IPRU (BANK)

Interim Prudential sourcebook: Banks

FSA

THE INTERIM PRUDENTIAL SOURCEBOOK FOR BANKS: NOTES

TRANS

Transitional Provisions [Deleted]

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TV	[Deleted]
LE	[Deleted]
CD	[Deleted]
SE	[Deleted]

Adequate liquidity

LM	Mismatch liquidity
LS	Sterling stock liquidity
AR	[Deleted]
ST	[Deleted]
FR	[Deleted]
CL	[Deleted]
VA	[Deleted]
NE	[Deleted]
CS	[Deleted]
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PN	[Deleted]

2 THE PRUDENTIAL SOURCEBOOK FOR BANKS: APPLICATION

APPLICATION

1. With the implementation of the recast Capital Adequacy Directive and the Banking Consolidation Directive in the UK from January 2007, the Integrated Prudential Sourcebook (*PRU*) and the Interim Prudential sourcebook for banks (*IPRU (BANK))* have, so far as *banks* are concerned, been substantially submitted by the General Prudential Sourcebook (*GENPRU*), part of the Senior Management Arrangements, Systems and Controls sourcebook (*SYSC*) and the Prudential Sourcebook for Banks, Building Societies and Investment Firms (*BIPRU*). The only remaining prudential standards in *IPRU (BANK)* are those that relate to liquidity. Over the transition period until all the provisions of *IPRU(BANK)* have been revoked, the FSA's detailed prudential standards (and some related notification requirements) applying to *banks* authorised under the *Act* are set out in a combination of *GENPRU, BIPRU, SYSC,* and *IPRU(BANK)*. *Banks* are responsible for ensuring that they meet all the prudential standards applying to them in *GENPRU, BIPRU, SYSC* and *IPRU(BANK)* during the transitional period.

2. The only part of *IPRU(BANK)* which applies to *EEA banks* and *overseas banks* is the rules and guidance on liquidity (in Chapter LM). The rules and guidance in Chapter LS apply only to the *UK banks*.

3. [Deleted]

4. [Deleted]

5. [Deleted]

6. [Deleted]

7. [Deleted]

8. [Deleted]

9. [Deleted]

10. [Deleted]

11. [Deleted]

3 THE FSA'S PRUDENTIAL RULES FOR BANKS

3.1 Introduction

3.1.1 G The *rules* in this section are made under sections 138 and 149 of the *Act*. Those sections and section 156 are specified for the purposes of section 153(2).

3.1.2 G A word which is printed in italics in this section indicates that it is used in the defined sense (see the definitions at the end of this section).

3.2 Application

3.2.1 R The *rules* (including *evidential provisions*) in this section apply as follows:

<u>**Rule/Evidential Provision**</u>	<u>**Application**</u>
R 3.5.1 - definitions	**All** ***banks***
R 3.4.3 - liquidity policy statement E 3.4.9 - policy statement procedures	**All** ***UK banks*** *UK* branches of ***EEA banks*** or *overseas banks*

3.3 [Deleted]

3.4 Policy Statement Rules

3.4.1 R **(1) [Deleted]**

(2) [Deleted]

3.4.2 G [Deleted]

Liquidity policy statement

3.4.3 R **(1) A *UK bank* and in the case of an *EEA bank* or *overseas bank*, its branch in the *UK* must set out its policy on the management of its liquidity in a written statement.**

(2) The policy in the statement must be such that compliance with it would enable the *bank* to maintain adequate liquidity in conformity with *GENPRU* 1.2.26R.

3.4.4 G *Guidance* on how a *bank* should comply with *IPRU (BANK)* 3.4.3R is set out in chapters LM and LS. These chapters also provide an overview of the underlying policy.

3.4.5 R **(1) [Deleted]**

(2) [Deleted]

3.4.6 G [Deleted]

3.4.7 R **(1) [Deleted]**

(2) [Deleted]

3.4.8 G [Deleted]

Policy statement procedures

3.4.9 E **(1) A *bank's* policy statements required under *IPRU (BANK)* 3.4.3R should be approved by its board or, where appropriate, by a person or body of persons to whom the board has delegated this function (the "delegate").**

(2)The function in(1) should only be delegated if the *bank's* board:

(a) is satisfied that the delegate is suitable for this purpose; and

(b) any such delegation is done formally and expressly by the board.

(3)The *bank* should:

(a) review the policy statements and, where necessary, update them at least once a year; and

(b) incorporate within the appropriate policy statement any change to any of its policies covered by the statement as soon as it has adopted the change.

(4)Contravention of (1), (2) or (3) may be relied on as tending to establish contravention of *SYSC* 2.1.1R.

3.4.10 G *SYSC* 2.1.1R requires a *firm* to take reasonable care to establish and maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers. This is so that the business and affairs of the *firm* can be adequately monitored and controlled by the senior managers and governing body of the *firm*.

3.4.11 G A *bank* should notify the *FSA* of its intention to make any significant changes in such policies before the *bank* adopts those changes.

3.4.12R [Deleted]

3.4.13 G [Deleted]

3.4.14 G A transitional *rule* applies to a *bank* which has provided the *FSA* with a written statement of its large *exposures*, liquidity, provisioning or trading book policies in the year preceding the date of the coming into force of *IPRU (BANK)* 3.4.12R (see section 3.6).

3.5 Definitions

3.5.1 R In this section the term or phrase in the first column of the following table has the meaning given to it in the second column:

accepting deposits	**See definition in the *Glossary*.**
Act	**See definition in the *Glossary*.**
bank	**See definition in the *Glossary*.**
branch	**See definition in the *Glossary*.**
credit institution	**See definition in the *Glossary*.**
credit union	**See definition in the *Glossary*.**
EEA bank	**An *incoming EEA firm* which is a *credit institution*.**
EEA firm	**See definition in the *Glossary*.**
evidential provision	**See definition in the *Glossary*.**
firm	**See definition in the *Glossary*.**
friendly society	**See definition in the *Glossary*.**
FSA	**See definition in the *Glossary*.**
Glossary	**The glossary of defined terms used in the Handbook.**
guidance	**See definition in the *Glossary*.**
Handbook	**See definition in the *Glossary*.**
incoming EEA firm	**See definition in the *Glossary*.**
IPRU (BANK)	**The Interim Prudential Sourcebook for *banks*.**
overseas bank	**A *bank* which is a body corporate or partnership formed under the law of any country or territory outside the EEA.**
permission	**See definition in the *Glossary***
requirement	**See definition in the *Glossary*.**
rule	**See definition in the *Glossary*.**
SYSC	**See definition in the *Glossary*.**
UK	**See definition in the *Glossary*.**

UK bank	**a *bank* which is a body corporate or partnership formed under the law of any part of the United Kingdom.**
undertaking	**See definition in the *Glossary*.**

3.6 [Deleted]

4 PRESENTATION AND CONVENTIONS

4.1 Organisation within each chapter

1 The chapters in the remainder of the IPRU (BANK) are structured using a common approach, to help users to find their way around easily.

2 Chapters are divided into sections. Typically, a chapter begins with an explanation of the legal starting-point of the policy area and the chapter's internal organisation. The general rationale for the FSA's approach to the subject is then given, followed by the main components of the FSA's policy. Detail of the framework used to assess fulfilment of those policy requirements follows.

3 One aim, in writing the chapters, has been to separate the main from the supporting material, and to have a presentation that helps clarity here.

(a) The main point is often the principal policy requirement; the supporting material may be a definition of a relevant term, how exactly to interpret a requirement, or the explanation of the reasons for adopting it (which can aid its interpretation).

(i) If the interpretative material is itself the subject of further clarification, it is presented as exemplified here.

(b) Note that the other chapters of the IPRU (BANK) consist solely of guidance for the purpose of the Act. This chapter contains the rules included in the IPRU (BANK) to which the other chapters refer.

4.2 Understanding the presentation

A number of presentational features are used in the remainder of the IPRU (BANK)

Header

- Chapter identifiers: Each chapter has a two-character identifier. This is shown on the left-hand side of the header to each page. The list of chapters with their chapter identifiers is given in the first section of these Notes.

- Date of issue: This is shown on the right-hand side of each header. Users can check whether any copy of a section they hold is the latest by comparing it with the date of the latest issue.

(a) The dates of latest issue of each section of each chapter can be checked via the FSA's internet site (at www.fsa.gov.uk).

Body of text

- Paragraph numbering: The main paragraphs within sections are numbered continuously (so a main paragraph can be identified as section x [shown on each page], paragraph y). Occasionally a main paragraph is unnumbered, where basically it and the previous paragraph concern a single point.

    a) Points of interpretation are listed 'a), b) etc' below the main paragraphs to which they refer.

See s22

- Cross-references: The cross-reference column on the left-hand side of each page is used to give a number of different sorts of reference (as exemplified across), to:

(a)Other useful sources, such as the Act and EU legislation.

(a) FSM = Financial Services and Markets Act 2000

(i) Sch = Schedule

(b)Other chapters of the IPRU (BANK) , or other sections of the current chapter.

(a) ch = chapter

(b) pa = paragraph

(c) s = section

(d) a = appendix

4.3 Definitions

6 The convention followed for definitions in the remaining chapters of the IPRU (BANK) is that, when a term is used and a definition is given nearby, the term is shown in both places in italics. Italics are used only for this purpose.

4.4 Terms used

7 The remaining chapters of the IPRU (BANK) use a number of conventions. The following list should help users with terms:

(a) 'The Act', unless otherwise made clear, refers to the Financial Services and Markets Act 2000.

(a) Any EU Directives or secondary legislation relevant to a particular chapter are usually outlined in the first section of the chapter.

(b) A'bank': is generally used to refer to banks authorised for the purposes of the Financial Services and Markets Act 2000. The definitions of a UK bank, overseas bank and EEA bank are generally the same as those given in section 3 of this chapter which also apply to the rules in that section.

(c) 'A CAD bank': is used as a shorthand for a 'bank to which the CAD trading book capital requirements apply'. Others are 'non-CAD banks'.

(d) 'The FSA' is used to refer to the Financial Services Authority.

(e) 'He' etc: for reasons of brevity, 'he' is used instead of saying 'he or she' throughout.

(f) 'IPRU (BANK)' is used instead of 'Interim Prudential Sourcebook applying to banks'.

