Supplementary Leverage Ratio (SLR)

Visual Memorandum

September 12, 2014

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Introduction to the SLR

- The Basel Committee's Basel III capital framework introduces a minimum 3% Tier 1 leverage ratio that takes into account both on-balance sheet assets and off-balance sheet exposures ("**Basel III Leverage Ratio**").
- **SLR Framework:** The SLR represents the U.S. banking agencies' implementation of the Basel III Leverage Ratio. Under the U.S. banking agencies' SLR framework:
  - Advanced approaches firms must maintain a minimum SLR of 3%.
  - The 8 U.S. bank holding companies that have been identified by the Financial Stability Board as global systemically important banks ("**U.S. G-SIBs**") and their U.S. insured depository institution ("**IDI**") subsidiaries are subject to enhanced SLR standards ("**eSLR**") that will effectively require them to maintain an SLR in excess of 5%. *See* **page 6** for an overview of the eSLR.
- **SLR Rulemakings**
  - April 2014: U.S. banking agencies finalized the eSLR.
    - U.S. banking agencies proposed revisions to the denominator of the SLR to implement the Basel Committee's January 2014 revisions to the denominator of the Basel III Leverage Ratio.
  - September 2014: U.S. banking agencies finalized revisions to the denominator of the SLR, which include a number of key changes and clarifications to the April 2014 proposal. *See* **page 9** for a summary of these changes and clarifications.

Visual Overview of the SLR

As defined in U.S. Basel III and consisting of Common Equity Tier 1 and Additional Tier 1 capital, subject to adjustments, deductions and transitional arrangements (no capital conservation buffer)

$$\text{SLR (\%)} = \frac{\textbf{Tier 1 Capital}}{\textbf{Total Leverage Exposure}}$$

- Advanced approaches firms* are subject to a minimum SLR of 3%.
- U.S. G-SIBs and their IDI subsidiaries are subject to the eSLR.

Takes into account both on-balance sheet assets and off-balance sheet exposures such as OTC derivatives, cleared derivatives, repo-style transactions and other off-balance sheet exposures

* **Advanced approaches firms** include:

- National and state banks, savings associations, BHCs and savings and loan holding companies (together, "**banking organizations**") with ≥ $250 billion in total consolidated assets **or** ≥ $10 billion of on-balance sheet foreign exposures
- A foreign banking organization's U.S. intermediate holding company ("**IHC**") that has ≥ $250 billion in total consolidated assets **or** ≥ $10 billion of on-balance sheet foreign exposures, regardless of whether the IHC is also a BHC.

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SLR vs. U.S. Leverage Ratio

- U.S. banking organizations have long been subject to a leverage capital requirement based on the ratio of a banking organization's Tier 1 capital to its average total consolidated on-balance sheet assets as reported in its regulatory report minus amounts deducted from Tier 1 capital ("**U.S. leverage ratio**").
- All U.S. banking organizations and IHCs are subject to a minimum 4% U.S. leverage ratio. An IDI must maintain a U.S. leverage ratio of at least 5% to be considered well-capitalized.
- **Difference:** A key difference between the SLR and the U.S. leverage ratio is that the former takes into account both on-balance sheet and certain off-balance sheet assets and exposures, whereas the latter only measures a banking organization's on-balance sheet leverage.
- In the case of a banking organization that has substantial off-balance sheet exposures, the denominator of its SLR would generally be higher than the denominator of its U.S. leverage ratio.

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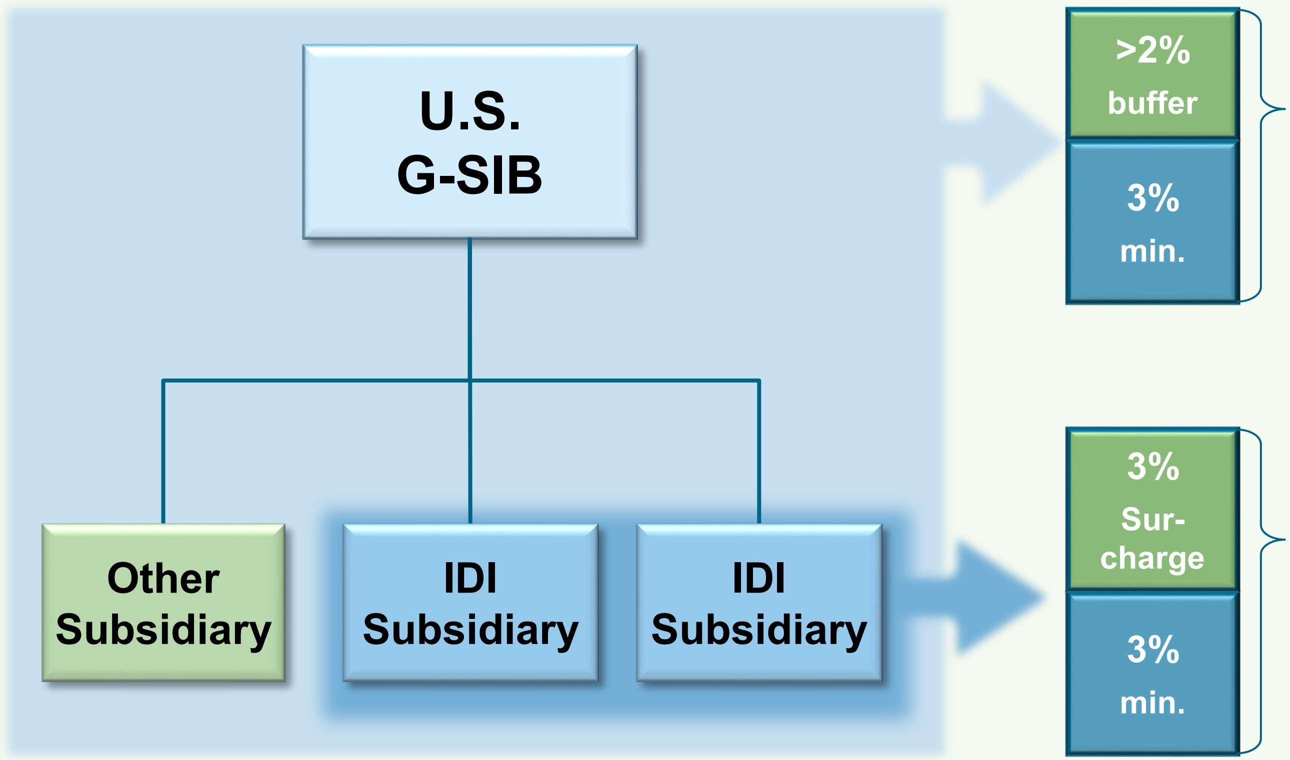
Overview of the eSLR



