

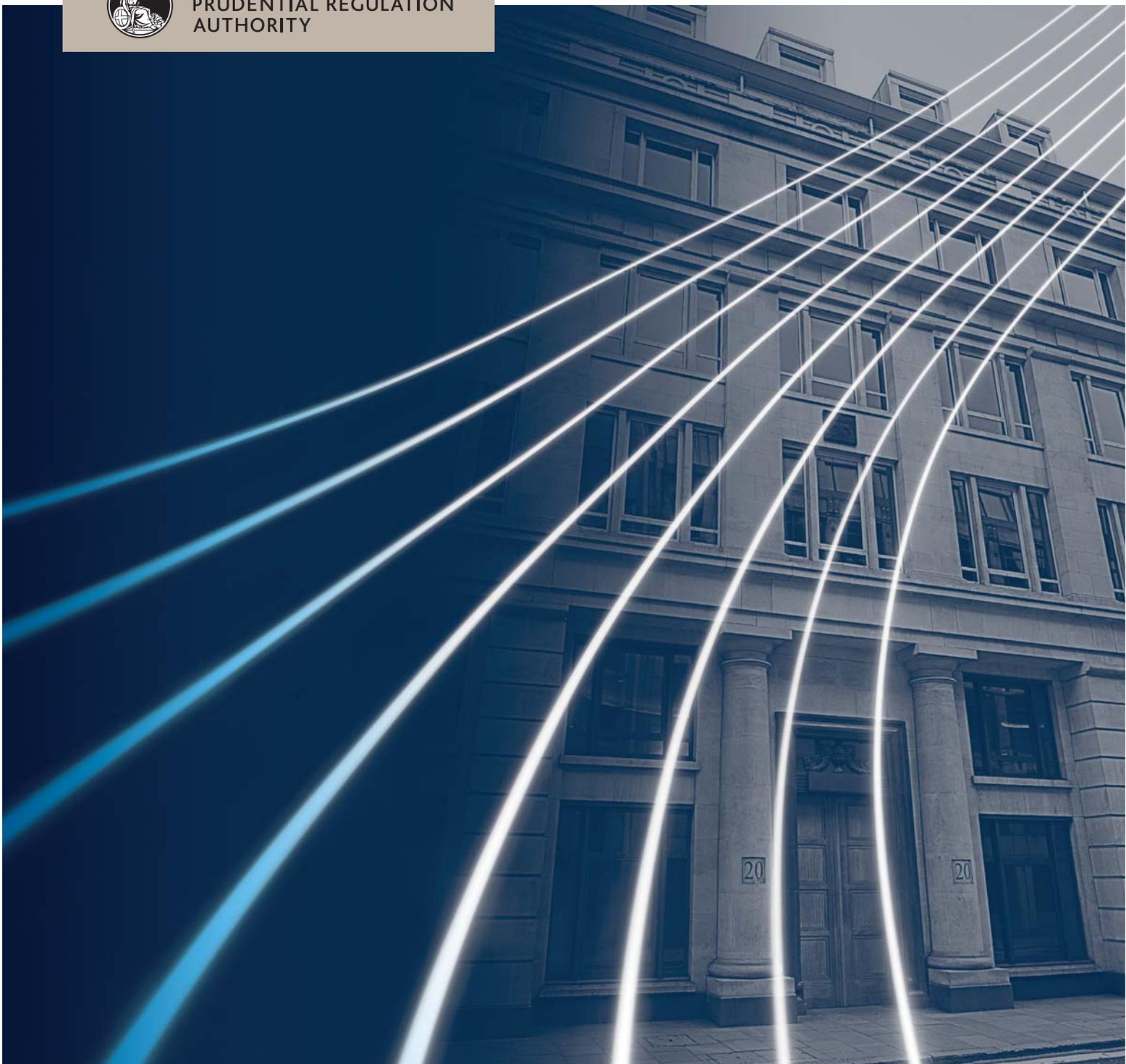
Policy Statement | PS4/14

# Responses to CP5/14

May 2014



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY



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The Bank of England and the Prudential Regulation Authority (PRA) reserve the right to publish any information which it may receive as part of this consultation.

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure, in accordance with access to information regimes under the Freedom of Information Act 2000 or the Data Protection Act 1998 or otherwise as required by law or in discharge of our statutory functions.

Please indicate if you regard all, or some of, the information you provide as confidential. If the Bank of England or the PRA receives a request for disclosure of this information, the Bank of England or the PRA will take your indication(s) into account, but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the Bank of England and the PRA.



## 1 Introduction

1.1 This policy statement (PS) sets out the Prudential Regulation Authority (PRA) response to feedback received from the following chapters in CP5/14:<sup>(1)</sup>

- Chapter 1 — Financial Conglomerates Capital Adequacy.
- Chapter 2 — Proposed amendment to SS5/13.
- Chapter 3 — Eligible liquid assets for Shari'ah compliant firms.
- Chapter 4 — Risk management of asset encumbrance.

1.2 Chapters 1 and 2 are relevant to all PRA firms and chapters 3 and 4 are relevant to banks, building societies and designated investment firms that are subject to chapter 12 of the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU).

