BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Publication

Statement of Policy

Liquidity and funding permissions

November 2021

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Contents

1 Introduction

1.1 This Statement of Policy (SoP) sets out the PRA's approach to granting selected regulatory permissions that are relevant to the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) requirements. It also sets out the PRA's expectation that eligible firms should notify the PRA if they intend to use the simplified NSFR (sNSFR) methodology. It is relevant to all UK banks, building societies, and PRA-designated investment firms, referred to collectively as 'firms'.

2 General matters

2.1 In determining whether or not to grant a regulatory permission, the PRA would be exercising its powers under the Financial Services and Markets Act 2000 (FSMA), s144G or s192XC. This allows the PRA to disapply, or modify the application of, certain PRA rules in the Liquidity (CRR) and Liquidity Coverage Ratio (CRR) Parts of the PRA Rulebook, upon the application or with the consent of a firm. The PRA may give such permission subject to conditions. It also has power to revoke or vary a permission which has been issued.

2.2 The exercise of the PRA's permission power is discretionary. In exercising its discretion, the PRA will consider whether the conditions set out in relation to each of the permissions in PRA rules are satisfied, as well as the additional conditions relating to certain permissions which are set out in this SoP.

2.3 Although FSMA s144G and s192XC do not set out any additional general considerations for the exercise of the permission power, the PRA will consider whether granting a permission in any particular case would be consistent with advancing its statutory objectives as set out in Part 1A, chapter 2 of FSMA, including in relation to ring-fencing.

2.4 The PRA will also consider whether granting the permission in a particular case may undermine any of the purposes for which the rule was made, including the matters set out in s144C of FSMA ('Matters to be considered when making CRR rules').

3 Ongoing expectation to notify the PRA of material information that is relevant to permissions

3.1 Unless otherwise stated, the conditions set out in PRA rules and in this SoP should be thought of as continuing conditions which firms need to satisfy on an ongoing basis. After the PRA has granted a permission, it expects that the firm promptly notifies it if it does not, or expects that it soon will not, continue to meet any of those conditions for as long as the permission remains effective.

3.2 The PRA further expects that firms promptly notify it of any material change in circumstances, including anticipated changes in circumstances that might affect the PRA's continuing assessment of this permission. This includes changes to the factors reported by firms set out in this SoP that the PRA will consider when assessing permission applications.

3.3 These expectations are an elaboration of firms' obligations to inform the PRA of relevant information under the PRA Fundamental Rules.[1]

1 PRA Rulebook: Fundamental Rules Instrument 2014, 2.7.

3.4 The PRA may decide not to revoke or modify a permission that it has granted when it receives the notifications set out in paragraphs 3.1 to 3.3 above.

3.5 The expectations in paragraphs 3.1 and 3.2 do not apply to changes in matters set out in paragraph 6.1 (information which firms should provide as part of pre-notifications to use the sNSFR methodology).

3A Liquidity (CRR) Rule 2.2: Domestic Liquidity sub-groups (DoLSubs)

3A.1 The PRA may grant waivers under this rule where the following conditions are met:

(i) to the satisfaction of the PRA, that the parent institution on a consolidated basis or the subsidiary institution on a sub-consolidated basis, where 2.2(b)(i) of the Liquidity (CRR) Part applies (or one of the institutions or the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies), monitors and has oversight at all times over the liquidity positions of all institutions within the group or sub-group which are subject to the waiver and ensures a sufficient level of liquidity for all these institutions;

(ii) the institutions (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies) have entered into contracts that, to the satisfaction of the PRA, provide for the free movement of funds between them to ensure they are able to meet their individual and joint obligations as they become due;

(iii) the members of the proposed DoLSub are either:

(a) all defined as 'ring-fenced bodies' under FSMA, s.142A; or

(b) all not defined as 'ring-fenced bodies' under FSMA.

