Consultation Paper

CP12/31*

Financial Services Authority

Removing the simplified ILAS BIPRU firm automatic scalar increase and other minor changes to BIPRU 12

November 2012

Financial Services Authority

Contents

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 8 December 2012.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2012/cp12-31-response.shtml.

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It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure.

A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

Abbreviations used in this paper

BIPRU	The Prudential sourcebook for Banks, Building Societies and Investment Firms
BoE	Bank of England
FPC	Financial Policy Committee
FSA	Financial Services Authority
ILAS	Individual Liquidity Adequacy Standards.
LCR	Liquidity Coverage Requirement
LAB	Liquid assets buffer
SUP	The Supervision manual
TP29	BIPRU transitional provision 29

1 Overview

Introduction

1.1 We propose to amend BIPRU Transitional Provision 29 (BIPRU TP29) – Liquid assets buffer scalar: simplified ILAS BIPRU firms – to remove the automatic increase to a 70% simplified buffer requirement, which is due to come into effect on 1 July 2013 and all subsequent scheduled increases.

1.2 The effect of this will be that simplified ILAS BIPRU firms will need to continue to maintain a liquid assets buffer (LAB) that is not less than 50% of the simplified buffer requirement. We propose to delete BIPRU TP29 from the Handbook and amend the simplified buffer requirement in BIPRU 12.6.9R to require a LAB at least equal to 50% of the current calculation.

1.3 BIPRU 12.7 sets out the criteria for assets that can be included in the liquid assets buffer. Currently high quality debt securities issued by a government or central bank and reserves in the form of sight deposits with a central bank are subject to restrictions in terms of the credit quality of the government or central bank and the currency denomination of the assets. We propose to add a new rule to BIPRU 12.7 so that similar credit quality and currency requirements apply to securities issued by a designated multilateral development bank.

1.4 We also propose to correct three drafting errors in the SUP 16 Annex 25 Guidance notes for data items in SUP 16 Annex 24R.

1.5 Given the need to implement the proposed change to the liquid assets buffer scalar for simplified ILAS BIPRU firms before the automatic increase takes effect on 1 July 2013 and the relatively minor nature of the other proposals, the consultation period for feedback on these proposals is one month.

2

Removing the simplified ILAS BIPRU firm automatic scalar increase

Background

2.1 In the current economic environment the costs of the FSA liquidity regime have been higher than thought when it was introduced in 2009. The Bank of England has also recently made additional contingent liquidity available. We now need to consider amending the BIPRU 12 regime to account for our assessment of the economic costs and the availability of this additional liquidity insurance by recalibrating individual firms' liquid assets buffer requirements.

2.2 No rule change is necessary to achieve this position for standard ILAS BIPRU firms because of the guidance status of their quantitative liquidity requirements and our intention not to increase, across the industry, the calibration of individual liquidity guidance for those firms. However, simplified ILAS BIPRU firms are subject to a specific calculation in determining their liquidity requirements, the calibration of which is specified in the transitional rules in BIPRU TP29. To achieve a similar outcome for those firms, we need to amend our rules.

2.3 BIPRU TP29 applies to simplified ILAS BIPRU firms between 1 December 2009 and 31 December 2015. It establishes a transitional period during which simplified ILAS BIPRU firms are required to increase their liquid assets buffers. Currently, simplified ILAS BIPRU firms are required to hold 50% of the simplified buffer requirement. This is due to increase to 70% of the simplified buffer requirement on 1 July 2013 and to 100% on 1 January 2016.

2.4 We therefore propose to amend the simplified buffer requirement and delete BIPRU TP29 to recognise these different circumstances and ensure that the calibration of the simplified buffer requirement remains consistent with the liquidity requirements of standard ILAS firms.

2.5 This consultation is consistent with the FSA press notice issued on 29 June 2012, which stated 'The FSA has also announced that, in the current conditions and in the light of the improved level of liquidity insurance to be provided by the Bank of England, it will adjust its guidance to certain banks on appropriate levels of liquid asset buffers.'

2.6 It is also in line with the recommendation of the interim Financial Policy Committee, which recommended at its June 2012 meeting that 'the FSA considers whether adjustments to micro-prudential liquidity guidance are appropriate, taking some account of this additional liquidity insurance'.

Proposal

2.7 Our proposal is that a simplified ILAS BIPRU firm must continue to ensure that its liquid assets buffer continues to be not less than 50% of the simplified buffer requirement and that the automatic increases set out in BIPRU TP29 are removed.

