BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

PRA interim level 2 liquid assets

Purpose

On 28 August 2013 the PRA set out the Board's decision to implement the FPC's recommendation on liquidity and the LCR:

> *"In order to deliver an outcome that is similar in nature to the Basel LCR, the PRA will allow banks to meet up to 40% of their reduced total liquidity requirement with either the haircutted value of assets pre-positioned at the Bank of England's Discount Window Facility or with certain assets specified by the PRA as Level 2 assets. (…)*
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> *The PRA will, in due course, publish a definition of Level 2 assets to be used on a transitional basis until EU legislation is in force. From the point of publication UK banks and building societies will be able to use such assets to meet their liquidity guidance."*

Following that announcement, this statement sets out the PRA's interim definition of which assets can be counted in Level 2. PRA interim Level 2 assets will be subject to a haircut of 15% when recognised against ILG requirements.

In setting this definition the PRA has sought to minimise the risk of recognising assets in an interim Level 2 definition that are later not recognised in the European implementation of the LCR. This interim definition should also not be seen as indicative the PRA's view on the likely outcome of the EU's implementation of the LCR.

At this stage we are proposing that the list of sovereigns whose debt is eligible, and the list of eligible currencies is consistent with those eligible or recognised under BIPRU 12.7.

Definition

PRA interim level 2 assets are restricted to

i. **Assets which trade in liquid cash or repo markets with observable market prices available in all but the most severe periods of market stress**; <u>and</u>

ii. Which meet the criteria set out in (a), (b) or (c) below:

a) **Marketable securities issued in public markets representing claims on or guaranteed by sovereigns or central banks of the EEA, Canada, Japan, Switzerland, the United States of America or Commonwealth of Australia, and public sector entities or multilateral development banks; that are assigned a risk weight of no more than 20% under the Basel II Standardised Approach for credit risk (at least A-/A3 credit rating from an eligible external credit assessment institution ("eligible ECAI").**

Securities should be denominated in the domestic currency of an EEA state, Euros, Sterling, Canadian Dollars, Japanese Yen, Swiss Francs, United States Dollars, or Australian Dollars and have a minimum issue outstanding of no less than: £500mn sterling, €500mn euros, $500mn USD, ¥50bn yen or $1bn Canadian dollars[1].

Where a firm has more than 10% of the total issue outstanding of a security it may only recognise PRA level 2 assets to offset reduced Individual Liquidity Guidance (ILG) up to the 10% threshold.

b) **Corporate debt securities (including commercial paper) issued in public markets that have a long-term credit rating from an eligible ECAI of at least AA-** or, in the absence of a long term rating, a short-term rating equivalent in quality to the long-term rating.

Only securities issued by a non-financial institution (including those with a finance subsidiary) are eligible. Securities should be denominated in the domestic currency of an EEA state, Euros, Sterling, Canadian Dollars, Japanese Yen, Swiss Francs, United States Dollars, or Australian Dollars and have a minimum issue outstanding of no less than $250mn, €250mn or £250mn respectively[1].

Where a firm has more than 10% of the total issue outstanding of a security it may only recognise PRA level 2 assets to offset reduced ILG up to the 10% threshold.

c) **Covered bonds issued in public markets by a credit institution domiciled in the EEA, Canada, Japan, Switzerland, the United States of America, or Commonwealth of Australia but not issued by the bank itself or any of its affiliates**.

The bonds should have a long-term credit rating from an eligible ECAI of at least AA-, should be denominated in the domestic currency of an EEA state, Euros, Sterling, Canadian Dollars, Japanese Yen, Swiss Francs, United States Dollars, or Australian Dollars and have a minimum issue outstanding of $250mn, €250mn, or £250mn[1].

Where a firm has more than 10% of the total issue outstanding of a security it may only recognise PRA level 2 assets to offset reduced ILG up to the 10% threshold. The assets underlying the covered bonds should be EEA social housing loans, public sector debt, or prime residential mortgage loans. The bonds must be listed. EEA bonds must be compliant with Article 52(4) of the UCITS Directive and with Article 129 of the CRR. Non-EEA bonds must be subject to rules which are broadly consistent with Article 52(4) of the UCITS Directive and with Article 129 of the CRR.

Assets which satisfy the conditions set out above but which, in the opinion of the PRA, would be unlikely to provide a reliable source of liquidity in times of stress, should not be included as Level 2 assets. For instance, the PRA may regard assets that have exhibited material price volatility to be insufficiently reliably liquid.

<u>Monitoring Approach</u>

In order to recognise the use of PRA level 2 assets to offset reduced ILG firms should provide data to allow the PRA to monitor those assets. These data should be provided on a "best efforts" basis at a weekly or monthly frequency (in line with the firm's FSA047/048 reporting frequency).

Firms should report the following information relating to those eligible PRA level 2 assets which count towards their ILG.

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[1] Comparable minimum issue sizes for other eligible currencies may be determined according to local benchmarks.

1. The unencumbered balance of PRA level 2 assets
2. Maturity flows over next 3 months
3. Repo over 3 month balance (cumulative security inflow)
4. Reverse repo over 3 month balance (cumulative security outflow)
5. PRA level 2 assets prepositioned at DWF

We may also request more detailed information on the PRA Level 2 assets. It is envisaged that this information will show the portfolio held by a firm split by type of asset, currency, sector, maturity and ratings. This information may be requested on an ad-hoc basis as required by supervisors.