Financial Services Authority

The FSA's BIPRU 12 liquidity regime and non-ILAS BIPRU firms

– Guidance Consultation

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The FSA's BIPRU 12 liquidity regime and non-ILAS BIPRU firms

Introduction

1. This communication is intended for firms that will be non-ILAS BIPRU firms under our new liquidity regime. It provides:
   - an overview of our liquidity regime;
   - the scope and application of our liquidity regime;
   - the BIPRU 12 systems and controls requirements;
   - the BIPRU 12 quantitative requirements (including intra-group liquidity modifications); and
   - the liquidity reporting requirements.

2. For the detailed rules and guidance for our liquidity regime, firms should refer to our Handbook (http://www.fsa.gov.uk/Pages/handbook/index.shtml).

Overview of our liquidity regime

3. The policy for our new liquidity regime is set out in PS09/16.[1] It came into force on 1 December 2009 and is being 'switched on' through a phased basis by class of firm. The systems and controls requirements commenced from 1 December 2009[2]; and the new quantitative and reporting requirements will be switched on during 2010.

4. There are five key strands to our new liquidity regime:

   - **Adequate liquidity and self-sufficiency (BIPRU 12.2)**: This policy is based on two high-level principles that apply to both ILAS BIPRU firms and non-ILAS BIPRU firms: (i) all FSA-regulated entities must have adequate liquidity; and (ii) they must not depend on other parts of their group to survive liquidity stresses, unless permitted to do so by the FSA.

   - **Systems and controls requirements (BIPRU 12.3 and 12.4)**: The requirements are relevant to ILAS BIPRU firms and non-ILAS BIPRU firms. Applying the requirements across all firms is intended to ensure that they consider their susceptibility to liquidity risk, and implement systems and controls that adequately mitigate the risk in a way that is proportionate to its nature, size and complexity.

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[1] PS09/16 Policy Statement - Strengthening liquidity standards (October 2009) http://www.fsa.gov.uk/pages/Library/Policy/Policy2009/09_16.shtml.

[2] 1 November 2010 for branches of non-UK banks which hold a Global Liquidity Concession (as provided by IPRU Bank Chapter LM). A GLC is not available under BIPRU 12.

- **Quantitative requirements**: The framework is based on firms being able to survive liquidity stresses of varying magnitude and duration. Quantitative standards will not prevent all firm failures, but will help to ensure that firms are better positioned when a crisis occurs. The quantitative requirements placed on ILAS BIPRU firms (including banks, building societies and larger full scope BIPRU investment firms[3]) are more prescriptive and intrusive compared to those placed on non-ILAS BIPRU firms.

    - **Non-ILAS BIPRU firms** will be required to comply with BIPRU 12.2, which includes the overall liquidity adequacy rule (BIPRU 12.2.1 R) and, where relevant, the modifications in BIPRU 12.8. Our Handbook does not prescribe what can count towards the liquidity resources of non-ILAS BIPRU firms. (The requirements set out in BIPRU 12.5 to 12.7, BIPRU 12.9, the Individual Liquidity Adequacy Assessment (ILAA), the Individual Liquidity Systems Assessment (ILSA), the Supervisory Liquidity Review Process (SLRP) and Individual Liquidity Guidance (ILG) processes do not apply to non-ILAS BIPRU firms.)

    - **ILAS BIPRU firms** will be required to comply with BIPRU 12.2, which includes the overall liquidity adequacy rule (BIPRU 12.2.1 R), and the detailed quantitative requirements (BIPRU 12.5 to 12.9). These firms must assess the adequacy of their liquidity resources by undertaking an ILAA.[4] Among other things, the ILAA must include an assessment of firms' compliance with the systems and controls requirements – including the results of the stress tests required by the rules in BIPRU 12.4 – and the stress testing and related requirements set out in BIPRU 12.5. These firms must ensure that their liquidity resources contain an adequate buffer of high quality, unencumbered assets. The nature of the assets eligible for inclusion in the liquid assets buffer of these firms is prescribed by BIPRU 12.7.[5] We will review a firm's ILAA as part of the SLRP, the adequacy of a firm's liquidity resources on a case-by-case basis and the amount of liquidity resources judged as adequate in a firm's ILG. BIPRU 12.9 provides guidance on individual liquidity guidance and regulatory intervention points for ILAS BIPRU firms.