(g) A number of paragraphs in the remainder of the IPRU (BANK) simply state "[This paragraph is intentionally blank.]". This has been done so as to avoid the need to renumber subsequent paragraphs.

CAPITAL ADEQUACY OVERVIEW

This chapter has been deleted.

THE BANKING BOOK/TRADING BOOK DIVISION

This chapter has been deleted.

DEFINITION OF CAPITAL

This chapter has been deleted.

CREDIT RISK IN THE BANKING BOOK

This chapter has been deleted.

PROXIES FOR MARKET RISK IN THE BANKING BOOK

This chapter has been deleted.

FOREIGN EXCHANGE RISK

This chapter has been deleted.

COMMODITY POSITION RISK

This chapter has been deleted.

COUNTERPARTY RISK TREATMENTS COMMON TO THE BANKING AND THE TRADING BOOK

This chapter has been deleted.

INTEREST RATE POSITION RISK

This chapter has been deleted.

EQUITY POSITION RISK

This chapter has been deleted.

COUNTERPARTY RISK IN THE TRADING BOOK

This chapter has been deleted.

INCREMENTAL CAPITAL FOR LARGE EXPOSURES

This chapter has been deleted.

SECURITIES UNDERWRITING

This chapter has been deleted.

OPTIONS PRR

This chapter has been deleted.

CAD1 MODELS

This chapter has been deleted.

USE OF A VALUE AT RISK MODEL

This chapter has been deleted.

LARGE EXPOSURES

This chapter has been deleted.

CREDIT DERIVATIVES

This chapter has been deleted.

SECURITISATION AND ASSET TRANSFERS

This chapter has been deleted.

MISMATCH LIQUIDITY

1 INTRODUCTION

1.1 Legal sources

1 There are a number of legal requirements arising out of the Act relating to the need to maintain adequate liquidity. These are:

See COND

(a) The Threshold Conditions require a firm to have adequate resources (which covers inter alia adequate liquidity).

(b) Principle 3 of the Principles for Businesses requires that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Principle 4 requires a firm to maintain adequate financial resources, including liquidity; and

(c) The rules requiring a bank to maintain adequate liquidity appropriate to the nature and scale of its business, and to set out its policy on liquidity risk management in a written statement.

See ch GN s3

The rules requiring a bank to maintain adequate liquidity appropriate to the nature and scale of its business, and to set out its policy on liquidity risk management in a written statement.

All UK banks authorised for the purposes of the Act are required to meet these requirements. An EEA bank or overseas bank with a branch in the UK is also subject to those requirements in relation to that branch.

2 As part of the implementation of the recast Capital Adequacy Directive and the Banking Consolidation Directive in the UK from January 2007, provisions relating to a firm's systems and controls for liquidity risk have been introduced in *SYSC* 11 and provisions concerning stress testing and scenario analysis have been introduced in *GENPRU* 1.2.30R. The relevant rules implement part of Article 22 and Annex V of the Banking Consolidation Directive. This chapter and chapter LS sets out the FSA's framework for monitoring the liquidity of banks authorised for the purposes of the Act to determine whether the above requirements are met.

See ch LS

a) Certain banks are subject to a different, stock liquidity, approach. For details of this approach see the chapter on stock liquidity.

3 The Banking Consolidation Directive (formerly the Second Banking Co-ordination Directive) requires the FSA as host supervisor to

monitor, in co-operation with the relevant home supervisor, the liquidity of UK branches of credit institutions incorporated in other EEA countries. This covers all such branches, regardless of whether or not they have a deposit-taking permission in the UK.

1.2 Application

4 This chapter applies to banks in the manner set out in 1.1. In respect of EEA banks that have a branch in the UK but do not have a UK deposit-taking permission, only Sections 1, 2, 3, 4.2, 9.1 and 10 of the chapter apply. In respect of all EEA banks and overseas banks with a branch in the UK, the chapter (or applicable sections of it) only applies in relation to the liquidity of those branches and not the bank as a whole.

a) For UK-incorporated banks, the reporting form LR (or data item FSA010 on and after 30 June 2008) is completed on a solo basis. Where a bank already reports for capital and large exposures purposes on a solo-consolidated basis with the agreement of the supervisor, the Form LR or FSA010 as appropriate should be submitted on a solo-consolidated basis rather than a solo basis.

   i) Definitions of solo supervision and solo-consolidated supervision can be found elsewhere in the Handbook.

b) Branches of EEA banks that do not have a deposit-taking permission in the UK are subject to some of the provisions of this chapter but are not subject to the liquidity mismatch guidelines set out in sections 4 to 8. The FSA monitors the liquidity of such branches by requiring them to submit Form LR, or FSA012 (which consists of a simplified cash flow maturity ladder) on and after 30 June 2008. Such branches may apply for a 'global concession' in accordance with section 4.2.

1.3 How this chapter is organised

5 Section 2 outlines the rationale for monitoring liquidity, and for the FSA's approach to it. Section 3 summarises the main features of the liquidity policy which banks must or should follow.

Section 4 describes the framework by which the FSA monitors banks' liquidity, while Section 5 details the components of the time bands in the mismatch ladder. Section 6 details the treatment of marketable assets and Section 7 covers the materiality treatment and behavioural adjustments. Section 8 outlines the factors considered when setting mismatch guidelines and Section 9 details how the FSA monitors liquidity using the mismatch approach. Section 10 covers liquidity policy statements. Section 11 is an appendix detailing settlement periods for securities in different countries.

2 RATIONALE

2.1 What is liquidity?

1 An important element of banking is maturity transformation, e.g. taking short-term deposits to make comparatively long-term loans. As a result of this, a bank is exposed to the risk that depositors' demands for repayment might outstrip its ability to transform assets into cash.

2 A bank should be able to meet its obligations as they fall due. A bank should hold sufficient liquidity to ensure that it can be considered to be conducting its business in a prudent manner. A bank may have various kinds of obligations, including:

(a) requirements to repay deposits;

(b) requirements to provide committed funds; and

(c) requirements to make other payments such as cash flows in respect of off balance sheet instruments, interest payments and other expenses.

3 A bank can meet such obligations in a number of ways:

(a) by holding sufficient immediately available cash or marketable assets;

a) However the marketability of the assets, and the speed with and quantity in which they can be sold at close to prevailing market values, varies. Furthermore, there is typically a settlement delay between the sale (or repo) of an asset and the receipt of cash, and there may also be a currency mismatch.

See s6

b) For details on marketable assets, see below.

(b) by securing an appropriate matching future profile of cash flows from maturing assets and liabilities; and

a) The effectiveness of this method may be restricted if there are shortfalls in practice if borrowers are unable (or unwilling) to repay or if depositors look for early repayment.

(c) by further borrowing.

a) A bank's ability to raise deposits (or other funding), and the cost at which these deposits can be raised, depends on its standing in the market and on the general liquidity situation at the time.

4 Banks are reluctant to hold a large stock of immediately available cash or marketable assets, as these generate no return (in the case of cash) or a comparatively low yield (in the case of easily marketable assets, e.g. government bonds). They therefore seek to depend on future cash flows and their ability to raise funds in the market as the need arises.

a) However this is not always a guarantee of liquidity as the interbank market can be volatile and is highly sensitive to an individual bank's reputation.

b) A distinction should be drawn between such "crisis funding" and banks' use of agreed lines with other banks to fund the majority of their business. In the second case, banks draw on their agreed lines as and when required on a day to day basis. Wholesale counterparties may be unwilling to provide funds committed under standby arrangements in a crisis.

See s5.1

c) For details of the treatment of standby lines in the maturity ladder, see the section on the components of the maturity ladder.

5 It is therefore essential that a bank has ample funding capacity, which depends on a variety of factors including strong liquidity management, market perception, earnings, and asset quality.

a) It is also prudent for a bank to maintain a mix of sources of liquidity. Some of these should be immediately available so that the bank is not exposed to suddenly rising costs from liquifying assets or bidding for deposits.

2.2 How the FSA monitors liquidity

6 The responsibility for ensuring a bank can meet its obligations as they fall due rests with the bank's own management. The bank should take account of its characteristics and position within the banking system in determining a prudent liquidity policy.

7 A bank should be able to satisfy the FSA on an on-going basis that it has a prudent liquidity policy, and adequate management systems in place to ensure that the policy is adhered to.

a) This is checked during the course of normal supervision through prudential discussions and the Form LR, FSA010 or FSA012 as applicable. These mechanisms are supplemented by review team visits, treasury visits and reports by accountants or other persons with relevant professional skills commissioned under the Act.

8 In the majority of cases the FSA monitors a bank's liquidity position through the maturity mismatch approach.

See ch LS

a) The sterling liquidity of some banks, principally those with large retail deposits in the form of current accounts is monitored by a stock approach.

b) The FSA does not apply the full maturity mismatch approach to Branches of EEA banks that do not have a deposit-taking permission in the UK, but instead monitors their liquidity via the Form LR or FSA012 as appropriate.

3 MAIN FEATURES OF THE LIQUIDITY POLICY

This section summarises the main features of the liquidity policy. It does not cover every feature and should be read in conjunction with the sections that follow, and other parts of the Handbook referred to below. Certain of the provisions referred to implement Article 22 and Annex V of the Banking Consolidation Directive.

3.1 See s10Main prudential policies applying to banks

See *GENPRU* 1.2

1 A bank must maintain adequate liquidity at all times.

See s10

2 A bank must formulate a statement of its liquidity management policy. It should agree with the FSA standards for adherence to this policy, i.e. mismatch guidelines and the procedures for the notification of breaches of those guidelines. (The rule requiring a liquidity policy statement is GN 3.4.3R. *SYSC* 11 requires a bank to have policies for liquidity risk management.)

See s9

3 A bank should have adequate systems for monitoring liquidity on a daily basis. (See *SYSC* 11)

3A A bank should carry out stress testing and scenario analysis in relation to liquidity risk. (See *GENPRU* 1.2.26R and associated guidance, and *SYSC* 11).

3B A bank should have a contingency funding plan. (see *SYSC* 11)

See s9.3

4 A bank that is subject to liquidity mismatch guidelines should notify the FSA of any breaches of those guidelines as soon as they occur.

