Office of the Superintendent of Financial Institutions Canada
Bureau du surintendant des institutions financières Canada

Guideline

Subject: Leverage Requirements Guideline

Effective Date: November 2018/ January 2019[1]

Subsections 485(1) and 949(1) of the *Bank Act* (BA) and subsection 473(1) of the *Trust and Loan Companies Act* (TLCA) and subsection 409(1) of the *Cooperative Credit Associations Act* (CCAA) require banks, bank holding companies, trust and loan companies, and cooperative retail associations, respectively, to maintain adequate capital. The Leverage Requirements Guideline is not made pursuant to subsections 485(2) or 949(2) of the BA, to subsection 473(2) of the TLCA, or to subsection 409(2) of the CCAA. However, the leverage requirements set out in this guideline, together with the capital standards specified in the Capital Adequacy Requirements (CAR) Guideline, provide the framework within which the Superintendent assesses whether a bank or a trust or loan company maintains adequate capital pursuant to the Acts. For this purpose, the Superintendent has established two minimum standards: the leverage ratio described in this Guideline, and the risk-based capital ratio set out in the CAR Guideline. The first test provides an overall measure of the adequacy of an institution's capital. The second measure focuses on risk faced by the institution. Notwithstanding that a bank, bank holding company, a trust and loan company, or cooperative credit association may meet these standards, the Superintendent may direct a bank or bank holding company to increase its capital under subsections 485(3) or 949(3) of the BA, a trust and loan company to increase its capital under subsection 473(3) of the TLCA, or a cooperative retail association to increase its capital under section 409(3) of the CCAA.

OSFI, as a member of the Basel Committee on Banking Supervision, participated in the development of the international leverage ratio framework, *Basel III leverage ratio framework and disclosure requirements* (January 2014), as well as the revisions to the framework under the Basel III reforms in December 2017. This domestic guidance is based on the Basel III leverage ratio framework.

Where relevant, the Basel III leverage ratio framework paragraph numbers are provided in square brackets at the end of each paragraph referencing material from the Basel III leverage ratio framework.

[1] For institutions with a fiscal year ending October 31 or December 31, respectively.

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Overview

1. Outlined below are the leverage requirements for banks (including federal credit unions), bank holding companies, federally regulated trust companies, federally regulated loan companies and cooperative retail associations, collectively referred to as ‘institutions’.

2. Parts of this guideline are drawn from the Basel Committee on Banking Supervision (BCBS) Basel III leverage ratio framework, entitled: *Basel III leverage ratio framework and disclosure requirements* (January 2014), the BCBS *Frequently asked questions on the Basel III leverage ratio framework* (October 2014), and the revised leverage ratio framework set out in *Basel III: Finalizing post-crisis reforms* (December 2017). For reference, the Basel text paragraph numbers and FAQ page numbers that are associated with the text appearing in this guideline are indicated in square brackets at the end of each paragraph[2].

Scope of Application

3. These leverage requirements apply on a consolidated basis and apply to all institutions as defined in paragraph 1 above[3]. The consolidated entity includes all subsidiaries except insurance subsidiaries. This is consistent with the scope of regulatory consolidation used under the risk-based capital framework as set out in Section 1.1 of OSFI’s Capital Adequacy Requirements (CAR) Guideline. [BCBS Jan 2014 par 8]

4. *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 (i.e., 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 15 may be excluded from the leverage ratio exposure measure. [BCBS Jan 2014 par 9]

Calculation of leverage requirements

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

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

[BCBS Jan 2014 par 6]

[2] Following the format: [BCBS Jan 2014 par xx], [BCBS FAQ #x, page x] and [BCBS Dec 2017 par xx]

[3] This includes “institutions” that are subsidiaries of other Federally Regulated Financial Institutions (FRFIs). Foreign bank branches are not subject to this guideline.

