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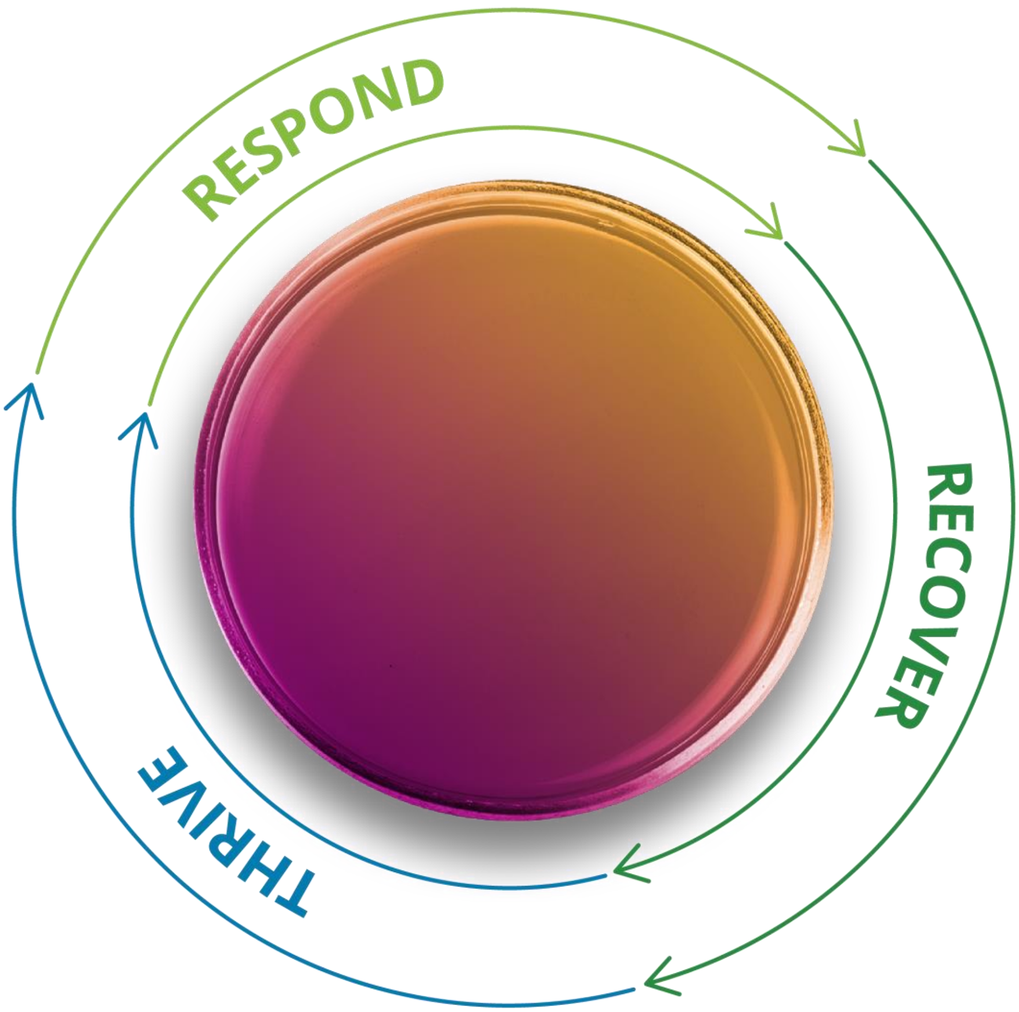


COVID-19 potential implications for the banking and capital markets sector

Maintaining business and operational resilience

March 20, 2020

COVID-19’s impact on individuals, communities, and organizations is rapidly evolving. A recent Deloitte Insights article posited four different scenarios for the global economy resulting from COVID-19, which ranged from a mild and temporary hit to the worst-case scenario, a global financial crisis.[1] Unfortunately, COVID-19 arrived when the global economy was already showing signs of a slowdown.[2]

In addition to the effects on the supply and demand side, COVID-19 has already jolted financial markets. Since February 21, 2020, bond yields, oil, and equity prices have sharply fallen, and trillions of dollars, across almost all asset classes, have sought safety. In the United States, 10-year bond yields have tumbled below 0.5 percent[3] (figure 1), and equity prices on major stock indices around the world have fallen. It appears, as of now, that the markets are trying to price using the worst-case scenario, which has increased volatility recently (figure 2).

