CA-15.1 Rationale and Objective

Scope and Factors Leading to Leverage

The content of this Chapter is applicable to all Bahraini conventional bank licensees except Section CA-15.7 which is applicable only to overseas conventional retail bank licensees.

CA-15.1.2 Financial leverage – that is, the use of non-equity funds to fund assets – allows a financial institution to increase the potential returns on its equity capital, with a concomitant increase in the riskiness of the equity capital and its exposure to losses since the non-equity funds are either not, or only partially risk-absorbent. Consequently, leverage is commonly accomplished through the use of borrowed funds, debt capital or derivative instruments, etc. It is common for banks to engage in leverage by borrowing to acquire more assets, with the aim of increasing their return on equity. Similarly, the contingent exposure of the banks can expose them to risk of losses much greater than is observable on the balance sheet.

CA-15.1.3 The leverage ratio serves as a supplementary measure to the risk-based capital requirements of the rest of this Module. The leverage ratio is a simple, transparent ratio and is intended to achieve the following objectives:

(a) To constrain the build-up of leverage in the banking sector, helping avoid destabilising deleveraging processes which can damage the broader financial system and the economy;
(b) To reinforce the risk-based requirements with a simple, non-risk based “backstop” measure; and
(c) To serve as a broad measure of both the on- and off-balance sheet sources of bank leverage.
CA-15.2 Definition, Calculation and Scope of the Leverage Ratio

**Computational Details**

CA-15.2.1 This section presents the definition and calculation of the leverage ratio. Transitional arrangements are set out in Paragraphs CA-15.5.1 to CA-15.5.3.

CA-15.2.2 The leverage ratio is defined as follows: The Numerator is Tier One Capital (described in Paragraph CA-1.1.2). The Denominator is Total Exposures (described in Section CA-15.3). Bahraini conventional bank licensees must exceed a minimum Tier 1 leverage ratio of 3% from 1 January 2018, calculated on a consolidated basis.

CA-15.2.3 The leverage ratio may be expressed as a percentage as follows:

\[
\text{Tier One Capital} \div \text{Total Exposures}
\]

Comment [RE2]: B3 P153

CA-15.2.4 The leverage ratio framework follows the same scope of regulatory consolidation for Tier One Capital and Total Exposures as is used in CA-B.1.2A, except for the following: Where a banking, financial, insurance or commercial entity is outside the scope of regulatory consolidation, only the investment in the capital of such entities (i.e. only the carrying value of the investment, as opposed to the underlying assets and other exposures of the investee) is to be included in the total exposures measure. However, investments in the capital of such entities that are deducted from Tier One Capital must also be deducted from the exposures measure for the purpose of the leverage ratio calculation.

Comment [RE3]: B3 P153

Comment [RE4]: B3 Lev P6

Comment [RE5]: B3 Lev P8 & 9
CA-15.3 Exposure Measure

General Measurement Principles

CA-15.3.1 A Bahraini conventional bank licensee’s Total Exposures are the sum of the following exposures: (a) on-balance sheet exposures; (b) derivative exposures; (c) securities financing transactions; and (d) off-balance sheet items as identified in this Section.

Comment [RE6]: B3 Lev P14

CA-15.3.2 For purposes of Paragraph CA-15.3.1, to be measured consistently with financial statements, the following must apply:

(a) On-balance sheet, non-derivative exposures are net of specific provisions and valuation adjustments (e.g. credit valuation adjustments under IFRS);

(b) Unless specified differently below, physical or financial collateral, guarantees or credit risk mitigation purchased is not allowed to reduce exposures; and

(c) Netting of loans and deposits is not allowed.

Comment [RE7]: B3 lev P13

On-balance Sheet Items

CA-15.3.3 Bahraini conventional bank licensees must include all balance sheet assets in their exposure measure, including on balance sheet derivatives’ collateral and collateral for Securities Financing Transactions (SFTs), with the exception of on-balance sheet derivative and SFT assets that are covered in Paragraphs CA-15.3.14 to C-15.3.27 and CA-15.3.7 to CA-15.3.12. On-balance sheet assets must be measured using their accounting balance sheet values (i.e. unweighted) for the purposes of the leverage ratio.

Comment [RE8]: B3 Lev p15

CA-15.3.4 Items (such as goodwill) that are deducted completely from Tier One Capital must be deducted from Total Exposures.

