BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Publication

This is a draft Statement of Policy to accompany Consultation Paper 5/21 'Implementation of Basel standards'

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Liquidity and funding permissions

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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

Contents

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1 Introduction

1.1 This statement of policy (SoP) sets out the PRA's approach to granting selected regulatory permissions that are relevant to the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) requirements. It also sets out the PRA's expectation that eligible firms should notify the PRA if they intend to use the simplified NSFR (sNSFR) methodology. It is relevant to all UK banks, building societies and PRA-designated investment firms, referred to collectively as 'firms'.

2 General matters

2.1 In determining whether or not to grant a regulatory permission, the PRA would be exercising its powers under the Financial Services and Markets Act 2000 (FSMA), s. 144g or s. 192XC. This allows the PRA to disapply, or modify the application of, certain PRA rules in the Liquidity (CRR) and Liquidity Coverage Ratio (CRR) Parts of the PRA Rulebook upon the application, or with the consent of a firm. The PRA may give such permission subject to conditions. It also has power to revoke or vary a permission which has been issued.

2.2 The exercise of the PRA's permission power is discretionary. In exercising its discretion, the PRA will consider whether the conditions set out in relation to each of the permissions in PRA rules are satisfied, as well as the additional conditions relating to certain permissions which are set out in this SoP.

2.3 Although FSMA s. 144G and s. 192XC do not set out any additional general considerations for the exercise of the permission power, the PRA will consider whether granting a permission in any particular case would be consistent with its statutory objectives as set out in Part 1A, chapter 2 of FSMA, including the PRA's objectives in relation to ring-fencing.

2.4 The PRA will also consider whether granting the permission in a particular case may undermine any of the purposes for which the rule was made, including the matters set out in s. 144C of FSMA ('Matters to be considered when making CRR rules').

3 Ongoing expectation to notify the PRA of material information that is relevant to permissions

3.1 Unless otherwise stated, the conditions set out in PRA rules and in this SoP should be thought of as continuing conditions which firms need to satisfy on an ongoing basis. After the PRA has granted a permission, it expects that the firm promptly notifies it if it does not, or expects that it soon will not, continue to meet any of those conditions for as long as the permission remains effective.

3.2 The PRA further expects that firms promptly notify it of any material change in circumstances including anticipated changes in circumstances that might affect the PRA's continuing assessment of this permission. This includes changes to the factors reported by firms set out in this SoP that the PRA will consider when assessing permission applications.

3.3 These expectations are an elaboration of firms' obligations to inform the PRA of relevant information under the PRA Fundamental Rules.[1]

1 PRA Rulebook: Fundamental Rules Instrument 2014, 2.7.

3.4 The PRA may decide not to revoke or modify a permission that it has granted when it receives the notifications set out in paragraphs 3.1 to 3.3 above.

3.5 The expectations in paragraphs 3.1 and 3.2 do not apply to changes in matters set out in the following paragraphs of this SoP:

(i) paragraphs 4.2, 4.5 and 4.6 (information which applicants should provide in support of applications under Liquidity (CRR) Rule 2.2); and

(ii) paragraph 7.1 (information which firms should provide as part of pre-notifications to use the sNSFR methodology).

4 Liquidity (CRR) Rule 2.2: Liquidity sub-groups

4.1 The PRA may grant permissions under this rule where the following conditions are met:

(i) the parent institution on a consolidated basis or a subsidiary institution on a sub-consolidated basis complies with the obligations laid down in the Liquidity (CRR) and Liquidity Coverage Ratio (CRR) Parts of the PRA Rulebook;

(ii) the parent institution on a consolidated basis or the subsidiary institution on a sub-consolidated basis monitors has oversight at all times over the liquidity positions of all institutions within the group or sub-group, that are subject to the waiver and ensures a sufficient level of liquidity for all these institutions;

(iii) the institutions have entered into contracts that, to the satisfaction of the PRA, provide for the free movement of funds between them to ensure they are able to meet their individual and joint obligations as they become due;

(iv) the regulated entities which would comprise the domestic liquidity subgroup (DoLSub) are either:

(a) all defined as 'ring-fenced bodies' under FSMA, s. 142A; or

(b) all not defined as 'ring-fenced bodies' under FSMA.