- **Group-wide and cross-border management of liquidity (BIPRU 12.8)**: ILAS BIPRU firms and non-ILAS BIPRU firms through the waivers and modifications process may apply to deviate from the self-sufficiency requirement where this is assessed as appropriate and would not result in undue risk to consumers and other persons whom the rules in question are intended to protect.

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[3] Exempt full scope BIPRU investment firms will be non-ILAS BIPRU firms (BIPRU 12.1.4 R).

[4] Simplified ILAS BIPRU firms are required to prepare an ILSA (BIPRU 12.6).

[5] The rules in BIPRU 12.7 provide that some types of assets are eligible for use only by a simplified ILAS BIPRU firm.

- **Reporting**: The liquidity reporting framework applicable to ILAS BIPRU firms enables us to collect granular, standardised liquidity data (at an appropriate frequency) so that we can form firm specific, sector and market-wide views on liquidity risk exposures. Non-ILAS BIPRU firms are not required to supply detailed liquidity data and they are required to complete only an annual FSA055 (systems and controls questionnaire).

Scope and application of our liquidity regime

Does my firm have to comply with the new liquidity regime?

5. Banks, building societies, branches of non-UK banks and certain investment firms are all within the scope of our BIPRU 12 liquidity regime (BIPRU 12.1.1 R). In the case of investment firms, the BIPRU 12 liquidity regime applies to:
   - full-scope BIPRU investment firms;
   - BIPRU limited licence firms; and
   - BIPRU limited activity firms.

Is my firm a non-ILAS BIPRU firm?

6. All the following firms are non-ILAS BIPRU firms[6]:
   - an exempt full-scope BIPRU investment firm (BIPRU 12.1.4 R);
   - a BIPRU limited-licence firm (see Glossary definition);
   - a BIPRU limited-activity firm (see Glossary definition); and
   - an exempt BIPRU commodities firm (see Glossary definition).

My firm is a full-scope BIPRU investment firm. How do I work out if it is an ILAS BIPRU firm or a non-ILAS BIPRU firm?

Step 1

7. Has your firm taken up the exemption provided by BIPRU TP15.6 R? (Exemption for a BIPRU firm whose main business relates to commodities.[7])

8. If it has the firm will be an exempt BIPRU commodities firm. All such firms are non-ILAS BIPRU firms irrespective of their balance sheet size. Step 2 does not apply.

9. If it has not the firm will not be an exempt BIPRU commodities firm and you need to consider Step 2.

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[6] See the Glossary definitions for an ILAS BIPRU firm and a non-ILAS BIPRU firm.

[7] The European Commission has extended the deadline for the exemptions provided to specialist commodity firms by Articles 45 and 48 of CAD to the end of 2014. The FSA implemented the articles at BIPRU TP 15 and 16 and consulted on the extension of the deadlines for the exemptions within CP09/29.

Step 2

10. Refer to the test in BIPRU 12.1.4 (1) R ('An exempt full scope BIPRU investment is a full scope BIPRU investment firm that at all times has total net assets which are less than or equal to £50 million').

11. To calculate the total net assets figure you will need to follow the approach described in BIPRU 12.1.4 (2) and (3) R. BIPRU 12.1.5 G provides guidance on the relevant cell entries in FSA001.

12. If your firm can comply at all times with the test in BIPRU 12.1.4 R it will be an exempt full scope BIPRU investment firm. All such firms are non-ILAS BIPRU firms.

