The PRA’s Strong and Simple Framework: Liquidity and Disclosure Requirements for Simpler-regime Firms (CP4/23)

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Agenda

- The Development of a Simpler Regime for Small Firms
- PRA CP4/23 – Phase 1 Proposals
- Questions and Discussion

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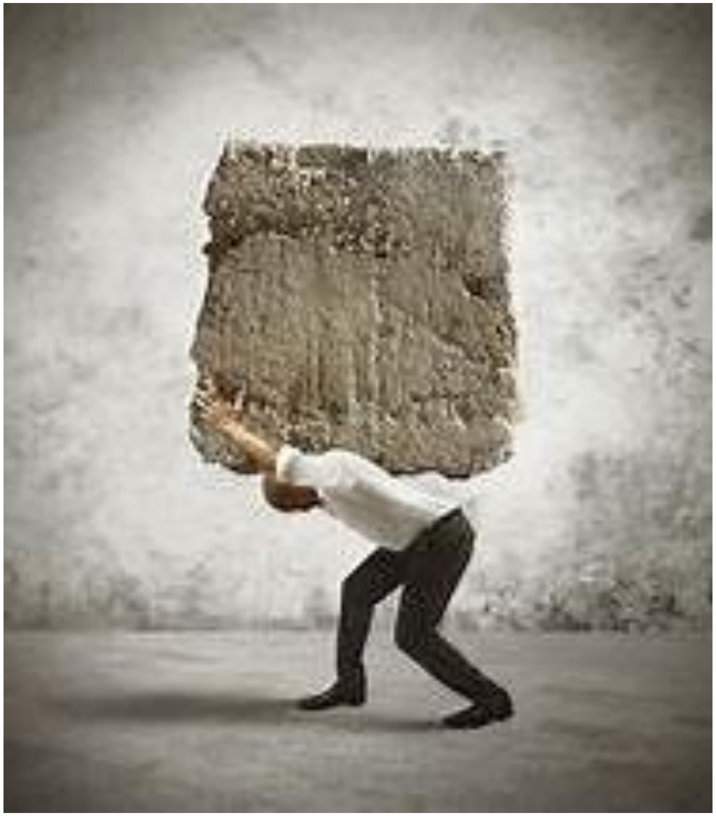
Reducing the Regulatory Burden

- The basic aim of the PRA's initiative is to mitigate the 'complexity problem' that can arise for smaller banks and building societies

- The proposed changes are consistent with the government's aim to deliver smart regulatory reform



Simpler Regime for Small Firms

- CP 16/22 sets out the proposed criteria that small firms should meet in order to qualify for the simpler regime, which include:

Size of total assets [1]	Assets located domestically	Small scale trading and foreign exchange [2]	No commodities or commodity derivatives
No IRB approach to credit risk	No clearing, settlement or custody credit risk	No payment system operation	Satisfaction of parent and consolidation requirement

1. Average total assets of less than and £20bn and complying with the other items
2. The trading book business is less than £44m (assets) and is less than 5% of the firm's total assets and foreign exchange positions do not exceed 3.5% of own funds or 2% of own funds on average

Note, the proposed Pillar 3 Remuneration disclosures (CP5/23) are subject to a similar set of criteria, but, in this case, satisfying a size threshold alone (average total assets of less than £4bn) will be sufficient to qualify for small firm arrangements

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Objectives of the Framework

Simplify prudential framework for small domestic banks and building societies (where there are little or no public policy benefits from compliance)

Reduce cost of understanding, interpreting and operationalising requirements

Reduce barriers to growth

Maintain resilience

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BTRM Global Standard in Bank Asset-Liability Management

Simpler Regime for Small Firms

- The development of the new regime is to be split into two phases:

Phase 1 — Non-capital related prudential measures (02/2023)

Phase 2 — Capital related prudential measures (H1 2024)

- The approach has been designed to ensure that firms benefit as soon as possible from prudential simplification

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Phase 1 Proposals

- New liquidity requirements for the application of the Net Stable Funding Ratio 1
- Revisions to the application of Pillar 2 liquidity add-ons 2
- A new, streamlined Internal Liquidity Adequacy Assessment Process (ILAAP) template 3
- The removal of certain liquidity reporting templates 4
- New Pillar 3 disclosure requirements for Simpler-regime firms 5
- Simplification of certain proportionality approaches (applicable in the PRA Rulebook)

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Application of the Net Stable Funding Ratio 1

- The PRA introduced the NSFR on 1 January 2022 to help to ensure that banks maintain a stable funding profile in relation to their assets

