

## FSA LIQUIDITY REQUIREMENTS UPDATE - JANUARY 2010



### UPDATE FOR NON ILAS FIRMS

On 5 October 2009, the FSA published their Policy Statement PS09/16 containing the final rules for improving liquidity standards.

The FSA have cited their proportionality principle throughout the statement and have as a result narrowed down the requirements applicable to non ILAS firms (these are any limited licence and limited activity BIPRU firms).

Non ILAS firms only need to comply with the systems and controls requirements set out in BIPRU 12.3 and 12.4. These are considered in more detail below.

Compliance will be assessed via an annual questionnaire (FSA055) and the first of these will need to be completed for the year ended 31 December 2010. It will need to be filed within 15 business days of the year end.

#### Systems and controls requirements

The new requirements build on the existing systems and controls procedures that firms should already have in place as part of the SYSC 11 requirements.

Some of the new requirements may not be applicable to all non ILAS firms. In these cases, the FSA have suggested that as long as the thought process for concluding these elements are

not applicable is documented, then that will satisfy the requirements.

The main new elements to be addressed are:

- Pricing liquidity risk
- Intra-day management of liquidity
- Management of collateral
- Management of liquidity across legal entities, business lines and currencies
- Funding diversification and market access

#### Pricing liquidity risk

This will be essential for firms with multiple business lines and sources of liquidity.

They will be required to consider what costs they are incurring to run committed facilities and whether these costs should be passed on to customers.

For smaller or simpler firms, this area is not likely to be significant. If this is the case, firms will still need to document that they have considered pricing liquidity risk and that they do not consider it applicable to their business.

#### Intra-day management of liquidity

Firms need to ensure they are actively managing intra-day liquidity requirements and related risks so that they can meet their payments and settlement obligations on a timely basis.

Again, for smaller and simpler firms, this is not likely to be an issue, but documentation must be in place to show that this point has been considered.

#### Management of collateral

Firms need to actively manage any collateral positions they hold and consider if any issues will arise from how these positions are managed, e.g. if they have deposits how quickly and easily can these be turned into available cash.

#### Management of liquidity across legal entities, business lines and currencies

Firms need to consider the impact of their own liquidity positions within their group. Consideration must also be given to the management of the liquidity position of individual business lines in addition to that of the firm as a whole and the liquidity risk arising from taking positions in foreign currencies.

#### Funding diversification and market access

Firms should consider the sources of credit available to them and whether these will remain available under stressed conditions, e.g. if a bank fails in stressed conditions and this is a firm's only source of credit would the firm still be able to carry on their day to day activities?

If a firm is relying on a group company for finance, terms should be formally documented.

## Other requirements

In addition to these new elements, firms also need to perform stress testing and document their contingency funding plan, their liquidity risk tolerance and governance arrangements in place to approve and review the framework.

## Stress tests

In a similar way to the stress tests performed in the ICAAP document, firms must again perform stress tests considering liquidity risks which consider both institution and market stresses as well as short and long term stresses. Firms must be able to justify the frequency (or infrequency) of their stress testing.

## Contingency funding plan

A contingency funding plan should already be in place which sets out how to deal with liquidity shortfalls in emergency situations.

It should aim to ensure that for each of the stresses considered in the stress tests, there would still be sufficient liquid resources to meet liabilities as they fall due.

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