



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

Consultation Paper | CP27/19

# Liquidity: The PRA's approach to supervising liquidity and funding risks

October 2019



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The response will be assessed to inform our work as a regulator and central bank, both in the public interest and in the exercise of our official authority. We may use your details to contact you to clarify any aspects of your response.

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Responses are requested by Sunday 17 November 2019.

**Please address any comments or enquiries to:**

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London  
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## 1 Overview

1.1 In this consultation paper (CP), the Prudential Regulation Authority (PRA) sets out its proposals to update Supervisory Statement (SS) 24/15 'The PRA's approach to supervising liquidity and funding risk'<sup>1</sup> (see Appendix) to reflect relevant updates to the Bank of England's Market Operations Guide (Market Operations Guide)<sup>2</sup> and to reiterate relevant expectations set out in SS9/17 'Recovery Planning'.<sup>3</sup>

1.2 The updates to SS24/15 propose that there should be no presumptive order in which firms should use the Bank of England's (Bank's) liquidity facilities, including the Discount Window Facility (DWF), or draw down their own liquid asset buffers to meet a liquidity need. Firms would be expected to use their own judgment in applying for and using the Bank's liquidity facilities. The proposals align the view of the appropriate usage of Bank facilities in SS24/15 with the Market Operations Guide.

1.3 The proposed updates to SS24/15 would also reiterate that where firms view central bank liquidity facilities, including at the Bank, as part of their liquidity risk management strategy, the PRA would expect this to be included as part of the credible recovery options outlined in the firms' recovery plans.

1.4 This CP is relevant to PRA-authorized UK banks, building societies, and PRA-designated UK investment firms, referred to collectively as 'firms'.

### Background

1.5 In October 2019, the Bank published its Market Operations Guide, which outlines the Bank's framework for its operations in sterling money markets, and updates its Sterling Market Framework (formally known as the 'Red Book').<sup>4</sup> The Market Operations Guide reiterates that there is a presumption that banks and building societies that meet the PRA's Threshold Conditions for authorisation may sign up to the Sterling Monetary Framework (SMF) and gain access to borrowing under the SMF against eligible collateral.<sup>5</sup> It also notes that the Bank does not consider that there is a presumptive order of usage between the SMF and a firm's liquid asset buffers. This CP proposes to update SS24/15 so that it aligns with the updated SMF as set out in the Market Operations Guide.

1.6 Use of central bank facilities, including at the Bank, could also form part of a firm's recovery plan. The PRA set out its expectations of the content of recovery plans and group recovery plans in SS9/17 'Recovery Planning'. These expectations include that firms should comment on the credibility of the recovery options outlined in their plan, including the circumstances under which the recovery options are no longer credible. Where the use of central bank liquidity facilities is included as a recovery option, SS9/17 sets out that the PRA expects firms to:

- consider the circumstances when they would access these facilities;

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<sup>1</sup> June 2019: [www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-approach-to-supervising-liquidity-and-funding-risks-ss](http://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-approach-to-supervising-liquidity-and-funding-risks-ss).

<sup>2</sup> October 2019: <https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide>.

<sup>3</sup> December 2017: [www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss](http://www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss).

<sup>4</sup> June 2015: [www.bankofengland.co.uk/markets/the-sterling-monetary-framework](http://www.bankofengland.co.uk/markets/the-sterling-monetary-framework).

<sup>5</sup> A firm's SMF eligibility is also subject to a regular and independent review of creditworthiness by the Bank's financial risk management function.

- test their operational ability to draw from the central bank facilities;
- undertake analysis of eligible assets and drawing capacity against these assets; and
- ensure that an appropriate amount of assets are pre-positioned.

1.7 SS9/17 also sets out that recovery plans should include the range of actions that would, over time, allow the firm to repay any funds received from central bank liquidity facilities.

## Implementation

1.8 The PRA proposes that the draft amendments to SS24/15 (see Appendix) will apply from the date of final publication.

## Responses and next steps

1.9 This consultation closes on Sunday 17 November 2019. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP27\_19@bankofengland.co.uk.

1.10 The PRA considers that a consultation period of one month is justified given the relatively minor impact of the proposed updates and the benefit of providing clarity to firms by aligning SS24/15 with the Market Operations Guide as soon as possible.

1.11 The proposals set out in this CP have been designed in the context of the current UK and EU regulatory framework. The PRA has assessed that the proposals will not be affected in the event that the UK leaves the EU with no implementation period in place.

