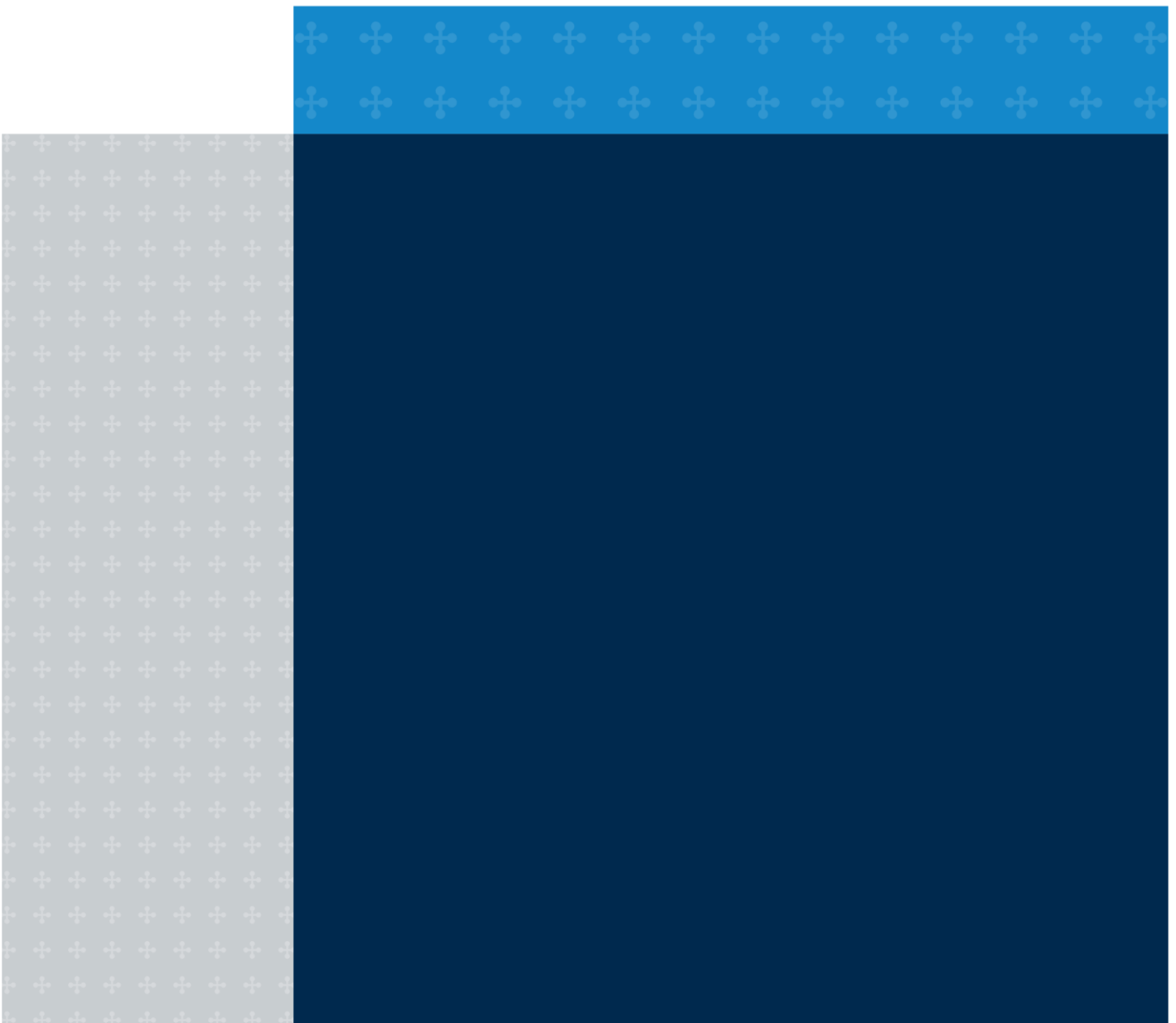




Policy Statement | PS26/21

Domestic Liquidity Sub-Groups

November 2021





BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

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1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 19/21 ‘Domestic Liquidity Sub-Groups’.¹ It also contains the PRA’s final policy, as follows:

- amendments to the Glossary, Liquidity (CRR), and Internal Liquidity Adequacy Assessment Parts of the PRA Rulebook (Appendix 1); and
- amendments to the Statement of Policy (SoP) ‘Liquidity and Funding Permissions’ (Appendix 2).