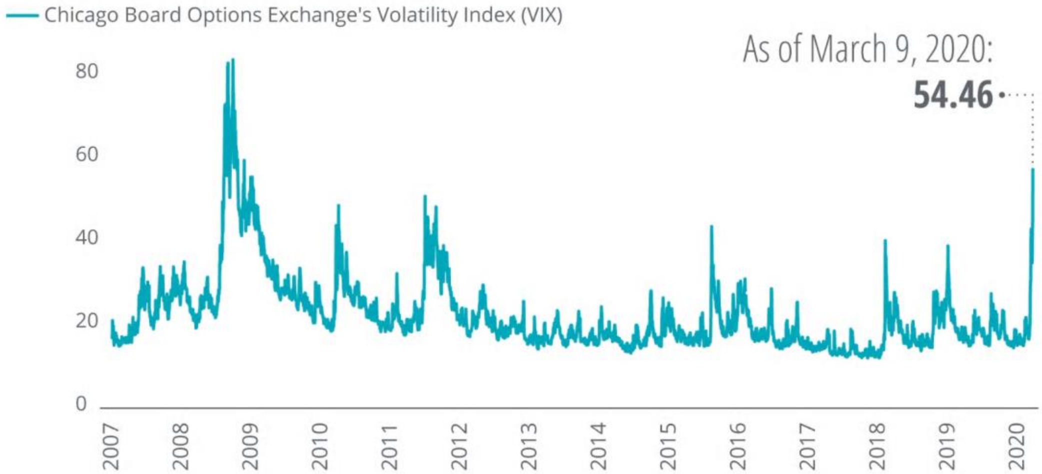
FIGURE 1

The 10-year US Treasury yield has been falling to record-low levels

Source: Federal Reserve Bank of St. Louis.

FIGURE 2

The VIX, a measure of the stock market's expectation of volatility based on S&P 500 index options, has risen significantly



Source: Federal Reserve Bank of St. Louis.

With ongoing shocks to the supply and demand side, there is potential for further market disruption. Institutions and individuals may be experiencing liquidity stress, including limited access to credit. This might, in turn, increase the probability of default, especially near or in the speculative grade of corporate debt. Private debt, including corporate and household debt, has reached record levels recently, and approximately one-half of the investment-grade market currently holds a triple-B rating.4

Central banks around the world, meanwhile, have already proactively intervened to calm markets and show commitment to using all possible measures. In its first emergency move since the recession in 2008, the US Federal Reserve (the Fed) recently cut the federal funds rate by 50 basis points.5 The Fed has also actively intervened in the repo market to add further liquidity.6 The Bank of Japan, meanwhile, issued an emergency statement signaling that it would inject liquidity into the market by increasing asset purchases.7 The People’s Bank of China has also pumped more than US$240 billion of liquidity into the financial system as a countermeasure to the virus.8 Additionally, the Bank of England and the European Central Bank have announced various plans to counter COVID-19 in the coming days.9

But as the situation develops, more action may be required by central banks, regulators, and governments, which would necessitate quick coordination at the national and international levels.

Meanwhile, banking and capital markets firms around the world are mobilizing and taking steps to minimize COVID-19’s effects on day-to-day operations. Firms are testing and implementing business continuity/contingency plans, which include alternate workplace arrangements such as split work sites, working from home, and rotating shifts for all types of employees, even traders. Many have also instituted universal travel bans beyond the countries experiencing the most severe effects, and have canceled large events. Institutions have also heightened measures to ensure the safety and health of their employees through various means. Banks have also requested that regulators ease capital requirements. Some regulators, such as the US Securities and Exchange Commission

(SEC), have proactively granted relief for regulatory financial reporting to companies affected by COVID-19.12

Many banks are also acting as responsible citizens by extending loans to hard-hit borrowers, renegotiating credit terms, and even donating face masks to their clients.

