Attachment # 1

SAMA's General Guidance concerning Amended LCR

A. **Introduction**

Saudi banks should complete the Amended LCR Prudential return in accordance with the following:

1. General Guidance Notes
2. Specific Guidance Notes
3. Prudential Return
4. Frequently Asked Questions (FAQs)
5. National Discretion

Please note that all revisions have been shaded in the above document.

For the ease of implementation, SAMA has used reference to paras in the BCBS document of January 2013. For example para 16 on page 2 of this document is adopted from para 16 of the BCBS document.

SAMA's General Guidance

1. **Background and Frequency of Reporting**

SAMA wishes to continue monitoring the LCR and NSFR Global Liquidity Ratios where for LCR, it will be on the basis of the Amended LCR package being implemented through this circular, and NSFR will continue to be on the basis of SAMA's circular of 8 February, 2012.

These guidance notes are built under the current BCBS regime of LCR as agreed in the GHOS meeting of January, 2013. In this regard, the following documents were issued in January 2013 and approved by the BCBS.

- A GHOS Press Release was issued entitled "Group of Governors and Heads of Supervision endorses revised liquidity standard for banks" of January 2013
- A BCBS document entitled "Basel III: The Liquidity Coverage Ratio and Liquidity Monitoring Tool".

The attached Guidance Notes and Prudential returns are based on the most recent Basle QIS package, and it should be noted that the attached SAMA Prudential returns contains a column entitled "Paragraph in document". This is reference to the paragraph in the BCBS document of January 2013 entitled "Basle III: Liquidity Coverage Ratio and Liquidity Monitoring tools" which can be obtained from the BIS website: www.bis.org.

1A). Objective of LCR and use of HQLA

16. This standard aims to ensure that a bank has an adequate stock of unencumbered HQLA that consists of cash or assets that can be converted into cash at little or no loss of value in private markets, to meet its liquidity needs for a 30 calendar day liquidity stress scenario. At a minimum, the stock of unencumbered HQLA should enable the bank to survive until Day 30 of the stress scenario, by which time it is assumed that appropriate corrective actions can be taken by management and supervisors (SAMA), or that the bank can be resolved in an orderly way. Furthermore, it gives the central bank additional time to take appropriate measures, should they be regarded as necessary. As

noted in the Sound Principles, given the uncertain timing of outflows and inflows, banks are also expected to be aware of any potential mismatches within the 30-day period and ensure that sufficient HQLA are available to meet any cash flow gaps throughout the period.

17. The LCR builds on traditional liquidity "coverage ratio" methodologies used internally by banks to assess exposure to contingent liquidity events. The total net cash outflows for the scenario are to be calculated for 30 calendar days into the future. The standard requires that, absent a situation of financial stress, the value of the ratio be no lower than 100%. The 100% threshold is the minimum requirement absent a period of financial stress, and after the phase-in arrangements are complete. References to 100% may be adjusted for any phase-in arrangements in force (The 100% threshold is the minimum requirement absent a period of financial stress, and after the phase-in arrangements are complete.) I.e. the stock of HQLA should at least equal total net cash outflows, on an ongoing basis because the stock of unencumbered HQLA is intended to serve as a defense against the potential onset of liquidity stress. During a period of financial stress, however, banks may use their stock of HQLA, thereby falling below 100%, as maintaining the LCR at 100% under such circumstances could produce undue negative effects on the bank and other market participants. SAMA will subsequently assess this situation and will adjust their response flexibly according to the circumstances.

18. SAMA's decisions regarding a bank's use of its HQLA should be guided by consideration of the core objective and definition of the LCR. SAMA would exercise judgment in their assessment and account not only for prevailing macro financial conditions, but also consider forward-looking assessments of macroeconomic and financial conditions. In determining a response, SAMA is aware that some actions could be pro-cyclical if applied in circumstances of market-wide stress. SAMA would seek to take these considerations into account on a consistent basis across jurisdictions, where considered pertinent.

(a) SAMA would assess conditions at an early stage, and take actions if deemed necessary, to address potential liquidity risk.

(b) SAMA would allow for differentiated responses to a reported LCR below 100%. Any potential supervisory response would be proportionate with the drivers, magnitude, duration and frequency of the reported shortfall.

(c) SAMA would assess a number of firm- and market-specific factors in determining the appropriate response as well as other considerations related to both domestic and global frameworks and conditions. Potential considerations include, but are not limited to: (i) The reason(s) that the LCR fell below 100%. This includes use of the stock of HQLA, an inability to roll over funding or large unexpected draws on contingent obligations. In addition, the reasons may relate to overall credit, funding and market conditions, including liquidity in credit, asset and funding markets, affecting individual banks or all institutions, regardless of their own condition; (ii) The extent to which the reported decline in the LCR is due to a firm-specific or market-wide shock; (iii) A bank's overall health and risk profile, including activities, positions with

respect to other supervisory requirements, internal risk systems, controls and other management processes, among others; (iv) The magnitude, duration and frequency of the reported decline of HQLA; (v) The potential for contagion to the financial system and additional restricted flow of credit or reduced market liquidity due to actions to maintain an LCR of 100%;
(vi) The availability of other sources of contingent funding such as central bank funding,(The Sound Principles require that a bank develop a Contingency Funding Plan (CFP) that clearly sets out strategies for addressing liquidity shortfalls, both firm-specific and market-wide situations of stress. A CFP should, among other things, "reflect central bank lending programs and collateral requirements, including facilities that form part of normal liquidity management operations, e.g. the availability of seasonal credit)" or other actions by prudential authorities.

(d) SAMA has a range of tools/ options at their disposal to address a reported LCR below 100%, Banks may use their stock of HQLA in both idiosyncratic and systemic stress events, although the supervisory response may differ between the two. (i) At a minimum, a bank should present an assessment of its liquidity position, including the factors that contributed to its LCR falling below 100%, the measures that have been and will be taken and the expectations on the potential length of the situation. Enhanced reporting to SAMA should be commensurate with the duration of the shortfall. (ii) If appropriate, SAMA could also require actions by a bank to reduce its exposure to liquidity risk, strengthen its overall liquidity risk management, or improve its contingency funding plan. (iii) However, in a situation of sufficiently severe system-wide stress, effects on the entire financial system should be considered. Potential measures to restore liquidity levels should be discussed, and should be executed over a period of time considered appropriate to prevent additional stress on the bank and on the financial system as a whole.

(e) SAMA's responses should be consistent with the overall approach to the prudential framework.

1B) Definition of the LCR

19. The scenario for this standard entails a combined idiosyncratic and market-wide shock that would result in:

(a) The run-off of a proportion of retail deposits;

(b) A partial loss of unsecured wholesale funding capacity;

(c) A partial loss of secured, short-term financing with certain collateral and counterparties;

(d) Additional contractual outflows that would arise from a downgrade in the bank's public credit rating by up to and including three notches, including collateral posting requirements;

(e) Increases in market volatilities that impact the quality of collateral or potential future exposure of derivative positions and thus require larger collateral haircuts or additional collateral, or lead to other liquidity needs;

(f) Unscheduled draws on committed but unused credit and liquidity facilities that the bank has provided to its clients; and

(g) The potential need for the bank to buy back debt or honor non-contractual obligations in the interest of mitigating reputational risk.

20. In summary, the stress scenario specified incorporates many of the shocks experienced during the crisis that started in 2007 into one significant stress scenario for which a bank would need sufficient liquidity on hand to survive for up to 30 calendar days.

21. This stress test should be viewed as a minimum supervisory requirement for banks. Banks are expected to conduct their own stress tests to assess the level of liquidity they should hold beyond this minimum, and construct their own scenarios that could cause difficulties for their specific business activities. Such internal stress tests should incorporate longer time horizons than the one mandated by this standard. Banks are expected to share the results of these additional stress tests with SAMA.

22. The LCR has two components:

(a) Value of the stock of HQLA in stressed conditions; and

(b) Total net cash outflows, calculated according to the scenario parameters outlined below.

Stock of HQLA/ Total net cash outflows over the next 30 calendar days ≥ 100%

Stock of HQLA

23. The numerator of the LCR is the “stock of HQLA”. Under the standard, banks must hold a stock of unencumbered HQLA to cover the total net cash outflows (as defined below) over a 30-day period under the prescribed stress scenario. In order to qualify as “HQLA”, assets should be liquid in markets during a time of stress and, ideally, be central bank eligible. The following sets out the characteristics that such assets should generally possess and the operational requirements that they should satisfy. (Refer to the sections on “Definition of HQLA” and “Operational requirements” for the characteristics that an asset must meet to be part of the stock of HQLA and the definition of “unencumbered” respectively.)

Characteristics of HQLA

24. Assets are considered to be HQLA if they can be easily and immediately converted into cash at little or no loss of value. The liquidity of an asset depends

on the underlying stress scenario, the volume to be monetized and the timeframe considered. Nevertheless, there are certain assets that are more likely to generate funds without incurring large discounts in sale or repurchase agreement (repo) markets due to fire-sales even in times of stress. This section outlines the factors that influence whether or not the market for an asset can be relied upon to raise liquidity when considered in the context of possible stresses. These factors should assist supervisors in determining which assets, despite meeting the criteria from paragraphs 49 to 54 of BCBS LCR Guidelines, 2013, are not sufficiently liquid in private markets to be included in the stock of HQLA.

(i) Fundamental characteristics

• **Low risk:** assets that are less risky tend to have higher liquidity. High credit standing of the issuer and a low degree of subordination increase an asset's liquidity. Low duration, (Footnote: Duration measures the price sensitivity of a fixed income security to changes in interest rate.) low legal risk, low inflation risk and denomination in a convertible currency with low foreign exchange risk all enhance an asset's liquidity.