13. If your firm cannot comply at all times with the test in BIPRU 12.1.4 R it will be an ILAS BIPRU firm.

BIPRU 12 Systems and controls requirements – non-ILAS BIPRU firms

14. The new systems and controls requirements (BIPRU 12.3 and 12.4) apply with certain exceptions[8] to non-ILAS BIPRU firms from 1 December 2009.

15. BIPRU 12.3 and 12.4 include a number of provisions that implement the Banking Consolidation Directive (BCD) Annex V (liquidity risk management provisions), including the amendments resulting from the implementation of CRD 2 (Directive 2000/111/EC).

16. The BIPRU 12.3 and 12.4 requirements include:

    - BIPRU 12.3: This sets out overarching systems and controls requirements in relation to: a firm's management of its liquidity risk; provisions outlining the responsibilities of that firm's governing body and senior managers for the oversight of liquidity risk; and more detailed provisions covering a number of specific risk areas.

    - BIPRU 12.4: Firms' strategies, policies, processes and systems, contingency funding plans, etc, should be sufficiently robust to enable firms to assess and maintain adequate amounts, types and distribution of liquidity resources on an ongoing basis. Firms should undertake stress testing to ensure their compliance with the overall liquidity adequacy rule. Firms should consider their liquidity risks and the events that might trigger them and implement systems and controls that mitigate that risk. The outcomes of the BIPRU 12.4 stress tests and contingency funding planning will be relevant to firms' compliance with the overall liquidity adequacy rule.

[8] There are some provisions contained within BIPRU 12.3 and 12.4 which apply only to an ILAS BIPRU firm. Where this is the case, the provision in question says so.

17. In applying the BIPRU 12 systems and controls requirements, firms should consider how the rules and guidance apply in relation to their business model and activities, so they can ensure their implementation of the requirements is proportionate to the nature, size and complexity of their particular liquidity risks.

18. Although liquidity risk management is particularly important for firms that engage in maturity transformation – such as banks and building societies – liquidity risk will be present in all firms, including within non-ILAS BIPRU firms. Applying BIPRU 12 systems and controls requirements across all firms (ILAS BIPRU firms and non-ILAS BIPRU firms) is intended to ensure that they consider their susceptibility to liquidity risk, and implement systems and controls that adequately mitigate the risk in a way that is proportionate to its nature, size and complexity.

19. We regard the new BIPRU 12.3 and 12.4 requirements as building on existing requirements. For example, before December 2009, BIPRU firms were required to comply with SYSC 11, which contained systems and controls requirements for liquidity risk. Under the ICAAP[9], BIPRU firms were required to regularly assess the adequacy of their internal capital to cover all the risks they are exposed to, within the context of the overall risk management framework. The approach includes the requirement that firms should: identify major sources of risk to their ability to meet their liabilities as they fall due; conduct stress and scenario tests; and ensure that the processes, strategies and systems required by the overall Pillar 2 rule and used in the ICAAP are both comprehensive and proportionate to the nature, scale and complexity of their activities.

BIPRU 12 Quantitative requirements (including intra-group liquidity modifications)

Which BIPRU 12 quantitative requirements apply to non-ILAS BIPRU firms? When do they 'switch on' for non-ILAS BIPRU firms?

20. The new liquidity regime began on 1 December 2009. At that time a transitional period[10] came into effect so that the new BIPRU 12 quantitative requirements will be 'switched on' for different classes of firm on a phased basis during the course of 2010.

21. In the case of non-ILAS BIPRU firms:

From 1 December 2009 to 31 October 2010:

- non-ILAS BIPRU firms (where applicable) remained subject to their predecessor quantitative and reporting requirements for liquidity; and
- the adequate financial resources rule (GENPRU 1.2.26R – as provided by BIPRU TP 27) applied in place of the overall liquidity adequacy rule (BIPRU

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[9] ICAAP – Internal Capital Adequacy Assessment Process (BIPRU 2.2)

[10] BIPRU TP26

12.2.1 R). This meant that the self-sufficiency requirement did not apply to non-ILAS BIPRU firms in the period up to 31 October 2010.

