

Saudi Central Bank (SAMA) Leverage Ratio Framework

December 2022

البنك المركزي السعودي
SAMA
Saudi Central Bank



Contents

1. Introduction	2
2. Scope of Application	2
3. Implementation Timeline	3
4. SAMA Reporting Requirements	3
5. Policy Requirements	3
6. Exposure Measure	4
7. Treatment of Exposure Measures Items	6
7.1 <i>On-balance sheet exposures</i>	6
7.2 <i>Derivative exposures</i>	9
7.3 <i>Securities financing transaction exposures</i>	22
7.4 <i>Off-balance sheet (OBS) items</i>	28

Leverage Ratio Framework

1. Introduction:

In line with SAMA’s continuous efforts to maintain the quality and soundness of Leverage Ratio Framework and due to the issuance of Basel III: Finalizing post-crisis reforms on December 2017, SAMA has decided to issue this updated Leverage Ratio Framework to act as a credible supplementary measure to the risk-based capital requirements to restrict the build-up of leverage in the banking sector and to reinforce the risk-based requirements with a simple, transparent, non-risk-based “backstop” measure.

This updated framework is issued by SAMA in exercise of the authority vested in SAMA under the Central Bank Law issued via Royal Decree No. M/36 dated 11/04/1442H, and the Banking Control Law issued 01/01/1386H.

The Leverage Ratio Framework issued by this circular supersedes the previous Guidance Document and Prudential Returns concerning the Implementation of Basel III Leverage Ratio Framework issued via SAMA circular 351000133367 dated 25 August 2014.

2. Scope of Application:

2.1 This framework applies to all domestic banks both on a consolidated basis, which include all branches and subsidiaries, and on a standalone basis.

2.2 Leverage ratio framework follows the same scope of regulatory consolidation as is used for the risk-based capital. The treatment of investments in the capital of banking, financial, insurance and commercial entities which are outside the regulatory scope of consolidation should be as following:

- (i) Investments in capital of such entities (i.e. only the carrying value of the investment, as opposed to the underlying assets and other exposures of the investee) is to be included in the Leverage ratio exposure measure.

(ii) Investments in capital of such entities that have been deducted from Tier 1 capital as set out in paragraph 6.2 below should be excluded from the Leverage ratio exposure measure.

2.3 This framework is not applicable to Foreign Banks Branches operating in the kingdom of Saudi Arabia, and the branches shall comply with the regulatory requirements stipulated by their respective home regulators.

3. Implementation Timeline:

This framework will be effective on **01 January 2023**.

4. SAMA Reporting Requirements:

SAMA expects all Banks to report the Leveraged Ratio, using SAMA's Q17 reporting template, within 30 days after the end of each quarter.

5. Policy Requirements:

5.1 The Leverage ratio is defined as the capital measure (the numerator) divided by the exposure measure (the denominator). This ratio should be expressed as a percentage.

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

5.2 Capital measure for Leverage ratio is Tier 1 regulatory capital¹, which include common equity Tier 1 and Additional Tier 1 Capital as defined in in the Finalized Guidance Document Concerning the Implementation of Basel III issued by SAMA circular No. 341000015689 Dated 19 December 2012 and any subsequent adjustments.

5.3 The exposure measure for the Leverage ratio should generally follow gross accounting value unless different treatment is specifically mentioned in this framework.

¹ In other words, the capital measure used for the Leverage ratio at any particular point in time is the Tier 1 capital measure applicable at that time taking into consideration all regulatory adjustments allowed by SAMA from time to time.

- 5.4 Exposure measure should include the following exposures:
- (i) On-balance sheet exposures (excluding on-balance sheet derivative and securities financing transaction exposures);
 - (ii) Derivative exposures;
 - (iii) Securities financing transaction (SFT) exposures; and
 - (iv) Off-balance sheet (OBS) items.
- 5.5 The leverage ratio (Capital measure and Exposure measure) must be calculated and reported to SAMA on a quarter-end basis.
- 5.6 Banks' Leverage ratio must be at least 3% at all time.

6. Exposure Measure:

- 6.1 Banks must not use physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the Leverage ratio exposure measure, nor may banks net assets and liabilities, unless specified differently by SAMA.
- 6.2 Any item deducted from Tier 1 capital, according to the Finalized Guidance Document Concerning the Implementation of Basel III issued by SAMA in 19 December 2012 and any subsequent regulatory adjustments, other than those related to liabilities can be deducted from the Leverage ratio exposure measure. Three examples follow:
- (i) Where a banking, financial or insurance entity is not included in the regulatory scope of consolidation as set out in paragraph 2.2, the amount of any investment in the capital of that entity that is totally or partially deducted from Common Equity Tier 1 (CET1) capital or from Additional Tier 1 capital of the bank follow the corresponding deduction approach in the Finalized Guidance Document Concerning the Implementation of Basel III issued by SAMA in 19 December 2012 and any subsequent regulatory adjustments, may also be deducted from the Leverage ratio exposure measure;
 - (ii) For banks using the internal ratings-based (IRB) approach to determining capital requirements for credit risk, the Excess of total eligible provisions under IRB section in the Finalized Guidance Document Concerning the Implementation of Basel III issued by

SAMA in 19 December 2012 and any subsequent regulatory adjustments requires any shortfall in the stock of eligible provisions relating to expected loss amounts to be deducted from CET1 capital. The same amount may be deducted from the Leverage ratio exposure measure; and

- (iii) Prudent valuation adjustments (PVAs) for exposures to less liquid positions, other than those related to liabilities, that are deducted from Tier 1 capital as per Prudent valuation guidance set out in the Basel framework, should be deducted from the Leverage ratio exposure measure.