1.2 Where certain conditions are met on the availability, distribution, management, and monitoring of liquidity, the Capital Requirements Regulation (CRR) allows the PRA to waive the application of liquidity requirements at the level of an individual firm and to permit a firm to form a Domestic Liquidity Sub-Group (DoLSub). Those requirements include the Liquidity Coverage Ratio (LCR), liquidity risk management, monitoring, reporting, and disclosure. Where a DoLSub permission is granted, PRA requirements apply at the level of a DoLSub on the basis of the consolidated situation of its members, rather than applying to member firms individually. This reflects the ability of some firms to manage their liquidity jointly with other entities, as if they were a single entity. This provision, in Article 8 of CRR, will be revoked from Saturday 1 January 2022.

1.3 This PS is relevant to PRA-authorised UK banks, PRA-designated UK investment firms, and building societies (hereafter known as ‘firms’). It is also relevant to UK financial or mixed financial holding companies that are immediate parent undertakings of firms that may be included in a DoLSub. It is not relevant to credit unions.

1.4 The purpose of the rules on DoLSubs is to ensure that liquidity requirements are sufficiently prudent and proportionate when applied at the level of a DoLSub, where certain conditions are met, including from 1 January 2022 for the Net Stable Funding Ratio (NSFR).

1.5 The PRA considered the interaction between its primary and secondary objectives and the ‘have regards’, including in relation to international standards, relative standing of the UK, and finance for the real economy. Overall, the PRA considers the final policy to be necessary and appropriate to enhance the proportionality of the PRA’s regulatory regime while maintaining firms’ safety and soundness.

Background

1.6 In CP5/21 ‘Implementation of Basel standards’,² the PRA proposed to implement international standards through a new PRA Rulebook (CRR) instrument. CP5/21 included rules specifying the level of application of prudential requirements, implementing the LCR and the NSFR, and a new ‘Liquidity and funding permissions’ SoP setting out the PRA’s approach to assessing DoLSub permission applications.

1.7 In PS17/21,³ the PRA provided feedback on the responses to CP5/21, and set out near-final rule instruments, SoPs, Supervisory Statements, and reporting templates and instructions, including for the LCR and NSFR. However, in light of the responses on levels of application, the PRA decided to consider further the conditions under which a DoLSub may be granted.

¹ September 2021: [CP19/21 ‘Domestic Liquidity Sub-Groups’](#).

² February 2021: [CP5/21 ‘Implementation of Basel standards’](#).

³ July 2021: [PS17/21 ‘Implementation of Basel standards’](#).

1.8 In CP19/21, the PRA proposed to:

- permit the inclusion in a DoLSub of firms that are subsidiaries of a common immediate UK qualifying parent undertaking that is not a bank or PRA-designated investment firm (referred to in this PS as a ‘sibling DoLSub’); and
- revise the conditions under which a firm would qualify for a DoLSub permission, and the factors that the PRA will take into account when considering DoLSub applications.

Summary of responses

1.9 The PRA received seven responses to the CP. Respondents were generally supportive of the PRA’s proposals, but also raised a number of concerns and requests for further clarification, which are set out in Chapter 2 of this PS.

Changes to draft policy

1.10 Where the final rules differ from the draft in the CP in a way which is, in the opinion of the PRA, significant, the Financial Services and Markets Act 2000 (FSMA)⁴ requires the PRA to publish:

- (a) details of the difference together with a cost benefit analysis; and
- (b) a statement setting out in the PRA’s opinion whether or not the impact of the final rule on mutuals is significantly different to: the impact that the draft rule would have had on mutuals; or the impact that the final rule will have on other PRA-authorized firms.

1.11 Following consideration of respondents’ comments, the PRA has not made any changes to the rules on which it consulted. However, the PRA has made a number of changes to the draft SoP published alongside CP5/21, to provide greater clarity on the PRA’s expectations in certain areas and to enhance the proportionality of the PRA’s approach. These amendments clarify:

- the information to be provided to demonstrate compliance with the conditions covering the governance arrangements of a DoLSub; and
- the circumstances in which a solo regulatory return for the LCR and/or NSFR should be submitted with a DoLSub application.