• **Ease and certainty of valuation:** an asset's liquidity increases if market participants are more likely to agree on its valuation. Assets with more standardized, homogenous and simple structures tend to be more fungible, promoting liquidity. The pricing formula of a high-quality liquid asset must be easy to calculate and not depend on strong assumptions. The inputs into the pricing formula must also be publicly available. In practice, this should rule out the inclusion of most structured or exotic products.

• **Low correlation with risky assets:** the stock of HQLA should not be subject to wrong-way (highly correlated) risk. For example, assets issued by financial institutions are more likely to be illiquid in times of liquidity stress in the banking sector.

• **Listed on a developed and recognized exchange:** being listed increases an asset's transparency.

(ii) Market-related characteristics

• Active and sizable market: the asset should have active outright sale or repo markets at all times. This means that:

− There should be historical evidence of market breadth and market depth. This could be demonstrated by low bid-ask spreads, high trading volumes, and a large and diverse number of market participants. Diversity of market participants reduces market concentration and increases the reliability of the liquidity in the market.

− There should be robust market infrastructure in place. The presence of multiple committed market makers increases liquidity as quotes will most likely be available for buying or selling HQLA.

• **Low volatility:** Assets whose prices remain relatively stable and are less prone to sharp price declines over time will have a lower probability of triggering forced sales to meet liquidity requirements. Volatility of traded prices and spreads are simple proxy measures of market volatility. There should be historical evidence of relative stability of market terms (e.g. prices and haircuts) and volumes during stressed periods.

• **Flight to quality:** historically, the market has shown tendencies to move into these types of assets in a systemic crisis. The correlation between proxies of market liquidity and banking system stress is one simple measure that could be used.

Note: By large, deep and active markets, SAMA understands that the relevant instrument should be at least repo-able with the Central banks and preferably other regulated entities

25. As outlined by these characteristics, the test of whether liquid assets are of "high quality" is that, by way of sale or repo, their liquidity-generating capacity is assumed to remain intact even in periods of severe idiosyncratic and market stress. Lower quality assets typically fail to meet that test. An attempt by a bank to raise liquidity from lower quality assets under conditions of severe market stress would entail acceptance of a large fire-sale discount or haircut to compensate for high market risk. That may not only erode the market's confidence in the bank, but would also generate mark-to-market losses for banks holding similar instruments and add to the pressure on their liquidity position, thus encouraging further fire sales and declines in prices and market liquidity. In these circumstances, private market liquidity for such instruments is likely to disappear quickly.

26. HQLA (except Level 2B assets as defined below) should ideally be eligible at central banks (In most jurisdictions, HQLA should be central bank eligible in addition to being liquid in markets during stressed periods. In jurisdictions where central bank eligibility is limited to an extremely narrow list of assets, SAMA may allow unencumbered, non-central bank eligible assets that meet the qualifying criteria for Level 1 or Level 2 assets to count as part of the stock - see Definition of HQLA beginning from paragraph 45) for intraday liquidity needs and overnight liquidity facilities. In the past, central banks have provided a further backstop to the supply of banking system liquidity under conditions of severe stress. Central bank eligibility should thus provide additional confidence that banks are holding assets that could be used in events of severe stress without damaging the broader financial system. That in turn would raise confidence in the safety and soundness of liquidity risk management in the banking system.

27. It should be noted however, that central bank eligibility does not by itself constitute the basis for the categorization of an asset as HQLA.

Operational Requirement

28. All assets in the stock of HQLA are subject to the following operational requirements. The purpose of the operational requirements is to recognize that not all assets outlined in paragraphs 49-54 of BCBS LCR Guidelines 2013 that meet the asset class, risk-weighting and credit-rating criteria should be eligible for the stock as there are other operational restrictions on availability of HQLA that can prevent timely monetization during a stress period.

29. These operational requirements are designed to ensure that the stock of HQLA is managed in such a way that the bank can, and is able to demonstrate that it can, immediately use the stock of assets as a source of contingent funds that is available for the bank to convert into cash through outright sale or repo, to fill funding gaps between cash inflows and outflows at any time during the 30-day stress period, with no restriction on the use of the liquidity generated.

30. A bank should periodically monetize a representative proportion of the assets in the stock through repo or outright sale, in order to test its access to the market, the effectiveness of its processes for monetization, the availability of the assets, and to minimize the risk of negative signaling during a period of actual stress.

31. All assets in the stock should be unencumbered. “Unencumbered” means free of legal, regulatory, contractual or other restrictions on the ability of the bank to liquidate, sell, transfer, or assign the asset. An asset in the stock should not be pledged (either explicitly or implicitly) to secure, collateralize or credit-enhance any transaction, nor be designated to cover operational costs (such as rents and salaries). Assets received in reverse repo and securities financing transactions that are held at the bank, have not been re- hypothecated, and are legally and contractually available for the bank's use can be considered as part of the stock of HQLA. In addition, assets which qualify for the stock of HQLA that have been pre-positioned or deposited with, or pledged to, the central bank or a public sector entity (PSE) but have not been used to generate liquidity may be included in the stock. (If a bank has deposited, pre-positioned or pledged Level 1, Level 2 and other assets in a collateral pool and no specific securities are assigned as collateral for any transactions, it may assume that assets are encumbered in order of increasing liquidity value in the LCR, i.e. assets ineligible for the stock of HQLA are assigned first, followed by Level 2B assets, then Level 2A and finally Level 1. This determination must be made in compliance with any requirements, such as concentration or diversification, of the central bank or PSE.)

32. A bank should exclude from the stock those assets that, although meeting the definition of “unencumbered” specified in paragraph 31 BCBS LCR Guidelines, 2013, the bank would not have the operational capability to monetize to meet outflows during the stress period. Operational capability to monetize assets requires having procedures and appropriate systems in place, including providing the function identified in paragraph 33 BCBS LCR Guidelines, 2013, with access to all necessary information to execute monetization of any asset at any time. Monetization of the asset must be executable, from an operational perspective, in the standard settlement period for the asset class in the relevant jurisdiction.

33. The stock should be under the control of the function charged with managing the liquidity of the bank (e.g. the treasurer), meaning the function has the continuous authority, and legal and operational capability, to monetize any asset in the stock. Control must be evidenced either by maintaining assets in a separate pool managed by the function with the sole intent for use as a source of contingent funds, or by demonstrating that the function can monetize the asset at any point in the 30-day stress period and that the proceeds of doing so are available to the function throughout the 30-day stress period without directly conflicting with a stated business or risk management strategy. For example, an asset should not be included in the stock if the sale of that asset, without replacement throughout the 30-day period, would remove a hedge that would create an open risk position in excess of internal limits.

34. A bank is permitted to hedge the market risk associated with ownership of the stock of HQLA and still include the assets in the stock. If it chooses to hedge the market risk, the bank should take into account (in the market value applied to each asset) the cash outflow that would arise if the hedge were to be closed out early (in the event of the asset being sold).

35. In accordance with Principle 9 of the Sound Principles a bank “should monitor the legal entity and physical location where collateral is held and how it may be mobilized in a timely manner”. Specifically, it should have a policy in place that identifies legal entities, geographical locations, currencies and specific custodial or bank accounts where HQLA are held. In addition, the bank should determine whether any such assets should be excluded for operational reasons and therefore, have the ability to determine the composition of its stock on a daily basis.

36. As noted in paragraphs 171 and 172, BCBS LCR Guidelines, 2013, qualifying HQLA that are held to meet statutory liquidity requirements at the legal entity or sub-consolidated level (where applicable) may only be included in the stock at the consolidated level to the extent that the related risks (as measured by the legal entity’s or sub-consolidated group’s net cash outflows in the LCR) are also reflected in the consolidated LCR. Any surplus of HQLA held at the legal entity can only be included in the consolidated stock if those assets would also be freely available to the consolidated (parent) entity in times of stress.

37. In assessing whether assets are freely transferable for regulatory purposes, banks should be aware that assets may not be freely available to the consolidated entity due to regulatory, legal, tax, accounting or other impediments. Assets held in legal entities without market access should only be included to the extent that they can be freely transferred to other entities that could monetize the assets.

38. In certain jurisdictions, large, deep and active repo markets do not exist for eligible asset classes, and therefore such assets are likely to be monetized through outright sale. In these circumstances, a bank should exclude from the stock of HQLA those assets where there are impediments to sale, such as large fire-sale discounts which would cause it to breach minimum solvency requirements, or requirements to hold such assets, including, but not limited to, statutory minimum inventory requirements for market making.

39. Banks should not include in the stock of HQLA any assets, or liquidity generated from assets, they have received under right of rehypothecation, if the beneficial owner has the contractual right to withdraw those assets during the 30-day stress period. (Refer to paragraph 146 for the appropriate treatment if the contractual withdrawal of such assets would lead to a short position - e.g. because the bank had used the assets in longer-term securities financing transactions).

40. Assets received as collateral for derivatives transactions that are not segregated and are legally able to be rehypothecated may be included in the stock of HQLA provided that the bank records an appropriate outflow for the associated risks as set out in paragraph 116 BCBS LCR Guidelines, 2013.

41. As stated in Principle 8 of the Sound Principles, a bank should actively manage its intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions and thus contribute to the smooth functioning of payment and settlement systems. Banks and regulators should be aware that the LCR stress scenario does not cover expected or unexpected intraday liquidity needs.

42. While the LCR is expected to be met and reported in a single currency, banks are expected to be able to meet their liquidity needs in each currency and maintain HQLA consistent with the distribution of their liquidity needs by currency. The bank should be able to use the stock to generate liquidity in the currency and jurisdiction in which the net cash outflows arise. As such, the LCR by currency is expected to be monitored and reported to allow the bank and SAMA to track any potential currency mismatch issues that could arise, as outlined in Part 2. In managing foreign exchange liquidity risk, the bank should take into account the risk that its ability to swap currencies and access the relevant foreign exchange markets may erode rapidly under stressed conditions. It should be aware that sudden, adverse exchange rate movements could sharply widen existing mismatched positions and alter the effectiveness of any foreign exchange hedges in place.