6.3 Deducting Liability items from the Leverage ratio exposure measure is not allowed. For example, gains/losses on fair valued liabilities or accounting value adjustments on derivative liabilities due to changes in the bank's own credit risk as described in the Cumulative gains and losses due to changes in own credit risk on fair valued financial liabilities section in of the Finalized Guidance Document Concerning the Implementation of Basel III circular No. 341000015689 issued by SAMA dated 19 December in 2012 and any subsequent adjustments, must not be deducted from the Leverage ratio exposure measure.

6.4 With regard to traditional securitizations, the originating bank may exclude securitized exposures from its leverage ratio exposure measure if the securitization meets the operational requirements for the recognition of risk transference². Banks meeting these conditions must include any retained securitization exposures in their leverage ratio exposure measure. In all other cases, traditional securitizations exposures that do not meet the operational requirements for the recognition of risk transference or synthetic securitizations, the securitized exposure must be included in the Leverage ratio exposure measure.

6.5 Banks should be particularly cautious to transactions and structures that have the result of inadequately capturing banks' sources of Leverage.

² As per paragraph 18.24 in the Minimum Capital Requirements for Credit Risk issued by SAMA.

Examples of concerns that might arise in such Leverage ratio exposure measure minimizing transactions and structures include the following:

- (i) Securities financing transactions where exposure to the counterparty increases as the counterparty's credit quality decreases, or securities financing transactions in which the credit quality of the counterparty is positively correlated with the value of the securities received in the transaction (i.e. the credit quality of the counterparty falls when the value of the securities falls);
- (ii) Banks that normally act as principal but adopt an agency model to transact in derivatives and SFTs in order to benefit from the more favorable treatment permitted for agency transactions under the Leverage ratio framework;
- (iii) Collateral swap trades structured to mitigate inclusion in the leverage ratio exposure measure; or use of structures to move assets off the balance sheet.

The above list of examples is by no means exhaustive.

6.6 SAMA reserves should be included in the Leverage exposure measure. SAMA may temporarily exempt central bank reserves from the Leverage ratio exposure measure in exceptional cases and when it deems necessary.

7. Treatment of Exposure Measures Items:

7.1 On-balance sheet exposures

7.1.1 All balance sheet assets including on-balance sheet derivatives collateral and collateral for secured financing transactions (SFTs) should be included in the Leverage ratio exposure measure except for the following:

- (i) On-balance sheet derivative and SFT assets that are covered in 7.2 Derivatives and 7.3 Security Financing Transactions below.
- (ii) fiduciary assets: Where a bank according to its operative accounting framework recognizes fiduciary assets on the balance sheet, these assets can be excluded from the Leverage ratio exposure measure

provided that the assets meet the IFRS 9 criteria for de-recognition and, where applicable, IFRS 10 for deconsolidation.

7.1.2 On-balance sheet non-derivative assets are included in the Leverage ratio exposure measure at their accounting values less deductions for associated specific provisions.

7.1.3 General provisions or general loan loss reserves that reduce the regulatory capital should be deducted from the Leverage ratio exposure measure. For the purposes of the leverage ratio exposure measure, the definition of general provisions/general loan-loss reserves applies to all banks regardless of whether they use the standardized approach or the IRB approach for credit risk for their risk based capital calculations.

7.1.4 The accounting for regular-way purchases or sales³ of financial assets that have not been settled (hereafter “unsettled trades”) differs across and within accounting frameworks. Unsettled trades can be accounted on the trade date (trade date accounting) or on the settlement date (settlement date accounting). For the purpose of the Leverage ratio exposure measure, treatment should be as below:

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

a. The financial assets bought and sold that are associated with cash payables and receivables are fair valued through income and included in the bank’s regulatory trading book as specified in Boundary between the banking book and

³ “regular-way purchases or sales” are purchases or sales of financial assets under contracts for which the terms require delivery of the assets within the time frame established generally by regulation or convention in the marketplace concerned.

the trading book in the Minimum Capital Requirement for Market Risk issued by SAMA.

b. The transactions of the financial assets are settled on a delivery-versus-payment (DVP) basis.

(ii) Banks using settlement date: accounting will be subject to the treatment set out in paragraph 7.4 off-balance sheet items below.

7.1.5 Cash pooling refers to arrangements involving treasury products whereby a bank combines the credit and/or debit balances of several individual participating customer accounts into a single account balance to facilitate cash and/or liquidity management. For the purposes of Leverage ratio exposure measure, the treatment of cash pooling should be as follow:

(i) where a cash pooling arrangement entails a transfer at least on a daily basis of the credit and /or debit balances of the individual participating customer accounts into a single account balance, the individual participating customer accounts are deemed to be extinguished and transformed into a single account balance upon the transfer provided the bank is not liable for the balances on an individual basis upon the transfer. Thus, the basis of the leverage ratio exposure measure for such a cash pooling arrangement is the single account balance and not the individual participating customer accounts

(ii) If the transfer of credit and/or debit balances of the individual participating customer accounts does not occur daily, extinguishment and transformation into a single account balance is deemed to occur and this single account balance may serve as the basis of the Leverage ratio exposure measure provided all of the following conditions are met:

a. In addition to providing for the several individual participating customer accounts, the cash pooling arrangement provides for a single account, into which the balances of all individual participating customer accounts can be transferred and thus extinguished;

b. The bank first has a legally enforceable right to transfer the balances of the individual participating customer accounts into a single account so that the bank is not liable for the balances on an individual

basis and second at any point in time, the bank must have the discretion and be in a position to exercise this right;

- c. There are no maturity mismatches among the balances of the individual participating customer accounts included in the cash pooling arrangement or all balances are either overnight or on demand; and
- d. The bank charges or pays interest and/or fees based on the combined balance of the individual participating customer accounts included in the cash pooling arrangement.
- e. SAMA does not deem as inadequate the frequency by which the balances of individual participating customer accounts are transferred to a single account.