1.12 The PRA considers that these changes to the draft policy maintain the safety and soundness of firms while the enhancing proportionality and promoting the clarity of the PRA’s approach. Due to the low materiality of the changes, the PRA continues to consider that it would not be practicable to develop a quantitative estimate of the direct costs to firms. The PRA also expects that these changes will not have a material impact on competition and are therefore consistent with the PRA’s secondary competition objective. The PRA considers that the changes to the draft policy outlined in this PS will not have a differential impact on mutual societies.

1.13 Further details on the PRA’s changes to the draft policy are set out in Chapter 2.

1.14 When making CRR rules, the PRA must consider, and publish an explanation of, the ways in which the PRA has had regard to certain additional matters, and how the additional have regards have affected the proposed rules.⁵ In CP19/21, the PRA set out this explanation in Chapter 3 ‘The

⁴ Sections 138J(5) and 138K(4) of FSMA.

⁵ Sections 144C(1)(2) and 144D(1) of FSMA.

PRA's statutory obligations', and the PRA has provided an updated explanation of the have regards to take into account consultation responses in Appendix 3.⁶

1.15 The PRA must also publish a summary of the purpose of the rules.⁷ In this case, the rules specify the permission for the derogation of the application of the Liquidity Coverage Ratio (LCR) and Liquidity (LCR) Parts of the PRA Rulebook on an individual basis. This permission enables institutions to waive the LCR and NSFR requirements at the level of individual legal entities. Its purpose is to give greater recognition of firms' management of liquidity and funding risks at a consolidated or sub-consolidated level. It also enhances proportionality by allowing firms with different group structures to apply for the permission.

Implementation

1.16 The implementation date for the policy changes resulting from this PS will be Saturday 1 January 2022. This policy is intended to take effect at the same time as the revocation of article 8 of CRR by regulation 4(4) of the Capital Requirements Regulation (Amendment) Regulations 2021.

1.17 HM Treasury did not implement a savings provision for LCR DoLSub permissions that are currently in force or would enter into force before Saturday 1 January 2022. This means that DoLSub permissions in existence before Saturday 1 January 2022 that disapply the LCR requirements at an individual level would not apply after that date.

1.18 The PRA expects firms to apply formally for LCR and NSFR DoLSub permissions at the earliest opportunity under the final revised DoLSub framework included in this PS. The PRA will assess all applications under the final revised framework, and permissions that are granted will take effect from Saturday 1 January 2022.

1.19 References related to the UK's membership of the EU in the SoP covered by the policy in this PS have been updated as part of this PS to reflect the UK's withdrawal from the EU. Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of retained EU law.⁸

⁶ September 2021: [CP19/21 'Domestic Liquidity Sub-Groups'](#).

⁷ Section 144D(2) of FSMA.

⁸ For further information please see [Transitioning to post-exit rules and standards](#).

2 Feedback to responses

2.1 Before making any proposed rules, the PRA is required by FSMA to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its feedback to them.⁹

2.2 The PRA has considered the responses received to CP19/21. This chapter sets out the PRA's feedback to those responses and its final decisions. The PRA has structured its feedback into three sections:

- process related matters;
- applying liquidity requirements at the level of domestic liquidity sub-groups; and
- conditions for forming a DoLSub.

Process related matters

Consultation period

2.3 Three respondents raised concerns that the two-week consultation period for CP19/21 constrained their ability to review the proposals, with two respondents stating they were unable to provide a written response as a result.¹⁰

2.4 The PRA recognises that the consultation period was relatively short. The date of application of the PRA's implementation of the Basel standards on liquidity is Saturday 1 January 2022. The PRA considered it necessary for the consultation to last only two weeks, as that would make it possible to obtain further views from respondents on the PRA's proposals, while also ensuring firms have sufficient time to apply for DoLSub permissions prior to implementation. In addition, the PRA considers that the consultation period was sufficient, given the proposals contained in CP19/21 acted on feedback the PRA received to the prior consultation in CP5/21.

Transitional arrangements

2.5 HM Treasury did not implement a transitional savings provision for LCR DoLSub permissions that are currently in force, or expected to be in force, prior to Saturday 1 January 2022. Three respondents commented on the lack of a savings provision. One respondent asked why the PRA did not propose to utilise its rule-making powers to implement transitional arrangements for existing DoLSub permissions.

