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

March 2020
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1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 27/19 ‘Liquidity: The PRA’s approach to supervising liquidity and funding risks’.¹

1.2 This PS also contains the PRA’s final policy, the updated Supervisory Statement (SS) 24/15 ‘The PRA’s approach to supervising liquidity and funding risks’ (Appendix 1).

1.3 This PS is relevant to PRA-authorised UK banks, building societies, and PRA-designated UK investment firms.

Background


1.5 In the CP, the PRA proposed that:

- there should be no presumptive order in which firms should use the 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 judgement in applying for and using the Bank’s liquidity facilities. These proposals would align the view of the appropriate usage of Bank facilities in SS24/15 with the Market Operations Guide; and

- the PRA’s expectations of firms set out in SS9/17 ‘Recovery Planning’ also apply with regards to the use of central bank facilities outlined in SS24/15. In particular, the proposals reiterated that recovery options should be credible, including where these involve use of central bank facilities at home or abroad.

Summary of responses

1.6 The PRA received three responses to the CP. Respondents generally welcomed the PRA’s proposals, while also requesting some clarifications and suggesting limited changes to the proposals. The details of these responses and the PRA’s feedback and final decisions are set out in Chapter 2.

Implementation

1.7 This policy comes into effect on publication of this PS.

1.8 The policy set out in this PS has been designed in the context of the UK’s withdrawal from the European Union and entry into the transition period, during which time the UK remains subject to European law. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the transition period, including those arising once any new arrangements with the European Union take effect.

² October 2019: https://www.bankofengland.co.uk/markets/bank-of-england-market-operations-guide.
1.9 The PRA has assessed that the policy would not need to be amended under the EU (Withdrawal) Act 2018 (EUWA). Please see PS5/19 ‘The Bank of England’s amendments to financial services legislation under the European Union (Withdrawal) Act 2018’ for further details.

2 Feedback to responses

2.1 The PRA has considered the three responses received to the CP. This chapter sets out the PRA’s feedback to those responses, and its final decisions.

2.2 One respondent supported the proposals outlined in the CP, stating they deemed them ‘sensible and proportionate’.

2.3 One respondent suggested a change to the wording of SS24/15 with the intention of improving the alignment with the Market Operations Guide.

2.4 The PRA notes that the changes to SS24/15 only intended to provide a high level overview of the appropriate usage of central bank facilities. Following the publication of this PS, SS24/15 will specifically reference the Market Operations Guide, which is significantly more detailed on the design and appropriate use of the Bank’s facilities. As a result, the PRA considers its view of appropriate use of central bank facilities to correspond to those outlined in the Market Operations Guide, and the wording in the Market Operations Guide is therefore applicable to SS24/15.

2.5 The same respondent also commented that they believe a change to Chapter 2 of the Internal Liquidity Adequacy Assessment (ILAA) Rules is warranted. The rule in question states that firms must maintain adequate liquidity resources to ensure that there is no significant risk that its liabilities cannot be met as they fall due, and that this must be achieved without including liquidity resources made available through Emergency Liquidity Assistance (ELA) from a central bank. The suggestion by the respondent was that ELA should count towards ‘adequate liquidity resources’.

2.6 The PRA notes that the Market Operations Guide focuses on the Sterling Monetary Framework as well as other selected sterling and non-sterling facilities (term funding, gilt/corporate bond purchases and short-term non-sterling liquidity facilities). It does not cover ELA, which is the focus of the ILAA rule referenced by the respondent. Hence the changes being made to SS24/15 do not imply any changes to the ILAA rule.

2.7 The respondent also suggested additional clarification be included in SS24/15 around the interaction of the Bank’s facilities and firms’ internal stress testing frameworks.

2.8 The PRA will align supervisory practice with the new policies outlined in SS24/15 and the Market Operations Guide. However, the PRA considers it important to distinguish between firms’ prudent self-insurance in the form of liquid asset buffers, and the ability of a firm to choose whether to make use of central bank facilities to meet a liquidity need according to its own preferences. The changes to SS24/15 proposed in the CP primarily reflect the latter, signalling that the PRA considers that there is no presumptive order between drawing down liquid asset buffers and using central bank facilities. The PRA will continue to reflect both considerations when supervising liquidity and funding risk, including ensuring firms prudently self-insure against the liquidity risk they face.

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2.9 The third respondent raised specific questions regarding the Bank of England’s market operations. These have been passed on to colleagues in the Markets area of the Bank of England to resolve on a bilateral basis.

2.10 Having considered the responses received, the PRA has decided to make no changes to the proposals originally outlined in the CP.
Appendix