In the event the abovementioned conditions are not met, the individual balances of the participating customer accounts must be reflected separately in the Leverage ratio exposure measure.

7.2 Derivative exposures

7.2.1 Treatment of derivatives:

Exposures to derivatives includes the following components under the Leverage ratio exposure measure:

- (i) Replacement cost (RC)
- (ii) Potential future exposure (PFE)

7.2.2 Calculation of Derivatives

- (i) Banks must calculate their exposures associated with all derivative transactions, including where a bank sells protection using a credit derivative as per subparagraph (iv) below
- (ii) If the derivative exposure covered by an eligible bilateral netting contract as specified in subparagraphs (v) and (vi) below, a specific treatment may be applied.
- (iii) Written credit derivatives are subject to an additional treatment, as set out in paragraphs 7.2.8 to 7.2.15 below.
- (iv) Derivative transactions not covered by an eligible bilateral netting contract as specified in subparagraphs (v) and (vi) below ,the

amount included in the Leverage ratio exposure measure will be determined for each transaction separately, as follows:

$$\text{Exposure measure} = \text{Alpha} * (\text{RC} + \text{PFE})$$

Where:

- a. Alpha = 1.4;
- b. RC = the replacement cost measured as follows:

$$\text{RC} = \max\{V - \text{CVM}_r + \text{CVM}_p, 0\}$$

Where:

- V is the market value of the individual derivative transaction or of the derivative transactions in a netting set;
- CVM_r is the cash variation margin received that meets the conditions set out in paragraph 7.2.4 and for which the amount has not already reduced the market value of the derivative transaction V under the bank's operative accounting standard; and
- CVM_p is the cash variation margin provided by the bank and that meets the same conditions.
- If there is no accounting measure of exposure for certain derivative instruments because they are held (completely) off balance sheet, the bank must use the sum of positive fair values of these derivatives as the replacement cost.

- c. **PFE** = The potential future exposure (PFE) for derivative exposures must be calculated in accordance with the Minimum Capital Requirement for Counterparty Credit Risk and Credit Valuation Adjustment paragraph 6.22 to 6.79. Mathematically:

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

Where:

- Multiplier fixed at one.
 - When calculating the aggregate Add-on component, for all margined transactions the maturity factor set out in the Minimum Capital Requirement for Counterparty Credit Risk and Credit Valuation Adjustment issued by SAMA paragraph 6.51 to 6.56 may be used. Further, as written options create an exposure to the underlying, they must be included in the Leverage ratio exposure measure by applying the required treatment, even if certain written options are permitted the zero exposure at default (EAD) treatment allowed in the risk-based framework.
- (v) Bilateral netting: when an eligible bilateral netting contract is in place the following will apply:
- a. Banks may net transactions subject to novation under which any obligation between a bank and its counterparty to deliver a given currency on a given value date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations.
 - b. Banks may also net transactions subject to any legally valid form of bilateral netting not covered in point (a) above, including other forms of novation.
 - c. In both cases (a) and (b) above, a bank will need to prove that it has:
 - A netting contract or agreement with the counterparty that creates a single legal obligation, covering all included transactions, such that the bank would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event that a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;

- Written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and authorities would find the bank’s exposure to be such a net amount under:
 - The law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of jurisdiction in which the branch is located;
 - The law that governs the individual transactions; and
 - The law that governs any contract or agreement necessary to effect the netting.
 - Procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law.
 - Netting agreements are not allowed in Saudi Arabia however, if netting is enforceable in any jurisdiction, positive and negative mark to market exposures in that jurisdiction will be allowed to net;⁴
- (vi) Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating the Leverage ratio exposure measure pursuant to this framework. A walkaway clause is a provision that permits a non-defaulting counterparty to make only limited payments or no payment at all, to the estate of a defaulter, even if the defaulter is a net creditor.

7.2.3 Treatment of related collateral

(i) Collateral received

- a. Collateral received in connection with derivative contracts has two countervailing effects on Leverage:
 - Reduces counterparty exposure

⁴ Paragraph 14 in SAMA Margin Requirements for Non-centrally Cleared Derivatives circular No42008998 dated 18/02/1442H

- Increases the economic resources at the disposal of the bank, as the bank can use the collateral to Leverage itself.
- b. Collateral received in connection with derivative contracts does not necessarily reduce the Leverage inherent in a bank’s derivative position, which is generally the case if the settlement exposure arising from the underlying derivative contract is not reduced.
- c. Collateral received should not be netted against derivative exposures whether or not netting is permitted under the bank’s operative accounting or risk-based framework. By applying 7.2.2 (derivative calculation) above, banks must not reduce the Leverage ratio exposure measure amount by any collateral received from the counterparty. This implies that replacement cost cannot be reduced by collateral received and the multiplier referenced in paragraph 7.2.2 is fixed at one for the purpose of the PFE calculation. However, the maturity factor in the PFE add-on calculation can recognize the PFE-reducing effect from the regular exchange of variation margin as specified above in paragraph 7.2.2.

