

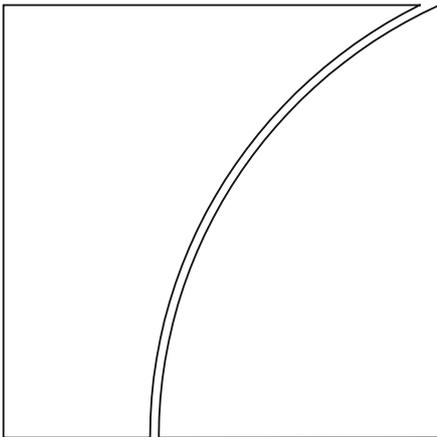
# Basel Committee on Banking Supervision

## Consultative Document

### Revisions to the Basel III leverage ratio framework

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# Revisions to the Basel III leverage ratio framework

## I. Background

An underlying cause of the global financial crisis was the build-up of excessive on- and off-balance sheet leverage in the banking system. In many cases, banks built up excessive leverage while apparently maintaining strong risk-based capital ratios. At the height of the crisis, financial markets forced the banking sector to reduce its leverage in a manner that amplified downward pressures on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling bank capital and shrinking credit availability.

The Basel III framework<sup>1</sup> introduced a simple, transparent, non-risk-based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The Basel III leverage ratio is intended to:

- restrict the build-up of leverage in the banking sector to avoid destabilising deleveraging processes that can damage the broader financial system and the economy; and
- reinforce the risk-based requirements with a simple, non-risk-based “backstop” measure.

The Basel Committee is of the view that:

- a simple leverage ratio framework is critical and complementary to the risk-based capital framework; and
- a credible leverage ratio is one that ensures broad and adequate capture of both the on- and off-balance sheet sources of banks’ leverage.

Public disclosure of the Basel III leverage ratio started effective 1 January 2015 based on the standards published in January 2014 (hereafter “Basel III leverage ratio framework”).<sup>2</sup>

In January 2016, the Group of Central Bank Governors and Heads of Supervision (GHOS), the Committee’s oversight body, discussed the final design and calibration of the Basel III leverage ratio. The GHOS agreed that the Basel III leverage ratio should be based on a Tier 1 definition of capital and should comprise a minimum level of 3%, and further discussed additional requirements for global systemically important banks (G-SIBs). The GHOS also agreed to finalise the calibration of the Basel III leverage ratio in 2016 to allow sufficient time for it to be implemented as a Pillar 1 measure by 1 January 2018, thereby confirming the timeline set out in the Basel III framework.

This document proposes revisions to the design and calibration of the Basel III leverage ratio framework. The proposed revisions have been informed by the monitoring process in the parallel run period since 2013, by discussions with market participants and stakeholders, and by the frequently asked questions (FAQ) process since the release of the Basel III leverage ratio framework in January 2014.

<sup>1</sup> Basel Committee on Banking Supervision, *Basel III: A global regulatory framework for more resilient banks and banking systems*, June 2011, available at [www.bis.org/publ/bcbs189.pdf](http://www.bis.org/publ/bcbs189.pdf).

<sup>2</sup> Available at [www.bis.org/publ/bcbs270.pdf](http://www.bis.org/publ/bcbs270.pdf).

## II. Overview of proposed changes to the Basel III leverage ratio framework

### II.1 Revisions to the treatment of derivative exposures

#### II.1.1 Adoption of a modified version of the standardised approach for measuring counterparty credit risk exposures (SA-CCR)

At present, the Basel III leverage ratio framework uses the Current Exposure Method (CEM) to measure the replacement cost (RC) and the potential future exposure (PFE) for derivative transactions, with certain leverage ratio-specific modifications to limit the recognition of collateral. This approach captures the exposure arising from the underlying of the derivative contract and counterparty credit risk (CCR) exposure. However, when the Basel III leverage ratio framework was published in January 2014, the Committee noted that it would consider replacing the Basel III leverage ratio framework's use of the CEM with an alternative approach adopted under the risk-based framework. In March 2014, the Committee published *The standardised approach for measuring counterparty credit risk exposures (SA-CCR)* to specify the measurement of derivative exposures for risk-based capital purposes in replacement of both the CEM and the Standardised Method (SM).<sup>3</sup>

The Committee's main objectives in formulating the SA-CCR framework were to: devise an approach to measuring the CCR exposure of derivatives that is suitable to be applied to a wide variety of derivative transactions (margined and unmargined, as well as bilaterally and centrally cleared); addresses known deficiencies of the CEM and the SM; draws on prudential approaches already available in the Basel framework; minimises discretion to be used by national supervisors and banks; and improves the risk sensitivity of the risk-based capital framework without creating undue complexity.

The identified deficiencies of the CEM that necessitated the development of the SA-CCR for the risk-based framework were that the CEM did not differentiate between margined and unmargined transactions; that the supervisory PFE add-on factors did not sufficiently capture the level of volatilities as observed over recent stress periods; and that the recognition of netting was too simplistic and not reflective of economically meaningful relationships between derivative positions. Conversely, one argument that has been cited in support of the use of CEM in the Basel III leverage ratio exposure measure is that it incorporates a margin of conservatism to address exposure to the underlying and that it is comparatively easy to understand and implement.

The Basel III leverage ratio framework lays out several general principles, among which is one that states that "banks must not take account of physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the [leverage ratio] exposure measure".<sup>4</sup> In addition, policy options for the Basel III leverage ratio must also be assessed in light of the rest of the Basel framework to ensure as much overall consistency as possible.

In balancing those criteria, the Committee proposes to implement a modified version of the SA-CCR to ensure consistency with these fundamental principles of the Basel III leverage ratio framework, especially with respect to not recognising collateral to reduce the leverage ratio exposure measure. In

<sup>3</sup> Available at [www.bis.org/publ/bcbs279.pdf](http://www.bis.org/publ/bcbs279.pdf).

<sup>4</sup> In accordance with paragraph 13 of the January 2014 Basel III leverage ratio framework, some exceptions to this principle have been specified. As an example, subject to specific conditions, eligible cash variation margin (CVM) received is allowed to reduce the replacement cost component of derivative exposures since CVM is viewed as a form of *pre-settlement payment* (see paragraphs 25 and 26 of the January 2014 Basel III leverage ratio framework). Also, subject to eligible netting arrangements, both derivative exposures and securities financing transactions (SFTs) may be netted as set out in the Annex to the Basel III leverage ratio framework.

particular, in the proposed modified version of the SA-CCR for the Basel III leverage ratio exposure measure:

- (i) as was the case with the application of the CEM in the Basel III leverage ratio framework, the RC component will continue to be modified to restrict the recognition of collateral by allowing only eligible cash variation margin (CVM) exchanged under the specified conditions set out in paragraph 25 of the Basel III leverage ratio framework as revised to act as an offset to the RC; and
- (ii) the PFE add-on component will be adjusted by setting the PFE multiplier to 1 (one), thereby not recognising any collateral posted by the counterparty (or any negative net market value of the derivative position). However, in line with the SA-CCR framework, the effect of margining would continue to be reflected in the potential shorter time horizon or margin period of risk (MPOR), ranging between five<sup>5</sup> and 20 days, depending on whether the transaction is margined and centrally cleared as well as on the size of the netting set as set out in paragraph 164 of the SA-CCR framework.

### II.1.2 Impact assessment on the client clearing business model

In a series of letters to the Committee, market participants have communicated a concern related to the treatment of initial margin (IM) posted by clients to banks serving on their behalf as clearing members (CMs) for centrally cleared client derivative transactions under the Basel III leverage ratio framework. Market participants have stated that the current approach to capturing the PFE of a transaction with a client is excessive because collateral posted as IM by the client to the CM is not permitted to reduce the CM's PFE (whereas such a reduction is permitted under both the CEM and the SA-CCR as applied for risk-based capital purposes).

Market participants have voiced concern that the Basel III leverage ratio treatment of client IM has the potential to adversely impact the ability of CMs to provide client clearing services, resulting in a potential outcome of increased concentration in the availability of client clearing, which could conflict with the G20 mandate to increase the use of central counterparty (CCP) clearing for derivatives that are sufficiently standardised and liquid as a means to mitigate systemic risk in derivatives markets.

The Committee is carefully considering this concern. As noted above, the Committee is consulting on implementation of a modified version of the SA-CCR that does not allow any offsetting of a CM's PFE with the IM posted by its central clearing clients. On the other hand, the maturity factor for client-cleared trades may be adjusted in line with the SA-CCR to take into account the shorter time horizons for margined trades, with the result that a five-day MPOR would apply to centrally cleared derivative transactions subject to daily margin agreements that CMs have with their clients. This approach can be viewed as internally consistent with the Basel III leverage ratio framework's principles and at the same time providing incentives to support the use of central clearing. Data collected on client clearing obtained through the Committee's Quantitative Impact Study (QIS) have shown that taking into account the shorter time horizon for MPOR results in a significant decrease in CMs' PFE, whereas potential recognition of offsets of IM against PFE in line with the unmodified SA-CCR calculation would not further decrease the amount of CMs' PFE substantially. In addition, in line with the risk-based framework, the Committee proposes to allow client servicing banks within multi-level client structures to exempt from their Basel III leverage ratio exposure measure the trade exposures to their CMs provided that the banks do not guarantee the performance of either their CMs or the qualifying central counterparties (QCCPs).

<sup>5</sup> The five-day MPOR applies only to centrally cleared derivative transactions subject to daily margin agreements that CMs have with their clients.

The Committee has decided that further evidence and data on the impact of the Basel III leverage ratio on client clearing and on CMs' business models should be collected during the consultation period, in light of the G20 mandate for central clearing. The Committee will consider both the effects of the Basel III leverage ratio on the client clearing business model and the need for banks to have adequate capital to support their clearing activities in deciding whether to expand upon the measures described above, which may include permitting offsetting of a CM's PFE with the IM posted by clients on whose behalf it clears derivative transactions. To that end, the Committee seeks comments on the impact of the Basel III leverage ratio on CMs' business models, including but not limited to the impact on the cost of CMs' provision of clearing services to clients. Respondents should provide concrete evidence and data in support of their comments. The Committee will also collect related data from participating banks through the additional QIS exercise in April 2016.<sup>6</sup>

### II.1.3 Clarification on the currency of settlement criterion associated with the eligible cash variation margin

The term "currency of settlement" in the criteria for eligible CVM in paragraph 25 (iii) in the January 2014 version of the Basel III leverage ratio framework has been cited as unclear in the context of multicurrency derivative contracts (eg foreign exchange swaps) and derivative contracts that are governed by master netting agreements (MNAs) and credit support annexes (CSAs), or by rules prescribed by CCPs. Market participants have asked for clarification as to whether CVM payments would reduce derivative exposure amounts for purposes of the Basel III leverage ratio exposure measure when the payments are made in a currency or currencies identified in the legal documentation supporting a derivative transaction, such as a CSA or MNA.

In particular, banks may have numerous derivative contracts, which may be specified in different currencies of settlement for contractual payments with the same counterparty, which are governed by the same MNA. The net amount under an MNA, determined utilising a spot FX conversion rate and expressed in a single currency, typically forms the basis for margin calls as well as for net settlement upon termination of the MNA.

A single daily margin payment may be owed under an MNA with respect to the net variation margin amount owed for all of the positions covered by the MNA, after completion of the netting process described above. This single net margin payment, or payments equivalent to it, will be made in the currency or currencies identified in the CSA (or relevant collateral agreement) to the MNA.

There are also cases where the currency (or currencies) of the cash flows of individual derivative transactions is (are) different from both the termination currency of the MNA and the currency (or currencies) of the eligible collateral specified in the CSA (eg CVM is usually paid in the currency specified in the CSA).

Moreover, there exist individual derivative contracts which involve the exchange of cash flows in more than one currency (eg cross-currency swaps).

The Committee issued an interim response through a set of FAQs in October 2014<sup>7</sup> whereby *currency of settlement* meant *any currency of settlement specified in the derivative contract, governing qualifying master netting agreement (MNA), or the credit support annex (CSA) to the qualifying MNA*. The Committee indicated that it would undertake further detailed analysis of this interpretation and the consequences of paragraph 25 (iii) of the Basel III leverage ratio framework, including issues arising from foreign exchange risk due to currency mismatches between the market value of the derivatives and the associated CVM.

<sup>6</sup> See also the *Tentative schedule for upcoming Basel III monitoring exercises* as set out in Annex 2 of the end-December 2015 instructions for Basel III monitoring, January 2016, available at [www.bis.org/bcbs/qis/biiimplmoninstr\\_jan16.pdf](http://www.bis.org/bcbs/qis/biiimplmoninstr_jan16.pdf).

<sup>7</sup> Available at [www.bis.org/bcbs/publ/d327.pdf](http://www.bis.org/bcbs/publ/d327.pdf).