Comment [RE9]: B3 Lev P16

CA-15.3.5 According to the treatment outlined in Paragraphs CA-2.4.20 to CA-2.4.24, where a financial entity is not included in the regulatory scope of consolidation in CA-B.1.2A, the amount of any investment in the capital of that entity that is totally or partially deducted from CET1 or from AT1 capital of the Bahraini conventional bank licensee following the corresponding deduction approach in Paragraphs CA-2.4.20 to CA-2.4.26 must be deducted from Total Exposures.

Comment [RE10]: B3 Lev P16

CA-15.3.6 Liability items must not be deducted from the measure of exposure.

Comment [RE11]: B3 lev P17
CA-15.3 Exposure Measure (continued)

Securities Financing Transaction Exposures (SFTs)

CA-15.3.7 SFTs are included in the exposure measure according to the treatment described below.

General Treatment (Bank Acting as Principal)

CA-15.3.8 The sum of the amounts in subparagraphs (a) and (b) are to be included in the leverage ratio exposure measure:

(a) Gross SFT assets\(^1\) (i.e. with no recognition of accounting netting),\(^2\) adjusted as follows:

(i) Excluding from the exposure measure the value of any securities received under an SFT, where the Bahraini conventional bank licensee has recognised the securities as an asset on its balance sheet; and

(ii) Cash payables and cash receivables in SFTs with the same counterparty may be measured net if the following criteria are met:

(A) Transactions have the same explicit final settlement date;

(B) The right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of: (i) default; (ii) insolvency; and (iii) bankruptcy; and

---

\(^1\) For SFT assets subject to novation and cleared through Qualifying Central Counterparties, “gross SFT assets recognised for accounting purposes”\(^3\) are replaced by the final contractual exposure, given that pre-existing contracts have been replaced by new legal obligations through the novation process.

\(^2\) Gross SFT assets must not recognise any accounting netting of cash payables against cash receivables.
CA-15.3 Exposure Measure (continued)

(C) The counterparties intend to settle net, settle simultaneously, or the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement, that is, the cash flows of the transactions are equivalent, in effect, to a single net amount on the settlement date. To achieve such equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash and/or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day and the linkages to collateral flows do not result in the unwinding of net cash settlement3; and

(b) A measure of Counterparty Credit Risk calculated as the current exposure without an add-on for Potential Future Exposure (PFE), calculated as follows:

(i) Where a qualifying Master Netting Agreement (MNA) is in place, the current exposure ($E^*$) is the greater of zero and the total fair value of securities and cash lent to a counterparty for all transactions included in the qualifying MNA ($\Sigma E_i$), less the total fair value of cash and securities received from the counterparty for those transactions ($\Sigma C_i$). This is illustrated in the following formula:

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

(ii) 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 is treated as its own netting set, as shown in the following formula:

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

Sale Accounting Transactions

CA-15.3.9

Leverage may remain with the lender of the security in a SFT whether or not sale accounting is achieved under IFRS. As such, where sale accounting is achieved for a SFT under IFRS, the Bahraini conventional bank licensee must reverse all sales-related accounting entries, and then calculate its exposure as if the SFT had been treated as a financing transaction (i.e. the Bahraini conventional bank licensee must include the sum of amounts in Subparagraphs CA-15.3.8 (a) and (b) for such a SFT) for the purposes of determining its exposure.

3 This latter condition ensures that any issues arising from the securities leg of the SFTs do not interfere with the completion of the net settlement of the cash receivables and payables.

4 A “qualifying” MNA is one that meets the requirements under Paragraphs CA-15.6.14 and 15.
CA-15.3 Exposure Measure (continued)

Bank Acting as Agent

CA-15.3.10 A bank acting as agent in a SFT generally provides an indemnity or guarantee to only one of the two parties involved, and only for the difference between the value of the security or cash its customer has lent and the value of collateral the borrower has provided. In this situation, the bank is exposed to the counterparty of its customer for the difference in values rather than to the full exposure to the underlying security or cash of the transaction (as is the case where the bank is one of the principals in the transaction). Where the bank does not own/control the underlying cash or security resource, that resource cannot be leveraged by the bank.

CA-15.3.11 Where a bank acting as agent in a SFT provides an indemnity or guarantee to a customer or counterparty for any difference between the value of the security or cash the customer has lent and the value of collateral the borrower has provided, then the Bahraini conventional bank licensee will be required to calculate its exposure measure by applying only Subparagraph 15.3.8(b).

CA-15.3.12 A bank acting as agent in a SFT and providing an indemnity or guarantee to a customer or counterparty will be considered eligible for the exceptional treatment set out in paragraph CA-15.3.11 only if the Bahraini conventional bank licensee’s exposure to the transaction is limited to the guaranteed difference between the value of the security or cash its customer has lent and the value of the collateral the borrower has provided. In situations where the Bahraini conventional bank licensees is further economically exposed (i.e. beyond the guarantee for the difference) to the underlying security or cash in the transaction, a further exposure equal to the full amount of the security or cash must be included in the exposure measure.