Beyond the operational actions already underway, banks and capital markets must remain hypervigilant. They need to also actively consider the short- and medium-term financial, risk, and regulatory compliance implications that are resulting from the continuing uncertainty around COVID-19.

This article explores these implications. It also raises questions around key areas that banking and capital markets leaders should be asking themselves right now and provides action steps for them to consider.

Of course, any actions taken will depend on the specific context of the organization and its unique circumstances regarding exposure to the virus. Also, organizational priorities may change dramatically depending on how the situation develops.

We do not know the long-term implications of COVID-19 for financial markets and banking and capital markets firms. But when normalcy returns, banks and capital markets firms will likely have learned a few lessons. These may include how to best retain operational resilience when confronted with future pandemics, and possibly how to design new operating models such as alternate work arrangements. COVID-19 may further accelerate migration to digital channels and connectivity.

Specific implications for banking and capital markets firms

Operational resilience			
Topic/issue	Current and potential developments	Relevant questions	Actions banks and capital markets firms should consider
Branch/ATM operations	• As the pandemic advances, some branches/offices may need to close temporarily, or employees may not want to come in to work. • ATMs may need to remain open and have enough cash to dispense.	• How can banks ensure operational consistency with branch/office operations if there are temporary closings or employee absences? • How can branches sufficiently replenish cash for ATMs?	• Consider reducing branch hours or, if possible, utilizing only drive-through operations. • Assess opportunities to deliver services solely through digital channels. Reprioritize the IT developments considering improvement of online platforms as strategical and among top priorities.

Trade compliance	• Many institutions already have traders working from home and remote offices, and some regulators such as the Financial Industry Regulatory Authority (FINRA) have temporarily waived rules in this regard. • Meanwhile, the United Kingdom's Financial Conduct Authority (FCA) has stated that all firms are expected to meet their regulatory compliance obligations regarding trading orders transactions, timely entry of orders, using recorded lines, and giving staff access to compliance support.	• What flexibility might regulators grant that would enable traders to work from home? • What systems/tools/ support need to be provided to traders who may be forced to work from home?	• Be in close contact with industry groups, such as European Securities and Markets Authority (ESMA), Financial Supervisory Authority (ASF Romania), National Bank of Romania (NBR) and the National Competent Authorities of the jurisdictions where the Parent Company operates, for information and updates on obtaining waivers and instructions. • Work with vendors to set up alternate recording options.

Sources: Rachel Louise Ensign, Liz Hoffman, and Justin Baer, "Wall Street scrambles to harden virus defenses," *Wall Street Journal,* March 1, 2020; Pete Schroeder and Michelle Price, "Wall Street regulator paves way for home trading as coronavirus spreads," Reuters, March 9, 2020; Laura Noonan, Nicholas Mcgaw, and Primrose Riordan, "Banks seek trading rule guidance as coronavirus spreads," *Financial Times,* March 6, 2020.

Financial and business impacts			
Topic/issue	Current and potential developments	Relevant questions	Actions banks and capital markets firms should consider
Liquidity management	The Federal Reserve has intervened in the repo market to ensure adequate market liquidity. The European Central Bank (ECB), Bank of Japan (BoJ), and the People's Bank of China (PBOC) have taken a variety of actions to ensure market liquidity. The EBA has also	If there is a liquidity crunch, what current plans and activation steps are in place? To what degree have they been reassessed in light of recent market conditions? If institutions needed to sell assets to cover liquidity shortfalls, are the requisite legal documents up to date?	Adequate liquidity across the enterprise globally should be ensured. Banks should be closely reviewing and monitoring daily liquidity stress testing reporting, limit/threshold monitoring, LCR results, etc. They should be monitoring market activity against their liquidity stress indicators for triggers that would