Minimum and authorized leverage requirements

6. Institutions are expected to maintain a leverage ratio that meets or exceeds 3% at all times. The Superintendent also prescribes authorized leverage ratio requirements for individual institutions. Authorized leverage ratios are communicated to individual institutions on a bilateral basis. The authorized leverage ratio is considered supervisory information and is not permitted to be disclosed under the *Supervisory Information Regulations*[4].

7. When setting authorized leverage ratios and when assessing whether an increase or a decrease in the institution's authorized leverage ratio is appropriate, OSFI will take into account the following factors:

    - the potential impact of the change in the leverage ratio on the institution's risk-based capital ratios compared to internal targets and OSFI targets;
    - the effectiveness of operational management and oversight functions;
    - the adequacy of capital and liquidity management processes and procedures;
    - the intervention history[5] of the institution;
    - the institution's risk profile and business lines (including diversification of exposures); and
    - the institution's strategic and business plans.

8. Requests for decreases in authorized leverage ratios should be addressed to the Legislation and Approvals Division[6], with a copy to the Lead Supervisor, and should also include a business case that, at a minimum, sets out:

    - the reason why a decrease is requested;
    - financial projections, including growth by business line; and
    - the expected impact of the projected growth on profitability, liquidity, and risk-based capital ratios.

9. As part of its intervention strategy for institutions, OSFI may increase the institution's authorized leverage ratio and, if so, may require the institution to file with OSFI an action plan for achieving the higher authorized level.

Capital Measure

10. The capital measure used for the leverage ratio is the Tier 1 capital of the institution as defined in Chapter 2 of the CAR Guideline. Therefore, 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 capital framework. [BCBS Jan 2014 par 10]

[4] *Supervisory Information (Banks) Regulations*, *Supervisory Information (Trust and Loan Companies) Regulations*, *Supervisory Information (Cooperative Credit Associations) Regulations*

[5] Refer to the *Guide to Intervention for Federal Financial Institutions*.

[6] Managing Director, Approvals and Precedents, approvalsandprecedents@osfi-bsif.gc.ca.

Exposure Measure

11. 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 or general provisions or accounting valuation adjustments (e.g., accounting credit valuation adjustments);
    - netting of loans and deposits is not allowed.

    [BCBS Jan 2014 par 12]

12. Unless specified differently in this guideline, institutions must not take account of physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the exposure measure. [BCBS Jan 2014 par 13]

13. An institution's total exposure measure is the sum of the following exposures: (a) on-balance sheet 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. [BCBS Jan 2014 par 14]

(a) On balance sheet exposures

14. Institutions must include all balance sheet assets in their 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 21 to 38 below. [BCBS Jan 2014 par 15]

15. However, to ensure consistency, balance sheet assets deducted from Tier 1 capital (as set out in section 2.3 of the CAR Guideline) 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 4 of this guideline, 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 institution following the corresponding deduction approach in paragraphs 77 to 83 of Chapter 2 of the CAR Guideline must also be deducted from the exposure measure.
    - For institutions using the internal ratings-based (IRB) approach to determining capital requirements for credit risk, paragraph 62 of Chapter 2 of the CAR Guideline requires any shortfall in the stock of eligible provisions relative to expected losses to be deducted from CET1 capital. The same amount must be deducted from the exposure measure.

    [BCBS Jan 2014 par 16]

16. Liability items must not be deducted from the measure of exposure. For example, gains/losses on fair valued liabilities or accounting valuation adjustments on derivative liabilities due to

changes in the institution’s own credit risk as described in paragraph 64 of the Chapter 2 of the CAR Guideline must not be deducted from the exposure measure. [BCBS Jan 2014 par 17]

17. With regard to traditional securitizations, an originating institution may exclude securitized exposures from its leverage ratio exposure measure if the securitization meets the operational requirements for the recognition of risk transference as set out in paragraph 27 of Chapter 7 of the CAR Guideline. Institutions can also apply the transitional arrangements described in section 7.12 of Chapter 7 of the CAR Guideline. Institutions meeting these conditions must include any retained securitization exposures in their leverage ratio exposure measure. In all other cases (e.g., traditional securitizations that do not meet the operational requirements for the recognition of risk transference or synthetic securitisations), the securitized exposures must be included in the leverage ratio exposure measure unless otherwise instructed by OSFI. [BCBS Dec 2017 par 24]