4.2 Applicants should provide the PRA with the following information as part of their application for permission under this rule:

(i) names of the entities in the proposed DoLSub;

(ii) regulatory classification of the entities (ie credit institution; institution);

(iii) country of incorporation of the entities;

(iv) a group structure chart showing the position of the proposed DoLSub within the applicant's wider group;

(v) an explanation of the reason for the application and the intended outcome of the permission;

(vi) a list of all material affiliates not included in the DoLSub with an assessment of the liquidity risks posed to the DoLSub;

(vii) the name of the entity within which the treasury, liquidity, or funding management function for the DoLSub will sit;

(viii) a declaration from the applicant firm that the parent institution on a consolidated basis or a subsidiary institution on a sub-consolidated basis complies with the obligations laid down in the Liquidity (CRR) and Liquidity Coverage Ratio (CRR) Parts of the PRA Rulebook, in accordance with 4.1(i), above; and

(ix) full details and an explanation (including procedural documentation) of how DoLSub liquidity risks are managed, including:

(a) internal liquidity policy;

(b) details of the limits, methods and systems used to manage and monitor liquidity;

(c) a copy of the stress testing procedures and the results of carrying out those procedures; and

(d) a copy of the contingency funding plan(s) which relate to the entities which would comprise the DoLSub.

(x) full details and an explanation (including procedural documentation) of how DoLSub funding risks are managed, including:

(a) internal funding policy; and

(b) details of the limits, methods and systems used to manage and monitor funding risks.

(xi) where the firm is applying for a waiver of the LCR requirements:

(a) a completed LCR liquidity return on a sterling-equivalent basis for the solo institutions that would be in the DoLSub; and

(b) a completed LCR liquidity return on a sterling-equivalent basis for the proposed DoLSub.

(xii) where the firm is applying for a waiver of the NSFR requirements:

(a) a completed NSFR funding return on a sterling-equivalent basis for the solo institutions that would be in the DoLSub; and

(b) a completed NSFR funding return on a sterling-equivalent basis for the proposed DoLSub.

(xiii) legally binding, two-way (ie cross committed) multi-currency loan facilities between the institutions within the proposed DoLSub, such that funds would be able to flow freely between all those firms (firms should set out the firm of the facility);

(xiv) a declaration from the firms that there are no current or foreseen material, practical or legal impediments of the contracts referred to in bullet point (xiii);

(xv) a legal opinion (one for each jurisdiction in which a party to the loan facility agreement described in bullet point (xiii) is located) from a reputable third-party counsel with expertise in the relevant field dealing with the following matters:

(a) compliance of the loan facility agreement with all the stipulations set out in bullet point (xiii);

(b) parties' corporate standing;

(c) whether the obligations under the loan facility agreement are legal, valid, binding and enforceable (including any relevant conflicts of laws issues and corporate benefit issues);

(d) due execution (including whether the agreement was within the capacity and powers of the parties, duly authorised, with all necessary consents and approvals);

(e) whether the provision of the loan facility agreement, and exercise of the rights thereunder, would conflict with any applicable laws or regulations; and

(f) whether the loan facility agreement complies with all the stipulations and is enforceable in all relevant jurisdictions and under all relevant systems of law.

(xvi) whether the applicants are part of a core UK Group and thus exempt from large exposure limits and related restrictions on the flow of liquidity and funding;

(xvii) where the firm applies to include a Financial Conduct Authority (FCA)-regulated entity in a PRA DoLSub, additional information explaining in detail how the proposed arrangement is intended to work and how the proposed structure would address any potential risks or issues of complexity arising, including but not limited to:

(a) details of how the FCA-regulated entity's liquidity and/or funding risks are currently managed and how these arrangements would change under a DoLSub;

(b) how the proposed arrangement complies with the criteria set out in CRR Article 8;

(c) a cost-benefit analysis of the proposed inclusion of the FCA-regulated entity in the PRA DoLSub, including an analysis of how liquidity requirements for the entities would be affected; and

(d) a copy of the FCA-regulated entity's most recently Individual Liquidity Adequacy Assessment (ILAA), Individual Liquidity Systems Assessment (ILSA) or equivalent liquidity assessment.