(ii) Collateral provided

Banks must gross up their Leverage ratio exposure measure by the amount of any derivatives collateral provided where the provision of that collateral has reduced the value of their balance sheet assets under their operative accounting framework.

7.2.4 Treatment of cash variation margin:

- (i) Treatment of derivative exposures for the purpose of the Leverage ratio exposure measure, the cash portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment if the following conditions are met:
 - a. Trades not cleared through a qualifying central counterparty (QCCP)⁵ the cash received by the recipient counterparty is not segregated. Cash variation margin would satisfy the non-

⁵ QCCP is defined in the Minimum Capital Requirement for Counterparty Credit Risk and Credit Valuation Adjustment issued by SAMA under paragraph 3 “Definitions”.

segregation criterion if the recipient counterparty has no restrictions by law, regulation, or any agreement with the counterparty on the ability to use the cash received (i.e. the cash variation margin received used as its own cash).

- b. Variation margin is calculated and exchanged on at least a daily basis based on mark-to-market valuation of derivative positions. To meet this criterion, derivative positions must be valued daily and cash variation margin must be transferred at least daily to the counterparty or to the counterparty's account, as appropriate. Cash variation margin exchanged on the morning of the subsequent trading day based on the previous, end-of-day market values would meet this criterion.
- c. The variation margin is received in a currency specified in the derivative contract, governing master netting agreement (MNA), credit support annex (CSA) to the qualifying MNA or as defined by any netting agreement with a CCP.
- d. Variation margin exchanged is the full amount that would be necessary to extinguish the mark to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty. If a margin dispute arises, the amount of non-disputed variation margin that has been exchanged can be recognized.
- e. Derivative transactions and variation margins are covered by a single MNA between the legal entities that are the counterparties in the derivative transaction. The MNA must explicitly stipulate that the counterparties agree to settle net any payment obligations covered by such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA must be legally enforceable and effective (i.e. it satisfies the conditions in point (c) in subparagraph (v) and subparagraph (vi) in paragraph 7.2.2

Calculation of Derivatives above) in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency.⁶

(ii) If the conditions above are met, the cash portion of variation margin received may be used to reduce the replacement cost portion of the Leverage ratio exposure measure, and the receivables assets from cash variation margin provided may be deducted from the Leverage ratio exposure measure as follows:

- a. In the case of cash variation margin received, the receiving bank may reduce the replacement cost (but not the PFE component) of the exposure amount of the derivative asset as specified 7.2.2 above.
- b. In the case of cash variation margin provided to a counterparty, the posting bank may deduct the resulting receivable from its Leverage ratio exposure measure. Where the cash variation margin has been recognized as an asset under the bank's operative accounting framework, and instead include the cash variation margin provided in the calculation of the derivative replacement cost as specified 7.2.2 above.

7.2.5 Treatment of clearing services:

- (i) If a bank acting as clearing member (CM)⁷ offers clearing services to clients.
 - a. The CM's trade exposures to the central counterparty (CCP) that arise when the CM is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults must be captured by applying the same treatment that applies to any other type of derivative transaction.

⁶ For the purposes of this paragraph, the term "MNA" includes any netting agreement that provides legally enforceable rights of offset (taking into account the fact that, for netting agreements employed by CCPs, no standardization has currently emerged that would be comparable with respect to over-the-counter netting agreements for bilateral trading) and Master MNA may be deemed to be a single MNA.

⁷ The terms "clearing member", "trade exposure", "central counterparty" and "qualifying central counterparty" are defined in the Minimum Capital Requirement for Counterparty Credit Risk and Credit Valuation Adjustment issued by SAMA under paragraph 3 "Definitions". In addition, for the purposes of this paragraph, the term "trade exposures" includes initial margin irrespective of whether or not it is posted in a manner that makes it remote from the insolvency of the CCP.

Leverage Ratio Framework	Version	Issuance Date	Page Number
	2.1	December 2022	15 of 31

- b. If the clearing member CM, based on the contractual arrangements with the client, is not obligated to reimburse the client for any losses suffered in the event that a QCCP defaults, the CM does not need to recognize the resulting trade exposures to the QCCP in the Leverage ratio exposure measure.
- (ii) Bank provides clearing services as a “higher level client” within a multi-level client structure⁸, the bank should not recognize in its Leverage ratio exposure measure the resulting trade exposures to the CM or to an entity that serves as a higher level client to the bank in the Leverage ratio exposure measure if it meets all of the following conditions:
- a. The offsetting transactions are identified by the QCCP as higher level client transactions and collateral to support them is held by the QCCP and/or the CM, as applicable, under arrangements that prevent any losses to the higher level client due to:
- The default or insolvency of the CM,
 - The default or insolvency of the CM’s other clients, and
 - The joint default or insolvency of the CM and any of its other clients⁹
- b. The bank must have conducted a sufficient legal review (and undertake such further review as necessary to ensure continuing enforceability) and have a well-founded basis to conclude that, in the event of legal challenge, the relevant courts and administrative authorities would find that such arrangements mentioned above would be legal, valid, binding and enforceable under relevant laws of the relevant jurisdiction(s);
- c. Relevant laws, regulation, rules, contractual or administrative arrangements provide that the offsetting transactions with the

⁸ A multi-level client structure is one in which banks can centrally clear as indirect clients; that is, when clearing services are provided to the bank by an institution which is not a direct clearing member, but is itself a client of a CM or another clearing client. The term “higher-level client” refers to the institution that provides clearing services.

