Pillar 3

Pillar 3 – Market Disclosures

I. Introduction

1. Market discipline has long been recognized as a key objective of the Central Bank of the UAE. The provision of meaningful information about common key risk metrics to market participants is a fundamental principle of a sound banking system. It reduces information irregularity and helps promote comparability of banks' risk profiles within UAE. Pillar 3 of the Basel framework aims to promote market discipline through regulatory disclosure requirements. These requirements enable market participants to access key information relating to a bank's regulatory capital and risk exposures in order to increase transparency and confidence about a bank's exposure to risk and the overall adequacy of its regulatory capital.

2. The revised Pillar 3 disclosures in this guidance focus on regulatory measures defined in Pillar 1 of the Basel framework, which requires banks to adopt specified approaches for measuring credit, market and operational risks and their associated resulting risk-weighted assets (RWA) and capital requirements. In some instances, Pillar 3 also requires supplementary information to be disclosed to improve the understanding of underlying risks. Central Bank continues to believe that a common disclosure framework based around Pillar 1 is an effective means of informing the market and allowing market participants to take informed investment decisions. However, in the wake of the 2007–09 financial crisis, it became apparent that the existing Pillar 3 framework failed to promote the identification of a bank's material risks and did not provide sufficient, and sufficiently comparable, information to enable market participants to assess a bank's overall capital adequacy and to compare it with its peers. The revised Pillar 3 disclosure requirements in this guidance are based on an extensive review of Pillar 3 reports.

3. A key goal of the revised Pillar 3 disclosures is to improve comparability and consistency of disclosures. However, it is recognized that a balance needs to be struck between the use of mandatory templates that promote consistency of reporting and comparability across banks, and the need to allow senior management sufficient flexibility to provide commentary on a bank's specific risk profile. For this reason, the revised disclosure regime introduces a "hierarchy" of disclosures; prescriptive fixed form templates which are used for quantitative information that is considered essential for the analysis of a bank's regulatory capital requirements, and templates with a more flexible format are proposed for information which is considered meaningful to the UAE market but not central to the analysis of a bank's regulatory capital adequacy. In addition, senior management may accompany the disclosure requirements in each template with a qualitative commentary that explains a bank's particular circumstance and risk profile.

II. Disclosure of Pillar 3 information

A. Scope and implementation of the revised Pillar 3 framework

Scope of application

4. The revised disclosure requirements presented in this guidance supersede the existing Pillar 3 disclosure requirements issued in 2009. These revised requirements are an integral part of the Basel framework and they complement other disclosure requirements issued separately by Central Bank, which are uploaded on Central Bank's website/online portal for banks to download.

Pillar 3 applies to all banks in the UAE at the top consolidated level for local banks and all branches of foreign banks. Banks having a banking subsidiary will be required to be consolidated at Group level as one Pillar 3 report as well as at subsidiary solo level as a separate Pillar 3 report Banks offering Islamic financial services should comply with these disclosure requirements. These requirements are applicable to their activities that are in line with Islamic Sharia rules and principals, which are neither interest-based lending nor borrowing but are parallel to the activities described in these Guidance and Explanatory Notes

Implementation date

5. The Pillar 3 tables and disclosures will be effective from the beginning of 2019 for the previous year's figures and every year going forward. Banks need to report in each table as per the requirements for that table set out in the Appendix since few tables are required to be reported every quarter or semi-annually or annually.

Reporting

6. Banks should publish their Pillar 3 report in a stand-alone document on the bank's UAE-specific website that provides a readily accessible source of prudential measures for users. The Pillar 3 report may be appended to form a discrete section of a bank's financial reporting, but the full report will be needed to be disclosed separately in the Pillar 3 tables as well.

7. Signposting of disclosure requirements is permitted in certain circumstances, as set out in paragraphs 21–23 below. Banks should also make available on their websites a 5-year archive of Pillar 3 reports (i.e. quarterly, semi-annual or annual) relating to prior reporting periods (past 5 years' data)

Frequency and timing of disclosures

8. The reporting frequencies for each disclosure requirement are set out in the schedule in paragraph 27 below. The frequencies vary between quarterly, semi-annual and annual reporting depending upon the nature of the specific disclosure requirement. If a bank publishes interim financial statements, then the bank should publish the quarterly Pillar 3 report, three (3) weeks after the interim financial statements are published. For banks who do not have an interim financial statement, the Pillar 3 quarterly report needs to be published 6 weeks from quarter end.

9. A bank's Pillar 3 report should be published with its financial report for the corresponding period as mandated in paragraph 8 above. If a Pillar 3 disclosure is required to be published for a period when a bank does not produce any financial report, the disclosure requirement should be published as soon as possible. However, the time lag should not exceed that allowed to the bank for its regular financial reporting period-ends (e.g. if a bank reports only annually and its annual financial statements are made available six weeks after the end of the annual reporting period-end, interim Pillar 3 disclosures on a quarterly and/or semi-annual basis should be available within six weeks after the end of the relevant quarter or semester).

Assurance of Pillar 3 data

10. The information provided by banks under Pillar 3 should be subject, at a minimum, to the same level of internal review and internal control processes as the information provided by banks for their financial reporting (i.e. the level of assurance should be the same as for information provided within the management discussion and analysis part of the financial report).

- The Pillar 3 Disclosures and reports have to be reviewed by internal audit of all bank for all Pillar 3 reports.

- All local banks and large foreign banks will need to have the annual Pillar 3 reports externally audited every two (2) years and smaller foreign banks (as defined in paragraph 27) will need to have the annual Pillar 3 reports externally audited every four (4) years.