1.3 For all chapters responded to in this PS, the analysis of costs and benefits and statutory obligations conducted at consultation have not changed following the responses received. Firms should note the final rules and supervisory statement set out in the appendix.

## 2 Consultation response

### Financial Conglomerates Capital Adequacy

2.1 No responses were received on this consultation and this instrument comes into force on 26 May 2014.

### Proposed amendment to SS5/13

2.2 No responses were received on this consultation and this supervisory statement comes into force on 27 May 2014.

### Eligible liquid assets for Shari'ah compliant firms

2.3 Four responses were received, all of which welcomed the proposals to allow Shari'ah-compliant firms to include a wider set of assets in their liquid assets buffers.

2.4 The respondents raised concerns that the haircuts and limits applied on the sukuk eligible for inclusion in the buffer are too restrictive. In particular, one respondent is concerned that allowing only 40% of the buffer to be sukuk other than sukuk issued by governments, or central banks, or designated multilateral development banks with a credit rating associated with credit quality step 1<sup>(2)</sup> will remain an onerous restriction. An additional concern raised was, that a limit of 10% on sukuk not issued by governments, or central banks, or designated multilateral development banks and the application of a 50% haircut irrespective of credit rating gives this type of asset little recognition. One respondent also asked for other types of Shari'ah compliant assets to be recognised including exchange traded commodities, equities listed on recognised exchanges and gold.

2.5 The PRA recognises the concerns raised, but believes that the proposals set out in CP5/14 remain appropriate. The proposals achieve a balance between ensuring that the liquidity buffers of Shari'ah compliant firms will generate sufficient liquidity to allow that firm to survive a severe liquidity stress and reducing the concentration risks currently present in a Shari'ah compliant firm's liquid asset buffer. The amendments will significantly increase the number of assets available to Shari'ah compliant firms to hold in their liquidity buffers, helping to ensure a level playing field for Shari'ah compliant firms while maintaining the quality of liquidity buffers and avoiding competitive distortion.

2.6 Other respondents requested clarity on:

- the relationship between the amended rules in chapter 12 of BIPRU, and the United Kingdom's implementation of the liquidity coverage ratio (LCR);
- the net stable funding ratio; and
- clarification of whether a sukuk issued by a government owned/guaranteed financial institutions would be eligible.

2.7 These amendments to chapter 12 of BIPRU are unrelated to the introduction of the LCR in Europe. The European Commission must adopt a delegated act to specify in detail the LCR for implementation in the EU in 2015. There is a longer timetable for the specification of the stable funding requirements. The Basel Committee on Banking Supervision and the EU institutions are considering policy options. Article 521(2)(b) of the Capital Requirements Regulation defers commencement of the general requirement for stable funding until 1 January 2016. Sukuk issued by government owned or guaranteed financial institutions will not be eligible.

2.8 This instrument comes into force on 26 May 2014.

### Risk management of asset encumbrance

2.9 Two responses were received, both of which supported the proposals set out in the consultation.

2.10 One respondent commented that the guidance related to the meaning of encumbrance proposed in BIPRU 12.3.35G would benefit from further clarity. They noted that the proposal does not recognise assets that can be freely withdrawn from encumbrance.<sup>(3)</sup>

2.11 The PRA has considered this comment and whilst it is recognised that some assets may be freely withdrawn from

(1) [www.bankofengland.co.uk/pru/Documents/publications/policy/2014/ocp5-14.pdf](http://www.bankofengland.co.uk/pru/Documents/publications/policy/2014/ocp5-14.pdf).

(2) As set out in BIPRU 12 Annex 1R.

(3) For example assets supporting unpledged retained covered bonds as these securities can be cancelled quickly leading to excess over-collateralisation that can be transferred from 'encumbered pools'.

encumbrance it is important that the firm's systems and controls include such assets so as to ensure the firm is appropriately monitoring and controlling these positions.

2.12 Another respondent requested a proportionate timescale to formalise the liquidity control framework, as well as stress testing, contingency funding plans and reporting governance so that the implementation can be as efficient as possible.

2.13 This instrument comes into force on 26 May 2014. The PRA expects firms to discuss with their supervisors the steps necessary to comply with these rules and guidance and agree appropriate timescales for any enhancements necessary.

# Appendices

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- 1 Financial Conglomerates Directive (Handbook Amendments) Instrument 2014

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  - 2 SS5/13 The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)

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  - 3 Prudential Sourcebook for Banks, Building Societies and Investment Firms (Liquidity Standards) Amendment Instrument 2014

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  - 4 Prudential Sourcebook for Banks, Building Societies and Investment Firms (Liquidity Standards No 2) Amendment Instrument

**FINANCIAL CONGLOMERATES DIRECTIVE (HANDBOOK AMENDMENTS)  
INSTRUMENT 2014**

**Powers exercised by the Board of the Prudential Regulation Authority (PRA)**

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

- (1) section 137G (The PRA's general rules); and
- (2) section 137T (General supplementary powers).

