PRUDENTIAL SOURCEBOOK FOR BANKS, BUILDING SOCIETIES AND INVESTMENT FIRMS (LIQUIDITY STANDARDS NO 2) AMENDMENT INSTRUMENT 2014

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (The PRA's general rules);
(2) section 137T (General supplementary powers); and
(3) section 138C (Evidential provisions).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority) ("FCA"), the PRA consulted the FCA. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

Amendments

D. The Prudential sourcebook of Bank, Building Societies and Investment Firms (BIPRU) is amended in accordance with the Annex to this instrument.

Commencement

E. The Annex to this instrument comes into force on 26 May 2014.

Citation

F. This instrument may be cited as the Prudential sourcebook of Bank, Building Societies and Investment Firms (Liquidity Standards No 2) Amendments Instrument 2014.

By order of the Board of the Prudential Regulation Authority

23 May 2014

Annex

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

12.3 ~~**Liquidity risk management**~~

12.3.1 ~~G~~ ~~The approach taken in *BIPRU* 12.3 is to set out:~~

~~(1)~~ ~~overarching systems and controls provisions in relation to a *firm's* management of its *liquidity risk*;~~

~~(2)~~ ~~provisions outlining the responsibilities of that *firm's governing body* and *senior managers* for the oversight of *liquidity risk*;~~

~~(3)~~ ~~more detailed provisions covering a number of specific areas, including:~~

~~(a)~~ ~~pricing *liquidity risk*;~~

~~(b)~~ ~~intra-day management of liquidity;~~

~~(c)~~ ~~management of collateral;~~

~~(d)~~ ~~management of liquidity across legal entities, business lines and currencies; and~~

~~(e)~~ ~~funding diversification and market access.~~

12.3.1A G The approach taken in *BIPRU* 12.3 is to set out:

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(2) provisions outlining the responsibilities of that *firm's governing body* and *senior managers* for the oversight of *liquidity risk*;

(3) more detailed provisions covering a number of specific areas, including:

(a) pricing *liquidity risk*;

(b) intra-day management of liquidity;

(c) management of collateral;

(d) management of liquidity across legal entities, business lines and currencies;

(e) funding diversification and market access; and

(f) asset encumbrance.

…

12.3.5A R The strategies, policies, process and systems referred to in *BIPRU* 12.3.4R must ensure that the risks associated with collateral management and asset encumbrance are adequately identified, monitored and managed.

…

12.3.8A R A *firm* must ensure that its *governing body* establishes that *firm's* approach to asset encumbrance and that this is appropriately documented.

…

12.3.12 ~~R~~ ~~A *firm* must ensure that its *senior managers*:~~

~~(1)~~ ~~continuously review that *firm's* liquidity position, including its compliance with the *overall liquidity adequacy rule*; and~~

~~(2)~~ ~~report to its *governing body* on a regular basis adequate information as to that *firm's* liquidity position and its compliance with the *overall liquidity adequacy rule* and with *BIPRU* 12.3.4R.~~

…

12.3.12A R A *firm* must ensure that its *senior managers*:

(1) continuously review that *firm's* liquidity position, including its compliance with the *overall liquidity adequacy rule*;

(2) report to its *governing body* on a regular basis adequate information as to that *firm's* liquidity position and its compliance with the *overall liquidity adequacy rule* and with *BIPRU* 12.3.4R; and

(3) continuously review that *firm's* asset encumbrance position in accordance with that *firm's* approach to asset encumbrance.