In the current proposal, the Committee retains the wording “currency of settlement” to specify the eligibility of the currency in which CVM payments are made. The Committee will continue to review the impact of the interpretation specified in the FAQ. With specific reference to issues arising from foreign exchange risk, the Committee proposes that CVM be subject to an FX haircut where the currency of the CVM does not match the termination currency of the netting set (ie the currency in which the bank would submit its claim upon a counterparty default). In its assessment, the Committee will consider the appropriateness of aligning the application of an FX haircut in the Basel III leverage ratio framework with the treatment as applied in the SA-CCR under the risk-based capital framework.

#### II.1.4 Revisions to the specific treatment for written credit derivatives

A bank that writes a credit derivative is exposed to the creditworthiness of the reference entity. The Basel III leverage ratio framework treats written credit derivatives consistently with cash instruments (eg loans, bonds) and requires that the effective notional amount of written credit derivatives be included in the Basel III leverage ratio exposure measure, in addition to any associated CCR. The effective notional amount of written credit derivatives may be reduced by any negative fair value of those instruments that has reduced Tier 1 capital and by the effective notional amount of credit protection purchased through credit derivatives on the same reference name provided that the purchased credit derivatives meet the criteria set out in paragraph 30 of the January 2014 Basel III leverage ratio framework.

The Committee considers that a credit derivative purchased from a counterparty that is connected with the reference obligation or from a counterparty whose credit quality is highly correlated with the value of the reference obligation may not provide effective protection against the risks arising from a written credit derivative, and therefore proposes to introduce an additional criterion to prevent the offsetting eligibility of any protection subject to such wrong-way risk.

Additional revisions proposed by the Committee pertaining to written credit derivatives include clarifications regarding the meaning of the term “written credit derivative” and the option of partial reduction of the PFE of written credit derivatives where the effective notional is included in the Basel III leverage ratio exposure measure.

## II.2 The treatment of regular-way purchases and sales of financial assets

The Committee acknowledges that the timing and method for recognising regular-way purchases or sales of financial assets that have not yet been settled differ across and within accounting frameworks.<sup>8</sup> Specifically, these trades may be accounted for either on the trade date (*trade date accounting*) or on the settlement date (*settlement date accounting*). Furthermore, for trade date accounting, the offsetting of cash receivables and payables associated with sales and purchases of financial assets, respectively, is allowed under certain accounting frameworks, but disallowed under others.

Therefore, the Committee proposes to clarify the calculation of regular-way purchases and sales of financial assets for purposes of the Basel III leverage ratio exposure measure to ensure that differences in accounting frameworks do not affect the calculation among comparably situated banks, and that the Basel III leverage ratio exposure measure properly reflects the inherent leverage associated with these trades. In this respect, the Committee notes that:

- in the case of financial asset purchases, a bank is exposed to the risk of a change in the value of the purchased assets as of the trade date, as well as to the cash or any other asset which will be the source of payment for the purchase until the settlement date; and

<sup>8</sup> For the purposes of this treatment, a regular-way purchase or sale is a purchase or sale of a financial asset under a contract for which its terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

- in the case of financial asset sales, a bank is exposed to the risk that cash will not be delivered by the counterparty of the transaction to the bank to settle the transaction.

This view of exposure for Basel III leverage ratio purposes is consistent in substance with a trade date approach to accounting for regular-way purchases and sales of financial assets, as the additive impact of the yet to be settled transaction (ie any associated exposure to the purchased assets or to the purchasing counterparty) is reflected on the bank's balance sheet from the time at which it enters into a transaction until the time at which the transaction settles. In contrast, a settlement date accounting approach does not reflect on the balance sheet the risks associated with the assets purchased but not yet settled, nor with the cash receivables from assets pending settlement.

The Committee is also aware that, under certain accounting frameworks, banks using trade date accounting that are active securities market-makers are allowed to offset cash receivables for unsettled regular-way sales of securities against cash payables for unsettled regular-way purchases of securities, and that this offsetting is unconditional (ie there are no restrictions on the counterparties, securities settled, settlement systems, etc). Given the transient nature of these transactions, the volatility in the amounts of securities that may be traded on a given day owing to market factors outside a bank's control, and the practice of using the cash received from securities sales to fund securities purchases, typically from the same set of counterparties, the Committee understands that this accounting treatment aims to minimise large day-to-day swings in market-makers' balance sheets, thus supporting their intermediation activity that provides liquidity to financial markets.

For these reasons, the Committee is considering two possible options for the treatment for measuring regular-way purchases and sales of financial assets for the purposes of the Basel III leverage ratio to ensure consistent measure of these exposures across banks regardless of the accounting framework used by a bank. Given that the current version of the Basel III leverage ratio framework provides no specific treatment for the measurement of these exposures, the Committee notes that both of the options outlined below represent treatments currently applied by some banks when calculating the Basel III leverage ratio exposure measure, and as such would not result in a change in impact for those banks were the treatment to be specified within the Basel III leverage ratio framework.

#### *Option A*

- Banks using settlement date accounting must treat unsettled financial asset purchases as off-balance sheet (OBS) items subject to a 100% credit conversion factor (CCF).
- Banks using trade date accounting must include the gross cash receivables owed that are attributable to sales of financial assets that are pending settlement. This implies that banks must reverse out any offsetting between cash receivables for unsettled sales and cash payables for unsettled purchases of financial assets that may be recognised under the applicable accounting framework.

#### *Option B*

- In addition to the criteria included in Option A, banks using trade date accounting may, subject to certain conditions, offset cash receivables and cash payables, with an equivalent effect to be permitted for banks using settlement date accounting.

In this regard, the Committee is seeking comments on the following:

- under Option A, the Committee seeks data from banks that trade in securities and that are currently allowed to offset under their applicable operative accounting framework or that are using settlement date accounting on the extent to which Option A would affect their balance sheets, as well as their views on the extent to which this treatment might constrain their market-making activities, thereby potentially impacting overall structural market liquidity. The Committee also seeks evidence on any impact already experienced by banks using trade date accounting that currently are not allowed to offset cash receivables and cash payables;

- under Option B, the Committee seeks comments on potential conditions that might be specified to allow for an offsetting treatment as referenced above, which may include one or more of the following: (i) the trades are conducted by an entity that meets the definition of a market-maker (eg as defined in CGFS Paper no 52<sup>9</sup>); (ii) the financial assets bought and sold that are associated with the cash payables and cash receivables are fair valued through income and included in the bank's regulatory trading book as defined in paragraphs 8 to 20 of the market risk framework; (iii) the transactions are settled on a delivery-versus-payment (DVP) basis; or (iv) other conditions; and
- under Option B, the criteria for application of an offsetting treatment for banks using settlement date accounting.<sup>10</sup>

## II.3 Revisions to the treatment of provisions

### II.3.1 Background

Paragraph 12 of the Basel III leverage ratio framework published in January 2014 states that the *exposure measure for the leverage ratio should generally follow the accounting value subject to the following:*

- *on balance sheet, non-derivative exposures are included in the exposure measure net of specific provisions or accounting valuation adjustments (eg accounting credit valuation adjustments);*
- *netting of loans and deposits is not allowed.*

As currently stated, paragraph 12 does not allow general provisions to reduce the Basel III leverage ratio exposure measure.

Similarly, paragraph 39 of the January 2014 Basel III leverage ratio framework describes that, for the purpose of determining the exposure amount of OBS items for the Basel III leverage ratio, the CCFs set out in paragraphs 14 to 22 of the Annex must be applied to the notional amount. However, neither paragraph 39 nor the Annex makes any reference to the possibility to reduce OBS exposures by any associated amount of specific or general provisions.

Paragraph 12 also specifies that on-balance sheet non-derivative exposures should be net of accounting valuation adjustments. However, the example provided in the January 2014 Basel III leverage ratio framework refers to accounting credit valuation adjustments, which may not be relevant in the context of non-derivative exposures. In addition, the treatment of prudent valuation adjustments (PVAs) for less liquid positions, which are deducted from Tier 1 capital according to paragraphs 718 (cx) through 718 (cxii) of the Basel II framework as amended by the market risk framework, is not specifically addressed in the January 2014 Basel III leverage ratio framework.

The Committee therefore proposes to revise the Basel III leverage ratio framework to provide clarification on: (i) whether general provisions may be deducted from the Basel III leverage ratio exposure measure; (ii) whether specific and general provisions may be deducted from OBS exposures and; (iii) the treatment of PVAs.

<sup>9</sup> Note that CGFS Paper no 52 (November 2014, available at [www.bis.org/publ/cgfs52.pdf](http://www.bis.org/publ/cgfs52.pdf)) defines a market-maker as an entity that (i) provides intermediary services to clients and other market participants, ensuring market liquidity and supporting price discovery; and (ii) contributes to the robustness of market liquidity by absorbing temporary supply and demand imbalances, dampening the impact of shocks on market volatility and quoting prices to support investors in valuing assets.

<sup>10</sup> For purposes of consultation, the Committee proposes for banks using settlement date accounting the permissibility of offsetting commitments to pay for unsettled purchases and cash to be received for unsettled sales subject to the same conditions proposed for the offsetting under trade date accounting. The Committee will analyse QIS data in conjunction with feedback received during consultation to inform any finalisation of offsetting treatments.

### II.3.2 Proposed revisions

The Committee intends to allow both general and specific provisions that have decreased Tier 1 capital to reduce the Basel III leverage ratio exposure measure. This modification is consistent with paragraph 16 of the January 2014 Basel III leverage ratio framework which specifies that *balance sheet assets deducted from Tier 1 capital (as set out in paragraphs 66 to 89 of the Basel III framework) may be deducted from the exposure measure*, which ensures that Tier 1 capital and the leverage ratio exposure measure are treated consistently and therefore avoids double-counting.

Similarly, the Committee proposes that OBS items may be reduced by the amount of any associated specific and general provisions provided that they have decreased Tier 1 capital. In calculating OBS exposures under the Basel III leverage ratio framework, it is proposed that specific and general provisions be deducted from OBS exposures after the application of the relevant CCF.

In addition, to be consistent with the treatment of other deductions, the Committee proposes that PVAs for less liquid positions related to on-balance sheet assets and that are deducted from Tier 1 capital may also be deducted from the Basel III leverage ratio exposure measure.

### II.4 Additional requirements for G-SIBs

As noted above, at its January 2016 meeting the GHOS discussed additional Basel III leverage ratio requirements for G-SIBs, above the 3% minimum. The Basel III framework has already introduced a higher risk-based capital ratio requirement for G-SIBs.

The Committee believes that one way to maintain the relative roles of the risk-based ratio and the leverage ratio in the regulatory capital framework would be to introduce a higher Basel III leverage ratio requirement for G-SIBs. An additional leverage ratio requirement for G-SIBs could be based on the same Tier 1 definition of capital by which the Basel III leverage ratio minimum is measured.

The Committee seeks views on the relative merits of the following characteristics that would need to be specified for an additional G-SIB requirement:

- whether there should be a limit on Additional Tier 1 capital that may be used to satisfy an additional requirement;
- whether an additional requirement should be fixed and applied uniformly to all G-SIBs or should vary based on a scaling of the G-SIB's higher loss absorbency requirement as applicable under the risk-based framework; and
- whether an additional requirement should be in the form of a higher minimum requirement or a buffer requirement. The latter could operate in a manner analogous to the Basel III framework's risk-based capital ratio buffers (ie with restrictions on capital distributions if a G-SIB operates below the leverage ratio buffer) or as a buffer whereby supervisors would be expected to take timely and appropriate action in the event of a breach to ensure that the breach is temporary (ie without automatic restrictions on capital distributions).

The Committee will continue to study the impact of a proposed additional Basel III leverage ratio requirement for G-SIBs in the course of its QIS analysis.

### III. Other proposed revisions

#### III.1 Revisions to the credit conversion factors for off-balance sheet items

In the January 2014 Basel III leverage ratio framework, the CCFs specified in the Basel II standardised approach for credit risk are applied to calculate the Basel III leverage ratio exposure measure for OBS items, subject to a floor of 10%. On 10 December 2015, the Committee published the second consultative document on the *Revisions to the Standardised Approach for credit risk*.<sup>11</sup> Paragraphs 64 to 74 of that document contain proposals for revising the CCFs for calculating the credit exposure equivalent amounts associated with OBS items. The proposals contain a strictly positive CCF for unconditionally cancellable commitments (UCCs) as well as a specified treatment for unsettled securities, commodities and foreign exchange rate transactions where they do not appear on the balance sheet (ie under settlement date accounting).

The Committee proposes to incorporate into the Basel III leverage ratio framework revisions to the CCFs for OBS items upon their finalisation and implementation into the revised standardised approach for credit risk. However, until those revised CCFs are implemented in the standardised approach for risk-based capital ratio purposes, the corresponding CCFs that currently apply in the Basel III leverage ratio framework will remain in effect.

Given that the treatment of OBS securitisation exposures has already been finalised in the standard *Revisions to the securitisation framework* (hereafter "securitisation framework")<sup>12</sup> (which is to be implemented in January 2018), the Committee proposes to include the same treatment for OBS securitisation exposures in the Basel III leverage ratio framework effective 1 January 2018.