From 1 November 2010:

- Non-ILAS BIPRU firms will be required to comply with the requirements set out in BIPRU 12.2 (adequacy of liquidity resources). This means that the overall liquidity adequacy rule (BIPRU 12.2.1 R), including the self-sufficiency requirement, will apply to non-ILAS BIPRU firms from 1 November 2010. Our Handbook does not prescribe what can count towards the liquidity resources of these firms (see later notes on this point).

- Where relevant, non-ILAS BIPRU firms will need to comply with BIPRU 12.8 (cross border and intra-group management of liquidity). From 1 November 2010, a non-ILAS BIPRU firm that wishes to rely on liquidity support provided by other entities in its group must be in possession of an intra-group liquidity modification.

- The requirements set out in BIPRU 12.5 to 12.7, BIPRU 12.9 and the ILAA/ILSA, SLRP and ILG processes do not apply to non-ILAS BIPRU firms.

What do 'liquidity resources' and 'self sufficiency' mean for a non-ILAS BIPRU firm?

22. The overall liquidity adequacy rule (BIPRU 12.2.1 R) applies to ILAS BIPRU firms and non-ILAS BIPRU firms. In the case of non-ILAS BIPRU firms, this rule begins on 1 November 2010.

23. The overall liquidity adequacy rule comprises two parts:

- A firm must at all times maintain liquidity resources that are adequate, in both amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due (BIPRU 12.2.1 (1) R).

- Self-sufficiency requirement (BIPRU 12.2.1 (2a – c) R).

Liquidity resources and non-ILAS BIPRU firms

24. Our Handbook does not prescribe what can count towards the liquidity resources of a non-ILAS BIPRU firm. A non-ILAS BIPRU firm must assess for itself what 'liquidity resources' means in its set of circumstances.

25. BIPRU 12.2.5 G provides some guidance on 'liquidity resources' for the purposes of the overall liquidity adequacy rule, including that, when assessing the adequacy of its liquidity resources, a firm should have regard to the overall character of the resources available that enable it to meet its liabilities as they fall due. The guidance goes on to say that a firm should ensure that:

(i) it holds sufficient assets which are marketable or otherwise realisable;

(ii) it is able to generate funds from those assets in a timely manner;

(iii) it maintains a prudent funding profile in which its assets are of appropriate maturities, taking account of the expected timing of the firm's liabilities; and

(iv) (if appropriate) it is able to generate unsecured funding of appropriate tenor in a timely manner.

26. There is potential for a wide range of assets to be considered as part of a non-ILAS BIPRU firm's liquidity resources. The items will need to be converted into funds on a sufficiently timely basis so that the funds are available to pay the firm's liabilities as they fall due. Potential examples (non-exhaustive list) include:

- On-balance sheet assets (e.g. securities, equities, cash balances and other assets the firm assesses that it could convert into cash).

- In the case of a non-ILAS BIPRU firm that has physical commodity holdings, it may be possible for these to be included within its consideration of liquidity resources. Factors to support their inclusion would include that legal title for the physical commodity would need to have passed to the firm and there would need to be a 'deep and liquid market' for the commodity in question. Firms should also consider the potential impact of liquidating assets (for example, on a firm's franchise and its ongoing solvency).

- Additionally, non-ILAS BIPRU firms may also be able to include some off-balance sheet assets from other members of its group – in this case the non-ILAS BIPRU firm must have an intra-group modification in place. We would expect firms to differentiate between contingent non-committed inflows and committed inflows obtained from members of the firm's group. This is important as contingent/non-committed inflows will not qualify for inclusion in the recipient firm's liquidity resources until actually allocated or received by the firm. We would also expect a firm to be able to identify its 'business as usual' fees or transactional flows.

