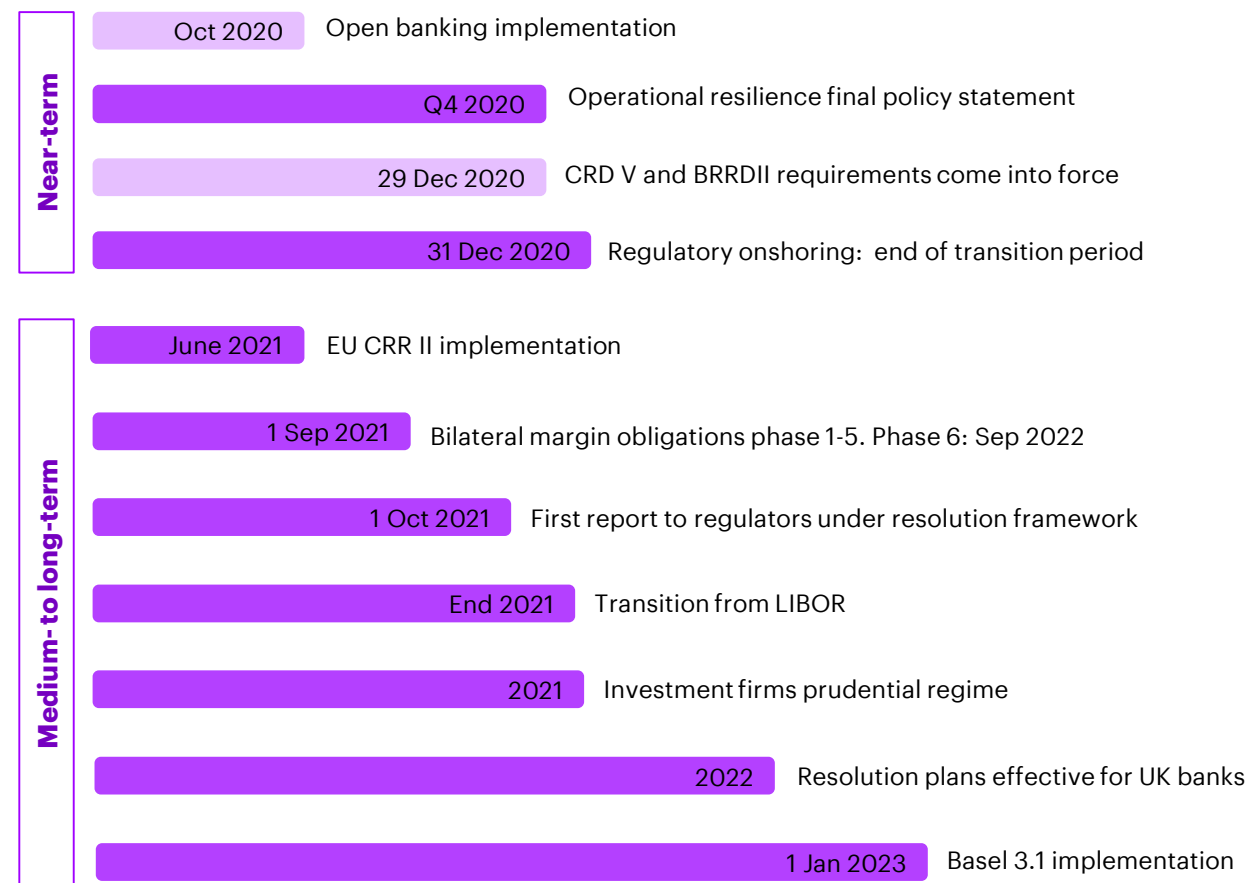
A key part of the regulatory response to C-19 has been to cancel or delay regulatory initiatives. In the UK, alongside the cancellation of the Bank of England’s annual stress testing, 52 out of the 80 regulatory initiatives have had their timings amended due to C-19,¹ including Basel 3.1. There are also delays to key consultations such as climate-related disclosure and operational resilience.²

Several high-impact initiatives, however, remained in place. Chief among them the onshoring of regulatory regime as the Brexit transition period ends on 31 December 2020, embedding approaches to managing climate change risks, and transitioning products and markets away from LIBOR by 31 December 2021.³

The amendment to regulatory timeline, while aimed at preserving operational capacity, may have unintended consequences on financial institutions. With consultation periods extended to 1 October 2020, we should anticipate a substantial volume of finalized policies around the turn of the year. The associated implementation dates – the point at which firms have to comply with finalized policies – require careful consideration and coordination among regulators and the industry.

