


Liquidity: Strengthening Standards



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From December 2009, the FSA is introducing rules such that all firms subject to BIPRU will be required to have a more detailed policy to address liquidity risk than has hitherto been the case, though firms will no doubt be familiar with the requirements of SYSC 11 (Liquidity risk systems and controls). BIPRU limited licence and small scope firms (broadly those with creditors less than £50million) will be mostly concerned with the systems and controls implications of this rather than the detailed requirements that are going to be phased in for large BIPRU full scope firms by October 2010. The former category of firms will become known as “non-ILAS firms” and the latter “ILAS” firms, where ILAS stands for Individual Liquidity Adequacy Standards.

The FSA will be monitoring firms’ adherence to these requirements by introducing a range of new data items that will need to be completed.

→ The Requirement

All BIPRU firms will be required to meet the “overall liquidity adequacy rule”, which stipulates that a firm must at all times maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

Many non ILAS firms tend to hold a substantial amount of their net assets in cash and may consider that there is little risk to their ability to meet the overall liquidity adequacy rule, at least on a short term basis.

→ Stress Event

However, the FSA wants firms to take into account what the liquidity needs would be should a severe stress event occur and for the firm’s resources to be sufficient to cover that also. Although this does not mean that a firm should hold cash to withstand any liquidity crisis, it does indicate that a firm should have a contingency plan for dealing with such a scenario.

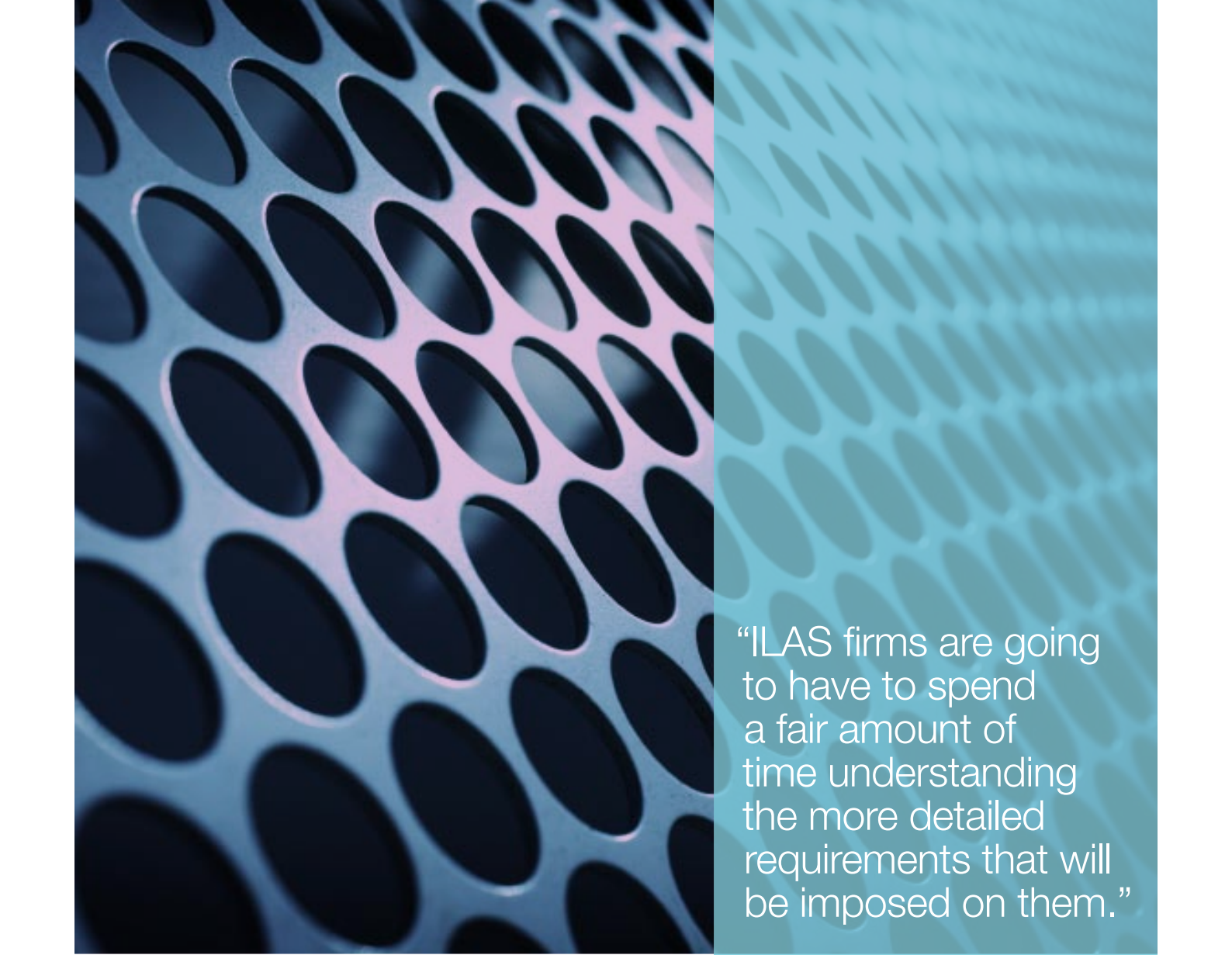
What may prove problematic for some firms is the expectation that all should manage their own liquidity. Thus, firms that are part of a wider group where another company in that group manages all the “surplus” cash that is not required for immediate working capital purposes may find it difficult to continue this arrangement.

The possibility of obtaining a waiver from this rule is available, however, providing certain conditions are met.

→ If you love acronyms, you’ll love this

ILAS firms are going to have to meet with many more requirements than the non-ILAS firms. Specifically, the systems and controls requirements are likely to be more detailed and the firms will also have to perform Individual Liquidity Adequacy Assessments (“ILAA”) in addition to its liquid assets having to meet defined criteria. In addition, ILAS firms will also be subject to the FSA’s Supervisory Liquidity Review Process, or “SLRP” as it is to be known.

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Presumably, this will be incorporated within the Supervisory Review and Evaluation Process (“SREP”) whereby the FSA performs an assessment of a firm’s Internal Capital Adequacy Assessment Process (“ICAAP”) as part of its Advanced, Risk-Responsive Operating frameWork (“ARROW”) review.

→ What you need to be thinking about now

Whether you are an ILAS or non-ILAS firm, you are going to need to:

- > Draft a liquidity policy
- > Determine what resources should be retained to ensure the firm can survive a stress event
- > Consider whether a waiver is needed if much of your spare cash is managed on a group basis by another entity (particularly if that entity is outside the UK)

- > Identify what contingency funding would be available in the event of a liquidity crisis occurring
- > Understand the new data items being proposed by the FSA and ensure that you are able to complete them within the timeframes. This will be particularly onerous for ILAS firms, though full scope BIPRU firms falling within this definition will have until Q4 2010 before they have to submit the new data items proposed.

Additionally, ILAS firms are going to have to spend a fair amount of time understanding the more detailed requirements that will be imposed on them.

→ Next Steps

If you would like any assistance in understanding how these requirements apply to your firm or with any of the detailed work required, please get in touch with us.

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