…

12.3.15 ~~R~~ ~~(1)~~ ~~In relation to all significant business activities, a *firm* should ensure that it accurately quantifies liquidity costs, benefits and risks and fully incorporates them into:~~

~~(a)~~ ~~product pricing;~~

~~(b)~~ ~~performance measurement and incentives; and~~

~~(c)~~ ~~the approval process for new products.~~

~~(2)~~ ~~For the purposes of (1), a *firm* should ensure that it:~~

~~(a)~~ ~~includes significant business activities whether or not they~~

~~are accounted for on-balance sheet; and~~

~~(b) carries out the exercise of quantification and incorporation both in normal financial conditions and under the stresses required by *BIPRU* 12.4.1R.~~

~~(3) A *firm* should ensure that the liquidity costs, benefits and risks are clearly and transparently attributed to business lines and are understood by business line management.~~

~~(4) Contravention of any of (1), (2) or (3) may be relied upon as tending to establish contravention of *BIPRU* 12.3.4R.~~

12.3.15A R (1) In relation to all significant business activities, a *firm* should ensure that it accurately quantifies liquidity costs, benefits and risks and fully incorporates them into:

(a) product pricing;

(b) performance measurement and incentives; and

(c) the approval process for new products.

(2) For the purposes of (1), a *firm* should ensure that it:

(a) includes significant business activities whether or not they are accounted for on-balance sheet; and

(b) carries out the exercise of quantification and incorporation both in normal financial conditions and under the stresses required by *BIPRU* 12.4.1AR.

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(4) Contravention of any of (1), (2) or (3) may be relied upon as tending to establish contravention of *BIPRU* 12.3.4R.

…

12.3.19 ~~R~~ ~~For the purposes of *BIPRU* 12.3.17R, a *firm* must ensure that:~~

~~(1) it is able to meet its payment and settlement obligations on a timely basis under both normal financial conditions and under the stresses required by *BIPRU* 12.4.1R; and~~

~~(2) its arrangements for the management of intra-day liquidity enable it to identify and prioritise the most time-critical payment and settlement obligations.~~

12.3.19A R For the purposes of *BIPRU* 12.3.17R, a *firm* must ensure that:

(1) it is able to meet its payment and settlement obligations on a timely basis under both normal financial conditions and under the stresses required by *BIPRU* 12.4.1AR; and

(2) its arrangements for the management of intra-day liquidity enable it to identify and prioritise the most time-critical payment and settlement obligations.

…

12.3.24 ~~G~~ ~~For the purposes of *BIPRU* 12.3.23R (8) and (9), a *firm* should take into account the impact of the stresses that it conducts under *BIPRU* 12.4.1R on the requirements which may be imposed on the provision of its assets as collateral (for example, haircuts) and also the availability of funds from private counterparties during such periods of stress.~~

12.3.24A G For the purposes of *BIPRU* 12.3.23R (8) and (9), a *firm* should take into account the impact of the stresses that it conducts under *BIPRU* 12.4.1AR on the requirements which may be imposed on the provision of its assets as collateral (for example, haircuts) and also the availability of funds from private counterparties during such periods of stress.

…

12.3.25 ~~E~~ ~~(1)~~ ~~A *firm* should ensure that its arrangements for the management of *liquidity risk*:~~

~~(a)~~ ~~enable it to monitor shifts between intra-day and overnight or term collateral usage;~~

~~(b)~~ ~~enable it to appropriately adjust its calculation of available collateral to account for assets that are part of a tied hedge;~~

~~(c)~~ ~~include adequate consideration of the potential for uncertainty around, or disruption to, intra-day asset flows; and~~

~~(d)~~ ~~take into account the potential for additional collateral requirements under the terms of contacts governing existing collateral positions (for example, as a result of a deterioration in its own credit rating).~~

~~(2)~~ ~~Contravention of any of (1)(a) to (d) may be relied upon as tending to establish contravention of *BIPRU* 12.3.4R.~~

12.3.25A E (1) A *firm* should ensure that its arrangements for the management of *liquidity risk*:

(a) enable it to monitor shifts between intra-day and overnight or term collateral usage;

(b) enable it to appropriately adjust its calculation of available collateral to account for assets that are part of a tied hedge;

(c) include adequate consideration of the potential for uncertainty around, or disruption to, intra-day asset flows; and

(d) take into account the potential for additional collateral requirements under the terms of contacts governing existing collateral positions (for example, as a result of a deterioration in its own credit rating) and the impact of these on its asset encumbrance position.

