



**BANK NEGARA MALAYSIA**  
CENTRAL BANK OF MALAYSIA

# **Leverage Ratio**

## **Exposure Draft**

Applicable to:

1. Licensed banks
2. Licensed investment banks
3. Licensed Islamic banks

This Exposure Draft sets out the Bank's proposals for the Leverage Ratio (LR) framework, which is part of the Basel III regulatory reforms.

Submission of feedback:

- (a) The Bank invites written feedback on the proposed regulatory requirements, including suggestions on areas to be clarified and alternative proposals that the Bank should consider. The written feedback should be constructive and supported with clear rationale, including accompanying evidence, empirical analysis or illustrations where appropriate;
- (b) In addition to providing general feedback, banking institutions are requested to respond to specific questions set out throughout this Exposure Draft; and
- (c) In addition to existing obligations under *Basel III Observation Period Reporting (Net Stable Funding Ratio and Leverage Ratio)*, banking institutions are required to report LR positions (at the entity, consolidated and Skim Perbankan Islam levels) as at 30 June 2017, based on the parameters in this exposure draft and using the reporting template provided. Please attach this to your written feedback under paragraph (a) and (b).

In addition to providing general feedback, financial institutions are requested to respond to the specific questions set out throughout this Exposure Draft.

Responses are to be submitted to the Bank by 16 September 2017 to the following mailing or e-mail address:

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In the course of providing your feedback, you may direct queries to the following officers at 03-26988044:

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## TABLE OF CONTENTS

<b>PART A</b>	<b>OVERVIEW.....</b>	<b>1</b>
1	Introduction .....	1
2	Applicability .....	1
3	Legal provisions .....	1
4	Effective date .....	1
5	Interpretation.....	1
6	Related legal instruments and policy documents .....	3
7	Policy documents superseded .....	3
<b>PART B</b>	<b>POLICY REQUIREMENTS.....</b>	<b>4</b>
8	Leverage Ratio.....	4
9	Minimum requirement .....	4
10	Tier 1 Capital.....	4
11	Total LR Exposure .....	4
12	On-balance sheet exposures .....	5
13	Derivative exposures.....	5
14	Securities financing transaction exposures .....	9
15	Off-balance sheet exposures .....	12
16	Reporting requirements.....	12
	<b>APPENDICES.....</b>	<b>14</b>
	Appendix 1: “Add-on” Factors for Credit Derivatives .....	14
	Appendix 2: Qualifying Master Netting Agreement for SFTs.....	15

## PART A OVERVIEW

### 1 Introduction

- 1.1 The Leverage Ratio (LR) is a non-risk based capital requirement which seeks to–
- (a) restrict the build-up of excessive levels of leverage in banking institutions to avoid destabilising deleveraging processes that can damage the broader financial system; and
  - (b) reinforce the risk-based Capital Adequacy Framework with a non-risk-based backstop measure.

### 2 Applicability

- 2.1 This policy document is applicable to all banking institutions as defined in paragraph 5.2.

### 3 Legal provisions

- 3.1 This policy document is issued pursuant to–
- (a) sections 47, 143(2) and 266 of the Financial Services Act 2013 (FSA); and
  - (b) sections 57, 155(2) and 277 of the Islamic Financial Services Act (IFSA).

### 4 Effective date

- 4.1 This policy document comes into effect on 1 January 2018.

### 5 Interpretation

- 5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the FSA and IFSA, as the case may be, unless otherwise defined in this policy document.

- 5.2 For the purpose of this policy document–

“**S**” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement action;

“**G**” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;

“**banking institution**” refers to–

- (a) a licensed bank;
- (b) a licensed investment bank; and
- (c) a licensed Islamic bank, except for a licensed international Islamic bank;

**“central counterparty”** or **“CCP”** refers to an entity that interposes itself between counterparties to contracts traded within one or more financial markets, becoming the legal counterparty such that it is the buyer to every seller and the seller to every buyer;

**“clearing member”** or **“CM”** refers to a member of, or a direct participant in, a CCP that is entitled to enter into a transaction with the CCP, regardless of whether it enters into trades with a CCP for its own hedging or investment purposes, or whether it also enters into trades as a financial intermediary between the CCP and other market participants;

**“credit derivative”** refers to any derivative through which credit protection is effectively provided and is not limited solely to credit default swaps and total return swaps;