2.8 This approach requires BIPRU TP29 to be deleted entirely and the 50% requirement given effect through an amendment to the simplified buffer requirement calculation in BIPRU 12.6.9R(1). The mathematical terms of the calculation in BIPRU 12.6.17G will be amended accordingly by multiplying the simplified buffer requirement by 0.5.

2.9 It is not appropriate to continue with the existing transitional approach by extending the timeline to step up to 70%. Given the current conditions and the additional liquidity available from the Bank of England we are not in a position to determine when, or if, an increase in liquidity requirements will be appropriate. It is therefore not appropriate to continue a transitional regime.

2.10 This proposal will not alter the need for a firm to ensure that the overall liquidity adequacy requirement (BIPRU 12.2.1R) is still met. A firm will need to consider holding a buffer in excess of 50% of the simplified buffer requirement to comply with the overall liquidity adequacy rule. Any amount held in excess of the 50% simplified buffer requirement may include assets other than those required for the purpose of BIPRU 12.7.

Q1: Do you agree with the proposal to delete BIPRU TP29 and require simplified ILAS BIPRU firms to hold a liquid assets buffer of at least 50% of the current simplified buffer requirement?

3

Amendments to the BIPRU 12.7 liquid assets buffer eligibility restrictions

Background

3.1 BIPRU 12.7.2R establishes the types of assets firms may include in their liquid assets buffers:

- high quality debt securities issued by a government or central bank;
- securities issued by a designated multilateral development bank;
- reserves in the form of sight deposits with a central bank; and
- investments in designated money market funds (simplified ILAS BIPRU firms only).

3.2 In the case of high quality debt securities and reserves in the form of sight deposits, further restrictions are present in the rules relating to the credit quality of the government or central bank and to the currency denomination. Similar restrictions on investments in designated money market funds are implemented through the glossary definition of those funds.

3.3 However, such restrictions are not placed on the securities of designated multilateral development banks.

Proposal

3.4 We propose that, to ensure consistency of treatment and reduce confusion among firms, we will add a new rule so that restrictions similar to those that apply to government and central bank issued securities and central bank sight deposits, also apply to securities issued by designated multilateral development banks.

3.5 This means that securities issued by designated multilateral development banks may be included in the LAB if the designated multilateral development bank has been assessed by at least two eligible external credit assessment institutions (ECAI) as having a credit rating associated with credit quality step 1 of the assessment scale published by the FSA. Those securities must also be denominated in any of Canadian dollars, euros, Japanese yen, sterling, Swiss francs or United States dollars.

> **Q2:** Do you agree with the proposal to amend BIPRU 12.7 to extend credit quality and currency restrictions to securities issued by designated multilateral development banks?

4

Amendments to correct three drafting errors in the SUP 16 Annex 25 reporting guidance

Proposal

4.1 We propose to amend three cross-referencing errors currently present in the SUP 16 Annex 25 Guidance notes for data items in SUP 16 Annex 24R. Specifically, the cross-reference in data item FSA048 line 50 currently referring to line 70 will be amended to refer to line 71. The reference in data item FSA048 Part 2 referring to repos and reverse repos in lines 25-30 and 34 – 39 will be amended to correct 'or' to 'of'. Finally, the reference in data item FSA053 to report the analysis of lines 52 and 53 in data item FSA048 in line 6-9 of data item FSA053 will be amended to lines 6-10 of data item FSA053.

4.2 These amendments are intended to correct errors that have come to light during the course of our interaction with firms.

Q3: Do you agree with the proposal to correct these errors?

Annex 1
Cost benefit analysis

Removing the simplified ILAS BIPRU firm automatic scalar increase

1. The proposed amendment means that simplified ILAS firms will still be required to hold 50% of the simplified buffer requirement. This will help to avoid these firms being treated in an inconsistent manner compared to standard ILAS BIPRU firms.

2. The BIPRU 12 buffers of the simplified ILAS regime and their transitional path were calibrated to deliver a level of resilience to liquidity stress that was judged to be appropriate at the time. The additional contingent liquidity currently being made available to banks by the Bank of England reduces the case for buffers of this level. Also, in the current economic environment, the costs of the FSA liquidity regime are higher than thought when the rules were made. So we do not expect the proposed amendment to materially change the overall net benefits of the ILAS regime.