(iv) all proposed DoLSub members are in the same UK consolidation group;

(v) the members of the DoLSub (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies) are members of the same core UK group;

(vi) where members of the DoLSub are ring-fenced bodies, those ring-fenced bodies meet paragraphs 5.13 to 5.17 of PRA Supervisory Statement 8/16;[2]

(vii) there is an unlimited, cross-currency, multilateral facility between all members of the proposed DoLSub (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies);

(viii) liquidity and/or funding risks (as applicable) are managed on the basis of the members of the proposed DoLSub;

(ix) the PRA has identified no cause for material concern about the management of liquidity and/or funding risks (as appropriate) within DoLSub members, including their governance and control arrangements, processes, and procedures;

2 December 2017: SS8/16 'Ring-fenced bodies (RFBs)'.

(x) all proposed DoLSub members meet their liquidity and/or funding requirements (as applicable) at the time of their application;

(xi) the PRA considers that the formation of the proposed DoLSub would not materially adversely affect the ability of the PRA to supervise entities under the DoLSub arrangement;

(xii) the PRA considers that the proposed DoLSub is consistent with the principle of individual accountability under the Senior Managers & Certification Regime and, in the case of a DoLSub where 2.2(b)(ii) of the Liquidity (CRR) Part applies, clearly identifies a Senior Management Function (SMF) individual who would have responsibility for the effective functioning of the DoLSub, such as through the appointment of an SMF 7 within the qualifying parent undertaking;

(xiii) the PRA considers that there are appropriate policies, processes, and procedures to ensure the timely identification and resolution of conflicts of interest and disputes, relating to the provision of funding under the Loan Facility Agreement between the members of the DoLSub (and the members of the DoLSub and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies); and

(xiv) the PRA considers that the proposed DoLSub is commensurate with the nature, scale, and complexity of the business conducted by the members of the DoLSub.

3A.2 The PRA will have regard to whether there is a material prudential benefit gained from the formation of the proposed DoLSub.

3A.3 Applicants should provide the PRA with the following information as part of their application for permission under this rule:

(i) names of the members of the proposed DoLSub (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies);

(ii) regulatory classification of the entities (ie credit institution, institution, qualifying parent undertaking);

(iii) country of incorporation of the entities;

(iv) a group structure chart showing the position of the members of the proposed DoLSub within the applicant's wider group;

(v) an explanation of the reason for the application and the intended outcome of the permission;

(vi) a list of all material affiliates not included in the DoLSub with an assessment of the liquidity risks posed to the DoLSub;

(vii) the name of the entity within which the treasury, liquidity, or funding management function for the DoLSub will sit;

(viii) a declaration from the applicant firm that all proposed DoLSub members meet their liquidity and/or funding requirements (as applicable) at the time of their application;

(ix) full details and an explanation (including procedural documentation) of how DoLSub liquidity risks are managed, including:

(a) internal liquidity policy;

(b) details of the limits, methods, and systems used to manage and monitor liquidity;

(c) a copy of the stress testing procedures and the results of carrying out those procedures; and

(d) a copy of the contingency funding plan(s) which relate to the entities that would comprise the DoLSub (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies);

(x) full details and an explanation (including procedural documentation) of how DoLSub funding risks are managed, including:

(a) internal funding policy;

(b) details of the limits, methods, and systems used to manage and monitor funding risks; and

(c) details of the policies, processes, and procedures that ensure the timely identification and resolution of conflicts of interest and disputes, relating to the provision of funding between the members of the DoLSub (and the members of the DoLSub and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies), in accordance with the Loan Facility Agreement.

(xi) where the firm is applying for a waiver of the LCR requirements and does not already have a DoLSub covering the LCR:

(d) a completed LCR liquidity return on a sterling-equivalent basis for the solo institutions that would be in the DoLSub; and

(e) a completed LCR liquidity return on a sterling-equivalent basis for the proposed DoLSub.

(xii) where the firm is applying for a waiver of the NSFR requirements and does not already have a DoLSub covering the NSFR:

(a) a completed NSFR funding return on a sterling-equivalent basis for the solo institutions that would be in the DoLSub; and

(b) a completed NSFR funding return on a sterling-equivalent basis for the proposed DoLSub.

(xiii) legally binding, two-way (ie cross committed) multi-currency loan facilities between the members of the proposed DoLSub (and the qualifying parent undertaking where 2.2(b)(ii) of the

Liquidity (CRR) Part applies), such that funds would be able to flow freely between all those firms;

(xiv) a declaration from the firms (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies) that there are no current or foreseen material, practical, or legal impediments of the contracts referred to in bullet point (xiii);

(xv) a declaration stating whether the applicants (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies) are part of a core UK Group and thus exempt from large exposure limits and related restrictions on the flow of liquidity and funding.

(xvi) the management responsibilities map(s) for the entities in the DoLSub.