2.6 The PRA has considered the responses received and decided to maintain its proposed approach. The PRA considers the revised framework for assessing DoLSub applications to provide an effective and efficient basis to process firms' applications in a timely manner. As a result, the PRA does not consider it necessary or appropriate to implement a transitional policy for existing LCR DoLSub permissions. The PRA considers this to be proportionate, as it considers the additional cost of re-applying for an LCR DoLSub permission to be limited, given the large overlap between the information that firms must provide for LCR DoLSub applications and the information required to support the NSFR DoLSub applications that firms intend to submit before year end.

⁹ Sections 138J(3) and 138J(4) of FSMA.

¹⁰ The PRA received a communication from one of these respondents after the consultation period had closed, and has considered their response as part of this PS.

DoLSub application timing

2.7 Five respondents raised concerns about the limited time available for DoLSub applications to be finalised, subject to the PRA's internal governance and processes. Three of those respondents asked for assurance that the PRA would have sufficient time to assess applications prior to the NSFR implementation date. One respondent suggested that the PRA could allow firms to leverage earlier DoLSub applications rather than submitting new ones, as that could help to reduce the time required for firms to review and subject their applications to their internal governance process. This respondent also welcomed the ability for firms to use one DoLSub application to cover both the LCR and NSFR requirements.

2.8 The PRA has considered the responses and decided to maintain its proposed approach. The PRA considers that firms should apply formally for LCR and NSFR DoLSub permissions at the earliest opportunity. This will help to ensure sufficient time to complete the applications process prior to the date of application of the requirements. As explained in CP19/21, the PRA has accepted information about firms' prospective applications before publishing final rules in order to ensure that applications can be processed in sufficient time prior to 1 January 2022. The PRA also intends to continue to engage with applicants to aid their understanding of how the PRA's expectations would apply in individual cases. Where aspects of earlier DoLSub applications remain valid under the revised framework, the PRA considers that firms could re-use that information when re-applying for the permission.

Applying liquidity requirements at the level of domestic liquidity sub-groups

Formation of sibling DoLSubs

2.9 In CP19/21, the PRA proposed to permit the inclusion in a DoLSub of firms that are subsidiaries of a common immediate UK qualifying parent undertaking that is not a bank or a PRA-designated investment firm (a 'sibling DoLSub').

2.10 Three respondents supported this aspect of the PRA's proposals. One respondent suggested that enabling a broader range of group structures to apply for a DoLSub permission would enhance the proportionality of the PRA approach and support effective competition.

2.11 The PRA has considered the responses and decided to maintain its proposed approach.

Conditions for forming a DoLSub

2.12 In CP19/21, the PRA proposed to enhance the framework that firms are currently required to comply with to qualify for a DoLSub permission. These proposals were intended to ensure the free flow of liquidity and funding within a DoLSub, including to address the additional risks where firms' immediate parent undertaking is a holding company that is not subject to solo liquidity requirements and is not included within the DoLSub. Respondents' comments focused on: the PRA's proposals to convert the factors that the PRA currently 'may take into account' into conditions that the PRA expects to be met; the proposed new governance and accountability arrangements; and the proposed new expectations in relation to LFAs.

Converting factors into conditions

2.13 The PRA proposed to convert the factors that the PRA currently 'may take into account' when assessing firms' DoLSub applications, into conditions that the PRA expects to be met, both for the permission to be granted and on an ongoing basis.

2.14 Three respondents commented on these new conditions. One respondent considered they would meet them on an ongoing basis. Two respondents requested that the PRA be judgement-based in assessing firms' applications under the new DoLSubs framework. One of those respondents

asked that the PRA recognise that firms' first submissions under the new conditions might be less comprehensive than the PRA would wish and suggested that the PRA grant three-month interim approvals for DoLSub applications, to allow firms to remediate any non-material non-compliance with the conditions. The other respondent encouraged the PRA to be pragmatic when assessing applications given many DoLSubs have been in existence since 2010 and given the date of application of the NSFR requirements.

2.15 The PRA has considered the responses and decided to maintain the approach as proposed. The PRA expects the conditions to be met. However, to the extent that firms or the PRA identify non-compliance with the conditions, the PRA intends to work with firms to determine their materiality and how they might be addressed, given the date of application of the requirements.

2.16 One respondent asked whether firms would need to meet the NSFR or LCR on an individual basis when applying for a DoLSub. The PRA has considered the response and decided to maintain the approach on which it consulted. The SoP clarifies that firms should meet their liquidity and/or funding requirements 'as applicable'. This ensures that it is only liquidity requirements that apply to a firm that must be met at the time of application.