With firms’ financial and operational capacity strained by C-19, **it is crucial that they effectively manage the evolving portfolio of regulatory changes and prioritize efforts accordingly.**

Amended timeline for key regulatory initiatives in the UK



Source: [Regulatory Initiatives Grid, FCA, 7 May 2020](#).

Low operational impact

High operational impact

BRRDII: Bank Recovery and Resolution Directive II.
 CRD V: Capital Requirements Directive V.
 CRR II: Capital Requirements Regulation II

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Greater regulatory focus on customer protection

The immediate challenge for financial regulators has been to support and channel government stimulus initiatives, particularly to smaller businesses. In the UK, the Coronavirus Business Interruption Loan Scheme (CBILS) has brought over forty banks to channel government support via the British Business Bank.⁴

Such initiatives have placed the commercial lending market and commercial banking conduct under the spotlight. **With only a small share of the commercial lending market falling under Financial Conduct Authority (FCA) rules, greater regulatory scrutiny should be expected.**⁵ In particular, the regulators are concerned about the fair treatment of corporate customers when negotiating new or existing debt facilities. The FCA called out this issue in a recent **Dear CEO letter** in relation to banks' use of lending relationship for gaining unwanted roles on equity mandates.⁶

As commercial lending needs are expected to grow in preparing for the aftermath of C-19, businesses should step up equity finance, rather than increase their debt pile, as urged by the Bank of England Governor.⁷ Doing so puts the fair treatment of corporate customers and commercial banking conduct in even sharper focus.

For financial institutions, this may allude to new regulatory initiatives in support of unleashing private capital while protecting customers. This could mean a greater role for the UK's established conduct regimes (SMCR) in the oversight and updating of processes to facilitate the deployment of private capital.⁸



Expand economic stress testing scenarios and introduce separate, operational stress testing

Scenarios in economic stress testing can seem limited in light of the pandemic. In the UK, the Bank of England projected that GDP could fall by 14% in 2020⁹ – three times more severe than the assumed decline in its latest stress testing scenarios.¹⁰ How economies emerge from the crisis remain uncertain: U-, V-, W- or L-shaped recoveries are all on the card.

In addition, real-time, price-driven events (such as margin calls) that have posed a meaningful threat to financial stability during the pandemic don't lend themselves well to conventional stress testing and risk models.

Indeed, the pandemic lays bare the issue that risk models draw heavily upon empirical data and past incidents. **More behavior-driven data and predictive analytics are required to gain a more timely and accurate view of financial resilience in the aftermath of C-19**, particularly as banks expect severe loan losses and dynamic interplay between credit and liquidity risks.¹¹

More importantly, regulatory stress testing has, to date, focused on economic swings, rather than operational disruptions. But as the pandemic shows, fraud concerns, disruptions to communication networks, and prolonged absence of critical staff have posed a greater material threat to the resilience and stability of our financial system.

These highlight the need for scenarios to be considered in both operational resilience and prudential stress testing domains. For banks, this may involve reconsidering model development and validation rules and anticipate any necessary updates to internal and regulatory stress tests.



Changing regulatory expectations on operational resilience

With the UK regulators currently consulting for the industry's views on operational resilience (FCA Consultation Paper 19/32; Prudential Regulation Authority Consultation Paper 29/19),¹² this should be **an opportunity for firms and regulators to reflect on the new norms emerging after the pandemic.**

While created primarily to address IT failures, **regulatory assumptions over operational resilience have been challenged by new norms emerging during C-19.** In the UK, remote working has proved effective and appears lasting in financial services.¹³ Firms' IT systems have remained resilient and Cloud platforms have delivered their promises of scalability and flexibility. **These call for a more balanced view of people vs. technology risks in the supervisory scope.** At the same time, -previous regulatory assumptions around multiple large-scale operational failures hitting all market actors simultaneously may prove too optimistic.

The regulatory view on the industry's outsourcing and offshoring may evolve too. When a pandemic disrupts multiple services, previously outsourced services may become more critical to consumer protection and therefore considered "important business services." For example, when access to branch banks is not an option, call centres become more important for vulnerable customers. Similarly, when a pandemic affects multiple geographies, **the balance between cost efficiency and third-party risk considerations may**

With regulatory scrutiny over operational resilience evolving, embedding a culture of resilience is key to harnessing the 'emergence measure' and technology investment made during C-19 and delivering more sustained business benefit.



Look ahead: broadening financial regulatory perimeter in a post C-19 world

C-19 should likely encourage cash-rich firms from adjacent industries to expand into financial services areas with fewer regulatory hurdles.