3A.4 The PRA expects the loan agreement referred to in paragraph 3A.3(xiii), above:

(i) is an enforceable contract for a two-way, unsecured, revolving loan facility, callable in all currencies that are significant in the businesses of the members of the proposed DoLSub. The obligation of each party to the loan agreement to lend may be limited to its available liquidity resources. 'Available liquidity resources' means in this context:

(a) those of the lending entity's liquidity resources that comprise cleared, immediately accessible funds or those of its assets, rights, facilities, or other resources that it, using its best efforts, is capable of converting to be cleared, immediately accessible funds such that they may be transferred to and received by the borrowing entity in accordance with paragraph 3A.4(xiii)(a) below.

(b) This definition excludes (i) those of its liquidity resources that the lending entity has calculated it is likely will be needed to meet its liabilities to entities other than those in the prospective DoLSub falling due in the 24-hour period following receipt of a request to borrow from the borrowing entity; (ii) those of its liquidity resources that the lending entity has already agreed to lend to entities in the DoLSub other than the borrowing entity in the 24-hour period following receipt of a request to borrow from the borrowing entity; and (iii) such portion of its liquidity resources which, if lent, would cause the lending entity to become balance sheet insolvent in the same sense as in the Insolvency Act 1986, s.123(2).

(ii) does not require the lending entity to lend if it reasonably believes that after making the loan, if made in full, it would expect to the extent approved in advance by the PRA to:

(a) be in breach of its capital resources requirement; or

(b) run a significant risk that it would not be able to pay its debts as they fall due.

(iii) requires the lending entity to notify the PRA promptly upon receipt of a request to make such a loan;

(iv) consists of liquidity support undertakings made between all members of the DoLSub (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies), thereby creating a 'cat's cradle' configuration of commitments. Where an applicant entity considers that another type of arrangement is more appropriate (given its group structure), the burden lies on the applicant to show that the proposed structure poses no undue risk in comparison with the

'cat's cradle' arrangement. In particular, the applicant firm will need to demonstrate how available liquidity could be moved within the proposed DoLSub if, for whatever reason, the primary lending entity (ie the 'hub') were to be unable to provide funding. In any event, the entirety of the undertaking(s) comprising the loan facility agreement should be contained in a single document;

(v) contains no conditions on the availability of the loan facility to a borrowing entity, or on a drawdown by a borrowing entity, except that:

(a) any borrowing entity that is an institution continues to be a member of the DoLSub; and

(b) the borrowing entity is solvent – meaning that no 'insolvent event' has occurred in respect of the borrowing entity. An 'insolvency event' occurs when: (i) an order (including a bank insolvency order or bank administration order as defined in the Banking Act 2009, s.94 and s.141, respectively) is made, or an effective resolution passed for the liquidation or winding-up of the relevant entity; or (ii) a receiver, administrator, trustee, bank liquidator, bank administrator, or other similar official shall be appointed in relation to the whole of the relevant entity.

(vi) is governed by English, Scottish, or Northern Irish law;

(vii) contains a 'jurisdiction clause' providing that disputes arising from the agreement are to fall within the exclusive jurisdiction of the courts of the country of the governing law, save that the borrowing entity may choose the jurisdiction of the courts of the lending entity's country of incorporation or head office (if different);

(viii) contains an 'entire agreement' clause;

(ix) contains no terms that limit the enforceability of the agreement by reference to representations, warranties, conditions precedent, or events of default (other than insolvency of the borrowing entity);

(x) contains no clause stipulating the recoverability of damages arising from an inability of the borrowing entity to repay, due to the non-provision of funds under the loan facility agreement, but should contain no liquidated damages or limitation clauses (ie no pre-estimates of, or limits on, damages recoverable for breach of the agreement);

(xi) contains a clause stating that:

(a) the purpose of the lending facility is to provide a borrowing entity with liquidity in a range of circumstances;

(b) the lending facility has been provided both to meet the funding needs of the borrowing entity and in connection with the Liquidity (CRR) 2.2 permission, which has enabled the borrowing and lending entities' DoLSub to fund itself on a more efficient basis;

(c) the facility may be drawn down by a borrowing entity either on its own initiative or in response to a request, requirement, or direction from the PRA; and

(d) the circumstances in which the facility may be used include those in which a borrowing entity is unable to access funding from other sources on normal market terms or at all, and that in such circumstances, damages will not be an adequate remedy for the lending entity's failure to lend money to the borrowing entity under the facility (ie for the lending entity's breach of the agreement).

