Chapter 12

Liquidity standards

12.5 Individual Liquidity Adequacy Standards

Individual Liquidity Adequacy Assessment

12.5.1 R This section applies to a *standard ILAS BIPRU firm*.

12.5.2 R A *firm* must carry out an individual liquidity adequacy assessment (*ILAA*) in accordance with this section.

12.5.3 G In conducting its *ILAA*, a *firm* is obliged to comply with the stress testing and related requirements which appear in this section. The *rules* in this section also provide that in its *ILAA* a *firm* must include an assessment of the *firm*'s compliance with the standards set out in BIPRU 12.3 and BIPRU 12.4.

12.5.4 R A *firm* must ensure that:

(1) it regularly carries out an *ILAA*;

(2) it makes a written record of its *ILAA*;

(3) its *ILAA* is proportionate to the nature, scale and complexity of its activities;

(4) its *ILAA* takes into account whole-*firm* and *group*-wide liquidity resources only to the extent that reliance on these is permitted by the *appropriate regulator*;

(5) its *ILAA* includes an assessment of the results of the stress tests required by BIPRU 12.5.6 R; and

(6) its *ILAA* includes an assessment of the *firm*'s compliance with BIPRU 12.3 and BIPRU 12.4, including the results of the stress tests required by the rules in BIPRU 12.4.

12.5.5 G A *firm* should carry out an *ILAA* at least annually, or more frequently if changes in its business or strategy or the nature, scale or complexity of its activities or the operational environment suggest that the current level of liquidity resources is no longer adequate. A *firm* should expect that its usual supervisory contact at the *appropriate regulator* will ask for the *ILAA* to be submitted as part of the ongoing supervisory process.

12.5.6 R A *firm* must ensure that in carrying out its *ILAA* it considers how that *firm*'s liquidity resources change as a result of:

(1) the stress in BIPRU 12.5.8 R (the first liquidity stress);

(2) the stress in BIPRU 12.5.11 R (the second liquidity stress); and

(3) the first and second liquidity stresses occurring simultaneously.

ILAA stresses

12.5.7 G The *appropriate regulator* will review the results of a *firm*'s *ILAA*, including the results of the stress tests required by BIPRU 12.5.6R, as part of its *Supervisory Liquidity Review Process* (*SLRP*). The *appropriate regulator*'s review of the stress test results will assist it assessing the adequacy of a *firm*'s liquidity resources relative to other *ILAS BIPRU firms* and, consequently, in calibrating the *individual liquidity guidance* that it gives to that *firm*. BIPRU 12.9.2G sets out the *appropriate regulator*'s approach to assessing the adequacy of a *firm*'s liquidity resources and indicates that, among other factors, it will have regard to the firms *ILAA*. It is not, therefore, the case that the amount of liquidity resources advised to the *firm* as being adequate in its *individual liquidity guidance* will necessarily equate to the amount needed to meet its liabilities as they fall due in the stresses required by BIPRU 12.5.6R. The *appropriate regulator* will assess the adequacy of a *firm*'s liquidity resources on a case-by-case basis and, accordingly, the amount of liquidity resources judged as adequate in the *firm*'s *individual liquidity guidance* might be either above or below the amount needed to survive the stresses required by BIPRU 12.5.6R.

First liquidity stress

12.5.8 R The first liquidity stress to which BIPRU 12.5.6R refers is an unforeseen, name-specific, liquidity stress in which:

(1) financial market participants and retail depositors consider that in the short-term the *firm* will be or is likely to be unable to meet its liabilities as they fall due;

(2) the *firm*'s counterparties reduce the amount of intra-day credit which they are willing to extend to it;

(3) the *firm* ceases to have access to foreign currency spot and *swap* markets; and

(4) over the longer-term the *firm*'s obligations linked to its credit rating crystallise as a result of a reduction in that credit rating.

12.5.9 R For the purpose of BIPRU 12.5.8R (1) to (3), a *firm* must assume that the initial, short-term, period of stress lasts for at least two weeks.