43. In order to mitigate cliff effects that could arise, if an eligible liquid asset became ineligible (e.g. due to rating downgrade), a bank is permitted to keep such assets in its stock of liquid assets for an additional 30 calendar days. This would allow the bank additional time to adjust its stock as needed or replace the asset.

Diversification of the stock of HQLA

44. The stock of HQLA should be well diversified within the asset classes themselves (except for sovereign debt of the bank's home jurisdiction or from the jurisdiction in which the bank operates; central bank reserves; central bank debt securities; and cash). Although some asset classes are more likely to remain liquid irrespective of circumstances, ex-ante it is not possible to know with certainty which specific assets within each asset class might be subject to shocks ex-post. Banks should therefore have policies and limits in place in order to avoid concentration with respect to asset types, issue and issuer types, and currency (consistent with the distribution of net cash outflows by currency) within asset classes.

(Refer to Paragraph 16-44 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

2. Frequency and Timing

With regard to submission of the attached Prudential return (Amended LCR), all Banks (except foreign bank's branches) will be expected to provide their returns to SAMA on a monthly basis to be due 30 days following each month end. However, given the significant changes in the amended LCR calculations, SAMA will provide additional time for banks for their first set of Prudential returns. This is in order to introduce the necessary systems changes and enhancements. Consequently, the first submission of prudential returns for data as of 30 June 2013 should be provided by 30 September 2013 while all subsequent monthly submissions are to be provided within 30 days following each month end.

All reporting will be as per the attached Prudential Returns in SR 000's.

3. Summary of Major Requirement and Changes in the amended LCR

3.1 Graduated approach

10. Specifically, the LCR will be introduced as planned on 1 January 2015, but the minimum requirement will be set at 60% and rise in equal annual steps to reach 100% on 1 January 2019. This graduated approach, coupled with the revisions made to the 2010 publication of the liquidity standards are designed to ensure that the LCR can be introduced without material disruption to the orderly strengthening of banking systems or the ongoing financing of economic activity.

	1 January 2015	1 January 2016	1 January 2017	1 January 2018	1 January 2019
Minimum LCR	60%	70%	80%	90%	100%

11. The Basel Committee and SAMA affirms their view that, during periods of stress, it would be entirely appropriate for banks to use their stock of HQLA, thereby falling below the minimum. SAMA will subsequently assess this situation and will give guidance on usability according to circumstances.

(Refer to Paragraph 11 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

3.2 **Definition of High Quality Liquid Assets (HQLA)**[1]

45. The stock of HQLA should comprise assets with the characteristics outlined in paragraphs 24-27 of LCR BCBS documentation. This section describes the type of assets that meet these characteristics and can therefore be included in the HGLA (stock).

46. There are two categories of assets that can be included in the stock. Assets to be included in each category are those that the bank is holding on the first day of the stress period, irrespective of their residual maturity. "Level 1" assets can be included without limit, while "Level 2" assets can only comprise up to 40% of the total (level 1 and level 2) stock.

47. SAMA may also choose to include within Level 2 as an additional class of assets (Level 2B assets - see paragraph 53 below). If included, these assets should comprise no more than 15% of the total stock of HQLA. They must also be included within the overall 40% cap on Level 2 assets.

48. The 40% cap on Level 2 assets and the 15% cap on Level 2B assets should be determined after the application of required haircuts, and after taking into account the unwind of short-term securities financing transactions and collateral swap transactions maturing within 30 calendar days that involve the exchange of HQLA. The details of the calculation methodology are provided in Annex 1 of BCBS document. In this context, short term transactions are transactions with a maturity date up to and including 30 calendar days.

(Refer to Paragraph 48 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

Note that SAMA has disallowed Level 2B assets in all aspect to LCR computation till further notice

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[1] With regard to level 2B assets, banks must refer to *National Discretion* item # 2 contained in attachment # 5

(i) Level 1 assets

49. Level 1 assets can comprise an unlimited share of the pool and are not subject to a haircut under the LCR (For purpose of calculating the LCR, Level 1 assets in the stock of HQLA should be measured at an amount no greater than their current market value). However, national supervisors may wish to require haircuts for Level 1 securities based on, among other things, their duration, credit and liquidity risk, and typical repo haircuts.

(Refer to footnote 11 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

In KSA, there are no requirements for haircuts to level-1 assets.

50. Level 1 assets are limited to:

(a) coins and banknotes;

(b) central bank reserves ,including required reserves, (In this context, central bank reserves would include banks' overnight deposits with the central bank, and term deposits with the central bank that: (i) are explicitly and contractually repayable on notice from the depositing bank; or (ii) that constitute a loan against which the bank can borrow on a term basis or on an overnight but automatically renewable basis ,only where the bank has an existing deposit with the relevant central bank. Other term deposits with central banks are not eligible for the stock of HQLA; however, if the term expires within 30 days, the term deposit could be considered as an inflow per paragraph 154.) to the extent that the central bank policies allow them to be drawn down in times of stress;
(Refer to footnote 12 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

Note: The Murabahah facility made available to SAMA by Shariah Compliant banks fall under the category on Central Bank reserves and can be included in Level 1 assets

(c) marketable securities representing claims on or guaranteed by sovereigns, central banks, PSEs, the Bank for International Settlements, the International Monetary Fund, the European Central Bank and European Community, or multilateral development banks (The Basel III liquidity framework follows the categorization of market participants applied in the Basel II Framework, unless otherwise specified) , and satisfying all of the following conditions:

(Refer to footnote 14 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

- Assigned a 0% risk-weight under the Basel II Standardized Approach for credit risk (Paragraph 50(c) includes only marketable securities that qualify for Basel II paragraph 53. When a 0% risk-weight has been assigned at national discretion according to the provision in paragraph 54 of the Basel II Standardized Approach, the treatment should follow paragraph 50(d) or 50(e).);
  (Refer to footnote 15 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

- Traded in large, deep and active repo or cash markets characterized by a low level of concentration;

- Have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions; and

- Not an obligation of a financial institution or any of its affiliated entities. (This requires that the holder of the security must not have recourse to the financial institution or any of the financial institution's affiliated entities. In practice, this means that securities, such as government-guaranteed issuance during the financial crisis, which remain liabilities of the financial institution, would not qualify for the stock of HQLA. The only exception is when the bank also qualifies as a PSE under the Basel II Framework where securities issued by the bank could qualify for Level 1 assets if all necessary conditions are satisfied.)
  (Refer to footnote 16 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

Note: By Reliable source of liquidity, SAMA understands that the relevant instrument, as a minimum has been eligible for Repo (without a significant increase in haircut received) either from the Central Bank or other key regulated entities even in stressful times such as those which transpired in the global financial crises from 2007, onwards.

(d) Where the sovereign has a non-0% risk weight, sovereign or central bank debt securities issued in domestic currencies by the sovereign or central bank.

(e) where the sovereign has a non-0% risk weight, domestic sovereign or central bank debt securities issued in foreign currencies are eligible up to the amount of the bank's stressed net cash outflows in that specific foreign currency stemming from the bank's operations in the jurisdiction where the bank's liquidity risk is being taken.

Note: The onus is on the regulated entities to determine if all of the above conditions are satisfied whilst reporting Liquid Assets under level 1 category to SAMA. SAMA would also review adherence to the stipulated conditions through off site and onsite monitoring.

(ii) Level 2A and 2B assets

With regard to Level 2A and 2B assets[1], in KSA, there is only a deep, large and active market for Saudi shares or equity. For other markets, banks must decide as to meeting the BCBS criteria.

51. Level 2 assets (comprising Level 2A assets and any Level 2B assets[1] permitted by the supervisor) can be included in the stock of HQLA, subject to the requirement that they comprise no more than 40% of the overall stock after haircuts have been applied. The method for calculating the cap on Level 2 assets and the cap on Level 2B assets is set out in paragraph 48 and Annex 1 of the BCBS LCR Guidelines, 2013,.

52. A 15% haircut is applied to the current market value of each Level 2A asset held in the stock of HQLA.

Level 2A assets are limited to the following:

(a) Marketable securities representing claims on or guaranteed by sovereigns, central banks, PSEs or multilateral development banks that satisfy all of the following conditions:

- assigned a 20% risk weight under the Basel II Standardized Approach for credit risk (Paragraphs 50(d) and (e) may overlap with paragraph 52(a) in terms of sovereign and central bank securities with a 20% risk weight. In such a case, the assets can be assigned to the Level 1 category according to Paragraph 50(d) or (e), as appropriate.);
  (Refer to footnote 17 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

- traded in large, deep and active repo or cash markets characterized by a low level of concentration;
- have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions (ie maximum decline of price not exceeding 10% or increase in haircut not exceeding 10 percentage points over a 30-day period during a relevant period of significant liquidity stress);
  (Refer to Paragraph 52(a) of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

- not an obligation of a financial institution or any of its affiliated entities.

(b) Corporate debt securities ,including commercial paper (Corporate debt securities (including commercial paper) in this respect include only plain-vanilla assets whose valuation is readily available based on standard methods and does not depend on private knowledge, i.e. these do not include complex structured products or subordinated debt.):and covered bonds (Covered bonds are bonds issued and owned by a bank or mortgage institution and are subject

[1] Refer to Note 1 on page 3.

by law to special public supervision designed to protect bond holders. Proceeds deriving from the issue of these bonds must be invested in conformity with the law in assets which, during the whole period of the validity of the bonds, are capable of covering claims attached to the bonds and which, in the event of the failure of the issuer, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest).that satisfy all of the following conditions:

(Refer to footnotes 19 and 20 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

- In the case of corporate debt securities or covered bonds not issued by a financial institution or any of its affiliated entities;

- Either (i) have a long-term credit rating from a recognized external credit assessment institution (ECAI) of at least AA- (In the event of split ratings, the applicable rating should be determined according to the method used in Basel II's standardized approach for credit risk. Local rating scales (rather than international ratings) of a SAMA approved ECAI that meet the eligibility criteria outlined in paragraph 91 of the Basel II Capital Framework can be recognized if corporate debt securities or covered bonds are held by a bank for local currency liquidity needs arising from its operations in that local jurisdiction. This also applies to Level 2B assets).or in the absence of a long term rating, a short-term rating equivalent in quality to the long-term rating; or (ii) do not have a credit assessment by a recognized ECAI but are internally rated as having a probability of default (PD) corresponding to a credit rating of at least AA-;

  (Refer to footnote 21 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

- Traded in large, deep and active repo or cash markets characterized by a low level of concentration; and

- have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions: ie maximum decline of price or increase in haircut over a 30-day period during a relevant period of significant liquidity stress not exceeding 10%.