(2) Contravention of any of (1)(a) to (d) may be relied upon as tending to establish contravention of *BIPRU* 12.3.4R.

…

Asset encumbrance

12.3.33 R A *firm* must actively manage its asset encumbrance position.

12.3.34 R For the purposes of *BIPRU* 12.3.33R, a *firm* must ensure that:

(1) its policies take into account the *firm's* business model, the specificities of the funding markets and the macroeconomic situation; and

(2) its *governing body* receives timely information on:

(a) the level, evolution and types of asset encumbrance;

(b) the amount, evolution and credit quality of unencumbered but encumberable assets; and

(c) the amount, evolution and types of additional encumbrance resulting from stress scenarios (contingent encumbrance).

12.3.35 G Asset encumbrance occurs when assets are used to secure creditors' claims so that they are no longer available to general creditors in the event of a *firm*'s failure. The *PRA* considers that this is the case where an asset is, either explicitly or implicitly, pledged or subject to an arrangement to secure, collateralise or credit-enhance a transaction.

12.4 Stress testing and contingency funding

…

12.4.1 ~~R~~ ~~In order to ensure compliance with the *overall liquidity adequacy rule* and with *BIPRU* 12.3.4R and *BIPRU* 12.4.-1R, a *firm* must:~~

~~(1)~~ ~~conduct on a regular basis appropriate stress tests so as to:~~

~~(a)~~ ~~identify sources of potential liquidity strain;~~

~~(b)~~ ~~ensure that current liquidity exposures continue to conform to the *liquidity risk* tolerance established by that *firm's governing body*; and~~

~~(c)~~ ~~identify the effects on that *firm's* assumptions about pricing; and~~

~~(2)~~ ~~analyse the separate and combined impact of possible future liquidity stresses on its:~~

~~(a)~~ ~~cash flows;~~

~~(b)~~ ~~liquidity position;~~

~~(c)~~ ~~profitability; and~~

~~(d)~~ ~~solvency.~~

12.4.1A R In order to ensure compliance with the *overall liquidity adequacy rule* and with *BIPRU* 12.3.4R and *BIPRU* 12.4.-1R, a *firm* must:

(1) conduct on a regular basis appropriate stress tests so as to:

(a) identify sources of potential liquidity strain;

(b) ensure that current liquidity exposures continue to conform to the *liquidity risk* tolerance established by that *firm's governing body*; and

(c) identify the effects on that *firm's* assumptions about pricing; and

(d) identify contingent asset encumbrance; and

(2) analyse the separate and combined impact of possible future liquidity stresses on its:

(a) cash flows;

(b) liquidity position;

(c) profitability; and

(d) solvency.

12.4.1B G For the purpose of *BIPRU* 12.4.1AR(1)(d), the stress tests should take into account a range of different stress scenarios, including downgrades in the *firm's* credit rating, devaluation of pledged assets and increases in margin requirements.

…

12.4.12 ~~G~~ ~~A *contingency funding plan* sets out a *firm's* strategies for addressing liquidity shortfalls in emergency situations. Its aim should be to ensure that, in each of the stresses required by *BIPRU* 12.4.1R, it would still have sufficient liquidity resources to ensure that it can meet its liabilities as they fall due.~~

12.4.12A G A *contingency funding plan* sets out a *firm's* strategies for addressing liquidity shortfalls in emergency situations. Its aim should be to ensure that, in each of the stresses required by *BIPRU* 12.4.1AR, it would still have sufficient liquidity resources to ensure that it can meet its liabilities as they fall due.