12.5.10 G For the purpose of BIPRU 12.5.8R (4), a *firm* should consider the effect of credit rating downgrades of varying degrees of severity. In doing so, it should also consider the cumulative effect of successive credit rating downgrades to its long-term credit rating.

12

Second liquidity stress

12.5.11 R The second liquidity stress to which ■ BIPRU 12.5.6R refers is an unforeseen, market-wide liquidity stress of three *months* duration.

12.5.12 R For the purpose of ■ BIPRU 12.5.11R, a *firm* must assume that the second liquidity stress is characterised by:

(1) uncertainty as to the accuracy of the valuation attributed to that *firm*'s assets and those of its counterparties;

(2) inability to realise, or ability to realise only at excessive cost, particular classes of assets, including those which represent claims on other participants in the financial markets or which were originated by them;

(3) uncertainty as to the ability of a significant number of *firms* to ensure that they can meet their liabilities as they fall due; and

(4) risk aversion among participants in the markets on which the *firm* relies for funding.

ILAA methodology

12.5.13 R In carrying out the liquidity stresses required by ■ BIPRU 12.5.6R, a *firm* must:

(1) analyse each of the sources of risk identified in ■ BIPRU 12.5.14R;

(2) record the evidence which supports any behavioural assumptions that it makes in carrying out those stress tests;

(3) record the evidence which supports its assessment of the adequacy of its liquid assets buffer; and

(4) identify those of the measures set out in its *contingency funding plan* that it would implement.

12.5.14 R The sources of risk referred to in ■ BIPRU 12.5.13R are:

(1) wholesale secured and unsecured funding risk;

(2) retail funding risk;

(3) intra-day *liquidity risk*;

(4) intra-*group liquidity risk*;

(5) cross-currency *liquidity risk*;

(6) off-balance sheet *liquidity risk*;

(7) franchise-viability risk;

(8) marketable assets risk;

(9) non-marketable assets risk; and

(10) funding concentration risk.

Wholesale secured and unsecured funding risk

12.5.15 R For the purpose of assessing its wholesale funding risk, a *firm* must estimate the gross wholesale outflows that could occur under the liquidity stresses required by BIPRU 12.5.6R.

12.5.16 R In assessing its wholesale funding risk, a *firm* must:

(1) identify its wholesale liabilities;

(2) determine how those liabilities behave under normal financial conditions;

(3) assess how they will behave under the stresses required by BIPRU 12.5.6R; and

(4) divide its wholesale liabilities into funding which the *firm* assesses as having a higher than average likelihood of withdrawal in response to actual or perceived changes in the *firm's* credit-worthiness (Type A wholesale funding) and other funding (Type B wholesale funding).

12.5.17 G In assessing how its liabilities behave under stress, the *firm* should categorise its liabilities according to value, maturity and estimated speed of outflow. The *firm* should bear in mind that wholesale funding risk may crystallise as an acute loss of funds in the short term, or as a longer-term gradual leakage of funds, or as both.

12.5.18 G In the *appropriate regulator's* view, Type A wholesale funding is likely to include at least funding which:

(1) is accepted from a *credit institution*, local authority, *insurance undertaking*, pension fund, money market fund, asset manager (including a hedge fund manager), government-sponsored agency, sovereign government, or sophisticated non-financial corporation; or

(2) is accepted through the treasury function of a sophisticated non-financial corporation which may be assumed to respond swiftly to negative news about a *firm's* credit-worthiness; or

(3) is accepted on wholesale market terms as a part of a *firm's* money market operations; or

(4) is accepted from a depositor with whom a *firm* does not have a long-established relationship or to whom a *firm* does not supply a range of services; or

(5) is accepted from overseas counterparties (other than those in the country or territory of incorporation of a *firm's parent undertaking*); or

(6) is obtained through unsecured debt instruments (such as certificates of deposit, medium-term notes and commercial paper); or

(7) is not obtained through *repo* against assets of the type described in BIPRU 12.7.2R (1) or BIPRU 12.7.2R (2); or

(8) is obtained from counterparties with a relatively low creditor seniority on the liquidation of the *firm*.