Specific cases where OSFI guidance has been provided

18. In the case of mortgage whole loan sale transactions having the following characteristics, the balance sheet exposure will be considered to be substantially reduced and the institution will not be required to include sold loans in the exposure measure.

    a) The mortgages are insured by CMHC or a private insurer recognized by the *Protection of Residential Mortgage or Hypothecary Insurance Act*;

    b) The institution has retained the option, not the obligation to repurchase the mortgages at par from the investor at the end of their contractual term.;

    c) The institution may continue to administer and service mortgages for the investor following the sale but the institution is not obligated to advance uncollected mortgage payments on account of delinquent or defaulted mortgages; and

    d) The investor has the right to sell the mortgages to a third party at any time.

19. Mortgages insured as per paragraph 18(a) above for their whole life, that have been pooled and sold as *National Housing Act* Mortgage Backed Securities (NHA MBS or NHA MBS Program) and derecognized under IFRS following a transaction with a third party with respect to the institution’s retained interest in any excess spread, can be excluded from the exposure measure. Such exclusion is subject to the institution obtaining written confirmation from CMHC that CMHC does not object to the institution proceeding with such a transaction or similar transactions. However, recognizing the potential liquidity constraints imposed by the NHA MBS Program on institutions in a stressed environment, institutions must be able to demonstrate alignment with OSFI’s B-6 Liquidity Guideline, Liquidity Adequacy Requirements Guideline, and other liquidity requirements as necessary and/or specified by OSFI. This includes institutions having in place appropriate liquidity plans that demonstrate the management of liquidity risks, including an appropriate laddering of the scheduled maturities for all outstanding NHA MBS and on-going tracking of cash flows against those plans.

20. The grandfathering treatment of mortgages sold through CMHC programs (which includes *National Housing Act* Mortgage-Backed Securities (NHA MBS) and Canada Mortgage Bond (CMB) Programs, as well as Insured Mortgage Purchase Program (IMPP)) permitted under OSFI's March 2010 Advisory *Conversion to International Financial Reporting Standards (IFRSs) by Federally Regulated Entities* where such assets were excluded from OSFI's previous Assets to Capital Multiple (ACM) test is permitted under the leverage ratio.

(b) Derivative exposures

(i) Treatment of derivatives

21. Institutions must calculate their derivative exposures, including where an institution sells protection using a credit derivative, as a scalar, alpha equal to 1.4, multiplied by the sum of the replacement cost (RC)[7] for the current exposure and an add-on for potential future exposure (PFE), as described in section 4.1.6 of the CAR Guideline. The treatment for trades where specific wrong-way risk (SWWR) has been identified under paragraph 148 of Chapter 4 of the CAR Guideline does not apply for purposes of calculating derivative exposures in this Guideline. Instead, the exposure for these trades should be calculated as if SWWR was not present according to section 4.1.6 of Chapter 4 of the CAR Guideline. Written credit derivatives are subject to an additional treatment, as set out in paragraphs 26 to 30 below. [BCBS Jan 2014 par 19]

22. In addition to the treatment in paragraph 21, in the case of cash variation margin *provided* to a counterparty, the posting institution may deduct the resulting receivable from its leverage ratio exposure measure, where the cash variation margin has been recognized as an asset under the institution's operative accounting framework (e.g., IFRS).