A U.S. G-SIB must maintain a **>5%** SLR, on a consolidated basis, to avoid restrictions on capital distributions and discretionary bonus payments to executive officers

Each IDI subsidiary must maintain a **6%** SLR to be considered well-capitalized

- The eSLR applies to a U.S. top-tier BHC with at least $700 billion in total consolidated assets **or** at least $10 trillion in assets under custody and its IDI subsidiaries – this threshold captures the 8 U.S. G-SIBs and their IDI subsidiaries.

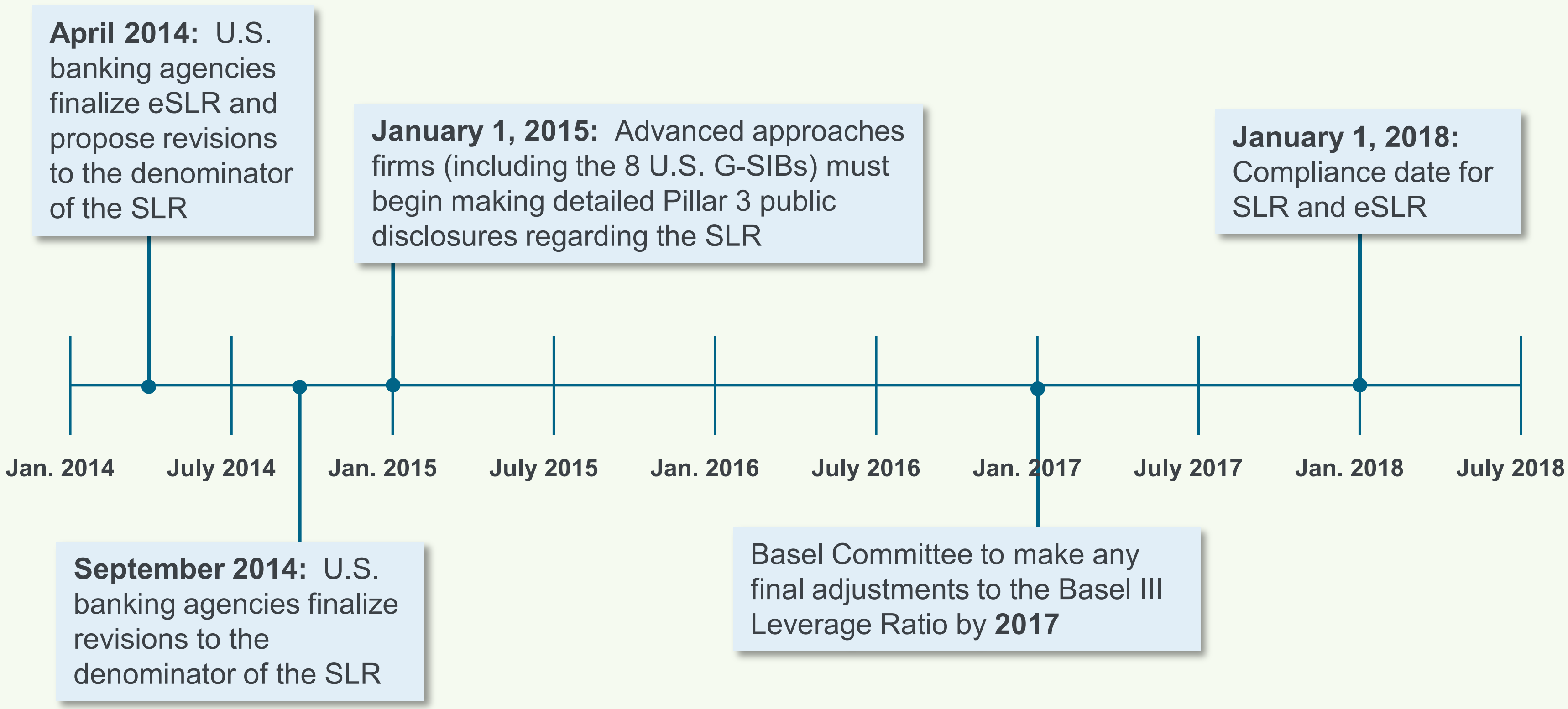
eSLR: Failure by a U.S. G-SIB to Maintain >5% SLR

- A U.S. G-SIB that does not maintain an SLR of greater than 5%, *i.e.*, a buffer of more than 2% on top of the 3% minimum, will be subject to increasingly stringent restrictions on its ability to make capital distributions and discretionary bonus payments to executive officers.
- The eSLR buffer for U.S. G-SIBs is analogous to the Basel III risk-based capital conservation buffer.