**“qualifying central counterparty”** or **“QCCP”** refers to an entity that is licensed to operate as a CCP (including a licence granted by way of confirming an exemption), and is permitted by the appropriate regulator/overseer to operate as such with respect to the products offered. This is subject to the provision that the CCP is based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the *Principles for Financial Market Infrastructures* published by the Committee on Payment and Settlement Systems of the Bank for International Settlements and the Technical Committee of the International Organization of Securities Commissions;

**“securities financing transaction”** or **“SFT”** includes–

- (a) a repurchase agreement transaction;
- (b) a reverse repurchase agreement transaction;
- (c) a securities/commodities lending or borrowing transaction;
- (d) a margin lending transaction;
- (e) a collateralised *murabahah* arrangement; and
- (f) a sell and buyback agreement transaction;

**“Skim Perbankan Islam”** or **“SPI”** refers to a licensed bank or licensed investment bank that has been approved under section 15(1)(a) of the FSA to carry on Islamic banking business.

## 6 Related legal instruments and policy documents

- 6.1 This policy document must be read together with other relevant legal instruments and policy documents that have been issued by the Bank, in particular–
- (a) *Capital Adequacy Framework (Basel II – Risk-Weighted Assets)* (hereafter referred to as “CAF-RWA”);
  - (b) *Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets)* (hereafter referred to as “CAFIB-RWA”);
  - (c) *Capital Adequacy Framework (Capital Components)* (hereafter referred to as “CAF-Capital Components”);
  - (d) *Capital Adequacy Framework for Islamic Banks (Capital Components)* (hereafter referred to as “CAFIB-Capital Components”);
  - (e) *Investment Account*; and
  - (f) *STATsmart Reporting Requirements on Data Submission for Reporting Entities*.

## 7 Policy documents superseded

- 7.1 This policy document supersedes the observation period reporting obligations for Leverage Ratio positions under the *Basel III Observation Period Reporting (Net Stable Funding Ratio and Leverage Ratio)*, issued on 7 August 2015.

## PART B POLICY REQUIREMENTS

### 8 Leverage Ratio

- S** 8.1 A banking institution must calculate its LR in the following manner:

$$\text{LR} = \frac{\text{Tier 1 Capital}}{\text{Total LR Exposure}}$$

- S** 8.2 A banking institution must comply with the requirements in this policy document at the following levels:
- entity level<sup>1</sup>, referring to the global operations of the banking institution (i.e. including its overseas branch operations) on a stand-alone basis, and including its Labuan banking subsidiary;
  - consolidated level, which includes entities covered under the entity level requirement, and the consolidation<sup>2</sup> of all subsidiaries<sup>3</sup>, except insurance and/or takaful subsidiaries<sup>4</sup>; and
  - SPI level, as if it were a stand-alone banking institution.

### 9 Minimum requirement

- S** 9.1 A banking institution must maintain a minimum LR of 3% at all times.

### 10 Tier 1 Capital

- S** 10.1 A banking institution must calculate its Tier 1 Capital in accordance with the CAF-Capital Components or the CAFIB-Capital Components, as the case may be.

### 11 Total LR Exposure

- S** 11.1 A banking institution must calculate its Total LR Exposure as the sum of the following exposures:
- on-balance sheet exposures as set out in paragraph 12;
  - derivative exposures as set out in paragraph 13;
  - securities financing transaction exposures as set out in paragraph 14; and
  - off-balance sheet (OBS) exposures as set out in paragraph 15.
- G** 11.2 The Total LR Exposure should generally follow gross accounting values.

<sup>1</sup> Also referred to as the “solo” or “stand-alone” level.

<sup>2</sup> Consolidation of financial reporting must be in accordance with the Malaysian Financial Reporting Standards (MFRS).

<sup>3</sup> Refers to financial and non-financial subsidiaries.

<sup>4</sup> For insurance and takaful subsidiaries, only the investment in the capital of such entities is to be included in the Total LR Exposure.

- S** 11.3 A banking institution must exclude from its Total LR Exposure, balance sheet assets deducted from Tier 1 Capital (in accordance with CAF-Capital Components or CAFIB-Capital Components).
- S** 11.4 Unless otherwise specified, a banking institution must not–
- (a) deduct any liability item from its Total LR Exposure;
  - (b) take into account physical or financial collateral, guarantees or any other credit risk mitigation technique to reduce its Total LR Exposure; and
  - (c) net assets and liabilities.
- S** 11.5 In calculating its Total LR Exposure, a banking institution must reverse the effects of any accounting treatment that results in the circumstances set out in paragraph 11.4.
- S** 11.6 A banking institution must exclude exposures funded by an investment account from its Total LR Exposure<sup>5</sup>.