B. The rule-making power referred to above is 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.

**Commencement**

D. This instrument comes into force on 26 May 2014.

**Amendments**

E. The rules in the modules of the PRA's Handbook listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Prudential sourcebook for Insurers (INSPRU)	Annex B
Interim Prudential sourcebook for Insurers (IPRU (INS))	Annex C

**Citation**

F. This instrument may be cited as the Financial Conglomerates Directive (Handbook Amendments) Instrument 2014.

**By order of the Board of the Prudential Regulation Authority**  
23 May 2014.

## Annex A

## Amendments to the Glossary of definitions

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

*ultimate EEA insurance parent undertaking* an *EEA insurance parent undertaking* that is not itself the *subsidiary undertaking* of another *EEA insurance parent undertaking* or of a mixed financial holding company which has its head office in an *EEA State*.

*ultimate insurance parent undertaking* an *insurance parent undertaking* that is not itself the *subsidiary undertaking* of another *insurance parent undertaking* or of a mixed financial holding company.

**Annex B****Amendments to the Prudential sourcebook for insurers (INSPRU)**

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

Scope – undertaking whose group capital is to be calculated and maintained

6.1.17 R The *undertakings* referred to in *INSPRU* 6.1.8R, *INSPRU* 6.1.9R, *INSPRU* 6.1.10R and *INSPRU* 6.1.15R are

(1) for any *firm* that is not within (2), each of the following:

...

(ba) the ~~ultimate~~ ultimate mixed financial holding company at the head of a *MFHC conglomerate* of which the *firm* is a member;

...

## Annex C

## Amendments to the Interim Prudential Sourcebook for Insurers (IPRU(INS))

## Appendix 9.9: Group Capital Adequacy (Form 95)

Form 95 is amended as set out below:

In this Part, the text in the data item set out in column (1) is amended as indicated in column (2).

(1)	(2)						
	Retain the text and amend as follows (underlining indicates new text):						
Form 95: INSURANCE GROUP CAPITAL ADEQUACY REPORTING FORM	...						
	<table border="1"> <thead> <tr> <th data-bbox="446 655 597 709"><i>Ref</i></th> <th data-bbox="602 655 1380 709"><i>Instructions</i></th> </tr> </thead> <tbody> <tr> <td data-bbox="446 716 597 793">A (pages 2, 3 &amp; 4)</td> <td data-bbox="602 716 1380 793">...</td> </tr> <tr> <td data-bbox="446 800 597 1486">D2 (page 2)</td> <td data-bbox="602 800 1380 1486"> <p>This column should be completed only for <i>related undertakings</i> which are <i>ancillary services undertakings</i> <u>when computing the <i>group capital resources</i> of an <i>insurance group</i></u>. The entry is the higher of: the book value of the direct or indirect investment by the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> in the <i>ancillary services undertaking</i>; and the <i>ancillary services undertaking's</i> notional capital resources requirement (see <i>INSPRU</i> 6.1.62R to 6.1.64R).</p> <p><u>For insurance-led conglomerates, for the purposes of <i>INSPRU</i> 6.1.43R, in calculating the <i>group capital resources</i> of an <i>undertaking</i> in <i>INSPRU</i> 6.1.17R (1)(ba) or (bb) or in applying the provisions of <i>INSPRU</i> 6.1 for the purposes of calculating the <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> under the provisions of <i>GENPRU</i> 3.1, a <i>firm</i> must, in accordance with <i>GENPRU</i> 3.1.30R but subject to <i>GENPRU</i> 3.1.31R, apply Method 2 (Deduction and Aggregation Method) or Method 1 (Accounting Consolidation Method) as set out in <i>GENPRU</i> 3 Annex 1 R to reflect direct or indirect investments by the <i>undertaking</i> in <i>INSPRU</i> 6.1.17R (1)(ba) or (bb) or by members of the <i>financial conglomerate</i> in each <i>related undertaking</i> which is an <i>ancillary services undertaking</i>.</u></p> </td> </tr> </tbody> </table>	<i>Ref</i>	<i>Instructions</i>	A (pages 2, 3 & 4)	...	D2 (page 2)	<p>This column should be completed only for <i>related undertakings</i> which are <i>ancillary services undertakings</i> <u>when computing the <i>group capital resources</i> of an <i>insurance group</i></u>. The entry is the higher of: the book value of the direct or indirect investment by the <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> in the <i>ancillary services undertaking</i>; and the <i>ancillary services undertaking's</i> notional capital resources requirement (see <i>INSPRU</i> 6.1.62R to 6.1.64R).</p> <p><u>For insurance-led conglomerates, for the purposes of <i>INSPRU</i> 6.1.43R, in calculating the <i>group capital resources</i> of an <i>undertaking</i> in <i>INSPRU</i> 6.1.17R (1)(ba) or (bb) or in applying the provisions of <i>INSPRU</i> 6.1 for the purposes of calculating the <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> under the provisions of <i>GENPRU</i> 3.1, a <i>firm</i> must, in accordance with <i>GENPRU</i> 3.1.30R but subject to <i>GENPRU</i> 3.1.31R, apply Method 2 (Deduction and Aggregation Method) or Method 1 (Accounting Consolidation Method) as set out in <i>GENPRU</i> 3 Annex 1 R to reflect direct or indirect investments by the <i>undertaking</i> in <i>INSPRU</i> 6.1.17R (1)(ba) or (bb) or by members of the <i>financial conglomerate</i> in each <i>related undertaking</i> which is an <i>ancillary services undertaking</i>.</u></p>
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Supervisory Statement | SS5/13