  (Refer to Paragraph 54(a) of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

Note: By relevant period of significant liquidity stress, SAMA understands these to be of similar quantum such as those which transpired in the global financial crises from 2007, onwards.

Note: The onus is on the regulated entities to determine if all of the above conditions are satisfied whilst reporting Liquid Assets under level 2A category to SAMA. SAMA would also review adherence to the stipulated conditions through off site and onsite monitoring.

(iii) Level 2B assets (additional HQLA available under amended LCR)

53. Certain additional assets (Level 2B assets)[1] may be included in Level 2 at the discretion of national authorities. In choosing to include these assets in Level 2 for the purpose of the LCR, supervisors are expected to ensure that such assets fully comply with the qualifying criteria (As with all aspects of the framework, compliance with these criteria will be assessed as part of peer reviews undertaken under the Committee's Regulatory Consistency Assessment Programme). Supervisors are also expected to ensure that banks have appropriate systems and measures to monitor and control the potential risks (e.g. credit and market risks) that banks could be exposed to in holding these assets.
(Refer to footnote 22 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

54. A larger haircut is applied to the current market value of each Level 2B asset held in the stock of HQLA.

Level 2B assets are limited to the following:

(a) Residential mortgage backed securities (RMBS) that satisfy all of the following conditions may be included in Level 2B, subject to a 25% haircut:

- Not issued by, and the underlying assets have not been originated by the bank itself or any of its affiliated entities;
- Have a long-term credit rating from a recognized ECAI of AA or higher, or in the absence of a long term rating, a short-term rating equivalent in quality to the long-term rating;
- Traded in large, deep and active repo or cash markets characterized by a low level of concentration;
- The underlying mortgages are "full recourse'' loans (i.e. in the case of foreclosure the mortgage owner remains liable for any shortfall in sales proceeds from the property) and have a maximum loan-to-value ratio (LTV) of 80% on average at issuance; and

(b) Corporate debt securities (Corporate debt securities (including commercial paper) in this respect include only plain-vanilla assets whose valuation is readily available based on standard methods and does not depend on private knowledge, ie these do not include complex structured products or subordinated debt.) that satisfy all of the following conditions may be included in Level 2B, subject to a 50% haircut:

- Not issued by a financial institution or any of its affiliated entities;
- Either (i) have a long-term credit rating from a recognized ECAI between A+ and BBB- or in the absence of a long term rating, a short-term rating equivalent in quality to the long-term rating; or (ii) do not have a credit assessment by a recognized ECAI and are internally rated as having a PD corresponding to a credit rating of between A+ and BBB-;
- Traded in large, deep and active repo or cash markets characterized by a low level of concentration; and

(Refer to footnote 22 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

(c) Common equity shares that satisfy all of the following conditions may be included in Level 2B, subject to a 50% haircut:

- not issued by a financial institution or any of its affiliated entities;
- exchange traded and centrally cleared;
- a constituent of the major stock index in the home jurisdiction or where the liquidity risk is taken, as decided by the supervisor in the jurisdiction where the index is located;
- denominated in the domestic currency of a bank's home jurisdiction or in the currency of the jurisdiction where a bank's liquidity risk is taken;
- traded in large, deep and active repo or cash markets characterized by a low level of concentration; and
- have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions, ie a maximum decline of share price not exceeding 40% or increase in haircut not exceeding 40 percentage points over a 30-day period during a relevant period of significant liquidity.

  (Refer to Paragraph 52(a) of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

Note: SAMA does not utilize Level 2B assets for the purpose of LCR computation, currently

3.2.1 Treatment for Jurisdictions with insufficient HQLA[1]

(a) Assessment of eligibility for alternative liquidity approaches (ALA)

55. Some jurisdictions may have an insufficient supply of Level 1 assets (or both Level 1 and Level 2 assets - Insufficiency in Level 2 assets alone does not qualify for the alternative treatment.) in their domestic currency to meet the aggregate demand of banks with significant exposures in this currency. To address this situation, the Committee has developed alternative treatments for holdings in the stock of HQLA, which are expected to apply to a limited number of currencies and jurisdictions, and subject to qualifying criteria set out in Annex 2 and will be determined through an independent peer review process overseen by the Committee. The purpose of this process is to ensure that the alternative treatments are only used when there is a **true shortfall** in HQLA in the domestic currency relative to the needs in that currency. (For member states of a monetary union with a common currency, that common currency is considered the "domestic currency").

(Refer to footnotes 24 and 25 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

[1] Refer to Note 1 on page 3.

56. To qualify for the alternative treatment, a jurisdiction should be able to demonstrate that:

- There is an insufficient supply of HQLA in its domestic currency, taking into account all relevant factors affecting the supply of, and demand for, such HQLA; (The assessment of insufficiency is only required to take into account the Level 2B assets if the national authority chooses to include them within HQLA. In particular, if certain Level 2B assets are not included in the stock of HQLA in a given jurisdiction, then the assessment of insufficiency in that jurisdiction does not need to include the stock of Level 2B assets that are available in that jurisdiction) (Refer to footnote 26 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

- The insufficiency is caused by long-term structural constraints that cannot be resolved within the medium term;
- It has the capacity, through any mechanism or control in place, to limit or mitigate the risk that the alternative treatment cannot work as expected; and
- It is committed to observing the obligations relating to supervisory monitoring, disclosure, and periodic self-assessment and independent peer review of its eligibility for alternative treatment.

All of the above criteria have to be met to qualify for the alternative treatment.

57. Irrespective of whether a jurisdiction seeking ALA treatment will adopt the phase-in arrangement set out in paragraph 10 for implementing the LCR, the eligibility for that jurisdiction to adopt ALA treatment will be based on a fully implemented LCR standard (i.e. 100% requirement).

(b) Potential options for alternative treatment[1]

58. Option 1: <u>A jurisdiction seeking to adopt Option 1 should justify in the independent peer review that the fee is suitably set in a manner as prescribed in this paragraph.</u> Contractual committed liquidity facilities from the relevant central bank, with a fee: For currencies that do not have sufficient HQLA, as determined by reference to the qualifying principles and criteria, Option 1 would allow banks to access contractual committed liquidity facilities provided by the relevant central bank (i.e. relevant given the currency in question) for a fee. These facilities should not be confused with regular central bank standing arrangements. In particular, these facilities are contractual arrangements between the central bank and the commercial bank with a maturity date which, at a minimum, falls outside the 30-day LCR window. Further, the contract must be irrevocable prior to maturity and involve no ex-post credit decision by the central banks. Such facilities are only permissible if there is also a fee for the facility which is charged regardless of the amount, if any, drawn down against that facility and the fee is set so that banks which claim the facility line to meet the LCR, and banks which do not, have similar financial incentives to reduce their exposure to liquidity risk. That is, the fee should be set so that the net yield on the assets used to secure the facility should not be higher than the net yield

on a representative portfolio of Level 1 and Level 2 assets, after adjusting for any material differences in credit risk. A jurisdiction seeking to adopt Option 1 should justify in the independent peer review that the fee is suitably set in a manner as prescribed in this paragraph.
(Refer to Paragraph 58 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

59. *Option 2 – Foreign currency HQLA to cover domestic currency liquidity needs:*

To qualify for this treatment, the jurisdiction concerned should demonstrate in the independent peer review the effectiveness of its currency peg mechanism and assess the long-term prospect of keeping the peg.

For currencies that do not have sufficient HQLA, as determined by reference to the qualifying principles and criteria, Option 2 would allow supervisors to permit banks that evidence a shortfall of HQLA in the domestic currency (which would match the currency of the underlying risks) to hold HQLA in a currency that does not match the currency of the associated liquidity risk, provided that the resulting currency mismatch positions are justifiable and controlled within limits agreed by their supervisors. Supervisors should restrict such positions within levels consistent with the bank's foreign exchange risk management capacity and needs, and ensure that such positions relate to currencies that are freely and reliably convertible, are effectively managed by the bank, and would not pose undue risk to its financial strength. In managing those positions, the bank should take into account the risks that its ability to swap currencies, and its access to the relevant foreign exchange markets, may erode rapidly under stressed conditions. It should also take into account that sudden, adverse exchange rate movements could sharply widen existing mismatch positions and alter the effectiveness of any foreign exchange hedges in place.

60. To account for foreign exchange risk associated with foreign currency HQLA used to cover liquidity needs in the domestic currency, such liquid assets should be subject to a minimum haircut of 8% for major currencies that are active in global foreign exchange markets (These refer to currencies that exhibit significant and active market turnover in the global foreign currency market (e.g. the average market turnover of the currency as a percentage of the global foreign currency market turnover over a ten-year period is not lower than 10%). For other currencies, jurisdictions should increase the haircut to an appropriate level on the basis of historical (monthly) exchange rate volatilities between the currency pair over an extended period of time. (As an illustration, the exchange rate volatility data used for deriving the FX haircut may be based on the 30-day moving FX price volatility data (mean + 3 standard deviations) of the currency pair over a ten-year period, adjusted to align with the 30-day time horizon of the LCR).If the domestic currency is formally pegged to another currency under an effective mechanism, the haircut for the pegged currency can be lowered to a level that reflects the limited exchange rate risk under the peg arrangement. To qualify for this treatment, the jurisdiction concerned should demonstrate in the

independent peer review the effectiveness of its currency peg mechanism and assess the long-term prospect of keeping the peg.