SLR Buffer	Allowed Capital Distributions and Discretionary Bonus Payments
Buffer > 2.0%	No limit imposed by the U.S. G-SIB leverage surcharge
2.0% ≥ Buffer > 1.5%	Up to 60% of eligible retained income
1.5% ≥ Buffer > 1.0%	Up to 40% of eligible retained income
1.0% ≥ Buffer > 0.5%	Up to 20% of eligible retained income
0.5% ≥ Buffer	No capital distributions or discretionary bonus payments allowed

- U.S. banking agencies estimate, based on Q2 2014 data, that banking organizations subject to the eSLR will need to raise an additional $14.5 billion of Tier 1 capital to cover differences in the definition of Total Leverage Exposure from 2013 U.S. Basel III final rule.

SLR and eSLR Implementation Timeline



Key Changes and Clarifications to April 2014 SLR Denominator Proposal

Topic	Overview of Key Change / Clarification
Conditions for cash variation margin to avoid reversal of the U.S. GAAP offset option	▪ Clarification that unless segregation is required by law, regulation or any agreement with the counterparty, a banking organization that posts cash variation margin to a counterparty may assume that its counterparty has **not** segregated the cash variation margin it has received for purposes of meeting criterion of absence of segregation for derivatives not cleared through a qualifying central counterparty ("**QCCP**"). ▪ Clarification that cash variation margin exchanged on the morning of the subsequent trading day would meet criterion of variation margin fully covering the current credit exposure.
Credit protection sold and purchased on overlapping portions of same reference index	▪ Clarification that where a banking organization has purchased and sold credit protection on overlapping portions of the same reference index, but the purchased credit protection does not cover the entirety of the portion of the index or securitization on which the banking organization has sold credit protection, the banking organization may offset the sold credit protection by the overlapping portion of purchased credit protection.
Cleared credit protection sold	▪ The effective notional principal amounts of sold credit protection that are cleared for clearing member clients through CCPs are **not** included in a clearing member banking organization's Total Leverage Exposure. These derivative transactions are treated in the same manner as other cleared derivative transactions.

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Key Changes and Clarifications to April 2014 SLR Denominator Proposal *(cont.)*

Topic	Overview of Key Change / Clarification
Conditions to avoid reversal of the U.S. GAAP offset for repo-style transactions	▪ Clarification of the criterion that "settlement of the underlying securities does not interfere with the net cash settlement": Failure of any single securities transaction in settlement system should only delay matching cash leg or create an obligation of the settlement system. Settlement system must not require **all** securities transactions to settle before settling any net cash obligations.
Potential future exposure exclusions	▪ The potential future exposure related to a forward agreement associated with a repurchase or securities lending transaction that qualifies for sales treatment under U.S. GAAP may be **excluded** from Total Leverage Exposure. Forward agreement should **not** be included as off-balance sheet exposure subject to credit conversion factor ("**CCF**").
Interaffiliate clearing arrangements	▪ A banking organization may **exclude** from its Total Leverage Exposure the clearing member's exposure to its clearing member client for a derivative transaction if the clearing member client and the clearing member are affiliates and consolidated on the banking organization's balance sheet.
Averaging of Total Leverage Exposure	▪ On-balance sheet portion of Total Leverage Exposure is calculated as the <u>daily</u> average for the reporting quarter. ▪ Off-balance sheet portion of Total Leverage Exposure is calculated as the average of the three <u>month-end</u> amounts for the reporting quarter.

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Key Comments Not Taken by U.S. Banking Agencies

- No exclusion of cash, central bank deposits or sovereign securities from Total Leverage Exposure
- No change in tenor requirements for purchased credit protection to reduce effective notional principal amount of sold credit protection
- No inclusion of undated or “open” repo-style transactions as offsetting repo-style transactions with same explicit final settlement date to avoid reversal of U.S. GAAP offset
- No exclusion of cash collateral posted to CCP for cleared repo-style transactions from Total Leverage Exposure
- No change to CCF applicable to trade finance exposures
- No exclusion of cash provided by clearing member client and held in segregated account from clearing member banking organization’s Total Leverage Exposure

SLR Denominator:
Components of Total Leverage Exposure

Total Leverage Exposure =

1. **On-balance Sheet Assets** (beginning on page 13)

\+

2. **Derivative Exposures** (beginning on page 14)

\+

3. **Repo-Style Transaction Exposures** (beginning on page 29)

\+

4. **Other Off-Balance Sheet Exposures** (beginning on page 36)

1. On-balance Sheet Assets

A banking organization must include in its Total Leverage Exposure:

- Balance sheet carrying value of all of its on-balance sheet assets

PLUS (+)

- Value of securities sold under a repurchase transaction or a securities lending transaction that qualifies for sales treatment under U.S. GAAP

LESS (-)

- Amounts deducted from Tier 1 capital under U.S. Basel III

LESS (-)

- Value of securities received in security-for-security repo-style transactions, where the banking organization acts as a securities lender and includes the securities received in its on-balance sheet assets but has not sold or re-hypothecated the securities received

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2. Derivative Exposures: Overview

A banking organization must include in its Total Leverage Exposure:

- **A.** Potential future exposure ("**PFE**") for each derivative contract or each single-product netting set of derivative contracts, subject to certain exceptions and adjustments

PLUS (+)

- **B.** Certain cash collateral received from or posted to a counterparty (*i.e.*, reversal of the U.S. GAAP offset option), ***unless*** such cash collateral is all or part of variation margin that satisfies certain conditions

PLUS (+)

- **C.** Effective notional principal amount of a credit derivative, or other similar instrument, through which the banking organization provides credit protection, which may be reduced by purchased credit protection that satisfies certain requirements

PLUS (+)

- **D.** Exposures arising from certain central clearing arrangements

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2A. PFE of Derivative Exposures: Single Derivative Not Subject to a Qualifying Master Netting Agreement

PFE = effective notional principal amount x add-on factor

PFE Add-on Factors							
Remaining maturity	**Interest rate**	**Foreign exchange rate and gold**	**Credit (investment grade reference asset)**	**Credit (non-investment grade reference asset)**	**Equity**	**Precious metals (except gold)**	**Other**
1 year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Over 1 to 5 years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Over 5 years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

- A banking organization may **exclude** from PFE calculations a forward agreement treated as a derivative contract that is part of a repurchase or reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP.

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2A. PFE of Derivative Exposures: Netting Set of Derivatives Subject to a Qualifying Master Netting Agreement

$$\textbf{PFE} = (0.4 \times A_{gross}) + (0.6 \times NGR \times A_{gross})$$

- A_{gross} = the gross PFE: the sum of the PFE amounts (as determined by multiplying the effective notional principal amount of the derivative contract by the appropriate add-on factor) for each individual derivative contract subject to the qualifying master netting agreement.
- **NGR** = net to gross ratio: the ratio of the net current credit exposure to the gross current credit exposure. The gross current credit exposure equals the sum of the positive current credit exposures of all individual derivative contracts subject to the qualifying master netting agreement.
- Cross-product netting may **not** be used to determine Total Leverage Exposure.

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2A. PFE of Derivative Exposures: Definition of Qualifying Master Netting Agreement

- A **qualifying master netting agreement** means a written, legally enforceable agreement provided that:
  - The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty.
  - The agreement provides the banking organization the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case, any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than in receivership, conservatorship, resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to government sponsored enterprises ("**GSEs**").
  - The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement).
  - In order to recognize an agreement as a qualifying master netting agreement, a banking organization must comply with the operational requirements for counterparty credit risk with respect to that agreement, including conducting a sufficient legal review of the agreement.

2A. PFE of Derivative Exposures: CEM and SA-CCR

- The SLR denominator final rule's approach for determining PFE is based on the current exposure method ("**CEM**").
- **SA-CCR:** The Basel Committee has adopted a standardized, non-internal-model-based method for calculating counterparty credit risk exposures associated with derivatives ("**SA-CCR**"). The SA-CCR will replace the CEM in the risk-based capital framework.
  - The U.S. banking agencies stated that they will consider the extent to which any changes should be made to the calculation of Total Leverage Exposure once the Basel Committee has reached an agreement on whether and how to incorporate the SA-CCR into the Basel III Leverage Ratio.
  - Davis Polk's summary of the SA-CCR is available **here**.

2B. Treatment of Collateral: U.S. GAAP Offset Option and Its Reversal Under Certain Circumstances

- **U.S. GAAP offset option:** Under U.S. GAAP, a banking organization has the option ("**U.S. GAAP offset option**") to:
  - reduce any positive mark-to-fair value of a derivative contract by the amount of any cash collateral received from the counterparty, provided the relevant GAAP criteria for offsetting are met,
  - offset the negative mark-to-fair value of a derivative contract with a counterparty by the amount of any cash collateral posted to the counterparty.
- **Requirement to reverse the U.S. GAAP offset option under certain circumstances:** If a banking organization applies the U.S. GAAP offset option to determine the carrying value of its derivative contracts, the banking organization must **reverse** the effect of the U.S. GAAP offset option for purposes of determining Total Leverage Exposure, **unless** the cash collateral recognized to reduce the mark-to-fair value is cash variation margin that satisfies all of the conditions on pages 20-21.
  - If a banking organization reduces the positive mark-to-fair value of a derivative contract with a counterparty as permitted under the U.S. GAAP offset option, but the cash collateral received does **not** meet the conditions for cash variation margin, the banking organization must include the positive mark-to-fair value of the derivative contract gross of any cash collateral in its Total Leverage Exposure.
  - Similarly, if a banking organization offsets the net negative mark-to-fair value of derivative contracts with a counterparty by the amount of any cash collateral posted to the counterparty, and does not include that cash collateral posted to the counterparty in its on-balance sheet assets, as permitted under the U.S. GAAP offset option, but the cash collateral posted does **not** meet the conditions for cash variation margin, the banking organization must include such cash collateral in its Total Leverage Exposure.