	advised that banks should make full use of the flexibility allowed by regulatory framework, for instance the liquidity coverage ratio (LCR) designed for stress situations, and has also advised national regulators to avoid measures that may entail the fragmentation of funding markets. Some institutions' contingency funding plans (CFPs) may have already been invoked. And due to market volatility, there could be big swings in stress testing results and limit/threshold breaches. Some market participants may already be experiencing increased liquidity tightening.		activate the CFP. Analyses should be conducted to determine the size and impact of any liquidity shortfall if liquidity stress indicators are being triggered regularly. Impacts to secured funding/asset sales (including market access) should be included in the analysis. This information should be presented to management across liquidity and liquidity risk (liquidity crisis team) as part of the CFP being activated. Liquidity preservation actions should be part of banks' CFPs and would include options for ensuring liquidity if the CFP has been invoked. Requirements should be recalibrated based on emerging market conditions and future likely scenarios. Banks should go beyond the LCR requirements when communicating their liquidity status to regulators. Regulatory relations teams should be part of the liquidity crisis management team/committee under the CFP.
Capital management	Risk-weighted assets (RWA) may be impacted by higher charges from increased volatility levels and higher	How do increased volatility and price movements of assets affect RWA? Does the current economic and market	Assumptions driving the valuation of asset values should be revisited. Additional stress tests with different

	counterparty risks. With the implementation of IFRS 9 Expected Credit Losses (ECL) model and a potentially less favorable economic outlook, banks' loss allowances may be negatively impacted. Also, borrowers may want to refinance at longer maturities to lock in lower interest rates. Under ECL, this could result in additional loss allowances.	environment warrant additional stress testing? How severe would a worst-case scenario be? With changes in economic assumptions, how will loan loss allowance estimates change? How do the Bank's initiatives to support the consumers affect the loan loss allowance and the capital?	underlying scenarios specific to COVID-19 should be conducted. In a similar way, Base scenarios are expected to be different and to consider risk drivers not considered before.
Revenue and cost management	If general economic conditions deteriorate and lead to lower GDP growth, there could be reduced demand for banking products and services. With central banks aggressively cutting interest rates, banks' net interest income will likely be challenged.	Do leaders know where potential revenue losses could be the steepest? With potential declines to net interest income, what options exist to boost noninterest income?	Work with relevant departments and units globally to develop an understanding of potential revenue hits and outline steps for mitigation. Reconsider the new influential elements in the capital optimization models and recalibrate the estimations.
Loan book, covenants, and exception management	With clients potentially experiencing stressed financial conditions, credit quality/ratings may be affected. Also, pledged collateral may experience a decline in value. Customers, both retail and institutional, may resort to minimal or delayed payments on their loan balances.	How can firms best assess and proactively work with clients who may be affected by the virus to renegotiate loan terms and conditions? Are there business interruption insurance policies in place? Are borrowers/clients at risk of violating loan covenants? Is there an exception management process in place? Can the lenders accelerate for	Find out which sectors/ regions/clients are most at risk. Reach out to clients with communications and information requests to provide temporary help as appropriate. To the extent amendments are sought with respect to lending documentation for ongoing contracts, additional reporting obligations (e.g. more frequent) should be considered, so that

		other reasons than non-payments (e.g. for MAE events, breaches of reporting obligations, market disruptions etc.)? Has the impact of such (mass) acceleration been thoroughly assessed? Is the initiation of enforcement / insolvency proceedings feasible and to what extent? Can the lenders withhold funding/refuse drawdowns for ongoing agreements (undrawn facilities, credit lines, etc.)? Will firms need to increase loan loss provisions?	the lenders are aware of rapid changes and can better assess the borrowers' status. Possibility of lenders/borrowers to access business interruption insurance policies should be considered and examined in advance. Lenders should carefully assess contractual provisions in place so as to be aware of any risks related to potential acceleration (for reasons other than non-payments) as well as the withholding of payments/refusal of drawdowns for ongoing loans. Loan loss provisions under different economic scenarios should be reexamined. The provisions are expected to increase. The models need to take into account that industries are impacted differently than in previous periods of economy slowdown. Most of the banks will need to reconsider the risks and reassess portfolio sensitivity under the COVID global medical situation as well as the validity of the assumptions used in current models and relevancy for the unusual situation they have to predict. Scenarios of propagation into economy and estimation on the time needed until the situation starts to improve will be joint

			effort of epidemiologists, economist and modelers. Local regulators in several jurisdictions imposed additional provision measures that can be reconsidered under the current situation. In a similar way, certain financial institutions used prudent assumptions which can now become of use.
Trading/ hedging strategies	Currently, increased volatility and decline in prices across many asset classes have impacted the trading books and increased market risk as well as counterparty credit risk.	How can capital allocations be determined across trading books in stressed markets? Are precautionary steps, such as trading asset divestments, required, and if so, which assets could be disposed of first? How quickly can hedging strategies be adjusted across foreign exchange, commodities, equities, or fixed income, as the situation develops?	Capital allocations and hedging strategies across trading books should be revisited.

