Dubai Financial Services Authority

CONSULTATION PAPER NO. 99

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BASEL III – LIQUIDITY COVERAGE RATIO AND LEVERAGE RATIO

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Part A: Introduction and Overview

Why are we issuing this paper?

1. The DFSA proposes to amend its prudential regime by introducing two key elements of the Basel III framework, namely the Liquidity Coverage Ratio and the Leverage Ratio. This paper sets out those proposals for public consultation.

2. The changes proposed in this paper are designed primarily to bring the DFSA's PIB module into closer alignment with the Basel III framework employed by leading jurisdictions across the world, while retaining features necessary to accommodate regional needs and circumstances, in particular regarding Islamic finance.

Overview of proposals

3. The Liquidity Coverage Ratio (LCR) requires relevant firms to hold an amount of high quality liquid assets (HQLA) relative to their expected net cash outflows over a 30-day horizon. The DFSA proposes, in line with the Basel III standards, to introduce the ratio from 1 January 2015 set at 60%, increasing by 10% each year until, from 1 January 2019, the ratio is set at 100%. These proposed rules would apply to firms in PIB Category 1 and 5[1].

4. The Leverage Ratio (LR) requires relevant firms to hold an amount of capital relative to their overall exposures. At this time, the final form of the Leverage Ratio, including the target ratio, has not been confirmed. Instead, there will be an observation period during which relevant firms will need to report to the DFSA and make appropriate public disclosures. In this paper, the DFSA is consulting on the reporting requirement and on public disclosure requirements, rather than on the final form of the LR itself. These proposed rules would apply to firms in PIB Category 1, 2[1] and 5. The DFSA would intend to consult again when the final form and level of the LR need to be set.

Who should read this paper?

5. The proposals in this paper would be of particular interest to:
   a. Authorised Firms who are in PIB Category 1, 2 or 5;
   b. a Parent of any Authorised Firm in PIB Category 1, 2 or 5 or any entities which might form part of a Group which includes an Authorised Firm in PIB Category 1, 2 or 5;
   c. credit rating agencies;
   d. Registered Auditors and auditing firms providing various accounting and audit services to Authorised Firms in PIB Category 1, 2 or 5;
   e. others conducting or wishing to conduct activities in or from the DIFC; and
   f. Financial Services Regulators, particularly in the GCC region.

[1] PIB Category 1 firms are those authorised to accept deposits. PIB Category 2 firms are those authorised to provide credit and/or to undertake dealing as principal. PIB Category 5 firms are those authorised to manage unrestricted profit sharing investments accounts (UPSIAs).

Terminology in this paper

6. In this paper, defined terms are identified throughout by the capitalisation of the initial letter of a word or of each word in a phrase and are defined in the PIB Glossary, Glossary Module (GLO) or in the proposed amendments in this paper. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning.

How to provide comments

7. All comments should be in writing and emailed to the address specified below. Please refer to the Consultation Paper number in the subject line. You may, identify the organisation you represent in providing your comments. The DFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise at the time of making comments.

   Comments to be addressed or emailed to:

   Consultation Paper No. 99
   Policy and Legal Services
   DFSA
   PO Box 75850
   Dubai, UAE

   Email: consultation@dfsa.ae

   Tel: +971(0)4 3621500

What happens next?

8. The deadline for providing comments on the proposals is **28 November 2014**. Once we receive your comments, we shall consider if any refinements are required to these proposals. We shall then seek approval from our Board of the finalised proposals. Once the proposals are approved, we shall issue a notice on our website to this effect.

Structure of this paper

9. The proposed amendments to the DFSA's prudential regime, and the structure of this consultation paper, are set out below:

   Part A: Introduction and Overview

   Part B: Proposals relating to the Liquidity Coverage Ratio;

   Part C: Proposals relating to the Leverage Ratio; and

   Appendix 1: draft amendments to the Rules.

Part B: Proposals relating to the Liquidity Coverage Ratio

Background

10. Throughout the recent global financial crisis many banks struggled to maintain adequate liquidity. The crisis illustrated how quickly and severely liquidity risks can crystallise and sources of funding thought of as certain can evaporate. This situation created clear evidence of the need for further liquidity regulation.

11. In response to that, the Basel Committee on Banking Supervision (the Basel Committee or Basel) has introduced a new liquidity framework as part of the Basel III regulatory reforms, aiming to strengthen global liquidity regulations with the goal of promoting a more resilient banking sector.

12. The Basel III regulatory liquidity framework was initially proposed by the Basel Committee in December 2009, supplemented by amendments published in December 2010. The Basel III liquidity framework introduced the Liquidity Coverage Ratio ("LCR") and the Net Stable Funding Ratio ("NSFR"), to be put in place in 2015 and 2018, respectively. In January 2013 the Basel Committee published the final text of the LCR, while the NSFR final text is expected to be published shortly.

13. The LCR promotes short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high-quality liquid assets (HQLA) to survive a significant stress scenario of one month's duration. It basically sets the minimum liquidity buffer to bridge liquidity mismatches for a one-month crisis scenario.

14. In January 2012 the DFSA launched an observation period to monitor the potential implication of the LCR (and NSFR) on Authorised Firms in the DIFC, as recommended by the Basel Committee. Over the last 30 months, Authorised Firms in Category 1, 2 and 5 have submitted to the DFSA their calculations of the LCR (and NSFR) on a monthly and quarterly basis, respectively. The results of these submissions were analysed for the purpose of the recommendations made in this paper.