11. Banks should also have a formal board-approved disclosure policy for Pillar 3 information that sets out the internal controls and procedures for disclosure of such information. The key elements of this policy should be described in the year-end Pillar 3 report. The board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over the disclosure of financial information, including Pillar 3 disclosures. They should also ensure that appropriate review of the disclosures takes place. One or more senior officers of a bank, ideally at board level or equivalent, should attest in writing that Pillar 3 disclosures have been prepared in accordance with the board-agreed internal control processes. For larger banks, Board member attestation will be expected.

<u>Proprietary and confidential information</u>

12. The Central Bank believes that the disclosure requirements set out below strike an appropriate balance between the need for meaningful disclosure and the protection of proprietary and confidential information. In exceptional cases, disclosure of certain items required by Pillar 3 may reveal the position of a bank or contravene its legal obligations by making public information that is proprietary or confidential in nature. In such cases, a bank would need to approach the Central Bank first and obtain approval for non-disclosure of such information they deem to be confidential. The Central Bank will review the information and provide approval if the bank does not need to disclose those specific items, but should disclose more general information about the subject matter of the requirement instead. The bank should also explain to Central Bank the specific items of information that cannot be disclosed and the reasons for this.

B. Guiding principles for banks' Pillar 3 disclosures

13. The Central Bank has agreed upon five guiding principles for banks' Pillar 3 disclosures. Pillar 3 complements the minimum risk-based capital requirements and other quantitative requirements (Pillar 1) and the supervisory review process (Pillar 2) and aims to promote market discipline by providing meaningful regulatory information to investors and other interested parties on a consistent and comparable basis. The guiding principles aim to provide a firm foundation for achieving transparent, high-quality Pillar 3 risk disclosures that will enable users to better understand and compare a bank's business and its risks.

14. The principles are as follows:

<u>Principle 1: Disclosures should be clear</u>

Disclosures should be presented in a form that is understandable to key stakeholders (i.e. investors, analysts, financial customers and others) and communicated through an accessible medium. Important messages should be highlighted and easy to find. Complex issues should be explained in simple language with important terms defined. Related risk information should be presented together.

<u>Principle 2: Disclosures should be comprehensive</u>

Disclosures should describe a bank's main activities and all significant risks, supported by relevant underlying data and information. Significant changes in risk exposures between reporting periods should be described, together with the appropriate response by management.

Disclosures should provide sufficient information in both qualitative and quantitative terms on a bank's processes and procedures for identifying, measuring and managing those risks. The level of detail of such disclosure should be proportionate to a bank's complexity.

Approaches to disclosure should be sufficiently flexible to reflect how senior management and the board of directors internally assess and manage risks and strategy, helping users to better understand a bank's risk tolerance/appetite.

Principle 3: Disclosures should be meaningful to users
Disclosures should highlight a bank's most significant current and emerging risks and how those risks are managed, including information that is likely to receive market attention. Where meaningful, linkages should be provided to line items on the balance sheet or the income statement. Disclosures that do not add value to users' understanding or do not communicate useful information should be avoided. Furthermore, information, which is no longer meaningful or relevant to users, should be removed.

Principle 4: Disclosures should be consistent over time
Disclosures should be consistent over time to enable key stakeholders to identify trends in a bank's risk profile across all significant aspects of its business. Additions, deletions and other important changes in disclosures from previous reports, including those arising from a bank's specific, regulatory or market developments, should be highlighted and explained.

Principle 5: Disclosures should be comparable across banks
The level of detail and the format of presentation of disclosures should enable key stakeholders to perform meaningful comparisons of business activities, prudential metrics, risks and risk management between banks and across jurisdictions.

C. Presentation of the disclosure requirements

Templates and tables
15. The disclosure requirements are presented either in the form of templates or of tables. Templates should be completed with quantitative data in accordance with the definitions provided. Tables generally relate to qualitative requirements, but quantitative information is also required in some instances. Banks may choose the format they prefer when presenting the information requested in tables.

16. In line with Principle 3 above, the information provided in the templates and tables should be meaningful to users. The disclosure requirements in this guidance that necessitate an assessment from banks are specifically identified. When preparing these individual tables and templates, banks will need to consider carefully how widely the disclosure requirement should apply. If a bank considers that the information requested in a template or table would not be meaningful to users, for example because the exposures and RWA amounts are deemed immaterial, it may choose not to disclose part or all of the information requested. In such circumstances, however, the bank will be required to explain in a narrative commentary why it considers such information not to be meaningful to users. It should describe the portfolios excluded from the disclosure requirement and the aggregate total RWAs those portfolios represent.

Templates with a fixed format
17. Where the format of a template is described as fixed, banks should complete the fields in accordance with the instructions given.
18. If a row/column is not considered to be relevant to a bank's activities the bank may delete the specific row/column from the template, but the numbering of the subsequent rows and columns should not be altered. Banks may add extra rows and extra columns to fixed format templates if they wish to provide additional detail to a disclosure requirement by adding sub-rows

or columns, but the numbering of prescribed rows and columns in the template should not be altered.

Templates/tables with a flexible format

19. Where the format of a template is described as flexible, banks may present the required information either in the format provided in this guidance or in one that better suits the bank. The format for the presentation of qualitative information in tables is not prescribed.

20. However, where a customized presentation of the information is used, the bank should provide information comparable with that required in the disclosure requirement (i.e. at a similar level of granularity as if the template/table were completed as presented in this document).