(xii) contains a clause stating that all parties to the agreement recognise that the purposes of the agreement include the protection of consumers and wider market stability;

(xiii) contains clauses providing that:

(a) liquidity support should be provided by a lending entity to a borrowing entity as cash in cleared, immediately accessible funds within 24 hours of the borrowing entity requesting the loan – it should be provided by the end of the same business day if the borrowing entity makes a request before noon; otherwise it should be provided by noon the following business day; and

(b) loaned funds may be used by the borrowing entity: (i) for its general corporate purposes where the borrowing entity is a member of the DoLSub; or (ii) if applicable, 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, where the borrowing entity is a qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies.

(xiv) contains a clause providing that the following provisions apply in respect of an entity ceasing to be a party to the loan facility agreement:

(a) any member of the DoLSub (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies) may cease to be a party to the loan facility agreement upon giving no less than six months' notice to the other parties to the loan facility agreement; in such circumstances, the contractual relations between the other parties to the loan facility agreement will continue in force unaltered (formally, this may mean that the contract is varied in order to discharge the departing party of its obligations);

(b) when a member of the DoLSub (or qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies) gives notice of its intention to cease to be a party to the loan facility agreement, its obligation to repay any loan with a term that extends beyond the date at which it will cease to be a party is accelerated, so that the loan should be repaid by the date at which it will cease to be a party to the loan facility agreement;

(c) the outstanding borrowings of a member of the DoLSub (or qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies) under the loan facility agreement should be repaid by the time at which it ceases to be a party to the loan facility agreement;

(d) the loan facility agreement (whether in its original form or as varied) may not be terminated while being relied on for a Liquidity (CRR) Rule 2.2 permission to form a DoLSub;

(e) gives each member of the DoLSub (and the qualifying parent undertaking where 2.2(b)(ii) of the Liquidity (CRR) Part applies) the right to be released from its loan-making obligations to other parties to the loan facility agreement if the PRA revokes the Liquidity (CRR) 2.2 permission (though each party's existing repayment obligations would be unaffected); and

(f) specifies the rate of interest and any other charges to be levied by the lending entity (the rate of interest should be a market rate that would not inhibit use of the loan facility).

3A.5 The PRA expects that the applicant firm has obtained a separate legal opinion from a reputable third-party counsel with expertise in the relevant field dealing with the following matters:

(i) compliance of the loan facility agreement with all the stipulations in paragraph 3A.4 above;

(ii) parties' corporate standing;

(iii) whether the obligations are legal, valid, binding, and enforceable under the governing law of the agreement (including any relevant conflicts of laws issues and corporate benefit issues);

(iv) due execution (including whether the agreement was within the capacity and powers of the parties, duly authorised, with all necessary consents and approvals); and

(v) whether the provision of the loan facility agreement, and exercise of the rights thereunder, would conflict with any applicable laws and regulations.

3A.6 The PRA expects that the legal opinion should find that the loan facility agreement complies with all the stipulations.

3A.7 The PRA expects that the applicant will make reasonable efforts to keep under review any legal or regulatory changes that could affect the efficacy of the loan facility agreement, and that it will take all reasonable steps to amend the agreement in the light of any such changes in order to maintain the loan facility agreement's efficacy.

3A.8 Where necessary to ensure the effective supervision of the members of a DoLSub, the PRA may request members of a DoLSub provide reporting to the PRA on a solo basis. The PRA may also require that firms provide additional information, such as information in relation to intragroup funding. The PRA expects that where such information is requested, an appropriate senior manager would be made responsible for the timeliness and accuracy of such information.

4 Liquidity (CRR) Article 428F: Interdependent assets and liabilities

4.1 The PRA will generally not grant permissions under this Article in cases where the firm applies on the basis of a liquidity consolidation group unless the entities that hold the asset and record the liability respective are either:

(i) both defined as 'ring-fenced bodies' or the subsidiaries or parents of ring-fenced bodies under FSMA, s142A; or

(ii) both not defined as 'ring-fenced bodies' or the subsidiaries of ring-fenced bodies under FSMA.

4.2 When assessing firms' applications under this Article, the PRA will consider whether the proposed treatment might give rise to perverse incentives or unintended consequences which would

be contrary to the PRA's statutory objectives. The PRA expects firms to provide particular assurances that this test is satisfied where the asset and/or liability in question is a derivative.