## **12 On-balance sheet exposures**

- S** 12.1 Subject to paragraphs 11.5 and 11.6, a banking institution must include all on-balance sheet assets in its Total LR Exposure at their accounting values (including on-balance sheet collateral for derivatives and SFTs), except for on-balance sheet derivative assets and SFT assets, which must be computed in accordance with paragraphs 13 and 14, respectively.

## **13 Derivative exposures**

- S** 13.1 Subject to paragraph 13.2, a banking institution must calculate its exposures for all derivative transactions, as the sum of–
- (a) replacement cost (RC); and
  - (b) potential future exposure (PFE),
- in accordance with the Current Exposure Method (CEM)<sup>6</sup> set out in Appendix VIII of the CAF-RWA or Appendix VI the CAFIB-RWA, as the case may be.
- S** 13.2 In calculating its derivative exposures, a banking institution–
- (a) must apply the add-on factors set out in Appendix I for the calculation of PFE for credit derivatives<sup>7</sup>;

<sup>5</sup> For the avoidance of doubt, exposures funded by investment accounts that are recognised as an asset in accordance with the accounting framework are to be reported in–

(a) the “LR\_Main” worksheet; and

(b) the “LR\_IA\_On” worksheet, which will be used to adjust the banking institution’s Total LR Exposure through cell J103 in the “LR\_Main” worksheet.

Exposures funded by investment account that are not recognised as assets in accordance with the accounting framework need not be reported.

<sup>6</sup> For the avoidance of doubt, although the Current Exposure Method set out under the CAF-RWA and the CAFIB-RWA only applies to over-the-counter (OTC) derivatives, for purposes of this policy document, this measurement approach must be applied for all types of derivative transactions.

<sup>7</sup> For the avoidance of doubt, this does not preclude the application of add-on factors set out in Appendix VIIIb of CAF-RWA and Appendix VIb of CAFIB-RWA where credit derivative contracts are sensitive to movements of more than one type of rates.

- (b) must not reduce its derivative exposures through use of any collateral, except as provided under paragraph 13.3;
  - (c) must not apply any haircut for currency risk; and
  - (d) may apply the bilateral netting rules, subject to compliance with the requirements set out in CAF-RWA or CAFIB-RWA, as the case may be.
- S** 13.3 Subject to paragraph 13.5, and all the conditions set out in paragraph 13.4 being fulfilled–
- (a) a banking institution *receiving* cash variation margin<sup>8</sup> may reduce its RC by the amount of cash variation margin *received*; and
  - (b) a banking institution *providing* cash variation margin may deduct the resulting receivable recognised as an asset under the accounting framework from its Total LR Exposure.
- S** 13.4 For purposes of paragraph 13.3, the conditions to be met are as follows:
- (a) for trades that are not cleared through a qualifying central counterparty (QCCP), the cash variation margin received by the recipient counterparty is not segregated<sup>9</sup>;
  - (b) the variation margin is calculated and exchanged on at least a daily basis based on mark-to-market valuations of the derivative positions<sup>10</sup>;
  - (c) the cash variation margin is received in the same currency as the currency of settlement of the derivative contract<sup>11</sup>;
  - (d) the variation margin exchanged is the full amount that would be necessary to extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty; and
  - (e) the derivative transactions and variation margins are covered by a single master netting agreement (MNA)<sup>12</sup> between the legal entities that are counterparties in the derivative transaction, and the MNA must–
    - (i) 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; and
    - (ii) be legally enforceable and effective<sup>13</sup> in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency.

<sup>8</sup> For the avoidance of doubt, this refers to the cash portion of variation margin exchanged between the counterparties.

<sup>9</sup> This condition is met if the recipient counterparty has no restrictions by law, regulation or any agreement with the counterparty on its ability to use the cash variation margin received (i.e. the cash variation margin received by the counterparty can be used as its own cash).

<sup>10</sup> To meet this condition, the derivative positions must be valued daily and the 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 condition.

<sup>11</sup> For the avoidance of doubt, currency of settlement of the derivative contract, means 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 or as defined by any netting agreement with a CCP.

<sup>12</sup> For the purpose of this paragraph, the term 'MNA' includes a reference to any netting agreement that provides legally enforceable rights of offset, and a Master MNA may be deemed to be a single MNA.