3.2 A bank's reporting obligations

See s9.2
See Supervision Manual, Chapter 16

5 A bank that has a deposit-taking permission in the UK must report its liquidity position quarterly on the Form LR (FSA010 on and after 30 June 2008) or more frequently as required by the FSA.

See Supervision Manual, Chapter 16

6 An EEA bank with a branch in the UK that does not have a UK deposit-taking permission must report its liquidity position quarterly on the Form LR (or six-monthly on FSA012 on and after 30 June 2008), or more frequently as required by the FSA.

4 THE FRAMEWORK FOR MEASURING LIQUIDITY

For those banks using the mismatch approach, the FSA agrees guidelines for the maximum size of liquidity mismatches it considers appropriate. This section and the following two outline the framework within which mismatches are measured and guidelines agreed. This section explains the overall framework and how it is applied to overseas banks. Section 5 gives detail on how assets and liabilities are placed into a ladder. Section 6 details the treatment of marketable assets and Section 7 covers the policy on materiality concessions and behavioural adjustments. Section 8 outlines the factors considered in setting guidelines.

4.1 The maturity mismatch approach

1 The FSA's mismatch approach measures a bank's liquidity by assessing the *mismatch* between its inflows (assets) and outflows (liabilities) within different time bands on a *maturity ladder.*

a) The extent of the difference between the maturities of inflows (assets) and outflows (liabilities) is termed a *mismatch.*

b) In the *maturity ladder*, inflows (assets) and outflows (liabilities) are slotted into time bands. Maturity is determined on a worst-case view, i.e. inflows (assets) are put in at their latest maturity and outflows (liabilities) at their earliest maturity.

   i) This approach is adopted to assess a bank's liquidity when its funding sources are unwilling to lend and its depositors withdraw their money.

c) The information provided in the maturity ladder is assessed in the cumulative time bands of sight - 8 days, sight - 1 month, sight - 3 months, etc..

See s5 d) The components of the time bands are covered below.

2 A net mismatch figure is obtained by subtracting outflows (liabilities) from inflows (assets) in each time band. Mismatches are then measured on a net cumulative basis.

a) A net overall cumulative mismatch figure is derived by accumulating the net positions in each successive time band.

3 The FSA normally assesses a bank's liquidity position by means of the net cumulative mismatch position expressed as a percentage of total deposit liabilities.

a) Total deposit liabilities (the total of the deposits held by the bank) are used because they represent a relatively stable approximation of the total external (or withdrawable) funding of the bank.

4 The FSA sets recommended guidelines for the maximum percentage for net cumulative mismatches as a percentage of total deposits. These are known as the *mismatch guidelines*.

a) These are intended to prevent banks operating with too large a negative mismatch, and therefore running an excessive risk of not being able to raise sufficient funds to cover the mismatch at short notice.

5 The FSA normally sets guidelines for maximum mismatches only for the time bands of sight - 8 days and sight - 1 month.

a) Mismatch guidelines are not usually set for the longer time bands, except in exceptional circumstances, as over a longer time period, in most cases, banks will have a greater opportunity to raise funds, and therefore a larger negative mismatch is not such a concern.

4.2 'Global concession' policy

See s1

6 The FSA supervises the liquidity of all banks operating in the United Kingdom except in the case of EEA banks and overseas banks it is only required to supervise the liquidity of their UK branches.

7 UK banks are expected to be able to stand alone, and therefore should normally monitor and manage their own liquidity separately from the liquidity of other institutions in the group. However, UK branches of overseas banks cannot be treated independently of their head offices: they are part of a wider legal entity and their liquidity inevitably reflects this fact.

As a result, the liquidity of the UK branch of an overseas banks sometimes managed from its head office on an integrated basis. Where this is the case, and providing certain safeguards are met, the FSA is willing to agree to a *global concession.*

a) A global policy may be agreed for an EEA or an overseas incorporated bank which has a UK branch.

8 The following conditions should be met before the FSA will agree that a global policy is appropriate for a UK branch of an overseas bank:

(a) The FSA should be provided with a description of the arrangements for supervision of liquidity implemented by the home supervisor;

  a) The FSA will need to be satisfied, in particular, that the scope of liquidity supervision of the home supervisor encompasses the whole bank (i.e. including overseas branches); and focuses on that bank's short-term liquidity position.

(b) The branch should be fully integrated with its head office for liquidity management purposes;

  a) There should be daily provision of information to head office, and the branch should have only limited autonomy: it should not be able to deliver a 'surprise' to its head office.

(c) The head office should assure the FSA in writing that liquidity is available at all times to the branch if needed, and that information on whole bank liquidity will be made available to the FSA in the event of a crisis;

(d) There should be no known constraints on the provision of liquidity by head office to the UK branch;

  a) The FSA monitors this condition on an on-going basis, taking into consideration, among others, the following factors:

    i) the ability and willingness of the head office to support the branch;

    ii) the question (where relevant) of differing time zones; and

    iii) the likelihood of a country imposing a moratorium on payments abroad.

(e) The home supervisor should be aware of, and have no objection to, both the dependence of the branch on the head office for liquidity and the assurance given that liquidity will be available;

(f) The home supervisor should undertake to inform the FSA of any material or persistent breaches by the bank of its liquidity rules, or risks that such breaches are imminent; and

(g) The FSA should gain annual confirmation from the home supervisor that it remains satisfied with the arrangements for liquidity supervision and their operation.

9 Where a global policy is agreed the FSA does not normally require a bank to complete the Form LR, FSA010 or FSA012 as applicable. However, the FSA will request information on a branch's liquidity position in an appropriate format should the need arise.

5 INCLUDING ASSETS AND LIABILITIES IN THE TIME BANDS

This section details how inflows (assets) and outflows (liabilities) are included in the various time bands of the maturity ladder.

5.1 Components of the cashflow and maturity analysis ladder

5.1.1 General

1 In the period up to 29 June 2008, the timebands in the maturity ladder are divided into two sections. The time periods out to 6 months are to be reported on the Form LR on a cashflow basis and those over 6 months to 5 years should be reported on the basis of residual maturities of assets and liabilities. On and after 30 June 2008, only the cashflow basis will be used on FSA010.

2 For a transitional period between 31 May 1999 and 30 September 2001, a bank should report on a cashflow basis for the time periods out to at least 1 month. At the end of this transitional period a bank should report on a cashflow basis out to 6 months. Periods over 6 months should <u>always</u> be reported on a maturity analysis basis. During the transitional period a bank may decide which periods they report on a cashflow basis, subject to the one month minimum and inform the FSA via its reporting on the Form LR.

3 The decision a bank takes at the start of the transitional period on which periods it reports on a cashflow basis is not binding for the rest of the transitional period. A bank may extend the time periods it reports on a cashflow basis throughout the transitional period; no separate notification is required. However, once a bank has reported a time period on a cashflow basis it should not change back to reporting that time period on a maturity analysis basis.

a) Timebands reported on a maturity analysis basis should only include payments or receipts of principal amounts. Certain transactions, for example interest rate swaps, are based on notional amounts. Where this is the case the flows associated with the transaction should only be reported in the cashflow timebands.

b) Cashflow reporting refers to the movement of money in or out of the banks. A bank should report the cashflows which assets or liabilities give rise to and not the size of the assets or liabilities themselves. Items such as salaries, fees and interest payments should be included in cashflow reporting.

5.1.2 Outflows (liabilities)

4 Outflows (liabilities) should be included in the maturity ladder according to their earliest contractual maturity.

See s7.2

a) Some transactions do not behave according to their contractual maturity. Where this is the case, the FSA is willing, in principle, to agree to a bank reporting the cashflows including certain behavioural adjustments.

5 Specific points to note are:

(a) client money accounts: a bank is required specifically to report information on client accounts. Under the Act the FSA may require client money to be returned if a bank is perceived to be in difficulties. Therefore the FSA will assume and a bank should assume that in adverse circumstances money in the client accounts of FSA authorised firms may be withdrawn with minimum notice; and

(b) Known firm commitments to make funds available on a particular date are to be included in the appropriate time band at their full value.

a) Commitments which are not due to be met on a particular date, e.g. undrawn overdraft and other facilities, are unlikely to have to be met in full and cannot be treated precisely. The FSA requires the inclusion of only a proportion of such outstanding commitments in the sight to eight day timeband, and the remainder are excluded. Where possible, the proportion for each bank is determined taking into account past and forecast draw-down trends.

i) Where such an analysis is not possible the FSA allows the inclusion of 15% of outstanding commitments.

6 *Contingent liabilities* are not included in the maturity ladder, unless there is a likelihood that the conditions necessary to trigger them will be fulfilled.

a) A *contingent liability* is a liability only triggered by the occurrence of an uncertain event, e.g. the liability of a guarantor should the principal debtor not repay.

5.1.3 *Inflows (Assets)*

7 Apart from the exceptions set out below, inflows (assets) are generally included in the maturity ladder according to their latest contractual maturity. The exceptions are:

(a) inflows (assets) only nominally repayable on demand (e.g. overdrafts);

See s7.2

a) Although these inflows may generate some regular cashflow the cashflow cannot be measured precisely. These inflows may therefore be more appropriately treated by reporting a behaviourally adjusted figure which may require the bank to report these inflows according to their historical maturity pattern.

(b) undrawn committed standby facilities provided by other banks; and

a) These are treated as a sight asset (giving due regard to their remaining term and the possibility that they may not be renewed).

b) Stand-by facilities with an unknown draw-down date received by a bank from other banks are treated in the same way as commitments to lend at some uncertain future date, i.e. a percentage (100%) are included at sight.

(c) marketable assets.

a) A bank should show these assets as a sight asset (at a discount) rather than according to final maturity.

See s6

b) For the detail on the treatment of marketable assets see below.

8 Assets known to be of doubtful value are excluded from the maturity ladder and treated on a case by case basis.

9 Assets which have been pledged as *collateral* and are therefore no longer available to a bank to meet obligations, should be excluded from the maturity ladder as they are no longer available to provide the bank with liquidity.

a) *Collateral* is an asset that a borrower leaves with a lender as security for a loan.

5.1.4 *Retail/ wholesale split*

10 For liquidity monitoring purposes only, a bank should classify its cashflows as being either retail or wholesale. A bank should decide how it is going to split its cashflows between retail and wholesale to achieve this split and agree its proposed split with its supervisor before entering the detail in its liquidity policy statement.

a) The FSA wishes to ensure that the split proposed by a bank is reasonable and appropriate to the nature and size of the business of that bank.