## 2 Proposals

2.1 The PRA proposes replacing the existing paragraph 5.2 of SS24/15 with the amended text set out in the appendix which would, in summary:

- update and clarify the PRA's view of appropriate use of the Bank's liquidity facilities, to reflect that the PRA does not consider that there is a presumptive order in which firms use the Bank's liquidity facilities and their own liquid asset buffers; and
- reiterate that firms should continue to meet the expectations set out in SS9/17 'Recovery Planning'. In particular recovery options should be credible, including where these involve use of central bank facilities at home or abroad.

2.2 The PRA considers that following the changes in the SMF, the PRA's approach to supervising liquidity and funding risk should be updated to reflect its view of the appropriate use of the Bank's liquidity facilities. In particular, the PRA considers that there should be no fixed ordering of the usage of central bank facilities, such as the DWF, and a firm's liquid asset buffers. Firms should instead be expected to use their own judgement when applying for and accessing liquidity facilities from the Bank, given that they are best placed to evaluate the relative costs and benefits of different sources of liquidity, as well as the effect on the firm's funding stability.

2.3 A liquidity and funding strategy that includes the use of central bank facilities to meet a funding need should be credible. The proposed updates to SS24/15 would highlight the PRA's expectations

regarding the credibility of firms' recovery plans, as set out in SS9/17. The expectations outlined in SS9/17 are unaffected by the proposals.

### 3 The PRA's statutory obligations

3.1 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to consult when setting its general policies and practices.<sup>6</sup> In doing so, it is required to comply with several statutory and public law obligations. The PRA meets these obligations by providing the following in its consultations:

- a cost benefit analysis;
- an explanation of the PRA's reasons for believing that making the proposed policy is compatible with the PRA's duty to act in a way that advances its general objective<sup>7</sup> and secondary competition objective;<sup>8</sup>
- an explanation of the PRA's reasons for believing that making the proposed policy is compatible with its duty to have regard to the regulatory principles;<sup>9</sup> and
- a statement as to whether the impact of the proposed policy will be significantly different to mutuals than to other persons.

3.2 The Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury.<sup>10</sup>

3.3 The PRA is also required by the Equality Act 2010<sup>11</sup> to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.

#### Cost benefit analysis

3.4 The PRA considers the updates to SS24/15 to be minor changes that reflect policy aimed at consistency and certainty. Clarifying that the PRA does not have a presumptive order of use between the Bank's facilities and drawing down on a firm's liquid asset buffer may increase the flexibility for firms in managing their liquidity needs. As such the PRA does not expect firms to incur any material costs as a result of the proposed changes.

3.5 The PRA considers there are considerable benefits from aligning SS24/15 to the Bank's Market Operations Guide, as this would provide clarity regarding the PRA and the Bank's view of use of the Bank's liquidity facilities. Firms should therefore face less uncertainty regarding the supervisory response when considering the different options of raising liquidity. The proposals would also reiterate that firms should use their judgment when considering using the Bank's facilities. This should result in firms being presented with a wider range of options for raising liquidity.

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<sup>6</sup> Section 2L of FSMA.

<sup>7</sup> Section 2B of FSMA.

<sup>8</sup> Section 2H(1) of FSMA.

<sup>9</sup> Section 2H(2) and 3B of FSMA.

<sup>10</sup> Section 30B of the Bank of England Act 1998.

<sup>11</sup> Section 149.

### Compatibility with the PRA's objectives

3.6 The PRA has a statutory objective to promote the safety and soundness of the firms it regulates. The proposals in this CP are intended to further that objective by providing clarity around the PRA's approach to firms' use of Bank facilities as well as the interaction with liquidity risk management and recovery planning. These proposals encourage firms to use their own judgement when making decision around whether to use the Bank's facilities. The PRA considers that this would allow firms greater freedom in deciding when to use these facilities, and to do so when it is judged to be the best course of action for the stability of the firm. As a result, the proposals would have positive effects on the safety and soundness of the individual firm and the financial system as a whole.

3.7 When discharging its general function in a way that advances its primary objectives, the PRA has, as a secondary objective, a duty to facilitate effective competition in the markets for services provided by PRA-authorized persons. The PRA considers that the proposals do not have a material impact on effective competition, as they do not change firms' access to central bank facilities.

### Regulatory principles

3.8 In developing the proposals in this CP, the PRA has had regard to the regulatory principles set out in FSMA. Three of the principles are of particular relevance.

