



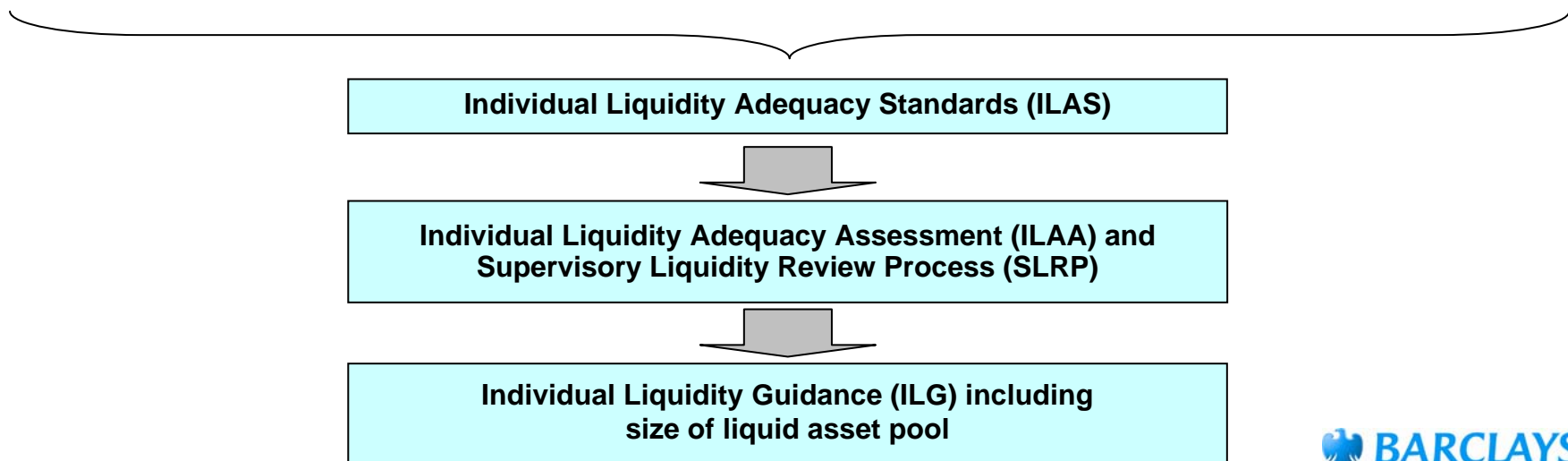
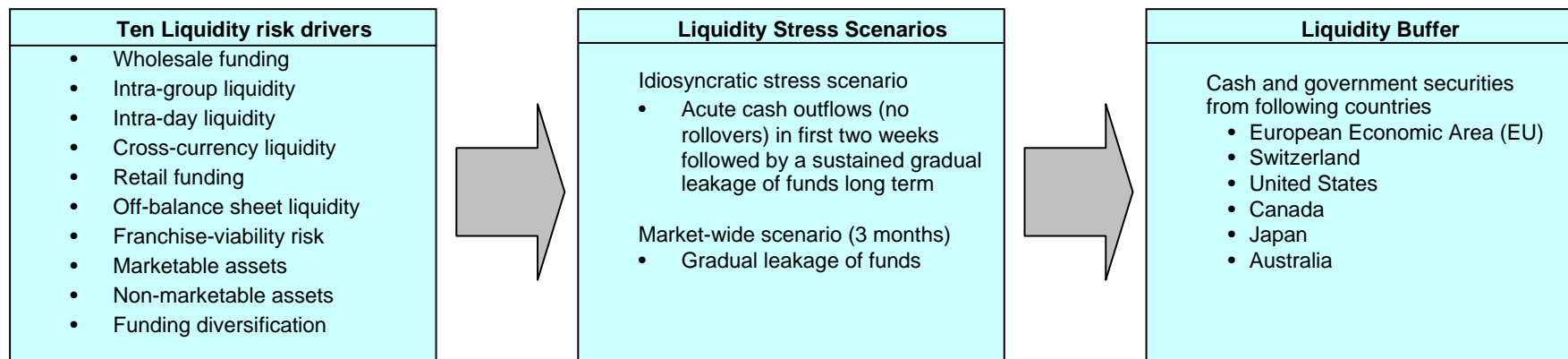
# **FSA Liquidity Overview**

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MMCG, 19 November 2009

# Overview: FSA aims to strengthen liquidity standards

- Identifies ten liquidity risk drivers, which analyze liquidity strength of financial institutions
- Liquidity risk drivers are included in liquidity stress scenarios, which in turn are used to size the liquidity buffer
- No standard rules used to build stress scenarios or size liquidity buffer (except for “simpler firms”). Instead the FSA will make an individual determination based on a detailed liquidity audit



# Individual Liquidity Adequacy Standards (ILAS)

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## ■ Premise of ILAS:

### ▶ Adequate Liquidity

- Firms have adequate liquidity at all times, and to limit the amount of liquidity risk they run.