#### III.2 Incorporation of responses to frequently asked questions

Since the January 2014 publication of the Basel III leverage ratio framework, the Committee has received more than 50 FAQs related to the framework. A first set of FAQs was published in October 2014, followed by a second set in July 2015, and a third set that was published in conjunction with this consultative document.<sup>13</sup>

The Committee has incorporated into the proposed revisions to the framework several clarifications related to published FAQs where questions were of a sufficiently general nature. Where a published question and response were of a more specific nature or pertinent to a unique transaction type, the Committee has opted not to include those clarifications within revisions to the Basel III leverage ratio framework text and instead to rely upon the published FAQs to clarify the relevant treatment.

#### III.3 Treatment of cash pooling transactions

Clarification has been sought regarding the Basel III leverage ratio framework's treatment of cash pooling transactions, ie a treasury product offered to large corporate clients which allows corporate groups to combine the credit and debit positions of various accounts into one account. Two different schemes can apply:

<sup>11</sup> Available at [www.bis.org/bcbs/publ/d347.pdf](http://www.bis.org/bcbs/publ/d347.pdf). The comment period for this document ended on 11 March 2016.

<sup>12</sup> Available at [www.bis.org/bcbs/publ/d303.pdf](http://www.bis.org/bcbs/publ/d303.pdf).

<sup>13</sup> The third set of FAQs (inclusive of those published in the first and second set) are available at [www.bis.org/bcbs/publ/d364.pdf](http://www.bis.org/bcbs/publ/d364.pdf).

- *Notional (or virtual)* cash pooling combines the balances of several accounts of the entities within a corporate group in order to limit low balance or transaction fees without physical transfer of funds. Instead, balances of different entities are set off within the group, so that a bank charges interest on the group's net cash balance. The Committee proposes that these balances be reported on a *gross* basis in line with revisions to paragraph 13 (paragraph 11 as revised) of the Basel III leverage ratio framework, which does not allow netting of assets and liabilities nor the recognition of credit risk mitigation techniques.
- *Physical* cash pooling, which combines various accounts from entities within a corporate group into a single master or concentration account at the end of each period through physical transfer of funds, typically by means of intraday settlement. The Committee proposes to allow banks to report those balances on a net basis if the transfer of credit and debit balances into a single account results in the balances being extinguished and transformed into a single balance (ie a single claim on or a single liability to a single legal entity on the basis of a single account) and the bank cannot be held liable in case of non-performance of one or multiple participants in the cash pool. The proposal also requires such settlement to take place at least on a daily basis in order to be recognised on a net basis for the Basel III leverage ratio exposure measure.

### III.4 Treatment of traditional securitisations

The Committee is also working on further clarification regarding the treatment of traditional securitisations for the purposes of the Basel III leverage ratio. More specifically, one particular case arises where an originating bank meets operational requirements for the recognition of risk transfer in the risk-based framework as set out in paragraph 24 of the securitisation framework, but does not meet the criteria for accounting de-recognition of securitised assets or has to include the special purpose vehicle (SPV) within its scope of accounting consolidation. In this case, the originating bank is allowed to exclude the securitised assets from the calculation of its risk-weighted assets (RWAs). It is possible to interpret such exclusion from the calculation of RWAs to mean either: (i) the securitised assets are excluded from the regulatory scope of consolidation and therefore should also be excluded from the Basel III leverage ratio exposure measure; or (ii) the securitised assets are included within the regulatory scope of consolidation, and therefore should be included in the Basel III leverage ratio exposure measure, but receive a 0% risk weight under the risk-based framework. While the two interpretations produce the same results for risk-based capital purposes (ie no associated RWAs), their respective impacts on the Basel III leverage ratio exposure measure can differ significantly.

The Committee will consider the outcome of its ongoing consultation on identification and measurement of *step-in risk*<sup>14</sup> as well as reasons for inconsistency across jurisdictions in recognition of significant risk transfer to clarify the Basel III leverage ratio exposure measure treatment of traditional securitisations.

### III.5 Treatment of securities financing transactions (SFTs)

The Basel III leverage ratio framework published in January 2014 contained a specific treatment for the measurement of SFT exposures. According to this treatment, cash payables and cash receivables that arise from SFTs with the same counterparty may be included in the Basel III leverage ratio exposure measure on a net basis provided that certain conditions are met. One of these conditions is that the transactions that give rise to the receivables and payables have the same explicit final settlement date.

Following the publication of the Basel III leverage ratio framework in January 2014, clarification has been sought regarding the treatment of *open repos* (ie repos with no explicit end date but which can

<sup>14</sup> Available at [www.bis.org/bcbs/publ/d349.pdf](http://www.bis.org/bcbs/publ/d349.pdf).

be unwound at any time by either party to the transaction) for purposes of the Basel III leverage ratio exposure measure. After examining the issue, the Committee concluded that open repos are not eligible for netting per the Basel III leverage ratio framework because they do not meet the above-mentioned condition of featuring an explicit settlement date. The relevant set of FAQs on this issue was published in July 2015.<sup>15</sup> The Committee is aware that there are countries where the use of open repos is widespread and that the current Basel III leverage ratio treatment may therefore have a material impact on banks operating in those countries despite open repos serving as a functional equivalent to overnight repos used in other countries. Although revisions to the framework as proposed in the Annex do not include any changes to the treatment of open repos, the Committee seeks further concrete evidence on any adverse impact of the Basel III leverage ratio framework on open repos and whether any revisions to the treatment may be warranted (eg so as to allow cash payables and cash receivables associated with open repos to offset each other but not to offset other repos with explicit final settlement dates).

### III.6 Disclosure requirements

Disclosure of the Basel III leverage ratio and of associated reconciliation of the Basel III leverage ratio exposure measure with banks' accounting assets has been an important element of the Basel III leverage ratio since its incorporation into the Basel capital framework. Given the Committee's consolidation of Pillar 3 disclosure requirements into a single, unified framework, disclosure requirements for the Basel III leverage ratio, including any changes to disclosure templates necessary to address revisions to the framework following consultation, will henceforth be incorporated into Pillar 3 disclosure requirements to be published separately by the Committee. As such, in this consultative document, references to disclosure requirements are marked for deletion from the text included in the Annex. There is, however, no intention to change the nature of the disclosure requirements.

### Next steps

The Committee welcomes comments on all aspects of the proposals, particularly in relation to matters in this consultative document on which the Committee specifically seeks views and additional information. Comments should be uploaded at [www.bis.org/bcbs/commentupload.htm](http://www.bis.org/bcbs/commentupload.htm) by **6 July 2016**. All comments will be published on the website of the Bank for International Settlements unless a respondent requests confidential treatment.

In addition to its Basel III monitoring exercise collecting data as of end-December 2015, the Committee will conduct an additional QIS exercise on Basel III monitoring also to use data as of end-December 2015 in order to assess the proposals in this document and to ensure overall consistency within the capital framework.

The Committee encourages market participants to contact their national supervisors if they wish to participate in the QIS on a best efforts basis. Extensive and good quality data will be crucial in supporting appropriate measurement and calibration of the Basel III leverage ratio.

Prior to finalising the Basel III leverage ratio framework, the Committee will evaluate appropriate implementation arrangements and will provide sufficient time for implementation, taking into account the range of related reforms that have been, or are due to be, agreed by the Committee.

<sup>15</sup> Available at [www.bis.org/bcbs/publ/d327.pdf](http://www.bis.org/bcbs/publ/d327.pdf).



## Annex

# Basel III leverage ratio framework ~~and disclosure requirements~~

## Introduction

1. An underlying cause of the global financial crisis was the build-up of excessive on- and off-balance sheet leverage in the banking system. In many cases, banks built up excessive leverage while apparently maintaining strong risk-based capital ratios. At the height of the crisis, financial markets forced the banking sector to reduce its leverage in a manner that amplified downward pressures on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling bank capital and shrinking credit availability.

2. The ~~Basel III framework~~ **standard Basel III: A global regulatory framework for more resilient banks and banking systems**<sup>1</sup> (hereafter “**Basel III framework**”) introduced a simple, transparent, non-risk-based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The leverage ratio is intended to:

- restrict the build-up of leverage in the banking sector to avoid destabilising deleveraging processes that can damage the broader financial system and the economy; and
- reinforce the risk-based requirements with a simple, non-risk-based “backstop” measure.

3. The Basel Committee is of the view that:

- a simple leverage ratio framework is critical and complementary to the risk-based capital framework; and
- a credible leverage ratio is one that ensures broad and adequate capture of both the on- and off-balance sheet sources of banks’ leverage.

~~4. Implementation of the leverage ratio requirements has begun with bank-level reporting to national supervisors of the leverage ratio and its components from 1 January 2013, and will proceed with public disclosure starting 1 January 2015. The Committee will continue monitoring the impact of these disclosure requirements. The final calibration, and any further adjustments to the definition, will be completed by 2017, with a view to migrating to a Pillar 1 (minimum capital requirement) treatment on 1 January 2018.~~

~~5.4. This document sets out the Basel III leverage ratio framework, along with the public disclosure requirements applicable as a Pillar 1 minimum capital requirement with associated Pillar 3 public disclosure requirements as from 1 January 2015–2018. These requirements supersede those in Section V of **Basel III: A global regulatory framework for more resilient banks and banking**~~

<sup>1</sup> **Basel Committee on Banking Supervision, *Basel III: A global regulatory framework for more resilient banks and banking systems – revised version*, June 2011, [www.bis.org/publ/bcbs189.htm](http://www.bis.org/publ/bcbs189.htm).**

~~systems.<sup>2</sup> the Basel III framework and the standard *Basel III leverage ratio framework and disclosure requirements* as finalised in January 2014.<sup>3</sup>~~

## Definition and minimum requirement

~~6.5.~~ The Basel III leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator), with this ratio expressed as a percentage:

$$\text{Leverage ratio} = \frac{\text{Capital measure}}{\text{Exposure measure}}$$

~~Both the capital measure and the exposure measure are to be calculated on a quarter-end basis. However, banks may, subject to supervisory approval, use more frequent calculations (eg daily or monthly averaging) as long as they do so consistently.~~

~~7.6. The Committee will continue to test a minimum requirement of 3% for the leverage ratio during the parallel run period (ie from 1 January 2013 to 1 January 2017). Additional transitional arrangements are set out in paragraphs 59 to 61 below. The capital measure must be at least 3% of the exposure measure at all times.~~

## Scope of consolidation

~~8.7.~~ The Basel III leverage ratio framework follows the same scope of regulatory consolidation, **including consolidation criteria**,<sup>4</sup> as is used for the risk-based capital framework. This is set out in Part I (Scope of Application) of the ***standard Basel II International Convergence of Capital Measurement and Capital Standards – Comprehensive Version (hereafter “Basel II framework”)***.<sup>5</sup>

~~9.8.~~ *Treatment of investments in the capital of banking, financial, insurance and commercial entities that are outside the regulatory scope of consolidation:* where a banking, financial, insurance or commercial entity is outside the scope of regulatory consolidation, only the investment in the capital of such entities (ie only the carrying value of the investment, as opposed to the underlying assets and other exposures of the investee) is to be included in the leverage ratio exposure measure. However, investments in the capital of such entities that are deducted from Tier 1 capital as set out in paragraph **16–12** may be excluded from the leverage ratio exposure measure.

<sup>2</sup> ~~For the preceding version of the leverage ratio framework, see paragraphs 151 to 167 of the Basel III framework, available at [www.bis.org/publ/bcbs189.htm](http://www.bis.org/publ/bcbs189.htm).~~

<sup>3</sup> ~~Basel Committee on Banking Supervision, *Basel III leverage ratio framework and disclosure requirements*, January 2014, [www.bis.org/publ/bcbs270.pdf](http://www.bis.org/publ/bcbs270.pdf).~~

<sup>4</sup> ~~For example, if proportional consolidation is applied for regulatory consolidation under the risk-based framework, the same criteria shall be applied for leverage ratio purposes.~~

<sup>5</sup> ~~Available at Basel Committee on Banking Supervision, *Basel II International Convergence of Capital Measurement and Capital Standards – Comprehensive Version*, June 2006, [www.bis.org/publ/bcbs128.pdf](http://www.bis.org/publ/bcbs128.pdf).~~

## Capital measure

~~10.9.~~ The capital measure for the leverage ratio is the Tier 1 capital of the risk-based capital framework as defined in paragraphs 49 to 96 of the Basel III framework,<sup>6</sup> taking account of the transitional arrangements. In other words, the capital measure used for the leverage ratio at any particular point in time is the Tier 1 capital measure applying at that time under the risk-based framework.