⁹ upon the insolvency of the clearing member, there is no legal impediment (other than the need to obtain a court order to which the client is entitled) to the transfer of the collateral belonging to clients of a defaulting clearing member to the QCCP, to one of more other surviving clearing members or to the client or the client’s nominee.

defaulted or insolvent CM are highly likely to continue to be indirectly transacted through the QCCP, or by the QCCP, if the CM defaults or becomes insolvent¹⁰. In such circumstances, the higher level client positions and collateral with the QCCP will be transferred at market value unless the higher level client requests to close out the position at market value;

d. The bank is not obligated to reimburse its client for any losses suffered in the event of default of either the CM or the QCCP.

(iii) Derivative exposures associated with the bank’s offering of client clearing services, the RC and the PFE of the exposure to the client (or the exposure to the “lower level client” in the case of a multi-level client structure) may be calculated according to the Minimum Capital Requirement for Counterparty Credit Risk and Credit Valuation Adjustment issued by SAMA paragraph 6.15 to 6.80.¹¹ For the determination of RC and PFE, the amount of initial margin received by the bank from its client that may be included in the haircut value of net collateral held (C) and net independent collateral amount (NICA) should be limited to the amount that is subject to appropriate segregation by the bank as defined in the relevant jurisdiction.

7.2.6 If a client enters into a derivative transaction with the CCP directly, and the CM guarantees the performance of its client’s derivative trade exposures to the CCP. The bank who’s acting as CM for the client to the CCP, must calculate its related Leverage ratio exposure resulting from the guarantee as a derivative exposure as set out in paragraphs 7.2.2 to 7.2.4 above, as if it had entered directly into the transaction

¹⁰ If there is a clear precedent for transactions being ported at a QCCP and industry intent for this practice to continue, then these factors must be considered when assessing if trades are highly likely to be ported. The fact that QCCP documentation does not prohibit client trades from being ported is not sufficient to say they are highly likely to be ported.

¹¹ The term “lower level client” refers to the institution that clears through that client.

with the client, including with regard to the receipt or provision of cash variation margin.

- 7.2.7 Affiliated entities to the bank acting as a CM may be considered a client if it is outside the relevant scope of regulatory consolidation at the level at which the Leverage ratio is applied. In contrast, if an affiliate entity falls within the regulatory scope of consolidation, the trade between the affiliate entity and the CM is eliminated in the course of consolidation but the CM still has a trade exposure to the CCP. In this case, the transaction with the CCP will be considered proprietary and the exemption in paragraph 7.2.5 above will not apply.
- 7.2.8 In addition to the CCR exposure arising from the fair value of the contracts, written credit derivatives create a notional credit exposure arising from the credit worthiness of the entity. Banks should treat written credit derivatives consistently with cash instruments (e.g. loans, bonds) for the purposes of the Leverage ratio exposure measure.
- 7.2.9 To capture the credit exposure of a certain entity, taking into consideration the treatment of derivatives and related collateral above, the effective notional amount referenced by a written credit derivative must be included in the Leverage ratio exposure measure. Unless the written credit derivative is included in a transaction cleared on behalf of a client of the bank acting as a CM (or acting as a clearing services provider in a multi-level client structure as referenced in paragraph 7.2.5 and the transaction meets the requirements of paragraph 7.2.5 for the exclusion of trade exposures to the QCCP (or, in the case of a multi-level client structure, the requirements of paragraph 7.2.5 for the exclusion of trade exposures to the CM or the QCCP).
- 7.2.10 The “effective notional amount” obtained by adjusting the notional amount to reflect the true exposure of contracts that are Leveraged or otherwise enhanced by the structure of the transaction. Further, the effective notional amount of a written credit derivative may be reduced by any negative change in fair value amount that has been incorporated into the calculation of Tier 1 capital with respect to the written credit

derivative¹²¹³. The resulting amount may be further reduced by the effective notional amount of a purchased credit derivative on the same reference name, provided that:

(i) The credit protection purchased through credit derivatives is otherwise subject to the same or more conservative material terms as those in the corresponding written credit derivative. This ensures that if a bank provides written protection via some type of credit derivative, the bank may only recognize offsetting from another purchased credit derivative to the extent that the purchased protection is certain to deliver a payment in all potential future states. Material terms include the level of subordination, optionality, credit events, reference and any other characteristics relevant to the valuation of the derivative. For example, the application of the same material terms condition would result in the following treatments:

a. in the case of single name credit derivatives, the credit protection purchased through credit derivatives is on a reference obligation which ranks pari passu with or is junior to the underlying reference obligation of the written credit derivative. Credit protection purchased through credit derivatives that references a subordinated position may offset written credit derivatives on a more senior position of the same reference entity as long as a credit event on the senior reference asset would result in a credit event on the subordinated reference asset;

¹² For example, if a written credit derivative had a positive fair value of 20 on one date and has a negative fair value of 10 on a subsequent reporting date, the effective notional amount of the credit derivative may be reduced by 10. The effective notional amount cannot be reduced by 30. However, if on the subsequent reporting date the credit derivative has a positive fair value of five, the effective notional amount cannot be reduced at all.

¹³ This treatment is consistent with the rationale that the effective notional amounts included in the exposure measure may be capped at the level of the maximum potential loss, which means that the maximum potential loss at the reporting date is the notional amount of the credit derivative minus any negative fair value that has already reduced Tier 1 capital.