### ▶ Self-sufficiency

- Branch not permitted to rely on other part of their group to satisfy the *overall liquidity adequacy rule*. Therefore must be:
  - Under the day-to-day control of the branch's senior management;
  - Held in the account with one or more custodians in the sole name of the UK branch;
  - Unencumbered;
  - Attributed to the balance sheet of the branch.
- Equivalence assessment of home regulator.
- Creditor preference not to detriment of UK depositors.
- All modifications.

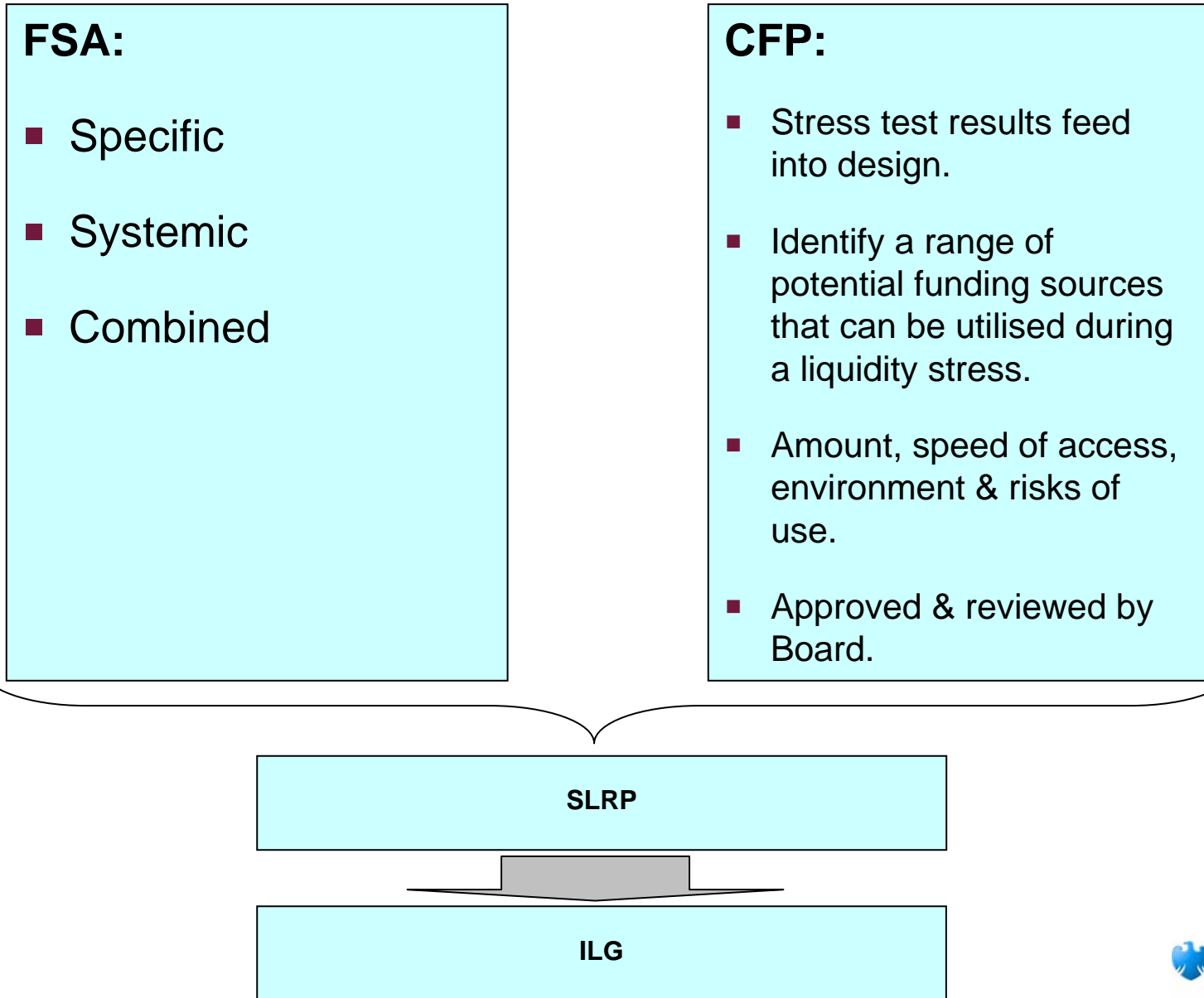
# ILAS

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- Bank conducts Individual Liquidity Adequacy Assessment (ILAA)
  - ▶ Stress test performed at least once a year and results analyzed.
  - ▶ Senior management reviews and reports outcome to Board.
  - ▶ Board involved in:
    - optimal size of liquid asset buffer;
    - develops contingency funding plan (CFP);
    - Internal limits or day-to-day liquidity management policies
  
- FSA conducts Supervisory Liquidity Review Process (SLRP)
  - ▶ Reviews results of ILAA using a risk-based approach.
  - ▶ Iterative process between FSA and bank.
  - ▶ Confirms satisfaction of bank ILAA .
  
- FSA issues Individual Liquidity Guidance (ILG)
  - ▶ Size of liquid asset buffer & funding profile that “ensures” firm passes combo stress test.
  - ▶ Bank must stick to ILG at all times - excluding phase-in.
  - ▶ Proactively report a breach, with immediate use CFP to remedy it.

# ILAA - the stress testing environment

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# ILAA - stress testing assumptions

- **MM**
  - ▶ Wholesale deposits fail to roll over & retail leakage;