2B. Treatment of Collateral: Conditions for Cash Variation Margin

- **1.** For derivative contracts that are not cleared through a QCCP, the cash collateral received by the recipient counterparty is not segregated (by law, regulation or an agreement with the counterparty).
  - The U.S. banking agencies clarified that unless segregation is required by law, regulation or any agreement with the counterparty, a banking organization that posts cash variation margin to a counterparty may assume that its counterparty has not segregated the cash variation margin it has received for purposes of meeting this criterion.
- **2.** Variation margin is calculated and transferred on a daily basis based on the mark-to-fair value of the derivative contract.
- **3.** The variation margin transferred under the derivative contract or the governing rules for a cleared transaction is the full amount that is necessary to fully extinguish the net current credit exposure to the counterparty of the derivative contracts, subject to the threshold and minimum transfer amounts applicable to the counterparty under the terms of the derivative contract or the governing rules for a cleared transaction.
  - The U.S. banking agencies clarified that temporary differences between the amount of variation margin provided and the current mark-to-fair value should not invalidate recognition of the variation margin already received. Accordingly, a morning margin call based on the mark from the end of the previous day would satisfy this criterion.

2B. Treatment of Collateral: Conditions for Cash Variation Margin *(cont.)*

- **4.** The variation margin is in the form of cash in the same currency as the currency of settlement set forth in the derivative contract.
  - "Currency of settlement" means any currency for settlement specified in the governing qualifying master netting agreement and the credit support annex to the qualifying master netting agreement, or in the governing rules for a cleared transaction.
- **5.** The derivative contract and the variation margin are governed by a qualifying master netting agreement between the legal entities that are the counterparties to the derivative contract or by the governing rules for a cleared transaction, and the qualifying master netting agreement or the governing rules for a cleared transaction must explicitly stipulate that the counterparties agree to settle any payment obligations on a net basis, taking into account any variation margin received or provided under the contract if a credit event involving either counterparty occurs.
- **6.** The variation margin is used to reduce the current credit exposure of the derivative contract and not the PFE.
- **7.** For the purpose of the calculation of the NGR, the variation margin may not reduce the net current credit exposure or the gross current credit exposure.

2C. Sold Credit Protection

- A banking organization must include in its Total Leverage Exposure the effective notional principal amount of a credit derivative, or other similar instrument, through which the banking organization provides credit protection.
- **Effective notional principal amount** = the apparent or stated notional principal amount multiplied by any multiplier in the derivative contract.
- **Reductions:** A banking organization may reduce the effective notional principal amount of a credit derivative:
  - By the amount of any reduction in the mark-to-fair value of the credit derivative if the reduction is recognized in Common Equity Tier 1 capital.
  - By the effective notional principal amount of a **purchased credit derivative** or other similar instrument that satisfies all of the conditions on pages 23-24.

2C. Sold Credit Protection: Conditions for Taking Into Account Purchased Credit Protection

- The remaining maturity of the purchased credit derivative is equal to or greater than the remaining maturity of the sold credit derivative.
- With respect to a credit derivative that references a single exposure, the reference exposure of the purchased credit derivative is to the same legal entity and ranks *pari passu* with, or is junior to, the reference exposure of the sold credit derivative.
- With respect to a credit derivative that references multiple exposures, the reference exposures of the purchased credit derivative are to the same legal entities and rank *pari passu* with the reference exposures of the sold credit derivative, and the level of seniority of the purchased credit derivative ranks *pari passu* to the level of seniority of the sold credit derivative.
  - The U.S. banking agencies clarified that where a banking organization has purchased and sold credit protection on overlapping portions of the same reference index, but the purchased credit protection does not cover the entirety of the portion of the index or securitization on which the banking organization has sold credit protection, the banking organization may offset the sold credit protection by the overlapping portion of purchased credit protection.
  - *E.g.*, if a banking organization has sold credit protection on the 3-7% tranche(s) of an index and purchased credit protection on the 5-10% tranche(s) of the same index, it may offset the 5-7% portion of the sold credit protection, assuming all of the other relevant criteria are met.

2C. Sold Credit Protection: Conditions for Taking Into Account Purchased Credit Protection *(cont.)*

- A banking organization that has reduced the effective notional amount of a sold credit derivative in accordance with the SLR denominator final rule must also reduce the effective notional principal amount of a purchased credit derivative used to offset the sold credit derivative, by the amount of any increase in the mark-to-fair value of the purchased credit derivative that is recognized in Common Equity Tier 1 capital.
- Where a banking organization purchases credit protection through a total return swap and records the net payments received on a sold credit derivative in net income, but does not record offsetting deterioration in the mark-to-fair value of the sold credit derivative (either through reductions in fair value or by additions to reserves), the banking organization may **not** use the purchased credit protection to offset the effective notional principal amount of the sold credit derivative.

2C. Sold Credit Protection: Adjustments to PFE to Avoid Double Counting

- The exposure measure of sold credit protection may be overstated by the inclusion in Total Leverage Exposure of both **(1)** PFE representing counterparty credit exposure and **(2)** effective notional amount representing reference entity exposure.
- Accordingly, a banking organization may choose to **exclude** the PFE of all credit derivatives or other similar instruments through which it provides credit protection when calculating the PFE, provided that it does not adjust the NGR.
- A banking organization that chooses to exclude the PFE of credit derivatives or other similar instruments through which it provides credit protection must do so consistently over time for the calculation of the PFE for all such instruments.