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5 Where, in addition to the conditions in Paragraphs CA-15.3.10 to 15.3.12, a bank acting as an agent in a SFT does not provide an indemnity or guarantee to any of the involved parties, the bank is not exposed to the SFT and therefore need not recognise those SFTs in its exposure measure.

6 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 (e.g. by on-lending or managing unsegregated collateral, cash or securities).
CA-15.3 Exposure Measure (continued)

Derivative Exposures

CA-15.3.13 Derivatives create two types of exposure:
(a) An exposure arising from the underlying of the derivative contract; and
(b) A counterparty credit risk (CCR) exposure.

The leverage ratio framework uses the method set out below to capture both of these exposure types.

CA-15.3.14 Bahraini conventional bank licensees must calculate their derivative exposures, including where a Bahraini conventional bank licensee sells protection using a credit derivative, as the replacement cost (RC) for the current exposure plus an add-on for PFE, as described in Paragraph CA-15.3.15. If the derivative exposure is covered by an eligible bilateral netting contract as specified in Section CA-15.6, the treatment in Chapter CA-4 may be applied. Written credit derivatives are subject to an additional treatment, as set out in Paragraphs CA-15.3.25 to CA-15.3.27.

CA-15.3.15 For a single derivative exposure not covered by an eligible bilateral netting contract as specified in Paragraphs CA-15.6.9 to CA-15.6.11, the amount to be included in the exposure measure is determined as follows:

\[
\text{Exposure measure} = \text{replacement cost (RC)} + \text{add-on}
\]

where

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

add-on = an amount for PFE over the remaining life of the contract calculated by applying an add-on factor to the notional principal amount of the derivative. The add-on factors are included in Paragraphs CA-15.6.2 and CA-15.6.4.

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7 This approach makes reference to the Current Exposure Method which is used in the Rulebook to calculate CCR exposure amounts associated with derivative exposures.

8 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.

9 These are netting rules in Chapter CA-4 excepting the rules for cross-product netting in Appendix CA-2, Section III (i.e. cross-product netting is not permitted in determining the leverage ratio exposure measure).
CA-15.3 Exposure Measure (continued)

*Bilateral Netting*

CA-15.3.16 When an eligible bilateral netting contract is in place (see Paragraphs CA-15.6.9 to CA-15.6.11), the RC for the set of derivative exposures covered by the contract will be the net replacement cost and the add-on will be $\Delta_{Net}$ as calculated in Paragraph CA-15.6.12.

*Treatment of Related Collateral*

CA-15.3.17 Collateral received in connection with derivative contracts has two countervailing effects on leverage:
(a) It reduces counterparty exposure; but
(b) It can also increase the economic resources at the disposal of the Bahraini conventional bank licensees, as the bank can use the collateral to leverage itself.

CA-15.3.18 Collateral received in connection with derivative contracts does not necessarily reduce the leverage inherent in a Bahraini conventional bank licensee's derivatives position, which is generally the case if the settlement exposure arising from the underlying derivative contract is not reduced. As a general rule, collateral received may not be netted against derivative exposures whether or not netting is permitted under IFRS or in Chapter CA-4. Hence, when calculating the exposure amount by applying Paragraphs CA-15.3.14 to CA-15.3.16, a Bahraini conventional bank licensee must not reduce the exposure amount by any collateral received from the counterparty.

CA-15.3.19 Similarly, with regard to collateral provided, Bahraini conventional bank licensees must gross up their exposure measure by the amount of any derivatives collateral provided where the provision of that collateral has reduced the value of their balance sheet assets under IFRS.

*Treatment of Cash Variation Margin*

CA-15.3.20 In the treatment of derivative exposures for the purpose of the leverage ratio, the cash portion of variation margin exchanged between counterparties may be viewed as a form of pre-settlement payment, if the following conditions are met:
(a) For trades not cleared through a qualifying central counterparty (QCCP) the cash received by the recipient counterparty is not segregated;
CA-15.3 Exposure Measure (continued)

(b) Variation margin is calculated and exchanged on a daily basis based on mark-to-market valuation of derivatives positions;
(c) The cash variation margin is received in the same currency as the currency of settlement of the derivative contract;
(d) Variation margin exchanged is the full amount that would be necessary to fully extinguish the mark-to-market exposure of the derivative subject to the threshold and minimum transfer amounts applicable to the counterparty; and
(e) Derivatives transactions and variation margins are covered by a single master netting agreement (MNA)\(^\text{10}\) between the legal entities that are the counterparties in the derivatives transaction. The MNA must explicitly stipulate that the counterparties agree to settle net any payment obligations covered by such a netting agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty. The MNA must be legally enforceable and effective in all relevant jurisdictions, including in the event of default and bankruptcy or insolvency.