  - ▶ Repo funding only active in Government securities;
  - ▶ Downgrade triggers;
  - ▶ Contingent Liability.
- **Collateral**
  - ▶ Government debt;
  - ▶ EU, AU, CA, CH, JP & US (min: Aa3).
- **FX**
  - ▶ No access for the first 2 weeks.
- **Survival Period**
  - ▶ 14 days (standard), but vary between individual institutions;
  - ▶ Stress period 12 weeks.
- **Use of CB facilities - NO**
  - ▶ OMO – probably;
  - ▶ BOE SLF – possibly.

First two weeks of stress	Remainder out to three months
<i>Idiosyncratic impact</i>	
Inability to roll over wholesale funding that is: (i) unsecured from credit-sensitive depositors or (ii) not secured on the most liquid securities.	Sustained leakage of funds
Sizeable retail outflow	Sustained outflow
Reduction in amount of intra-day credit provided to a customer by its settlement bank; Increase in payments withheld to a direct participant by its counterparties; and Increase in need for all firms (both direct and indirect participants) to make payments.	N/A
Closure of FX markets	N/A
Intra-group deposits repaid at maturity, intra-group loans treated as evergreen.	
Downgrade of long-term rating, proportional impact of all other downgrade triggers.	
<i>Market-wide impact</i>	
Uncertainty as to the accuracy of the valuation of a firm's assets and those of its counterparties.	
Inability to realise or ability to realise only at excessive cost particular classes of assets.	
Risk aversion among participants in the markets on which the firm relies on for funding.	
Uncertainty as to whether many firms will be able to meet liabilities as they fall due.	

Source: FSA document 09/16

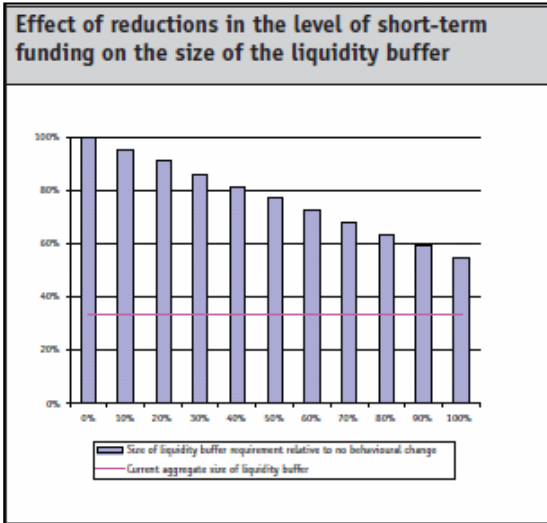
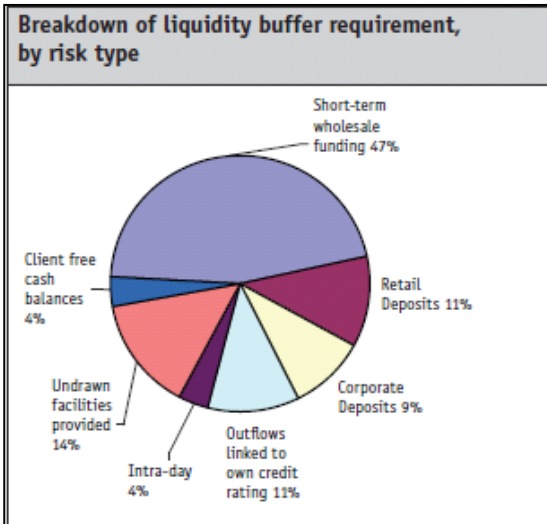