The NSFR is calculated as follows:

$$\frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} \geq \mathbf{100\%}$$

- Firms that qualify as ‘Small and Non-complex Institutions’ can apply a simplified version of the NSFR (sNSFR) calculation with a reduced number of data points
- In practice, this approach has not been commonly selected by smaller firms

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Application of the Net Stable Funding Ratio 1

BCBS NSFR Factors - Available Stable Funding

Summary of liability categories and associated ASF factors

ASF factor	Components of ASF category
100%	• Total regulatory capital (excluding Tier 2 instruments with residual maturity of less than one year) • Other capital instruments and liabilities with effective residual maturity of one year or more
95%	• Stable non-maturity (demand) deposits and term deposits with residual maturity of less than one year provided by retail and small business customers
90%	• Less stable non-maturity deposits and term deposits with residual maturity of less than one year provided by retail and small business customers
50%	• Funding with residual maturity of less than one year provided by non-financial corporate customers • Operational deposits • Funding with residual maturity of less than one year from sovereigns, PSEs, and multilateral and national development banks • Other funding with residual maturity between six months and less than one year not included in the above categories, including funding provided by central banks and financial institutions
0%	• All other liabilities and equity not included in the above categories, including liabilities without a stated maturity (with a specific treatment for deferred tax liabilities and minority interests) • NSFR derivative liabilities net of NSFR derivative assets if NSFR derivative liabilities are greater than NSFR derivative assets • "Trade date" payables arising from purchases of financial instruments, foreign currencies and commodities

Retail and SME deposits are considered to be stable and an excellent long-term source of funding

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Application of the Net Stable Funding Ratio - PRA Proposal

Proposal

- Apply a new Retail Deposit Ratio (RDR) to Simpler-regime Firms

$$\text{RDR (\%)} = \frac{\text{Total Retail Deposits}}{\text{Total Funding}}$$

- Disapply NSFR to Simpler-regime firms if RDR condition met
- Otherwise apply the NSFR
- Remove the sNSFR from the liquidity part of the PRA rulebook

Conditions/Definitions

- 4 quarter moving average of the RDR must be greater than or equal to 50% for 4 consecutive quarters
- Total Retail Deposits = sum of liabilities to natural persons and SMEs (up to £880,000)
- Total Funding = Total Retail Deposits and wholesale funding
- A firm that has a 4 quarter moving average RDR of below 50% has 1 year to implement NSFR. Transitional arrangements for new firms

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NSFR Proposal – Analysis and Discussion Points

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- The PRA considers a 50% RDR a reasonable proxy for the point at which a firm's funding structure switches from predominantly retail to predominantly wholesale (and exposure to funding stress increases)
- PRA has calculated that the proposals would reduce the number of data points reported by 758 as firms no longer required to submit C80, C81 and C84 (with associated cost savings)
- Cost of RDR calculation negligible as calculated from existing returns

Discussion Point:

✓ Why shouldn't the same 'proportionality' logic be applied to firms that do not meet the conditions for the 'Simpler-regime', but have an RDR above 50%?

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Observation – NSFR Proposal

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Extract from Draft Amendment to Supervisory Statement SS24/15

Draft

Example of a firm that must apply the NSFR because its four-quarter moving average RDR is below 50%

By 12 May 2025, the firm calculates the four-quarter moving average using its RDR as at 31 March 2025 reference date, and as at the three preceding quarterly reference dates:

$$\frac{RDR_{2025\,Q1} + RDR_{2024\,Q4} + RDR_{2024\,Q3} + RDR_{2024\,Q2}}{4}$$

If the output from this calculation is below 50% on the remittance date on 12 May 2025, then under Rule 5.7 of Chapter 5 of the Liquidity (CRR) Part of the Rulebook, the firm would be required to notify the PRA without delay and, under Rule 5.6, the firm would be required to implement the NSFR one year from the day after the remittance date.

However, if the firm's four-quarter moving average RDRs for the quarters Q2 2025, Q3 2025, Q4 2025 and Q1 2026 were all greater than or equal to 50%, the firm would now meet the RDR condition so the NSFR requirement would not apply.

The 'Stop-Start' nature of the proposed rules may be problematic for firms that are close to the 50% RDR cut-off

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Pillar 2 Liquidity Add-ons 2

- Firms are required to undertake their own assessment of liquidity risks including Pillar 2 risks, and to take appropriate measures to manage these risks
- Where the PRA assesses that a firm is exposed to such risks, it may apply individual guidance and an ‘add-on’ to the Liquidity Coverage ratio, in the form of an additional HQLA requirement
- As Simpler-regime firms are limited in the breadth of their activities, the PRA proposes to disapply Pillar 2 liquidity guidance

Discussion Point:

✓ In practice, is the PRA making much of a concession with this proposed amendment?