(Refer to Paragraph 60 and footnotes 27 and 28 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

61. Haircuts for foreign currency HQLA used under Option 2 would apply only to HQLA in excess of a threshold specified by supervisors which is not greater than 25%. (The threshold for applying the haircut under Option 2 refers to the amount of foreign currency HQLA used to cover liquidity needs in the domestic currency as a percentage of total net cash outflows in the domestic currency. Hence under a threshold of 25%, a bank using Option 2 will only need to apply the haircut to that portion of foreign currency HQLA in excess of 25% that are used to cover liquidity needs in the domestic currency.) This is to accommodate a certain level of currency mismatch that may commonly exist among banks in their ordinary course of business.
(Refer to footnotes 29 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

62. *Option 3 – Additional use of Level 2 assets with a higher haircut:* This option addresses currencies for which there are insufficient Level 1 assets, as determined by reference to the qualifying principles and criteria, but where there are sufficient Level 2A assets. In this case, supervisors may choose to allow banks that evidence a shortfall of HQLA in the domestic currency (to match the currency of the liquidity risk incurred) to hold additional Level 2A assets in the stock. These additional Level 2A assets would be subject to a minimum haircut of 20%, i.e. 5% higher than the 15% haircut applicable to Level 2A assets that are included in the 40% cap. The higher haircut is used to cover any additional price and market liquidity risks arising from increased holdings of Level 2A assets beyond the 40% cap, and to provide a disincentive for banks to use this option based on yield considerations. (For example, a situation to avoid is that the opportunity cost of holding a portfolio that benefits from this option would be lower than the opportunity cost of holding a theoretical compliant portfolio of Level 1 and Level 2 assets, after adjusting for any material differences in credit risk.)
(Refer to footnotes 30 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

Supervisors have the obligation to conduct an analysis to assess whether the additional haircut is sufficient for Level 2A assets in their markets, and should increase the haircut if this is warranted to achieve the purpose for which it is intended. Supervisors should explain and justify the outcome of the analysis (including the level of increase in the haircut, if applicable) during the independent peer review assessment process. Any Level 2B assets held by the bank would remain subject to the cap of 15%, regardless of the amount of other Level 2 assets held.

Note: SAMA has not utilized any of the options under the alternate treatment

(Refer to Paragraph 62 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

(c) Maximum level of usage of options for alternative treatment[1]

63. The usage of any of the above options would be constrained by a limit specified by supervisors in jurisdictions whose currency is eligible for the alternative treatment. The limit should be expressed in terms of the maximum amount of HQLA associated with the use of the options (whether individually or in combination) that a bank is allowed to include in its LCR, as a percentage of the total amount of HQLA the bank is required to hold in the currency concerned. (The required amount of HQLA in the domestic currency includes any regulatory buffer (i.e. above the 100% LCR standard) that the supervisor may reasonably impose on the bank concerned based on its liquidity risk profile.)
(Refer to footnotes 31 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

Amount of HQLA associated with the options refer to:

(i) in the case of Option 1, the amount of committed liquidity facilities granted by the relevant central bank;

(ii) in the case of Option 2, the amount of foreign currency HQLA used to cover the shortfall of HQLA in the domestic currency; and

(iii) in the case of Option 3, the amount of Level 2 assets held (including those within the 40% cap).

64. If, for example, the maximum level of usage of the options is set at 80%, it means that a bank adopting the options, either individually or in combination, would only be allowed to include HQLA associated with the options (after applying any relevant haircut) up to 80% of the required amount of HQLA in the relevant currency. (As an example, if a bank has used Option 1 and Option 3 to the extent that it has been granted an Option 1 facility of 10%, and held Level 2 assets of 55% after haircut (both in terms of the required amount of HQLA in the domestic currency), the HQLA associated with the use of these two options amount to 65% (i.e. 10%+55%), which is still within the 80% level. The total amount of alternative HQLA used is 25% (i.e. 10% + 15% (additional Level 2A assets used).Thus, at least 20% of the HQLA requirement will have to be met by Level 1 assets in the relevant currency.
(Refer to footnotes 32 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

[1] Refer to Note 1 on page 3.

65. The appropriateness of the maximum level of usage of the options allowed by a supervisor will be evaluated in the independent peer review process. The level set should be consistent with the projected size of the HQLA gap faced by banks subject to the LCR in the currency concerned, taking into account all relevant factors that may affect the size of the gap over time. The supervisor should explain how this level is derived, and justify why this is supported by the insufficiency of HQLA in the banking system. Where a relatively high level of usage of the options is allowed by the supervisor (eg over 80%), the suitability of this level will come under closer scrutiny in the independent peer review.

Note: SAMA has not utilized any of the options under the alternate treatment
(Refer to Paragraph 65 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

(d) Supervisory obligations and requirements[1]

66. A jurisdiction with insufficient HQLA must, among other things, fulfil the following obligations (the detailed requirements are set out in Annex 2):

• Supervisory monitoring: There should be a clearly documented supervisory framework for overseeing and controlling the usage of the options by its banks, and for monitoring their compliance with the relevant requirements applicable to their use of the options;

• Disclosure framework: The jurisdiction should disclose its framework for applying the options to its banks (whether on its website or through other means). The disclosure should enable other national supervisors and stakeholders to gain a sufficient understanding of its compliance with the qualifying principles and criteria and the manner in which it supervises the use of the options by its banks;

• Periodic self-assessment of eligibility for alternative treatment: The jurisdiction should perform a self-assessment of its eligibility for alternative treatment every five years after it has adopted the options, and disclose the results to other national supervisors and stakeholders.
(Refer to Paragraph 66 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

67. The use of the options by their banks, having regard to the guiding principles set out below.

- Principle 1: Banks' use of the options is not simply an economic choice that maximizes the profits of the bank through the selection of alternative HQLA based primarily on yield considerations.

- Principle 2: Supervisors should ensure that the use of the options is constrained, both for all banks with exposures in the relevant currency and on a bank-by-bank basis.

- banks have, to the extent practicable, taken reasonable steps to use Level 1 and Level 2 assets and reduce before the alternative treatment.

- Principle 4: Supervisors should have a mechanism for restraining the usage of the options to mitigate risks of non-performance of the alternative HQLA.

Note: SAMA has not utilized any of the options under the alternate treatment

3.4 Treatment for Shariah[1]

68. *Shari'ah* compliant banks face a religious prohibition on holding certain types of assets, such as interest-bearing debt securities. Even in jurisdictions that have a sufficient supply of HQLA, an insurmountable impediment to the ability of *Shari'ah* compliant banks to meet the LCR requirement may still exist. In such cases, national supervisors in jurisdictions in which *Shari'ah* compliant banks operate have the discretion to define *Shari'ah* compliant financial products (such as *Sukuk*) as alternative HQLA applicable to such banks only, subject to such conditions or haircuts that the supervisors may require. **It should be noted that the intention of this treatment is not to allow *Shari'ah* compliant banks to hold fewer HQLA. The minimum LCR standard, calculated based on alternative HQLA (post-haircut) recognized as HQLA for these banks, should not be lower than the minimum LCR standard applicable to other banks in the jurisdiction concerned.**

Note: SAMA has not utilized any of the options under the alternate treatment

B. Total net cash outflows

69. The term total net cash outflows (Where applicable, cash inflows and outflows should include interest that is expected to be received and paid during the 30-day time horizon).is defined as the total expected cash outflows minus total expected cash inflows in the specified stress scenario for the subsequent calendar days. Total expected cash inflows are subject to an aggregate cap of 75% of total expected cash outflows. Total expected cash outflows are calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance sheet commitments by the rates at which they are expected to run off or be drawn down. Total expected cash inflows are calculated by multiplying the outstanding balances of various categories of contractual receivables by the rates at which they are expected to flow in under the scenario up to an aggregate cap of 75% of total expected cash outflows.

Total net cash outflows over the next 30 calendar days = Total expected cash outflows – Min {total expected cash inflows; 75% of total expected cash outflows}

[1] Refer to Note 1 on page 3.

(Refer to footnotes 33 and Paragraph 69 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

Note: Saudi Arabia has no effective deposit insurance scheme. Consequently, any run-off rate subject to deposit insurance is not valid for KSA banks.

70. While most roll-off rates, draw-down rates and similar factors are harmonized across jurisdictions as outlined in this standard, a few parameters are to be determined by supervisory authorities at the national level. Where this is the case, the parameters should be transparent and made publicly available.

71. Annex 4 of BCBS LCR guidelines provide a summary of the factors that are applied to each category.

72. Banks will not be permitted to double count items, ie if an asset is included as part of the "stock of HQLA" (ie the numerator), the associated cash inflows cannot also be counted as cash inflows (ie part of the denominator). Where there is potential that an item could be counted in multiple outflow categories, (e.g. committed liquidity facilities granted to cover debt maturing within the 30 calendar day period), a bank only has to assume up to the maximum contractual outflow for that product.

(Refer to Paragraph 70-72 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

3.5 Cash Outflows

*3.5.1 **(i) RETAIL DEPOSIT RUN-OFF***

73. Retail deposits are defined as deposits placed with a bank by a natural person, and those subject to the LCR include demand deposits and term deposits, unless otherwise excluded under the criteria set out in paragraphs 82 and 83 BCBS LCR Guidelines, 2013.