Self-sufficiency and non-ILAS BIPRU firms

27. The starting point of the BIPRU 12 liquidity regime is a presumption that every branch or firm, including a non-ILAS BIPRU firm, must be self-sufficient in terms of its own liquidity adequacy.

28. The intention of the liquidity regime is that each firm (including non-ILAS BIPRU firms) as a solo legal entity should have sufficient resilience provided by its own resources and arrangements to be able to survive liquidity stresses of varying magnitude and duration. Regulation at the entity level is important – in times of difficulty, liquidity believed to be available to the whole group can be hoarded by the parent or seized by local authorities. The liquidity regime is intended to ensure each entity has sufficient liquidity to meet its operational needs.

29. Intra-group receivables which belong to and are under the control of a non-ILAS BIPRU firm can count towards its liquidity resources and the self- sufficiency requirement. This is the case even if the funds are held in (say) another group entity,

such as a centralised treasury management. The key point would be that the funds legally belong to the non-ILAS BIPRU firm. In such a case the firm would not require an intra-group modification to recognise these liquidity resources. Similarly, the use of group-wide systems and controls in this manner does not require a modification, but they must deliver solo compliance for the non-ILAS BIPRU firm.

30. 'Self-sufficiency' does not mean that a non-ILAS BIPRU firm can never recognise liquidity resources made available to it from elsewhere in the group. The key consideration is that the liquidity resources in question must legally belong to the non-ILAS BIPRU firm and not simply be potentially available. Where a non-ILAS BIPRU firm wishes to rely on liquidity support provided by other entities in its group, it will need to obtain an intra-group liquidity modification.

31. In practice, we expect that a number of firms (both ILAS BIPRU firms and non-ILAS BIPRU firms) will apply for modifications of the self-sufficiency requirements such that they can rely on liquidity support provided by other entities in their group. The intra-group liquidity modification process provides us with the opportunity to consider the arrangements and the level of risk it poses and to 'register' the fact of the reliance of a firm on another entity within its group.

My firm is a non-ILAS BIPRU firm. How do I know if it needs an intra-group liquidity modification? What do I need to do?

32. We recognise that there are circumstances in which it may be appropriate for a firm, including a non-ILAS BIPRU firm, to rely on liquidity support provided by related entities within its group. If a non-ILAS BIPRU firm wishes this to apply in its case it will need to apply to the FSA for an intra-group liquidity modification.

33. To work out if a non-ILAS BIPRU firm requires an intra-group liquidity modification, it may be helpful for it to consider the following steps:

Step 1 – Firm to identify its liquidity resources.

Step 2 – Firm to consider the range of liquidity risks that it is subject to and perform stress tests in line with BIPRU 12.4.

Step 3 – Firm to consider its liquidity position for the stress tests performed.

Step 4 – If the firm can comply with the overall liquidity adequacy rule without seeking funding from another group entity or entities in addition to its own liquidity resources, it will not need additional funding and will not require an intra-group liquidity modification.

Step 5 – If the firm's own liquidity resources are insufficient to survive the stress tests, it will need to review its liquidity arrangements to bring them into compliance with the overall liquidity adequacy rule. The exact nature of these amendments will depend on the individual firm's circumstances. For example, a firm may seek to increase the level of committed funding or replace contingent funding arrangements with committed funding arrangements.

Step 6 – Where additional funding cannot be provided – so the non-ILAS BIPRU firm isn't able to comply with the overall liquidity adequacy rule on a self-sufficient basis – the firm will need to consider applying for an intra-group liquidity modification (BIPRU 12.8).

What information do we need to support a non-ILAS BIPRU firm's application for an intra-group liquidity modification?

34. An intra-group liquidity modification is our process for granting and maintaining modifications of the self-sufficiency requirement. When considering an application from a non-ILAS BIPRU firm for an intra-group liquidity modification to rely on other group members in meeting the overall liquidity adequacy rule, we will need to be satisfied that the statutory tests under the Financial Services and Markets Act 2000 (FSMA), section 148 are met including the 'undue risk' limb.