Signposting

21. Banks may disclose in a document separate from their Pillar 3 report (e.g. in a bank's annual report or through published regulatory reporting) the templates/tables with a flexible format, and the fixed format templates where the criteria in paragraph 22 are met. In such circumstances, the specific Pillar 3 table(s) may form a section in a bank's financial reporting, but the full table will be needed to be disclosed in the Pillar 3 tables separately as well.

22. The disclosure requirements for templates with a fixed format can be disclosed by banks in a separate document other than the Pillar 3 report provided all of the following criteria are met:

- the information contained in the signposted document is equivalent in terms of presentation and content to that required in the fixed template and allows users to make meaningful comparisons with information provided by banks disclosing the fixed format templates;
- the information contained in the signposted document is based on the same scope of consolidation as the one used in the disclosure requirement;
- the disclosure in the signposted document is mandatory.

Banks should note that although signposting may be allowed in the annual report, the bank would still need to disclose this table separately in the Pillar 3 Disclosure along with all other tables mentioned in paragraph 27 below.

23. Banks can only make use of signposting to another document if the level of assurance on the reliability of data in the separate document are equivalent to, or greater than, the internal assurance level required for the Pillar 3 report (see sections on reporting and assurance of Pillar 3 data above).

Qualitative narrative to accompany the disclosure requirements

24. Banks are expected to supplement the quantitative information provided in both fixed and flexible templates with a narrative commentary to explain at least any significant changes between reporting periods and any other issues that management considers to be of interest to market participants. The form taken by this additional narrative is at the bank's discretion.

25. Disclosure of additional quantitative and qualitative information will provide market participants with a broader picture of a bank´s risk position and promote market discipline.

26. Additional voluntary risk disclosures allow banks to present information relevant to their business model that may not be adequately captured by the standardised requirements. Additional quantitative information that banks choose to disclose should provide sufficient meaningful information to enable market participants to understand and analyze any figures provided. It should also be accompanied by a qualitative discussion. Any additional disclosure should comply with the five guiding principles set out in paragraph 14 above.

D. Format and reporting frequency of each disclosure requirement

27. The schedule below presents a summary of the disclosure requirements, whether they are required in a fixed or flexible format. It also lists the publishing frequency associated with each template and table. Please also note that the below tables will be available as an Excel file on the Central Bank alert portal on the Central Bank's website for download.

Please note: It is mandatory for all local banks to report all tables as per below schedule. It is also mandatory for branches of foreign banks with RWA of more than AED 5 billion to report all tables as per below schedule.

Branches of foreign banks with RWA of less than AED 5 billion should report the below tables highlighted in **Yellow and BOLD** only as mandatory.

Topic	Table	Information Overview	Format	Disclosure Frequency
Overview of risk management and RWA	**KM1**	**Key metrics (at consolidated group level)**	Fixed	Quarterly
	OVA	**Bank risk management approach**	Flexible	Annual
	OV1	**Overview of RWA**	Fixed	Quarterly
Linkages between financial statements and regulatory exposures	LI1	Differences between accounting and regulatory scopes of consolidation and mapping of financial statement categories with regulatory risk categories	Flexible	Annual
	LI2	**Main sources of differences between regulatory exposure amounts and carrying values in financial statements**	Flexible	Annual
	LIA	Explanations of differences between accounting and regulatory exposure amounts	Flexible	Annual
Prudential valuation adjustments	PV1	Prudent valuation adjustments	Fixed	Annual
Composition of capital	**CC1**	**Composition of regulatory capital**	Fixed	Semi-annual
	CC2	**Reconciliation of regulatory capital to balance sheet**	Flexible	Semi-annual
	CCA	**Main features of regulatory capital instruments**	Fixed	Semi-annual
Macroprudential Supervisory measures	**CCyB1**	**Geographical distribution of credit exposures used in the countercyclical buffer**	Flexible	Semi-annual
	LR1	Summary comparison of accounting assets vs leverage ratio exposure measure (January 2014 standards)	Fixed	Quarterly
Leverage ratio	**LR2**	**Leverage ratio common disclosure template (January 2014 standards)**	Fixed	Quarterly

	LIQA	**Liquidity risk management**	Flexible	Annual
Liquidity	**LIQ1**	**Liquidity Coverage Ratio**	Fixed	Quarterly
	LIQ2	**Net Stable Funding Ratio**	Fixed	Semi-annual
	CRA	**General qualitative information about credit risk**	Flexible	Annual
Credit risk	**CR1**	**Credit quality of assets**	Fixed	Semi-annual
	CR2	**Changes in the stock of defaulted loans and debt securities**	Fixed	Semi-annual
	CRB	**Additional disclosure related to credit quality of assets**	Flexible	Annual
	CRC	Qualitative information on the mitigation of credit risk	Flexible	Annual
	CR3	Credit risk mitigation techniques – overview	Fixed	Semi-annual
	CRD	Qualitative disclosures on banks' use of external credit ratings under the standardised approach for credit risk	Flexible	Annual
	CR4	**Standardised approach - credit risk exposure and CRM effects**	Fixed	Semi-annual
	CR5	**Standardised approach - exposures by asset classes and risk weights**	Fixed	Semi-annual
	CCRA	Qualitative disclosure related to CCR	Flexible	Annual
Counterparty credit risk (CCR)	CCR1	Analysis of CCR by approach	Fixed	Semi-annual
	CCR2	Credit valuation adjustment capital charge	Fixed	Semi-annual
	CCR3	Standardised approach - CCR exposures by regulatory portfolio and risk weights	Fixed	Semi-annual
	CCR5	Composition of collateral for CCR exposure	Flexible	Semi-annual
	CCR6	Credit derivatives exposures	Flexible	Semi-annual
	CCR8	Exposures to central counterparties	Fixed	Semi-annual
	SECA	Qualitative disclosures related to securitisation exposures	Flexible	Annual
Securitisation	SEC1	Securitisation exposures in the banking book	Flexible	Semi-annual
	SEC2	Securitisation exposures in the trading book	Flexible	Semi-annual
	SEC3	Securitisation exposures in the banking book and associated regulatory capital requirements - bank acting as originator or as sponsor	Fixed	Semi-annual