CA-15.3.21 If the conditions in Paragraph CA-15.3.20 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 add-on portion) of the exposure amount of the derivative asset by the amount of cash received if the positive mark-to-market value of the derivative contract(s) has not already been reduced by the same amount of cash variation margin received under the Bahraini conventional bank licensee’s operative accounting standard; and

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\(^{10}\) A Master MNA may be deemed to be a single MNA for this purpose.

\(^{11}\) To the extent that the criteria in this paragraph include the term “master netting agreement”, this term should be read as including any “netting agreement” that provides legally enforceable rights of offsets. This is to take account of the fact that for netting agreements employed by CCPs, no standardisation has currently emerged that would be comparable with respect to OTC netting agreements for bilateral trading.
CA-15.3 Exposure Measure (continued)

(b) In the case of cash variation margin provided to a counterparty, the posting Bahraini conventional bank licensee may deduct the resulting receivable from its leverage ratio exposure measure, where the cash variation margin has been recognised as an asset under the Bahraini conventional bank licensee's operative accounting framework.

CA-15.3.22 Cash variation margin may not be used to reduce the PFE amount (including the calculation of the net-to-gross ratio (NGR) as defined in Paragraph CA-15.6.11).

**Treatment of Clearing Services**

CA-15.3.23 Where a Bahraini conventional bank licensee acting as clearing member (CM)\(^{12}\) offers clearing services to clients, the clearing member's trade exposures\(^{13}\) to the central counterparty (CCP) that arise when the clearing member is obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that the CCP defaults, must be captured by applying the same treatment that applies to any other type of derivatives transactions. However, if the clearing member, based on the contractual arrangements with the client, is not obligated to reimburse the client for any losses suffered due to changes in the value of its transactions in the event that a QCCP defaults, the clearing member need not recognise the resulting trade exposures to the QCCP in the leverage ratio exposure measure.

CA-15.3.24 Where a client enters directly into a derivatives transaction with the CCP and the CM guarantees the performance of its clients' derivative trade exposures to the CCP, the Bahraini conventional bank licensee acting as the clearing member for the client to the CCP must calculate its related leverage ratio exposure resulting from the guarantee as a derivative exposure as set out in Paragraphs CA-15.3.14 to CA-15.3.21, as if it had entered directly into the transaction with the client, including with regard to the receipt or provision of cash variation margin.

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\(^{12}\) For the purposes of this Paragraph, a clearing member (CM) is defined as a member of, or a direct participant in, a CCP that is entitled to enter into a transaction with the CCP, regardless of whether it enters into trades with a CCP for its own hedging, investment or speculative purposes or whether it also enters into trades as a financial intermediary between the CCP and other market participants.

\(^{13}\) For the purposes of Paragraphs CA-15.5.23 and CA-15.5.24, “trade exposures” includes initial margin irrespective of whether or not it is posted in a manner that makes it remote from the insolvency of the CCP.
CA-15.3 Exposure Measure (continued)

**Additional Treatment for Written Credit Derivatives**

**CA-15.3.25** In addition to the CCR exposure arising from the fair value of the contracts, written credit derivatives create a notional credit exposure arising from the creditworthiness of the reference entity. Written credit derivatives must be treated consistently with cash instruments (e.g. loans, bonds) for the purposes of the exposure measure.

**CA-15.3.26** In order to capture the credit exposure to the underlying reference entity, in addition to the above CCR treatment for derivatives and related collateral, the effective notional amount referred to a written credit derivative is to be included in the exposure measure. The effective notional amount of a written credit derivative may be reduced by any negative change in fair value amount that has been incorporated into the calculation of Tier 1 capital with respect to the written credit derivative. The resulting amount may be further reduced by the effective notional amount of a purchased credit derivative on the same reference name, provided:

(a) The credit protection purchased is on a reference obligation which ranks pari passu with or is junior to the underlying reference obligation of the written credit derivative in the case of single name credit derivatives, and

14 The effective notional amount is obtained by adjusting the notional amount to reflect the true exposure of contracts that are leveraged or otherwise enhanced by the structure of the transaction.

