Supervisory Statement | LSS12/13

Settlement bank exposures to customer banks: management of the risks

April 2013

BANK OF ENGLAND
PRUDENTIAL REGULATION
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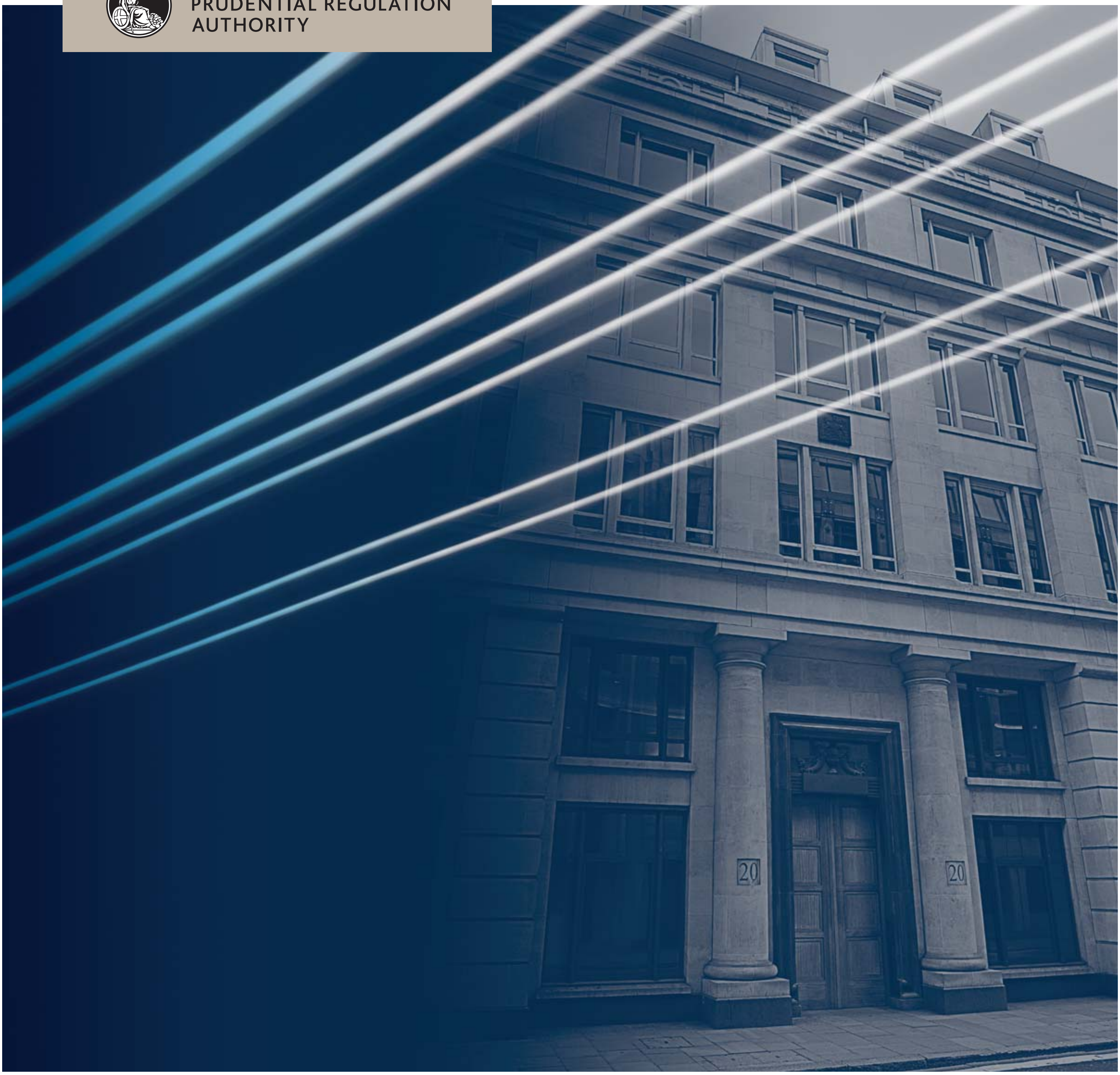

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From its commencement on 1 April 2013, the Prudential Regulation Authority (PRA) has adopted a number of legacy FSA policy publications relevant to the advancement of its objectives. This document, initially issued by the FSA, has been adopted by the PRA as a Supervisory Statement as part of this process. The PRA may choose to review this legacy publication at a later stage.

1. Banks' risk assessments of customer banks should include a specific assessment of the risks arising from acting as settlement bank (as an additional element of the regular credit assessment process), in particular credit, settlement and operational risks. These should include:

- Analysis of potential exposure in each payment system taking account of the controls available to manage these exposures.
- Scenario analysis of potential exposures in the event of a 'run' on a customer bank in retail or wholesale markets: for example, consideration of through which payments systems funds might be withdrawn.
- Analysis of the susceptibility and vulnerability of customer banks to a 'run' in the event that they become distressed, taking account, for example, of their reliance on less-sticky retail deposits or short-term wholesale funding.

2. Banks should adjust risk controls as necessary in response to these credit risk assessments.

3. Banks should have formal contingency plans for dealing with customer banks in distress, including suffering a wholesale or retail 'run'. These should include:

- An analysis of how they would use scheme rules to limit their risks; banks should check their understanding of how they would plan to use these rules with the relevant payment system operators.
- Procedures for reducing credit limits, including potentially to zero (equivalent to pre-funding).
- Procedures for pre-collateralisation of exposures.
- Procedures for communication to the customer.
- Procedures for communication to payment system operators.
- Procedures for communication to the authorities.

4. These contingency plans should involve and be signed off by credit, operations and treasury management functions.