	SEC4	Securitisation exposures in the trading book and associated capital requirements - bank acting as investor	Fixed	Semi-annual
	MRA	General qualitative disclosure requirements related to market risk	Flexible	Annual
Market risk	**MR1**	Market risk under the standardised approach	Fixed	Semi-annual
	IRRBBA	IRRBB risk management objectives and policies	Flexible	Annual
Interest rate risk in the banking book (IRRBB)	**IRRBB1**	Quantitative information on IRRBB	Fixed	Annual
	OR1	Qualitative disclosures on operational risk	Flexible	Annual
Operational risk	**REMA**	Remuneration policy	Flexible	Annual
Remuneration Policy	**REM1**	Remuneration awarded during the financial year	Flexible	Annual
	REM2	Special payments	Flexible	Annual
	REM3	Deferred remuneration	Flexible	Annual

III. Frequently Asked Questions (FAQ)

Question 1: One or more senior officers of a bank, ideally at board level or equivalent, should attest in writing that Pillar 3 disclosures have been prepared in accordance with the board-agreed internal control processes. For banks of foreign branches, is Country Manager or CFO at Head office attestation sufficient?
For local banks and large foreign banks, Board member attestation will be expected. For smaller foreign bank branches, Country Manager/GM will be sufficient

Question 2: There are requirements on the Pillar III disclosure that is dependent on the BASEL returns (BRF 95), in relation to this, the submission that mentions 6 weeks after the end of the relevant quarter starts from the BASEL quarter reporting deadline or actual quarter end?
Pillar 3 disclosure submission will be 6 weeks after the quarter end date. For example, December quarter submission will be 6 weeks from December 31st and **not** 6 weeks from January 31st. Since the BRF95 should mandatorily be submitted by banks within 4 weeks from quarter end, the bank still has additional 2 weeks to complete the Pillar 3 disclosures based on BRF95.

Question 3: Pillar 3 applies to all banks in the UAE at the top consolidated level for local banks... Please clarify in case of subsidiary of a bank, whether revised pillar 3 disclosures will be required to be prepared at consolidated Group level or stand-alone level?
Bank subsidiaries will be consolidated at stand-alone subsidiary level and the group bank will be consolidated at the stand-alone of the group bank only without the bank's subsidiary data.

Question 4: Pillar 3 disclosures can be presented in a separate report; however, Can it be signposted to the audited financial statements?
Signposting is allowed if the bank chooses to use the same template in their audited financial statements but a separate reporting template needs to be prepared as per Pillar 3 templates which is mandatory and cannot be omitted from the Pillar 3 tables.

Question 5: If any section/ table of Template is not applicable to the Bank (i.e. DSIBs, Securitisation), shall the Bank exclude this section/ table completely irrespective of type of table.
Yes, banks can exclude the tables/templates not pertaining to the bank, for example DSIB and Securitisation

Question 6: Banks should also have a formal board-approved disclosure policy for Pillar 3 information that sets out the internal controls and procedures for disclosure of such information. Should this formal Disclosure policy still be submitted to Central Bank along with ICAAP or it shall only be published / disclosed as mentioned?
The formal disclosure policy should not be submitted but should be available on request by Central Bank of UAE.

Question 7: Will it be sufficient to publish Basel 3 disclosures on its investor relations page on the bank's website without any physical printouts?
Banks should publish their Pillar 3 report in a stand-alone document on the bank's UAE-specific website. This can be anywhere on the website but it needs to be clearly visible and easily available for all stakeholders. Banks which do not have a UAE-Specific website should create a website specific to UAE so that all stakeholders can have access to the Pillar 3 disclosures of the bank.

Question 8: For REM1 template, is Central Bank expecting the Bank to report overseas earnings or only the locally paid compensation? Are deferrals awarded in the current

year only to be reported? If an employee has a deferral which has a tranche of a prior year paid out after they have left the Branch, is it expected that this would be reported or not? If a prior year tranches awarded is reported should this be reported if the individual is no longer an employee of the Branch?
All contract earnings of all employees need to be reported even if the employee is earning compensation in UAE and outside UAE. The full contractual award needs to be mentioned and not only the physical payout

Question 9: Is the End of Service Benefit (EOSB) i.e. severance payment for a normal leaver to be reported depending upon the definition of "other material risk taker" OR are banks also required to report any additional payment such as a redundancy type payment? Should a transfer of Senior Management personnel or Other Material Risk-takers to other branch of the Bank be considered as severance for reporting purpose?
All payments regardless of the type of payment based on the contract needs to be reported

Question 10: For branches of foreign banks where the Head Office reports to the home regulator, there are pre-fixed formats prepared and submitted at a frequency as stipulated by home regulator. Can the branch of foreign banks provide such reports in UAE which are submitted to the home regulator as a part of UAE Pillar 3 Disclosures?
Reports sent between Head Office and UAE needs to be separated and only the Pillar 3 disclosures as per this Guidance needs to be reported for UAE branches in the mandatory formats published here.