15 Two reference names are considered identical only if they refer to the same legal entity. For single name credit derivatives, protection purchased that references a subordinated position may offset protection sold on a more senior position of the same reference entity as long as a credit event on the senior reference asset would result in a credit event on the subordinated reference asset. Protection purchased on a pool of reference entities may offset protection sold on individual reference names if the protection purchased is economically equivalent to buying protection separately on each of the individual names in the pool (this would, for example, be the case if a bank were to purchase protection on an entire securitisation structure). If a bank purchases protection on a pool of reference names, but the credit protection does not cover the entire pool (i.e. the protection covers only a subset of the pool, as in the case of an nth-to-default credit derivative or a securitisation tranche), then offsetting is not permitted for the protection sold on individual reference names. However, such purchased protections may offset sold protections on a pool provided the purchased protection covers the entirety of the subset of the pool on which protection has been sold. In other words, offsetting may only be recognised when the pool of reference entities and the level of subordination in both transactions are identical.

16 The effective notional amount of a written credit derivative may be reduced by any negative change in fair value reflected in the bank’s Tier 1 capital provided the effective notional amount of the offsetting purchased credit protection is also reduced by any resulting positive change in fair value reflected in Tier 1 capital. Where a bank buys credit protection through a total return swap (TRS) and records the net payments received as net income, but does not record offsetting deterioration in the value of the written credit derivative (either through reductions in fair value or by an addition to reserves) reflected in Tier 1 capital, the credit protection will not be recognised for the purpose of offsetting the effective notional amounts related to written credit derivatives.

17 For tranched products, the purchased protection must be on a reference obligation with the same level of seniority.
CA-15.3 Exposure Measure (continued)

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

Since written credit derivatives are included in the exposure measure at their effective notional amounts, and are also subject to add-on amounts for PFE, the exposure measure for written credit derivatives may be overstated. Bahraini conventional bank licensees must deduct the individual PFE add-on amount relating to a written credit derivative (which is not offset according to Paragraph CA-15.3.26 and whose effective notional amount is included in the exposure measure) from their gross add-on in Paragraphs CA-15.3.14 to CA-15.3.16.18

Off-balance Sheet Items (OBS)

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.

In the risk-based capital framework, OBS items are converted under the standardised approach into credit exposure equivalents through the use of credit conversion factors (CCFs). For the purpose of determining the exposure amount of OBS items for the leverage ratio, the CCFs set out in Paragraphs CA-15.6.16-24 must be applied to the notional amount.19

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18 In these cases, where effective bilateral netting contracts are in place, and when calculating $\Delta Net = 0.4 \cdot AGross + 0.6 \cdot NGR \cdot AGross$ as per paragraphs CA-15.3.14 to CA-15.3.16, $\Delta Gross$ may be reduced by the individual add-on amounts (i.e. notional multiplied by the appropriate add-on factors) which relate to written credit derivatives whose notional amounts are included in the leverage ratio exposure measure. However, no adjustments must be made to $NGR$. Where effective bilateral netting contracts are not in place, the PFE add-on may be set to zero in order to avoid the double-counting described in this paragraph.

19 These correspond to the CCFs of the standardised approach for credit risk in the CBB Rulebook, subject to a floor of 10%. The floor of 10% will affect commitments that are unconditionally cancellable at any time by the bank without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower’s creditworthiness.
CA-15.4 Additional Supervisory Guidance

CA-15.4.1 A higher ratio may be required for any Bahraini conventional bank licensee if warranted by its risk profile or circumstances. The CBB may use stress testing as a complementing tool to adjust the leverage ratio requirement at the macro- and/or individual conventional bank licensee level.

CA-15.4.2 The leverage ratio can be used for both micro- and macroprudential surveillance; for example, as a macroprudential tool, a consistent leverage ratio can be applied for all Bahraini conventional bank licensees as an indicator for monitoring vulnerability. As a microprudential tool, it can be used as a trigger for increased surveillance or capital requirements for specific licensees under the supervisory review process.
CA-15.5 Transitional Arrangements

CA-15.5.1 Quarterly reporting of the pro-forma leverage ratio to the CBB commenced with effect from March 2013 data. Monitoring of the leverage ratio by the CBB using a standardised reporting format in the PIR commences with effect from 30 September 2015 data.

CA-15.5.2 The initial monitoring period runs until 31st December 2017. During this period, the leverage ratio and its components will be monitored, including its behaviour relative to the capital adequacy ratios. Mandatory public disclosure of the leverage ratio and its components will start with end March 2017 data. Bahraini conventional bank licensees are encouraged to start public disclosure of their leverage ratio earlier than the mandatory date. Disclosure of the ratio will be closely monitored by the CBB.