Governance and accountability

2.17 The PRA proposed to strengthen governance and accountability for DoLSubs by introducing conditions covering:

- whether governance within a DoLSub is consistent with the principle of individual accountability under the Senior Managers & Certification regime (SM&CR);
- whether there are appropriate policies, processes, and procedures to ensure the timely identification and resolution of conflicts of interest and disputes between DoLSub members; and
- whether there is sufficient evidence of effective processes and procedures within a DoLSub, including those relating to governance and control arrangements.

2.18 Four respondents commented on this aspect of the PRA's proposals. One respondent asked whether significant enhancements to governance and accountability arrangements would be required to meet the new conditions, and sought clarity on what evidence would be required to meet the conditions. Another respondent requested information on how firms could re-use governance material already provided to the PRA and requested further guidance on how firms could meet the new requirements. Two respondents asked whether their existing governance and accountability arrangements would meet the new conditions. Three of the four respondents also requested further guidance, in particular, on the PRA's expectations for its proposed conflicts of interest framework, with one questioning whether the PRA had identified a specific need to strengthen conflict and dispute management for DoLSub permissions.

2.19 After considering the responses, the PRA has decided to clarify in the SoP that firms should submit a copy of their management responsibility map(s) produced for the SM&CR as evidence of clear individual accountability in the proposed DoLSub. The PRA considers this will provide sufficient clarity on how firms can provide evidence of compliance with the individual accountability condition in the revised DoLSubs framework. The PRA has decided not to provide additional detail on how firms are expected to meet the new governance and accountability conditions, re-use of materials, or meet the conflicts of interest framework. The PRA does not consider this necessary, in particular as supervisors intend to discuss firms' applications with them to help to ensure they understand what is required.

2.20 Two respondents requested that the PRA provide additional guidance and/or examples on the additional information requested for new DoLSub applications to be successful, beyond information relating to governance and accountability. For these other aspects of the PRA's policy, the PRA may provide further clarification where necessary in relation to individual applications.

Loan facility agreements

2.21 The PRA proposed to enhance conditions that mitigate risks to the free transfer of funds between DoLSub entities. This included specifying that the qualifying parent undertaking in a sibling DoLSub must be in a core UK large exposures group with the members of the DoLSub, and party to multilateral, cross currency, and unlimited LFAs with members of the DoLSub.

2.22 Five respondents commented on the external legal opinion that firms must obtain as to the LFAs' compliance with the stipulations outlined in the SoP. Three respondents sought to clarify whether a legal opinion obtained for a recently submitted DoLSub application could be re-used for DoLSub applications under the revised framework. One respondent also asked whether the LFA for a core UK Group permission was the same as that required for a DoLSub, and whether the same legal opinion could be re-used for the DoLSub permission. Two respondents suggested the PRA allow firms to leverage existing legal opinions for their new DoLSub applications, citing potential resource constraints within firms applying for the permission and for their legal advisors.

2.23 After considering the responses, the PRA considers that firms may rely on legal opinions that have been provided as part of DoLSub applications submitted during 2021, subject to confirmation by external legal counsel that the associated LFAs do not need to change as a result of the revised DoLSub framework set out in this PS.

2.24 One respondent asked whether a firms' DoLSub regulatory consolidation should include the immediate parent holding company in a sibling DoLSub, and if not, whether the PRA intended to allow the consolidation of such entities in the future.

2.25 While the PRA expects the holding company to be part of the LFA in respect of a sibling DoLSub, the PRA considers that firms cannot include the holding company of a sibling DoLSub as part of the DoLSub regulatory consolidation. Such holding companies are not subject to PRA authorisation and supervision, and therefore could not form part of the DoLSub to which they are a parent.

2.26 One respondent stated that making the holding company in a sibling DoLSub party to LFAs with DoLSub entities could give rise to additional risks to the DoLSub, as the holding company could call upon funding from the DoLSub entities in a stress.

2.27 The PRA has considered this comment and decided to amend its proposed approach. The PRA considers that its proposed approach would help to enhance firms' safety and soundness, by supporting the free movement of funds within the DoLSub via immediate the parent holding company. However, the PRA notes that this could introduce additional risks. The PRA has decided to amend the SoP to specify that the PRA expects that LFAs should include a clause specifying that funds loaned under the LFA may be used by the borrowing entity exclusively to provide for the free movement of funds between the members of the DoLSub to enable them to meet their individual and joint obligations as they become due. This provision applies only where the borrowing entity is a qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies.