12.5.19 R For the purpose of BIPRU 12.5.15R, a *firm* must assume that it is unable to roll any of its Type A wholesale funding in the first two weeks of the stresses.

Retail funding risk

12.5.20 R In this part of BIPRU 12.5, retail funding is funding that is accepted from a *consumer*.

12.5.21 R For the purpose of assessing its retail funding risk, a *firm* must:

(1) estimate the gross retail outflows that could occur under the liquidity stresses required by BIPRU 12.5.6R;

(2) identify the stress, or combination of stresses, to which it considers its retail funding to be most vulnerable and estimate the gross retail outflows that could occur under that stress or combination of stresses; and

(3) divide its retail funding into funding which the *firm* assesses as having a higher than average likelihood of withdrawal in response to actual or perceived changes in the *firm's* credit-worthiness (Type A retail funding) and other funding (Type B retail funding).

12.5.22 G In general, the *appropriate regulator* expects a *firm's* retail funding to be less responsive than its wholesale funding to actual or perceived changes in the *firm's* credit-worthiness. However, a *firm* should nevertheless make its own assessment of the relative responsiveness of its wholesale and retail funding.

12.5.23 G For the purposes of assessing behaviour under stress, a *firm* should categorise its retail liabilities according to: value, maturity, estimated speed of outflow, product type, interest rate applied and any other factor that it considers relevant to its retail *deposit* structure.

12.5.24 G A *firm* should also be mindful that its retail funding profile is unlikely to be constant. In carrying out its *ILAA*, a *firm* should have regard to any changes to its retail funding profile since the previous *ILAA* and also to the possible impact of any future changes on its ability to maintain retail funding during periods of stress. In its *ILAA* submission to the *appropriate regulator*, a firm should include an analysis of:

(1) its retail funding profile as at the date of its *ILAA*;

(2) its retail funding profile over the twelve *months* preceding its *ILAA*;

(3) its projected retail funding profile over the twelve *months* following the date of its *ILAA*; and

(4) its approach to assessing which of its retail funding it has classed as Type A retail funding and which as Type B retail funding.

12.5.25 G In the *appropriate regulator's* view Type A retail funding is likely to include at least funding which:

(1) has been accepted through the internet; or

(2) is considered to have a more than average sensitivity to interest rate changes (such as a *deposit* whose acceptance can reasonably be attributed to the use of price-focused advertising by the *firm* accepting the *deposit*); or

(3) in relation to any individual depositor exceeds to a significant extent the amount of that individuals *deposits* with the accepting *firm* that are covered by a national deposit guarantee scheme; or

(4) is not accepted from a depositor with whom the *firm* has had a long relationship; or

(5) is accepted from retail depositors who can access their *deposits* before their residual contractual maturity subject to a loss of interest or payment of another form of early access charge (as a general proposition, the behaviour of liabilities to retail depositors is likely to depend in part on the contractual terms and conditions which give rise to those liabilities); or

(6) is not held in an account which is maintained for transactional purposes.

12

Intra-day liquidity risk

12.5.26 R For the purpose of assessing its intra-day *liquidity risk* arising from its direct participation in a payment or settlement system, a *firm* must in relation to each such system in which it participates:

(1) calculate on an intra-day basis the net amounts of collateral and cash required by that *firm* to fund participation in that system; and

(2) estimate how the amounts in (1) could change under the liquidity stresses required by BIPRU 12.5.6 R.

12.5.27 G For the purpose of calculating the net amounts of collateral and cash under BIPRU 12.5.26R, a *firm* should separately analyse:

(1) the amounts of collateral and cash needed in relation to both its own payments and those of its customers; and

(2) the intra-day timing of the payment of cash and the posting of the collateral, including the time at which the demand for its collateral and cash is greatest.