3. A potential risk is that firms will perceive the amendment to mean the maximum level of liquid assets they need to hold is 50% of the simplified buffer requirement, which is not the case. A firm will need to consider holding a buffer in excess of 50% of the simplified buffer requirement to comply with the overall liquidity adequacy rule. Any amount held in excess of the 50% simplified buffer requirement may include assets other than those required for the purpose of BIPRU 12.7.

4. Another potential risk is that the proposed amendment could leave simplified ILAS BIPRU firms with a large step up to meet the Liquidity Coverage Requirement (LCR) once these requirements are introduced as the standard through the EU Capital Requirements Regulation. This risk will be present where the LCR is calibrated higher than the amount required under a 50% simplified buffer requirement and with the differences in definition of liquid assets taken into account.

5. According to our liquidity reporting data items, most firms affected by the proposed change will benefit from not having to increase their LAB holding, and the great majority will not be exposed to a risk of having a very steep transition to the LCR.

6. There will be other minor costs associated with the proposal, including adjusting internal FSA systems.

Amendments to the BIPRU 12.7 liquid assets buffer eligibility restrictions

7. The benefits of the proposed change are from ensuring that only high-quality liquid assets are included in the liquidity buffer and that there is a consistent understanding and treatment in this area across the industry.

8. Policy Statement PS09/16 considered the cost and benefits of firms holding high-quality government bonds, central bank reserves and bonds issued by designated multi lateral development banks. The proposed amendment will ensure that the quality of the assets is as it was intended by the policy by making clear the credit quality and currency restrictions for the eligibility of these assets. If firms have been holding assets for the purpose of meeting their ILG that do not satisfy these restrictions, these firms will face costs to replacing these assets. Benefits arise from preventing firms from holding low quality assets in the LAB. We do not believe any of the designated multilateral development banks will cease to be eligible as a result of these changes.

9. We do not expect any significant changes in costs and benefits from the proposals considered within the cost benefit analysis in PS09/16.

Amendments to correct three drafting errors in the SUP 16 Annex 25 reporting guidance

10. These are minor corrections and are not expected to materially impact firms or the reports they submit.

Annex 2
Compatibility statement

Compatibility with the FSA's general duties

1. In Chapter 14 of PS09/16, we set out our view that the liquidity reporting regime is compatible with our statutory objectives and the principles of good regulation.

2. The proposed amendments in this Consultation Paper are driven by feedback from firms and other industry participants, as well as internal FSA analysis. The policy intention has not changed from that set out in PS09/16.

3. The amendments we are consulting on are intended to help ensure consistent treatment of simplified and standard ILAS BIPRU firms and help us deliver PS09/16 to meet our statutory objectives of market confidence and consumer protection. We have considered the principles of good regulation and, in particular, that a burden or restriction should be proportionate to the benefits. We have also looked at the need to use our resources in the most efficient and economic way, and taken into account the international character of financial services and markets and the desirability of maintaining the competitive position in the UK. We are satisfied that these proposals are compatible with our general duties under section 2 of FSMA.

Annex 3

List of questions

Q1: Do you agree with the proposal to delete BIPRU TP29 and require simplified ILAS BIPRU firms to hold a liquid assets buffer of at least 50% of the current simplified buffer requirement?

Q2: Do you agree with the proposal to amend BIPRU 12.7 to extend credit quality and currency restrictions to securities issued by designated multilateral development banks?

Q3: Do you agree with the proposal to correct these errors?

Appendix 1

Draft Handbook text

Appendix

LIQUIDITY STANDARDS (MISCELLANEOUS AMENDMENTS NO 7) INSTRUMENT 2012

Powers exercised

A. The Financial Services Authority 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 138 (General rule-making power);
(2) section 156 (General supplementary powers); and
(3) section 157(1) (Guidance).

B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. The Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) is amended in accordance with Annex A to this instrument.

E. The Supervision manual (SUP) is amended in accordance with Annex B to this instrument.

Citation

F. This instrument may be cited as the Liquidity Standards (Miscellaneous Amendments No 7) Instrument 2012.

By order of the Board
[*date*]

Annex A

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.