74. These retail deposits are divided into "stable" and "less stable" portions of funds as described below. The run-off rates for retail deposits are minimum floors, with higher run-off rates established by individual jurisdictions as appropriate to capture depositor behavior in a period of stress in each jurisdiction.
(Refer to Paragraph 74 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

(a) Stable deposits (run-off rate = 3% and higher)

75. Stable deposits, which usually receive a run-off factor of 5%, are the amount of the deposits that are fully insured ("Fully insured" means that 100% of the deposit amount, up to the deposit insurance limit, is covered by an effective deposit insurance scheme. Deposit balances up to the deposit insurance limit can be treated as "fully insured" even if a depositor has a balance in excess of the deposit insurance limit. However, any amount in excess of the deposit

insurance limit is to be treated as "less stable". For example, if a depositor has a deposit of 150 that is covered by a deposit insurance scheme, which has a limit of 100, where the depositor would receive at least 100 from the deposit insurance scheme if the financial institution were unable to pay, then 100 would be considered "fully insured" and treated as stable deposits while 50 would be treated as less stable deposits. However if the deposit insurance scheme only covered a percentage of the funds from the first currency unit (e.g. 90% of the deposit amount up to a limit of 100) then the entire 150 deposit would be less stable.)
by an effective deposit insurance scheme or by a public guarantee that provides equivalent protection and where:

- The depositors have other established relationships with the bank that make deposit withdrawal highly unlikely; or

- The deposits are in transactional accounts (e.g. accounts where salaries are automatically deposited).

(Refer to footnotes 34 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

76. For the purposes of this standard, an "effective deposit insurance scheme" refers to a scheme (i) that guarantees that it has the ability to make prompt payouts, (ii) for which the coverage is clearly defined and (iii) of which public awareness is high. The deposit insurer in an effective deposit insurance scheme has formal legal powers to fulfil its mandate and is operationally independent, transparent and accountable. A jurisdiction with an explicit and legally binding sovereign deposit guarantee that effectively functions as deposit insurance can be regarded as having an effective deposit insurance scheme.

(Refer to Paragraph 76 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

77. The presence of deposit insurance alone is not sufficient to consider a deposit "stable".

78. Jurisdictions may choose to apply a run-off rate of 3% to stable deposits in their jurisdiction, if they meet the above stable deposit criteria and the following additional criteria for deposit insurance schemes (The Financial Stability Board has asked the International Association of Deposit Insurers (IADI), in conjunction with the Basel Committee and other relevant bodies where appropriate, to update its Core Principles and other guidance to better reflect leading practices. The criteria in this paragraph will therefore be reviewed by the Committee once the work by IADI has been completed).

(Refer to footnotes 35 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

- The insurance scheme is based on a system of prefunding via the periodic collection of levies on banks with insured deposits; (The requirement for periodic collection of levies from banks does not

preclude that deposit insurance schemes may, on occasion, provide for contribution holidays due to the scheme being well-funded at a given point in time.)
(Refer to footnotes 36 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

- the scheme has adequate means of ensuring ready access to additional funding in the event of a large call on its reserves, e.g. an explicit and legally binding guarantee from the government, or a standing authority to borrow from the government;

- access to insured deposits is available to depositors in a short period of time once the deposit insurance scheme is triggered. (This period of time would typically be expected to be no more than 7 business days)

Jurisdictions applying the 3% run-off rate to stable deposits with deposit insurance arrangements that meet the above criteria should be able to provide evidence of run-off rates for stable deposits within the banking system below 3% during any periods of stress experienced that are consistent with the conditions within the LCR.

Note: KSA does not currently have deposit insurance; hence the guidelines identified above, for stable deposits do not apply

(Refer to Paragraph 78 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

(b) Less stable deposits (run-off rates = 10% and higher)

79. Supervisory authorities are expected to develop additional buckets with higher run-off rates as necessary to apply to buckets of potentially less stable retail deposits in their jurisdictions, with a minimum run-off rate of 10%. These jurisdiction-specific run-off rates should be clearly outlined and publicly transparent. Buckets of less stable deposits could include deposits that are not fully covered by an effective deposit insurance scheme or sovereign deposit guarantee, high-value deposits, deposits from sophisticated or high net worth individuals, deposits that can be withdrawn quickly (e.g. internet deposits) and foreign currency deposits, as determined by each jurisdiction.

Note: In connection with the guidance provided in Para 79, above, SAMA would be undertaking a study shortly to assess if potentially higher run off rates would be applicable to the less stable deposits category.

(Refer to Paragraph 79 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

80. If a bank is not able to readily identify which retail deposits would qualify as "stable" according to the above definition (e.g. the bank cannot determine which deposits are covered by an effective deposit insurance scheme or a sovereign deposit guarantee), it should place the full amount in the "less stable" buckets as established by its supervisor.

81. Foreign currency retail deposits are deposits denominated in any other currency than the domestic currency in a jurisdiction in which the bank operates. Supervisors will determine the run-off factor that banks in their jurisdiction should use for foreign currency deposits. Foreign currency deposits will be considered as "less stable" if there is a reason to believe that such deposits are more volatile than domestic currency deposits. Factors affecting the volatility of foreign currency deposits include the type and sophistication of the depositors, and the nature of such deposits (eg whether the deposits are linked to business needs in the same currency, or whether the deposits are placed in a search for yield).

Note: **In KSA, run-off rates for all currencies are as per BCBS guidelines.**

Currently in KSA, there are no material factors to suggest that foreign currency deposits would be less stable in comparison to SAR denominated deposits. Its noteworthy that the USD denominated deposits are the most common category of FCY deposits with regulated entities, which is pegged to Saudi Riyal.

(Refer to Paragraph 81 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

82. Cash outflows related to retail term deposits with a residual maturity or withdrawal notice period of greater than 30 days will be excluded from total expected cash outflows if the depositor has no legal right to withdraw deposits within the 30-day horizon of the LCR. (If a portion of the term deposit can be withdrawn without incurring such a penalty, only that portion should be treated as a demand deposit. The remaining balance of the deposit should be treated as a term deposit.)

In KSA, with regard to item 82 above, Term Deposits are not to be withdrawn under exceptional circumstances as described below in items 83 and 84.

(Refer to footnote 38 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

83. If a bank allows a depositor in exceptional circumstances to withdraw such deposits without applying the corresponding penalty, or despite a clause that says the depositor has no legal right to withdraw, the entire category of these funds would then have to be treated as demand deposits (i.e. regardless of the remaining term, the deposits would be subject to the deposit run-off rates as specified in paragraphs 74-81 BCBS LCR Guidelines, 2013.

84. Notwithstanding the above, SAMA may also opt to treat retail term deposits that meet the qualifications set out in paragraph 82, BCBS LCR Guidelines, 2013, with a higher than 0% run-off rate, if they clearly state the treatment that applies for their jurisdiction and apply this treatment in a similar fashion across banks in their jurisdiction. Such reasons could include, but are not limited to, supervisory concerns that depositors would withdraw term deposits in a similar fashion as retail demand deposits during either normal or stress times, concern that banks may repay such deposits early in stressed times for reputational reasons, or the presence of unintended incentives on banks to impose material penalties on consumers if deposits are withdrawn early. In these cases SAMA would assess a higher run-off against all or some of such deposits.

3.5.2 (ii) Unsecured wholesale funding run-off

85. For the purposes of the LCR, "unsecured wholesale funding" is defined as those liabilities and general obligations that are raised from non-natural persons (i.e. legal entities, including sole proprietorships and partnerships) and are **not** collateralized by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation or resolution. Obligations related to derivative contracts are explicitly excluded from this definition.

86. The wholesale funding included in the LCR is defined as all funding that is callable within the LCR's horizon of 30 days or that has its earliest possible contractual maturity date situated within this horizon (such as maturing term deposits and unsecured debt securities) as well as funding with an undetermined maturity. This should include all funding with options that are exercisable at the investor's discretion within the 30 calendar day horizon. For funding with options exercisable at the bank's discretion, SAMA would take into account reputational factors that may limit a bank's ability not to exercise the option. (This could reflect a case where a bank may imply that it is under liquidity stress if it did not exercise an option on its own funding.) In particular, where the market expects certain liabilities to be redeemed before their legal final maturity date, banks and SAMA should assume such behavior for the purpose of the LCR and include these liabilities as outflows.

87. Wholesale funding that is callable (This takes into account any embedded options linked to the funds provider's ability to call the funding before contractual maturity.) by the funds provider subject to a contractually defined and binding notice period surpassing the 30-day horizon is not included.

88. For the purposes of the LCR, unsecured wholesale funding is to be categorised as detailed below, based on the assumed sensitivity of the funds providers to the rate offered and the credit quality and solvency of the borrowing bank. This is determined by the type of funds providers and their level of sophistication, as well as their operational relationships with the bank. The run-off rates for the scenario are listed for each category.

(Refer to Paragraph 86-88 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

(a) Unsecured wholesale funding provided by small business customers: 5%, 10% and higher

89. Unsecured wholesale funding provided by small business customers is treated the same way as retail deposits for the purposes of this standard, effectively distinguishing between a "stable" portion of funding provided by small business customers and different buckets of less stable funding defined by each jurisdiction. The same bucket definitions and associated run-off factors apply as for retail deposits.

90. This category consists of deposits and other extensions of funds made by nonfinancial small business customers. “Small business customers” are defined in line with the definition of loans extended to small businesses in paragraph 231 of the Basel II framework that are managed as retail exposures and are generally considered as having similar liquidity risk characteristics to retail accounts provided the total aggregated funding (“Aggregated funding” means the gross amount (i.e. not netting any form of credit extended to the legal entity) of all forms of funding (e.g. deposits or debt securities or similar derivative exposure for which the counterparty is known to be a small business customer). In addition, applying the limit on a consolidated basis means that where one or more small business customers are affiliated with each other, they may be considered as a single creditor such that the limit is applied to the total funding received by the bank from this group of customers.) raised from one small business customer is less than €1 million (on a consolidated basis where applicable).
(Refer to footnote 41 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

92. Term deposits from small business customers should be treated in accordance with the treatment for term retail deposits as outlined in paragraph 82, 83, and 84, BCBS LCR Guidelines, 2013.