Question 11: What does "Fully loaded" ECL accounting model mean and what is the difference between total capital and fully loaded capital?
"Fully Loaded" means bank's regulatory capital compared with a situation where the transitional arrangement had not been applied

Question 12: For branches of foreign banks, would Central Bank allow for a transition period if the threshold for partial disclosure is reached? (i.e. if RWA exceed AED 5 billion)
Transition will be granted on a case by case basis

Question 13: Currently CCyB buffer is 0% in UAE. In this case, what do banks need to report in CCyB template?
Currently CCyB is not applicable in UAE but if banks in UAE have branches in other countries this needs to be reported if CCyB is being reported as per that foreign country's regulations. Banks, hence, need to calculate and fill the CCyB1 as explained in the Capital Supply standards.

Question 14: In Sheet CR5, for "Unrated" Category, should we include the Post CRM and CCF amounts in their respective Risk Weight categories or should we club it under "Others"?
Yes, it can be placed in "Others" along with any other ratings.

Question 15: In Sheet OV1, is the minimum requirements simply 10.5% of the RWA.
Pillar 1 capital requirements at the reporting date will normally be RWA*10.5% but may differ if a floor is applicable or adjustments (such as scaling factors).

Question 16: CCR8 requires Bank to report Exposures to Non QCCPs (excluding initial margin and default fund contribution) arising of (i) OTC derivatives, (ii) Exchange-traded derivatives, (iii) Securities financing transactions & (iv) Netting sets where cross-product netting has been approved. Does this mean the Exposures computed under SA-CCR which are eligible under Netting Jurisdiction to be disclosed under (iv)?
Currently, UAE has no netting jurisdiction but such exposures reported will be taken into

consideration on a case-by-case basis.

Question 17: LIQA, Liquidity exposures and funding needs at the level of individual legal entities, foreign branches and subsidiaries, taking into account legal, regulatory and operational limitations on the transferability of capital. Are insurance or non-bank subsidiaries to be included?
All entities that are consolidated by the bank must be included.

Question 18: LIQA, Balance sheet and off-balance sheet items broken down into maturity buckets and the resultant liquidity gaps. Is there any format for reporting the liquidity gap report?
As per BRF 9 reported by the bank. The bank may add a section for Off Balance sheet as required

Leverage Ratio

Leverage Ratio

I. Introduction

1. Risk-based capital adequacy ratios measure the extent to which a bank has sufficient capital relative to the risk of its business activities. They are based on a foundational principle: that a bank that takes higher risks should have higher capital to compensate.

2. Leverage, on the other hand, measures the extent to which a bank has financed its assets with equity. It does not matter what those assets are, or their risk characteristics. The leverage ratio, by placing an absolute cap on exposures relative to a bank's capital, is an important component of the Central Bank capital framework, and complements the risk-based capital adequacy regime. However, neither of these parts of the framework stands alone: it is important to look at Central Bank capital requirements as a package of constraints that mutually reinforce prudent behaviour. Even though the leverage ratio has been designed as a backstop, it must be a meaningful backstop if it is to serve its intended purpose.

3. One of the underlying causes of the global financial crisis is believed to have been the build-up of excessive on- and off-balance-sheet leverage in the banking system. At the height of the crisis, developments in financial markets forced banks to reduce leverage in a manner that likely amplified downward pressures on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling bank capital, and shrinking credit availability.

4. The Central Bank's leverage ratio framework introduces a simple, transparent, non-risk-based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements. The leverage ratio is intended to:

- restrict the build-up of leverage in the banking sector to avoid destabilizing deleveraging processes that can damage the broader financial system and the economy; and
- reinforce the risk-based requirements with a simple, non-risk-based "backstop" measure.

5. The Basel Committee on Banking Supervision (BCBS) adopted the leverage ratio with the launch of Basel III in December 2010. A revised leverage ratio framework, titled *Basel III Leverage Ratio Framework and Disclosure Requirements*, was published in January 2014. In December 2017, the leverage ratio was finalized along with the rest of the Basel III capital framework. Prior to each release of the leverage ratio, the BCBS published consultative documentation and sought comments from the industry. Additionally, in 2015 and 2017, the BCBS published revised Pillar 3 disclosure requirements, including updated disclosure requirements for the leverage ratio.

6. In designing the UAE leverage ratio framework, the Central Bank considered the full evolution of the BCBS leverage ratio, including consultative frameworks, reporting requirements, and comments raised by banks and industry bodies across the globe. The Central Bank's *Standards for Leverage Ratio* is based closely on the requirements articulated by the BCBS in the document *Basel III: Finalising post-crisis reforms*, December 2017.

7. This Guidance should be read in conjunction with the Central Bank's *Standards on Leverage Ratio,* as it is intended to provide clarification of the requirements of that Standards, and together with that Standards supports the Central Bank's *Regulations Re Capital Adequacy*.

II. Clarifications of the Standards

8. The leverage ratio framework is designed to capture leverage associated with both on- and off-balance-sheet exposures. It also aims to make use of accounting measures to the greatest extent possible, while at the same time addressing concerns that (i) different accounting frameworks across jurisdictions raise level playing field issues and (ii) a framework based exclusively on accounting measures may not capture all risks.

a. Leverage Ratio and Capital

9. The leverage ratio is defined as the capital measure divided by the exposure measure, expressed as a percentage:

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

10. The capital measure is Tier 1 capital as defined for the purposes of the Central Bank risk-based capital framework, subject to transitional arrangements. In other words, the capital measure for the leverage ratio at a particular point in time is the applicable Tier 1 capital measure at that time under the risk-based framework.

11. The minimum requirement for the leverage ratio is established in the Central Bank's *Regulations Re Capital Adequacy*.