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2C. Sold Credit Protection: Client Clearing

- The effective notional principal amounts of sold credit protection that are cleared for clearing member clients through CCPs are **not** included in a clearing member banking organization's Total Leverage Exposure.
- The clearing member banking organization would include such a derivative transaction, or other similar instrument, related to the sold credit protection in its Total Leverage Exposure in the **same manner as other cleared derivative transactions.**
  - *E.g.*, if the clearing member banking organization guarantees the performance of a clearing member client with respect to a cleared transaction, the clearing member banking organization should treat the exposure to the clearing member client as a derivative contract.

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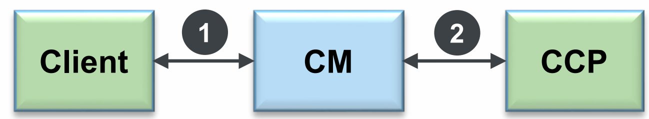
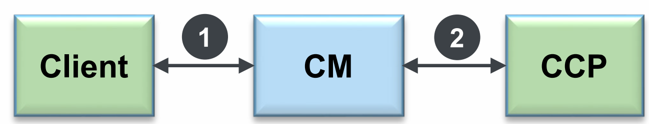
2D. Cleared Derivative Exposures

The following treatments apply when a clearing member banking organization ("**CM**") offers derivatives clearing services to a clearing member client ("**Client**") with respect to a CCP:

Client Clearing Arrangement	Illustrative Example
CM Guarantees CCP's Performance to Client A CM that guarantees the performance of a CCP with respect to a transaction cleared on behalf of a Client must treat its exposure to the CCP as a derivative contract for purposes of determining its Total Leverage Exposure.	**CM Guarantees Client's Performance to CCP**  Include both derivative ➊ and derivative ➋ in Total Leverage Exposure
CM Does <u>Not</u> Guarantee CCP's Performance to Client A CM that does **not** guarantee the performance of a CCP with respect to a transaction cleared on behalf of a Client may **exclude** its exposure to the CCP for purposes of determining its Total Leverage Exposure.	**CM Does <u>Not</u> Guarantee Client's Performance to CCP**  Include <u>only</u> derivative ➊ in Total Leverage Exposure

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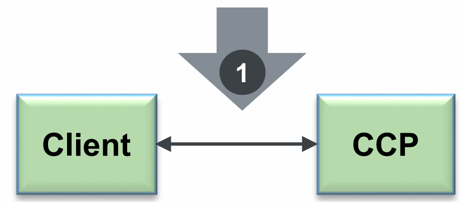
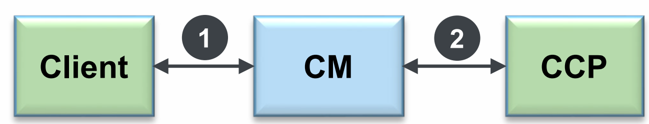
2D. Cleared Derivative Exposures *(cont.)*

Client Clearing Arrangement	Illustrative Example
CM Guarantees Client's Performance to CCP A CM that guarantees the performance of a Client with respect to a cleared transaction must treat its exposure to the Client as a derivative contract for purposes of determining its Total Leverage Exposure.	**CM Guarantees Client's Performance to CCP**  Include guarantee ❶ in Total Leverage Exposure as a derivative transaction with the Client
CM and Client Are Consolidated Subsidiaries of a Banking Organization A banking organization may **exclude** from Total Leverage Exposure a CM's exposure to a Client for a derivative contract, if the CM and Client are affiliates and consolidated for financial reporting purposes on the banking organization's balance sheet.	**CM and Client Are Consolidated Subsidiaries of a Banking Organization**  Exclude derivative ❶ from Total Leverage Exposure

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3. Repo-Style Transaction Exposures: Overview

A banking organization must include in its Total Leverage Exposure:

- **A.** Gross value of receivables associated with the repo-style transactions less any on-balance sheet receivables amount associated with these transactions (*i.e.*, reversal of the U.S. GAAP offset for repo-style transactions), ***unless*** certain conditions are satisfied

PLUS (+)

- **B.** Measure for counterparty credit risk of a repo-style transaction or a netting set of repo-style transactions, including where the banking organization acts as an agent for a repo-style transaction and indemnifies the customer with respect to the performance of the customer's counterparty in an amount **limited to** the difference between the fair value of the security or cash its customer has lent and the fair value of the collateral the borrower has provided

PLUS (+)

- **C.** If a banking organization acting as an agent for a repo-style transaction provides a guarantee to a customer of the security or cash its customer has lent or borrowed with respect to the performance of the customer's counterparty and the guarantee **exceeds** the difference between the fair value of the security or cash its customer has lent and the fair value of the collateral the borrower has provided, the amount of excess

3A. U.S. GAAP Offset for Repo-Style Transactions and Its Reversal Under Certain Circumstances