12.5.28 G For the purpose of BIPRU 12.5.26R, a *firm* should ensure that it takes into account, in both normal financial conditions and in periods of stress, the effect of:

(1) other participants in a payment system withholding some or all of the payments expected from them; and

(2) its customers increasing either or both the volume and value of their payments.

12.5.29 R At the same time as it carries out the calculation and estimation in BIPRU 12.5.26 R, a *firm* which participates directly in one or more payment or settlement systems must also estimate the impact on its liquidity position of the customer to which it has the largest intra-day credit exposure defaulting on its payment obligations to the *firm*:

(1) under normal financial conditions; and

(2) under the stresses required by BIPRU 12.5.6 R.

12.5.30 G For the purpose of BIPRU 12.5.29R, a *firm* should assume that the effect of that default is that the exposure is rolled overnight.

12.5.31 R A *firm* must, as part of its *ILAA* submission to the *appropriate regulator*:

(1) identify those payment and settlement systems in which it is a direct participant; and

(2) provide details of the intra-day credit policies that it applies, including the criteria against which it sets credit limits, when extending credit to a customer which is not a direct participant in the payment or settlement system in question.

12.5.32 G For the purpose of BIPRU 12.5.31R, the *appropriate regulator* would expect a *firm*, in relation to each payment or settlement system in which it participates directly, to provide details of:

(1) that *firm*'s charges for providing intra-day credit;

(2) any collateral requirements which it applies to its customers;

(3) the credit limits that it imposes (and the circumstances, if any, in which credit may be provided notwithstanding a limit breach);

(4) the extent to which the customers of that *firm* make use of the credit extended to them; and

(5) where relevant, the points during the day at which a customer is required to settle, or provide assets as collateral to cover, that *firm*'s credit exposure to it.

12.5.33 R BIPRU 12.5.34R applies to a *firm* which:

(1) is not a direct participant in a given payment or settlement system;

(2) is a customer of a *firm* that is a direct participant in such a system for the purposes of gaining access to that system; and

(3) receives intra-day credit from that participant *firm* or prefunds its account with such a *firm*.

12.5.34 R For the purpose of assessing its intra-day *liquidity risk* a *firm* to which BIPRU 12.5.33R applies must assess the effect on its own position of a participant *firm* from which it receives intra-day credit or with which it has a prefunded account being unable to perform its obligations to that *firm*:

(1) under normal financial conditions; and

(2) under the stresses required by BIPRU 12.5.6 R.

12.5.35 G As part of its *ILAA* submission to the *appropriate regulator*, a *firm* to which BIPRU 12.5.33R applies should include:

(1) details of any alternative arrangements that it has in place to ensure that it continues to be able to meet its liabilities as they fall due in the circumstances set out in BIPRU 12.5.34R; and

(2) details of the policies governing the use of intra-day credit provided to it by a *firm* which is a direct participant in a given payment or settlement system, including details of the criteria against which that participant will decide whether to reduce or cease the provision of intra-day credit.

Intra-group liquidity risk

12.5.36 R Where a *firm* has an *intra-group liquidity modification* permitting it to rely on liquidity from other members of its *group* in order to satisfy the *overall liquidity adequacy rule*, or may be exposed to calls on its own liquidity resources from others in its *group*, then in assessing its intra-*group liquidity risk* it must:

(1) take into account:

(a) the extent to which it and other entities in its *group* have access to central bank funding;

(b) in relation to any *group* entity on which a *firm* relies for liquidity support, the legal and regulatory regime to which that entity is subject, in particular that covering liquidity regulation; and

(c) the contractual arrangements governing any agreed forms of intra-*group* liquidity support (including committed funding lines); and

(2) assume that in periods of stress, *group* entities will not repay loans or *deposits* made by the *firm* to them, but that the *firm* will meet its liabilities that fall due to other *group* entities during the period of the relevant stress.