~~11. The Committee will continue to collect data during the transition period to track the impact of using either Common Equity Tier 1 (CET1) or total regulatory capital as the capital measure for the leverage ratio.~~

## Exposure measure

~~12.10.~~ The leverage ratio exposure measure ~~for the leverage ratio should~~ generally follows the accounting values subject to the following. In particular, on-balance sheet, non-derivative assets are included in the leverage ratio exposure measure at their accounting values less deductions for associated specific provisions. In addition, general provisions or general loan loss reserves as defined in paragraph 60 of the Basel III framework which have reduced Tier 1 capital may be deducted from the leverage ratio exposure measure.<sup>7</sup>

- ~~on-balance sheet, non-derivative exposures are included in the exposure measure net of specific provisions or accounting valuation adjustments (eg accounting credit valuation adjustments);~~
- ~~netting of loans and deposits liabilities is not allowed.~~

~~13.11.~~ Unless specified differently below, banks must not take account of physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the leverage ratio exposure measure, nor may banks net assets and liabilities.

~~12.~~ To ensure consistency, any item deducted from Tier 1 capital according to the Basel III framework and regulatory adjustments other than those related to liabilities may be deducted from the leverage ratio exposure measure. Three examples follow:

- where a banking, financial or insurance entity is not included in the regulatory scope of consolidation as set out in paragraph 7, the amount of any investment in the capital of that entity that is totally or partially deducted from Common Equity Tier 1 (CET1) capital or from Additional Tier 1 capital of the bank following the corresponding deduction approach in paragraphs 84 to 89 of the Basel III framework may also be deducted from the leverage ratio exposure measure;
- for banks using the internal ratings-based (IRB) approach to determining capital requirements for credit risk, paragraph 73 of the Basel III framework requires any

<sup>6</sup> Available at [www.bis.org/publ/bcbs189.htm](http://www.bis.org/publ/bcbs189.htm).

<sup>7</sup> Although paragraph 60 of the Basel III framework specifies the treatment of general provisions/general loan-loss reserves for banks using the standardised approach for credit risk, for the purposes of the leverage ratio exposure measure the definition of general provisions/general loan-loss reserves specified in paragraph 60 of the Basel III framework applies to all banks regardless of whether they use the standardised approach or the internal ratings-based (IRB) approach for credit risk for their risk-based capital calculations.

shortfall in the stock of eligible provisions relative to expected loss amounts to be deducted from CET1 capital. The same amount may be deducted from the leverage ratio exposure measure; and

- prudent valuation adjustments (PVAs) for exposures to less liquid positions that are deducted from Tier 1 capital as per paragraph 718 (cxii) of the Basel II framework as amended by the standard Minimum capital requirements for market risk<sup>8</sup> (hereafter “market risk framework”) may be deducted from the leverage ratio exposure measure.

**14-13.** A bank’s total **leverage ratio** exposure measure is the sum of the following exposures: (a) on-balance sheet exposures (**excluding on-balance sheet derivative and securities financing transaction exposures**); (b) derivative exposures; (c) securities financing transaction (SFT) exposures; and (d) off-balance sheet (OBS) items. The specific treatments for these four main exposure types are defined below.

#### (a) On-balance sheet exposures

**15-14.** Banks must include *all* balance sheet assets in their **leverage ratio** exposure measure, including on-balance sheet derivatives collateral and collateral for SFTs, with the exception of on-balance sheet derivative and SFT assets that are covered in paragraphs ~~18 to 37~~ **18 to 42** below.<sup>9</sup>

~~16. — However, to ensure consistency, balance sheet assets deducted from Tier 1 capital (as set out in paragraphs 66 to 89 of the Basel III framework) may be deducted from the exposure measure. Two examples follow:~~

- ~~Where a banking, financial or insurance entity is not included in the regulatory scope of consolidation as set out in paragraph 8, the amount of any investment in the capital of that entity that is totally or partially deducted from CET1 capital or from Additional Tier 1 capital of the bank following the corresponding deduction approach in paragraphs 84 to 89 of the Basel III framework may also be deducted from the exposure measure.~~
- ~~For banks using the internal ratings-based (IRB) approach to determining capital requirements for credit risk, paragraph 73 of the Basel III framework requires any shortfall in the stock of eligible provisions relative to expected losses to be deducted from CET1 capital. The same amount may be deducted from the exposure measure.~~

**17-15.** Liability items must not be deducted from the **leverage ratio exposure** ~~measure~~ **of exposure**. For example, gains/losses on fair valued liabilities or accounting value adjustments on derivative liabilities due to changes in the bank’s own credit risk as described in paragraph 75 of the Basel III framework must not be deducted from the **leverage ratio** exposure measure.

**16.** The accounting for regular-way purchases or sales<sup>10</sup> of financial assets that have not been settled (hereafter “unsettled trades”) differs across and within accounting frameworks, with the result that those unsettled trades can be accounted for either on the trade date (*trade date accounting*) or on the settlement date (*settlement date accounting*).

<sup>8</sup> Basel Committee on Banking Supervision, *Minimum capital requirements for market risk*, January 2016, [www.bis.org/bcbs/publ/d352.pdf](http://www.bis.org/bcbs/publ/d352.pdf).

<sup>9</sup> Where a bank according to its operative accounting framework recognises fiduciary assets on the balance sheet, these assets can be excluded from the leverage ratio exposure measure provided that the assets meet the IAS 39 criteria for derecognition and, where applicable, IFRS 10 for deconsolidation. ~~When disclosing the leverage ratio, banks must also disclose the extent of such de-recognised fiduciary items as set out in paragraph 52.~~

<sup>10</sup> For the purposes of this treatment, “regular-way purchases or sales” are purchases or sales of financial assets under contracts for which the terms require delivery of the assets within the time frame established generally by regulation or convention in the marketplace concerned.

## [Option A

For such exposures, banks using trade date accounting must reverse out any offsetting between cash receivables for unsettled sales and cash payables for unsettled purchases of financial assets that may be recognised under the applicable accounting framework.

## Option B

For such exposures, banks using trade date accounting must reverse out any offsetting between cash receivables for unsettled sales and cash payables for unsettled purchases of financial assets that may be recognised under the applicable accounting framework, but may offset between those cash receivables and cash payables (regardless of whether such offsetting is recognised under the applicable accounting framework) if the following conditions are met:

- the bank is serving as a market-maker for the financial assets;<sup>11</sup>
- the financial assets bought and sold that are associated with cash payables and receivables are fair valued through income and included in the bank's regulatory trading book as specified by paragraphs 8 to 20 of the market risk framework; and
- the transactions of the financial assets are settled on a delivery-versus-payment (DVP) basis.]

Banks using settlement date accounting will be subject to the treatment set out in paragraphs 43 to 45 and paragraph 9 of the Annex.

17. The extinguishment of credit and debit balances of a group of entities and their transformation into a single balance by way of a daily transfer of credit and debit balances into a single account is not considered as netting of assets and liabilities. The condition of "extinguished and transformed into a single balance" is not met when the bank potentially could be held liable in case of non-performance of one or more of the entities involved. To the extent that some but not all of the credit and/or debit balances are extinguished, the remaining balances must be included in the leverage ratio exposure measure.

## (b) Derivative exposures

18. *Treatment of derivatives:* derivatives ~~create have~~ two ~~types of components of counterparty credit risk (CCR) exposure:~~ (a) ~~an exposure arising from the underlying of the derivative contract replacement cost (RC);~~ and (b) ~~a counterparty credit risk (CCR) exposure potential future exposure (PFE).~~ The leverage ratio framework uses the method set out below to capture both of these ~~exposure types components.~~

19. Banks must calculate their ~~derivative~~ exposures associated with all derivative transactions,<sup>12</sup> including where a bank sells protection using a credit derivative, as a scalar multiplier alpha set at 1.4

<sup>11</sup> For the purposes of this treatment, a market-maker is an entity that (i) provides intermediary services to clients and other market participants, ensuring market liquidity and supporting price discovery; and (ii) contributes to the robustness of market liquidity by absorbing temporary supply and demand imbalances, dampening the impact of shocks on market volatility and quoting prices to support investors in valuing assets.

<sup>12</sup> This approach makes reference to the Current Exposure Method (CEM) which is used under the Basel II framework to calculate CCR exposure amounts associated with derivative exposures. The Committee is considering alternatives to the CEM. If an alternative approach is adopted as a replacement for the CEM, the Committee will consider whether that alternative approach is appropriate in the context of the need to capture both types of exposures created by derivatives as described in paragraph 18.

~~times the sum of the replacement cost (RC)<sup>13</sup> for the current exposure plus an add-on for potential future exposure ( and the PFE), as described in paragraph 20. If the derivative exposure is covered by an eligible bilateral netting contract as specified in the Annex, a specific treatment may be applied.<sup>14</sup> Written credit derivatives are subject to an additional treatment, as set out in paragraphs ~~29 to 31~~ **30 to 35** below.~~

20. For ~~a single~~ derivative ~~exposure transactions~~ not covered by an eligible bilateral netting contract as specified in paragraphs ~~8 and 9~~ **4 and 5** of the Annex, the amount to be included in the **leverage ratio** exposure measure is determined, **for each transaction separately**, as follows:

$$\text{exposure measure} = \text{replacement cost (RC)} + \text{add-on alpha} * (\text{RC} + \text{PFE})$$

where

- o **alpha = 1.4;**
- o RC = the replacement cost ~~of the contract (obtained by marking to market), where the contract has a positive value calculated according to paragraph 2 of the Annex; and~~
- o **add-on PFE** = an amount for PFE ~~over the remaining life of the contract~~ calculated **by applying an add-on factor to the notional principal amount of the derivative. The add-on factors are included in paragraphs 1 and 3 of the Annex according to paragraph 3 of the Annex.**

21. *Bilateral netting*: when an eligible bilateral netting contract is in place as specified in paragraphs ~~8 and 9~~ **4 and 5** of the Annex, ~~the RC for the set of derivative exposures covered by the contract will be the net replacement cost and the add-on will be A<sub>Net</sub> as calculated in paragraph 10 of the Annex the formula in paragraph 20 is applied at the netting set level as described in paragraphs 2 and 3 of the Annex.~~

22. *Treatment of related collateral*: collateral received in connection with derivative contracts has two countervailing effects on leverage:

- it reduces counterparty exposure; but
- it can also increase the economic resources at the disposal of the bank, as the bank can use the collateral to leverage itself.

23. *Collateral received* in connection with derivative contracts does not necessarily reduce the leverage inherent in a bank's derivative position, which is generally the case if the settlement exposure arising from the underlying derivative contract is not reduced. As a general rule, collateral received may not be netted against derivative exposures whether or not netting is permitted under the bank's operative accounting or risk-based framework. Hence, when calculating the exposure amount by applying paragraphs 19 to 21 above, a bank must not reduce the **leverage ratio** exposure **measure** amount by any collateral received from the counterparty. **This implies that the RC cannot be reduced by collateral received and that the multiplier referenced in paragraph 3 of the Annex is fixed at one for the purpose of the PFE calculation. However, the maturity factor in the PFE add-on**

<sup>13</sup> If, under a bank's national accounting standards, there is no accounting measure of exposure for certain derivative instruments because they are held (completely) off-balance sheet, the bank must use the sum of positive fair values of these derivatives as the replacement cost.

<sup>14</sup> These are netting rules of the Basel II framework excepting the rules for cross-product netting in Annex 4, Section III (ie ~~cross-product netting netting across product categories such as derivatives and SFTs~~ is not permitted in determining the leverage ratio exposure measure). **However, where a bank has a cross-product netting agreement in place that meets the eligibility criteria of paragraphs 4 and 5 of the Annex, it may choose to perform netting separately in each product category provided that all other conditions for netting in this product category that are applicable to the current framework are met.**

**calculation can recognise the PFE-reducing effect from the regular exchange of variation margin as specified in paragraph 3 of the Annex.**

24. Similarly, with regard to *collateral provided*, banks must gross up their **leverage ratio** exposure measure by the amount of any derivatives collateral provided where the provision of that collateral has reduced the value of their balance sheet assets under their operative accounting framework.