- **U.S. GAAP offset for repo-style transactions:** Under U.S. GAAP, a banking organization may offset the gross values of receivables due from a counterparty under reverse repurchase agreements by the amount of the payments due to the same counterparty (that is, amounts recognized as payables to the same counterparty under repurchase agreements), provided the relevant accounting criteria are met ("**U.S. GAAP offset for repo-style transactions**").
- **Requirement to reverse the U.S. GAAP offset for repo-style transactions under certain circumstances:** If a banking organization applies the U.S. GAAP offset for repo-style transactions, it must **reverse** the effect of the U.S. GAAP offset for repo-style transactions for purposes of determining Total Leverage Exposure, **unless** all of the conditions on pages 31-32 are satisfied.
  - Where a banking organization acting as a principal (as opposed to as agent) has more than one repo-style transaction with the same counterparty and has offset the gross value of receivables due from a counterparty under reverse repurchase transactions by the gross value of payables under repurchase transactions due to the same counterparty, but the repo-style transactions do **not** meet the SLR denominator final rule's conditions for recognizing the U.S. GAAP offset for repo-style transactions, the banking organization must include in its Total Leverage Exposure the gross value of receivables associated with the repo-style transactions less any on-balance sheet receivables amount associated with these repo-style transactions.

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3A. Conditions for Recognizing the U.S. GAAP Offset for Repo-Style Transactions

- **1.** The offsetting repo-style transactions have the same explicit final settlement date under their governing agreements.
  - The U.S. banking agencies clarified that the "same explicit final settlement date" requirement does **not** permit receivables or payables from undated or "open" repo-style transactions, which can be unwound unconditionally at any time by either counterparty, to be offset against payables or receivables from overnight transactions or against other "open" transactions.
- **2.** The right to offset the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable in the normal course of business and in the event of receivership, insolvency, liquidation, or similar proceeding.
- **3.** Under the agreements governing the repo-style transactions, the counterparties intend to settle net, settle simultaneously, or settle according to a process that is 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), where both transactions are settled through the same settlement system, the settlement arrangements are supported by cash or intraday credit facilities intended to ensure that settlement of both transactions will occur by the end of the business day, and the settlement of the underlying securities does not interfere with the net cash settlement.

3A. Conditions for Recognizing the U.S. GAAP Offset for Repo-Style Transactions *(cont.)*

- **Clarifications regarding criterion 3:** The U.S. banking agencies clarified that criterion 3 requires that the settlement of the underlying securities be subject to a settlement mechanism that results in the functional equivalence of net settlement. In other words, the cash flows of the transactions must be equivalent, in effect, to a single net amount on the settlement date.
  - To achieve such equivalence, all transactions must be settled through the same settlement system, and any settlement system used to settle the transactions must not require all securities to have successfully settled before settling any net cash obligations.
  - The settlement system's procedures must provide that the failure of any single securities transaction in the settlement system should only delay the matching cash leg (payment) or create an obligation to the settlement system, supported by an associated credit facility.
  - If a settlement system's procedures allow for all of the above, criterion 3 would be met. If the failure of the securities leg of a transaction in such a system persists at the end of the settlement period, however, then this transaction and its matching cash leg must be split out from the netting set and treated gross for the purposes of Total Leverage Exposure.

3B. Measure for Counterparty Credit Risk of Repo-Style Transactions: Overview

- A banking organization must include a measure for counterparty credit risk measure in Total Leverage Exposure to capture the banking organization's exposure to its counterparty in repo-style transactions.
- To determine the measure for counterparty credit risk of a repo-style transaction, including a transaction in which a banking organization acts as an agent for a customer and indemnifies the customer against loss, the banking organization would subtract the fair value of the instruments, gold, and cash received from a counterparty from the fair value of any instruments, gold, and cash lent to the counterparty.
  - If a qualifying master netting agreement is in place, or the transactions are cleared, the banking organization can net the total fair value of instruments, gold, and cash lent to a counterparty against the total fair value of instruments, gold, and cash received from the same counterparty across all those transactions.
  - For repo-style transactions that are not subject to a qualifying master netting agreement or that are not cleared, the counterparty exposure measure would be calculated on a transaction-by-transaction basis.

3B. Measure for Counterparty Credit Risk of Repo-Style Transactions: Formulas

If a qualifying master netting agreement is in place:

Measure for counterparty credit risk = greater of (i) **0** and (ii) $\Sigma E_i - \Sigma C_i$

If a qualifying master netting agreement is <u>not</u> in place:

Measure for counterparty credit risk = greater of (i) **0** and (ii) $E_i - C_i$

- ΣE_i = total fair value of the instruments, gold, or cash that the banking organization has lent, sold subject to repurchase or provided as collateral to a counterparty for all transactions included in the qualifying master netting agreement.
- ΣC_i = total fair value of the instruments, gold, or cash that the banking organization borrowed, purchased subject to resale or received as collateral from the counterparty for all transactions included in the qualifying master netting agreement.
- If a qualifying master netting agreement is <u>not</u> in place, the measure for counterparty credit risk is calculated on a transaction by transaction basis, *i.e.*, each transaction *i* is treated as its own netting set.