(ii) Treatment of clearing services

23. Where an institution acting as clearing member (CM)[8] offers clearing services to clients, the CM's trade exposures[9] to the central counterparty (CCP)[10] that arise when the CM 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 CM, based on the contractual arrangements with the client, is not obligated to reimburse the client for any losses suffered in the event that a QCCP defaults, the CM need not recognize the

[7] If under an institution's national accounting standards, there is no accounting measure of exposure for certain derivative instruments because they are held (completely) off-balance sheet, the institution must use the sum of the positive fair values of these derivatives as the replacement cost. [BCBS Jan 2014 par 19 footnote 6]

[8] For purposes of this paragraph, the terms "clearing member", "trade exposure", "central counterparty" and "qualifying central counterparty" are defined as in section 4.1 of the CAR Guideline. [BCBS December 2017 par 41 footnote 19]

[9] For purposes of paragraphs 23 and 24, "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. [BCBS Jan 2014 par 27 footnote 12]

[10] A central counterparty (CCP) is a clearing house that interposes itself between counterparties to contracts traded in one or more financial markets, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the future performance of open contracts. A CCP becomes counterparty to trades with market participants through novation, an open system, or another legally binding arrangement.

resulting trade exposures to the QCCP in the leverage ratio exposure measure[11]. In addition, where a institution provides clearing services as a “higher level client” within a multi-level client structure[12], the institution need not recognize in its leverage ratio exposure measure the resulting trade exposure to the CM or to an entity that serves as a higher level client to the institution in the leverage ratio exposure measure if it meets all of the following conditions:

- The offsetting transactions are identified by the QCCP as higher level client transactions and collateral to support them is held by the QCCP and/or the CM, as applicable, under arrangements that prevent any losses to the higher level client due to: (i) the default or insolvency of the CM; (ii) the default or insolvency of the CM’s other clients, and (iii) the joint default of insolvency of the CM and any of its other clients;[13]
- The institution must have conducted sufficient legal review (and undertaken such further review as necessary to ensure continuing enforceability) and have a well-founded basis to conclude that, in the event of legal challenge, the relevant courts and administrative authorities would find that such arrangement mentioned above would be legal, valid, binding and enforceable under relevant laws of the relevant jurisdiction(s);
- Relevant laws, regulations, rules, contractual or administrative arrangements provide that the offsetting transactions with the defaulted or insolvent CM are highly likely to continue to be indirectly transacted through the QCCP, or by the QCCP, if the CM defaults or becomes insolvent[14]. In such circumstances, the higher level client positions and collateral with the QCCP will be transferred at market value unless the higher level client requests to close out the position at market value; and
- The institution is not obligated to reimburse its client for any losses suffered in the event of default of either the CM or the QCCP.

[BCBS Dec 2017 par 41]

24. Where a client enters directly into a derivatives transaction with the CCP and the CM guarantees the performance of its clients’ derivative trade exposures to the CCP, the institution acting as the CM for the client to the CCP must *calculate* its related leverage ratio exposure resulting from the guarantee as a derivative exposure as set out in paragraphs 21 to

[11] Where an institution acts as a clearing member and does not guarantee the CCP’s performance to the client, the institution may exclude from the exposure measure the effective notional principal amount of credit protection sold through a credit derivative contract that it clears on behalf of a clearing member client.

[12] A multi-level client structure is one in which institutions can centrally clear as indirect clients; that is, when clearing services are provided to the institution by another institution which is not a direct clearing member, but is itself a client of a clearing member or another clearing client. The term “higher level client” refers to the institution that provides clearing services. [BCBS Dec 2017, par 41, footnote 20]

[13] That is, upon the insolvency of the clearing member, there is no legal impediment (other than the need to obtain a court order to which the client is entitled) to the transfer of the collateral belonging to clients of a defaulting clearing member to the QCCP, to one or more other surviving clearing members or to the client or the client’s nominee. [BCBS Dec 2017, par 41, footnote 21]

[14] If there is clear precedent for transactions being ported at a QCCP and industry intent for this practice to continue, then these factors must be considered when assessing if trades are highly likely to be ported. The fact that QCCP documentation does not prohibit client trades from being ported is not sufficient to say they are highly likely to be ported. [BCBS Dec 2017, par 41, footnote 22]

30 of this guideline, as if the institution had entered directly into the transaction with the client. [BCBS Jan 2014 par 28]