25. *Treatment of cash variation margin*: in the treatment of derivative exposures for the purpose of the leverage ratio **exposure measure**, the cash portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment<sup>15</sup> if the following conditions are met:

- (i) For trades not cleared through a *qualifying* central counterparty (QCCP)<sup>15</sup> the cash received by the recipient counterparty is not segregated. **Cash variation margin would satisfy the non-segregation criterion if the recipient counterparty has no restrictions by law, regulation, or any agreement with the counterparty on the ability to use the cash received (ie the cash variation margin received is used as its own cash).**
- (ii) Variation margin is calculated and exchanged on **at least** a daily basis based on mark-to-market valuation of derivative positions. **To meet this criterion, derivative positions must be valued daily and cash variation margin must be transferred at least daily to the counterparty or to the counterparty's account, as appropriate. Cash variation margin exchanged on the morning of the subsequent trading day based on the previous, end-of-day market values would meet this criterion, provided that it meets criterion (iv) below.**
- (iii) The cash variation margin is received in the same currency as the currency of settlement of the derivative contract.
- (iv) Variation margin exchanged is the full amount that would be necessary to ~~fully~~ extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty.<sup>16</sup>
- (v) Derivatives transactions and variation margins are covered by a single master netting agreement (MNA)<sup>17,18</sup> between the legal entities that are the counterparties in the derivatives transaction. The MNA must explicitly stipulate that the counterparties agree to settle net any payment obligations covered by such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA must be legally enforceable and effective **(ie it satisfies the conditions in paragraph 4 (c) and paragraph 5 of the Annex)** in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency. **For the purposes of this paragraph, the term "MNA" includes any**

<sup>15</sup> A QCCP is defined as in Annex 4, Section I, A. General Terms of the **Basel II framework as amended by the standard Capital requirements for bank exposures to central counterparties (Basel Committee on Banking Supervision, Capital requirements for bank exposures to central counterparties, April 2014, www.bis.org/publ/bcbs282.pdf).** ~~BCBS document International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version, June 2006 as amended.~~

<sup>16</sup> **In situations where the intent is to extinguish the mark-to-market exposure (subject to thresholds and minimum transfer amounts) but a margin dispute arises, any non-disputed margin that has been exchanged can be recognised.**

<sup>17</sup> **A Master MNA may be deemed to be a single MNA for this purpose.**

<sup>18</sup> **To the extent that the criteria in this paragraph include the term "master netting agreement", this term should be read as including any "netting agreement" that provides legally enforceable rights of offsets. This is to take account of the fact that for netting agreements employed by CCPs, no standardisation has currently emerged that would be comparable with respect to OTC netting agreements for bilateral trading.**

**netting agreement that provides legally enforceable rights of offset<sup>19</sup> and a Master MNA may be deemed to be a single MNA.**

26. If the conditions in paragraph 25 are met, the cash portion of variation margin *received* may be used to reduce the replacement cost portion of the leverage ratio exposure measure, and the receivables assets from cash variation margin *provided* may be deducted from the leverage ratio exposure measure as follows:

- In the case of cash variation margin *received*, the receiving bank may reduce the replacement cost (but not the ~~add-on portion PFE component~~) of the exposure amount of the derivative asset ~~by the amount of cash received if the positive mark-to-market value of the derivative contract(s) has not already been reduced by the same amount of cash variation margin received under the bank's operative accounting standard as specified in paragraph 2 of the Annex.~~
- In the case of cash variation margin *provided* to a counterparty, the posting bank may deduct the resulting receivable from its leverage ratio exposure measure, where the cash variation margin has been recognised as an asset under the bank's operative accounting framework, **and instead include the cash variation margin provided in the calculation of the derivative replacement cost as specified in paragraph 2 of the Annex.**

**Cash variation margin may not be used to reduce the PFE amount (including the calculation of the net-to-gross ratio (NGR) as defined in paragraph 10 of the Annex).**

27. *Treatment of clearing services:* where a bank acting as clearing member (CM)<sup>20</sup> offers clearing services to clients, the clearing member's trade exposures<sup>21</sup> to the central counterparty (CCP) that arise when the clearing member is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults, must be captured by applying the same treatment that applies to any other type of derivatives transactions. However, if the ~~clearing member CM~~, based on the contractual arrangements with the client, is not obligated to reimburse the client for any losses suffered ~~due to changes in the value of its transactions~~ in the event that a QCCP defaults, the ~~clearing member CM~~ need not recognise the resulting trade exposures to the QCCP in the leverage ratio exposure measure. **In addition, where a bank provides clearing services within a multi-level client structure as defined in Annex 4 of the Basel II framework,<sup>22</sup> the bank need not recognise the resulting trade exposures to the CM in the leverage ratio exposure measure if it meets the conditions set out in paragraph 197 of Annex 4 of the Basel II framework<sup>23</sup> and if the bank is not obligated to reimburse its client for any losses suffered in the event of default of either the CM or the QCCP.**

28. Where a client enters directly into a derivatives transaction with the CCP and the CM guarantees the performance of its client's derivative trade exposures to the CCP, the bank acting as the ~~clearing member CM~~ for the client to the CCP must calculate its related leverage ratio exposure resulting from

<sup>19</sup> **This is to take into account the fact that, for netting agreements employed by CCPs, no standardisation has currently emerged that would be comparable with respect to over-the-counter netting agreements for bilateral trading.**

<sup>20</sup> For the purposes of this paragraph, ~~a-the terms "clearing member" (CM), "trade exposure", "central counterparty" and "qualifying central counterparty" are~~ defined as in Annex 4, Section I, A. General Terms of the ~~BCBS document International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version, June 2006 Basel II framework~~ as amended.

<sup>21</sup> ~~For the purposes of paragraphs 27 and 28, "trade exposures" includes initial margin irrespective of whether or not it is posted in a manner that makes it remote from the insolvency of the CCP.~~

<sup>22</sup> **As amended by the standard Capital requirements for bank exposures to central counterparties.**

<sup>23</sup> **Ibid.**

the guarantee as a derivative exposure as set out in paragraphs 19 to 26, as if it had entered directly into the transaction with the client, including with regard to the receipt or provision of cash variation margin.

**29. For the purposes of paragraphs 27 and 28, an entity affiliated to the bank acting as a CM may be considered a client if it is outside the relevant scope of regulatory consolidation at the level at which the Basel III leverage ratio is applied. In contrast, if an affiliate entity falls within the regulatory scope of consolidation, the trade between the affiliate entity and the CM is eliminated in the course of consolidation but the CM still has a trade exposure to the CCP. In this case, the transaction will be considered proprietary and the exemption in paragraph 27 will not apply.**

**29-30. Additional treatment for written credit derivatives:** in addition to the CCR exposure arising from the fair value of the contracts, written credit derivatives create a notional credit exposure arising from the creditworthiness of the reference entity. The Committee therefore believes that it is appropriate to treat written credit derivatives consistently with cash instruments (eg loans, bonds) for the purposes of the **leverage ratio** exposure measure.

**30-31. In order to capture the credit exposure to the underlying reference entity, in addition to the above CCR treatment for derivatives and related collateral, the effective notional amount<sup>24</sup> referenced by a written credit derivative is to be included in the leverage ratio exposure measure unless the written credit derivative is included in a transaction cleared on the behalf of a client of the bank acting as a CM (or acting as a clearing services provider in a multi-level client services structure as referenced in paragraph 27) and the transaction meets the requirements of paragraph 27 for the exclusion of trade exposures to the QCCP (or, in the case of a multi-level client services structure, the requirements of paragraph 27 for the exclusion of trade exposures to the CM or the QCCP). The “effective notional amount” is obtained by adjusting the notional amount to reflect the true exposure of contracts that are leveraged or otherwise enhanced by the structure of the transaction. Further, ~~the~~ the effective notional amount of a written credit derivative may be reduced by any negative change in fair value amount that has been incorporated into the calculation of Tier 1 capital with respect to the written credit derivative.<sup>25, 26</sup> The resulting amount may be further reduced by the effective notional amount of a purchased credit derivative on the same reference name,<sup>27, 28</sup> provided that:**

<sup>24</sup> ~~The effective notional amount is obtained by adjusting the notional amount to reflect the true exposure of contracts that are leveraged or otherwise enhanced by the structure of the transaction.~~

<sup>25</sup> ~~For example, if a written credit derivative had a positive fair value of 20 on one date and has a negative fair value of 10 on a subsequent reporting date, the effective notional amount of the credit derivative may be reduced by 10. The effective notional amount cannot be reduced by 30. However, if on the subsequent reporting date the credit derivative has a positive fair value of five, the effective notional amount cannot be reduced at all.~~

<sup>26</sup> ~~This treatment is consistent with the rationale that the effective notional amounts included in the exposure measure may be capped at the level of the maximum potential loss, which means that the maximum potential loss at the reporting date is the notional amount of the credit derivative minus any negative fair value that has already reduced Tier 1 capital.~~

<sup>27</sup> ~~Two reference names are considered identical only if they refer to the same legal entity. For single-name credit derivatives, protection purchased that references a subordinated position may offset set protection sold on a more senior position of the same reference entity as long as a credit event on the senior reference asset would result in a credit event on the subordinated reference asset. Protection purchased on a pool of reference entities may offset protection sold on individual reference names if the protection purchased is economically equivalent to buying protection separately on each of the individual names in the pool (this would, for example, be the case if a bank were to purchase protection on an entire securitisation structure). If a bank purchases protection on a pool of reference names, but the credit protection does not cover the entire pool (ie the protection covers only a subset of the pool, as in the case of an nth-to-default credit derivative or a securitisation tranche), then offsetting is not permitted for the protection sold on individual reference names. However, such purchased protections may offset sold protections on a pool provided the purchased protection covers the entirety of the subset of the pool on which protection has been sold. In other words, offsetting may only be recognised when the pool of reference entities and the level of subordination in both transactions are identical.~~

- in the case of single name credit derivatives, the credit protection purchased through credit derivatives is on a reference obligation which ranks pari passu with or is junior to the underlying reference obligation of the written credit derivative. Credit protection purchased through credit derivatives that references a subordinated position may offset written credit derivatives on a more senior position of the same reference entity as long as a credit event on the senior reference asset would result in a credit event on the subordinated reference asset; in the case of single name credit derivatives;<sup>29</sup> and
- for tranching products, the credit protection purchased through credit derivatives must be on a reference obligation with the same level of seniority;
- the remaining maturity of the credit protection purchased through credit derivatives is equal to or greater than the remaining maturity of the written credit derivative;
- the credit protection purchased through credit derivatives is otherwise subject to the same material terms as those in the corresponding written credit derivative;
- the credit protection purchased through credit derivatives is not purchased from a counterparty connected with the reference name as defined in Section II.E of the standard Supervisory framework for measuring and controlling large exposures<sup>30</sup> or from a counterparty whose credit quality is highly correlated with the value of the reference obligation in the sense specified in paragraph 101 of the Basel III framework;
- in the event that the effective notional amount of a written credit derivative is reduced by any negative change in fair value reflected in the bank's Tier 1 capital, the effective notional amount of the offsetting credit protection purchased through credit derivatives must also be reduced by any resulting positive change in fair value reflected in Tier 1 capital; and
- the credit protection purchased through credit derivatives is not included in a transaction that has been cleared on behalf of a client (or that has been cleared by the bank in its role as a clearing services provider in a multi-level client services structure as referenced in paragraph 27) and for which the effective notional amount referenced by the corresponding written credit derivative is excluded from the leverage ratio exposure measure according to this paragraph.

32. For the purposes of paragraph 31, the term "written credit derivative" refers to a broad range of credit derivatives through which a bank effectively provides credit protection and is not limited solely to credit default swaps and total return swaps. In particular, all options where the bank has the obligation to provide credit protection under certain conditions qualify as "written credit derivatives". The effective notional amount of such options may be offset by the effective notional amount of options by which the bank has the right to purchase credit protection which fulfils the conditions of paragraph 31, provided that the strike price of the underlying purchased credit protection is equal to or lower than the strike price of the underlying sold credit protection.

<sup>28</sup> The effective notional amount of a written credit derivative may be reduced by any negative change in fair value reflected in the bank's Tier 1 capital provided the effective notional amount of the offsetting purchased credit protection is also reduced by any resulting positive change in fair value reflected in Tier 1 capital. Where a bank buys credit protection through a total return swap (TRS) and records the net payments received as net income, but does not record offsetting deterioration in the value of the written credit derivative (either through reductions in fair value or by an addition to reserves) reflected in Tier 1 capital, the credit protection will not be recognised for the purpose of offsetting the effective notional amounts related to written credit derivatives.

<sup>29</sup> For tranching products, the purchased protection must be on a reference obligation with the same level of seniority.

<sup>30</sup> Basel Committee on Banking Supervision, Supervisory framework for measuring and controlling large exposures, April 2014, [www.bis.org/publ/bcbs283.pdf](http://www.bis.org/publ/bcbs283.pdf).

In all other cases, options that have not yet been exercised do not qualify as “credit protection purchased through credit derivatives” for the purposes of offsetting.

**33.** Two reference names are considered identical only if they refer to the same legal entity. Credit protection on a pool of reference names purchased through credit derivatives may offset credit protection sold on individual reference names if the credit protection purchased is economically equivalent to purchasing credit protection separately on each of the individual names in the pool (this would, for example, be the case if a bank were to purchase credit protection on an entire securitisation structure). If a bank purchases credit protection on a pool of reference names through credit derivatives, but the credit protection purchased does not cover the entire pool (ie the protection covers only a subset of the pool, as in the case of an nth-to-default credit derivative or a securitisation tranche), then the written credit derivatives on the individual reference names may not be offset. However, such purchased credit protection may offset written credit derivatives on a pool provided that the credit protection purchased through credit derivatives covers the entirety of the subset of the pool on which the credit protection has been sold. In other words, offsetting may only be recognised when the pool of reference entities and the level of subordination in both transactions are identical.

**34.** Where a bank purchases credit protection through a total return swap (TRS) and records the net payments received as net income, but does not record offsetting deterioration in the value of the written credit derivative (either through reductions in fair value or by an addition to reserves) in Tier 1 capital, the credit protection will not be recognised for the purpose of offsetting the effective notional amounts related to written credit derivatives.