3C. Banking Organization Acting as Agent for Repo-Style Transactions

- The measure for counterparty credit risk includes where a banking organization acts as an agent for a repo-style transaction and indemnifies the customer with respect to the performance of the customer's counterparty in an amount **limited to** the difference between the fair value of the security or cash its customer has lent and the fair value of the collateral the borrower has provided.
- **Further Economic Exposure:** If a banking organization acting as an agent for a repo-style transaction provides a guarantee to a customer of the security or cash its customer has lent or borrowed with respect to the performance of the customer's counterparty and the guarantee **exceeds** the difference between the fair value of the security or cash its customer has lent and the fair value of the collateral the borrower has provided, the excess must be included in Total Leverage Exposure.
- **No Guarantee or Indemnity:** Where a banking organization acting as an agent for a repo-style transaction does <u>not</u> provide an indemnity or guarantee to any of the involved parties, the bank is not exposed to the repo-style transaction and should <u>not</u> include the repo-style transaction in its Total Leverage Exposure.

4. Other Off-Balance Sheet (OBS) Exposures

- A banking organization must include in its Total Leverage Exposure the credit equivalent amount of all of its off-balance sheet exposures determined using the applicable credit conversation factor ("**CCF**") under the U.S. Basel III Standardized Approach, subject to a CCF floor of 10%.
  - **Exclusions:** Repo-style transactions, repurchase or reverse repurchase or securities borrowing or lending transactions that qualify for sales treatment under U.S. GAAP and derivative transactions.

Credit Equivalent Amount = Notional amount of OBS exposure x CCF

4. Other Off-Balance Sheet (OBS) Exposures *(cont.)*

OBS Exposure	CCF
Commitments that are unconditionally cancelable by the banking organization	10%
Commitments with original maturity of ≤ 1 year that are not unconditionally cancellable by the banking organization	20%
Self-liquidating trade-related contingent items that arise from the movement of goods with original maturity of ≤ 1 year	20%
Commitments with original maturity of > 1 year that are not unconditionally cancellable by the banking organization	50%
Transaction-related contingent items, including performance bonds, bid bonds, warranties and standby letters of credit	50%
Guarantees, credit-enhancing representations and warranties that are not securitization exposures, financial standby letters of credit and forward agreements	100%

Pillar 3 Public Disclosure Requirements

- Beginning in 2015, advanced approaches firms must make quarterly public disclosures regarding their SLR, in accordance with the disclosure tables beginning on the **next page**.
- If a banking organization has material differences between its total consolidated assets as reported in published financial statements and regulatory reports and its reported on-balance sheet assets for purposes of calculating the SLR, it must disclose and explain the source of the material differences.
- If a banking organization's SLR changes significantly from one reporting period to another, it must explain the key drivers of the material changes.

Pillar 3 Public Disclosure Tables

Part 1: Summary comparison of accounting assets and total leverage exposure		
1	Total consolidated assets as reported in published financial statements	
2	Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation	
3	Adjustment for fiduciary assets recognized on balance sheet but excluded from total leverage exposure	
4	Adjustment for derivative exposures	
5	Adjustment for repo-style transactions	
6	Adjustment for off-balance sheet exposures (that is, conversion to credit equivalent amounts of off-balance sheet exposures)	
7	Other adjustments	
8	Total leverage exposure	

Pillar 3 Public Disclosure Tables *(cont.)*

Part 2: Supplementary leverage ratio		
	On-balance sheet exposures	
1	On-balance sheet assets (excluding on-balance sheet assets for repo-style transactions and derivative exposures, but including cash collateral received in derivative transactions)	
2	LESS: Amounts deducted from tier 1 capital	
3	Total on-balance sheet exposures (excluding on-balance sheet assets for repo-style transactions and derivative exposures, but including cash collateral received in derivative transactions) (sum of lines 1 and 2)	
	Derivative exposures	
4	Replacement cost for derivative exposures (that is, net of cash variation margin)	
5	Add-on amounts for potential future exposure (PFE) for derivative exposures	
6	Gross-up for cash collateral posted if deducted from the on-balance sheet assets, except for cash variation margin	
7	LESS: Deductions of receivable assets for cash variation margin posted in derivative transactions, if included in on-balance sheet assets	
8	LESS: Exempted CCP leg of client-cleared transactions	
9	Effective notional principal amount of sold credit protection	
10	LESS: Effective notional principal amount offsets and PFE adjustments for sold credit protection	
11	Total derivative exposures (sum of lines 4 to 10)	

Pillar 3 Public Disclosure Tables *(cont.)*

	Repo-style transactions	
12	On-balance sheet assets for repo-style transactions, except include the gross value of receivables for reverse repurchase transactions. Exclude from this item the value of securities received in a security-for-security repo-style transaction where the securities lender has not sold or re-hypothecated the securities received. Include in this item the value of securities that qualified for sales treatment that must be reversed.	
13	LESS: Reduction of the gross value of receivables in reverse repurchase transactions by cash payables in repurchase transactions under netting agreements	
14	Counterparty credit risk for all repo-style transactions	
15	Exposure for repo-style transactions where banking organization acts as an agent	
16	Total exposures for repo-style transactions (sum of lines 12 to 15)	
	Other off-balance sheet exposures	
17	Off-balance sheet exposures at gross notional amounts	
18	LESS: Adjustments for conversion to credit equivalent amounts	
19	Off-balance sheet exposures (sum of lines 17 and 18)	
	Capital and total leverage exposure	
20	Tier 1 capital	
21	Total leverage exposure (sum of lines 3, 11, 16 and 19)	
	Supplementary leverage ratio	
22	Supplementary leverage ratio	

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