# Liquidity Buffer

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- Assets:
  - ▶ High quality Government bonds.
  - ▶ Multi-lateral development banks.
  - ▶ Eligible central bank reserves & their tradable securities.
- Rating:
  - ▶ At least Aa3/AA-.
- Collateral Countries:
  - ▶ EEA, CH, US, CA, JP & AU.
- Currencies:
  - ▶ GBP, EUR, USD, JPY, CHF, DKK, SEK, NOK, CAD & AUD
  - ▶ Non-collateral currencies: Firms given limited allowance within ILG when a local supervisor sets a requirement to hold a liquidity buffer in local currency.
- Make-up:
  - ▶ An appropriate mix of eligible assets and can not be constructed to “chase yield.”
- Turnover requirement:
  - ▶ Sale or repo of liquid assets in private markets.
- Standing Facilities:
  - ▶ Required to access central bank facilities regularly (BoE, ECB, FED).

# Costs



		Liquidity buffer shortfall (in £bn) to industry assuming ILG is calibrated as:					Amount of short-term funding in the system (funding < 3 months)
		100% of ILAA stresses	80% of ILAA stresses	60% of ILAA stresses	40% of ILAA stresses	20% of ILAA stresses	
<b>Reduction in short-term wholesale funding</b>	No change	620	440	150	0	0	500
	20% reduction	530	370	110	0	0	400
	40% reduction	450	310	70	0	0	300
	60% reduction	370	240	30	0	0	200
	80% reduction	290	180	0	0	0	100
	100% reduction	210	110	0	0	0	0

		Cost to industry (in £bn) assuming ILG is calibrated as:				
		100% of ILAA stresses	80% of ILAA stresses	60% of ILAA stresses	40% of ILAA stresses	20% of ILAA stresses
<b>Reduction in short-term wholesale funding</b>	No change	9.2	6.6	2.3	0	0
	20% reduction	8.5	6.1	2.2	0.5	0.5
	40% reduction	7.8	5.7	2.2	1.1	1.1
	60% reduction	7.2	5.2	2.1	1.6	1.6
	80% reduction	6.5	4.8	2.2	2.2	2.2
	100% reduction	5.9	4.4	2.7	2.7	2.7

Source: FSA document 09/16





# ILAS and Foreign Banks

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- FSA default position

- ▶ *“Every UK legal entity and every UK branch must satisfy our quantitative requirements on a ‘self-sufficient’ basis.”*
- ▶ *“However, branches and subsidiaries can apply for modifications from self-sufficiency, where statutory tests within the Financial Services and Markets Act 2000 are met.”*

- Self-sufficiency modifications:

- ▶ Whole firm liquidity modification

- replaces current Global Liquidity Concession regime;
- branch will no longer be subject to FSA quantitative ILAS regime;
- conditions as set out in FSA CP 08/22,

- ▶ Intra-group liquidity modification

- only partial switch of ILAS regime;
- branch can rely on some parental funding;
- importance attached to supervisory equivalence and information exchange;
- conditions as set out in FSA CP 08/22.

## Implementation dates

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### ■ FSA

- ▶ 1 Dec 2009: Phased introduction of Individual Liquidity Adequacy Standards (ILAS):
- ▶ 31 May 2010: transitional arrangements end.
- ▶ 1 June 2010: New ILG “Flight path” takes effect.

### ■ EU & RoW

- ▶ June 2010: Finalisation of common “minimum” recommendations on liquidity regulations. (C-EBS)
- ▶ July 2010: Introduction of new liquidity regulations due in France (BdF/CB) and Australia (APRA) with both proposed to come into force by the end of the year.

## Aims

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- Over-arching principles of self-sufficiency & adequacy for liquidity resources;
- Enhanced systems & control requirements, which implement BCBS 17 principles;
- Updated quantitative requirements (ILAS), coupled with narrow definition of liquid assets;
- New modifications regime for branches and subsidiaries;
- Granular & frequent reporting requirements.

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