# **The Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)**

December 2013

## 1 Introduction

- 1.1 This supervisory statement is aimed at firms to which CRD IV<sup>(1)</sup> applies.
- 1.2 The purpose of this supervisory statement is to set out the expectations that the Prudential Regulation Authority (PRA) has in relation to the Internal Capital Adequacy Assessment Process (ICAAP) and the requirements set out in the PRA Rulebook in the Internal Capital Adequacy Assessment rules.
- 1.3 It provides further detail in relation to the high-level expectations outlined in The PRA's approach to banking supervision.<sup>(2)</sup>
- 1.4 The PRA will review a firm's ICAAP as part of its Supervisory Review and Evaluation Process (SREP), and this supervisory statement also sets out some of the factors that the PRA will take into consideration during the SREP.
- 1.5 In addition, this supervisory statement sets out the PRA's expectations with regard to firms' coverage and treatment of interest rate risk arising in the non-trading book, group risk operational risk and foreign currency lending to unhedged retail and SME borrowers.

## 2 Expectations of firms undertaking an ICAAP

- 2.1 A firm must carry out an ICAAP in accordance with the PRA's ICAAP rules. These include requirements on the firm to undertake a regular assessment of the amounts, types and distribution of capital that it considers adequate to cover the level and nature of the risks to which it is or might be exposed. This assessment should cover the major sources of risks to the firm's ability to meet its liabilities as they fall due and incorporate stress testing and scenario analysis. The ICAAP should be documented and updated annually by the firm or more frequently if changes in the business, strategy, nature or scale of its activities or operational environment suggest that the current level of financial resources is no longer adequate.
- 2.2 The PRA expects firms in the first instance to take responsibility for ensuring that the capital they have is adequate, with the ICAAP being an integral part of meeting this expectation. The PRA expects the ICAAP to be the responsibility of a firm's governing body, that it is reviewed and signed off by the governing body, and that it is used as an integral part of the firm's management process and decision-making culture. The processes and systems used to produce the ICAAP should ensure that the assessment of the adequacy of a firm's financial resources is reported to its governing body and senior management as often as is necessary.

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<sup>1</sup> The Capital Requirements Directive (2013/36/EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR), jointly "CRD IV".

<sup>2</sup> [www.bankofengland.co.uk/pras/pages/supervision/approach/default.aspx](http://www.bankofengland.co.uk/pras/pages/supervision/approach/default.aspx)

- 2.3 The ICAAP, and internal processes and systems supporting it, should be proportionate to the nature, scale and complexity of the activities of a firm, as set out in Internal Capital Adequacy Assessment 3.3 in the PRA's Rulebook. Where a firm has identified risks as not being material, it should be able to provide evidence of the assessment process that determined this and discuss why that conclusion has been reached.
- 2.4 Liquidity risk should also be assessed, including in relation to potential losses arising from the liquidation of assets and increases in the cost of funding during periods of stress. The requirements in relation to liquidity risk may be found in BIPRU 12.
- 2.5 As outlined in the supervisory statement on stress testing, the PRA expects firms to develop a framework for stress testing, scenario analysis and capital management that captures the full range of risks to which they are exposed and enables these risks to be assessed against a range of plausible yet severe scenarios. The ICAAP should outline how stress testing supports capital planning for the firm.
- 2.6 Where a firm uses a model to aid its assessment of the level of adequate capital, it should be appropriately conservative and should contribute to prudent risk management and measurement. The firm should expect the PRA to investigate the structure, parameterisation and governance of the model, and the PRA will seek reassurance that the firm understands the attributes, outputs and limitations of the model, and that it has the appropriate skills and expertise to operate, maintain and develop the model.

### **3 The SREP**

- 3.1 The SREP is a process by which the PRA will, taking into account the nature, scale and complexity of a firm's activities:
- review the arrangements, strategies, processes and mechanisms implemented by a firm to comply with its regulatory requirements laid down in PRA rules and the CRR;
  - evaluate the risks to which the firm is or might be exposed;
  - assess the risks that the firm poses to the financial system; and
  - evaluate the further risks revealed by stress testing.
- 3.2 As part of its SREP, the PRA will review the firm's ICAAP and have regard to the risks outlined in the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1, the governance arrangements of the firm, its corporate culture and values, and the ability of members of the management body to perform their duties. The degree of involvement of the governing body of the firm will be taken into account by the PRA when assessing the ICAAP, as will the appropriateness of the internal processes and systems for supporting and producing the ICAAP.
- 3.3 When the PRA reviews an ICAAP as part of the SREP, it does so in order to determine whether all of the material risks have been identified and that the amount and quality of

capital identified by the firm is sufficient to cover the nature and level of the risks to which it is or might be exposed.