CA-15.5.3 Based on the results of the monitoring period, any final adjustments to the definition and calibration of the leverage ratio will be carried out by 31st December 2017, with a view to migrating to a Pillar One treatment on 1st January 2018, based on appropriate review and calibration.
CA-15.6 Derivative Exposures, Netting, Securities Transactions and Off-Balance sheet items

To improve the understanding of leverage ratio framework, this Section includes the relevant detailed information applicable for the purposes of calculating the leverage ratio.

*Derivative Exposures - Add-on Factors for Determining PFE*

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

<table>
<thead>
<tr>
<th></th>
<th>Interest rates</th>
<th>FX and gold</th>
<th>Equities</th>
<th>Precious metals except gold</th>
<th>Other commodities</th>
</tr>
</thead>
<tbody>
<tr>
<td>One year or less</td>
<td>0.0%</td>
<td>1.0%</td>
<td>6.0%</td>
<td>7.0%</td>
<td>10.0%</td>
</tr>
<tr>
<td>Over one year to five years</td>
<td>0.5%</td>
<td>5.0%</td>
<td>8.0%</td>
<td>7.0%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Over five years</td>
<td>1.5%</td>
<td>7.5%</td>
<td>10.0%</td>
<td>8.0%</td>
<td>15.0%</td>
</tr>
</tbody>
</table>

Notes:
1. For contracts with multiple exchanges of principal, the factors are to be multiplied by the number of remaining payments in the contract.
2. For contracts that are structured to settle outstanding exposures following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be set equal to the time until the next reset date. In the case of interest rate contracts with remaining maturities of more than one year that meet the above criteria, the add-on is subject to a floor of 0.5%.
3. Forwards, swaps, purchased options and similar derivative contracts not covered by any of the columns in this matrix are to be treated as “other commodities.”
4. No potential future credit exposure would be calculated for single currency floating / floating interest rate swaps; the credit exposure on these contracts would be evaluated solely on the basis of their mark-to-market value.

*Add-ons must be based on effective rather than apparent notional amounts.* In the event that the stated notional amount is leveraged or enhanced by the structure of the transaction, Bahraini conventional bank licensees must use the effective notional amount when determining PFE.

Comment [FSA34]: B3 Lev Annex
Comment [FSA35]: B3 Lev Annex, P1
Comment [FSA36]: B3 Lev Annex, P2
CA-15.6 Derivative Exposures, Netting, Securities Transactions and Off-Balance sheet items (continued)

The following add-on factors apply to single-name credit derivatives:

<table>
<thead>
<tr>
<th>Total return swaps</th>
<th>Protection buyer</th>
<th>Protection seller</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Qualifying&quot; reference obligation</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>&quot;Non-qualifying&quot; reference obligation</td>
<td>10%</td>
<td>10%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Credit default swaps</th>
<th>Protection buyer</th>
<th>Protection seller</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Qualifying&quot; reference obligation</td>
<td>5%</td>
<td>5%**</td>
</tr>
<tr>
<td>&quot;Non-qualifying&quot; reference obligation</td>
<td>10%</td>
<td>10%**</td>
</tr>
</tbody>
</table>

There will be no difference depending on residual maturity.

** The protection seller of a credit default swap shall only be subject to the add-on factor where it is subject to closeout upon the insolvency of the protection buyer while the underlying is still solvent. The add-on should then be capped to the amount of unpaid premiums.

CA-15.5 Where the credit derivative is a first-to-default transaction, the add-on is determined by the lowest credit quality underlying the basket, i.e. if there are any non-qualifying items in the basket, the non-qualifying reference obligation add-on must be used. For second and subsequent nth-to-default transactions, underlying assets must continue to be allocated according to the credit quality, i.e. the second or, respectively, nth lowest credit quality determines the add-on for a second-to-default or an nth-to-default transaction, respectively.

CA-15.6 The “qualifying” category includes securities issued by public sector entities and multilateral development banks, plus other securities that are:

(a) Rated investment grade\(^2\) by at least two credit rating agencies specified by the CBB;
(b) Rated investment grade by one rating agency and not less than investment grade by any other rating agency specified by the CBB; or
(c) Subject to CBB approval, unrated, but deemed to be or comparable to investment grade credit quality by the reporting bank, and the issuer has securities listed on a recognised exchange.

