

Chapter 6

Basic liquid assets requirement

6.1 Application and purpose

- 6.1.1** **R** This chapter applies to:
- (1) a *MIFIDPRU investment firm*; and
 - (2) a *UK parent entity* that is required by **■ MIFIDPRU 2.5.11R** to comply with **■ MIFIDPRU 6** on the basis of its *consolidated situation*.
- 6.1.2** **R** Where this chapter applies on the basis of the *consolidated situation* of the *UK parent entity*, any reference to a "*firm*" or "*MIFIDPRU investment firm*" in this chapter is a reference to the hypothetical single *MIFIDPRU investment firm* created under the *consolidated situation*.
- 6.1.3** **G** **■ MIFIDPRU 2.5.47R** and **■ MIFIDPRU 2.5.48G** contain additional *rules and guidance* on how a *UK parent entity* should apply the requirements in this chapter on a *consolidated basis*. A *UK parent entity* may apply for an exemption from the application of this chapter on a consolidated basis under **■ MIFIDPRU 2.5.19R**.
- Purpose and interpretation**
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- 6.1.4** **G** This chapter contains:
- (1) a *basic liquid assets requirement* for *MIFIDPRU investment firms* (**■ MIFIDPRU 6.2**); and
 - (2) *rules and guidance* on which assets count as *core liquid assets* for the purposes of the *basic liquid assets requirement* (**■ MIFIDPRU 6.3**).
- 6.1.5** **G**
- (1) Where this chapter applies to a *MIFIDPRU investment firm* on a solo basis, the *firm* must comply with this chapter relying only on the *core liquid assets* it holds itself.
 - (2) However, the *FCA* recognises that there are circumstances in which it may be appropriate for a *firm* to rely on liquidity support provided by other entities within its group. Therefore, a *firm* that is subject to prudential consolidation may apply for an exemption from the application of this chapter on an individual basis under **■ MIFIDPRU 2.3.2R(1)**.

6.1.6 **G** ■ MIFIDPRU 7 contains requirements relating to a *MIFIDPRU investment firm's* systems and controls for the identification, monitoring and management of material potential harms that arise out of liquidity risk.

6.1.7 **G** The *basic liquid assets requirement* in this chapter is based on a proportion of a *firm's fixed overheads requirement* and any guarantees provided to *clients*. A *firm* may need to hold more *liquid assets* to comply with its *liquid assets threshold requirement* under ■ MIFIDPRU 7.

6.2 Basic liquid assets requirement

- 6.2.1** **R** A *firm* must hold an amount of *core liquid assets* equal to the sum of:
- (1) one third of the amount of its *fixed overhead requirement*; and
 - (2) 1.6% of the total amount of any guarantees provided to *clients*.
- 6.2.2** **R** Where a *firm* calculates a total amount for guarantees under **■ MIFIDPRU 6.2.1R(2)**, it must calculate:
- (1) the total value of guarantees that the *firm* has outstanding at the end of each *business day*; or
 - (2) an average value for the guarantees that the *firm* has had outstanding over an appropriate time period, which must be updated at regular, appropriate intervals.
- 6.2.3** **G**
- (1) **■ MIFIDPRU 6.2.2R(2)** is intended to allow a *firm* to smooth out its liquidity requirement for guarantees, where the value of its outstanding guarantees fluctuates on a daily basis.
 - (2) An appropriate time period for calculating and updating this amount is likely to be a period that produces an average value that is representative of the overall liquidity risk arising out of the provision of guarantees to *clients*.
- 6.2.4** **G** The approach in **■ MIFIDPRU 6.2.2R(2)** is illustrated by the following example:
- (1) a *firm* that executes orders on behalf of a *client* may guarantee the settlement of any resulting transactions between the *client* and a third party;
 - (2) in this case, it may be appropriate for the *firm* to use the principles for calculating *average COH* to calculate an average value for the guarantees that the *firm* has had outstanding over an appropriate time period;
 - (3) *average COH* is calculated as the arithmetic mean of historic daily *COH* values. The *firm* could use the arithmetic mean of historic daily values for outstanding guarantees to calculate its amount for guarantees;

- (4) *average COH* is calculated by reference to the historic three-month period beginning six months ago (i.e. excluding the three most recent months). The *firm* could calculate its amount for guarantees by reference to the same time period, if this produces an average value for guarantees that is representative of the overall liquidity risk in these guarantees; and
- (5) a *firm* could update this calculation monthly, in line with the requirement to update *average COH* in ■ MIFIDPRU 4, if this produces a value that is representative of the overall liquidity risk.