25. An affiliate entity to the institution acting as a CM may be considered a client for the purpose of paragraph 23 and 24 if it is outside the relevant scope of regulatory consolidation at the level at which the leverage ratio is applied as specified in paragraph 4. 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 QCCP, which will be considered *proprietary* and the exemption in paragraph 23 no longer applies. [BCBS FAQ#3, page 3]

(iii) Additional treatment of written credit derivatives

26. In addition to the counterparty credit risk (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. Therefore written credit derivatives will be treated consistently with cash instruments (e.g., loans, bonds) for the purposes of the exposure measure. [BCBS Jan 2014 par 29]

27. In order to capture the credit exposure to the underlying reference entity, in addition to the above CCR treatment for derivatives, the effective notional amount[15] referenced by a written credit derivative is to be included in the exposure measure, unless the written credit derivative is included in a transaction cleared on the behalf of a client of the institution acting as a CM (or acting as a clearing services provider in a multi-level client structure as referenced in paragraph 23) and the transaction meets the requirements of paragraph 23 for the exclusion of trade exposures to the QCCP (or, in the case of a multi-level client structure, the requirements of paragraph 23 for the exclusion of trade exposures to the CM or the QCCP). 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. The resulting amount may be further reduced by the effective notional amount of a purchased credit derivative on the same reference name provided:

    a) the credit protection purchased through credit derivatives is otherwise subject to the same or more conservative material terms as those in the corresponding written credit derivative. This ensures that if an institution provides written protection via some type of credit derivative, the institution may only recognise offsetting from another purchased credit derivative to the extent that the purchased protection is certain to deliver a payment in all potential future states. Material terms include the level of subordination, optionality, credit events, reference and any other characteristics relevant to the valuation of the derivative;[16]

[15] 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. [BCBS Jan 2014 par 30 footnote 13]

[16] For example, the application of the same material terms condition would result in the following treatments:

- 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

b) the remaining maturity of the credit protection purchased is equal to or greater than the remaining maturity of the written credit derivative;

c) The credit protection purchased through credit derivatives is not purchased from a counterparty whose credit quality is highly correlated with the value of the reference obligation in the sense specified in paragraph 73 of Chapter 4 of the CAR Guideline.[17];

d) 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 institution'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

e) 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 institution in its role as a clearing services provider in a multi-level client services structure as referenced in paragraph 23) 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.

[BCBS Dec 2017 par 45]

28. For the purposes of paragraph 27, the term "written credit derivative" refers to a broad range of credit derivatives through which a institution effectively provides credit protection and is not limited solely to credit default swaps and total return swaps. For example, all options where the institution has the obligation to provide credit protection under certain conditions qualify as "written credit derivatives". The effective notional amount of such options sold by the institution may be offset by the effective notional amount of options by which the institution has the right to purchase credit protection which fulfils the conditions of paragraph 28. For example, the condition of same or more conservative material terms as those in the corresponding written credit derivatives as referenced in paragraph 27 can be considered met only when the strike price of the underlying purchased credit protection is equal to or lower than the strike price of the underlying sold credit protection. [BCBS Dec 2017 par 46]

29. For purposes of paragraph 27, 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

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;

- For tranched products, the credit protection purchased through credit derivatives must be on a reference obligation with the same level of seniority. [BCBS Dec 2017 par 45, footnote 25]

[17] Specifically, the credit quality of the counterparty must not be positively correlated with the value of the reference obligation (i.e. the credit quality of the counterparty falls when the value of the reference obligation falls and the value of the purchased credit derivative increases). In making this determination, there does not need to exist a legal connection between the counterparty and the underlying reference entity.

each of the individual names in the pool (this would, for example, be the case if a institution were to purchase credit protection on an entire securitisation structure). If a institution 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. [BCBS Dec 2017 par 47]