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ILAAP Document Template 3

1. Overview	
2. Overall Liquidity Adequacy Rule – Risk Strategy and Appetite	
3. Stress Testing	3.1 Framework
	3.2 Evaluation of Liquidity Buffers and Counterbalancing Capacity
	3.3 Evaluation of Liquidity Risk and Funding Risk
	Retail Funding Risk, Wholesale Secured and Unsecured Funding Risk, Non-marketable Assets Risk, Off-balance Sheet Funding Risk, Cross-currency Funding Risk, Correlation between Funding Markets and Lack of Diversification in Funding Types, Risk from Firm's Funding Tenors, Franchise Risk, Asset Encumbrance Risk, Deterioration in Firm's Credit Rating, Risk that Liquidity Cannot be Transferred across Entities, Sectors and Countries and Intra-day Risk
	3.4 Stress Testing Output
4. LCR and NSFR Reporting	
5. Liquidity and Funding Risk Management Framework	5.1 Organisational Framework, Policies and Procedures
	5.2 Risk Identification, Measurement, Management and Reporting
6. Other Materials	6.1 Contingency Plans
	6.2 Funding Plans
	6.3 Funds Transfer Pricing Policy
	6.4 Minutes Related to ILAAP Document

- A new simplified ILAAP document template is proposed. Many of the characteristics of the SS24/15 template have been retained, but with:

- greater emphasis on stress-testing
- removal of the quantitative assessment of Pillar 2 add-ons and aspects not relevant to Simpler-regime firms, such as discussion on NSFR, marketable asset risk, internalisation risk etc..
- increased guidance to make ILAAP preparation more cost effective

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ILAAP Template Document 3

- Adoption of the new template is not mandatory for Simplified regime firms
- The PRA would retain the ability to apply Pillar 2 guidance where warranted

Discussion Point:

- ✓ Will the revised template lead to a material reduction in the complexity and cost of producing the ILAAP document for Simplified-regime firms

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Liquidity Reporting

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- The PRA collects Additional Liquidity Monitoring Metrics (ALMM) returns to augment the information provided on the LCR and NSFR

Metric	Explanation	Why it is Useful?
A contractual maturity ladder **C66**	Provides insight into the extent to which a bank relies on maturity transformation	Advanced warning of potential future liquidity stress
Concentration of funding by counterparty **C67**	The top 10 largest counterparties from which funding obtained exceeds a threshold of 1% of total liabilities	Identification of those sources of wholesale and retail funding of such significance that their withdrawal could trigger liquidity problems
Concentration of funding by product type **C68**	the total amount of funding received from each product category when it exceeds a threshold of 1% of total liabilities	Identification of those sources of wholesale and retail funding of such significance that their withdrawal could trigger liquidity problems

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Liquidity Reporting 4

Metric	Explanation	Why it is Useful?
Prices for various lengths of funding **C69**	Average transaction volume and prices paid by institutions for funding with different maturities	Advanced warning of deteriorating liquidity position. Peer Group comparison
Rollover of funding **C70**	Volume of funds maturing and new funding obtained, on a daily basis over a monthly time horizon	Validation of behavioural assumptions. Advanced warning of deteriorating liquidity position. Peer Group comparison
Concentration of counterbalancing capacity by issuer/counterparty **C71**	The 10 largest holdings of assets or liquidity lines granted	Potential borrowing capacity in a stress

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Liquidity Reporting – Strong and Simple Framework Proposal (Simpler – Regime Firms)

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Additional Liquidity Monitoring Metrics (ALMM)

C66 - Contractual Maturity Ladder

C67 – Concentration of Funding by Counterparty

STOP

C68 – Concentration of Funding by Product Type

C69 – Prices for Various Lengths of Funding

STOP

C70 – Rollover of Funding

STOP

C71 - Concentration of counterbalancing capacity

STOP

Implementation date: H2 2024

Revised Reporting Framework for ALMM (Proposed) – Implementation H2 2024

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Simpler-Regime Firms

- C66 - Contractual Maturity Ladder
- C67 – Concentration of Funding by Counterparty
- C68 – Concentration of Funding by Product Type
- C69 – Prices for Various Lengths of Funding
- C70 – Rollover of Funding
- C71 - Concentration of counterbalancing capacity