4.3 In assessing firms' applications, the PRA may consider the following factors:

(i) whether all proposed DoLSub members are credit institutions as defined by the CRR;

(ii) whether all proposed DoLSub members are in the same UK consolidation;

(iii) whether there is a core UK group (or other full exemption for large exposure limits) in place;

(iv) whether the proposed DoLSub meets the PRA's ring-fencing policy;

(v) whether there is a material prudential benefit gained from the formation of the proposed DoLSub;

(vi) whether there is an unlimited, cross-currency, multilateral facility between all members of the proposed DoLSub;

(vii) whether liquidity and/or funding risks (as applicable) are managed on the basis of the proposed DoLSub;

(viii) whether there are material concerns about the management of liquidity and/or funding risks (as appropriate) at the DoLSub level, including its processes and procedures;

(ix) whether all applicable proposed DoLSub members are currently meeting their individual liquidity and/or funding requirements (as applicable); and

(x) the impact on the ability of the PRA to supervise entities under the DoLSub arrangement.

4.4 The PRA expects the loan agreement referred to in paragraph 4.2(xiii), above:

(i) is an enforceable contract for a two-way, unsecured, revolving loan facility, callable in all currencies that are significant in the businesses of the members of the prospective DoLSub. The obligation of each member institution to lend may be limited to its available liquidity resources. 'Available liquidity resources' means in this context:

(a) those of the lending entity's liquidity resources that comprise cleared, immediately accessible funds or those of its assets, rights, facilities or other resources that it, using its best efforts, is capable of converting to be cleared, immediately accessible funds such that they may be transferred to and received by the borrowing entity in accordance with paragraph 4.4(xiii)(a), below.

(b) This definition excludes (i) those of its liquidity resources that the lending entity has calculated it is likely will be needed to meet its liabilities to entities other than those in the prospective DoLSub falling due in the 24-hour period following receipt of a request to borrow from the borrowing entity; (ii) those of its liquidity resources that the lending entity has already agreed to lend to entities in the DoLSub other than the borrowing entity in the 24-hour period following receipt of a request to borrow from the borrowing entity; and (iii) such portion of its liquidity resources which, if lent, would cause the lending entity to become balance sheet insolvent in the same sense as in the Insolvency Act 1986, s. 123(2).

(ii) does not require the lending entity to lend if it reasonably believes that after making the loan, if made in full, it would expect to the extent approved in advance by the PRA to:

(a) be in breach of its capital resources requirement; or

(b) run a significant risk that it would not be able to pay its debts as they fall due.

(iii) requires the lending entity to notify the PRA promptly upon receipt of a request to make such a loan;

(iv) consists of liquidity support undertakings made between all members of the DoLSub, thereby creating a 'cat's cradle' configuration of commitments. Where an applicant firm considers that another type of arrangement is more appropriate (given its group structure), the burden lies on the applicant to show that the proposed structure poses no undue risk in comparison with the 'cat's cradle' arrangement. In particular, the applicant firm will need to demonstrate how available liquidity could be moved within the proposed DoLSub if, for whatever reason, the

primary lending entity (ie the 'hub') were to be unable to provide funding. In any event the entirety of the undertaking(s) comprising the loan facility agreement should be contained in a single document;

(v) contains no conditions on the availability of the loan facility to a borrowing entity, or on a drawdown by a borrowing entity, except that:

(a) the borrowing entity continues to be a member of the DoLSub; and

(b) the borrowing entity is solvent – meaning that no 'insolvent event' has occurred in respect of the borrowing entity. An 'insolvency event' occurs when: (i) an order (including a bank insolvency order or bank administration order as defined in the Banking Act 2009, s. 94 and s. 141, respectively) is made, or an effective resolution passed for the liquidation or winding-up of the relevant entity; or (ii) a receiver, administrator, trustee, bank liquidator, bank administrator, or other similar official shall be appointed in relation to the whole of the relevant entity.

(vi) is governed by English, Scottish or Northern Irish law;

(vii) contains a 'jurisdiction clause' providing that disputes arising from the agreement are to fall within the exclusive jurisdiction of the courts of the country of the governing law, save that the borrowing entity may choose the jurisdiction of the courts of the lending entity's country of incorporation or head office (if different);

(viii) contains an 'entire agreement' clause;

(ix) contains no terms that limit the enforceability of the agreement by reference to representations, warranties, conditions precedent or events of default (other than insolvency of the borrowing entity);

(x) contains no clause stipulating the recoverability of damages arising from an inability of the borrowing entity to repay, due to the non-provision of funds under the loan facility agreement, but should contain no liquidated damages or limitation clauses (ie no pre-estimates of, or limits on, damages recoverable for breach of the agreement);

(xi) contains a clause stating that:

(a) the purpose of the lending facility is to provide a borrowing entity with liquidity in a range of circumstances;

(b) the lending facility has been provide both to meet the funding needs of the borrowing entity and in connection with the Liquidity (CRR) 2.2 permission, which has enabled the borrowing and lending entities' DoLSub to fund itself on a more efficient basis;

(c) the facility may be drawn down by a borrowing entity either on its own initiative or in response to a request or requirement from the PRA; and

(d) the circumstances in which the facility may be used include those in which a borrowing entity is unable to access funding from other sources on normal market terms or at all, and that in such circumstances, damages will not be an adequate remedy for the lending entity's failure to lend money to the borrowing entity under the facility (ie for the lending entity's breach of the agreement).