30. Since written credit derivatives are included in the exposure measure at their effective notional amounts, and are also subject to add-on amounts for PFE, the exposure measure for written credit derivatives may be overstated. Institutions may therefore choose to exclude from the netting set for the PFE calculation the portion of the written credit derivative which is not offset according to paragraph 27 and whose effective notional amount is included in the exposure measure. 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. [BCBS Dec 2017 par 49]

(c) Securities financing transaction (SFT) exposures

31. SFTs[18] are included in the 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. [BCBS Jan 2014 par 32]

(i) General treatment (institution acting as a principal)

32. Where an institution acts as a principal, the sum of the amounts in subparagraphs (i) and (ii) below are to be included in the leverage ratio exposure measure:

    (i) Gross SFT assets[19] recognised for accounting purposes (i.e., with no recognition of accounting netting),[20] adjusted as follows:

[18] 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. [BCBS Jan 2014 par 32 footnote 18]

[19] For SFT assets subject to novation and cleared through QCCPs, “gross SFT assets recognised for accounting purposes” are replaced by the final contractual exposure, given that pre-existing contracts have been replaced by new legal obligations through the novation process. [BCBS Jan 2014 par 33 footnote 19]

[20] Gross SFT assets recognised for accounting purposes must not recognise any *accounting* netting of cash payables against cash receivables (e.g., as currently permitted under IFRS). This regulatory treatment has the benefit of avoiding inconsistencies from netting which may arise across different accounting regimes. [BCBS Jan 2014 par 33 footnote 20]

- excluding from the exposure measure the value of any securities received under an SFT, where the institution has recognised the securities as an asset on its balance sheet; 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;[21]

  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: (i) default; (ii) insolvency; and (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, all transactions must be settled through the same settlement mechanism and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of all 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[22]. The failure of any single securities transaction in the settlement mechanism should 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 for purposes of total exposures.

(ii) A measure of CCR calculated as the current exposure without an add-on for PFE[23], calculated as follows:

[21] Open maturity secured financing transactions can be treated as overnight maturity provided the institution can demonstrate to OSFI: i) that it can contractually and operationally collapse an open maturity trade on the next business day without incurring legal or reputational risk; and ii) that the trades are priced similarly to overnight trades.

[22] This latter condition ensures that any issues arising from the securities leg do not interfere with the completion of the net settlement of the cash receivables and payables. This criterion is not intended to preclude *a Delivery-versus-Payment* (DvP) settlement mechanism or other type of settlement mechanism, provided that the settlement mechanism meets the functional requirements as set out in this paragraph. For example, a settlement mechanism may meet these functional requirements if any failed transactions (that is, 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. [BCBS Jan 2014 par 33 footnote 22; BCBS FAQ#3, pages 3-4]

[23] The determination of PFE for SFTs under paragraph 66 of Chapter 5 of the CAR Guideline (applicable to those executed under MNAs) and footnote 16 of that chapter (which recapitulates paragraph 29 and is applicable to those transactions not executed under MNAs) requires the institution to apply haircuts to the value of securities

- Where a qualifying master netting agreement (MNA) is in place, the current exposure (E^*) is the greater of zero and the total fair value of securities, gold and cash that the institution has lent, sold subject to repurchase or provided as collateral to the counterparty for all transactions included in the qualifying MNA (ΣEi), less the total fair value of securities, gold and cash that the institution has borrowed, purchased subject to resale or received as collateral from the counterparty for those transactions (ΣCi). This is illustrated in the following formula:

  $$E^* = \max\ \{0, [\Sigma Ei - \Sigma Ci]\}$$

- 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:

  $$Ei^* = \max\ \{0, [Ei - Ci]\}$$

[BCBS Jan 2014 par 33]

(ii) Qualifying master netting agreement[24]

33. The effects of bilateral netting agreements for 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, 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.

    [BCBS Jan 2014 Annex par 12]

and for foreign exchange risk. Since counterparty risk for SFTs for leverage ratio purposes is determined solely by the current exposure portion of the formulas in those paragraphs, no haircuts are needed in the calculation.