Sources: Federal Reserve Bank of St. Louis, "Overnight repurchase agreements: Treasury Securities purchased by the Federal Reserve in the temporary open market operations," accessed March 9, 2020; European Central Bank, "Statement by the president of the ECB," March 2, 2020; John Ainger and Anooja Debnath, "Investors dodging market meltdown say they can't find liquidity," Bloomberg, March 9, 2020; Sohini Chowdhury and Cristian deRitis, "Beyond theory: A practical guide to using economic forecasts for CECL estimates," *Moody's Analytics*, August 2018; Laurent Birade, "CECL: Credit cards and lifetime estimation—a reasonable approach," *Moody's Analytics*, September 2018; David Enrich, James B. Stewart, and Matt Phillips, "Spiraling virus fears are causing financial carnage," *New York Times,* March 6, 2020.

Risk and controls			
Topic/issue	Current and potential developments	Relevant questions	Actions banks and capital markets firms should consider
Market risk	A sharp drop in interest rates and increased volatility in securities and FX prices increases banks' market risk, potentially leading to losses.	Has the exposure of the institution's earnings or economic value of capital been adversely affected, and is it materially different from model-implied scenarios? Does the current environment warrant an update of internal models?	Revisit internal models capturing market risk and account for potentially higher correlation. Communicate with the regulator if capital is adversely affected and materially differs from model-implied scenarios.
Counterparty credit risk	Recent market events may have affected counterparties' credit profile.	How should any potential changes to counterparty creditworthiness be addressed in existing contracts and arrangements? How are market intermediaries, such as clearing agents, responding to any decline in counterparty credit standing?	Assess/revisit existing contracts with counterparties most at risk. Work with market intermediaries to stay informed about any changes to counterparties' standing.
Nonfinancial risks	Nonfinancial risks such as conduct risk/culture, model risk, third-party, and cyber risk may also become more pressing. Potential disruptions to trading infrastructure may require that trades be rerouted to other venues, locations, and	How can risk controls regarding conduct risk be upheld in alternate work arrangements? To what degree are recent market conditions impacting model risk? What would regulatory requirements look like under alternate trade	Rethink risk controls for alternate work arrangements and potential disruptions that could warrant a reassessment of conduct risk, cyber risk, and third-party risk. Revisit to what extent model assumptions reflect current and possibly

	countries.	routing? As business process and flows change, what is the best way to manage cyber risk?	future market conditions. Obtain clarity from regulators about alternate trade routing.
Risk governance	If a bank's operating model needs to change, it may become difficult for the board of directors to continue to meet governance obligations such as overseeing risk, providing credible challenge to management, and acting as responsible stewards of the organization.	How should the board of directors adapt its governance?	Management should err on the side of overcommunicating with the board of directors, keeping them apprised and seeking their guidance on alternate operating procedures. Flexibility in work arrangements and speed of decision-making among the board of directors could become paramount in these circumstances.
Dividends and stock buybacks	Banks have been returning capital to shareholders in the form of dividends and share buybacks over the past few years. Recent market stress may put liquidity pressure on banks, which may want to preserve capital by halting or reducing dividends and share buybacks.	What is the appropriate strategy for dividends and buybacks, given current liquidity preferences? If there are commitments in place about dividends and/or stock buybacks, and banks want to temporarily halt these actions, how should this be communicated to shareholders?	Assess institutional shareholder interest and preferences for share buybacks and dividends and communicate any potential changes
Credit ratings	The COVID-19-induced market environment may negatively impact banks' credit rating profile. New systemic,	How are rating agencies accounting for the changes to these risk factors? How should any potential changes to the credit profiles of	Stay in active communication with rating agencies and apprise them of changes to the credit standing. Determine whether