\(^2\) Eg rated Baa or higher by Moody’s and BBB or higher by Standard & Poor’s.
CA-15.6 Derivative Exposures, Netting, Securities Transactions and Off-Balance sheet items (continued)

CA-15.6.7 The CBB is responsible for monitoring the application of these qualifying criteria, particularly in relation to the last criterion where the initial classification is essentially left to the reporting banks. The CBB has discretion to include within the qualifying category debt securities issued by banks in other countries which have implemented Basel III, subject to the express understanding that supervisory authorities in such countries undertake prompt remedial action if a bank fails to meet the leverage ratio standards set forth in this framework. Similarly, the CBB has discretion to include within the qualifying category debt securities issued by securities firms that are subject to equivalent rules.

CA-15.6.8 For purposes of Paragraph CA-15.6.7, the “qualifying” category includes securities issued by institutions that are deemed to be equivalent to investment grade quality and subject to supervisory and regulatory arrangements comparable to those under this Rulebook.

Bilateral Netting

CA-15.6.9 Bilateral netting is allowed subject to the following conditions:

(a) The transactions are covered by Resolution No 44 of the year 2014 with respect to promulgating a regulation for close-out netting under a market contract (Appendix CM-4);  
(b) Bahraini conventional bank licensees 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; or  
(c) Bahraini conventional bank licensees may also net transactions subject to any legally valid form of bilateral netting not covered in (b), including other forms of novation.
CA-15.6 Derivative Exposures, Netting, Securities Transactions and Off-Balance sheet items (continued)

CA-15.6.10 In both cases in CA-15.6.9 (b) and (c), a Bahraini conventional bank licensee will need to satisfy the CBB that it has:

(a) A netting contract or agreement with the counterparty that creates a single legal obligation, covering all included transactions, such that the Bahraini conventional bank licensee would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;

(b) Written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the Bahraini conventional bank licensee's exposure to be such a net amount under:

(i) The law of the home jurisdiction in which the counterparty is incorporated and, if the foreign branch of a counterparty is involved, then also under the law of jurisdiction in which the branch is located;

(ii) The law that governs the individual transactions; and

(iii) The law that governs any contract or agreement necessary to effect the netting.

The CBB, after consultation when necessary with other relevant supervisors, must be satisfied that the netting is enforceable under the laws of each of the relevant jurisdictions;

(c) 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.

CA-15.6.11 Contracts containing walkaway clauses are not eligible for netting for the purpose of calculating the leverage ratio requirements. 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.

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21 Thus, if any of the concerned supervisors are dissatisfied about enforceability under their laws, the netting contract or agreement will not meet the condition and neither counterparty could obtain supervisory benefit.
CA-15.5 Derivative Exposures, Netting, Securities Transactions and Off-Balance sheet items (continued)

CA-15.6.12 Credit exposure on bilaterally netted forward transactions are calculated as the sum of the net mark-to-market replacement cost, if positive, plus an add-on based on the notional underlying principal. The add-on for netted transactions ($ANet$) equals the weighted average of the gross add-on ($AGross$) and the gross add-on adjusted by the ratio of net current replacement cost to gross current replacement cost ($NGR$). This is expressed through the following formula:

$$ANet = 0.4 \cdot AGross + 0.6 \cdot NGR \cdot AGross$$

where:

$$NGR = \frac{\text{level of net replacement cost}}{\text{level of gross replacement cost}}$$

for transactions subject to legally enforceable netting agreements$^{22}$

$$AGross = \text{sum of individual add-on amounts}$$

(calculated by multiplying the notional principal amount by the appropriate add-on factors set out in paragraphs CA-15.6.2 to CA-15.6.8) of all transactions subject to legally enforceable netting agreements with one counterparty.

CA-15.6.13 For the purposes of calculating PFE to a netting counterparty for forward foreign exchange contracts and other similar contracts in which the notional principal amount is equivalent to cash flows, the notional principal is defined as the net receipts falling due on each value date in each currency. The reason for this is that offsetting contracts in the same currency maturing on the same date will have lower PFE as well as lower current exposure.