➢ Qualifying firms required to provide C68 report on all product types, not just those comprising more than 1% of liabilities

➢ Information could still be required by PRA but in a form available to the firm

➢ Small and Non-Complex Institutions

- C66 - Contractual Maturity Ladder
- C67 – Concentration of Funding by Counterparty
- C68 – Concentration of Funding by Product Type
- C69 – Prices for Various Lengths of Funding
- C70 – Rollover of Funding
- C71 - Concentration of counterbalancing capacity

➢ Firms meeting conditions set out in point 145 of Article 4 (1) of the CRR but not classified as Simpler-Regime Firms:

✓ 3-year transition from quarterly to monthly reporting

All other Institutions currently required to submit ALMM

- C66 - Contractual Maturity Ladder
- C67 – Concentration of Funding by Counterparty
- C68 – Concentration of Funding by Product Type
- C69 – Prices for Various Lengths of Funding
- C70 – Rollover of Funding
- C71 - Concentration of counterbalancing capacity

➢ Continue to submit monthly reports

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Revised Reporting Framework for ALMM (Proposed) – Implementation H2 2024

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- PRA has calculated that the proposals would reduce the number of data points reported by 4294
- In a related EBA exercise, it was estimated that the proposed simplification would reduce reporting costs by 2-3%

Discussion Points:

- ✓ Is it simpler to report all product types rather than those comprising greater than 1% of liabilities?
- ✓ Is the estimated 2-3% cost saving worth the upfront effort?
- ✓ Could ad-hoc PRA data requests (permitted under the proposals) wipe-out any cost savings?

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New Pillar 3 Disclosure Requirements for Simpler-regime Firms 5

- Public disclosures are an important component of a well-functioning financial system
- Regulation helps to ensure that disclosures amongst firms are consistent
- However, for disclosures to be beneficial and support the effective exercise of market discipline, they need to be focussed on information that is of value to investors and other market participants
- The PRA proposes to introduce disclosure requirements for simpler firms that recognise the lower capacity for these firms to cause significant financial disruption

New Pillar 3 Disclosure Requirements for Simpler-regime Firms 5

<u>Simpler-Regime Firms No Listing</u>

- Pillar 3 disclosure requirements to be removed

<u>Simpler-Regime Firms With a Listing</u>

- No qualitative disclosure on the processes under which the regulatory metrics are measured and managed
- Quantitative disclosure on capital and core regulatory metrics required (UK KM1 and UK OV1)
- If qualify for the 'Other' category for disclosure, the required number of templates would reduce from 88 to 7

<u>Small and Non-Complex Institutions (not Qualifying as a Simpler-Regime Firm)</u>

- Existing CRR disclosures (Article 433b) removed
- Replaced with disclosure requirements applicable to 'Other Institutions' per CRR Article 433c
- 3-year transition period proposed (from H2 2024)
- The required number of templates would reduce from 12 to 7

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New Pillar 3 Disclosure Requirements for Simpler-regime Firms 5

- Qualitative disclosures removed as these are not being consulted by market participants
- Remuneration disclosures for Simpler-regime firms is the subject of a separate consultation

Discussion Points:

✓ In theory, reduced disclosure will allow senior executives of simpler firms to spend greater time on risk management activities, but could it mean that by not routinely reviewing/signing-off disclosures, they will have a lesser grip on the risks being run by their business?

✓ Overall, the proposals are clearly beneficial for simpler firms, but do they go far enough?

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PRA Questions and Consultation Timetable

- The PRA has posed 5 questions to the industry:

  Q1: Do you have any comments on the proposed implementation date and whether it would strike an appropriate balance between allowing firms to implement the measures set out in this CP quickly and providing sufficient time to implement the measures?

  Q2: Do you have any comments on potential future changes to the content, clarity, and presentation of PRA rules and policies that could help to achieve the aims of Strong and Simple?

  Q3: Do you have any comments on the PRA's proposals for the scope and level of application for the simplifications set out in this CP?

  Q4: Given the simplified approach to stable funding under the simpler regime that is set out in this chapter, do you have any comments on the appropriateness and proportionality of the proposed approach to the sNSFR?

  Q5: Are there any factors or stakeholders the PRA has not identified or considered sufficiently in respect of the proposed exclusion of non-listed Simpler-regime Firms from Pillar 3 requirements?

Interesting question – the PRA is asking the industry to check its work!

- All responses must be submitted by 30 May 2023

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Any Questions?

If questions occur to you later, please feel free to contact me via the forum

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