(b) Operational deposits generated by clearing, custody and cash management activities: 25%

93. Certain activities lead to financial and non-financial customers needing to place, or leave, deposits with a bank in order to facilitate their access and ability to use payment and settlement systems and otherwise make payments. These funds may receive a 25% run-off factor only if the customer has a substantive dependency with the bank and the deposit is required for such activities. SAMA’s approval on a case by case basis, would have to be given to ensure that banks utilizing this treatment (para 93-104) actually are conducting these operational activities at the level indicated. SAMA may choose not to permit banks to utilise the operational deposit run-off rates in cases where, for

example, a significant portion of operational deposits are provided by a small proportion of customers (i.e. concentration risk).

94. Qualifying activities in this context refer to clearing, custody or cash management activities that meet the following criteria:

• The customer is reliant on the bank to perform these services as an independent third party intermediary in order to fulfil its normal banking activities over the next 30 days. For example, this condition would not be met if the bank is aware that the customer has adequate back-up arrangements.

• These services must be provided under a legally binding agreement to institutional customers.

• The termination of such agreements shall be subject either to a notice period of at least 30 days or significant switching costs (such as those related to transaction, information technology, early termination or legal costs) to be borne by the customer if the operational deposits are moved before 30 days.

95. Qualifying operational deposits generated by such an activity are ones where:

• The deposits are by-products of the underlying services provided by the banking organization and not sought out in the wholesale market in the sole interest of offering interest income.

• The deposits are held in specifically designated accounts and priced without giving an economic incentive to the customer (not limited to paying market interest rates) to leave any excess funds on these accounts. In the case that interest rates in a jurisdiction are close to zero, it would be expected that such accounts is non-interest bearing. Banks should be particularly aware that during prolonged periods of low interest rates, excess balances (as defined below) could be significant.

96. Any excess balances that could be withdrawn and would still leave enough funds to fulfil these clearing, custody and cash management activities do not qualify for the 25% factor. In other words, only that part of the deposit balance with the service provider that is proven to serve a customer's operational needs can qualify as stable. Excess balances should be treated in the appropriate category for non-operational deposits. If banks are unable to determine the amount of the excess balance, then the entire deposit should be assumed to be excess to requirements and, therefore, considered non-operational.

97. Banks must determine the methodology for identifying excess deposits that are excluded from this treatment. This assessment should be conducted at a sufficiently granular level to adequately assess the risk of withdrawal in an idiosyncratic stress. The methodology should take into account relevant factors such as the likelihood that wholesale customers have above average balances in advance of specific payment needs, and consider appropriate indicators (e.g. ratios of account balances to payment or settlement volumes or to assets under

custody) to identify those customers that are not actively managing account balances efficiently.

98. Operational deposits would receive a 0% inflow assumption for the depositing bank given that these deposits are required for operational reasons, and are therefore not available to the depositing bank to repay other outflows.

99. Notwithstanding these operational categories, if the deposit under consideration arises out of correspondent banking or from the provision of prime brokerage services, it will be treated as if there were no operational activity for the purpose of determining run-off factors. (Correspondent banking refers to arrangements under which one bank /correspondent, holds deposits owned by other banks/ respondents and provides payment and other services in order to settle foreign currency transactions e.g. so-called nostro and vostro accounts used to settle transactions in a currency other than the domestic currency of the respondent bank for the provision of clearing and settlement of payments. Prime brokerage is a package of services offered to large active investors, particularly institutional hedge funds. These services usually include: clearing, settlement and custody; consolidated reporting; financing e.g. margin, repo or synthetic; securities lending; capital introduction; and risk analytics.)

(Refer to Paragraph 93-99 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

100. **The following paragraphs describe the types of activities that may generate operational deposits.** A bank should assess whether the presence of such an activity does indeed generate an operational deposit as not all such activities qualify due to differences in customer dependency, activity and practices.

101. **A clearing relationship**. In this context, refers to a service arrangement that enables customers to transfer funds (or securities) indirectly through direct participants in domestic settlement system to final recipients. Such services are limited to the following activities: transmission, reconciliation and confirmation of payment orders; daylight overdraft, overnight financing and maintenance of post-settlement balances; and determination of intra-day and final settlement positions.

(Refer to Paragraph 101 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

102. **A custody relationship, in this context**, refers to the provision of safekeeping, reporting, processing of assets or the facilitation of the operational and administrative elements of related activities on behalf of customers in the process of their transacting and retaining financial assets. Such services are limited to the settlement of securities transactions, the transfer of contractual payments, the processing of collateral, and the provision of custody related cash management services. Also included are the receipt of dividends and other income, client subscriptions and redemptions. Custodial services can furthermore extend to asset and corporate trust servicing, treasury, escrow,

funds transfer, stock transfer and agency services, including payment and settlement services (excluding correspondent banking), and depository receipts.

(Refer to Paragraph 102 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

103. **A cash management relationship, in this context**, refers to the provision of cash management and related services to customers. Cash management services, in this context, refers to those products and services provided to a customer to manage its cash flows, assets and liabilities, and conduct financial transactions necessary to the customer's ongoing operations. Such services are limited to payment remittance, collection and aggregation of funds, payroll administration, and control over the disbursement of funds

(Refer to Paragraph 103 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

(d) Unsecured wholesale funding provided by non-financial corporates and sovereigns, central banks, multilateral development banks, and PSEs: 20% or 40%

104. The portion of the operational deposits generated by clearing, custody and cash management activities that is fully covered by deposit insurance can receive the same treatment as "stable" retail deposits.

(c) Treatment of deposits in institutional networks of cooperative banks: 25% or 100%

105. Treatment of deposits in institutional networks of cooperative banks: 25% or 100% - An institutional network of cooperative (or otherwise named) banks is a group of legally autonomous banks with a statutory framework of cooperation with common strategic focus and brand where specific functions are performed by central institutions or specialized service providers. A 25% run-off rate can be given to the amount of deposits of member institutions with the central institution or specialized central service providers that are placed (a) due to statutory minimum deposit requirements, which are registered at regulators or (b) in the context of common task sharing and legal, statutory or contractual arrangements so long as both the bank that has received the monies and the bank that has deposited participate in the same institutional network's mutual protection scheme against illiquidity and insolvency of its members. As with other operational deposits, these deposits would receive a 0% inflow assumption for the depositing bank, as these funds are considered to remain with the centralized institution.

106. SAMA's prior approval would have be required to ensure that banks utilizing this treatment actually are the central institution or a central service provider of such a cooperative (or otherwise named) network. Correspondent banking activities would not be included in this treatment and would receive a 100% outflow treatment, as would funds placed at the central institutions or

specialized service providers for any other reason other than those outlined in (a) and (b) in the paragraph above, or for operational functions of clearing, custody, or cash management as outlined in paragraphs 101-103, BCBS LCR Guidelines, 2013,

(d) Unsecured wholesale funding provided by non-financial corporates and sovereigns, central banks, multilateral development banks, and PSEs: 20% or 40%

(Refer to Paragraph 104-106 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

107. This category comprises all deposits and other extensions of unsecured funding from non-financial corporate customers (that are not categorized as small business customers) and (both domestic and foreign) sovereign, central bank, multilateral development bank, and PSE customers that are not specifically held for operational purposes (as defined above). The run-off factor for these funds is 40%, unless the criteria in paragraph 108, BCBS LCR Guidelines, 2013, are met.

108. Unsecured wholesale funding provided by non-financial corporate customers, sovereigns, central banks, multilateral development banks, and PSEs without operational relationships can receive a 20% run-off factor if the entire amount of the deposit is fully covered by an effective deposit insurance scheme or by a public guarantee that provides equivalent protection.

(e) Unsecured wholesale funding provided by other legal entity customers: 100%

109. This category consists of all deposits and other funding from other institutions (including banks, securities firms, insurance companies, etc.), fiduciaries, (Fiduciary is defined in this context as a legal entity that is authorized to manage assets on behalf of a third party. Fiduciaries include asset management entities such as pension funds and other collective investment vehicles).beneficiaries, (Beneficiary is defined in this context as a legal entity that receives, or may become eligible to receive, benefits under a will, insurance policy, retirement plan, annuity, trust, or other contract), conduits and special purpose vehicles, affiliated entities of the bank (Outflows on unsecured wholesale funding from affiliated entities of the bank are included in this category unless the funding is part of an operational relationship, a deposit in an institutional network of cooperative banks or the affiliated entity of a non-financial corporate) and other entities that are not specifically held for operational purposes (as defined above) and not included in the prior three categories. The run-off factor for these funds is 100%.
(Refer to footnotes 43-45 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

110. All notes, bonds and other debt securities issued by the bank are included in this category regardless of the holder, unless the bond is sold exclusively in the retail market and held in retail accounts (including small business customer accounts treated as retail per paragraphs 89-91), in which case the instruments

can be treated in the appropriate retail or small business customer deposit category. To be treated in this manner, it is not sufficient that the debt instruments are specifically designed and marketed to retail or small business customers. Rather there should be limitations placed such that those instruments cannot be bought and held by parties other than retail or small business customers.

111. Customer cash balances arising from the provision of prime brokerage services, including but not limited to the cash arising from prime brokerage services as identified in paragraph 99, should be considered separate from any required segregated balances related to client protection regimes imposed by national regulations, and should not be netted against other customer exposures included in this standard. These offsetting balances held in segregated accounts are treated as inflows in paragraph 154 and should be excluded from the stock of HQLA.

(Refer to Paragraph 110-111 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

(iii) Secured funding run-off

112. For the purposes of this standard, “secured funding” is defined as those liabilities and general obligations that are collateralized by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation or resolution.