3.4 The SREP will also consider:

- (a) the results of stress tests carried out in accordance with the CRR by firms that use the Internal Ratings-Based (IRB) approach or internal models for market risk capital requirements;
- (b) the exposure to and management of concentration risk by firms, including their compliance with the requirements set out in Part Four of the CRR and Chapter 6 of the ICAAP rules;
- (c) the robustness, suitability and manner of application of policies and procedures implemented by firms for the management of the residual risk associated with the use of credit risk mitigation techniques;
- (d) the extent to which the capital held by a firm in respect of assets which it has securitised is adequate, having regard to the economic substance of the transaction, including the degree of risk transfer achieved;
- (e) the exposure to and management of liquidity risk by firms, including the development of alternative scenario analyses, the management of risk mitigants (including the level, composition and quality of liquidity buffers), and effective contingency plans;
- (f) the impact of diversification effects and how such effects are factored into firms' risk measurement system;
- (g) the geographical location of firms' exposures;
- (h) the exposure of firms to the risk of excessive leverage; and
- (i) whether a firm has provided implicit support to a securitisation.
- (j) the exposure to and management of foreign currency lending risk to unhedged retail and SME borrowers by firms, in line with the European Banking Authority's Guidelines on capital measures for foreign currency lending to unhedged borrowers under the Supervisory Review and Evaluation Process (SREP).<sup>(3)</sup>

3.5 The PRA will also assess as part of the SREP the risks that the firm poses to the financial system.

3.6 The PRA may need to request further information and meet with the governing body and other representatives of a firm in order to evaluate fully the comprehensiveness of the ICAAP. The management of the firm, including the governing body, should therefore be prepared to discuss all aspects of the ICAAP, covering both quantitative and qualitative components. Additionally, the PRA will consider the business model of the firm and the

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<sup>3</sup> <http://www.eba.europa.eu/documents/10180/535130/EBA-GL-2013-02+%28Guidelines+on+capital+measures+for+FX+lending%29.pdf/966f1ca0-7454-4003-a40a-e2fc98214fc1>. Title I "Subject matter, scope and definitions" of the EBA Guidelines, section 2, page 8, provides definitions of "FX", "FX lending", (i.e. "foreign currency lending") and "unhedged borrower".

advocated rationale for the model, as well as the firm's expectations regarding the future market and economic environment and how they might affect its business model.

- 3.7 The SREP will generally be the same across all types of firms, but will be proportionate given the nature, scale and complexity of a firm's activities. There may also be a different emphasis depending on the type of firm or its potential risk to the financial system. For example, banks and building societies may be more exposed to credit concentration risk and interest rate risk in the non-trading book, with investment firms being more likely to be exposed to market risk; these potentially different areas of emphasis will be reflected in the conduct of the SREP, where applicable, for relevant firms.
- 3.8 On the basis of the SREP, the PRA will determine whether the arrangements implemented by a firm and the capital held by it provide sound management and adequate coverage of its risks. If necessary, the PRA will require the firm to take appropriate actions or steps at an early stage to address any future potential failure to meet its prudential regulatory requirements.

## **4 The setting of Individual Capital Guidance (ICG) and the Capital Planning Buffer (CPB) ICG**

- 4.1 Following the SREP, including both a review of the ICAAP and any further interactions with a firm, the PRA will normally give the firm Individual Capital Guidance (ICG), advising the firm of the amount and quality of capital that the PRA considers the firm should hold to meet the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1.
- 4.2 The PRA will give ICG on a consolidated basis to firms which must comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1 on a consolidated basis. The PRA may decide not to give ICG on an individual basis to members of a group where firms are able to demonstrate that capital has been adequately allocated among subsidiaries and that there are no impediments to the transfer of capital within the group. This does not absolve individual firms or members of the group of their obligation to comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1, which applies to all firms on an individual basis whether or not it also applies to the firm on a consolidated basis.
- 4.3 Where the PRA gives ICG to a firm it will generally specify an amount of capital (Pillar 2A) that the firm should hold at all times in addition to the capital it must hold to comply with the CRR (Pillar 1). It will usually do so stating that the firm should hold capital of an amount at least equal to a specified percentage of that firm's capital requirement under the CRR, plus one or more static add-ons in relation to specific risks in accordance with the overall Pillar 2 rule in Internal Capital Adequacy Assessment 3.1. The PRA expects firms to meet Pillar 2A with at least 56% Common Equity Tier 1 (CET1) capital and no more than 44% in AT1 by 1 January 2015.

- 4.4 It is for firms to ensure that they comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. However, if a firm holds the level of capital recommended as its ICG that does not necessarily mean that it is complying with the overall financial adequacy rule. Deviation by a firm from the terms of the ICG given to it by the PRA does not automatically mean that the firm is in breach of the overall financial adequacy rule or that the PRA will Consider that the firm is failing or is likely to fail to satisfy the Threshold Conditions (TCs). However, firms should expect the PRA to investigate whether any firm is failing or likely to fail to satisfy the TCs, with a view to taking further action as necessary.
- 4.5 The PRA does not expect a firm to meet the CRD IV buffers with any CET1 capital maintained to meet its ICG. If a firm agrees with its ICG, the PRA will expect the firm to apply for a requirement under Section 55M(5) of the Financial Services and Markets Act 2000 (FSMA) preventing the firm from meeting any of the CRD IV buffers that apply to it with any CET1 capital maintained to meet its ICG. The firm will normally be invited to apply for such a requirement at the same time as it is advised of its ICG. If the firm does not apply for such a requirement the PRA will consider using its powers under Section 55M(3) to impose one of its own initiative.
- 4.6 Where a firm is subject to the Basel 1 floor the PRA does not expect a firm to meet the CRD IV buffers with any CET1 maintained by the firm to meet the Basel 1 floor and will use its powers under Section 55M to prevent a firm from doing so. Where applicable to a firm, global and other systemically important institution buffers will also be set by the PRA using its powers under Section 55M of FSMA.

