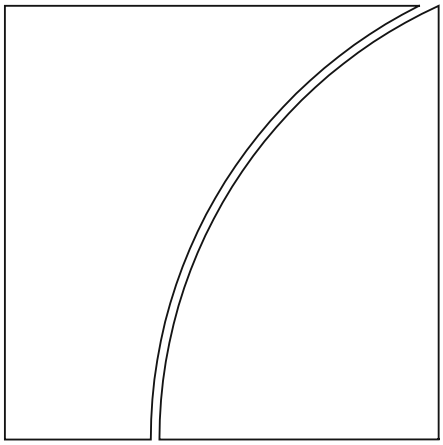
Basel Committee
on Banking Supervision



Basel III leverage ratio framework and disclosure requirements

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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 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. This document sets out the Basel III leverage ratio framework, along with the public disclosure requirements applicable as from 1 January 2015. These requirements supersede those in Section V of *Basel III: A global regulatory framework for more resilient banks and banking systems*.[1]

Definition and minimum requirement

6. 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:

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

7. 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.

[1] 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.

Scope of consolidation

8. The Basel III leverage ratio framework follows the same scope of regulatory consolidation as is used for the risk-based capital framework. This is set out in Part I (Scope of Application) of the Basel II framework.[2]

9. *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 may be excluded from the leverage ratio exposure measure.

Capital measure

10. 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,[3] 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. 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.

13. Unless specified differently below, banks must not take account of physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the exposure measure.

14. A bank'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.

[2] Available at www.bis.org/publ/bcbs128.pdf.

[3] Available at www.bis.org/publ/bcbs189.htm.

(a) On-balance sheet exposures

15. Banks 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 18 to 37 below.[4]

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. Liability items must not be deducted from the 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 exposure measure.

(b) Derivative exposures

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

19. Banks must calculate their derivative exposures,[5] including where a bank sells protection using a credit derivative, as the replacement cost (RC)[6] for the current exposure plus an add-on for potential future exposure (PFE), as described in paragraph 20. If the derivative exposure is covered by an eligible bilateral netting contract as specified in the Annex, an alternative treatment may be applied.[7] Written credit derivatives are subject to an additional treatment, as set out in paragraphs 29 to 31 below.

[4] 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.

[5] 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.

[6] 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.

[7] 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 is not permitted in determining the leverage ratio exposure measure).

20. For a single derivative exposure not covered by an eligible bilateral netting contract as specified in paragraphs 8 and 9 of the Annex, the amount to be included in the exposure measure is determined as follows:

exposure measure = replacement cost (RC) + add-on

where

RC = the replacement cost of the contract (obtained by marking to market), where the contract has a positive value.

add-on = 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.

21. *Bilateral netting*: when an eligible bilateral netting contract is in place as specified in paragraphs 8 and 9 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_{Net} as calculated in paragraph 10 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. C*ollateral received* in connection with derivative contracts does not necessarily reduce the leverage inherent in a bank's derivatives 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 exposure amount by any collateral received from the counterparty.

24. Similarly, with regard to *collateral provided*, banks must gross up their 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, the cash portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment, if the following conditions are met:

(i) For trades not cleared through a *qualifying* central counterparty (QCCP) [8] the cash received by the recipient counterparty is not segregated.

(ii) Variation margin is calculated and exchanged on a daily basis based on mark-to-market valuation of derivatives positions.

(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.

[8] A QCCP is 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 as amended.

(v) Derivatives transactions and variation margins are covered by a single master netting agreement (MNA)[9,10] 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 in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency.

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) 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.
- 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.

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)[11] offers clearing services to clients, the clearing member's trade exposures[12] 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, 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 need not recognise the resulting trade exposures to the QCCP in the leverage ratio exposure measure.

28. 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 bank acting as the clearing member 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 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. *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

[9] A Master MNA may be deemed to be a single MNA for this purpose.

[10] 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.

[11] For the purposes of this paragraph, a clearing member (CM) is 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 as amended.

[12] 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.

written credit derivatives consistently with cash instruments (eg loans, bonds) for the purposes of the exposure measure.

30. 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[13] referenced by a written credit derivative is to be included in the exposure measure. 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,[14, 15] provided:

- the credit protection purchased 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;[16] and
- the remaining maturity of the credit protection purchased is equal to or greater than the remaining maturity of the written credit derivative.

31. 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. 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.[17]

[13] 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.

[14] 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 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.

[15] 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.

[16] For tranched products, the purchased protection must be on a reference obligation with the same level of seniority.

[17] 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.

(c) Securities financing transaction exposures

32. 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.

33. *General treatment (bank acting as 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 (ie with no recognition of accounting netting),[20] adjusted as follows:

- excluding from the 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;[21] 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;

  (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, 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.[22]

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

- Where a qualifying MNA[23] 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

[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.

[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.

[20] 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.

[21] 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.

[22] 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.

[23] A "qualifying" MNA is one that meets the requirements under paragraphs 12 and 13 of the Annex.

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:

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

34. *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 for such an SFT) for the purposes of determining its exposure measure.