- b. for tranche products, the credit protection purchased through credit derivatives must be on a reference obligation with the same level of seniority.
- (ii) The remaining maturity of the credit protection purchased through credit derivatives is equal to or greater than the remaining maturity of the written credit derivative;
 - (iii) The credit protection purchased through credit derivatives is not purchased from a counterparty whose credit quality is highly correlated with the value of the reference obligation in the sense specified in the Minimum Capital Requirement for Counterparty Credit Risk and Credit Valuation Adjustment issued by SAMA paragraph 7.48. The credit quality of the counterparty must not be positively correlated with the value of the reference obligation (ie the credit quality of the counterparty falls when the value of the reference obligation falls and the value of the purchased credit derivative increases). In making this determination, there does not need to exist a legal connection between the counterparty and the underlying reference entity.
 - (iv) In the event that the effective notional amount of a written credit derivative is reduced by any negative change in fair value reflected in the bank's Tier 1 capital, the effective notional amount of the offsetting credit protection purchased through credit derivatives must also be reduced by any resulting positive change in fair value reflected in Tier 1 capital; and
 - (v) The credit protection purchased through credit derivatives is not included in a transaction that has been cleared on behalf of a client (or that has been cleared by the bank in its role as a clearing services provider in a multi-level client services structure as referenced in paragraph 7.2.5) and for which the effective notional amount referenced by the corresponding written credit derivative is excluded from the Leverage ratio exposure measure according to this paragraph.

- 7.2.11 Written credit derivative refers to a broad range of credit derivatives through which a bank effectively provides credit protection and is not limited solely to credit default swaps and total return swaps. For example, all options where the bank has the obligation to provide credit protection under certain conditions qualify as “written credit derivatives”. The effective notional amount of such options sold by the bank may be offset by the effective notional amount of options by which the bank has the right to purchase credit protection which fulfils the conditions of paragraph 7.2.9 and 7.2.10 above. Also, the condition of same or more conservative material terms as those in the corresponding written credit derivatives as referenced in paragraph 7.2.9 and 7.2.10 above can be considered met only when the strike price of the underlying purchased credit protection is equal to or lower than the strike price of the underlying sold credit protection.
- 7.2.12 For the purposes of paragraph 7.2.9 and 7.2.10 above, two reference names are considered identical only if they refer to the same legal entity. Credit protection on a pool of reference names purchased through credit derivatives may offset credit protection sold on individual reference names, if the credit protection purchased is economically equivalent to purchasing credit protection separately on each of the individual names in the pool (this would, for example, be the case if a bank were to purchase credit protection on an entire securitization structure).
- 7.2.13 If a bank purchases credit protection on a pool of reference names through credit derivatives but the credit protection purchase does not cover the entire pool (i.e. the protection covers only a subset of the pool, as in the case of an nth-to-default credit derivative or a securitization tranche), then the written credit derivatives on the individual reference names should not be offset. However, such purchased credit protection may offset written credit derivatives on a pool provided that the credit protection purchased through credit

derivatives covers the entirety of the subset of the pool on which the credit protection has been sold.¹⁴

- 7.2.14 Where a bank purchases credit protection through a total return swap (TRS) and records the net payments received as net income, but does not record offsetting deterioration in the value of the written credit derivative (either through reductions in fair value or by an addition to reserves) in Tier 1 capital, the credit protection will not be recognized for the purpose of offsetting the effective notional amounts related to written credit derivatives.
- 7.2.15 Since written credit derivatives are included in the Leverage ratio exposure measure at their effective notional amounts, and are also subject to amounts for PFE, the Leverage ratio exposure measure for written credit derivatives may be overstated. Banks may therefore choose to exclude from the netting set for the PFE calculation the portion of a written credit derivative which is not offset according to paragraph 7.2.9 and 7.2.10¹⁵ and for which the effective notional amount is included in the Leverage ratio exposure measure.

7.3 Securities financing transaction exposures

- 7.3.1 SFTs such as repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin-lending transactions where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements, are included in the Leverage ratio exposure measure.
- 7.3.2 The treatment recognizes that secured lending and borrowing in the form of SFTs is an important source of Leverage, and ensures consistent international implementation by providing a common

¹⁴ In other words, offsetting may only be recognized when the pool of reference entities and the level of subordination in both transactions are identical.

¹⁵ the removal of a PFE add-on associated with a written credit derivative from the leverage ratio exposure measure refers only to the offset by credit protection purchased through a credit derivative according to paragraph 7.2.9 and 7.2.10 and not to the reduction of the effective notional amount as a result of the negative change in fair value that has reduced Tier 1 capital.

measure for dealing with the main differences in the operative accounting frameworks.

Treatment of Securities financing transaction exposures:

7.3.3 Bank acting as principal (General treatment): the sum of the amounts below must be included in the Leverage ratio exposure measure:

- (i) Gross SFT assets¹⁶ recognized for accounting purposes (i.e. with no recognition of accounting netting)¹⁷ will be adjusted as follows:
 - a. Excluding from the Leverage ratio exposure measure the value of any securities received under an SFT, where the bank has recognized the securities as an asset on its balance sheet.
 - b. Cash payables and cash receivables in SFTs with the same counterparty may be measured net if all the following criteria are met:
 - Transactions have the same explicit final settlement date; in particular, transactions with no explicit end date but which can be unwound at any time by either party to the transaction are not eligible;
 - The right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of the counterparty’s default; insolvency; or bankruptcy;
 - The counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement – that is, the cash flows of the transactions are equivalent, in effect, to

¹⁶ For SFT assets subject to novation and cleared through QCCPs, “gross SFT assets recognized for accounting purposes” are replaced by the final contractual exposure, i.e. the exposure to the QCCP after the process of novation has been applied, given that pre-existing contracts have been replaced by new legal obligations through the novation process. However, banks can only net cash receivables and cash payables with a QCCP if the criteria in paragraph 7.3.3 (i) are met. Any other netting permitted by the QCCP is not permitted for the purposes of the Leverage ratio.

