Chapter 12

Liquidity standards

12.4 Stress testing and contingency funding

12.4.-2 R A *firm* must consider different liquidity risk mitigation tools, including a system of limits and liquidity buffers in order to be able to withstand a range of different stress events and an adequately diversified funding structure and access to funding sources. Those arrangements must be reviewed regularly.

[**Note:** article 86(7) of the *CRD*]

Stress testing

12.4.-1 R A *firm* must consider alternative scenarios on liquidity positions and on risk mitigants and must review the assumptions underlying decisions concerning the funding position at least annually. For these purposes, alternative scenarios must address, in particular, off-balance sheet items and other contingent liabilities, including those of *securitisation special purpose entities (SSPEs)* or other special purpose entities, as referred to in the *UK CRR* in relation to which the *firm* acts as *sponsor* or provides material liquidity support.

[**Note:** article 86(8) of the *CRD*]

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12.4.1 R In order to ensure compliance with the *overall liquidity adequacy rule* and with BIPRU 12.3.4R and BIPRU 12.4.-1 R, a *firm* must:

(1) conduct on a regular basis appropriate stress tests so as to:

(a) identify sources of potential liquidity strain;

(b) ensure that current liquidity exposures continue to conform to the *liquidity risk* tolerance established by that *firm's governing body*; and

(c) identify the effects on that *firm's* assumptions about pricing; and

(2) analyse the separate and combined impact of possible future liquidity stresses on its:

(a) cash flows;

(b) liquidity position;

(c) profitability; and

(d) solvency.

12.4.1A R

12.4.1B G

12.4.2 R In accordance with BIPRU 12.3.11R, BIPRU 12.4.-2 R and BIPRU 12.4.-1 R, a *firm* must ensure that its *governing body* reviews regularly the stresses and scenarios tested to ensure that their nature and severity remain appropriate and relevant to that *firm*.

12.4.3 G Consistent with BIPRU 12.3.5R, the expects that the extent and frequency of such testing, as well as the degree of regularity of *governing body* review under BIPRU 12.4.2R, should be proportionate to the nature scale and complexity of a *firm's* activities, as well as to the size of its liquidity risk exposures. Consistent with the *appropriate regulator's* statutory objectives under the *Act*, in assessing the adequacy of a *firm's* stress testing arrangements (including their frequency and the regularity of *governing body* review) the *appropriate regulator* will also have regard to the role and importance of that *firm* in the *UK financial system*. The *appropriate regulator* will, however, expect stress testing and *governing body* review to be carried out no less frequently than annually. The *appropriate regulator* expects that a *firm* will build into its stress testing arrangements the capability to increase the frequency of those tests in special circumstances, such as in volatile market conditions or where requested by the *appropriate regulator*.

12.4.4 G For the purposes of BIPRU 12.4.2R, a review should take into account:

(1) changes in market conditions;

(2) changes in the nature, scale or complexity of the *firm's* business model and activities; and

(3) the *firm's* practical experience in periods of stress.

12.4.5 E (1) [deleted]

(2) [deleted]

12.4.5A R A *firm* must consider the potential impact of institution-specific, market-wide and combined alternative scenarios. Different time periodsand varying degrees of stressed conditions must be considered.

[**Note:** article 86(9) of the *CRD*]

12.4.6 G The *appropriate regulator* expects every *firm*, including a *firm* with an apparently strong liquidity profile, to consider the potential impact of severe stress scenarios.

12.4.7 G In conducting its stress testing, a *firm* should also, where relevant, consider the impact of its chosen stresses on the appropriateness of its assumptions relating to:

(1) correlations between funding markets;

(2) the effectiveness of diversification across its chosen sources of funding;

(3) additional margin calls and collateral requirements;

(4) contingent claims, including potential draws on committed lines extended to third parties or to other entities in that *firm's group*;

(5) liquidity absorbed by off-balance sheet vehicles and activities (including conduit financing);

(6) the transferability of liquidity resources;

(7) access to central bank market operations and liquidity facilities;

(8) estimates of future balance sheet growth;

(9) the continued availability of market liquidity in a number of currently highly liquid markets;

(10) ability to access secured and unsecured funding (including retail *deposits*);

(11) currency convertibility; and

(12) access to payment or settlement systems on which the *firm* relies.

12.4.8 E

(1) A *firm* should ensure that the results of its stress tests are:

(a) reviewed by its *senior managers*;

(b) reported to that *firm's governing body*, specifically highlighting any vulnerabilities identified and proposing appropriate remedial action;

(c) reflected in the processes, strategies and systems established in accordance with BIPRU 12.3.4R;

(d) used to develop effective *contingency funding plans*;

(e) integrated into that *firm's* business planning process and day-to-day risk management; and

(f) taken into account when setting internal limits for the management of that *firm's liquidity risk* exposure.