~~12.4.13~~ ~~R~~ ~~A *firm* must ensure that its *contingency funding plan*:~~

~~(1) outlines strategies, policies and plans to manage a range of stresses;~~

~~(2) establishes a clear allocation of roles and clear lines of management responsibility;~~

~~(3) is formally documented;~~

~~(4) includes clear invocation and escalation procedures;~~

~~(5) is regularly tested and updated to ensure that it remains operationally robust;~~

~~(6) outlines how that *firm* will meet time-critical payments on an intra-day basis in circumstances where intra-day liquidity resources become scarce;~~

~~(7) outlines that *firm's* operational arrangements for managing a retail funding run;~~

~~(8) in relation to each of the sources of finding identified for use in emergency situations, is based on a sufficiently accurate assessment of:~~

~~(a) the amount of funding that can be raised from that source; and~~

~~(b) the time needed to raise funding from that source;~~

~~(9) is sufficiently robust to withstand simultaneous disruptions in a range of payment and settlement systems;~~

~~(10) outlines how that *firm* will manage both internal communications and those with its external stakeholders; and~~

~~(11) establishes mechanisms to ensure that the *firm's governing body* and senior managers receive management information that is both relevant and timely.~~

12.4.13A R A *firm* must ensure that its *contingency funding plan*:

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(a) the amount of funding that can be raised from that source; and

(b) the time needed to raise funding from that source;

(9) is sufficiently robust to withstand simultaneous disruptions in a range of payment and settlement systems;

(10) outlines how that *firm* will manage both internal communications and those with its external stakeholders;

(11) establishes mechanisms to ensure that the *firm's governing body* and senior managers receive management information that is both relevant and timely; and

(12) outlines strategies to address the contingent asset encumbrance resulting from the relevant stress events.

12.4.14 ~~E~~ ~~(1)~~ ~~In designing a *contingency funding plan* a *firm* should ensure that it takes into account:~~

~~(a)~~ ~~the impact of stressed market conditions on is ability to sell or securitise assets;~~

~~(b)~~ ~~the impact of extensive or complete loss of typically available market funding options;~~

~~(c)~~ ~~the financial, reputational and any other additional consequences for that firm arising from the execution of the contingency funding plan itself;~~

~~(d)~~ ~~its ability to transfer liquid assets having regard to any legal, regulatory or operational constraints; and~~

~~(e)~~ ~~its ability to raise additional funding from central bank market operations and liquidity facilities.~~

~~(2)~~ ~~Contravention of any of (1)(a) to (e) may be relied upon as tending to establish contravention of *BIPRU* 12.3.4R.~~

12.4.14A E (1) In designing a *contingency funding plan* a *firm* should ensure that it takes into account:

(a) the impact of stressed market conditions on is ability to sell or securitise assets;

(b) the impact of extensive or complete loss of typically available market funding options;

(c) the financial, reputational and any other additional consequences for that *firm* arising from the execution of the contingency funding plan itself;

(d) its ability to transfer liquid assets having regard to any legal, regulatory or operational constraints;

(e) its ability to raise additional funding from central bank market operations and liquidity facilities; and

(f) the impact of increased collateral requirements.

(2) Contravention of any of (1)(a) to (f) may be relied upon as tending to establish contravention of *BIPRU* 12.3.4R.

…

12.4.16	~~G~~	~~The *appropriate regulator* expects that a *firm's contingency funding plan* will encompass a range of actions that the *firm* might take in anticipation of or in response to changes in its funding position. These changes could result from either *firm*-specific or general developments. The *appropriate regulator* anticipates that different actions in a *contingency funding plan* would be taken at different stages of a developing situation.~~
12.4.16A	G	The *appropriate regulator* expects that a *firm's contingency funding plan* will encompass a range of actions that the *firm* might take in anticipation of or in response to changes in its funding position or asset encumbrance position. These changes could result from either *firm*-specific or general developments. The *appropriate regulator* anticipates that different actions in a *contingency funding plan* would be taken at different stages of a developing situation.