6.3 Core liquid assets

- 6.3.1** **R** Subject to ■ MIFIDPRU 6.3.3R to ■ MIFIDPRU 6.3.5R, a *core liquid asset* means any of the following, when denominated in pound sterling:
- coins and banknotes;
 - short-term deposits at a *UK-authorised credit institution*;
 - assets representing claims on or guaranteed by the UK government or the Bank of England;
 - units or shares in a *short-term MMF*;
 - units or shares in a *third country* fund that is comparable to a *short-term MMF*; and
 - trade receivables*, if the conditions in ■ MIFIDPRU 6.3.3R are met.
- 6.3.2** **G** When assessing whether a *third country* fund is comparable to a *short-term MMF*, a *firm* should consider factors such as:
- (1) whether the restrictions on instruments eligible for inclusion in the fund are comparable to the restrictions on instruments in article 10(1) of the *Money Market Funds Regulation*; and
 - (2) whether the fund is subject to requirements concerning portfolio diversification and risk management which are comparable to the requirements applicable to *short-term MMFs* in the *Money Market Funds Regulation*.
- 6.3.3** **R** A *firm* may treat *trade receivables* as *core liquid assets* if:
- (1) the *firm* is:
 - (a) an *SNI MIFIDPRU investment firm*; or
 - (b) a *MIFIDPRU investment firm* that does not have permission to carry on:
 - (i) *dealing on own account*; or
 - (ii) underwriting of *financial instruments* and/or placing of *financial instruments* on a *firm commitment* basis;
 - (2) they are receivable within 30 days;

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- (3) they account for no more than one third of the requirement based upon the *fixed overheads requirement* in ■ MIFIDPRU 6.2.1R(1);
 - (4) they are not used to meet the requirement for guarantees in ■ MIFIDPRU 6.2.1R(2); and
 - (5) they are subject to a minimum haircut of 50%.
- (1) If a *firm's relevant expenditure* or guarantees are incurred in a currency other than pound sterling, the *firm* may also treat the following assets as *liquid assets*, when denominated in that currency:
- (a) coins and banknotes;
 - (b) short-term deposits at a *credit institution*;
 - (c) assets representing claims on or guaranteed by a central bank or government in a *third country*;
 - (d) units or shares in a *short-term MMF*;
 - (e) units or shares in a *third country* fund that is comparable to a *short-term MMF*; and
 - (f) *trade receivables*, if the conditions in ■ MIFIDPRU 6.3.3R are met.
- (2) The proportion of *core liquid assets* denominated in any currency other than pound sterling that a *firm* can rely upon to meet its *basic liquid asset requirement*, must be no greater than:
- (a) for the requirement in ■ MIFIDPRU 6.2.1R(1), the proportion of *relevant expenditure* incurred in that currency; and
 - (b) for the requirement in ■ MIFIDPRU 6.2.1R(2), the proportion of *guarantees* provided in that currency.
- (3) This *rule* is subject to ■ MIFIDPRU 6.3.5R.

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The effect of ■ MIFIDPRU 6.3.4R(2) is illustrated by the following example:

- (1) A *firm* has total fixed overheads with a value of £1,200,000, as follows:
 - (a) 20%, equivalent to £240,000, are incurred in USD; and
 - (b) 5%, equivalent to £60,000, are incurred in Swiss francs (CHF).
- (2) In addition, the *firm* has provided total guarantees to *clients* with a value of £10,000,000, of which 50%, equivalent to £5,000,000, are incurred in USD.
- (3) The *firm's fixed overheads requirement* (one quarter of its total fixed overheads calculated in accordance with ■ MIFIDPRU 4.5) is £300,000.
- (14) Under ■ MIFIDPRU 6.2.1R, the *firm's basic liquid assets requirement* amounts to £260,000, as follows:
 - (a) £100,000 are in respect of the requirement in ■ MIFIDPRU 6.2.1R(1) (one third of the amount of its *fixed overheads requirement*); and

(b) £160,000 are in respect of the requirement in ■ MIFIDPRU 6.2.1R(2) (1.6% of the total amount of any guarantees provided to *clients*).

(5) To meet its requirement in ■ MIFIDPRU 6.2.1R, a *firm* may choose to use *liquid assets* listed in ■ MIFIDPRU 6.3.4R denominated in a currency other than pound sterling, up to a maximum equivalent to £105,000, as follows:

(a) Up to the equivalent of £100,000 may be held in USD denominated *liquid assets* (i.e. 20% of 100,000 = 20,000, to meet the requirement in ■ MIFIDPRU 6.2.1R(1); and 50% of 160,000 = 80,000 to meet the requirement in ■ MIFIDPRU 6.2.1R(2)); and

(b) Up to the equivalent of £5,000 may be held in CHF denominated *liquid assets* (i.e. 5% of 100,000 = 5,000, to meet the requirement in ■ MIFIDPRU 6.2.1R(1)).

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A *firm* must not treat any of the following as a *core liquid asset*:

- (1) any asset that belongs to a *client*; and
- (2) any other asset that is encumbered.

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(1) For the purposes of ■ MIFIDPRU 6.3.5R(1), an asset may belong to a *client* even if the asset is held in the *firm's* own name. Examples of assets belonging to a *client* include money or other assets held under the *FCA's client asset rules*.

(2) For the purposes of ■ MIFIDPRU 6.3.5R(2), an asset may be encumbered if it is pledged as security or collateral, or subject to some other legal restriction (for example, due to regulatory or contractual requirements) which affects the *firm's* ability to liquidate, sell, transfer, or assign the asset.