~~**31-35.** Since written credit derivatives are included in the leverage ratio exposure measure at their effective notional amounts, and are also subject to add-on amounts for PFE, the leverage ratio exposure measure for written credit derivatives may be overstated. Banks may therefore choose to deduct the individual PFE add-on amount relating to a written credit derivative (which is not offset according to paragraph 30 and whose effective notional amount is included in the exposure measure) from their gross add-on in paragraphs 19 to 21,<sup>31</sup> to exclude from the netting set for the PFE calculation the portion of a written credit derivative which is not offset according to paragraph 31 and for which the effective notional amount is included in the leverage ratio exposure measure.~~

### (c) Securities financing transaction exposures

~~**32-36.** SFTs<sup>32</sup> are included in the leverage ratio exposure measure according to the treatment described below. The treatment recognises that secured lending and borrowing in the form of SFTs is an important source of leverage, and ensures consistent international implementation by providing a common measure for dealing with the main differences in the operative accounting frameworks.~~

~~**33-37.** *General treatment (bank acting as principal):* the sum of the amounts in subparagraphs (i) and (ii) below are is to be included in the leverage ratio exposure measure:~~

~~<sup>31</sup> In these cases, where effective bilateral netting contracts are in place, and when calculating  $A_{Net} = 0.4 \cdot A_{Gross} + 0.6 \cdot NGR \cdot A_{Gross}$  as per paragraphs 19 to 21,  $A_{Gross}$  may be reduced by the individual add-on amounts (ie notionals multiplied by the appropriate add-on factors) which relate to written credit derivatives whose notional amounts are included in the leverage ratio exposure measure. However, no adjustments must be made to NGR. Where effective bilateral netting contracts are not in place, the PFE add-on may be set to zero in order to avoid the double-counting described in this paragraph.~~

<sup>32</sup> SFTs are transactions such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements.

- (i) Gross SFT assets<sup>33</sup> recognised for accounting purposes (ie with no recognition of accounting netting),<sup>34</sup> adjusted as follows:
- excluding from the **leverage ratio** exposure measure the value of any securities received under an SFT, where the bank has recognised the securities as an asset on its balance sheet;<sup>35</sup> and
  - cash payables and cash receivables in SFTs with the same counterparty may be measured net if all the following criteria are met:
- (a) ~~Transactions have the same explicit final settlement date; **in particular, transactions with no explicit end date but which can be unwound at any time by either party to the transaction are not eligible;**~~
- (b) ~~The right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of **the counterparty's** (i) default; (ii) insolvency; or (iii) bankruptcy; and~~
- (c) ~~The counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement, – that is, the cash flows of the transactions are equivalent, in effect, to a single net amount on the settlement date. To achieve such equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day ~~and the linkages to collateral flows do not result in the unwinding of net cash settlement.~~<sup>36</sup>, **and any issues arising from the securities legs of the SFTs do not interfere with the completion of the net settlement of the cash receivables and payables. In particular, this latter condition means that the failure of any single securities transaction in the settlement mechanism may delay settlement of only the matching cash leg or create an obligation to the settlement mechanism, supported by an associated credit facility. If there is a failure of the securities leg of a transaction in such a mechanism at the end of the window for settlement in the settlement mechanism, then this transaction and its matching cash leg must be split out from the netting set and treated gross.**<sup>37</sup>~~
- (ii) A measure of CCR calculated as the current exposure without an add-on for PFE, calculated as follows:

<sup>33</sup> For SFT assets subject to novation and cleared through QCCPs, “gross SFT assets recognised for accounting purposes” are replaced by the final contractual exposure, **ie the exposure to the QCCP after the process of novation has been applied**, given that pre-existing contracts have been replaced by new legal obligations through the novation process. **However, banks can only net cash receivables and cash payables with a QCCP if the criteria in paragraph 37 (i) are met. Any other netting permitted by the QCCP is not permitted for the purposes of the Basel III leverage ratio.**

<sup>34</sup> Gross SFT assets recognised for accounting purposes must not recognise any *accounting* netting of cash payables against cash receivables (eg as currently permitted under the IFRS and US GAAP accounting frameworks). This regulatory treatment has the benefit of avoiding inconsistencies from netting which may arise across different accounting regimes.

<sup>35</sup> This may apply, for example, under US GAAP, where securities received under an SFT may be recognised as assets if the recipient has the right to rehypothecate but has not done so.

<sup>36</sup> ~~**This latter condition ensures that any issues arising from the securities leg of the SFTs do not interfere with the completion of the net settlement of the cash receivables and payables.**~~

<sup>37</sup> **Specifically, the criteria in paragraph 37 (i) (c) above are not intended to preclude a DVP settlement mechanism or other type of settlement mechanism, provided that the settlement mechanism meets the functional requirements set out in paragraph 37 (i) (c). For example, a settlement mechanism may meet these functional requirements if any failed transactions (ie the securities that failed to transfer and the related cash receivable or payable) can be re-entered in the settlement mechanism until they are settled.**

- Where a qualifying MNA<sup>38</sup> is in place, the current exposure ( $E^*$ ) is the greater of zero and the total fair value of securities and cash lent to a counterparty for all transactions included in the qualifying MNA ( $\sum E_i$ ), less the total fair value of cash and securities received from the counterparty for those transactions ( $\sum C_i$ ). This is illustrated in the following formula:

$$E^* = \max \{0, [\sum E_i - \sum C_i]\}$$

- Where no qualifying MNA is in place, the current exposure for transactions with a counterparty must be calculated on a transaction-by-transaction basis – that is, each transaction  $i$  is treated as its own netting set, as shown in the following formula:

$$E_i^* = \max \{0, [E_i - C_i]\}$$

**For the purposes of this subparagraph, the term “counterparty” includes not only the counterparty of the bilateral repo transactions but also triparty repo agents that receive collateral in deposit and manage the collateral in the case of triparty repo transactions. Therefore, securities deposited at triparty repo agents are included in “total value of securities and cash lent to a counterparty” (E) up to the amount effectively lent to the counterparty in a repo transaction. However, excess collateral that has been deposited at triparty agents but that has not been lent out may be excluded.**

**34-38.** *Sale accounting transactions:* leverage may remain with the lender of the security in an SFT whether or not sale accounting is achieved under the operative accounting framework. As such, where sale accounting is achieved for an SFT under the bank’s operative accounting framework, the bank must reverse all sales-related accounting entries, and then calculate its exposure as if the SFT had been treated as a financing transaction under the operative accounting framework (ie the bank must include the sum of amounts in subparagraphs (i) and (ii) of paragraph **33-37** for such an SFT) for the purpose of determining its **leverage ratio** exposure measure.

**35-39.** *Bank acting as agent:* a bank acting as agent in an SFT generally provides an indemnity or guarantee to only one of the two parties involved, and only for the difference between the value of the security or cash its customer has lent and the value of collateral the borrower has provided. In this situation, the bank is exposed to the counterparty of its customer for the difference in values rather than to the full exposure to the underlying security or cash of the transaction (as is the case where the bank is one of the principals in the transaction). Where the bank does not own/control the underlying cash or security resource, that resource cannot be leveraged by the bank.

**36-40.** Where a bank acting as agent in an SFT provides an indemnity or guarantee to a customer or counterparty for any difference between the value of the security or cash the customer has lent and the value of collateral the borrower has provided, then the bank will be required to calculate its **leverage ratio** exposure measure by applying only subparagraph (ii) of paragraph **33-37**.<sup>39</sup>

**37-41.** A bank acting as agent in an SFT and providing an indemnity or guarantee to a customer or counterparty will be considered eligible for the exceptional treatment set out in paragraph **36-40** *only* if the bank’s exposure to the transaction is limited to the guaranteed difference between the value of the security or cash its customer has lent and the value of the collateral the borrower has provided. In situations where the bank is further economically exposed (ie beyond the guarantee for the difference)

<sup>38</sup> A “qualifying” MNA is one that meets the requirements under paragraphs **12 and 13-6 and 7** of the Annex.

<sup>39</sup> Where, in addition to the conditions in paragraphs **35 to 37-39 to 41**, a bank acting as an agent in an SFT does not provide an indemnity or guarantee to any of the involved parties, the bank is not exposed to the SFT and therefore need not recognise those SFTs in its **leverage ratio** exposure measure.

to the underlying security or cash in the transaction,<sup>40</sup> a further exposure equal to the full amount of the security or cash must be included in the **leverage ratio** exposure measure.

**42. Where a bank acting as agent provides an indemnity or guarantee to both parties involved in an SFT (ie securities lender and securities borrower), the bank will be required to calculate its leverage ratio exposure measure in accordance with paragraphs 39 to 41 separately for each party involved in the transaction.**

(d) Off-balance sheet (**OBS**) items

**38.43.** This section explains the incorporation of OBS items as defined in the **Basel II framework standardised approach for credit risk** into the leverage ratio exposure measure. OBS items include commitments (including liquidity facilities), whether or not unconditionally cancellable, direct credit substitutes, acceptances, standby letters of credit and trade letters of credit.

**39.44.** In the risk-based capital framework, OBS items are converted under the standardised approach into credit exposure equivalents through the use of credit conversion factors (CCFs). For the purpose of determining the exposure amount of OBS items for the leverage ratio, the CCFs set out in the Annex must be applied to the notional amount.<sup>41</sup>

**45. In addition, specific and general provisions that have decreased Tier 1 capital may be deducted from the credit exposure equivalent amount (ie the exposure amount after the application of the relevant CCF).**

## **Disclosure requirements**

**40. Banks will be required to publicly disclose their Basel III leverage ratio on a consolidated basis from 1 January 2015.**

**41. To enable market participants to reconcile leverage ratio disclosures with banks' published financial statements from period to period, and to compare the capital adequacy of banks across jurisdictions with varying accounting frameworks, it is important that banks adopt a consistent and common disclosure of the main components of the leverage ratio, while also reconciling these disclosures with their published financial statements.**

**42. To facilitate consistency and ease of use of disclosures relating to the composition of the leverage ratio, and to mitigate the risk of inconsistent formats undermining the objective of enhanced disclosure, the Committee has agreed that internationally active banks will be required to publish their leverage ratio according to a common set of templates.**

**43. The public disclosure requirements include:**

<sup>40</sup> For example, due to the bank managing collateral received in the bank's name or on its own account rather than on the customer's or borrower's account (eg by on-lending or managing unsegregated collateral, cash or securities). **However, this does not apply to client omnibus accounts that are used by agent lenders to hold and manage client collateral provided that client collateral is segregated from the bank's proprietary assets and the bank calculates the exposure on a client-by-client basis.**

<sup>41</sup> **These correspond to the CCFs of the standardised approach for credit risk under the Basel II framework, subject to a floor of 10%. The floor of 10% will affect commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. These may receive a 0% CCF under the risk-based capital framework.**

- ~~a summary comparison table that provides a comparison of banks' total accounting assets amounts and leverage ratio exposures;~~
- ~~a common disclosure template that provides a breakdown of the main leverage ratio regulatory elements;~~
- ~~a reconciliation requirement that details the source(s) of material differences between banks' total balance sheet assets in their financial statements and on-balance sheet exposures in the common disclosure template; and~~
- ~~other disclosures as set out below.~~

### (i) Implementation date, frequency and location of disclosure

~~44. National authorities will give effect to the public disclosure requirements set out in this document by no later than 1 January 2015. Banks will be required to comply with these requirements from the date of publication of their first set of financial statements relating to a balance sheet on or after 1 January 2015.~~

~~45. Frequency of disclosure: with the exception of the mandatory quarterly frequency requirement in paragraph 46 below, disclosures required according to this document must be published by banks at the same frequency as, and concurrent with, the publication of their financial statements (ie typically quarterly or half-yearly).~~

~~46. Under Pillar 3 (market discipline) of the Basel II framework, large banks are subject to minimum disclosure requirements with respect to defined key capital ratios and elements on a quarterly basis, regardless of the frequency of publication of their financial statements.<sup>42</sup> As the leverage ratio is an important supplementary measure to the risk-based capital requirements, the Committee has agreed that the same Pillar 3 requirement also applies to the leverage ratio. In order for a bank to meet this additional requirement, at a minimum, three items must be publicly disclosed quarterly irrespective of the frequency of publication of the financial statements: (i) the numerator (Tier 1 capital); (ii) the denominator (exposure measure); and (iii) the Basel III leverage ratio according to paragraph 6. At a minimum, these disclosures should be on a quarter-end basis, along with the figures of the prior three quarter-ends. However, banks may, subject to supervisory approval, use more frequent calculations (eg daily or monthly averaging), as long as they do so consistently.~~

~~47. Location of disclosure: disclosures required by this document must either be included in banks' published financial statements or, at a minimum, provide a direct link to the completed disclosures on the banks' websites or in publicly available regulatory reports.~~

~~48. Banks must make available on their websites, or through publicly available regulatory reports, an ongoing archive of all reconciliation templates, disclosure templates and explanatory tables relating to prior reporting periods. Irrespective of the location of the disclosure (published financial statements, bank websites or publicly available regulatory reports), all disclosures must be made according to the templates defined below.~~