- S** 13.5 A banking institution must not use cash variation margin to reduce the PFE, including the calculation of the net-to-gross ratio (NGR)<sup>14</sup>.

***Treatment of clearing services***

- S** 13.6 A banking institution that is a clearing member (CM) offering clearing services to clients–
- (a) must calculate a trade exposure<sup>15</sup> to the CCP, if the CM is obligated to reimburse the client for any losses suffered due to changes in the value of its derivative transactions in the event the CCP defaults; and
  - (b) need not recognise the resulting trade exposure to a CCP in its Total LR Exposure, if the CM is not obligated to reimburse the client for any losses suffered in the event the CCP defaults, based on its contractual arrangements with its client.
- S** 13.7 Where a client enters directly into a derivative transaction with a CCP and the banking institution guarantees the performance of its client’s derivative trade exposures to the CCP, the banking institution must calculate its exposures resulting from the guarantee as a derivative exposure, as if it had entered directly into the transaction with the client, including with regard to the receipt or provision of cash variation margin.
- S** 13.8 For purposes of paragraphs 13.6 and 13.7, where a banking institution acts as a CM for an affiliated entity that–
- (a) falls outside the banking institution’s scope of regulatory consolidation, the banking institution may treat the affiliated entity as a client; and
  - (b) falls within the banking institution’s scope of regulatory consolidation, the transaction with the CCP will be considered proprietary and the banking institution must not apply the exemption set out in paragraph 13.6(b)<sup>16</sup>.

**Question 1**

- (a) Please specify the size of your institution’s trade exposures to central counterparties (CCPs) arising from the provision of central clearing services to clients as a higher-level client within a multi-level client structure<sup>17</sup>.
- (b) Please specify the relevant CCPs involved.

<sup>13</sup> Namely, where the MNA satisfies paragraphs 21 and 22 of Appendix VIII of the CAF-RWA or paragraphs 17 and 18 of Appendix VI of the CAFIB-RWA, as the case may be.

<sup>14</sup> Specifically, in the calculation of the NGR, cash variation margin may not reduce the ‘net replacement cost’ (i.e. the numerator of the NGR) nor the ‘gross replacement cost’ (i.e. the denominator of the NGR).

<sup>15</sup> For the avoidance of doubt, this includes initial margin irrespective of whether it is posted in a manner that makes it remote from the insolvency of the CCP.

<sup>16</sup> While the trade between the affiliated entity and the CM is eliminated in the course of consolidation, the CM still has a trade exposure to the CCP.

<sup>17</sup> A “multi-level client structure” is one in which banking institutions can centrally clear as indirect clients; that is, when clearing services are provided to the banking institution by a direct CM of a CCP or an institution which is a client of a direct CM or another clearing client. The term “higher-level client” refers to the institution providing the clearing services.

**Additional treatment for written credit derivatives**

- S** 13.9 Where a banking institution provides credit protection through a credit derivative (written credit derivative), the banking institution must include the effective notional amount<sup>18</sup> referenced by the written credit derivative in the calculation of its derivative exposures.
- S** 13.10 A banking institution may reduce the effective notional amount by the negative fair value of a written credit derivative that has been recognised in the calculation of Tier 1 Capital<sup>19,20</sup>. The resulting amount may be further reduced by the effective notional amount of a purchased credit derivative on the same reference name, provided that–
- (a) the purchased credit derivative is on a reference obligation which ranks *pari passu* with, or is junior to, the underlying reference obligation of the written credit derivative in the case of single name credit derivatives<sup>21</sup>;
  - (b) the remaining maturity of the purchased credit derivative is equal to, or greater than, the remaining maturity of the written credit derivative; and
  - (c) in the event that the effective notional amount of a written credit derivative is reduced by any negative fair value reflected in Tier 1 Capital, the effective notional amount of the purchased credit derivatives is similarly reduced by any resulting positive fair value reflected in Tier 1 Capital<sup>22</sup>.
- S** 13.11 For the purpose of paragraph 13.10, two reference names must not be considered identical unless they refer to the same legal entity. Where a banking institution purchases credit protection on a pool of reference names through credit derivatives, the banking institution may offset–
- (a) written credit derivatives on individual reference names, only if the credit protection purchased is economically equivalent to purchasing credit protection separately on each individual name in the pool<sup>23</sup>. Therefore, written credit derivatives on individual reference names must not be offset if the credit protection purchased does not cover the entire pool<sup>24</sup>; and

<sup>18</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>19</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 5, the effective notional amount cannot be reduced at all.

