Liquidity adequacy and cash management

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Objectives

- Provide an update on the liquidity regulatory environment for IFPRU firms
- Review liquidity adequacy standards, both quantitative and qualitative
- Discuss cash management activities and their impact on liquidity adequacy

The liquidity regulatory environment for IFPRU firms

CRD IV liquidity requirements

- **CRD IV – CRR Part Six**
  - New quantitative standards (LCR)
  - Qualitative standards (similar to BIPRU standards)
  - Liquidity Delegated Act

- **EBA SREP Guidelines**
  - Liquidity adequacy and risk framework discussions now required in ICAAP and SREP (Titles 8 and 9)

- **Pillar 2 Liquidity Requirements**
  - Essentially, the systems and controls sections of BIPRU 12

Liquidity Delegated Act

- **Provides detail for calculating the binding LCR**
  - Applies from 1 October 2015
  - New COREP liquidity templates

- ***Does not*** ***apply to Investment Firms***

- **CRR Article 508(2)** mandates a review on the application of the LCR to Investment Firms

What this means for IFPRU firms

- We stated in **PS13/10** – '*we confirm our approach to* ***continue the UK's liquidity regime*** *(including ILAS) until binding minimum standards for liquidity coverage requirements are implemented in the CRR in 2015'*
- We will issue a further statement on our liquidity approach in due course
- Until then, **BIPRU 12 requirements continue to apply to all IFPRU firms** and some Significant IFPRU / ILAS firms will continue to report CRD IV LCR and NSFR COREP templates

Liquidity adequacy

Overall liquidity adequacy rule

‘A firm ***must at all times*** *maintain* ***liquidity resources*** *which are* ***adequate*** *both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.’*

BIPRU 12.2.1R

Overall liquidity adequacy rule

What does '*at all times*' mean?

> *At all times* ***including*** *during a* ***period of liquidity stress***

Liquidity covering only a **business as usual** assessment is **inadequate**

Overall liquidity adequacy rule

What stress should be considered and evaluated?

> *'Firms are required to develop their own liquidity* ***risk scenarios*** *ranging from mild to "extreme but plausible" in scope and impact'*

BIPRU 12.4.1R

Overall liquidity adequacy rule

What does **adequate** mean and who determines this?

> *Adequate means the amount of liquidity necessary to **maintain overall liquidity** within **your liquidity risk tolerance***

You determine this – through your firm specific stress testing required by BIPRU 12.4.1R

Liquidity systems and controls

‘A firm **must** have in place **robust strategies, policies, processes and systems** that enable it to identify, measure, manage and monitor liquidity risk over an appropriate set of time horizons, including intra-day, so as to ensure that it **maintains adequate levels of liquidity’**

BIPRU 12.3.4R

Cash management and liquidity adequacy

Cash management and liquidity adequacy

Certain **cash management practices** inherently impact a firm's ability to meet the overall **liquidity adequacy rule**

- Among these is **cash concentration accounts** used to maximise interest conditions on collected cash balance across a group of related entities

- By using a 'zero balance account' (ZBA) structure to **move and manage cash to a central treasury concentration account**, participating subsidiaries may **not be able to demonstrate compliance with the liquidity adequacy rule**

- This is because they **no longer have their liquidity (cash) on their own balance sheet**

Why this is an issue

- The liquidity adequacy **rule requires a firm to 'own' the liquidity** / working capital **it needs to** at all times **meet its obligations as they fall due**

- If a **subsidiary** participates in a cash concentration programme, it **gives all, or most of its cash** to a central treasury and that subsidiary **will not have adequate liquidity on its balance sheet to meet the liquidity adequacy rule**

- If you don't or can't meet the liquidity adequacy rule, you may be in breach of Threshold Conditions

The solution

- The solution is to **modify the liquidity adequacy rule** through an Intra-Group Liquidity Modification (**IGLM**) and create a **Defined Liquidity Group** (DLG)
- This allows for **liquidity to be shared** among the firms participating in the DLG by modifying the BIPRU 12.2.1R
- Each individual firm in the DLG has access to the total amount of liquidity within the DLG
- So long as the **total amount** of liquidity in the DLG is **sufficient to meet the total liquidity needs** of the entire DLG, each member of the DLG is **deemed to have access to adequate liquidity**

IGLM process

- Firms apply for an **IGLM** as set out in **BIPRU 12.8.7G – 12.8.13G**
- The applicant firm(s) will need to demonstrate with clarity that the **proposed DLG has, and will continue to have access to sufficient liquidity at all times** – this may require the firms seeking to participate in the DLG to **submit individually** a **Liquidity Metric Monitor** (LMM) (or FCA 047/048 if the firms are ILAS firms), ***and*** an LMM for the proposed DLG
- Applicant firms must satisfy the statutory tests under FSMA