	country, or other business risk factors may intensify and affect the creditworthiness of banks, counterparties, and borrowers, especially in the high-yield grade.	counterparties and borrowers resulting from COVID-19 be accounted for?	any rating actions flowing from COVID-19-induced stress would necessitate giving counterparties and borrowers some slack.
LIBOR transition and EONIA / EURIBOR reform	The reference rates will be replaced with alternative reference rates in various jurisdictions by 2022.	Does the current market disruption impact transition plans and timing to replace LIBOR/EONIA?	Stay abreast of regulators' guidance and market developments in the alternate reference rate markets, such as ECB and FSA.

Sources: Laura Noonan, Nicholas Mcgaw, and Primrose Riordan, "Banks seek trading rule guidance as coronavirus spreads," *Financial Times,* March 6, 2020; Alexandra Dimitrijevic and Paul F. Gruenwald, "Coronavirus casts shadow over credit outlook," S&P Global Ratings, February 11, 2020; Sinead Cruise and Lawrence White, "The end of Libor: the biggest banking challenge you've never heard of," *Reuters*, October 8, 2019.

General implications for banks and capital markets firms

Operational resilience			
Topic/issue	Current and potential developments	Relevant questions	Actions banks and capital markets firms should consider
COVID-19 crisis readiness	COVID-19 is disrupting the operations of many banks and capital markets firms	Has a comprehensive reassessment of exposure to the full vectors of threat been	Banks and capital markets firms should reexamine their crisis readiness, run tests, reexamine governance, and

	globally. Financial institutions have already taken a number of actions, but they may need to do more as the situation evolves.	done? How is the playbook for pandemics being updated as a result of unfolding events? What is the best way to determine the appropriate organizational response? How is the COVID-19 task force empowered?	streamline decision-making and communication approaches. Determine what constitutes a proportionate response and encourage decisive action. Playbooks already in place should be reviewed with necessary updates made to ensure organizational resilience. Activation and deactivation triggers should be determined and continuity procedures reviewed. The COVID-19 task force should be empowered to make decisions at both the global and local level, where applicable. The task force should be connected to and actively align its priorities with the CEO and board of directors. Ensure empathetic responses to employees' situations.
Communications and public disclosure	Communicating regularly with various stakeholders may continue to grow in importance.	How quickly can tailored communications be initiated with employees, customers, business partners, vendors, investors, regulators, etc., across offices, regions, and businesses, nationally, and internationally?	Appropriate communication mechanisms tailored to different audiences should be prepared and tested. FSA (Romanian Financial Supervisory Authority) encourages all the issuers to ensure the

			proper information of the shareholders in the next period and to facilitate them the possibility to vote in the general meetings of the shareholders through all the alternative communication systems regulated by the law (i.e. correspondence, electronic systems). Breaching the rights of the shareholders to participate or to vote in the general meetings of the shareholders may lead to the annulment of the decisions approved by these forums and even to sanctions applied by the regulator. Participate in financial system task force to make your voice heard, suggest mitigation actions to Local and European regulators. It is essential to ensure the proper information of the shareholders/investors concerning any inside information. Persons who have access to such information before getting public (e.g., members of the management bodies) must be aware that insider dealing is criminal offence and is punished with imprisonment. All the information disclosed must observe the legal criteria, in order to ensure the quality and the validity of

			this information, as well as the uniform information by using the well-known communication channels.
Monitoring and review	The evolving developments regarding COVID-19 call for institutions to be agile/flexible	Is scenario planning being done proactively? Are plans, policies, and procedures adaptive and flexible, and are they in line with national and local regulations and laws? Is there a clear governance mechanism in place if the pandemic worsens?	Consider testing preparedness using interactive, scalable crisis exercises. Actively monitor results and iterate as needed. Ensure that policies, procedures, and plans are in line with current local, state, and national laws, and any updates. ESMA (European Securities Markets Authority) advises all the EU financial market participants to be ready at any time to apply their business continuity plans for situation of crisis, including deployment of special measures if deemed necessary for ensuring the continuity and operation of their businesses. All the measures taken by the financial market participants must ensure operational continuity, in line with the existing regulatory obligations that apply to each participant.
Flex and remote work	As the situation continues to rapidly develop, alternate work	What flex and remote work policies are currently in place? For those with business models that preclude	Based on the most up-to-date information, whenever possible, consider instituting work-from-home or