(2) Contravention of any of (1)(a) to (f) may be relied upon as tending to establish contravention of BIPRU 12.3.4 R.

12.4.9 R

A *firm* must ensure that the results of its stress tests are reported to the *appropriate regulator* in a timely manner.

Contingency funding plans

12.4.10 R

A *firm* must adjust its strategies, internal policies and limits on *liquidity risk* and develop an effective *contingency funding plan*, taking into account the outcome of the alternative scenarios referred to in BIPRU 12.4.-1 R.

[**Note**: article 86(10) of the *CRD*]

12.4.11 R

A *firm* must have in place liquidity recoveryplans setting out adequate strategies and proper implementation measures in order to address possible liquidity shortfalls. Those plans must be tested at least annually, updated on the basis of the outcome of the alternative scenarios set out in BIPRU 12.4.-1 R, and be reported to and approved by the *firm's governing body*, so that internal policies and processes can be adjusted accordingly. A *firm* must take the necessary operational steps in advance to ensure that liquidity recovery plans can be implemented immediately.

[**Note:** article 86(11) (part) of the *CRD*]

12.4.11A R

[**Note:** article 86(11) (part) of the *CRD*]

12.4.12 G

A *contingency funding plan* sets out a *firm's* strategies for addressing liquidity shortfalls in emergency situations. Its aim should be to ensure that, in each of the stresses required by BIPRU 12.4.1R, it would still have sufficient liquidity resources to ensure that it can meet its liabilities as they fall due.

12.4.12A G

12.4.13 R

A *firm* must ensure that its *contingency funding plan*:

(1) outlines strategies, policies and plans to manage a range of stresses;

(2) establishes a clear allocation of roles and clear lines of management responsibility;

(3) is formally documented;

(4) includes clear invocation and escalation procedures;

(5) is regularly tested and updated to ensure that it remains operationally robust;

(6) outlines how that *firm* will meet time-critical payments on an intra-day basis in circumstances where intra-day liquidity resources become scarce;

(7) outlines that *firm's* operational arrangements for managing a retail funding run;

(8) in relation to each of the sources of funding identified for use in emergency situations, is based on a sufficiently accurate assessment of:

(a) the amount of funding that can be raised from that source; and

(b) the time needed to raise funding from that source;

(9) is sufficiently robust to withstand simultaneous disruptions in a range of payment and settlement systems;

(10) outlines how that *firm* will manage both internal communications and those with its external stakeholders; and

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(11) establishes mechanisms to ensure that the *firm's governing body* and *senior managers* receive management information that is both relevant and timely.

12.4.13A R

12.4.14 E

(1) In designing a *contingency funding plan* a *firm* should ensure that it takes into account:

(a) the impact of stressed market conditions on its ability to sell or securitise assets;

(b) the impact of extensive or complete loss of typically available market funding options;

(c) the financial, reputational and any other additional consequences for that *firm* arising from the execution of the *contingency funding plan* itself;

(d) its ability to transfer liquid assets having regard to any legal, regulatory or operational constraints; and

(e) its ability to raise additional funding from central bank market operations and liquidity facilities.

(2) Contravention of any of (1)(a) to (e) may be relied upon as tending to establish contravention of BIPRU 12.3.4R.

12.4.14A E

12.4.15 G A *firm* should ensure that its *contingency funding plan* takes into account the terms and conditions of any central bank liquidity facilities to which it has access, including both facilities that form part of normal liquidity management operations and emergency liquidity assistance on a secured basis. Where a *firm* includes in its *contingency funding plan* the use of central bank liquidity facilities it should consider the nature of those facilities, collateral eligibility, haircuts to which its collateral might be subject, terms in its existing or available funding arrangements which might impact its ability to access central bank facilities, operational arrangements for accessing those facilities and the potential reputational consequences for that *firm* in accessing them. In formulating its *contingency funding plan*, a *firm* should not rely on expectations it may have about future changes to central bank facilities, either in relation to their normal liquidity management operations or in relation to the availability of specific liquidity facilities in exceptional circumstances.

12.4.16 G The *appropriate regulator* expects that a *firm's contingency funding plan* will encompass a range of actions that the *firm* might take in anticipation of or in response to changes in its funding position. These changes could result from either *firm*-specific or general developments. The *appropriate regulator* anticipates that different actions in a *contingency funding plan* would be taken at different stages of a developing situation.

12.4.16A G