11 A bank may decide that it does not wish to agree a retail/wholesale split with its supervisor, because the systems work required outweighs the advantages. In this case, all the cashflows should be entered as wholesale.

a) The FSA takes the balance of the retail/wholesale split into account when setting a bank's mismatch guidelines. A bank whose cashflows are heavily dependent on the wholesale markets may be set a tighter mismatch than one with cashflows from the retail sector. A bank which is heavily dependant on retail business may be set less tight mismatch guidelines, since these cashflows tend to be more "sticky" in nature.

b) Where a bank is uncertain how to classify a cashflow, the FSA takes a worst case view and assumes that all a bank's cashflows are wholesale. In this way all the cashflows are entered at their contractual maturity and the bank is set the most conservative mismatch. A bank wishing to enter these cashflows as retail should discuss this with its supervisor and provide relevant data to support its case.

c) Cashflows which are reported as wholesale transactions will not normally be eligible for a behavioural adjustment.

12 Depending on the nature and size of their business, different banks may choose to classify the same transaction differently.

13 A bank will have its own means of classifying cashflows, but may also wish to consider the following (which should be considered together):

- Size, both in absolute terms and in relation to the business as a whole; larger amounts are more likely to be classified as wholesale; small amounts will probably be retail.

- Volatility. Wholesale cashflows are likely to be highly volatile whereas retail cashflows have a low volatility.

- Type of business relationship. Retail customers tend to develop long term relationships with their bank and use one bank for all their banking needs. Wholesale counterparties will generally tend to work on a transactional basis with a number of banks.

14 The detail of the retail/wholesale split should be entered in a bank's liquidity policy statement. The split should be reviewed by the bank and the FSA as part of the annual review of the liquidity policy statement.

6 STOCK OF MARKETABLE ASSETS

This section details the treatment of marketable assets.

6.1 General

See ch LS

1 Except for a sterling stock liquidity bank, the FSA does not consider that a bank needs to hold a stock of liquid (or marketable) assets. It is, however, prudent for a bank which has substantial uncovered liabilities to hold some of its assets in a liquid or near-liquid form.

a) Such assets may be held both as part of the day-to-day liquidity management and to "buy time" in the event of a disruption to normal cash flows.

See s10

2 A bank's liquidity policy statement should make clear the contribution which a stock of liquid assets is expected to make to a bank's management of its liquidity.

6.2 Assessing the role of a bank's stock of marketable assets

3 In assessing whether marketable assets may be included as such for liquidity reporting to the FSA, a bank should consider the following:

(a) access to central bank encashment facilities (i.e. whether a bank's central bank will trade such assets in its open market operations);

a) The highest quality liquid assets are those which can be offered for discount at a central bank although even here issues of potential marketability and volatility may be relevant. Liquid assets need to be composed mainly of this type of instrument, although in some circumstances other, less high quality instruments, may also be discounted (e.g. high-grade corporate bonds, and in some circumstances Brady bonds).

(b) depth of market;

a) It is essential that a bank can find a ready buyer when it seeks to realise an asset for cash. Therefore tradable securities for which only a limited market exists are of little value as liquid assets, and should be included at maturity and not discounted to sight.

See s11

b) Allowance should also be made for factors such as settlement delay.

(c) likelihood and extent of forced-sale loss;

a) Generally, the higher the quality of the asset, the lower is likely to be the loss faced by a bank in the event of a forced sale.

(d) the proportion of a debt issue that a bank holds; and

a) A bank that holds all, or the greater part, of a debt issue will find it difficult to sell its holding without causing the price of the debt to fall.

(e) Exchange rate risk.

a) A bank which holds liquid assets denominated in currencies which differ from those of its liabilities may be faced with foreign exchange risk when seeking to realise these assets (i.e. the value of the asset may diminish, leaving the liabilities only partly covered).

6.3 Inclusion of marketable assets in the maturity ladder

6.3.1 General

4 Assets considered to be readily marketable are included in the maturity ladder in the sight - 8 days time band, generally at a discount to their recorded value.

a) Such assets may be included in the 8 days - 1 month time band in the light of the settlement period.

5 The minimum criteria which should be fulfilled if an asset is to be considered *marketable* are that:

- prices are regularly quoted for the asset;

- the asset is regularly traded;

- the asset may be readily sold, including by repo, either on an exchange, or in a deep and liquid market for payment in cash; and

- settlement is according to a prescribed timetable, rather than a negotiated timetable.

a) The treatment of marketable assets takes account of the extent to which they can be sold for cash quickly (or used as security for borrowing), incurring little or no cost penalty; and of any credit or investment risks which may make their potential value less predictable.

b) It is important that the market for the asset is sufficiently deep to ensure a stable demand for it. A key factor in this is the willingness of the central bank to use the asset in its normal market operations.

c) The FSA may vary the discounts to reflect the conditions of a particular market or institution.

6 Securities held as a result of reverse repos, or securities which form part of a hedged transaction or synthetic asset (e.g. bonds attached to an interest rate swap), may be included in a portfolio of discountable assets if such assets are marketable (whether in isolation of their attached swap or as a package).

a) Marketable assets should be reported at a discount in the sight - 8 days time band. Banks should note that the marketability of some assets may change both significantly and quickly. It is therefore important that banks review the marketability of assets and the risk to that marketability regularly.

b) Although a bank selling such holdings may face market risk (e.g. where they sell an asset in isolation of its attached swap), the liquidity framework is not designed to take this into account and, in calculating mismatches, the FSA does not treat such securities in a distinctive way unless there is a restriction on sale.

7 In general, a discount should be applied to an asset's market value. Assets should only be classified as marketable where an institution can readily obtain a market value and where it is marking assets to market on a regular basis.

a) The latter is necessary because a bank is expected to assess its liquidity position using the FSA's methodology daily and the FSA reserves the right to request daily liquidity reporting.

b) The need for regular marking to market varies according to the nature of the bank's portfolio of marketable assets.

i) Where the portfolio is primarily comprised of *Zone A* government stock , it is less crucial. But where a bank wishes to discount a portfolio containing a material proportion of other assets, it should mark to market at least weekly and preferably daily, or be moving towards the capacity to do so.

c) In particular, equities and *Zone B* debt should not be included in a portfolio of marketable assets where the bank is unable to mark to market regularly.

See ch BC s3

d) The meaning of a *Zone A country* is as defined in the glossary of defined terms used in the Handbook.

"*Zone B*" compromises all countries not in *Zone A countries*.

6.3.2 *The standard "matrix" approach*

8 The discount factors applied to different types of marketable assets in the FSA's mismatch calculations are given in the table below:

Central government debt, local authority paper and *eligible* bank bills (and comparable assets from other Zone A countries)	**Benchmark discount**
Central government and central government guaranteed marketable securities with twelve or fewer months residual maturity, including treasury bills; and *eligible* local authority paper and *eligible* bank bills.	0%
Other central government, central government guaranteed and local authority marketable debt with five or fewer years residual maturity or at variable rates.	5%
Other central government, central government guaranteed and local authority marketable debt with over five years residual maturity.	10%
Other securities denominated in freely tradable currencies (usually Zone A)	
Non-government debt securities falling within the definition of *qualifying debt security*, and which have six or fewer months to residual maturity.	5%
Non-government debt securities falling within the definition of *qualifying debt security*, and which have five or fewer years residual maturity.	10%
Non-government debt securities falling within the definition of *qualifying debt security*, and which have more than five years residual maturity.	15%
Equities which (in the FSA's implementation of the CAD) qualify for a specific risk weight no higher than 42%.	20%
Zone B central government debt	
Where such debt is actively traded. (However where such debt is denominated in local currency, it is usually deemed to be available to provide liquidity only in that currency).	20-40%

a) *Eligible* means that the paper is accepted as discountable by the Bank of England in its open market operations.

b) *Qualifying debt security* is defined in the glossary of defined terms used in the Handbook.

c) The definition of *Zone A/Zone B* countries is given in 6.3.1.7(d) above.

d) The discount applied by the FSA to Zone B government debt varies between 20% and 40%, depending on the residual maturity of the asset.

e) Debt securities issued by Zone B central governments in Brady-bond swaps can be considered marketable in cases where they are actively traded in secondary markets and are marked to market on a regular basis.

i) The discount factor applied to Zone B Brady bonds is 40% when they are denominated in a Zone B currency and 20% when denominated in a Zone A currency.

ii) Brady bonds issued by Zone A governments are treated for liquidity purposes as Zone A government debt, and discounted as such.

f) Zone B non-government debt may also be considered to be marketable. Discounts should not be more favourable than those applied to Zone B government debt.

g) Zone B equities, which (in the FSA's implementation of the CAD) qualify for a specific risk weight (no higher than 42%), can be considered to be marketable and are discounted at 40%.

9 Where a bank holds securities issued by Zone B entities in local currency, the liquidity position of the bank in individual currencies should be considered.

a) It should not be assumed that the proceeds of a sale of these assets can be readily and quickly converted into other currencies. As a result these assets are generally considered to provide liquidity only against liabilities in the same currency.

See s10

i) A bank's liquidity policy statement should comment on how liquidity in less freely convertible currencies is managed.

6.3.3 *Procedures for discounting assets*

10 In deciding whether a bank should enter assets on Part 1 of the Form LR (or FSA010 on and after 30 June 2008) the FSA takes account of the following factors:

(a) the frequency of *marking to market* of assets;

  a) *Marking to market* is the practice of re-valuing tradable assets according to current market prices. Assets should be marked to market at the bid price.

(b) whether the proportion of a debt issue held by a bank is large enough that rapid disposal of it might significantly move the price against the bank;

(c) the marketability of the assets;

(d) the settlement periods pertaining to the assets being classed as marketable; and

  a) Where a bank will be unable to receive cash for a significant proportion of assets within the sight – 8-day band, the FSA allows an offset against the 8-day - 1 month band only.

See s11

    i) For details of settlement periods in different financial markets see the appendix.

(e) a bank's ability to repo assets.