<sup>20</sup> This treatment is consistent with the rationale that the effective notional amounts included in the Total LR Exposure 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>21</sup> In the case of a tranching product, the credit protection purchased through credit derivatives must be on a reference obligation with the same level of seniority.

<sup>22</sup> Where the effective notional amount of the purchased credit derivative has **not** been reduced by any resulting change in fair value reflected in Tier 1 Capital, then the effective notional amount of the written credit derivative may only be offset if the effective notional amount of that written credit derivative has **not** been reduced by any change in fair value reflected in Tier 1 Capital.

<sup>23</sup> e.g. where the banking institution purchases credit protection on an entire securitisation structure.

<sup>24</sup> Where the protection covers only a subset of the pool, as in the case of an nth-to-default credit derivative or a securitisation tranche.

- (b) written credit derivatives on a pool of reference names, provided that the credit protection purchased covers the entire subset of the pool on which the credit protection has been sold.

- S** 13.12 The effective notional amount of a written credit derivative must not be offset against credit protection purchased through a total return swap (TRS), if the banking institution records the net payments received under the TRS as net income but does not record offsetting deterioration in the value of the written credit derivative in Tier 1 Capital (either through reductions in fair value or by additions to reserves).
- G** 13.13 A banking institution's exposure may be overstated where both the effective notional amount and PFE for written credit derivatives are included in its Total LR Exposure. As such, where the effective notional amount of a written credit derivative has not been offset by purchased credit derivatives in accordance with paragraph 13.10, a banking institution may reduce its PFE as follows:
- (a) if there is no eligible bilateral netting contract in place, the PFE of the written credit derivative may be set to zero; and
  - (b) if an eligible bilateral netting contract is in place, the PFE of the written credit derivative can be excluded from  $A_{Gross}$  when calculating  $A_{Net}$ .

## 14 Securities financing transaction exposures

- S** 14.1 A banking institution must calculate its SFT exposures as the sum of–
- (a) **gross SFT assets** recognised for accounting purposes<sup>25</sup> (i.e. without recognition of accounting netting), which may be adjusted in accordance with paragraph 14.2; and
  - (b) a measure of **counterparty credit risk** calculated as the current exposure without an add-on for PFE, in accordance with paragraphs 14.4 and 14.5.

### **Adjusted gross SFT assets**

- S** 14.2 A banking institution may adjust its gross SFT assets as follows:
- (a) the value of any security received under an SFT may be excluded from its Total LR Exposure where the security has been recognised as an asset on the balance sheet of the banking institution;
  - (b) cash payables and cash receivables in SFTs with the same counterparty may be measured net, provided that–
    - (i) the SFTs have the same explicit final settlement date<sup>26</sup>;
    - (ii) the banking institution has a legally enforceable right to set off the amounts owed to, and owed by, the counterparty, both in the normal course of business and in the event of the counterparty's default, insolvency or bankruptcy; and
    - (iii) the banking institution and its counterparty intend to settle net or settle simultaneously, or the SFTs are subject to a settlement mechanism that results in the functional equivalent of net

<sup>25</sup> In respect of SFT assets that are subject to novation and cleared through QCCPs, "gross SFT assets recognised for accounting purposes" refers to the final contractual exposure.

<sup>26</sup> For the avoidance of doubt, SFTs with no explicit end date but which can be unwound at any time by either party to the SFT are not eligible to be measured net.

settlement (i.e. the cash flows of the SFTs are equivalent, in effect, to a single net amount on the settlement date).

- S** 14.3 For the purpose of paragraph 14.2(b)(iii), a settlement mechanism will not result in the functional equivalent of net settlement, unless–
- (a) the SFTs are settled through the same settlement system; and
  - (b) the settlement arrangements are supported by cash or intraday credit facilities intended to ensure that the SFTs are settled by the end of the business day and that 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<sup>27</sup>.

**Counterparty credit risk**

- S** 14.4 Where a qualifying master netting agreement (MNA)<sup>28</sup> is in place, the current exposure ( $E^*$ ) must be calculated as the greater of–
- (a) zero; and
  - (b) total fair value of securities and cash that the banking institution has provided to the counterparty for all SFTs included in the qualifying MNA ( $\Sigma E_i$ ), less total fair value of cash and securities that the banking institution has received from the counterparty for all SFTs included in the qualifying MNA ( $\Sigma C_i$ ).