12.5.37 G For the purpose of BIPRU 12.5.36R, a *firm* should consider the full range of legal and regulatory restrictions on the availability to it of liquidity support from other members of its *group*. A *firm* should ensure that it understands restrictions in force in other jurisdictions, as well as the potential for such restrictions to be imposed in the future, as to the allowable size of intra-*group* exposures. A *firm* should also consider the circumstances in which it may find itself obliged to transfer liquidity resources to other entities in its *group*.

12.5.38 R [deleted]

12.5.39 G [deleted]

Cross-currency liquidity risk

12.5.40 R For the purpose of assessing its cross-currency *liquidity risk*, a *firm* must:

(1) in relation to each currency in which it has significant positions, calculate its gross outflows and gross inflows having regard to their respective maturities;

(2) where it identifies a net outflow in (1), assess how it will fund that outflow; and

(3) estimate how the amounts in (1) and the assessment in (2) could change under the liquidity stresses required by BIPRU 12.5.6R.

12

12.5.41 R A *firm* must, as part of its *ILAA* submission to the *appropriate regulator*, in relation to each currency in which it has significant positions:

(1) identify the type of financial instruments which that firm uses to raise funding in that currency;

(2) identify the main counterparties which provide funding to that *firm* in that currency; and

(3) describe the arrangements that it has in place to fund net outflows in that currency on a timely basis.

Off-balance sheet liquidity risk

12.5.42 R For the purpose of assessing its off-balance sheet *liquidity risk*, a *firm* must:

(1) identify all off-balance sheet activities that might affect its cash flows;

(2) calculate the effect on its cash flows of those activities in normal financial conditions; and

(3) estimate the effect on its cash flows of those activities under the liquidity stresses required by BIPRU 12.5.6R.

12.5.43 R For the purpose of BIPRU 12.5.42R, a *firm* must take into account the circumstances in which it may choose to provide liquidity support in respect of its off-balance sheet activities beyond its contractual obligations (if any) to do so.

12.5.44 R For the purpose of BIPRU 12.5.42R, a *firm* must in particular consider the impact on its cash flows of:

(1) *derivatives* positions;

(2) contingent liabilities;

(3) commitments given; and

(4) liquidity facilities to support securitisation programmes.

12.5.45 G In relation to *derivatives* positions, a *firm* should:

(1) assess the effect on its cash flows arising from the maturity, exercise and repricing of *derivatives* in which it holds a position, including the impact of counterparties:

(a) who may require the posting of additional margin or collateral in the event of a decline in that *firm's* credit rating;

(b) who may require the posting of additional margin or collateral (or the return to them of margin or collateral) in the event of a change in the value of a *derivative* or of the posted collateral;

(c) who (in the case of those that are any of a *recognised investment exchange*, a *designated investment exchange* or a *recognised clearing house*) may require the posting of additional margin in volatile market conditions;

(d) who may choose to terminate an *OTC derivative* which they have entered into with the *firm* rather than post additional margin or collateral;

(e) who, in periods of name-specific liquidity stress experienced by the *firm*, may choose to terminate out of the money *derivatives* which they have entered into with that *firm*; and

(f) who, in periods of stress, may choose to post less liquid collateral than would likely be the case in normal financial conditions; and

(2) assume that under the stresses required by BIPRU 12.5.6 R there may be uncertainty as to the accuracy of the valuation attributed to a *derivative* contract.

12.5.46 G In relation to its contingent liabilities, a *firm* should:

(1) calculate the impact on its cash flows of those of its contingent obligations that will be triggered in normal financial conditions; and

(2) estimate the impact on its cash flows of those of its contingent obligations that may be triggered under the liquidity stresses required by BIPRU 12.5.6 R.

12.5.47 G For the purpose of BIPRU 12.5.46G, a *firm* should therefore assess the impact on its cash flows of the triggering of contingent obligations contained in all contractual documentation to which it is party, including: acceptances, endorsements, guarantees, underwriting agreements, standby letters of credit, documentary credits, warrants, indemnities, undrawn note issuance facilities and other revolving credit facilities. A *firm* should also assess the degree of concentration in its total contingent liabilities as respects obligations arising from particular types of contract, counterparty and market sector.