## **CPB**

- 4.7 Following the SREP, the PRA may also notify the firm of an amount and quality of capital that it should hold as a Capital Planning Buffer (CPB), over and above the level of capital recommended as its ICG, and will generally do so at the same time as advising the firm of its ICG. The CPB, based on a firm-specific supervisory assessment, should be of sufficient amount and adequate quality to allow the firm to continue to meet the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. This should be the case even in adverse circumstances, after allowing for realistic management actions that a firm could and would take in a stress scenario. Use of the CPB is not of itself a breach of capital requirements or the TCs. The automatic distribution constraints associated with the CRD IV buffers do not apply to the CPB.
- 4.8 The PRA may set a firm's CPB either as an amount of capital which it should hold from the time of the PRA's notification following the firm's SREP or, in exceptional cases, as a forward-looking target that a firm should build up over time. More information on setting the CPB is outlined in the supervisory statement on stress testing. Where the general stress and scenario testing rule, as part of the ICAAP rules, applies to a firm on consolidated basis the PRA may notify the firm that it should hold a group CPB.
- 4.9 Where the amount or quality of capital which the PRA considers a firm should hold to meet the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1 or as a CPB

is different from that identified by the firm through its ICAAP, the PRA usually expects to discuss the difference with the firm and may consider the use of its powers under Section 166 of FSMA to assist in such circumstances.

- 4.10 If a firm considers that the ICG or the CPB advised to it by the PRA is inappropriate to its circumstances it should notify the PRA of this, consistent with Principle 11 (Relations with regulators). If, after discussion, the PRA and the firm do not agree on an adequate level of capital, the PRA may consider using its powers under Section 55M of FSMA to impose a requirement on the firm to hold capital in accordance with the PRA's view of the capital necessary to comply with the overall financial adequacy rule in Internal Capital Adequacy Assessment 2.1. In deciding whether it should use its powers under Section 55M of FSMA, the PRA will take into account the amount and quality of the capital that the firm should hold for its CPB.

## **5 Failure to meet ICG and use of the CPB**

- 5.1 The PRA expects every firm to hold at least the level of capital advised to it via its ICG at all times. If a firm's capital has fallen or is expected to fall below that level it should inform the PRA as soon as practicable (even if the firm has not accepted the ICG given by the PRA), explaining why this has happened or is expected to happen. The firm will also be expected to discuss the actions that it intends to take to increase its capital and/or reduce its risks (and therefore capital requirements), and any potential modification that it considers should be made to the ICG.
- 5.2 Where this has happened, the PRA may ask a firm for alternative and more detailed proposals or further assessments of capital adequacy and risks faced by the firm. The PRA will seek to agree with the firm appropriate timescales and the scope for any such additional work.
- 5.3 Where a firm has a CPB in place, it should only use that buffer to absorb losses or meet increased capital requirements if certain adverse circumstances materialise. These should be circumstances beyond the firm's normal and direct control, whether relating to a deteriorating external environment or periods of stress such as macroeconomic downturns or financial/market shocks, or firm-specific circumstances.
- 5.4 Consistent with Principle 11, a firm should notify the PRA as early as possible in advance where it has identified that it would need to use its CPB (even if the firm has not accepted the PRA's assessment of the amount or quality of the capital required for the CPB). The firm's notification should state as a minimum:
- what adverse circumstances are likely to force the firm to draw down its CPB;
  - how the CPB will be used up in line with the firm's capital planning projections; and
  - what plan is in place for the eventual restoration of the CPB.

- 5.5 Following discussions with the firm, the PRA may put in place additional reporting arrangements to monitor the firm's use of its CPB in accordance with the plan agreed to restore that buffer. The PRA may also identify specific trigger points as the CPB is being used up by the firm, which may lead to additional supervisory actions.
- 5.6 Where a firm's CPB is being drawn down due to circumstances other than those arising from a deteriorating external environment or periods of stress (eg macroeconomic downturns or financial/market shocks), or firm-specific circumstances (eg poor planning), the PRA may ask the firm for more detailed plans to restore its CPB. In light of the relevant circumstances, the PRA may consider taking other remedial actions, which may include using its powers under Section 55M of FSMA to require the firm to take specified action to restore its CPB within an appropriate timeframe.
- 5.7 Where a firm has started to use its CPB in circumstances where it was not possible to notify the PRA in advance, it should notify the PRA and provide information about the cause, the current and projected usage of the buffer, and its eventual restoration as soon as practicable afterwards.