35. *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. 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 exposure measure by applying only subparagraph (ii) of paragraph 33. [24]

37. 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 *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) to the underlying security or cash in the transaction,[25] a further exposure equal to the full amount of the security or cash must be included in the exposure measure.

(d) Off-balance sheet items

38. This section explains the incorporation of OBS items as defined in the Basel II framework 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. 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

[24] Where, in addition to the conditions in paragraphs 35 to 37, 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 exposure measure.

[25] 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).

determining the exposure amount of OBS items for the leverage ratio, the CCFs set out in paragraphs 14 to 22 of the Annex must be applied to the notional amount.[26]

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:

- 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.[27] As the leverage ratio is an

[26] 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.

[27] For the relevant Pillar 3 disclosure requirements, see paragraph 818 of the Basel II framework.

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, 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.[28]

(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;

[28] 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.

- 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

	Item	In relevant currency
1	Total consolidated assets as per published financial statements	
2	Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	
3	Adjustment for fiduciary assets recognised on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure	
4	Adjustments for derivative financial instruments	
5	Adjustment for securities financing transactions (ie repos and similar secured lending)	
6	Adjustment for off-balance sheet items (ie conversion to credit equivalent amounts of off-balance sheet exposures)	
7	Other adjustments	
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

	Item	Leverage ratio framework
	On-balance sheet exposures	
1	On-balance sheet items (excluding derivatives and SFTs, but including collateral)	
2	(Asset amounts deducted in determining Basel III Tier 1 capital)	
3	**Total on-balance sheet exposures** (excluding derivatives and SFTs) (sum of lines 1 and 2)	
	Derivative exposures	
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	
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)	
11	**Total derivative exposures (sum of lines 4 to 10)**	
	Securities financing transaction exposures	
12	Gross SFT *assets* (with no recognition of netting), after adjusting for sale accounting transactions	
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	
14	CCR exposure for SFT assets	
15	Agent transaction exposures	
16	**Total securities financing transaction exposures (sum of lines 12 to 15)**	
	Other off-balance sheet exposures	
17	Off-balance sheet exposure at gross notional amount	
18	(Adjustments for conversion to credit equivalent amounts)	
19	**Off-balance sheet items (sum of lines 17 and 18)**	
	Capital and total exposures	
20	**Tier 1 capital**	
21	**Total exposures (sum of lines 3, 11, 16 and 19)**	
	Leverage ratio	
22	**Basel III leverage ratio**	

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

Row number	Explanation
1	On-balance sheet assets according to paragraph 15.
2	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.
3	Sum of lines 1 and 2.
4	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.
5	Add-on amount for all derivative exposures according to paragraphs 19–21.
6	Grossed-up amount for collateral provided according to paragraph 24.
7	Deductions of receivables assets from cash variation margin provided in derivatives transactions according to paragraph 26, reported as negative amounts.
8	Exempted trade exposures associated with the CCP leg of derivatives transactions resulting from client-cleared transactions according to paragraph 27, reported as negative amounts.
9	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.
10	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.
11	Sum of lines 4–10.
12	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.
13	Cash payables and cash receivables of gross SFT assets netted according to paragraph 33 (i), reported as negative amounts.
14	Measure of counterparty credit risk for SFTs as determined by paragraph 33 (ii).
15	Agent transaction exposure amount determined according to paragraphs 35 to 37.
16	Sum of lines 12–15.
17	Total off-balance sheet exposure amounts on a gross notional basis, before any adjustment for credit conversion factors according to paragraph 39.
18	Reduction in gross amount of off-balance sheet exposures due to the application of credit conversion factors in paragraph 39.
19	Sum of lines 17 and 18.
20	Tier 1 capital as determined by paragraph 10.
21	Sum of lines 3, 11, 16 and 19.
22	Basel III leverage ratio according to paragraph 54.

58. In general, to ensure that the summary comparison table, common disclosure template and explanatory table[29] 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,

[29] Individual banks need not disclose the explanatory table.

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, 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 provisions applicable for the purposes of calculating the leverage ratio.

Derivative exposures

Add-on factors for determining potential future exposure

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

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

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:

	Protection buyer	Protection seller
Total return swaps		
"Qualifying" reference obligation	5%	5%
"Non-qualifying" reference obligation	10%	10%
Credit default swaps		
"Qualifying" reference obligation	5%	5%**
"Non-qualifying" reference obligation	10%	10%**

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[30] by at least two credit rating agencies specified by the national authority; or
- 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. For the purposes of the leverage ratio, the following will apply:

[30] Eg rated Baa or higher by Moody's and BBB or higher by Standard & Poor's.

(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 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;[31] 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. Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating the leverage ratio requirements 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[32]

[31] 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.

[32] 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

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[33]

12. *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 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. 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 items

14. For the purpose of the leverage ratio, OBS items will be converted into credit exposure equivalents through the use of credit conversion factors (CCFs).

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.

[33] 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 33 (ii) only.

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.[34]

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 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%.

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.

[34] 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.