¹⁷ Gross SFT assets recognized for accounting purposes must not recognize any accounting netting of cash payables against cash receivables (eg as currently permitted under the IFRS). This regulatory treatment has the benefit of avoiding inconsistencies from netting which may arise across different accounting regimes

a single net amount on the settlement date. To achieve such equivalence both transactions are settled through the same settlement system and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day and any issues arising from the securities legs of the SFTs do not interfere with the completion of the net settlement of the cash receivables and payables. In particular, this latter condition means that the failure of any single securities transaction in the settlement mechanism may delay settlement of only the matching cash leg or create an obligation to the settlement mechanism, supported by an associated credit facility. If there is a failure of the securities leg of a transaction in such a mechanism at the end of the window for settlement in the settlement mechanism, then this transaction and its matching cash leg must be split out from the netting set and treated gross.¹⁸

- (ii) A measure of CCR calculated as the current exposure without an add-on for PFE, should be calculated as follows:
- a. Where a qualifying MNA¹⁹ is in place, the current exposure (E*) is the greater of zero and the total fair value of securities and cash lent to a counterparty for all transactions included in the qualifying MNA ($\sum E_i$), less the total fair value of cash and securities received from the counterparty for those transactions ($\sum C_i$). This is illustrated in the following formula:

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

¹⁸ the criteria in this paragraph are not intended to preclude a DVP settlement mechanism or other type of settlement mechanism, provided that the settlement mechanism meets the functional requirements. For example, a settlement mechanism may meet these functional requirements if any failed transactions (ie the securities that failed to transfer and the related cash receivable or payable) can be re-entered in the settlement mechanism until they are settled.

¹⁹ A “qualifying” MNA is one that meets the requirements under paragraphs 7.3.4 in this document.

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

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

Where E_i^* may be set to zero if:

- E_i is the cash lent to a counterparty.
- This transaction is treated as its own netting set and
- The associated cash receivable is not eligible for the netting treatment in paragraph 7.3.3 (i).

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

7.3.4 *Securities financing transaction exposures calculation:*

- (i) The effects of bilateral netting agreements²⁰ for covering SFTs will be recognized on a counterparty-by-counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:
- a. Provide the non-defaulting party with the right to terminate and close out in a timely manner all transactions under the agreement

²⁰ The provisions related to qualifying master netting agreements for SFTs are intended for the calculation of the counterparty credit risk measure of SFTs as set out in paragraph 7.3.3 (ii) only.

upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;

- b. Provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;
 - c. Allow for the prompt liquidation or setoff of collateral upon the event of default; and
 - d. Be together with the rights arising from provisions required in (a) and (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default regardless of the counterparty's insolvency or bankruptcy.
- (ii) Netting across positions held in the banking book and trading book will only be recognized when the netted transactions fulfil the following conditions:
- a. All transactions are marked to market daily; and
 - b. The collateral instruments used in the transactions are recognized as eligible financial collateral in the banking book

7.3.5 Sale accounting transactions: Leverage may remain with the lender of the security in an SFT whether or not sale accounting is achieved under the operative accounting framework. If the sale accounting is achieved for an SFT under the bank's operative accounting framework, the bank must reverse all sales-related accounting entries, and then calculate its exposure as if the SFT had been treated as a financing transaction under the operative accounting framework. I.e. the bank must include the sum of amounts in subparagraphs (i) and (ii) of paragraph 7.3.3 for such an SFT) for the purpose of determining its Leverage ratio exposure measure.

7.3.6 Bank acting as agent:

- (i) A bank acting as agent in an SFT provides Indemnity or guarantee to only one of the two parties involved, and only for the difference between the value of the security or cash its customer has lent and the value of collateral the borrower has provided. In this situation,

the bank is exposed to the counterparty of its customer for the difference in values rather than to the full exposure to the underlying security or cash of the transaction (as is the case where the bank is one of the principals in the transaction).

(ii) A bank acting as agent in an SFT provides Indemnity or guarantee to a customer or counterparty for any difference between the value of the security or cash the customer has lent and the value of collateral the borrower has provided and the bank does not own or control the underlying cash or security resource, then the bank will be required to calculate its Leverage ratio exposure measure by applying only measure of CCR calculated as the current exposure without an add-on for PFE (subparagraph (ii) of paragraph 7.3.3). In addition to the conditions mentioned from paragraph 7.3.3 to 7.3.6 bank acting as an agent in an SFT does not provide an indemnity or guarantee to any of the involved parties, the bank is not exposed to the SFT and therefore need not recognize those SFTs in its Leverage ratio exposure measure.

(iii) A bank acting as agent in an SFT provides Indemnity or guarantee to a customer or counterparty will be considered eligible for the exceptional treatment above only if the bank's exposure to the transaction is limited to the guaranteed difference between the values of the security or cash its customer has lent and the value of the collateral the borrower has provided. In situations where the bank is further economically exposed (i.e. beyond the guarantee for the difference) to the underlying security or cash in the transaction, a further exposure equal to the full amount of the security or cash must be included in the Leverage ratio exposure measure. For example, due to the bank managing collateral received in the bank's name or on its own account rather than on the customer's or borrower's account (eg by on-lending or managing unsegregated collateral, cash or securities). However, this does not apply to client omnibus accounts that are used by agent lenders to hold and manage client collateral provided that client collateral is segregated from the

bank's proprietary assets and the bank calculates the exposure on a client-by-client basis.