2.28 One respondent sought to clarify a provision in the SoP stating that LFAs must be 'enforceable in the UK', and whether that implies that LFAs need be enforceable only under the governing law of

the LFA. The respondent also asked whether firms should provide CRR legal opinions confirming that the LFA complies with CRR and PRA requirements, and capacity legal opinions in relation to each party in the LFA.

2.29 The PRA has considered the response and decided to maintain its proposed approach. The PRA agrees that the legal opinion should confirm enforceability under the governing law of the agreement, and has amended the SoP to reflect this position. Firms may need to provide more than one legal opinion if LFA counterparties are located in different jurisdictions in the UK (to confirm due execution, including the power and capacity of each party to enter into the agreement).

Other aspects of the framework

FCA solo regulated entities

2.30 The PRA proposed to preclude the inclusion of Financial Conduct Authority (FCA) solo-regulated firms in a DoLSub. One respondent suggested the PRA should reconsider this proposal, as not including such firms would result in additional levels of consolidation and increased compliance burden for limited prudential benefit.

2.31 The PRA has considered the response and decided to maintain the approach as proposed. The PRA considers that there are prudential benefits to ensuring that all of the entities in a DoLSub are subject to the same prudential requirements, given the revised scope of application of the on-shored CRR following the introduction of the UK Investment Firms Prudential Regime (IFPR). This would not be the case if FCA solo-regulated entities were to be included in a DoLSub. The PRA considers that the PRA's waiver/modification power is available, and could be exercised, in individual cases where the PRA considers that the application of the unmodified rule would impose an undue burden on a firm or would not achieve the purpose for which the rule was intended.

Provision of solo reporting when applying for a DoLSub permission

2.32 Two respondents stated that the PRA's proposal to request solo LCR and NSFR returns from firms applying for DoLSubs would be resource-intensive, in particular given time constraints associated with submitting a DoLSub application before year-end.

2.33 The PRA has considered the responses. The PRA considers it could be disproportionate to require a firm that has a DoLSub permission for the LCR or NSFR to submit a solo return for that standard when applying to renew a DoLSub permission covering the relevant standard. However, where a firm is applying for a DoLSub permission for the relevant standard for the first time, the PRA considers it to be necessary for a firm to provide a completed regulatory return for that standard with its application. This will ensure the PRA is sufficiently informed about the impact of the standard at the level of an individual firm, and the effect of granting or not granting a DoLSub permission. However, to ensure this approach is sufficiently proportionate, the PRA has decided to modify its approach to clarify that firms may complete such returns using estimates of a solo entity's liquidity and/or funding position, and confirming in writing any significant simplifying assumptions made in deriving the estimates. The PRA considers this approach to be prudent and proportionate, as it would inform the PRA of the liquidity and funding situation of member firms in the proposed DoLSub while also not requiring the same assurance as would be required if a firm had to implement solo reporting for that standard.

Provision of solo reporting on an on-going basis

2.34 The PRA proposed in CP19/21 to clarify that it may request entities in a DoLSub to continue to provide reporting on a solo basis, where necessary to ensure the effective supervision of the firms in the DoLSub. Three respondents commented on this proposal, with one seeking further clarity on when the PRA might request such solo reporting. One respondent stated that it would be difficult to

produce solo returns on an ongoing basis; another stated it would not be difficult to produce these returns on an ongoing basis.

2.35 The PRA has considered the responses and decided to implement its policy as proposed. The PRA does not consider it necessary or appropriate to list the possible circumstances in which it might require firms in a DoLSub to continue to provide solo liquidity reporting. However, the PRA intends to require such reporting only on a case-by-case basis, where warranted and necessary, based on the risks of an individual firm.

Appendices

- 1 PRA RULEBOOK (CRR NO. 2) INSTRUMENT 2021, available at:
<https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/november/ps2621app1.pdf>

- 2 Statement of Policy (SoP) 'Liquidity and funding permissions', available at:
<https://www.bankofengland.co.uk/prudential-regulation/publication/2021/july/liquidity-and-funding-permissions-sop>

- 3 Detailed analysis of objectives and 'have regards', available at:
<https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/november/ps2621app3.pdf>

- 4 Corresponding provisions, available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/november/ps2621app4.pdf>