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$^{22}$ The CBB may allow a choice of calculating the NGR on a counterparty by counterparty or on an aggregate basis for all transactions that are subject to legally enforceable netting agreements. The method chosen must be notified to the CBB and then used consistently. Under the aggregate approach, net negative current exposures to individual counterparties cannot be used to offset net positive current exposures to others, i.e. for each counterparty the net current exposure used in calculating the NGR is the maximum of the net replacement cost or zero. Note that under the aggregate approach, the NGR is to be applied individually to each legally enforceable netting agreement so that the credit equivalent amount will be assigned to the appropriate counterparty risk weight category.
CA-15.6 Derivative Exposures, Netting, Securities Transactions and Off-Balance sheet items (continued)

**Securities Financing Transaction Exposures**

**CA-15.6.14** Where a qualifying master netting agreement is in place, the effects of bilateral netting agreements for SFTs are recognised on a counterparty by counterparty basis if the agreements are legally enforceable in each relevant jurisdiction upon the occurrence of an event of default and regardless of whether the counterparty is insolvent or bankrupt. In addition, netting agreements must:

(a) Provide the non-defaulting party with the right to terminate and close out in a timely manner all transactions under the agreement upon an event of default, including in the event of insolvency or bankruptcy of the counterparty;

(b) Provide for the netting of gains and losses on transactions (including the value of any collateral) terminated and closed out under it so that a single net amount is owed by one party to the other;

(c) Allow for the prompt liquidation or setoff of collateral upon the event of default; and

(d) Be, together with the rights arising from provisions required in (a) and (c) above, legally enforceable in each relevant jurisdiction upon the occurrence of an event of default regardless of the counterparty’s insolvency or bankruptcy.

**CA-15.6.15** Netting across positions held in the banking book and trading book can only be recognised when the netted transactions fulfil the following conditions:

(a) All transactions are marked to market daily; and

(b) The collateral instruments used in the transactions are recognised as eligible financial collateral in the banking book.

**Off-Balance Sheet Items**

**CA-15.6.16** For the purpose of the leverage ratio, OBS items must be converted into credit exposure equivalents through the use of credit conversion factors (CCFs).

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23 The provisions related to qualifying master netting agreements (MNAs) for SFTs are intended for the calculation of the counterparty add-on of the exposure measure of SFTs as set out in paragraph CA-15.3.3A (ii) only.
CA-15.6 Derivative Exposures, Netting, Securities Transactions and Off-Balance sheet items (continued)

CA-15.6.17 Commitments other than securitisation liquidity facilities with an original maturity up to one year and commitments with an original maturity over one year receive a CCF of 20% and 50%, respectively. However, any commitments that are unconditionally cancellable at any time by the Bahraini conventional bank licensee without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness, receive a 10% CCF24.

CA-15.6.18 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) receive a CCF of 100%.

CA-15.6.19 Forward asset purchases, forward deposits and partly paid shares and securities, which represent commitments with certain drawdown, will receive a CCF of 100%.

CA-15.6.20 The following transaction-related contingent items (performance bonds, bid bonds, warranties and standby letters of credit related to particular transactions) receive a CCF of 50%.

CA-15.6.21 Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs) receive a CCF of 50%.

CA-15.6.22 For short-term self-liquidating trade letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment), a 20% CCF is applied to both issuing and confirming banks.

CA-15.6.23 Where there is an undertaking to provide a commitment on an OBS item, Bahraini conventional bank licensees are to apply the lower of the two applicable CCFs.

24 In Bahrain, retail commitments such as credit cards and overdrafts are considered unconditionally cancellable where the terms permit the bank to cancel them without notice.
CA-15.6 Derivative Exposures, Netting, Securities Transactions and Off-Balance sheet items (continued)

**CA-15.6.24** All off-balance sheet securitisation exposures, except an eligible liquidity facility or an eligible servicer cash advance facility as set out in Paragraphs CA-6.4.17 and CA-6.4.19 of this Module, receive a CCF of 100% conversion factor. All eligible liquidity facilities receive a CCF of 50%. Undrawn servicer cash advances or facilities that are unconditionally cancellable without prior notice are eligible for a 10% CCF.
CA-15.7 Gearing

The content of this Section is applicable to all overseas conventional retail bank licensees.

Measurement

The gearing ratio is measured with reference to the ratio of deposit liabilities against the bank’s capital and reserves as reported in the PIR.

For overseas conventional retail bank licensee, the reference to capital and reserves in Paragraph CA-15.7.2 includes the following items reported in Section A Balance Sheet of the PIR:

(a) Paid up share capital (net of treasury shares);
(b) General (disclosed reserves);
(c) Retained earnings (or losses) brought forward; and
(d) Net profit (or loss) for the current period.

Under Paragraph CA-15.7.3, item (a) refers to the capital provided by the head office to the overseas conventional retail bank licensee, also referred to as endowment capital.

The reference to deposit liabilities in Paragraph CA-15.7.2 includes the following items reported in Section A Balance Sheet of the PIR:

(a) Deposits from banks; and
(b) Deposits from non-banks.

Gearing Limit

Deposit liabilities must not exceed 20 times the respective bank’s capital and reserves at all times.