- (iv) A bank acting as agent in an SFT provides Indemnity or guarantee to both parties involved in an SFT (i.e. securities lender and securities borrower), the bank will be required to calculate its Leverage ratio exposure measure in accordance with paragraph 7.3.3 to 7.3.6 separately for each party involved in the transaction.

7.4 Off-balance sheet (OBS) items

7.4.1 OBS items include commitments (including liquidity facilities), whether or not unconditionally cancellable, direct credit substitutes, acceptances, standby letters of credit and trade letters of credit.

7.4.2 Treatment of OBS items for inclusion in the Leverage ratio exposure measure should be as follows:

- (i) The standardized approach for credit risk as it applies to individual claims and the standardized approach for counterparty credit risk (SA-CCR) as well as treatments unique to the Leverage ratio framework.
- (ii) If the OBS item is treated as a derivative exposure per the bank's relevant accounting standard, then the item must be measured as a derivative exposure for the purpose of the Leverage ratio exposure measure. In this case, the bank does not need to apply the OBS item treatment to the exposure.
- (iii) OBS items are converted under the standardized approach for credit risk into credit exposure equivalents through the use of credit conversion factors (CCFs) as mentioned in the latest risk-based capital framework adopted by SAMA. For the purpose of determining the exposure amount of OBS items for the Leverage ratio, the CCFs set out in Paragraph 7.4.3 from (iv) to (x) must be applied to the notional amount.
- (iv) Specific and general provisions set aside against OBS exposures that have decreased regulatory capital may be deducted from the credit exposure equivalent amount of those exposures (ie the exposure

amount after the application of the relevant CCF). However, the resulting total off-balance sheet equivalent amount for OBS exposures cannot be less than zero.

7.4.3 Calculation of off balance sheet items should be as follows:

- (i) For the purposes of the Leverage ratio, OBS items will be converted into credit exposures by multiplying the committed but undrawn amount by a credit conversion factor (CCF).
- (ii) Commitment means any contractual arrangement that has been offered by the bank and accepted by the client to extend credit, purchase assets or issue credit substitutes. It includes the following:
 - a. Any arrangement that can be unconditionally cancelled by the bank at any time without prior notice to the obligor.
 - b. Any arrangement that can be cancelled by the bank if the obligor fails to meet conditions set out in the facility document, including conditions that must be met by the obligor prior to any initial or subsequent drawdown arrangement.
- (iii) Certain arrangements that meets the following requirements can be exempted from the definition of commitments after obtaining SAMA prior approval:
 - a. The bank receives no fees or commissions to establish or maintain the arrangements;
 - b. The client is required to apply to the bank for the initial and each subsequent drawdown;
 - c. The bank has full authority, regardless of the fulfilment by the client of the conditions set out in the facility documentation, over the execution of each drawdown; and
 - d. The bank's decision on the execution of each drawdown is only made after assessing the creditworthiness of the client immediately prior to drawdown. Exempted arrangements that meet the above criteria are confined to certain arrangements for

corporates and SMEs²¹, where counterparties are closely monitored on an ongoing basis).

- (iv) A 100% CCF will be applied to the following items:
- a. Direct credit substitutes, e.g. general guarantees of indebtedness (including standby letters of credit serving as financial guarantees for loans and securities) and acceptances (including endorsements with the character of acceptances).
 - b. Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawdown.
 - c. The exposure amount associated with unsettled financial asset purchases (i.e. the commitment to pay) where regular-way unsettled trades are accounted for at settlement date. Banks may offset commitments to pay for unsettled purchases and cash to be received for unsettled sales provided that the following conditions are met:
 - the financial assets bought and sold that are associated with cash payables and receivables are fair valued through income and included in the bank's regulatory trading book as specified in Boundary between the banking book and the trading book in the Minimum Capital Requirement for Market Risk issued by SAMA paragraph 5.1 to 5.13; and
 - The transactions of the financial assets are settled on a DVP basis.
 - d. Off-balance sheet items that are credit substitutes not explicitly included in any other category.
- (v) A 50% CCF will be applied to the following :
- a. Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) regardless of the maturity of the underlying facility.

²¹ As defined in SAMA circular No.381000064902 dated 16/06/1438 or any subsequent definition by SAMA.

- b. To certain transaction-related contingent items (e.g. performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions).
- (vi) A 40% CCF will be applied to commitments, regardless of the maturity of the underlying facility, unless they qualify for a lower CCF.
- (vii) A 20% CCF will be applied to both the issuing and confirming banks of short-term(Less than a year) self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralized by the underlying shipment).
- (viii) A 10% CCF will be applied to commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower’s creditworthiness.
- (ix) Where there is an undertaking to provide a commitment on an off-balance sheet item, banks are to apply the lower of the two applicable CCFs. For example, if a bank has a commitment to open short-term self-liquidating trade letters of credit arising from the movement of goods, a 20% CCF will be applied (instead of a 40% CCF); and if a bank has an unconditionally cancellable commitment described in 7.92 in the Minimum Capital Requirements for Credit Risk issued by SAMA to issue direct credit substitutes, a 10% CCF will be applied (instead of a 100% CCF).
- (x) OBS securitization exposures must be treated as per paragraph 18.20 in the Minimum Capital Requirements for Credit Risk issued by SAMA.