### (ii) Disclosure templates

~~49. The summary comparison table, common disclosure template and explanatory table, qualitative reconciliation and other requirements are set out in the following sections. Together,~~

<sup>42</sup> ~~For the relevant Pillar 3 disclosure requirements, see paragraph 818 of the Basel II framework.~~

~~these ensure transparency between the values used for the calculation of the Basel III leverage ratio and the values used in banks' published financial statements.~~

~~50. The scope of consolidation of the Basel III leverage ratio as set out in paragraph 8 may be different from the scope of consolidation of the published financial statements. Also, there may be differences between the measurement criteria of assets on the accounting balance sheet in the published financial statements relative to measurement criteria of the leverage ratio (eg due to differences of eligible hedges, netting or the recognition of credit risk mitigation). Further, in order to adequately capture embedded leverage, the framework incorporates both on- and off-balance sheet exposures.~~

~~51. The templates set out below are designed to be flexible enough to be used under any accounting standard, and are consistent yet proportionate, varying with the complexity of the balance sheet of the reporting bank.<sup>43</sup>~~

~~(iii) Summary comparison table~~

~~52. Applying values at the end of period (eg quarter-end), banks must report a reconciliation of their balance sheet assets from their published financial statements with the leverage ratio exposure measure as shown in Table 1. Specifically:~~

- ~~• line 1 should show the bank's total consolidated assets as per published financial statements;~~
- ~~• line 2 should show adjustments related to investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes, but outside the scope of regulatory consolidation as set out in paragraphs 9 and 16;~~
- ~~• line 3 should show adjustments related to any fiduciary assets recognised on the balance sheet pursuant to the bank's operative accounting framework but excluded from the leverage ratio exposure measure, as described in footnote 4;~~
- ~~• lines 4 and 5 should show adjustments related to derivative financial instruments and securities financing transactions (ie repos and other similar secured lending), respectively;~~
- ~~• line 6 should show the credit equivalent amount of OBS items, as determined under paragraph 39;~~
- ~~• line 7 should show any other adjustments; and~~
- ~~• line 8 should show the leverage ratio exposure, which should be the sum of the previous items. This should also be consistent with line 22 of Table 2 below.~~

~~Summary comparison of accounting assets vs leverage ratio exposure measure Table 1~~

	<del>Item</del>	<del>In-relevant currency</del>
<del>1</del>	<del>Total consolidated assets as per published financial statements</del>	
<del>2</del>	<del>Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation</del>	

~~<sup>43</sup> Specifically, a common template is set out. However, with respect to reconciliation, banks are to qualitatively reconcile any material difference between total balance sheet assets in their reported financial statements and on-balance sheet exposures as prescribed in the leverage ratio.~~

<del>3</del>	<del>Adjustment for fiduciary assets recognised on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure</del>	
4	Adjustments for derivative financial instruments	
<del>5</del>	<del>Adjustment for securities financing transactions (ie repos and similar secured lending)</del>	
<del>6</del>	<del>Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)</del>	
<del>7</del>	<del>Other adjustments</del>	
8	Leverage ratio exposure	

**(iv) Common disclosure template and explanatory table, reconciliation and other requirements**

~~53. Banks must report, in accordance with Table 2 below, and applying values at the end of period (eg quarter end), a breakdown of the following exposures under the leverage ratio framework: (i) on-balance sheet exposures; (ii) derivative exposures; (iii) SFT exposures; and (iv) OBS items. Banks must also report their Tier 1 capital, total exposures and the leverage ratio.~~

~~54. The Basel III leverage ratio for the quarter, expressed as a percentage and calculated according to paragraph 6, is to be reported in line 22.~~

~~55. Reconciliation with public financial statements: banks are required to disclose and detail the source of material differences between their total balance sheet assets (net of on-balance sheet derivative and SFT assets) as reported in their financial statements and their on-balance sheet exposures in line 1 of the common disclosure template.~~

~~56. Material periodic changes in the leverage ratio: banks are required to explain the key drivers of material changes in their Basel III leverage ratio observed from the end of the previous reporting period to the end of the current reporting period (whether these changes stem from changes in the numerator and/or from changes in the denominator).~~

**Leverage ratio common disclosure template**

**Table 2**

	<u>Item</u>	<u>Leverage ratio framework</u>
<b>On-balance sheet exposures</b>		
<del>1</del>	<del>On-balance sheet items (excluding derivatives and SFTs, but including collateral)</del>	
<del>2</del>	<del>(Asset amounts deducted in determining Basel III Tier 1 capital)</del>	
<del>3</del>	<del>Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 and 2)</del>	
<b>Derivative exposures</b>		
4	Replacement cost associated with all derivatives transactions (ie net of eligible cash variation margin)	
5	Add-on amounts for PFE associated with all derivatives transactions	
6	Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework	
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	
8	(Exempted CCP leg of client-cleared trade exposures)	
9	Adjusted effective notional amount of written credit derivatives	

<del>10</del>	<del>(Adjusted effective notional offsets and add-on deductions for written credit derivatives)</del>	
<del>11</del>	<del>Total derivative exposures (sum of lines 4 to 10)</del>	
<b>Securities financing transaction exposures</b>		
<del>12</del>	<del>Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions</del>	
<del>13</del>	<del>(Netted amounts of cash payables and cash receivables of gross SFT assets)</del>	
<del>14</del>	<del>CCR exposure for SFT assets</del>	
<del>15</del>	<del>Agent transaction exposures</del>	
<del>16</del>	<del>Total securities financing transaction exposures (sum of lines 12 to 15)</del>	
<b>Other off balance sheet exposures</b>		
<del>17</del>	<del>Off-balance sheet exposure at gross notional amount</del>	
<del>18</del>	<del>(Adjustments for conversion to credit equivalent amounts and for deduction of provisions)</del>	
<del>19</del>	<del>Off-balance sheet items (sum of lines 17 and 18)</del>	
<b>Capital and total exposures</b>		
<del>20</del>	<del>Tier 1 capital</del>	
<del>21</del>	<del>Total exposures (sum of lines 3, 11, 16 and 19)</del>	
<b>Leverage ratio</b>		
<del>22</del>	<del>Basel III leverage ratio</del>	

~~57. The following table sets out explanations for each row of the disclosure template referencing the relevant paragraphs of the Basel III leverage ratio framework detailed in this document.~~

### Explanatory table for the common disclosure template

**Table 3**

#### Explanation of each row of the common disclosure template

<u>Row number</u>	<u>Explanation</u>
<del>1</del>	<del>On-balance sheet assets according to paragraph 15.</del>
<del>2</del>	<del>Deductions from Basel III Tier 1 capital determined by paragraphs 9 and 16 and excluded from the leverage ratio exposure measure, reported as negative amounts.</del>
<del>3</del>	<del>Sum of lines 1 and 2.</del>
<del>4</del>	<del>Replacement cost (RC) associated with all derivatives transactions (including exposures resulting from transactions described in paragraph 28), net of cash variation margin received and with, where applicable, bilateral netting according to paragraphs 19–21 and 26.</del>
<del>5</del>	<del>Add-on amount for all derivative exposures according to paragraphs 19–21.</del>
<del>6</del>	<del>Grossed-up amount for collateral provided according to paragraph 24.</del>
<del>7</del>	<del>Deductions of receivables assets from cash variation margin provided in derivatives transactions according to paragraph 26, reported as negative amounts.</del>
<del>8</del>	<del>Exempted trade exposures associated with the CCP leg of derivatives transactions resulting from client-cleared transactions according to paragraph 27, reported as negative amounts.</del>
<del>9</del>	<del>Adjusted effective notional amount (ie the effective notional amount reduced by any negative change in fair value) for written credit derivatives according to paragraph 30.</del>
<del>10</del>	<del>Adjusted effective notional offsets of written credit derivatives according to paragraph 30 and deducted add-on amounts relating to written credit derivatives according to paragraph 31, reported as negative amounts.</del>

<u>11</u>	<u>Sum of lines 4–10.</u>
<u>12</u>	<u>Gross SFT assets with no recognition of any netting other than novation with QCCPs as set out in footnote 19, removing certain securities received as determined by paragraph 33 (i) and adjusting for any sales accounting transactions as determined by paragraph 34.</u>
<u>13</u>	<u>Cash payables and cash receivables of gross SFT assets netted according to subparagraph 33 (i), reported as negative amounts.</u>
<u>14</u>	<u>Measure of counterparty credit risk for SFTs as determined by paragraph 33 (ii).</u>
<u>15</u>	<u>Agent transaction exposure amount determined according to paragraphs 35 to 37.</u>
<u>16</u>	<u>Sum of lines 12–15.</u>
<u>17</u>	<u>Total off-balance sheet exposure amounts on a gross notional basis, before any adjustment for credit conversion factors and before provisions according to paragraph 39.</u>
<u>18</u>	<u>Reduction in gross amount of off-balance sheet exposures due to the application of credit conversion factors and the deduction of provisions according to in paragraph 39.</u>
<u>19</u>	<u>Sum of lines 17 and 18.</u>
<u>20</u>	<u>Tier 1 capital as determined by paragraph 10.</u>
<u>21</u>	<u>Sum of lines 3, 11, 16 and 19.</u>
<u>22</u>	<u>Basel III leverage ratio according to paragraph 54.</u>

~~58. — In general, to ensure that the summary comparison table, common disclosure template and explanatory table<sup>44</sup> remain comparable across jurisdictions, there should be no adjustments made by banks to disclose their leverage ratio. However, national authorities may choose, for the local version of the explanatory table, to reference the national rules that implement the relevant sections of the Basel III framework, provided the row numbering remains unchanged in order to permit market participants to easily map the national templates to the internationally agreed one. Banks are not permitted to add, delete or change the definitions of any rows from the summary comparison table and common disclosure template implemented in their jurisdiction. This will prevent a divergence of tables and templates that could undermine the objectives of consistency and comparability.~~

## Transitional arrangements

~~59. — The transition period for the leverage ratio commenced 1 January 2011. The Committee is using the transition period to monitor banks' leverage ratio data on a semiannual basis in order to assess whether the proposed design and calibration of a minimum Tier 1 leverage ratio of 3% is appropriate over a full credit cycle and for different types of business models. The Committee will also closely monitor accounting standards and practices to address any differences in national accounting frameworks that are material to the definition and calculation of the leverage ratio.~~

~~60. — The transition period comprises a supervisory monitoring period and a parallel run period:~~

- ~~• — The supervisory monitoring period commenced 1 January 2011. The supervisory monitoring process focused on developing templates to track the underlying components of the agreed definitions and resulting ratio in a consistent manner.~~
- ~~• — The parallel run period commenced 1 January 2013 and runs until 1 January 2017. During this period, the leverage ratio and its components are being reported and tracked.~~

<sup>44</sup> ~~Individual banks need not disclose the explanatory table.~~

~~including its behaviour relative to the risk-based capital requirement. Also, as noted above, the public disclosure requirements start on 1 January 2015. The Committee will closely monitor the implementation of these disclosure requirements.~~

~~61. Based on the results of the parallel run period, any final adjustments to the definition and calibration of the Basel III leverage ratio will be carried out by 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.~~

# Annex

## References

To improve the understanding of the Basel III leverage ratio framework, this Annex includes the relevant Basel II and Basel III provisions applicable for the purposes of calculating the leverage ratio.

## Derivative exposures

**1. The calculation of derivative exposures for the leverage ratio exposure measure is based on a modified version of the standard set out in Annex 4 of the Basel II framework as amended by The Standardised Approach for measuring counterparty credit risk exposures (hereafter “SA-CCR framework”).<sup>45</sup>**

### Calculation of replacement cost

**2. The replacement cost of a transaction or netting set is measured as follows:**

$$RC = \max\{V - CVM_r + CVM_p; 0\}$$

**where (i) V is the market value of the individual derivative transaction or of the derivative transactions in a netting set; (ii) CVM<sub>r</sub> is the cash variation margin received that meets the conditions set out in paragraph 25 and for which the amount has not already reduced the market value of the derivative transaction V under the bank’s operative accounting standard; and (iii) CVM<sub>p</sub> is the cash variation margin provided by the bank and that meets the same conditions. Both CVM received and provided are subject to an FX haircut if there is a currency mismatch between the CVM and the termination currency of the netting set (ie the currency in which the bank would submit its claim upon a counterparty default).**

### ~~Add-on factors for determining~~ Calculation of potential future exposure

**3. The potential future exposure (PFE) for derivative exposures must be calculated in accordance with paragraphs 146 to 187 of Annex 4 of the SA-CCR framework. Mathematically:**

$$PFE = \text{multiplier} \cdot \text{AddOn}^{\text{aggregate}}$$

**For the purposes of the Basel III leverage ratio framework, the multiplier is fixed at one. Moreover, when calculating the add-on component, for all margined transactions the maturity factor set out in paragraph 164 of Annex 4 of the SA-CCR framework may be used. Further, as written options create an exposure to the underlying, they must be included in the leverage ratio exposure measure even in those cases where their exposure at default (EAD) can be set at zero in the risk-based framework.**

**1. The following add-on factors apply to financial derivatives, based on residual maturity:**

<sup>45</sup> Basel Committee on Banking Supervision, The standardised approach for measuring counterparty credit risk exposures, March 2014 (rev. April 2014), [www.bis.org/publ/bcbs279.pdf](http://www.bis.org/publ/bcbs279.pdf).