7 MATERIALITY AND BEHAVIOURAL ADJUSTMENTS

7.1 Materiality

7.1.1 General

1 The materiality concession is designed to make reporting easier for banks. The FSA is willing in principle to allow a bank to exclude certain cashflows from its liquidity reporting where they are not material in relation to the total. This is because the FSA recognises that the systems work involved in extracting this information may be greater than the benefit gained since these flows have a negligible impact on the total cashflows.

2 Not all banks may wish to take advantage of this concession. A bank which does not have complex systems and for which it is not overly burdensome to extract all cashflows from its systems may decide to report all the cashflows and not apply for a materiality concession.

3 A bank wishing to apply for this concession should not use it as a device to improve its compliance with its mismatch guidelines. The FSA will expect each bank to apply the same approach to both inflows and outflows and to present a balanced case to its supervisor.

7.1.2 Assessing the proposal

4 A bank should approach its supervisor with a proposal, which should include the following:

(a) a list of items it proposes to exclude from reporting, e.g. utility bills or salaries.

(b) details of how the individual items and the aggregate of the items roughly will affect the bank's mismatch.

(c) past actuals detailing the amounts of the cashflows over time and a forecast of the level of the cashflows in the future. A bank should support these data with an analysis of the nature of the cashflows. This analysis should include an assessment of:

a) The predictability of the cashflow: a bank will probably not wish to exclude those cashflows which are totally predictable since they can be easily forecast and reported. Cashflows which are highly unpredictable should be included in cashflow reporting since they are by nature subject to large movement;

b) External factors affecting the reliability of forecasts: a bank should conduct a simple sensitivity analysis on the figures looking at other non statistical factors which impact on the level of the cashflow; and

c) Distribution of the cashflow: evenly distributed cashflows have a less variable effect on the mismatch than flows of a similar size concentrated in one period. In addition, cashflows have a more material impact on the mismatch the closer they are to the reporting date.

5 The FSA will have an idea as to the extent of the impact on a bank's mismatch ratios it will allow, though this may vary between banks. In addition to examining the documents submitted by a bank as part of its proposal (paragraph 4 above) the FSA will consider the following factors:

(a) a bank's previous record of accuracy for statistical and prudential reporting; and

a) This is important because it affects the degree to which the FSA can rely on the information it receives.

(b) a bank's performance against its mismatch guidelines, including whether a bank frequently breaches its guidelines and whether a bank normally operates well within or close to its mismatch guidelines; and

7.1.3 Reviewing the concession

ee s10

6 Details of any agreed materiality concession should be entered in the bank's liquidity policy statement. The basis on which the concession is granted should be reviewed by the FSA and the bank on an annual basis as part of a wider review of the liquidity policy statement.

7 A review primarily looks at how accurately the past actuals reflect the bank's original forecasts, whether there has been any change in the factors underlying the sensitivity of the cashflows and consequently whether any changes need to be made to the agreement.

8 A bank is also expected to monitor the level of the cashflows throughout the year and inform the FSA of any significant change

in either the level of the cashflow or the factors influencing the level of the cashflow.

7.2 Behavioural Adjustments

7.2.1 General

9 For supervisory monitoring, the FSA normally wishes to assess a bank's liquidity position on a "worst case" basis. Therefore, cash inflows are deemed to occur at their latest contractual maturity and cash outflows at their earliest contractual maturity.

10 The FSA recognises that the contractual maturities relating to certain (mainly retail) cashflows do not bear a close relationship to their actual behavioural characteristics. So a bank may apply to the FSA to report its cashflows on two bases: first on a "contractual" basis assuming cashflows behave according to their contractual maturity; and second, with certain "behavioural" assumptions, e.g. assuming current accounts will not all be withdrawn at sight, factored into the calculations.

(a) The FSA may require a bank to report behaviourally adjusted figures for certain cashflows (e.g. for inflows arising from overdrafts granted by a bank), even if it normally reports only on a contractual basis.

(b) Where a bank reports on a behaviourally adjusted basis, compliance with mismatch guidelines are monitored using the behaviourally adjusted data.

(c) A bank reporting on a behaviourally adjusted basis should also report on a contractual basis.

7.2.2 Factors to be included in a proposal

11 Since a behavioural adjustment will in most cases make it easier for a bank to comply with its mismatch guidelines, a bank wishing to take advantage of behavioural adjustments needs to present a proposal to its supervisor. The FSA expects a proposal to contain the following elements, where relevant:

(a) empirical evidence to support the assertion that certain cashflows behave according to a particular maturity profile;

a) This should include a run of historical data, covering previous economic cycles where appropriate and evidence proving the relevance of the data

(b) some form of sensitivity analysis and any other factors affecting the behaviour of the cashflows;

(c) breakdown of the cashflows. This is particularly relevant for a mortgage or credit card portfolio covering a number of products targeted at different sectors of the economy;

(d) responsiveness and relevance of models;

(e) general details of customers, e.g. where they come from, economic status, why they use a particular bank. Proposals should in general relate to the behaviour of the customer rather than the behaviour of the bank itself;

(f) currency of denomination;

(g) penalty clauses for early withdrawal of deposits or early redemption of loans; and

(h) details of the home country's economic position.

12 Proposals, in general, should not be dependent upon a single factor such as a tax benefit since the behaviour may be radically altered if that factor is changed or withdrawn. A bank may still put forward a proposal on this basis, although the FSA will take a view on the long term durability and stability of the factor in question in assessing the proposal.

13 A bank which has recently moved into a new area of business may still apply for a behavioural adjustment using data relating to other banks already in the same market or that bank's experience in another country. The bank needs to provide evidence to prove that the two markets or banks are comparable and that the data provided is relevant to its case.

7.2.3 Reviewing the adjustment

See s10

14 Any behavioural adjustment agreed between a bank and the FSA should be recorded in the bank's liquidity policy statement. The basis on which the adjustment was granted, along with the behaviour of the cashflow against the predicted behaviour, should be reviewed by the bank and the FSA in conjunction with the overall annual liquidity policy statement review.

15 A bank should continuously monitor the behaviour of the cashflows that have been granted a behavioural adjustment throughout the year. A bank should immediately notify the FSA

of any material changes either in the figures themselves or the assumptions underlying the adjustment.

16 A change in the behaviour of a particular cashflow will act as a trigger for the FSA to review, but not necessarily withdraw, the behavioural adjustment. The FSA may decide instead to change the nature of the adjustment or take no action pending further information or investigation.

7.3 Committed facilities

7.3.1 Undrawn committed facilities granted to a bank

17 Undrawn committed facilities granted to a bank should not be included as inflows in the receiving bank's mismatch calculated on a contractual basis. However, the FSA may consider that a proportion of undrawn committed facilities granted to a bank should count towards the mismatch calculated on a behavioural basis.

(a) It is the behaviourally calculated mismatch that should be maintained within the mismatch guidelines set by the FSA for sight to 8 days and sight to one month. This calculation includes all behavioural adjustments.

18 Unless a specific percentage has been agreed with a supervisor, a bank should not report any committed facilities granted to it in the behavioural mismatch calculation (mirroring the reporting in the contractual mismatch calculation).

19 The percentage of any committed facilities counted towards the behavioural mismatch should be agreed with a bank's supervisor on a case-by-case basis. The amount should normally be included in the demand timeband.

7.3.2 Factors considered when agreeing the percentage of committed facilities to be included in the behavioral mismatch calculation

20 A bank wishing to vary the percentages included as inflows in the behaviourally adjusted mismatch calculations will be expected to provide the FSA with copies of facility documentation.

21 In considering the percentage of a facility that it is appropriate to include at sight in the behavioural mismatch calculation the FSA takes into account any factors likely to influence a lender's ability or desire to allow drawings. In particular, the FSA considers the following (not listed in order of importance):

(a) whether the facility is legally binding;

(b) whether the facility is regularly used to fund a bank's business or whether it is a standby facility expected to be drawn down in an emergency;

a) The FSA takes the view that regularly used facilities are less likely to be withdrawn when most needed than emergency standby facilities. In the case of the latter request to draw can suggest to the lender that there is a problem. The FSA therefore takes a more favourable view of facilities used regularly when considering inclusion of such facilities in the behavioural mismatch calculation.

(c) the identity of the provider of the facility;

(d) the relationship between the provider of the facility and the bank; and

a) In the case of an intra-group facility, the FSA considers the strength of the group and its relevant constituent parts.

(e) the existence of covenants in the facility documentation;

a) Covenanted funding is funding where specific covenants (and/or material adverse change clauses) included in the terms of the agreement specify events of default. If triggered, these covenants/material adverse change clauses prevent further drawings under the facility or, if already drawn, provide for its immediate repayment.

b) Covenants provide legitimate safeguards to lenders. However, the existence of covenants means that a facility may be withdrawn under certain circumstances and this, in turn, can threaten a bank's liquidity. The existence of covenants in a facility is likely to reduce the percentage of the facility allowed in the mismatch calculation.

c) A bank should provide the FSA with copies of facility documentation, declaring any covenants and confirming that it is not in default against these covenants. A bank's supervisor will examine the wording of covenants in the facility letters before deciding what percentage of the facility it is appropriate to include in the behavioural mismatch calculation.

i) The FSA may seek legal opinion on specific covenants.

ii) A bank should notify the FSA if at any time a covenant is breached.

d) A bank's supervisor will consider the amount of headroom a bank has before a covenant is triggered (where there is adequate headroom above a covenant the FSA will be more inclined to consider appropriate a larger percentage of the facility concerned to count towards the mismatch).

e) Where a bank depends on a single standby (as opposed to several) that might be judged to be unavailable in a crisis, a supervisor may be inclined to consider appropriate a smaller percentage (if any) of the standby to count towards the behavioural mismatch calculation. However, this logic does not apply if there is a cross-default clause that may mean a breach of one facility may have a knock-on effect for other facilities.

22 Any agreements regarding the reporting of committed facilities in the behaviourally adjusted mismatch calculations should be recorded in a bank's liquidity policy statement. Like behavioural and materiality adjustments, agreements regarding committed facilities reporting will be reviewed by the FSA in conjunction with the overall annual liquidity policy statement review.

(a) In the case of covenanted funding, banks may be asked to submit (as part of the FSA's annual review) a retrospective summary of the previous year's covenant breaches, or else confirm that there have been no such breaches.