(xii) contains a clause stating that all parties to the agreement recognise that the purposes of the agreement include the protection of consumers and wider market stability;

(xiii) contains clauses providing that:

(a) liquidity support should be provided by a lending entity to a borrowing entity as cash in cleared, immediately accessible funds within 24 hours of the borrowing entity requesting the loan – it should be provided by the end of the same business day if the borrowing entity makes a request before noon; otherwise it should be provided by noon the following business day; and

(b) the loaned funds may be used by the borrowing entity for its general corporate purposes.

(xiv) contains a clause providing that the following provisions apply in respect of a firm ceasing to be a party to the loan facility agreement:

(a) any member of the DoLSub may cease to be a party to the loan facility agreement upon giving no less than six months' notice to the other members of the DolSub; in such circumstances, the contractual relations between the other members of the DoLSub under the loan facility agreement will continue in force unaltered (formally, this may mean that the contract is varied in order to discharge the departing member of its obligations);

(b) when a member of the DoLSub gives notice of its intention to cease to be a party to the loan facility agreement, its obligation to repay any loan whose term extends beyond the date at which it will cease to be a party is accelerated so that the loan should be repaid by the date at which it will cease to be a party to the loan facility agreement;

(c) the outstanding borrowings of a member of the DoLSub under the loan facility agreement should be repaid by the time at which it ceases to be a party to the loan facility agreement;

(d) the loan facility agreement (whether in its original form or as varied) may not be terminated while being relied on for a Liquidity (CRR) Rule 2.2 permission to form a DoLSub;

(e) gives each member of the DoLSub the right to be released from its loan-making obligations to other members of the DoLSub under the loan facility agreement if the PRA revokes the Liquidity (CRR) 2.2 permission (though each member's existing repayment obligations would be unaffected); and

(f) specifies the rate of interest and any other charges to be levied by the lending entity (the rate of interest should be a market rate that would not inhibit use of the loan facility).

4.5 The PRA expects that the applicant firm has obtained a separate legal opinion (one for each jurisdiction in which a party to the loan facility agreement is located) from a reputable third-party counsel with expertise in the relevant field dealing with the following matters:

(i) compliance of the loan facility agreement with all the stipulations above;

(ii) parties' corporate standing;

(iii) whether the obligations are legal, valid, binding and enforceable (including any relevant conflicts of laws issues and corporate benefit issues);

(iv) due execution (including whether the agreement was within the capacity and powers of the parties, duly authorised, with all necessary consents and approvals); and

(v) whether the provision of the loan facility agreement, and exercise of the rights thereunder, would conflict with any applicable laws and regulations.

4.6 The PRA expects that the legal opinion should find that the loan facility agreement complies with all the stipulations and is enforceable in all relevant jurisdictions and under all relevant systems of law.

4.7 The PRA expects that the applicant will make reasonable efforts to keep under review any legal or regulatory changes that could affect the efficacy of the loan facility agreement, and that it will take all reasonable steps to amend the agreement in the light of any such changes in order to maintain the loan facility agreement's efficacy.

5 Liquidity (CRR) Article 428F: Interdependent assets and liabilities

5.1 The PRA will generally not grant permissions under this Article in cases where the firm applies on the basis of a liquidity consolidation group unless the entities that hold the asset and record the liability respective are either:

(i) both defined as 'ring-fenced bodies' or the subsidiaries or parents of ring-fenced bodies under FSMA, s.142A; or

(ii) both not defined as 'ring-fenced bodies' or the subsidiaries of ring-fenced bodies under FSMA.

5.2 When assessing firms' applications under this Article, the PRA will consider whether the proposed treatment might give rise to perverse incentives or unintended consequences which would be contrary to the PRA's statutory objectives. The PRA expects firms to provide particular assurances that this test is satisfied where the asset and/or liability in question is derivative.