	arrangements are being implemented to limit the spread of the illness and ensure employee safety.	remote work arrangements, have flexible or rotating schedules been considered? What are the risks associated with remote work? Do organizations have tools and solutions to implement remote work?	flexible/rotating schedules. Ensure that technology options are in place to connect employees working remotely without compromising access/data security.
Infrastructure/capacity	To enable flexible or remote work, organizations need to have the right infrastructure in place.	Is the necessary technical infrastructure in place to support alternate work arrangements, and how secure is it? Which existing tools could enable remote work collaboration?	Review infrastructure that is currently in place, such as VPN connections, security tokens, bandwidth, and laptops.
Quality of work/productivity and employee well-being	The spread of COVID-19 could result in further work disruptions and delays, as governments, public transportation agencies, and educational institutions adjust their practices and policies.	How can organizations ensure that the quality of work and productivity remain high? How can organizations ensure they are nimble enough to adjust workflows if work needs to be reprioritized? How can they modify plans to sustain employee engagement, well-being, and motivation?	Prioritize which projects, workflows, and deliverables matter most, and communicate these clearly to employees. Provide appropriate tools and employ relevant tactics to maintain quality of work/productivity
Offshore delivery centers	Many organizations have offshore delivery centers, from IT services to call centers.	How can firms ensure delivery from offshore centers with minimal disruption? Are there alternate/ secondary delivery options in case the offshore delivery center is compromised?	Maintain frequent communication with offshore delivery centers and develop appropriate contingency plans if they are not yet in place. Consider testing alternate work arrangements from

		What is the business continuity plan for offshore centers?	offshore delivery centers to determine if service performance is affected in any way. Find alternate venues for service delivery if a particular center experiences an operational disruption.
Global operations	Each market could experience varying levels of stress and disruption.	How efficiently can critical activities be rerouted to local offices around the world? How resilient are global entities/offices operationally?	Identify which operations and/or activities can be rerouted or sent to other global offices, or even third parties.
Digital/IT infrastructure	There may be increased demands on organizations' digital infrastructure to replace manual operations.	Are digital banking, payments, trading platforms, and other systems robust and resilient enough to handle disruption?	Consider testing and planning for alternate capacity to process and continue to deliver services whenever possible.
Legal matters	At any institution, legal contracts that deal with labor, clients, counterparties, and/or vendors, may be at risk.	Are there any work/projects/deliverables that are at risk of missing deadlines or not being fulfilled? What are the third-party and client implications?	Confirm if existing contracts include force majeure clauses. Contracts or statements of work should be revisited or amended, whenever possible.
Tax, financial, and regulatory compliance reporting	Looming deadlines for tax filings, financial reporting, and regulatory compliance reporting may be jeopardized due to	How would changes to operations and alternate work arrangements or reduced capacity affect tax filings, financial reporting, and regulatory compliance reporting? What are the tax implications from work	Be realistic about meeting deadlines. Proactively communicate with tax authorities and regulators, such as the FSA, NBR EBA, ESMA, ECB, Bank of England, and local tax authorities in

	operational disruptions. There may be tax implications as employees work remotely, potentially in different cities or states.	being done remotely? What would the potential losses be for tax-loss carry forwards?	Europe. From a reporting perspective, the EBA has advised national regulators to postpone non-essential supervisory activities, and to allow banks a certain flexibility with respect to the deadlines for certain areas of supervisory reporting - yet without jeopardizing access to material information allowing financial and prudential supervision. Gain an understanding of the tax implications. ESMA and FSA advise the market participants to perform an own evaluation concerning the existing or potential impact of COVID-19, based on both a qualitative and quantitative assessment, on their business activity and to publish a proper report in this regard.

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