7.3.3 The drawn portion of a committed facility

23 Once a bank has drawn down a committed facility, the amount drawn down should be treated for reporting purposes by the receiver as a potential outflow according to the final maturity date of the facility.

(a) Supervisors may in certain circumstances request that a bank report the drawings made under committed facilities at the date of the maturity of the drawing (rather than the facility) or even at sight.

24 A drawing under a committed facility should usually be reported by the giver as a potential inflow at the end of the term of the facility.

7.3.4 Undrawn committed facilities granted by a bank

25 Undrawn committed facilities granted by a bank should be included as demand outflows in the providers' mismatch calculated on a contractual basis to the value of 15% of the total

undrawn committed facilities. The supervisor may consider that this percentage should be adjusted to anywhere between 0% and 100% in the behavioural mismatch calculation to reflect more sensitively the expected behaviour of the facility.

8 FACTORS CONSIDERED IN SETTING MISMATCH GUIDELINES

Mismatch guidelines are agreed for each bank for the sight - 8 days and sight - 1 month timebands. These are specific to the bank, taking account of a number of factors.

The factors considered are explained in this section. Some factors may not be relevant to all banks.

8.1 General factors

1 In setting mismatch guidelines, the following factors are considered in all cases:

(a) the volatility, diversity and source of deposits;

> a) The volatility of deposits may be more closely related to a bank's perceived creditworthiness, to its position in the banking system or to current economic or financial conditions, than to the precise term of the deposits.
>
> b) Particular attention is paid to those deposits that are known to be sensitive to a bank's reputation and standing, e.g. fiduciary deposits.

(b) the presence of concentrations in the deposit base, including single-source introductions or investment firms' client money accounts;

(c) the degree of reliance on marketable assets, the depth of market in such assets and the price volatility of such assets;

(d) the degree of diversification in a bank's portfolio of marketable assets;

> a) It should not be assumed that large holdings of single assets can be realised at short notice without causing prices to move against the bank. This applies particularly to banks which rarely trade their portfolio (their presence will tend to be noted early in the market) and to large banks (where the asset holding may be large in relation to total market size).

(e) the availability and reliability of undrawn standby lines;

(f) the dependence on drawings of standby lines in order to maintain adequate liquidity, and in particular the possibility of calls for early repayment on lines which have already been drawn (which may result from breaches of material adverse change clauses or other covenants); and

(g) the impact of other business such as off balance sheet obligations, cash flows from FRAs, swaps, forwards etc.

8.2 Qualitative factors

2 In setting mismatch guidelines consideration should also be given to certain qualitative factors.

a) In the event of a bank experiencing liquidity difficulties, it may be the qualitative factors that weaken first.

3 Qualitative factors which should be taken into consideration are:

(a) the asset profile;

(b) the quality of management information systems;

(c) the market reputation, general ability of management and the particular skills of the treasury area;

(d) the ability and willingness of the parent/head office to provide liquidity; and

(e) the bank's standing and reputation in the market.

8.3 Home country lending

4 A branch which lends a considerable proportion of its own balance sheet back to its home country risks becoming illiquid if, for any reason, the home country is unable to meet its debt service obligations. Partly for this reason the FSA assesses whether to place limits on home country lending for branches

9 MONITORING LIQUIDITY

9.1 A bank's monitoring of liquidity

9.1.1 Liquidity policy statements

1 Each bank is required under rule 3.4.3 to formulate a statement of its policy for managing liquidity. It should also agree with the FSA guidelines by which adherence to this policy can be assessed.

See s10

a) Details on the policy on liquidity policy statements are given below.

9.1.2 Systems for monitoring liquidity

2 In order to be considered to be conducting its business in a prudent manner a bank must maintain adequate systems. A bank should therefore have in place systems which enable it to monitor its liquidity profile on a frequent and timely basis.

See *SYSC* 11

a) What in detail will be considered adequate systems depends on the nature of business conducted by the bank. But every bank should have systems in place that enables it to calculate its liquidity position on a daily basis.

FSM Act, see Supervsion manual, chapter 5

b) The adequacy of the systems in place for monitoring liquidity is checked through the section 166 process and through review team visits.

9.2 Monitoring performance against guidelines

3 The FSA conducts its supervision of a bank's liquidity on a quarterly basis by monitoring the performance of a bank against its recommended guidelines.

4 A bank is required to report its cashflow and asset and liability maturity profile on a quarterly basis using the LR return (or FSA010 on and after 30 June 2008).

a) The accuracy of this return may be examined by the reporting accountants in the course of their section 166 work.

b) While there can be considerable value in management accounts, non-standard reports are only acceptable if they are consistent over time for the bank and are in addition to the standard reporting framework.

c) A bank should be able to provide information to the FSA on a more frequent basis, including on a daily basis where required.

5 A bank is required to report all deposits or groups of connected deposits that exceed 2% of total deposit liabilities.

a) Part 5 of the Form LR is used to identify the concentration of deposits held by the bank.

i) UK branches of EEA banks do not need to complete Part 5 of the Form LR.

9.3 Breaches of guidelines

6 A bank should report exceptions to its mismatch guidelines to the FSA as soon as they occur. The reason for the breach should be given, together with the bank's proposed action to bring its liquidity position back within its guidelines. A bank should also report any breaches of its guidelines on the Form LR (or FSA010 on and after 30 June 2008) retrospectively at the end of each quarter.

10 POLICY STATEMENTS

See ch GN s3

1 In order to provide a framework for monitoring liquidity on a basis appropriate to each bank the FSA has made a rule requiring each bank to maintain a statement of its liquidity management policy (see rule 3.4.3).

2 The FSA assesses the liquidity policy taking into consideration the nature of the bank and its business activities.

3 A bank with significant currency business should include in its policy statement its policy for controlling and monitoring its liquidity positions in individual currencies.

a) A bank should not rely on the swaps market in less freely convertible currencies as a means of switching liquidity from one currency to another, since difficulties in one deposit market may affect others.

b) An analysis of liquidity by individual currency may be requested where the business of the bank denominated in that currency is significant, or it is considered that the currency is not quickly and easily convertible.

4 The policy statement should consider the management of liquidity in both normal and abnormal circumstances. In particular, it should include details of the bank's contingency funding plan maintained as required by *SYSC* 11.1.24E.

a) The statement should also include:

i) who is responsible for liquidity management on a day to day basis; and

ii) what are likely to be the most reliable sources of funds in normal circumstances.

5 Except in the case of an EEA bank with a branch in the UK that does not have a UK deposit-taking permission, a liquidity policy statement should also cover a bank's agreed guidelines, its retail/wholesale split and any behavioural or materiality adjustments.

11 APPENDIX 1 - SECURITIES SETTLEMENT

11.1 General considerations

1 Banks selling marketable assets receive cash once they have found a counterparty and once the transaction has settled. The discounts allowed for marketable assets are intended to take account of the price that a bank might have to be willing to accept if it needs to find a counterparty immediately.

This appendix details the time that is then likely to elapse before cash is actually received. In particular, it seeks to identify clear outliers - cases where it would not be prudent to discount to sight as opposed to the eight day to one month time band.

a) The settlement times given apply to repos as well as outright sales, because the same system is used for the transfer of funds in each case.

2 In general, the settlement times given represent the earliest opportunity to receive funds.

a) In many countries, trades can take place over the counter and in such instances, the settlement period is often a matter for agreement at the time of the trade.

3 The times given usually apply to members of a particular settlement system. Many banks (especially small ones) are not members and the time taken to receive funds is therefore longer (by up to 2-3 working days).

4 Varied time zones also need to be taken into account.

11.2 Domestic settlement systems

Country	Instrument	Settlement
Belgium	Government issued securities, CDs and CP Equities	Same day T+3
Canada	Treasury bills Central and provincial government bonds	Same day T+2 (if maturity < 3 years) T+3 (otherwise)

	Equities	T+3
Denmark	Treasury bills All other securities Money market transactions	T+2 Rolling T+3 T+1/T+2
France	Money market instruments (through SATURNE) Other securities (through RELIT)	T (but investors can choose to settle at any time up to T+3) Rolling T+3 (for stock exchange transactions)
Germany	Stock exchange transactions in securities	T+2 (settlement in T is also possible with agreement of recipient)
Greece	Stock Exchange transactions OTC transactions Registered shares	T+2 T+3 T+5
Ireland	Government bonds (through Gilts Settlement Office) Other securities use CREST Trading outside CREST	T+1 See below T+2
Italy	Treasury Bills Other government securities (including corporate bonds)	T+2 T+3
	Equities	T+5
Japan	Treasury bills Government bonds	T+3 T+3

	Equities	T+3
Luxembourg	Most securities settled through Clearstream When physical delivery required	See below T+3
Netherlands	Money market instruments Other securities (including government bonds)	T+2 T+3
Portugal	All securities	T+4
Spain	Government securities Securities listed on stock exchange	T+1 T+5 (due to move to T+3)
	Non-government bonds	T+1
Sweden	Short-term instruments Long-term bonds Equities and corporate bonds	T+2 T+3 T+3
Switzerland	Securities (through Swiss Securities Clearing Corporation)	T+3 (same day optional)
United Kingdom	Government securities and money market instruments (through CGO/CMO/ESO) Equities (through CREST) Corporate bonds	T+1 T+5 (due to become T+3) T+7
United States	US treasuries and municipals MBS Corporate securities Corporate MBS Equities	T+1 (same day possible) T+3 Fixed point in calendar month T+3

11.3 International settlement systems

5 Euroclear and Clearstream are the two major depositories and settlement organisations in international securities markets. They deal with Eurobonds, foreign bonds (securities issued in domestic capital markets by non-resident borrowers), euro-notes and domestic securities including equities.

6 Members hold cash deposits with Euroclear/Clearstream which allows them to provide settlement facilities:

(a) In Clearstream, funds can be received on the same day if instructions are issued by 11am, and otherwise settlement is on T+1.

(b) In Euroclear, settlement on T is provided. However, standard settlement is T+3.

11.4 Brady bonds/LDC debt

7 Brady bonds are almost always settled through Euroclear/Clearstream.

8 LDC bank debt which has not been swapped for Brady bonds (or otherwise converted into a security) typically takes three weeks to settle once a price is agreed.