12.5.48 G In relation to its commitments (other than liquidity facilities to support securitisation programmes)), a *firm* should:

(1) calculate its maximum contractual exposure arising from those commitments;

(2) calculate the effect on its cash flows of the drawing of those commitments in normal financial conditions; and

(3) estimate the effect on its cash flows of the drawing of those commitments under the liquidity stresses required by BIPRU 12.5.6 R.

12.5.49 G For the purpose of BIPRU 12.5.48G, a firm should:

(1) consider its contractual exposure to the following types of commitment: committed funding facilities, undrawn loans and advances to wholesale counterparties, mortgages that have been agreed but not yet been drawn down, credit cards, overdrafts (and other retail lending facilities);

(2) ensure that its analysis of each type of commitment is sufficiently granular to enable that *firm* to:

(a) assess the circumstances in which counterparties will draw down;

(b) identify the extent of any correlations as between counterparties in deciding whether or not to draw down;

(c) identify the extent to which decisions by the *firm*'s counterparties to draw down may be correlated to a decline in the *firm*'s own liquidity resources; and

(d) assess the proportion of its total commitments attributable to particular counterparties; and

(3) assess the extent to which draw down requires the counterparty in question to deliver to the *firm* collateral in the form of marketable assets, while also assessing the anticipated effect of such a requirement on:

(a) the likelihood that the counterparty in question will draw down; and

(b) the *firm*'s liquidity position if the counterparty in question delivers collateral on draw down; and

(4) assess the impact on its cash flows of its commitment counterparties experiencing liquidity stress at the same time as that *firm* is subject to the stresses required by BIPRU 12.5.6 R.

12.5.50 G In relation to liquidity facilities to support securitisation programmes, a *firm* should:

(1) assess the extent of its contractual obligations to provide liquidity support to sponsored and third-party structured vehicles;

(2) identify the circumstances in which support will, or is likely to, be called; and

(3) assess the impact on that *firm*'s cash flows of such support being called:

(a) in normal financial conditions; and

(b) under the liquidity stresses required by BIPRU 12.5.6R.

12.5.51 G For the purpose of BIPRU 12.5.50G (2), a *firm* should consider the impact of the following events on the likelihood of a call for liquidity support: inability of a vehicle to roll over commercial paper (due either to disruption in the CP market or to concern as to the quality of the assets securitised) and, in relation to sponsored vehicles, concern as to the solvency of that *firm* as sponsor and, separately, the possibility of draw down of undrawn commitments entered into by the sponsored vehicle in its own right.

Franchise-viability risk

12.5.52 R For the purposes of assessing its franchise-viability risk, a *firm* must assess, under the liquidity stresses required by BIPRU 12.5.6 R, the liquidity resources required to maintain its core business franchise and reputation.

12.5.53 G Franchise-viability risk is the risk that in the stresses required by BIPRU 12.5.6R a *firm* may not have sufficient liquidity resources to maintain its core business franchise and reputation.

12.5.54 G In complying with BIPRU 12.5.52R, a *firm* should assess the extent to which it can and realistically will:

(1) restrict new retail lines without significantly damaging customer relationships;

(2) restrict new wholesale lending without significantly damaging its ability to resume such lending following the period of stress in question;

(3) cease to provide liquidity support to its sponsored vehicles;

(4) decline to exercise call *options* whose effect if not exercised might be to cause market participants to question the *firm's* ability to continue to meet its liabilities as they fall due; and

(5) continue any regular programme of buying back its issued debt.

12.5.55 G For the purpose of BIPRU 12.5.54G (5), a *firm* may wish to continue repurchasing its debt to help demonstrate that a two-way market continues to be made in its paper and, more generally, in order to maintain the long-term viability of its debt issuance programme. Equally, a *firm* may wish to continue repaying retail depositors before the contractual maturity of those *deposits* in order to maintain confidence in its ability to continue to meet its liabilities as they fall due.