[24] The provisions related to qualifying master netting agreements (MNAs) for SFTs are intended for the calculation of the counterparty add-on of the exposure measure of SFTs as set out in paragraph 32 (ii) only. [BCBS Jan 2014 Annex par 12 footnote 33]

34. 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.

    [BCBS Jan 2014 Annex par 13]

(iii) Sale accounting transactions

35. Leverage may remain with the lender of the security in an SFT whether or not sale accounting is achieved under the operative accounting framework (e.g., IFRS). As such, where sale accounting is achieved for an SFT under the institution's operative accounting framework, the institution 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 (i.e., the institution must include the sum of amounts in subparagraphs (i) and (ii) of paragraph 32 for such an SFT) for the purposes of determining its exposure measure. Forward purchase agreements or forward sale agreements treated as derivative contracts that are part of SFTs that qualify for sale accounting treatment under IFRS may be excluded from the exposure measure. [BCBS Jan 2014 Annex par 34]

(iv) Institution acting as an agent providing an indemnity for credit risk

36. An institution 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 institution 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 institution is one of the principals in the transaction). Where the institution does not own/control the underlying cash or security resource, that resource cannot be leveraged by the institution. [BCBS Jan 2014 par 35]

37. Where an institution 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 institution will be required to calculate its exposure measure by applying only subparagraph (ii) of paragraph 32.[25] [BCBS Jan 2014 par 36]

38. An institution 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 37 *only* if the institution's exposure to the transaction is limited to the guaranteed

[25] Where, in addition to the conditions in paragraphs 36 to 38, an institution acting as an agent in an SFT does not provide an indemnity or guarantee to any of the involved parties, the institution is not exposed to the SFT and therefore need not recognise those SFTs in its exposure measure. [BCBS Jan 2014 par 36, footnote 24]

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 institution is further economically exposed (i.e., beyond the guarantee for the difference) to the underlying security or cash in the transaction, a further exposure equal to the full amount of the security or cash must be included in the exposure measure. For example, due to the institution managing collateral received in the institution's 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). [BCBS Jan 2014 par 37]

(d) Off balance sheet exposures

39. For the purpose of the leverage ratio, off balance sheet (OBS) items will be converted into credit exposure equivalents by applying credit conversion factors (CCFs) to the notional amount of the exposure. The amount after applying the applicable CCF will be included in the exposure measure. Institutions should refer to section 3.2 of the CAR Guideline for a more detailed description of off balance sheet items. [BCBS Jan 2014 Annex par 14]

40. 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 institution without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, will receive a 10% CCF. Retail commitments are considered unconditionally cancellable if the terms permit the institution to cancel them to the full extent allowable under consumer protection and related legislation. [BCBS Jan 2014 Annex par 15]

41. Direct credit substitutes, e.g., 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%. [BCBS Jan 2014 Annex par 16]

42. Forward asset purchases, forward forward deposits and partly paid shares and securities, which represent commitments with certain drawdown, will receive a CCF of 100%. [BCBS Jan 2014 Annex par 17]

43. Certain transaction-related contingent items (e.g., performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) will receive a CCF of 50%. [BCBS Jan 2014 Annex par 18]

44. Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) will receive a CCF of 50%. [BCBS Jan 2014 Annex par 19]

45. For short-term self-liquidating trade letters of credit arising from the movement of goods (e.g., documentary credits collateralised by the underlying shipment), a 20% CCF will be applied to both issuing and confirming institutions. [BCBS Jan 2014 Annex par 20]

46. Where there is an undertaking to provide a commitment on an OBS item, institutions are to apply the lower of the two applicable CCFs. [BCBS Jan 2014 Annex par 21]

47. All off-balance sheet securitisation exposures, except an eligible servicer cash advance facility as set out in paragraph 43 of Chapter 7 of the CAR Guideline, will receive a CCF of 100% conversion factor. Undrawn servicer cash advances or facilities that are unconditionally cancellable without prior notice are eligible for a 10% CCF.
[BCBS Jan 2014 Annex par 22]