This is illustrated in the following formula:

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

- S** 14.5 Where no qualifying MNA is in place, the current exposure ( $E_i^*$ ) must be calculated on a transaction-by-transaction basis (i.e. each transaction  $i$  is treated as its own netting set), as the greater of–
- (a) zero; and
  - (b) total fair value of securities or cash that the banking institution has provided to the counterparty for SFT  $i$  ( $E_i$ ), less total fair value of cash or securities that the banking institution has received from the counterparty for SFT  $i$  ( $C_i$ ).

This is illustrated in the following formula:

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

<sup>27</sup> The failure of any single securities transaction in the settlement mechanism should only delay the settlement of the matching cash leg or create an obligation to the settlement mechanism, supported by an associated credit facility. Where 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 should be split out from the netting set and treated as gross. The criteria in paragraph 14.2(b)(iii) 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 14.2(b)(iii). For example, a settlement mechanism may meet these functional requirements if any failed transactions (i.e. 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.

<sup>28</sup> A qualifying MNA is one that meets the requirements under Appendix 2.

**Question 2**

In respect of your banking institution's reverse repo positions which are not subject to a qualifying MNA, please specify your institution's aggregate counterparty credit risk calculated in accordance with paragraph 14.5.

- S** 14.6 The term “counterparty” in respect of a triparty repo transaction includes reference to a triparty repo agent. As such, in calculating “the total fair value of securities and/or cash provided to the counterparty” ( $\sum E_i$  or  $E_i$ ), a banking institution–
- (a) must include any securities deposited at a triparty repo agent, up to the amount effectively provided to the counterparty in the SFT; and
  - (b) may exclude any excess collateral deposited at a triparty repo agent that has not been provided to the counterparty in the SFT.

**Sales accounting transactions**

- S** 14.7 A banking institution that has achieved sale accounting for any SFT under the accounting framework must reverse any sales-related accounting entries and calculate its SFT exposures in accordance with paragraphs 14.1 (i.e. as if the SFT had been treated as a financing transaction).

**Bank acting as agent**

- S** 14.8 A banking institution acting as an agent that provides an **indemnity or guarantee to one party** in an SFT, must calculate its SFT exposures as follows:
- (a) by applying only paragraph 14.1(b), if the banking institution's guarantee exposure is limited to the difference between–
    - (i) the value of the security or cash its customer has provided; and
    - (ii) the value of the collateral the counterparty has provided, and the banking institution does not control the underlying cash or security; or
  - (b) by applying paragraph 14.1(b) and adding a further exposure equal to the full amount of the underlying security or cash in its SFT exposure, if the banking institution is further economically exposed to the underlying security or cash<sup>29</sup> in the SFT (i.e. beyond the guarantee on the difference).
- S** 14.9 A banking institution that acts as an agent providing an **indemnity or guarantee to both parties** in an SFT, must calculate its SFT exposure separately for each party in accordance with paragraph 14.8.
- G** 14.10 Where a banking institution acting as an agent that **does not provide an indemnity or guarantee to any party** in an SFT, the banking institution need not recognise the SFTs in its exposures.

<sup>29</sup> For example, due to the banking institution managing collateral received in its name or on its own account rather than on the customer's or borrower's account (e.g. 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 banking institution's proprietary assets and the banking institution calculates the exposure on a client-by-client basis.

## 15 Off-balance sheet exposures

- S** 15.1 Subject to paragraph 15.2, a banking institution must calculate its OBS exposures in accordance with the standardised approach for credit risk and the standardised approach for securitisation exposures, as set out in the CAF-RWA or the CAFIB-RWA, as the case may be.
- S** 15.2 In calculating its OBS exposures, a banking institution must–
- (a) apply a credit conversion factor (CCF) of 10% to OBS items that receive a CCF of 0% under the standardised approach for credit risk; and
  - (b) exclude any derivative contract from its OBS exposures, since derivative contracts must be calculated in accordance with paragraph 13.