## 6 Interest rate risk in the non-trading book

- 6.1 Firms must have appropriate systems and processes, proportionate to the nature, scale and complexity of their business, to evaluate and manage interest rate risk in the non-trading book. Examples of interest rate risk in the non-trading book include:
- the mismatch of repricing of assets and liabilities and off balance sheet short and long-term positions (termed 'repricing risk');
  - hedging exposure to one interest rate with exposure to a rate which reprices under slightly different conditions ('basis risk');
  - the uncertainties of occurrence of transactions, eg where actual transactions do not equal those that were expected in the future ('pipeline risk'); and
  - consumers redeeming fixed rate products when market rates change ('optionality risk').
- 6.2 The systems and processes should allow the firm to include:
- the ability to measure the exposure and sensitivity of the firm's activities, if material, to repricing risk, yield curve risk, basis risk and risks arising from embedded optionality (eg pipeline risk, prepayment risk) as well as changes in assumptions (eg those about customer behaviour);
  - consideration as to whether a purely static analysis of the impact on its current portfolio of a given shock or shocks should be supplemented by a more dynamic simulation approach; and
  - scenarios in which different interest rate paths are computed and in which some of the assumptions (eg about behaviour, contribution to risk and balance sheet size and composition) are themselves functions of interest rate level.

6.3 Under Internal Capital Adequacy Assessment 13.1, a firm is required to make a written record of its assessments made under those rules. A firm's record of its approach to evaluating and managing interest rate risk as it affects the firm's non-trading activities should cover the following issues:

- the internal definition of the boundary between 'banking book' and 'trading activities';
- the definition of economic value and its consistency with the method used to value assets and liabilities (eg discounted cash flows);
- the size and the form of the different shocks to be used for internal calculations;
- the use of a dynamic and/or static approach in the application of interest rate shocks;
- the treatment of commonly called 'pipeline transactions' (including any related hedging);
- the aggregation of multi-currency interest rate exposures;
- the inclusion (or not) of non-interest bearing assets and liabilities (including capital and reserves);
- the treatment of current and savings accounts (ie the maturity attached to exposures without a contractual maturity);
- the treatment of fixed rate assets (liabilities) where customers still have a right to repay (withdraw) early;
- the extent to which sensitivities to small shocks can be scaled up on a linear basis without material loss of accuracy (ie covering both convexity generally and the non-linearity of pay-off associated with explicit option products);
- the degree of granularity employed (for example offsets within a time bucket); and
- whether all future cash flows or only principal balances are included.

6.4 In accordance with Internal Capital Adequacy Assessment 9.2, a firm should apply a 200 basis point shock in both directions to each major currency exposure. The PRA will periodically review whether the level of the shock is appropriate in light of changing circumstances, in particular the general level of interest rates (for instance, during periods of very low interest rates) and their volatility. The level of shock required may also be changed in accordance with EBA guidelines. A firm's internal systems should, therefore, be flexible enough to compute its sensitivity to any standardised shock that is prescribed. If a 200 basis point shock would imply negative interest rates, or if such a shock would otherwise be considered inappropriate, the PRA will consider adjusting the requirements accordingly.

6.5 Alongside the requirement to monitor and evaluate the potential impact of changes in interest rates on economic value, the PRA expects firms to monitor the potential impact on earnings volatility. This should be assessed on an appropriate timeframe of three to five years, and factor in the firm's forward-looking view of product volumes, based on its proposed business model, and the projected path of interest rates.

## 7 Group risk

7.1 Under SYSC 12.1.8R a firm is required to have adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing its own exposure to group risk, including sound administrative and accounting procedures.

## 8 Operational Risk

8.1 In meeting the general standard referred to in Internal Capital Adequacy Assessment 10.1, a firm that undertakes market-related activities should be able to demonstrate to the PRA:

- in the case of a firm calculating its capital requirement for operational risk using the basic indicator approach or standardised approach, that it has considered; or
- in the case of a firm with an Advanced Measurement Approach (AMA) permission, compliance with the Committee of European Banking Supervisors' Guidelines on the management of operational risk in market-related activities,<sup>(1)</sup> published in October 2010.

8.2 In meeting the general standards referred to in Internal Capital Adequacy Assessment 10.1, a firm with an AMA approval should be able to demonstrate to the appropriate regulator that it has considered and complies with Section III of the European Banking Authority's Guidelines on the Advanced Measurement Approach (AMA) — Extensions and Changes,<sup>(2)</sup> published in January 2012.

8.3 The matters dealt with in a business continuity plan should include:

- (a) resource requirements such as people, systems and other assets, and arrangements for obtaining these resources;
- (b) the recovery priorities for the firm's operations;
- (c) communication arrangements for internal and external concerned parties (including the PRA, clients and the press);
- (d) escalation and invocation plans that outline the processes for implementing the business continuity plans, together with relevant contact information;
- (e) processes to validate the integrity of information affected by the disruption; and
- (f) regular testing of the business continuity plan in an appropriate and proportionate manner.