Marketable assets risk

12.5.56 R For the purpose of assessing its exposure to marketable assets risk, a *firm* must assess how the marketable assets comprised in its liquidity resources will behave:

(1) under normal financial conditions; and

(2) under the liquidity stresses identified in BIPRU 12.5.6R, including an assessment of the effect of these stresses on:

(a) its ability to derive funding from its marketable assets in a timely fashion;

(b) the potential for using those assets as collateral to raise secured funding and the size of the haircut likely to be required by a counterparty;

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

(d) the effect on its business activities of any changes in (a) to (c) identified as likely to result from those liquidity stresses.

12.5.57 G In complying with BIPRU 12.5.56R, a *firm* should consider all marketable assets which count towards its liquidity resources for the purposes of meeting the *overall liquidity adequacy rule*. A firm should therefore include in this assessment any assets that it holds in its liquid assets buffer.

12.5.58 G The *appropriate regulator* regards as marketable those of a *firm's* assets that it is able to sell outright or *repo*. For liquidity management purposes, a *firm* would ordinarily expect to hold a stock of assets of this kind in order to reduce the likelihood that it may need to borrow unsecured at short notice. To the extent that these assets may behave differently under stress conditions than under normal financial conditions, a *firm* is subject to marketable assets risk.

12.5.59 G As a general proposition, the speed with which a *firm* may be able to realise a marketable asset, and the price impact of doing so, will depend to a significant extent on the volume of those assets which that *firm* wishes to realise and the market conditions prevailing at the time.

12.5.60 G The behaviour of a *firm*'s marketable assets under conditions of stress is likely to depend on a number of different factors, including:

(1) the depth and competitiveness of the market for the marketable asset in question, the size of the bid-offer spread, the presence of committed market-makers, the nature of the information available to potential counterparties, the degree of structural complexity of the assets in question and the assets eligibility in central bank market operations and liquidity facilities; and

(2) that *firm*'s operational capability to generate funding from those assets in a timely manner.

12.5.61 G In considering its operational capability to generate funding from assets, a *firm* should be aware that its capability in this regard is likely to depend on:

(1) whether it has in place arrangements for *repo*;

(2) the extent to which that *firm* already holds a significant proportion of the market for the marketable asset in question;

(3) the extent to which that *firm* periodically realises some or all of its holdings of that asset; and

(4) that *firm*'s accounting treatment and valuation of that asset.

12.5.62 R For the purpose of its *ILAA* submission to the *appropriate regulator*, a *firm* must provide the *appropriate regulator* with an analysis of the profile of its marketable assets as at the date of submission in a way that:

(1) separately identifies its marketable assets according to asset class, maturity, currency, their eligibility for use in central bank monetary operations and liquidity facilities and any other characteristic that it uses in its liquidity management; and

(2) assesses the degree of diversification achieved across its marketable assets.

Non-marketable assets risk

12.5.63 R For the purpose of assessing its exposure to non-marketable assets risk, a *firm* must assess how the non-marketable assets in its liquidity resources will behave:

(1) under normal financial conditions; and

(2) under the liquidity stresses required by BIPRU 12.5.6 R, including an assessment of the effect of these stresses on:

(a) the *firm*'s ability to derive funding from its non-marketable assets; and

(b) the impact on the *firm*'s liquidity position of any consequences for its funding ability identified in (a).

12.5.64 G In complying with ■ BIPRU 12.5.63R, a *firm* should consider all non-marketable assets which count towards its liquidity resources for the purposes of meeting the *overall liquidity adequacy rule*.

12.5.65 G ■ BIPRU 12.2.5 G notes that a *firm* should include in its liquidity resources sufficient assets which are marketable or otherwise realisable. The *appropriate regulator* considers those assets which are capable of realisation, but other than through *repo* or outright sale, as non-marketable assets. To the extent that these assets may behave differently under stress conditions than under normal financial conditions, a *firm* is subject to non-marketable assets risk. Different forms of non-marketable assets risk arise, particularly in relation to:

(1) retail loans; and

(2) unsecured wholesale assets.