STERLING STOCK LIQUIDITY

1 INTRODUCTION

1.1 Legal resources

1 There are a number of legal requirements arising out of the Act relating to the need to maintain adequate liquidity. These are:

See COND

(a) The Threshold Conditions require a firm to have adequate resources (which covers inter alia adequate liquidity).

(b) Principle 3 of the Principles for Businesses requires that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. Principle 4 requires a firm to maintain adequate financial resources, including liquidity; and

(c) The rules made to require a bank to maintain adequate liquidity appropriate to the nature and scale of its business, and to set out its policy on liquidity risk management in a written statement.

All UK banks authorised for the purposes of the Act are required to meet these requirements. An EEA bank or overseas bank with a branch in the UK is also subject to those requirements in relation to that branch.

2 As part of the implementation of the recast Capital Adequacy Directive and the Banking Consolidation Directive in the UK from January 2007, provisions relating to a firm's systems and controls for liquidity risk have been introduced in *SYSC* 11 and provisions concerning stress testing and scenario analysis are introduced in *GENPRU* 1.2.30R. The relevant rules implement part of Article 22 and Annex V of the Banking Consolidation Directive. This chapter and chapter LM sets out the FSA's framework for monitoring the liquidity of banks authorised for the purposes of the Act to determine whether the above requirements are met.

See ch LM

a) Certain banks are subject to a different, mismatch liquidity, approach. For details of this approach see the chapter LM on mismatch liquidity.

The Banking Consolidation Directive (formerly the Second Banking Co-ordination Directive - "2BCD") requires the FSA as host supervisor to monitor, in co-operation with the relevant home supervisor, the liquidity of UK branches of credit institutions incorporated in other EEA countries.

1.2 Application

See ch LM

3 This chapter applies only to retail UK banks. Such a bank should obtain the FSA's written agreement that its use of the Sterling Stock Liquidity approach is appropriate.

See ch LM

a) The FSA may consider that it is more appropriate for a bank to which this chapter applies to monitor some or all of its foreign currency liquidity according to the maturity mismatch approach.

Chapter LM on mismatch liquidity sets out the ordinary framework adopted by the FSA for monitoring the liquidity of banks (other than EEA banks). The principles set out in that chapter form the basis for the stock liquidity policy the FSA considers appropriate for UK banks with a large retail deposit base ('UK-incorporated retail banks').

For the majority of banks, the main focus of the FSA's liquidity policy is cash flow, involving the allocation of assets and liabilities to different time bands according to contractual maturity and setting mismatch limits in relation to respective time bands. The FSA considers that such an approach is unsuitable for UK-incorporated retail banks because sterling retail deposits at call or short notice dominate their liabilities, not all of which in practice are withdrawn on the date of their contractual maturity. This 'stickiness' leads to apparently large mismatches at shorter maturities. For these banks, holding an appropriate stock of sterling liquidity against an unexpected loss of funding is more important.

1.3 How this chapter is organised

4 Section 2 outlines the FSA's approach to sterling stock liquidity. Section 3 summarises the main features of the policy. Section 4 describes the detail of the FSA's sterling stock liquidity policy and explains the calculations that are used to determine the stock of marketable sterling assets that a bank on the sterling stock liquidity regime should hold against its estimated possible outflow of sterling funds arising from its liabilities to wholesale and retail depositors within a given timeframe. Section 5 covers monitoring and reporting requirements associated with the sterling stock liquidity regime.

2 THE FSA'S APPROACH TO STERLING STOCK LIQUIDITY

See ch LM s2

1 Regardless of whether a bank reports on a mismatch basis or a stock liquidity basis, the same principles apply. Namely, prudent liquidity management (on the part of the bank) and liquidity monitoring. Details of these are outlined in Chapter LM on mismatch liquidity.

See s1

2 The FSA concentrates primarily on a mismatch approach to liquidity management. However, this approach is usually less appropriate for UK banks whose liquidity profile is dominated by sterling retail deposits at call or short notice which, when aggregated, are 'sticky'. Application of the mismatch approach would require a bank to hold more liquid assets with short term maturities than necessary, bearing in mind the 'stickiness' of its deposit base. So the FSA considers it more important that such banks hold an appropriate stock of sterling liquid assets against an unexpected loss of funding.

a) A bank should not change to or from the sterling stock liquidity approach unless it has received the FSA's written agreement.

See ch LM

b) For the FSA's general approach to liquidity and the mismatch approach to liquidity management, see the chapter on mismatch liquidity.

3 The key element of the FSA's sterling stock liquidity policy is that a bank should hold a *stock of sterling liquid assets* that can be sold quickly and discreetly in order to replace funding that has been withdrawn due to an actual or perceived problem with the bank.

See s4

a) The components of a *stock of sterling liquid assets* are set out below.

4 The objective is that this stock should enable the bank to continue business for a period of five working days (the *survival period*), thus providing an opportunity to arrange more permanent funding solutions.

Five working days is taken to represent the critical period for a bank in crisis, and in which remedial action is most needed and most effective.

See s4

5 It is difficult to predict accurately how the various classes of depositor will behave if a bank gets into difficulties. Based on experience, the safest assumption to make is that wholesale depositors will be the quickest to react by withdrawing funds.

Accordingly a UK-incorporated bank that is covered by the Sterling Stock Liquidity policy should hold a reserve of high quality sterling liquid assets large enough for it to survive for at least five working days without renewal of its maturing *sterling wholesale funding (on a net basis)* and after the leakage of a small proportion (5%) of its gross *retail deposits*.

a) The FSA's approach in focusing on the need to hold stock against the wholesale cash flow mismatch and a proportion of retail deposits mirrors the way a number of UK-incorporated retail banks manage their liquidity.

See s4

b) For the definition of w*holesale funding (on a net basis)* and *retail deposits*, see below.

See s4

6 In considering the adequacy of a UK-incorporated bank's stock of sterling liquid assets, the FSA also has regard to the degree of diversification of those holdings and the bank's ability to mobilise them quickly and discreetly when required (so as not to alert the market to a possible crisis).

See s4

7 In order to prevent its stock holdings from becoming excessively volatile, a retail UK bank is also expected to hold sufficient sterling stock to meet at all times a minimum 'floor' requirement agreed with the FSA.

3 MAIN FEATURES OF THE POLICY

See ch LM s3

This section should be read in conjunction with its equivalent section in the chapter on mismatch liquidity, which sets out the obligations in respect of liquidity, which apply to all authorised banks. The policy set out below replaces the framework for sterling maturity mismatches and applies only to UK-incorporated retail banks on a consolidated basis (unless otherwise agreed in writing with the FSA).

3.1 The main features of the sterling stock liquidity policy

1 A bank should not use the sterling stock liquidity approach except with the FSA's written agreement.

2 A sterling stock liquidity bank should include in the statement of its liquidity management policy its intention to:

- maintain an internal limit for its maximum wholesale sterling net outflow over the next five working days, as agreed with the FSA;
- hold, as a minimum requirement, a stock of sterling liquid assets sufficient to cover the 'floor', as agreed with the FSA;
- ensure that its sterling stock liquidity ratio is at least 100%; and
- notify the FSA of any breaches.

See s4

a) For definitions of the 'floor' and sterling stock liquidity ratio, see below.

See ch LM s10

b) For matters that all banks should consider for inclusion in their liquidity management policy statements, see Chapter LM on mismatch liquidity.

See s5

3 A sterling stock liquidity bank should monitor its compliance with the sterling liquidity stock policy on an inter-day basis.

See s4

4 A sterling stock liquidity bank should ensure that details of its 'floor' and limit are communicated to the relevant personnel and effectively managed.

See s5

5 A sterling stock liquidity bank should notify the FSA of any breaches of its agreed 'floor' or the sterling stock liquidity ratio as soon as they occur.

See s4

6 A sterling stock liquidity bank should not change its 'floor' or limit without the prior written agreement of the FSA.

3.2 Reporting by a sterling stock liquidity bank

See s5

7 A sterling stock liquidity bank should report its sterling stock liquidity position to the FSA monthly up to end May 2008, and quarterly on and after 30 June 2008.

a) Its liquidity position should be reported on the Sterling Liquidity Return ('form SLR1') up to 29 June 2008, and on data item FSA013 on and after 30 June 2008. Unless otherwise agreed with the FSA in writing, the form SLR1 (or FSA013) should be completed <u>on a consolidated basis</u>.

   i) A sterling stock liquidity bank therefore does not have to complete the other sterling liquidity forms.

b) Unless otherwise agreed in writing with the FSA, the form SLR1 should be completed as at the second Wednesday of each month and FSA013 quarterly at dates based on a firm's accounting reference date.

4 THE MEASUREMENT OF STERLING STOCK LIQUIDITY

4.1 Introduction

1 A sterling stock liquidity bank should at all times hold as a minimum a stock of liquid assets sufficient to cover its agreed 'floor' and to ensure that its sterling stock liquidity ratio is at least 100%, unless otherwise agreed with FSA in writing.

a) A sterling stock liquidity bank should ensure that the sterling stock liquidity ratio is calculated daily and that all marketable assets included in it are marked to market daily.

2 This section sets out the framework for these two components. It first explains the *sterling stock liquidity ratio* calculation, listing the components of *sterling liquid stock*.

It then describes, for the purposes of the *sterling stock liquidity ratio* calculation, the wholesale sterling net outflow, the treatment of sterling certificates of deposit and the definition of retail deposits. Finally, it covers the wholesale sterling net outflow limit and the sterling stock 'floor.'

4.2 The sterling stock liquidity ratio

3 Unless otherwise agreed in writing with the FSA, a sterling stock liquidity bank should work to a *sterling stock liquidity ratio* of at least 100%.

4 The *sterling stock liquidity ratio* should be calculated as:

$$\frac{\text{Stock of sterling liquid assets}}{\begin{array}{l}\text{(Wholesale sterling net outflow over the next 5 working days}\\ \text{- allowable sterling certificates of deposit held) +}\\ \text{5\% sterling retail deposits falling due in the next 5 working days.}\end{array}} \times 100$$

a) For the purposes of this calculation, the date of the calculation counts as the first of the 'next 5 working days'.

b) A wholesale sterling net inflow is treated as zero. This disallows all sterling certificates of deposit held and means that a bank only needs sufficient stock to cover 5% of its sterling retail deposits falling due in the next 5 working days.

i) However, it also has to have sufficient stock to cover its agreed 'floor', as set out below.