12. The Standards includes the possibility that the Central Bank may consider temporarily exempting certain central bank "reserves" from the leverage ratio exposure measure to facilitate the implementation of monetary policies in exceptional macroeconomic circumstances. In this context, the term "reserves" refers to certain bank balances or placements at the Central Bank. Certain other jurisdictions have pursued monetary policies that resulted in a significant expansion of such bank balances at the Central Bank, for example through policies commonly described as "quantitative easing." While the Central Bank has no plan to implement such policies, the inclusion of this flexibility in the Standards ensures that, in the event that such policies were to be implemented, the minimum leverage requirement could be adjusted in a manner that allows it to continue to serve its appropriate prudential role. Per the requirements of the BCBS framework, the Central Bank would also increase the calibration of the minimum leverage ratio requirement commensurately to offset the impact of exempting central bank reserves, since actual bank leverage ratios would be expected to increase due to the exclusion of these exposures.

b. Scope of Consolidation

13. The framework applies on a consolidated basis, following the same scope of regulatory consolidation used in the risk-based capital requirements (see Regulations re Capital Adequacy). For example, if proportional consolidation is applied for regulatory consolidation under the risk-based framework, the same criteria shall be applied for leverage ratio purposes.

14. Where a banking, financial, insurance or commercial entity is outside the scope of regulatory consolidation, only the investment in the capital of such entities (that is, only the carrying value of the investment, as opposed to the underlying assets and other exposures of the investee) is included in the exposure measure. However, any such investments that are deducted from Tier 1 capital may be excluded from the exposure measure.

c. Exposure Measure

15. The exposure measure includes both on-balance-sheet exposures and off-balance-sheet (OBS) items. On-balance-sheet exposures are generally included at their accounting value, although exposures arising from derivatives transactions and securities financing transactions (SFTs) are subject to separate treatment.

16. Except where a different treatment is specified, no offset is allowed for physical or financial collateral held, guarantees in favour of the bank or other credit risk mitigation techniques.

17. Balance sheet assets that are deducted from Tier 1 capital may also be deducted from the exposure measure. For example:

- Where a banking, financial or insurance entity is not included in the regulatory scope of consolidation, the amount of any investment in the capital of that entity that is totally or partially deducted from Common Equity Tier 1 (CET1) or Additional Tier 1 capital may also be deducted from the leverage ratio exposure measure.

- Prudent valuation adjustments for exposures to less liquid positions that are deducted from Tier 1 capital as per the Central Bank's Market Risk Standards may be deducted from the leverage ratio exposure measure.

18. Liability items must not be deducted from the leverage ratio exposure measure. 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 must not be deducted from the leverage ratio exposure measure.

19. The Central Bank will be vigilant to transactions and structures that have the result of inadequately capturing banks' sources of leverage. Examples of concerns that might arise in such leverage ratio exposure measure minimizing transactions and structures may include: 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); 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; collateral swap trades structured to mitigate inclusion in the leverage ratio exposure measure; or use of structures to move assets off the balance sheet. This list of examples is by no means exhaustive.

d. On-Balance Sheet Exposures

20. Where a bank 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.

e. Derivative Exposures

21. The basis for the framework's treatment of derivative transactions is a modified version of Standardised Approach to Counterparty Credit Risk (SA-CCR) in Basel III. It captures both the exposure arising from the underlying of the derivative contract and the related counterparty credit risk. The exposure measure amount is generally equal to the sum of the replacement cost (the mark-to-market value of contracts with positive value) and an add-on representing the transaction's potential future exposure, with that sum multiplied by a scaling factor of 1.4. Valid bilateral netting contracts can reduce the exposure amount, but

collateral received generally cannot. There are specific rules governing the treatment of cash variation margin, clearing services and written credit derivatives.

22. If, under a bank's operative accounting standards, there is no accounting measure of exposure for certain derivative instruments because they are held (completely) off balance sheet, the bank must use the sum of positive fair values of these derivatives as the replacement cost.

23. Netting across product categories such as derivatives and SFTs is not permitted in determining the leverage ratio exposure measure. However, where a bank has a cross-product netting agreement in place that meets the eligibility criteria; it may choose to perform netting separately in each product category provided that all other conditions for netting in this product category that are applicable to the leverage ratio framework are met."

24. Variation margin may be netted against derivative exposures, but only where the margin is paid in cash. This is the appropriate treatment for the leverage calculation, since the cash margin payment is, for all intents and purposes, a settlement of a liability. It also has the advantage, as would not have otherwise been the case, of encouraging the good risk management practice of taking cash collateral against derivative exposures, and is consistent with broader regulatory objectives that promote the margining of OTC derivatives.

25. One of the criteria necessary in order to recognize cash variation margin received as a form of pre-settlement payment is that variation margin exchanged must be the full amount necessary to extinguish the mark-to-market exposure of the derivative. In situations where a margin dispute arises, the amount of non-disputed variation margin that has been exchanged can be recognized.

26. Where a bank provides clearing services as a "higher level client" within a multi-level client structure, the bank need not recognize in its leverage ratio exposure measure the resulting trade exposures to the ultimate clearing member (CM) or to an entity that provides higher-level services to the bank if it meets specific conditions.

27. Among these conditions is a requirement that 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 joint default or insolvency of the CM and any of its other clients. To clarify, upon the insolvency of the clearing member, there must be no legal impediment (other than the need to obtain a court order to which the client is entitled) to the transfer of the collateral belonging to clients of a defaulting clearing member to the QCCP, to one or more other surviving clearing members or to the client or the client's nominee.