12.6 Simplified ILAS

…

12.6.9 R (1) A *simplified ILAS BIPRU firm* must ensure that the size of its liquid assets buffer is at all times greater than or equal to 50% of the amount produced by adding:

…

…

…

12.6.17 G In mathematical terms the calculation *BIPRU* 12.6.9R and *BIPRU* 12.6.16R may be represented as follows:

Liquidity Buffer ≥ (Wholesale net cash outflow component + Retail deposit component + Credit pipeline Component) x 0.5
…

…

12.7 Liquid assets buffer

…

12.7.6A R For the purpose of *BIPRU* 12.7.2R(2), a *firm* may not include securities issued by a *designated multilateral development bank* unless:

(1) the *designated multilateral development bank* in question has been assessed by at least two *eligible ECAIs* as having a credit rating associated with *credit quality step* 1 in the *credit quality assessment scale* published by the *FSA* for the purpose of *BIPRU* 3 (The Standardised Approach: mapping of the ECAIs' credit assessments to credit quality steps (Long term mapping)); and

(2) those securities are denominated in any of Canadian dollars, euros, Japanese yen, sterling, Swiss francs or United States dollars.

…

TP 29 Liquid assets buffer scalar: simplified ILAS BIPRU firms

Application

29.1 R ~~BIPRU TP 29 applies to a simplified ILAS BIPRU firm.~~

[deleted]

Duration of transitional provisions

29.2 R ~~BIPRU TP 29 applies from 1 December 2009 until 31 December 2015.~~

[deleted]

Transitional provisions

29.3 R ~~A simplified ILAS BIPRU firm falling into BIPRU TP 29.1 must ensure that:~~

[deleted]

(1) ~~at all times between 1 October 2010 and, 29 February 2012, its liquid assets buffer is no less than 30% of the amount of its simplified buffer requirement;~~

[deleted]

(2) ~~at all times between 1 March 2012and 30 June 2013, its liquid assets buffer is no less than 50% of its simplified buffer requirement; and~~

[deleted]

(3) ~~at all times between 1 July 2013 and 31 December 2015, its liquid assets buffer is no less than 70% of its simplified buffer requirement.~~

[deleted]

29.4 G ~~The effect of BIPRU TP 29.3 is that a firm that is a simplified ILAS BIPRU firm has a transitional period until 31 December 2015 to build up its liquid assets buffer so that at the end of that period it holds in its buffer assets equal to 100% of its simplified buffer requirement.~~

[deleted]

29.5 G ~~In relation to a firm which becomes a simplified ILAS BIPRU firm after 25 March 2011, the FSA will consider as part of that firm's simplified ILAS waiver application how to apply the scalar approach described in BIPRU TP 29.3 to the firm in question. The FSA will incorporate the scalar into the terms of the firm's simplified ILAS waiver.~~

[deleted]

…

Annex B

Amendments to the Supervision manual (SUP)

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

16 Annex 25G Guidance notes for data items in SUP 16 Annex 24R

…

FSA048 – Enhanced mismatch report

…

Part 2 Security, transferable whole-loan and commodity flows

…

In the case ~~or~~ <u>of</u> reverse repos and repos corresponding cash outflows and inflows should be reported in lines 25 to 30 and lines 34 to 39 as appropriate.

…

50 Conditional liabilities pre-trigger contractual profile

…

In addition to reporting in this line, a *firm* should further breakdown the liabilities where those triggers are dependent on its credit rating, in the appropriate *data element* on line ~~70~~ <u>71</u>.

…

FSA053 Retail, SME and Large Enterprises Type B Funding

…

Part 2 SME and large enterprises Type B

A *firm* should report information related to the SME and Large financial Enterprise (Type B) accounts reported in lines 52 and 53 of FSA 048 in rows 6 to ~~9~~ <u>10</u>.

…

Appendix 2

Designation of Handbook provisions

1. FSA Handbook provisions will be 'designated' to create a FCA Handbook and a PRA Handbook on the date that the regulators exercise their legal powers to do so. Please visit our website[1] for further details about this process.

2. We plan to designate the Handbook Provisions we are proposing to create and/or amend within this Consultation Paper as follows. These designations are draft and are subject to change prior to the new regulators exercising their legal powers.

Handbook Provision	Designation
BIPRU 12.6.9R	FCA and PRA
BIPRU 12.7.6AR	FCA and PRA
BIPRU 12.6.17G	FCA and PRA
BIPRU TP 29	FCA and PRA
16 Annex 25G	FCA and PRA

1 One-minute guide http://media.fsahandbook.info/latestNews/One-minute%20guide.pdf

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