113. Loss of secured funding on short-term financing transactions: In this scenario, the ability to continue to transact repurchase, reverse repurchase and other securities financing transactions is limited to transactions backed by HQLA or with the bank’s domestic sovereign, PSE or central bank.(In this context, PSEs that receive this treatment should be limited to those that are 20% risk weighted or better, and “domestic” can be defined as a jurisdiction where a bank is legally incorporated.) Collateral swaps should be treated as repurchase or reverse repurchase agreements, as should any other transaction with a similar form. Additionally, collateral lent to the bank’s customers to effect short positions (A customer short position in this context describes a transaction where a bank’s customer sells a security it does not own, and the bank subsequently obtains the same security from internal or external sources to make delivery into the sale. Internal sources include the bank’s own inventory of collateral as well as rehypothecatable collateral held in other customer margin accounts. External sources include collateral obtained through a securities borrowing, reverse repo, or like transaction.) should be treated as a form of secured funding. For the scenario, a bank should apply the following factors to all outstanding secured funding transactions with maturities within the 30 calendar day stress horizon, including customer short positions that do not have a specified contractual maturity. The amount of outflow is calculated based on the amount of funds raised through the transaction, and not the value of the underlying collateral.

114. Due to the high-quality of Level 1 assets, no reduction in funding availability against these assets is assumed to occur. Moreover, no reduction in funding availability is expected for any maturing secured funding transactions with the bank's domestic central bank. A reduction in funding availability will be assigned to maturing transactions backed by Level 2 assets equivalent to the required haircuts. A 25% factor is applied for maturing secured funding transactions with the bank's domestic sovereign, multilateral development banks, or domestic PSEs that have a 20% or lower risk weight, when the transactions are backed by assets other than Level 1 or Level 2A assets, in recognition that these entities are unlikely to withdraw secured funding from banks in a time of market-wide stress. This, however, gives credit only for outstanding secured funding transactions, and not for unused collateral or merely the capacity to borrow.

(Refer to Paragraph 113-114 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

(iv) Additional requirements

116. **Derivatives cash outflows:** the sum of all net cash outflows should receive a 100% factor. Banks should calculate, in accordance with their existing valuation methodologies, expected contractual derivative cash inflows and outflows. Cash flows may be calculated on a net basis (i.e. inflows can offset outflows) by counterparty. Only where a valid master netting agreement exists. Banks should exclude from such calculations those liquidity requirements that would result from increased collateral needs due to market value movements or falls in value of collateral posted. (These risks are captured in paragraphs 119 and 123,of BCBS LCR guidelines). Options should be assumed to be exercised when they are 'in the money' to the option buyer.
(Refer to Paragraph 116 of Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools – Jan 2013)

2. Cash inflows

142. When considering its available cash inflows, the bank should only include contractual inflows (including interest payments) from outstanding exposures that are fully performing and for which the bank has no reason to expect a default within the 30-day time horizon. Contingent inflows are not included in total net cash inflows.

Illustrative Summary of the Amended LCR

Item	Factors
Stock of HQLA	
A. Level 1 assets:	
• Coins and bank notes • Qualifying marketable securities from sovereigns, central banks, PSEs, and multilateral development banks • Qualifying central bank reserves • Domestic sovereign or central bank debt for non-0% risk-weighted • Sovereigns	100%
B. Level 2 assets (maximum of 40% of HQLA):	
Level 2A assets	
• Sovereign, central bank, multilateral development banks, and PSE assets qualifying for 20% risk weighting • Qualifying corporate debt securities rated AA- or higher • Qualifying covered bonds rated AA- or higher	85%
Level 2B assets (maximum of 15% of HQLA)	
• Qualifying RMBS	75%
• Qualifying corporate debt securities rated between A+ and BBB-	50%
• Qualifying common equity shares	50%
Total value of stock of HQLA	

Cash Outflows	
A. Retail deposits:	
Demand deposits and term deposits (less than 30 days maturity)	
• Stable deposits (deposit insurance scheme meets additional criteria)	3%
• Stable deposits	5%
• Less stable retail deposits	10%
Term deposits with residual maturity greater than 30 days	0%
B. Unsecured wholesale funding:	
Demand and term deposits (less than 30 days maturity) provided by small business customers:	
• Stable deposits	5%
• Less stable deposits	10%
Operational deposits generated by clearing, custody and cash management activities	25%
• Portion covered by deposit insurance	5%
Cooperative banks in an institutional network (qualifying deposits with the centralized institution)	25%
Non-financial corporates, sovereigns, central banks, multilateral development banks, and PSEs	40%
• If the entire amount fully covered by deposit insurance scheme	20%
Other legal entity customers	100%
C. Secured funding:	
• Secured funding transactions with a central bank counterparty or • backed by Level 1 assets with any counterparty.	0%
• Secured funding transactions backed by Level 2A assets, with any • counterparty	15%

• Secured funding transactions backed by non-Level 1 or non-Level 2A • assets, with domestic sovereigns, multilateral development banks, or • domestic PSEs as a counterparty	25%
• Backed by RMBS eligible for inclusion in Level 2B	25%
• Backed by other Level 2B assets	50%
• All other secured funding transactions	100%
D. Additional requirements:	
Liquidity needs (e.g. collateral calls) related to financing transactions, derivatives and other contracts	3 notch downgrade
Market valuation changes on derivatives transactions (largest absolute net 30-day collateral flows realized during the preceding 24 months)	Look back approach
Valuation changes on non-Level 1 posted collateral securing derivatives	20%
Excess collateral held by a bank related to derivative transactions that could contractually be called at any time by its counterparty	100%
Liquidity needs related to collateral contractually due from the reporting bank on derivatives transactions	100%
Increased liquidity needs related to derivative transactions that allow collateral substitution to non-HQLA assets	100%
ABCP, SIVs, conduits, SPVs, etc.:	
• Liabilities from maturing ABCP, SIVs, SPVs, etc. (applied to maturing amounts and returnable assets)	100%
• Asset Backed Securities (including covered bonds) applied to maturing amounts.	100%
Currently undrawn committed credit and liquidity facilities provided to:	
• retail and small business clients	5%
• non-financial corporates, sovereigns and central banks, multilateral development banks, and PSEs	10% for credit 30% for liquidity
• banks subject to prudential supervision	40%
• other financial institutions (include securities firms, insurance companies)	40% for credit 100% for liquidity
• other legal entity customers, credit and liquidity facilities	100%
Other contingent funding liabilities (such as guarantees, letters of credit, revocable credit and liquidity facilities, etc.)	National discretion
Trade finance	0-5%
Customer short positions covered by other customers' collateral	50%
Any additional contractual outflows	100%
Net derivative cash outflows	100%
Any other contractual cash outflows	100%
Total cash outflows	

Specific changes in LCR[1]

A. HIGH QUALITY LIQUID ASSETS (HQLA)

Expand the definition of HQLA by including Level 2B assets, subject to higher haircuts and a limit

- Corporate debt securities rated A+ to BBB– with a **50%** haircut
- Certain unencumbered equities subject to a **50%** haircut
- Certain residential mortgage-backed securities rated AA or higher with a **25%** haircut

Aggregate of Level 2B assets, after haircuts, subject to a limit of **15%** of total HQLA

Rating requirement on qualifying Level 2 assets

- Use of local rating scales and inclusion of qualifying commercial paper

Usability of the liquidity pool

- Incorporate language related to the expectation that banks will use their pool of HQLA during periods of stress

Operational requirements

- Refine and clarify the operational requirements for HQLA

Operation of the cap on Level 2 HQLA

- Revise and improve the operation of the cap on Level 2 assets

Central bank reserves

- Clarify language to confirm that supervisors have national discretion to include or exclude required central bank reserves (as well as overnight and certain term deposits) as HQLA as they consider appropriate.

B. INFLOWS AND OUTFLOWS

Insured deposits

- Reduce outflow on certain types of fully insured retail deposits from **5% to 3%**[1]

Reduce outflow on fully insured non-operational deposits from non-financial corporates, sovereigns, central banks and public sector entities (PSEs) from **40% to 20%**

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[1] Extract of GHOS Press Release of January 2013

Non-financial corporate deposits

- Reduce the outflow rate for "non-operational" deposits provided by non-financial corporates, sovereigns, central banks and PSEs from **75% to 40%**

Committed liquidity facilities to non-financial corporates

- Clarify the definition of liquidity facilities and reduce the drawdown rate on the unused portion of committed liquidity facilities to non-financial corporates, sovereigns, central banks and PSEs from **100% to 30%**

Committed but unfunded inter-financial liquidity and credit facilities

- Distinguish between interbank and inter-financial credit and liquidity facilities and reduce the outflow rate on the former from **100% to 40%**

Derivatives

- Additional derivatives risks included in the LCR with a **100%** outflow (relates to collateral substitution, and excess collateral that the bank is contractually obligated to return/provide if required by a counterparty)
- Introduce a standardized approach for liquidity risk related to market value changes in derivatives positions
- Assume net outflow of **0%** for derivatives (and commitments) that are contractually secured/collateralized by HQLA

Trade finance

- Include guidance to indicate that a low outflow rate (**0–5%**) is expected to apply

Equivalence of central bank operations

- Reduce the outflow rate on maturing secured funding transactions with central banks from **25% to 0%**

Client servicing brokerage

- Clarify the treatment of activities related to client servicing brokerage (which generally lead to an **increase in net outflows**)

C. <u>OTHERS</u>

Rules text clarifications

- A number of clarifications to the rules text to promote consistent application and reduce arbitrage opportunities (e.g. operational deposits

from wholesale clients, derivatives cash flows, open maturity loans). Also incorporation of previously published FAQs.

Internationally agreed phase-in of the LCR

- The minimum LCR in 2015 would be **60%** and increase by **10 percentage points per year** to reach 100% in 2019.

- Regulatory Guidance concerning specific items on Prudential returns refer to next page.