28. Another required condition is that relevant laws, regulation, rules, contractual or administrative arrangements provide that the offsetting transactions with the defaulted or insolvent CM are highly likely to continue to be indirectly transacted through the QCCP, or by the QCCP, if the CM defaults or becomes insolvent. Assessing whether trades are highly likely to be ported should consider factors such as a clear precedent for transactions being ported at a QCCP, and industry intent for this practice to continue. The fact that QCCP documentation does not prohibit client trades from being ported is not sufficient to conclude that they are highly likely to be ported.

29. The effective notional amount referenced by a written credit derivative is to be included in the leverage ratio exposure measure. Note that this is added to the general exposure measure for derivatives because a written credit derivative exposes a bank both to counterparty credit risk and to credit risk from the underlying reference entity for the derivative.

30. 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. For example, if a written credit derivative

had a positive fair value of 20 on one date, but then declines by 30 to have 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 may not 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. 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.

31. The resulting exposure amount for a written credit derivative may be further reduced by the effective notional amount of a purchased credit derivative on the same reference name, provided that certain conditions are met. Among these conditions is a requirement that credit protection purchased through credit derivatives is otherwise subject to the same or more conservative terms as those in the corresponding written credit derivative. For example, the application of the same material terms would result in the following treatments:

- In the case of single name credit derivatives, the credit protection purchased through credit derivatives is on a reference obligation that 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.
- For tranched products, the credit protection purchased through credit derivatives must be on a reference obligation with the same level of seniority.

32. Another required condition is that 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, which would generate wrong-way risk. Specifically, the credit quality of the counterparty must not be positively correlated with the value of the reference obligation (i.e. the credit quality of the counterparty falls when the value of the reference obligation falls and the value of the purchased credit derivative increases). This determination should reflect careful analysis of the actual risk; a legal connection does not need to exist between the counterparty and the underlying reference entity.

33. For the purposes of the leverage ratio, the term “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 that fulfils the conditions stated in the Standards. For example, to have the same or more conservative material terms, the strike price of the underlying purchased credit protection would need to be equal to or lower than the strike price of the underlying sold credit protection.

f. Securities Financing Transaction (SFT) Exposures

34. Secured lending and borrowing in the form of SFTs is an important source of leverage. How the framework measures exposure from SFTs depends on whether the bank is acting as a principal or agent. For principal banks, the exposure measure is equal to the sum of gross SFT assets (gross receivables related to SFTs, with some adjustments) and an amount representing counterparty credit risk. When acting as an agent, depending on the structure of the SFT, a bank may be able to ignore the collateral involved and reflect only the counterparty credit risk component, or it may have to include both. The framework also

includes specific rules for SFTs that qualify for sale treatment under the operative accounting regime.

35. A degree of netting is allowed for SFTs, but only where strict criteria are met (for example, same counterparty, same maturity date). In these cases, the net position provides the better measure of the degree of leverage in a set of transactions between counterparties.

36. When a bank acts as a principal, its SFT exposure is the sum of gross SFT assets (subject to adjustments) and a measure of counterparty credit risk calculated as the current exposure without an add-on for potential future exposure.

37. For SFT assets subject to novation and cleared through QCCPs, "gross SFT assets recognized for accounting purposes" are replaced by the final contractual exposure, that is, 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 requisite criteria are met. Any other netting permitted by the QCCP is not permitted for the purposes of the Basel III leverage ratio. Gross SFT assets recognized for accounting purposes must not recognize any accounting netting of cash payables against cash receivables (e.g. as currently permitted under the IFRS accounting framework). This regulatory treatment has the benefit of avoiding inconsistencies from netting which may arise across different accounting regimes.

38. Where a bank acting as an agent in an SFT does not provide an indemnity or guarantee to any of the involved parties, the bank is not exposed to the SFT and therefore need not recognize those SFTs in its leverage ratio exposure measure.

39. In situations where a bank is economically exposed beyond providing an indemnity or guarantee for the difference between the value of the security or cash its customer has lent and the value of the collateral the borrower has provided, a further exposure equal to the full amount of the security or cash must be included in the leverage ratio exposure measure. An example of this scenario could arise 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). 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.

g. Off-Balance Sheet Items

40. OBS items arise from such transactions as credit and liquidity commitments, guarantees and standby letters of credit. The amount that is included in the exposure measure is determined by multiplying the notional amount of an OBS item by the relevant credit conversion factor (CCF) from the Central Bank's *Standards for Leverage Ratio*.

41. The off-balance-sheet exposure measure will be calculated using credit equivalent values. This reflects the fact that the degree of leverage in these transactions is not the same as if banks had made fully funded loans. That is, a 100% credit conversion factor (CCF) overestimates leverage. The use of standardised CCFs retains a consistent and conservative treatment that is not dependent on the risk of the bank's counterparty.

42. 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 apply, instead of a 40% CCF; and

- If a bank has an unconditionally cancellable commitment to issue direct credit substitutes, a 10% CCF will apply, instead of a 100% CCF.

III. Frequently Asked Questions

Question 1: Is the starting point for the leverage ratio exposure calculation total on-balance-sheet assets as reported in the financial statements?
Yes, total assets are the correct starting point, with adjustments as specified in the Standards, and with additions for off-balance-sheet exposure as required under the Standards.

Question 2: Should aspects of derivatives exposures or SFT exposures that are on the balance sheet be included as part of on-balance-sheet exposure, or as part of derivatives or SFT exposure?
Certain exposures related to derivatives may appear on the balance sheet; the same is true for SFTs. Those exposures related to derivatives or SFTs should be excluded from the on-balance-sheet component of the leverage ratio exposure calculation, and instead included with either derivatives exposure or SFT exposure, as appropriate.