	<u>Interest rates</u>	<u>FX and gold</u>	<u>Equities</u>	<u>Precious metals except gold</u>	<u>Other commodities</u>
<u>One year or less</u>	<u>0.0%</u>	<u>1.0%</u>	<u>6.0%</u>	<u>7.0%</u>	<u>10.0%</u>
<u>Over one year to five years</u>	<u>0.5%</u>	<u>5.0%</u>	<u>8.0%</u>	<u>7.0%</u>	<u>12.0%</u>
<u>Over five years</u>	<u>1.5%</u>	<u>7.5%</u>	<u>10.0%</u>	<u>8.0%</u>	<u>15.0%</u>

**Notes:**

1. ~~For contracts with multiple exchanges of principal, the factors are to be multiplied by the number of remaining payments in the contract.~~
2. ~~For contracts that are structured to settle outstanding exposures following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date. In the case of interest rate contracts with remaining maturities of more than one year that meet the above criteria, the add-on is subject to a floor of 0.5%.~~
3. ~~Forwards, swaps, purchased options and similar derivative contracts not covered by any of the columns in this matrix are to be treated as "other commodities".~~
4. ~~No potential future credit exposure would be calculated for single currency floating / floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.~~

~~2. Supervisors will take care to ensure that add-ons are based on effective rather than apparent notional amounts. In the event that the stated notional amount is leveraged or enhanced by the structure of the transaction, banks must use the effective notional amount when determining potential future exposure.~~

~~3. The following add-on factors apply to single-name credit derivatives:~~

	<u>Protection buyer</u>	<u>Protection seller</u>
<b>Total return swaps</b>		
<u>"Qualifying" reference obligation</u>	<u>5%</u>	<u>5%</u>
<u>"Non-qualifying" reference obligation</u>	<u>10%</u>	<u>10%</u>
<b>Credit default swaps</b>		
<u>"Qualifying" reference obligation</u>	<u>5%</u>	<u>5%**</u>
<u>"Non-qualifying" reference obligation</u>	<u>10%</u>	<u>10%**</u>

~~There will be no difference depending on residual maturity.~~

~~\*\* The protection seller of a credit default swap shall only be subject to the add-on factor where it is subject to closeout upon the insolvency of the protection buyer while the underlying is still solvent. The add-on should then be capped to the amount of unpaid premiums.~~

~~4. Where the credit derivative is a first-to-default transaction, the add-on will be determined by the lowest credit quality underlying the basket, ie if there are any non-qualifying items in the basket, the non-qualifying reference obligation add-on should be used. For second and subsequent nth-to-default transactions, underlying assets should continue to be allocated according to the credit quality, ie the second or, respectively, nth lowest credit quality will determine the add-on for a second-to-default or an nth-to-default transaction, respectively.~~

~~5. The "qualifying" category includes securities issued by public sector entities and multilateral development banks, plus other securities that are:~~

- ~~• rated investment grade<sup>46</sup> by at least two credit rating agencies specified by the national authority; or~~

<sup>46</sup> ~~Eg rated Baa or higher by Moody's and BBB or higher by Standard & Poor's.~~

~~• rated investment grade by one rating agency and not less than investment grade by any other rating agency specified by the national authority (subject to supervisory oversight);  
or~~

~~• subject to supervisory approval, unrated, but deemed to be or comparable to investment grade credit quality by the reporting bank, and the issuer has securities listed on a recognised exchange.~~

~~6. Each supervisory authority will be responsible for monitoring the application of these qualifying criteria, particularly in relation to the last criterion where the initial classification is essentially left to the reporting banks. National authorities will also have discretion to include within the qualifying category debt securities issued by banks in countries which have implemented the current framework, subject to the express understanding that supervisory authorities in such countries undertake prompt remedial action if a bank fails to meet the leverage ratio standards set forth in this framework. Similarly, national authorities will have discretion to include within the qualifying category debt securities issued by securities firms that are subject to equivalent rules.~~

~~7. Furthermore, the “qualifying” category shall include securities issued by institutions that are deemed to be equivalent to investment grade quality and subject to supervisory and regulatory arrangements comparable to those under this framework.~~

## Bilateral netting

~~8.4.~~ For the purposes of the leverage ratio **exposure measure**, the following will apply:

- (a) Banks may net transactions subject to novation under which any obligation between a bank and its counterparty to deliver a given currency on a given value date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations.
- (b) Banks may also net transactions subject to any legally valid form of bilateral netting not covered in (a), including other forms of novation.
- (c) In both cases (a) and (b), a bank will need to satisfy its national supervisors that it has:
  - (i) a netting contract or agreement with the counterparty that creates a single legal obligation, covering all included transactions, such that the bank would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event **that** a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;
  - (ii) written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the bank’s exposure to be such a net amount under:
    - the law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of jurisdiction in which the branch is located;
    - the law that governs the individual transactions; and
    - the law that governs any contract or agreement necessary to effect the netting.

The national supervisor, after consultation when necessary with other relevant supervisors, must be satisfied that the netting is enforceable under the laws of each of the relevant jurisdictions;<sup>47</sup> and

- (iii) procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law.

**9.5.** Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating the leverage ratio ~~requirements exposure measure~~ pursuant to this framework. A walkaway clause is a provision that permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of a defaulter, even if the defaulter is a net creditor.

~~**10.** Credit exposure on bilaterally netted forward transactions will be calculated as the sum of the net mark-to-market replacement cost, if positive, plus an add-on based on the notional underlying principal. The add-on for netted transactions ( $A_{Net}$ ) will equal the weighted average of the gross add-on ( $A_{Gross}$ ) and the gross add-on adjusted by the ratio of net current replacement cost to gross current replacement cost (NGR). This is expressed through the following formula:~~

$$~~A_{Net} = 0.4 \cdot A_{Gross} + 0.6 \cdot NGR \cdot A_{Gross}~~$$

~~where:~~

~~$NGR$  = level of net replacement cost/level of gross replacement cost for transactions subject to legally enforceable netting agreements<sup>48</sup>~~

~~$A_{Gross}$  = sum of individual add-on amounts (calculated by multiplying the notional principal amount by the appropriate add-on factors set out in paragraphs 1 to 7 of this Annex) of all transactions subject to legally enforceable netting agreements with one counterparty.~~

~~**11.** For the purposes of calculating potential future credit exposure to a netting counterparty for forward foreign exchange contracts and other similar contracts in which the notional principal amount is equivalent to cash flows, the notional principal is defined as the net receipts falling due on each value date in each currency. The reason for this is that offsetting contracts in the same currency maturing on the same date will have lower potential future exposure as well as lower current exposure.~~

## Securities financing transaction exposures<sup>49</sup>

**12.6.** *Qualifying master netting agreement:* the effects of bilateral netting agreements for covering SFTs will be recognised on a counterparty-by-counterparty basis if the agreements are legally

<sup>47</sup> Thus, if any of these supervisors are dissatisfied about enforceability under its laws, the netting contract or agreement will not meet the condition and neither counterparty could obtain supervisory benefit.

<sup>48</sup> ~~National authorities may permit a choice of calculating the NGR on a counterparty by counterparty or on an aggregate basis for all transactions that are subject to legally enforceable netting agreements. If supervisors permit a choice of methods, the method chosen by the institution is to be used consistently. Under the aggregate approach, net negative current exposures to individual counterparties cannot be used to offset net positive current exposures to others, ie for each counterparty the net current exposure used in calculating the NGR is the maximum of the net replacement cost or zero. Note that under the aggregate approach, the NGR is to be applied individually to each legally enforceable netting agreement so that the credit equivalent amount will be assigned to the appropriate counterparty risk weight category.~~

<sup>49</sup> The provisions related to qualifying master netting agreements (MNAs) for SFTs are intended for the calculation of the counterparty ~~credit risk add-on of the leverage ratio~~ exposure measure of SFTs as set out in paragraph ~~33 (ii) 37 (ii)~~ only.

enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:

- (a) provide the non-defaulting party with the right to terminate and close out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;
- (b) provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;
- (c) allow for the prompt liquidation or setoff of collateral upon the event of default; and
- (d) be, together with the rights arising from provisions required in (a) and (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default regardless of the counterparty's insolvency or bankruptcy.

**13.7.** Netting across positions held in the banking book and trading book will only be recognised when the netted transactions fulfil the following conditions:

- (a) all transactions are marked to market daily; and
- (b) the collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

## Off-balance sheet (OBS) items

**14.8.** For the purposes of the leverage ratio, OBS items will be converted into credit exposures equivalents through the use of credit conversion factors (CCFs) by multiplying the committed but undrawn amount by a credit conversion factor (CCF). For these purposes, commitment means any contractual arrangement accepted by the client whereby the bank is committed to extend credit, purchase assets or issue credit substitutes.

~~15. Commitments other than securitisation liquidity facilities with an original maturity up to one year and commitments with an original maturity over one year will receive a CCF of 20% and 50%, respectively. However, any commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, will receive a 10% CCF.<sup>50</sup>~~

~~16. Direct credit substitutes, eg general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances) will receive a CCF of 100%.~~

~~17. Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawdown, will receive a CCF of 100%.~~

~~18. Certain transaction-related contingent items (eg performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) will receive a CCF of 50%.~~

~~19. Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) will receive a CCF of 50%.~~

<sup>50</sup> ~~In certain countries, retail commitments are considered unconditionally cancellable if the terms permit the bank to cancel them to the full extent allowable under consumer protection and related legislation.~~

~~20. For short-term self-liquidating trade letters of credit arising from the movement of goods (eg documentary credits collateralised by the underlying shipment), a 20% CCF will be applied to both issuing and confirming banks.~~

~~21. Where there is an undertaking to provide a commitment on an OBS item, banks are to apply the lower of the two applicable CCFs.~~

~~22. All off-balance sheet securitisation exposures, except an eligible liquidity facility or an eligible servicer cash advance facility as set out in paragraphs 576 and 578 of the Basel II framework, will receive a CCF of 100% conversion factor. All eligible liquidity facilities will receive a CCF of 50%. At national discretion, undrawn servicer cash advances or facilities that are unconditionally cancellable without prior notice may be eligible for a 10% CCF.~~

~~9. A 100% CCF will be applied to the following items:~~

- ~~• Direct credit substitutes, eg general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances).~~
- ~~• Sale and repurchase agreements and asset sales with recourse where the credit risk remains with the bank, other than SFT sale accounting transactions specified in paragraph 38.~~
- ~~• Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawdown.~~

#### [Option A

- ~~• The exposure amount associated with unsettled financial asset purchases (ie the commitment to pay) where regular-way unsettled trades are accounted for at settlement date.~~

#### Option B

- ~~• The exposure amount associated with unsettled financial asset purchases (ie the commitment to pay) where regular-way unsettled trades are accounted for at settlement date. Banks may offset commitments to pay for unsettled purchases and cash to be received for unsettled sales provided that the following conditions are met: (i) the bank is serving as a market-maker for the financial assets;<sup>51</sup> (ii) the financial assets bought and sold that are associated with cash payables and receivables are fair valued through income and included in the bank's regulatory trading book as specified by paragraphs 8 to 20 of the market risk framework; and (iii) the transactions of the financial assets are settled on a DVP basis.]~~
- ~~• OBS items not explicitly included in any other category.~~

~~10. A [50–75%] CCF will be applied to:~~

- ~~• Commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF.~~
- ~~• Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) regardless of the maturity of the underlying facility.~~

~~11. A 50% CCF will be applied to certain transaction-related contingent items (eg performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions).~~

<sup>51</sup> See paragraph 16 for the definition of the term "market-maker".

**12. A 20% CCF will be applied to both the issuing and confirming banks of short-term self-liquidating trade letters of credit arising from the movement of goods (eg documentary credits collateralised by the underlying shipment).**

**13. A [10–20%] CCF will be applied to retail commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower’s creditworthiness.<sup>52</sup>**

**14. Where there is an undertaking to provide a commitment on an OBS item, banks are to apply the lower of the two applicable CCFs.**

**15. OBS securitisation exposures must be treated as per the second bullet of paragraph 20 of the Basel III securitisation framework.<sup>53</sup>**

<sup>52</sup> **In certain countries, retail commitments are considered unconditionally cancellable if the terms permit the bank to cancel them to the full extent allowable under consumer protection and related legislation.**

<sup>53</sup> **Basel Committee on Banking Supervision, *Revisions to the securitisation framework*, December 2014, [www.bis.org/bcbs/publ/d303.pdf](http://www.bis.org/bcbs/publ/d303.pdf).**