35. A non-ILAS BIPRU firm that requires an intra-group liquidity modification should supply the following:

- A completed modification application form. The firm will be applying to modify the overall liquidity adequacy rule (BIPRU 12.2.1R) so that it is permitted to rely on liquidity support from within its group to enable it to meet its obligations under BIPRU 12 as they apply to the firm. As for any other modification application, the completed application form will need to include arguments to evidence how the statutory tests have been met.

- Information in support of the application. A letter from the firm's parent, addressed to FSA, which includes the unqualified statement '.....We will ensure our subsidiary [……insert name of firm……] will have sufficient liquidity resources to enable it to meet its obligations under BIPRU 12 as it applies to the firm'.

In considering applications we may need to seek further information and clarification during the process.

36. The completed application form and letter should be sent to centralwaiversteam@fsa.gov.uk.

37. The application form and general information about the modification process is available on our web site at: http://www.fsa.gov.uk/pages/Doing/Regulated/Notify/Waiver/guidelines/liquidity_mod.shtml

38. Information about the intra-group liquidity modification for non-ILAS BIPRU firms is available on our web site at: http://www.fsa.gov.uk/pages/Doing/Regulated/Notify/Waiver/guidelines/intra_group_non_ilas_bipru.shtml

Timeline for liquidity modification applications

39. In view of the expected volume of applications, classes of firm were requested to apply for liquidity modifications within certain time windows. In the case of non-

ILAS BIPRU firms, the application window was extended to 30 June 2010.[11] It is intended that applications received by 30 June 2010 would be determined by 1 October 2010 in time for the switch-on of the BIPRU 12 quantitative requirements for non-ILAS BIPRU firms on 1 November 2010.

40. Firms may continue to submit applications for liquidity modifications outside of the allocated 'time window', but in this case they will be lower on our priority list and will not have a specified 'respond by' date. If the application contains all the information requested and is of good quality, this will aid the speed at which it can be processed.

Which rules will apply to a non-ILAS BIPRU firm that has been granted an intra-group liquidity modification from 1 November 2010?

41. A non-ILAS BIPRU firm that has been granted an intra-group liquidity modification will need to comply with the following requirements:

- Systems and controls requirements (BIPRU 12.3 and 12.4).

- Quantitative requirements (BIPRU 12.2). The overall liquidity adequacy rule BIPRU 12.2.1 R will continue to apply to the firm as modified by the intra-group liquidity modification. The intra-group liquidity modification shows our consent to the firm's reliance on liquidity support provided by other entities in its group to enable it to meet its obligations under BIPRU 12 as they apply to the firm.

- Reporting requirements. The firm will be required to complete the FSA055 systems and controls questionnaire annually (for the year to 31 December). The firm will not be required to form or belong to a defined liquidity group (DLG). The DLG concept does not apply to non-ILAS BIPRU firms.

Liquidity reporting requirements

42. **From 1 December 2009 to 31 October 2010**, non-ILAS BIPRU firms will continue to report liquidity as required by their predecessor liquidity reporting regime.

43. **From 1 November 2010**, the new liquidity regulatory reporting requirements begin for non-ILAS BIPRU firms.

- They will be required to complete only FSA055 (systems and controls questionnaire) annually for the year to 31 December. The first FSA055 to be completed will be for the year to 31 December 2010.

- If the firm has been granted an intra-group liquidity modification, it will continue to be required to complete the FSA055 systems and controls questionnaire annually (for the year to 31 December). The firm will not be required to form or belong to a DLG as a result of having an intra-group

[11] The allocated application window has now closed.

liquidity modification. The DLG concept does not apply to non-ILAS BIPRU firms.

- The other detailed liquidity reporting forms (FSA047 to FSA054) do not apply to non-ILAS BIPRU firms.

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