Question 3: Why is collateral on the bank's balance sheet part of the exposure measure for the leverage ratio calculation?
The leverage ratio framework as developed by the Basel Committee treats all assets on a bank's balance sheet as creating equal risk. If the bank holds collateral on its balance sheet, the collateral is an asset of the bank, and changes in the value of that collateral affect the bank's total assets and capital. In this sense, the leverage ratio calculation treats collateral as an additional source of risk exposure to the bank, even though the purpose of taking the collateral may be credit risk mitigation. The leverage ratio treats most types of secured exposures the same way, on a gross basis without taking into account the effects of collateral.

Question 4: Is the calculation of counterparty credit risk exposure the same as the calculation used in the SA-CCR standards of the Central Bank?
Not quite – the CCR exposure calculation for the leverage ratio is similar, but with some differences. Potential Future Exposure is different because the PFE multiplier is set equal to 1, rather than possibly being less than 1 as under the CCR Standards. Replacement Cost also differs, due to some differences in the treatment of eligible collateral. The requirements are covered in para 44 to 46 of the Leverage Ratio Standards.

Question 5: Why is the PFE multiplier set to 1 for derivatives in the calculation of the leverage ratio exposure measure?
The PFE multiplier is set to 1 because unlike the SA-CCR calculation, there is no "credit" given to the bank for overcollateralization for the leverage ratio. This is in the spirit of other aspects of the leverage ratio exposure calculation, which strictly limits the recognition of various forms of credit risk mitigation.

Question 6: What types of commitments can qualify for a CCF less than 40%?
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, without observed constraints on the bank's ability to cancel such commitments. As noted in the Standards, such commitments are subject to a 10% CCF.

Question 7: The Standards states "general provisions or general loan loss reserves which have reduced Tier 1 capital may be deducted from the leverage ratio exposure measure." Does this imply that for banks under the standardised approach all general provisions held on the balance sheet are permitted to be deducted from the exposure measure?

Yes, that interpretation is correct.

Question 8: The Standards does not mention interest in suspense; are bank's allowed to deduct this from the leverage ratio exposure measure?
No, interest in suspense should be included as an exposure. However, specific provisions for interest in suspense can be deducted.

IV. Examples: Calculation of Gross SFT Assets

This section provides simple examples to help clarify the calculation of adjusted gross SFT assets for the leverage ratio exposure measure. These examples are for guidance only; banks should consult the actual Leverage Ratio Standards for the specific requirements. Note that the SFT examples do not include the calculation of CCR exposure for the SFTs, which is required under the leverage ratio standards.
For purposes of these examples, consider a bank with a simple initial balance sheet consisting of assets of 200 cash and 400 in investment securities, funded by 600 in equity, with no other initial liabilities. In simple T-account format, the bank's initial position is the following:

Assets		Liabilities and Equity	
Cash	200		
Investment Securities	400	Equity	600
	600		600

Example 1: Single Repurchase Agreement

A customer obtains financing from the bank through a repurchase agreement. The customer provides securities to the bank of 110, receives cash of 100, and commits to repurchase the securities at a specified future date. This is the bank's only SFT.
After the transaction, the bank's balance sheet appears as follows:

Assets		Liabilities and Equity	
Cash	100		
Investment Securities	510		
Repo Encumbered Securities	-110		
Cash Receivable	100	Equity	600
	600		600

For purposes of the leverage ratio, gross SFT assets would be the sum of the cash receivable created and the investment securities received, 100+110, for a total of 210. However, this total is reduced by the value of the securities received under the SFT because the bank has recognized the securities as an asset on its balance sheet, leading to an adjusted gross SFT asset value of 100 for inclusion in the leverage ratio exposure measure.
Note that in this example, the net effect on leverage ratio exposure would be zero, since on-balance-sheet assets exclusive of SFT assets decline by 100.

Example 2: Single Reverse Repurchase Agreement

A bank obtains funding by reversing out securities in exchange for cash. The bank receives 100 cash, repos out 110 in securities, and will repurchase the securities at a specified future date. This is the bank's only SFT.
After the transaction, the bank's balance sheet appears as follows:

Assets		Liabilities and Equity	
Cash	300		
Investment Securities	290	Cash Payable	100
Repo Encumbered Securities	110	Equity	600
	700		700

For purposes of the leverage ratio, gross SFT assets would be simply the 100 cash received. Note that in this example, the net effect would be to increase the measured leverage ratio exposure by 100.

Example 3: Simple Repo Portfolio

The bank has two SFTs, the repo from Example 1 above, and the reverse repo from Example 2 above. Both SFTs are with the same counterparty, and are subject to a qualifying master netting agreement under which cash payables and receivables qualify for netting. These are the bank's only SFTs.
After the transaction, the bank's balance sheet appears as follows:

Assets		Liabilities and Equity	
Cash	200		
Investment Securities	400	Cash Payable	100
Cash Receivable	100	Equity	600
	700		700

Because the SFT transactions have matching terms, there are offsetting accounting entries for Repo Encumbered Securities, Investment Securities, and Cash. In this case, gross SFT assets would be 310, consisting of 100 cash receivable, 110 investment securities received, and 100 cash received. However, this total is adjusted down by the amount of the securities received and held on the balance sheet (110), and by another 100 due to the netting of the cash payable and the cash receivable, leaving an adjusted total gross SFT assets of 100 to be included in the leverage ratio exposure measure.