## 9 Foreign currency lending to unhedged retail and SME borrowers

- 9.1 Foreign currency lending is defined in the EBA Guidelines on capital measures for foreign currency lending to unhedged borrowers under the Supervisory Review and Evaluation Process (SREP).<sup>4</sup>
- 9.2 As part of its obligations under Internal Capital Adequacy Assessment 3.1 a firm that lends in foreign currency to unhedged retail and SME borrowers should determine whether it meets the thresholds of materiality in Title II, section 1 paragraph 9 of the European Banking Authority's Guidelines on capital measures for foreign currency lending to unhedged borrowers under the Supervisory Review and Evaluation Process (SREP). Where a firm meets the threshold it should notify the PRA and reflect the risk in its ICAAP.

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<sup>4</sup> <http://www.eba.europa.eu/documents/10180/535130/EBA-GL-2013-02+%28Guidelines+on+capital+measures+for+FX+lending%29.pdf/966f1ca0-7454-4003-a40a-e2fc98214fc1>. Title I "Subject matter, scope and definitions" of the EBA Guidelines, section 2, page 8, provides definitions of "FX", "FX lending", (i.e. "foreign currency lending") and "unhedged borrower".

**PRUDENTIAL SOURCEBOOK FOR BANKS, BUILDING SOCIETIES AND INVESTMENT FIRMS  
(LIQUIDITY STANDARDS) 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); and
  - (2) section 137T (General supplementary powers).
- 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.

**Commencement**

- D. This instrument comes into force on 26 May 2014.

**Amendments**

- E. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- F. The Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) is amended in accordance with Annex B to this instrument.

**Citation**

- G. This instrument may be cited as the Prudential sourcebook for Banks, Building Societies and Investment Firms (Liquidity Standards) Amendments Instrument 2014.

**By order of the Board of the Prudential Regulation Authority**  
23 May 2014

**Annex A****Amendments to the Glossary of definitions**

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

<i>Shari'ah compliant firm</i>	a <i>firm</i> whose entire operations are structured and conducted in accordance with Islamic commercial jurisprudence and its investment principles.
<i>sukuk</i>	certificates of equal value representing an undivided interest in the ownership of specified assets or investments acquired or to be acquired and that comply with Islamic commercial jurisprudence and its investment principles, but excluding <i>shares</i> .

## Annex B

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

In this Annex, all text is new and is not underlined.

### 12.7 Liquid assets buffer

...

12.7.2A R Notwithstanding *BIPRU* 12.7.2R, for the purpose of satisfying *BIPRU* 12.2.8R a *Shari'ah compliant firm* may include *sukuk* in its liquid assets buffer.

...

12.7.8A R For the purpose of *BIPRU* 12.7.2AR, a *Shari'ah compliant firm* may include only a *sukuk* which:

- (1) is issued by a government or central bank or *designated multilateral development bank*; or
- (2) satisfies the following conditions:
  - (a) the *sukuk* is not issued by a member of the *financial sector* or where that member is a member of a *group* by any member of that *group*; and
  - (b) the issuer of the *sukuk* has been assessed by at least one *eligible ECAI* as having a credit rating associated with credit quality step 3 or above in the table set out in *BIPRU* 12 Annex 1R (Mapping of credit assessments of *ECAs* to credit quality steps).

...

12.7.8B R For the purpose of *BIPRU* 12.7.8AR, a *Shari'ah compliant firm* may count *sukuk* only up to the limits on the share of total assets in the *firm's* liquid assets buffer and after haircuts have been applied as follows:

- (1) For the purpose of *BIPRU* 12.7.8AR(1),
  - (a) if the central bank or government or *designated multilateral development bank* in question has been assessed by at least one *eligible ECAI* as having a credit rating associated with credit quality step 1 in the table set out in *BIPRU* 12 Annex 1R (Mapping of credit assessments of *ECAs* to credit quality steps), *sukuk* can comprise an unlimited share of the total assets in the *firm's* liquid assets buffer and are not subject to a haircut; or
  - (b) if the central bank or government or *designated multilateral development bank* in question has been assessed by at least one *eligible ECAI* as having a credit rating associated with credit quality step 2 in the table set out in *BIPRU* 12 Annex 1R (Mapping of credit assessments of *ECAs* to credit quality steps), *sukuk* can comprise not more than 40% of the total assets in the *firm's* liquid assets buffer after a haircut of 25% has been

applied; or

- (c) in all other cases, *sukuk* can comprise not more than 20% of the total assets in the *firm's* liquid assets buffer after a haircut of 50% has been applied.
- (2) For the purpose of *BIPRU* 12.7.8AR(2), *sukuk* cannot comprise more than 10% of the total assets in the *firm's* liquid assets buffer after a haircut of 50% has been applied.
- (3) The total amount of *sukuk* not falling under *BIPRU* 12.7.8BR(1)(a) cannot comprise more than 40% of the total amount of assets in the *firm's* liquid assets buffer.

...

12.7.12A R For the purpose of *BIPRU* 12.7.8AR(1) and (2), a *Shari'ah compliant firm* must count *sukuk* only that comply with *BIPRU* 12.7.9R(1), (2) and (3).

**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:

- (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;
  - (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.
- (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.
- ...
- 12.3.19      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 contracts 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 contracts 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

- (e) 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 funding 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:*
- (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 funding 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;
- (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 its 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 its 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.