5 Liquidity (CRR) Article 428H: Preferential treatment within a group

5.1 The PRA may grant permissions under this Article where the following conditions are met:

(i) there are reasons to expect that the liability or committed credit or liquidity facility received by the institution constitutes a more stable source of funding, or that the asset or committed credit or liquidity facility granted by the institution requires less stable funding over the one-year horizon of the net stable funding ratio than the same liability, asset, or committed credit or liquidity facility granted by other counterparties; and

(ii) where the firm applies on the basis of the counterparty being another subsidiary of the same parent, the firm and the other relevant subsidiary are either:

  (a) both defined as 'ring-fenced bodies' or the subsidiaries or parents of ring-fenced bodies under FSMA, s142A; or

  (b) both not defined as 'ring-fenced bodies' or the subsidiaries of ring-fenced bodies under FSMA.

6 Liquidity (CRR) Article 428AI: Calculating simplified NSFR (sNSFR)

6.1 The PRA expects to receive the following information alongside firms' pre-notifications that they will calculate the sNSFR:

(i) evidence that the firm meets the definition of 'small and non-complex' in CRR Article 4(145);

(ii) confirmation that the firm expects to continue to meet the definition in bullet (i), above, for the foreseeable future;

(iii) evidence that the firm's sNSFR is at least 100%, and the basis on which the firm expects that it will continue to be at least 100% for the foreseeable future; and

(iv) assessment that the complexity of the firm's funding profile is such that the sNSFR is not an inappropriately simple methodology for the calculation of funding risks.

6.2 The PRA expects that firms which use the sNSFR methodology notify it promptly when the following occurs or is expected to occur:

(i) the firm no longer meets the definition of 'small and non-complex' in CRR Article 4(145);

(ii) the firm's sNSFR falls below 100%; or

(iii) the complexity of the firm's funding profile is such that the sNSFR is an inappropriately simple methodology for the calculation of funding risks.

7 Liquidity Coverage Ratio (CRR) Article 12(3): Permission to derogate in respect of Level 2B assets for reasons of religious observance

7.1 In respect of applications for permission under this Article, in determining whether the non-interest bearing assets are adequately liquid for the purposes of Article 12(3) paragraph 12(1), the PRA will consider at least the following factors:

(i) the available data in respect of their market liquidity, including trading volumes, observed bid-offer spreads, price volatility, and price impact; and

(ii) other factors relevant to their liquidity, including the historical evidence of the breadth and depth of the market for those non-interest bearing assets, the number and diversity of market participants, and the presence of a robust market infrastructure.

8 Liquidity Coverage Ratio (CRR) Article 17(4): Liquidity buffer composition requirements

8.1 The PRA may grant permission under this Article where exceptional circumstances exist which pose a systemic risk affecting the banking sector of the United Kingdom.

9 Liquidity Coverage Ratio (CRR) Article 29: Permission to apply lower LCR outflow rate to certain outflows within a group

9.1 The PRA may grant permission under this Article where the following conditions are met:

(i) there are reasons to expect a lower outflow even under a combined market and idiosyncratic stress of the provider; and

(ii) the applicant firm and the counterparty either:

(a) are both defined as 'ring-fenced bodies' or the subsidiaries or parents of ring-fenced bodies under FSMA, s142A; or

(b) are both not defined as 'ring-fenced bodies' or the subsidiaries of ring-fenced bodies under FSMA.

10 Liquidity Coverage Ratio (CRR) Article 33(3) and 33(4): Permission to exempt from cap on inflows or increase cap on inflows

10.1 In assessing whether a firm's business activities exhibit a low liquidity risk profile, the PRA may consider the following:

(i) the extent to which the timing of inflows matches the timing of outflows; and

(ii) the extent to which, at the individual level, the firm is financed by retail deposits.

11 Liquidity Coverage Ratio (CRR) Article 34: Permission to apply higher inflow rate to certain inflows within a group

11.1 The PRA may grant permission under this Article when the following conditions are met:

(i) there are reasons to expect a higher inflow even under a combined market and idiosyncratic stress of the provider; and

(ii) the applicant firm and the counterparty either:

(a) are both defined as 'ring-fenced bodies' or the subsidiaries or parents of ring-fenced bodies under FSMA, s142A; or

(b) are both not defined as 'ring-fenced bodies' or the subsidiaries of ring-fenced bodies under FSMA.