

PRA Consultation Proposes Modernising Liquidity Policy

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On 17 March the UK's Prudential Regulation Authority (**PRA**) published a Consultation Paper on "**Modernising the liquidity policy framework**" (**CP5/26**), which is an ambitious salvo aimed at making "targeted and proportionate" adjustments to firms' responses to liquidity shocks and enhance their operational readiness for future challenges across an increasingly wide range of scenarios.

Existing requirements for firms to maintain a Liquidity Coverage Ratio (**LCR**), essentially by holding sufficient high-quality liquid assets (**HQLA**) to satisfy payment obligations during a 30-day period of stress, were set following the liquidity shocks of the financial crisis of 2007/8. Technological developments since that time have shown that the speed at which confidence is lost and outflows gain pace now outstrips the assumptions that underpin the LCR.

What is the PRA proposing?

The PRA is not proposing firms hold more liquid assets. Rather, it is looking to strengthen Pillar 2 and banks' liquidity risk management and operational resilience in a way that is proportionate to the risk the particular institution identifies.

Proposal 1: Assess the composition of liquidity resources and monetisation risk - the PRA is proposing a clarification to the Overall Liquidity Adequacy Rule (**OLAR**) to make it clear that banks must at all times maintain a composition of liquidity resources that means there is no significant risk that liabilities cannot be met as they fall due. In addition, and importantly, firms will be required to prepare stress scenarios that deal with the first seven days of a sudden and severe liquidity outflow.

Banks will also be required to assess frictions to the monetisation process, including internal frictions such as internal governance processes, and whether accounting treatments or the effects on capital ratios would be detrimental to their ability or willingness to monetise when necessary. This will entail a shift away from considerations for firms of 'marketable asset risk', which will be replaced with the wider concept of 'monetisation risk' in the Internal Liquidity Adequacy Assessment Rule.

Proposal 2: Remove exemption for Level 1 Assets (including sovereign bonds) from the LCR Operational Requirement for monetisation testing – the proposal to no longer exempt this category of asset from the annual operational testing requirement is consistent with Basel's approach to monetisation testing.

Proposal 3: Clarify the role of central bank facilities within the prudential liquidity framework – the PRA proposes clarifying that firms may include central bank facilities that are regularly available and offered on published terms as part of the OLAR and for internal stress testing purposes, but may not include emergency central bank liquidity assistance. Banks that do include these facilities must be operationally ready to use them and meet the eligibility criteria (including prepositioning eligible collateral).

Proposal 4: Managing collateral – here the PRA proposes requiring banks to monitor and assess pre-positioned collateral with central banks as an additional liquidity resource, and to estimate the amount of additional unencumbered assets that are not prepositioned but which may be eligible as central bank collateral.

Responses are due by 17 June 2026.