6 Liquidity (CRR) Article 428H: Preferential treatment within a group

6.1 The PRA may grant permissions under this Article where the following conditions are met:

(i) there are reasons to expect that the liability or committed credit or liquidity facility received by the institution constitutes a more stable source of funding, or that the asset or committed credit or liquidity facility granted by the institution requires less stable funding over the one-year horizon of the net stable funding ratio than the same liability, asset or committed credit or liquidity facility granted by other counterparties; and

(ii) where the firm applies on the basis of the counterparty being another subsidiary of the same parent, the firm and the other relevant subsidiary are either:

  (a) both defined as 'ring-fenced bodies' or the subsidiaries or parents of ring-fenced bodies under FSMA, s. 142A; or

  (b) both not defined as 'ring-fenced bodies' or the subsidiaries of ring-fenced bodies under FSMA.

7 Liquidity (CRR) Article 428AI: Calculating simplified NSFR (sNSFR)

7.1 The PRA expects to receive the following information alongside firms' pre-notifications that they will calculate the sNSFR:

(i) evidence that the firm meets the definition of 'small and non-complex' in CRR Article 4(145);

(ii) confirmation that the firm expects to continue to meet the definition in bullet (i), above, for the foreseeable future;

(iii) evidence that the firm's sNSFR is at least 100%, and the basis on which the firm expects that it will continue to be at least 100% for the foreseeable future; and

(iv) assessment that the complexity of the firm's funding profile is such that the sNSFR is not an inappropriately simple methodology for the calculation of funding risks.

7.2 The PRA expects that firms which use the sNSFR methodology notify it promptly when the following occurs or is expected to occur:

(i) the firm no longer meets the definition of 'small and non-complex' in CRR Article 4(145);

(ii) the firm's sNSFR falls below 100%; or

(iii) the complexity of the firm's funding profile is such that the sNSFR is an inappropriately simple methodology for the calculation of funding risks.

8 Liquidity Coverage Ratio (CRR) Article 12(3): Permission to derogate in respect of Level 2B assets for reasons of religious observance

8.1 In respect of applications for permission under this Article, in determining whether the non-interest bearing assets are adequately liquid for the purposes of Article 12(3) paragraph 12(1), the PRA will consider at least the following factors:

(i) the available data in respect of their market liquidity, including trading volumes, observed bid-offer spreads, price volatility and price impact; and

(ii) other factors relevant to their liquidity, including the historical evidence of the breadth and depth of the market for those non-interest bearing assets, the number and diversity of market participants and the presence of a robust market infrastructure.

9 Liquidity Coverage Ratio (CRR) Article 17(4): Liquidity buffer composition requirements

9.1 The PRA may grant permission under this Article where exceptional circumstances exist which pose a systemic risk affecting the banking sector of the United Kingdom.

10 Liquidity Coverage Ratio (CRR) Article 29: Permission to apply lower LCR outflow rate to certain outflows within a group

10.1 The PRA may grant permission under this Article where the following conditions are met:

(i) there are reasons to expect a lower outflow even under a combined market and idiosyncratic stress of the provider; and

(ii) the applicant firm and the counterparty either:

(a) are both defined as 'ring-fenced bodies' or the subsidiaries or parents of ring-fenced bodies under FSMA, s. 142A; or

(b) are both not defined as 'ring-fenced bodies' or the subsidiaries of ring-fenced bodies under FSMA.

11 Liquidity Coverage Ratio (CRR) Article 33(3) and 33(4): Permission to exempt from cap on inflows or increase cap on inflows

11.1 In assessing whether a firm's business activities exhibit a low liquidity risk profile, the PRA may consider the following:

(i) the extent to which the timing of inflows matches the timing of outflows; and

(ii) the extent to which, at the individual level, the firm is financed by retail deposits.

12 Liquidity Coverage Ratio (CRR) Article 34: Permission to apply higher inflow rate to certain inflows within a group

12.1 The PRA may grant permission under this Article when the following conditions are met:

(i) there are reasons to expect a higher inflow even under a combined market and idiosyncratic stress of the provider; and

(ii) the applicant firm and the counterparty either:

(a) are both defined as 'ring-fenced bodies' or the subsidiaries or parents of ring-fenced bodies under FSMA, s. 142A; or

(b) are both not defined as 'ring-fenced bodies' or the subsidiaries of ring-fenced bodies under FSMA.