12.5.66 G In addition to realising a *firm's* marketable assets, a *firm* can meet its outflows in part by expected inflows from maturing non-marketable assets such as retail loans. Inflows from these assets (principal and interest) may in stressed conditions be affected by counterparty behaviour, exposing that *firm* to non-marketable assets risk.

12.5.67 R For the purpose of assessing its exposure to non-marketable assets risk a *firm* must assess the extent to which the behaviour of inflows from retail loans under the liquidity stresses required by ■ BIPRU 12.5.6R may differ from that suggested by their contractual terms.

12.5.68 G For the purpose of the assessment in ■ BIPRU 12.5.67R, a *firm* should ensure that it assesses repayment behaviour at a level of granularity sufficient to enable it to draw informed conclusions about its liquidity exposure. The *appropriate regulator* would expect a *firm's* assessment to analyse separately the non-marketable assets risk associated with each of its relevant products and with each type of counterparty from whom it is expecting repayments.

12.5.69 G For the purpose of the assessment in ■ BIPRU 12.5.67R, a *firm* should in particular have regard to the risk associated with:

(1) repayment defaults; and

(2) exercise by its counterparties of contractual rights to repay before the expected maturity date or to delay repayment beyond that date.

12.5.70 G A *firm* may also use its unsecured wholesale assets to generate liquidity, otherwise than by outright sale or *repo*. A *firm* may, for example, choose to generate funding from some of the assets included in its liquidity resources by using them in securitisation or covered bond programmes. Assets that are typically used to raise liquidity in this manner include residential mortgage loans; commercial mortgage and other loans; credit card and automobile receivables, which have been packaged for the wholesale markets. To the extent that the ability to fund from these non-marketable assets may be limited under stressed conditions, a *firm* may be exposed to non-marketable assets risk.

12.5.71 G The assessment required by ■ BIPRU 12.5.63R is particularly important for a firm which:

(1) ordinarily does not raise funding from its non-marketable assets in this way; or

(2) places proportionately greater reliance on securitisation programmes as compared to other funding strategies to generate liquidity.

12.5.72 R In complying with ■ BIPRU 12.5.63R, a *firm* must in particular assess the non-marketable assets risk associated with asset securitisations, having regard to:

(1) the existence of early amortisation triggers and the consequences of their operation; and

(2) its financing of assets which are warehoused prior to their securitisation.

12.5.73 G A *firm* which chooses to warehouse assets in the way described in ■ BIPRU 12.5.72R should consider the particular risks that arise from the method of financing that it uses to pre-fund those assets. For example, financing of warehoused assets by means of short-term (rather than long-term) funding is more likely to put that *firm* under liquidity pressure in the event that its proposed securitisation is not completed (either at all, or at the expected date).

Funding concentration risk

12.5.74 G A *firm* with a sufficiently flexible funding strategy should be able to reduce its *liquidity risk* by diversifying its liquidity resources.

12.5.75 R As part of its *ILAA*, a *firm* must assess the impact on the degree of diversification in its liquidity resources of the stresses required by ■ BIPRU 12.5.6R.

12.5.76 G For the purpose of ■ BIPRU 12.5.75R, a *firm* should take into account the extent to which its liquidity resources are diversified according to:

(1) type of instrument and product;

(2) currency;

(3) counterparty;

(4) liability term structure; and

(5) market for their realisation (provided that such market is open to the *firm* as counterparty).

12.5.77 G A *firm* should be aware that the degree of diversification in its liquidity resources can be compromised, particularly in periods of stress, by a number of factors, including:

(1) reduced or terminated funding provision from some counterparties as a result of that *firm's* credit-rating being downgraded or its financial condition deteriorating;

(2) disputes over the terms of legally binding commitments to lend which delay the provision of funding;

(3) markets previously used by the *firm* for raising funding ceasing to be open or operating but at reduced capacity;

(4) reliance on a small number of brokers to access funding sources; and

(5) positive correlations in the behaviour of different instruments and products.