- The principle that the PRA should exercise its functions as transparently as possible: the PRA is following this principle by stating the PRA's view of the use of the Bank liquidity facilities by firms and its expectations of firms in this regard.
- The principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of that burden: the PRA considered the costs and benefits when developing the proposals outlined in this CP, and the proposed amendments to the PRA's approach to supervising liquidity and funding risk is consistent with this approach. By cross referencing existing PRA expectations in SS9/17, the PRA has looked to minimise the cost of the proposed updates to SS24/15.
- The principle that the PRA should recognise the diversity of different businesses: the proposed changes updating the PRA's view of the appropriate usage of Bank of England facilities would result in the PRA being less prescriptive in its expectations regarding how firms should meet a liquidity need. This would reflect that the availability and sources of funding will vary across different business models of funding. Through the proposed changes the PRA is encouraging firms to use their own judgments when deciding how to meet liquidity needs, if possible in a manner best suited to their individual circumstances.

### Impact on mutuals

3.9 The PRA considers that the impact of the proposed changes on mutuals is expected to be no different from the impact on other firms.

### HM Treasury recommendation letter

3.10 HM Treasury has made recommendations to the PRC about aspects of the Government's economic policy to which the PRC should have regard when considering how to advance the PRA's objectives and apply the regulatory principles. The PRA has considered HMT's recommendations when developing the proposals in this CP, in particular with regards to recognising different business models to help foster innovation and competition in the financial services industry, and has set out its analysis in general terms in the sections above.

## **Equality and diversity**

3.11 The PRA considers that the proposals do not give rise to equality and diversity implications.



## Appendix: Draft amendments to SS24/15 'The PRA's approach to supervising liquidity and funding risks'

In this appendix, new text is underlined and deleted text is struck through.

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### 5 Collateral placed at the Bank of England

5.1 The Bank of England announced a number of changes to its liquidity insurance facilities in October 2013,<sup>x</sup> which were further updated with the publication of the Bank of England Market Operations Guide in October 2019.<sup>x</sup> These changes were designed to increase the availability and flexibility of liquidity insurance, by providing liquidity at longer maturities, against a wider range of collateral, at a lower cost and with greater predictability of access. The certainty with which a firm can expect to be able to access the Bank of England's facilities has been reinforced through a presumption that all firms that meet Threshold Conditions may sign up for the Sterling Monetary Framework and have full access to Sterling Monetary Framework facilities against eligible collateral. ~~use the Bank of England's facilities.~~

5.2 ~~[Deleted]~~ The terms of the Bank of England's liquidity insurance facilities are set to ensure counterparties have the incentive to manage their liquidity primarily through private markets in normal times. Consistent with this, for limited liquidity shocks, it is appropriate for firms to draw initially on their holdings of HQLAs. For larger or more severe liquidity outflows, the Bank of England expects firms to consider using the Discount Window Facility or other liquidity insurance facilities alongside, rather than after, using a significant proportion of their liquidity buffer. As noted in the PRA's approach document,<sup>14</sup> the PRA expects firms to have credible options in their liquidity contingency plan for restoring their HQLAs following firm-specific or market-wide stress.

5.2A All of the Bank of England's liquidity facilities are intended to be open for business. As such there is no presumptive order of use for firms between using the Bank of England's liquidity facilities, including the Discount Window Facility (DWF), and drawing down of their liquidity buffers to meet a liquidity need. Firms should exercise their own judgement in applying for, and using, the Bank of England's liquidity facilities. Although the PRA does not expect firms to rely on the DWF for routine day-to-day liquidity management, neither is it intended to be a last resort.

5.2B As noted in SS9/17 'Recovery Planning',<sup>x</sup> firms are expected to have credible options to restore their financial position under different types of stresses. Firms might consider the use of central bank facilities, whether at the Bank of England or other central banks, in their recovery plans. As part of recovery planning, firms are required to consider the circumstances in which they would need to access these facilities and also test the operational aspects of their plan for accessing central banks facilities. They should undertake an analysis of eligible assets and the drawing capacity against these, and ensure that an appropriate amount of assets are pre-positioned.

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<sup>x</sup> 'Liquidity Insurance at the Bank of England: developments in the Sterling Monetary Framework', October, 2013: [www.bankofengland.co.uk/markets/the-sterling-monetary-framework](http://www.bankofengland.co.uk/markets/the-sterling-monetary-framework).

<sup>x</sup> October 2019: <https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide>.

<sup>14</sup> See footnote (1) on page 4.

<sup>x</sup> December 2017: [www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss](http://www.bankofengland.co.uk/prudential-regulation/publication/2017/recovery-planning-ss).