4.3 The wholesale sterling net outflow limit and sterling stock 'floor'

4.3.1 General

5 A sterling stock liquidity bank should not change its limit or 'floor' without the prior written agreement of the FSA.

6 A bank's limit and 'floor' should be those included in its most recent liquidity policy statement unless otherwise agreed in writing with the FSA.

4.3.2 The wholesale sterling net outflow limit

7 A sterling stock liquidity bank should set an internal limit for its maximum wholesale sterling net outflow over the next five working days.

4.3.3 The sterling stock 'floor'

8 A sterling stock liquidity bank should agree in writing with the FSA a *sterling stock 'floor'*. The FSA would normally agree a 'floor' at 50% of the bank's internal limit.

a) So a bank normally has to have sufficient stock to cover 50% of its limit on the wholesale sterling net outflow over the next five working days.

4.4 Definitions relevant to both components

4.4.1 The stock of sterling liquid assets

9 The stock of *sterling liquid assets* consists of:

(a) *cash*, i.e. Bank of England and other sterling notes and UK coin;

a) *Cash* includes cash paid into another UK bank which has not yet been credited to the sterling stock liquidity bank's account in the books of the other UK bank.

b) Holdings of gold sovereigns are excluded.

(b) operational balances with the Bank of England;

a) These include reserves that are held with the Bank of England's reserves scheme as part of the Bank of England's framework for it's operations in the sterling money markets, of the type set out in Section V of the Bank of England's paper 'The Framework for the Bank of England's Operations in the Sterling Money Markets' (the 'Red Book'), as periodically updated.

b) Special deposits and cash ration deposits are excluded.

(c) UK Treasury bills (including those denominated in Euro) and Bank of England Euro bills and notes;

(d) sterling international bonds ('bulldogs') where they have been issued into (and are held by) the CREST settlements system;

(e) sterling international bonds issued by certain EEA government and international financial institutions, where they have been issued into Euroclear or Clearstream settlement systems;

(f) Euro-denominated bonds issued by EEA governments or certain international financial institutions, where they have been issued into Euroclear or Clearstream settlement systems and where they are eligible for use in ESCB monetary policy operations;

(g) a range of Euro-denominated securities, where they are issued by the central governments and central banks of certain EEA countries, where they are eligible for use in ESCB monetary policy operations, and where the relevant central bank of a country participating in EMU has agreed to act as a bank's custodian under the Correspondent Central Banking Model (CCBM);

a) Detailed lists of the bonds described in (d), (e) ,(f) and (g) above can be found on the Bank of England's website under OMO on the 'Eligible Securities' page (www.bankofengland.co.uk/markets/money/eligiblesecurities.htm).

b) The FSA will automatically update the list of bonds that it considers banks may include in their stock of sterling liquid assets in line with the Bank of England's programme of reviewing its eligible securities.

i) All relevant announcements can be found on the Bank of England's website.

ii) The Bank of England will update its lists of eligible securities regularly.

(h) *gilts*;

a) *Gilts* are defined for this purpose as:

- sterling and foreign currency denominated stock issued by HMG;
- stocks of nationalised industries guaranteed by HMG;

- the Irish land purchase stocks; and
- gilt strips.

i) The inclusion of gilt strips is subject to review in the light of the development of the gilt strips market.

b) Other HMG guaranteed stocks are excluded.

(i) [Deleted]

a) [Deleted]

i) [Deleted]

(j) [Deleted]

a) [Deleted]

b) [Deleted]

(k) certificates of tax deposit; and

(l) foreign currency debt securities issued by the Bank of England.

10 Gilts and other components of the stock of sterling liquid assets acquired as a result of entering into a repo or reverse repo transaction may be included in the stock for the duration that they are held.

a) Collateral taken should, however, be excluded even if it is eligible as liquidity stock, to avoid double counting.

11 Stock lent may be included in the stock provided that title remains with the bank.

a) Collateral taken against such stock lent should, however, be excluded even if it is eligible as liquidity stock, to avoid double counting.

12 Where a bank has pledged out or charged assets otherwise qualifying to be part of its stock, it may continue to include them as part of its stock provided it retains the title to them. Conversely it should not include assets otherwise qualifying to be part of its stock, which have been acquired as pledged or charged assets, unless it receives the title to them.

a) These treatments are because the bank receiving pledged or charged assets does not obtain ownership unless or until the borrower fails and so cannot on-sell until then.

4.4.2 Wholesale sterling net outflow

13 A sterling stock liquidity bank's *wholesale sterling net outflow* is obtained by subtracting wholesale sterling assets maturing over the next five working days and reserves that are held with the Bank of England's reserves scheme from wholesale sterling liabilities falling due over the same period.

For the purposes of this calculation, a bank should include as wholesale sterling liabilities:

(a) all sterling deposits from banks and building societies taken by its treasury division; and

(b) all other sterling *deposits* of £1mn or more taken *on wholesale market terms*.

a) The FSA recognises that banks differ in the way they manage their wholesale cash flows; the aim of the second element here is to ensure a minimum level of consistency across sterling stock liquidity banks.

b) For the purpose of the second element, *deposits on wholesale market terms* are defined as deposits closely related to money market operations which are made as a result of individual customers being offered a specific rate for a particular deposit for a particular period.

i) Interest-bearing funds, deposited either with a sterling stock liquidity bank's branches or directly with, for example, its treasury division, on the strength of the interest rate quoted on enquiry on each occasion that a deposit is made, should be included.

All other deposits should be classified as retail deposits.

14 A bank's wholesale sterling assets should include the converse of paragraph 13(a) and (b) above.

4.4.3 Allowable sterling certificates of deposit

15 A sterling stock liquidity bank may offset its holdings of sterling certificates of deposit against up to 50% of its wholesale sterling net outflow. When included in this way, sterling certificates of deposit are subject to a 15% discount.

a) The 15% discount reflects the possible effect of a forced sale in a troubled market on the value of the bank's certificate of deposit portfolio.

b) This treatment recognises the role that sterling certificates of deposit play in practice in liquidity management. However, in the FSA's view, sterling certificates of deposit cannot be treated as equivalent to other components of liquidity stock on the grounds that there is no lender of last resort facility for CDs. The risk being that this may make the CD market unpredictable in the event of an actual or perceived problem with a sterling stock liquidity bank.

c) Negotiable deposits made on terms identical to those on which a sterling certificate of deposit would have been issued, but for which it is mutually convenient not to issue a certificate, should be included in the offset calculation.

d) If a bank holds sterling certificates of deposit which it has itself issued, these should be excluded from the offset calculation.

e) A bank's holdings of sterling certificates of deposit maturing within five working days may be included in the sterling liquidity stock ratio calculation.

4.4.4 Sterling retail deposits

16 When calculating its sterling stock liquidity ratio, a bank should include its gross sterling *retail deposits* with a residual contractual maturity of five working days or less.

17 For this purpose, *retail deposits* are defined as deposits which arise from customer acceptance of an advertised rate (including 0%) for a particular product.

a) *Retail deposits* include deposits taken in a sterling stock liquidity bank's branch network on the grounds of an existing or new customer relationship where the rates of interest are not directly linked to interbank rates, and are advertised or displayed at the branch counter or are part of standard tariff terms so that depositors can establish, without further enquiry, the rate applicable to each type of deposit.

i) All retail deposits with a residual contractual maturity of five working days or less should be included.

ii) Deposits subject to a penalty on withdrawal should only be included if the residual contractual maturity is five working days or less.

iii) All deposits of under £1mn taken on wholesale market terms should be included.

5 MONITORING LIQUIDITY

5.1 General

1 All banks are required to maintain a liquidity policy statement to the FSA. They should also maintain adequate systems for monitoring liquidity.

a) These are checked during the normal course of supervision by review team visits, treasury visits and reports under section 166 of the Act.

See ch LM s9 and s10

b) For further details, see the chapter on mismatch liquidity.

5.2 Monitoring and reporting performance of sterling stock liquidity

2 A sterling stock liquidity bank should monitor its liquidity position on an inter-day basis. Any breaches of the wholesale sterling net outflow limit, the sterling stock 'floor' or the sterling stock liquidity ratio should be reported immediately to the FSA and a completed, contemporaneous form SLR1 (or a paper version of FSA013 on and after 30 June 2008) sent to the firm's usual supervisory contact at the FSA detailing the liquidity breach. The reason for the breach should also be given, together with the bank's proposed action to bring its liquidity position back within its guidelines.

a) In normal circumstances, a bank's wholesale sterling actual net outflow should not exceed its wholesale sterling net outflow limit. Exceptions should be notified to the FSA unless the bank concerned has enough surplus sterling stock liquidity, over and above that required to meet the sterling stock liquidity ratio. If this condition is met, the exception need not be reported to the FSA.

3 A sterling stock liquidity bank should report its liquidity position to the FSA monthly on the form SLR1 up to end May 2008 and, on and after 30 June 2008, quarterly on FSA013. Unless otherwise agreed in writing with the FSA, the form SLR1 (FSA013 on and after 30 June 2008) should be completed on a consolidated basis.

a) Unless otherwise agreed in writing with the FSA, the form SLR1 should be completed as at the second Wednesday of each month and FSA013 quarterly at dates based on a firm's accounting reference date.

4 The FSA monitors a sterling stock liquidity bank's liquidity profile up to end May 2008 on a monthly basis in line with the submission of the form SLR1: on and after 30 June 2008, it will monitor the liquidity profile quarterly in line with the submission of FSA013.

a) A sterling stock liquidity bank should be able to provide information on a more frequent basis, where necessary, including on a daily basis.

ACCOUNTING AND OTHER RECORDS AND INTERNAL CONTROL SYSTEMS

This chapter has been deleted.

FOREIGN EXCHANGE RISK BASED SUPERVISION

This chapter has been deleted.

FRAUD

This chapter has been deleted.

COMFORT LETTERS

This chapter has been deleted.

VALUATION

This chapter has been deleted.

COLLATERAL AND NETTING

This chapter has been deleted.

CONSOLIDATED SUPERVISION

This chapter has been deleted.

OUTSOURCING

This chapter has been deleted.

PROVISIONING POLICY STATEMENTS

This chapter has been deleted.