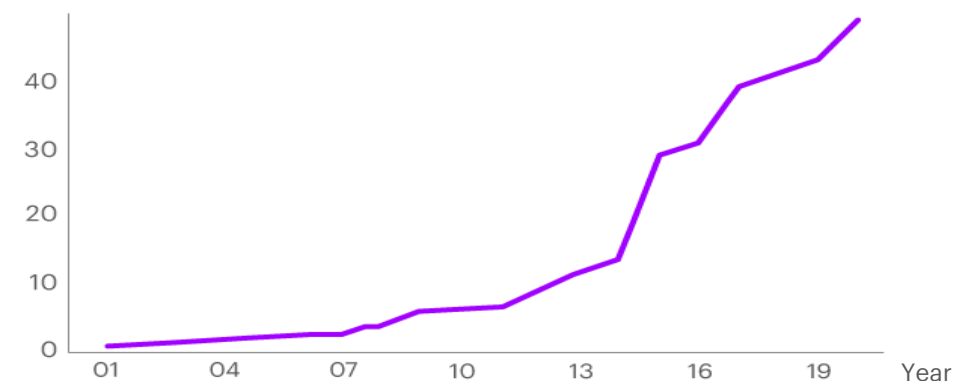
Already, technology firms are accelerating expansion through acquisitions and organic growth, as the combined cash and marketable securities of the five largest firms now exceed US\$560 billion.¹⁴

This should further increase non-financial services (FS) firms' footprint and reinforce financial regulators' need for broadening perimeter and/or increasing cross-industry and cross-border regulatory collaboration.

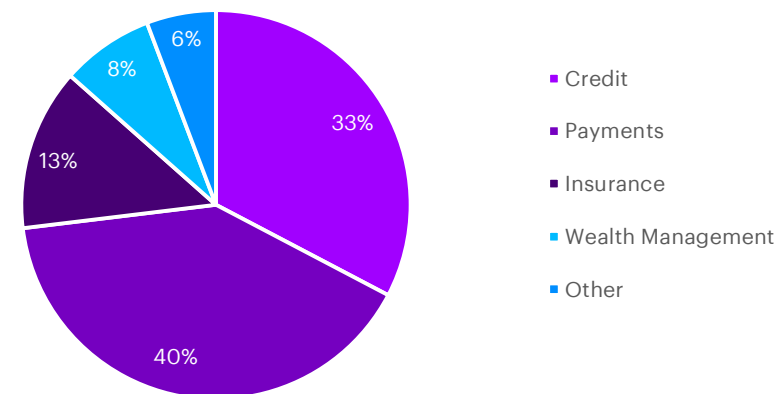
Areas in which existing financial regulatory framework may affect non-FS firms, particularly large technology organizations in the near-term include:

- **The expansion of credit provision outside tradition financial services** is a particular concern as non-FS firms are unlikely to have their credit assessment tested through an entire financial cycle and prove their ability to maintain credit supply during a downturn.
- **Non-FS firms' access to and use of financial data** is heightening financial authorities' oversight on data rights. This introduces greater complexity and potentially overlapping requirements with the broader context of data protection regulations.
- From a financial stability perspective, financial regulators should likely observe **the effect of non-FS firms' activities on incumbent financial institutions' ability to generate capital via retained profits**, as well as any concentration risks in service provision among third parties to financial services.

Number of financial services provided by ten largest tech firms



Types of financial services offered by ten largest technology firms



Source: [Big Tech in finance](#), Financial Stability Board, 9 December 2019.

Actions Now and Next

NOW  NEXT

We expect regulatory and government positions to remain dynamic for a while to come. For financial institutions, this may raise dilemmas between regulatory measures, complex interplays between risk types, and the need for more balanced consideration between cost efficiency and risk profile.

Actions to take now

- **Step up regulatory engagement to understand evolving expectations and implementation timeline**
- **Fine tune investment budget allocation and regulatory change portfolio, and plan for longer implementation timelines for in-flight programs**
- **Expand stress testing scenarios and reconsider model development and validation rules**



Actions to take next

- **Assess the impact of a post C-19 industry and regulatory landscape on business model**
- **Provide and manage resilience data ready for supervisory engagement**
- **Expect regulatory agenda on emerging risks (e.g. climate change risk) to re-emerge quickly**

Contacts



Peter Beardshaw

Managing Director

Accenture Strategy & Consulting

peter.beardshaw@accenture.com



Kuangyi Wei

Director

Accenture Strategy & Consulting

kuangyi.wei@accenture.com

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