## 16 Reporting requirements

- S** 16.1 A banking institution must submit to the Bank an electronic copy of its LR report, based on the LR reporting templates, through Statistical Mart for Analysis and Reporting (STATsmart), as follows:

Reporting Level	Reporting Date Position	Reporting Frequency	Reporting Deadline
Entity	End-of-month	Monthly	15 days after month-end
SPI			
Consolidated	End-of-quarter	Quarterly	60 days after quarter-end

In April 2016, the Basel Committee on Banking Supervision (BCBS) issued a consultative document on *Revisions to the Basel III leverage ratio framework*<sup>30</sup> (LR CD). To assist the Bank's assessment on the impact of such enhancements on the Malaysian banking system, the Bank would like to collect the following information relevant to the proposed changes.

**Question 3: Securitisation**

Please specify the size of your institution's on-balance sheet securitisation exposures<sup>31</sup> which meet the Operational Requirements for Capital Relief<sup>32</sup>.

**Question 4: Cash pooling arrangements**<sup>31</sup>

- (a) Please specify the size of your institution's LR Exposures<sup>31</sup> for cash pooling arrangements calculated on gross basis.
- (b) Please specify the size of your institution's LR Exposures<sup>31</sup> for cash pooling arrangements calculated in accordance with paragraph 17 of the LR CD.

**Question 5: Regular way trades of financial assets**

- (a) Please specify whether your institution adopts trade date or settlement date accounting for regular way trades of financial assets.
- (b) For trade date institutions, please specify the size of your institution's LR Exposures<sup>31</sup> for regular way trades of financial assets calculated in accordance with—
  - (i) Option A of paragraph 16 of the LR CD; and
  - (ii) Option B of paragraph 16 of the LR CD.
- (c) For settlement date institutions, please specify the size of your institution's LR Exposures<sup>31</sup> for regular way trades of financial assets calculated in accordance with—
  - (i) Option A of paragraph 9, Annex A of the LR CD; and
  - (ii) Option B of paragraph 9, Annex A of the LR CD.
- (d) Please specify whether your institution will face any challenges in calculating regular way trade exposures according to any of the treatments specified above (e.g. systems enhancements).

<sup>30</sup> <http://www.bis.org/bcbs/publ/d365.pdf>.

<sup>31</sup> As at 30 June 2017. Please specify amounts in thousands ('000) in Ringgit Malaysia.

<sup>32</sup> Cash pooling refers to a treasury product offered to corporate clients which allows corporate groups to combine the credit and debit positions of various accounts into one account.

## APPENDICES

### Appendix 1: “Add-on” Factors for Credit Derivatives

1. The following add-on factors for PFE apply to single-name credit derivatives<sup>33</sup>:

	Protection Buyer	Protection Seller
<b>Total Return Swap</b>		
Investment grade reference obligation	5%	5%
Non-investment grade reference obligation	10%	10%
<b>Credit Default Swap</b>		
Investment grade reference obligation	5%	5%*
Non-investment grade reference obligation	10%	10%*

There will be no difference depending on residual maturity.

Investment grade refers to securities with an external credit rating of BBB+ and above.

\* 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. Add-on should then be capped to the amount of unpaid premiums.

2. Where the credit derivative is a first to default transaction, the add-on will be determined by the lowest credit quality underlying in the basket i.e. if there are any non-investment grade items in the basket, the non-investment grade reference obligation add-on should be used. For second and subsequent to default transactions, underlying assets should continue to be allocated according to the credit quality, i.e. the second lowest credit quality will determine the add-on for a second to default transaction etc.

<sup>33</sup> For purposes of this policy document, these add on factors also apply in respect of index credit default swaps.

## Appendix 2: Qualifying Master Netting Agreement for SFTs

1. The effects of bilateral netting agreements covering SFTs will be recognised on a counterparty-by-counterparty basis if the agreements are legally 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, the netting agreement must–
  - (a) provide the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon event of default, including in the event of insolvency or bankruptcy of the counterparty;
  - (b) provide for the netting of gains and losses in 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 legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of the counterparty's insolvency or bankruptcy, together with the rights arising from the provisions required above.
2. In addition, all repo transactions<sup>34</sup> should be subjected to the Global Master Repurchase Agreement (GMRA) with its relevant annexes that specify all terms of the transaction, duties and obligations between the parties concerned. Banking institutions must also ensure that other requirements specified under the Bank's current guidelines on repo transactions have also been met.
3. Netting across positions in the banking and trading book will only be recognised when the netted SFTs fulfil the following:
  - (a) all SFTs are marked to market daily; and
  - (b) the collateral instruments used in the SFTs are recognised as eligible financial collateral in the banking book.

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<sup>34</sup> This refers to repurchase agreement transactions and reverse repurchase agreement transactions.