Benchmarking

15. Detailed benchmarking was conducted against other international jurisdictions, including Australia (APRA), Hong Kong (HKMA), Singapore (MAS), UK (PRA) and the United States (Fed, FDIC, and OCC). In all of these jurisdictions, the basic shape of the LCR, once implemented, will be as proposed by the Basel Committee. There are differences in implementation timetable, arrangements for branches of foreign banks and – as would be expected – in areas where the Basel proposals allow explicit national discretion. Relevant issues relating to these points are discussed in the rest of this paper.

Overview: The Liquidity Coverage Ratio

16. The LCR was developed by the Basel Committee to promote short-term resilience of a bank's liquidity risk profile. The LCR aims to ensure that a bank has an adequate stock of unencumbered HQLA, which consists of cash or assets that can be converted into cash at little or no loss of value in private markets, to meet its liquidity needs for a 30 calendar day liquidity stress scenario. The LCR has two components:
    a. Value of the stock of HQLA in stressed conditions; and,

b. Total Net Cash Outflows, calculated according to specified stressed scenarios.

and is expressed as:

$$\text{LCR} = \frac{\text{Stock of HQLA}}{\text{Total Net Cash Outflows over the next 30 calendar days}} \geq 100\%$$

17. The value of the LCR should be, absent a situation of financial stress, no lower than 100% (i.e. the stock of HQLA should at least equal total net cash outflows). Banks are expected to meet this requirement on an ongoing basis and hold a stock of unencumbered HQLA as a defence against the potential onset of liquidity stress. During a period of financial stress, however, banks may use their stock of HQLA, thereby falling below 100%.

High Quality Liquid Assets

18. The numerator of the LCR is the stock of HQLA. In order to qualify as HQLA, assets should be liquid in markets during a time of stress and, in most cases, be eligible for use in central bank operations. Certain types of assets within HQLA are subject to a range of haircuts.

19. Assets are considered to be HQLA if they can be easily and immediately converted into cash at little or no loss of value. The Basel Committee has specified fundamental and market-related characteristics for determining whether or not the market for an asset can be relied upon to raise liquidity when considered in the context of possible stresses.

20. HQLA are comprised of Level 1 and Level 2 assets. Level 1 assets generally include cash, central bank reserves, and certain marketable securities backed by sovereigns and central banks, among others. These assets are typically of the highest quality and the most liquid, and there is no limit on the extent to which a bank can hold these assets to meet the LCR.

21. Level 2 assets are comprised of Level 2A and Level 2B assets. Level 2A assets include, for example, certain government securities, covered bonds and corporate debt securities. Level 2B assets include lower rated corporate bonds, residential mortgage backed securities and equities that meet certain conditions. Level 2 assets may not in aggregate account for more than 40% of a bank's stock of HQLA. Level 2B assets may not account for more than 15% of a bank's total stock of HQLA.

Summarised overview of HQLA categories

- **Level 1 assets:** cash, central bank reserves, qualifying government bonds (0% standardised risk-weight under Basel II), etc.
- **Level 2A assets:** government bonds (20% standardised risk-weight under Basel II), qualifying corporate bonds and covered bonds with credit rating AA- and above
- **Level 2B assets:** qualifying RMBS (credit rating AA and above) and corporate bonds (credit rating between A+ and BBB-), qualifying common equity shares

22. The Basel Committee has also specified operational requirements for assets to be recognised as HQLA. These operational requirements are designed to ensure that the bank can immediately use the stock of HQLA as a source of contingent

funds to fill funding gaps between cash inflows and outflows at any time during the 30-day stress period, with no restriction on the use of the liquidity generated.

Total Net Cash Outflows

23. The denominator of the LCR is the total net cash outflows, defined as total expected cash outflows minus the lower of (i) total expected cash inflows or (ii) 75% of total expected cash outflows, under specified stress scenarios for the subsequent 30 calendar days.

24. Total expected cash outflows are calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance sheet commitments by the rates at which they are expected to run off or be drawn down.

25. Total expected cash inflows are calculated by multiplying the outstanding balances of various categories of contractual receivables by the rates at which they are expected to flow in. Total cash inflows are subject to an aggregate cap of 75% of total expected cash outflows, thereby ensuring a minimum level of HQLA holdings at all times.

Total net cash outflows over the next 30 calendar days

=

Total expected cash outflows

–

Whichever is the lower of {total expected cash inflows; 75% of total expected cash outflows}

26. The specified stress scenarios entail both institution-specific and systemic shocks built upon actual circumstances experienced during the global financial crisis. The scenarios entail:
    a. the run-off of a proportion of deposits;
    b. downgrade of the institution’s credit rating;
    c. loss of unsecured wholesale funding;
    d. increase in market volatilities that impact the quality of collateral or potential future exposure of derivative positions;
    e. increase in secured funding haircuts; and
    f. increase in derivative collateral and non-contractual off-balance sheet exposure, including committed credit and liquidity facilities.

27. While most roll-off rates, draw-down rates and inflow rates are specified by the Basel Committee, a few parameters are to be determined by supervisory authorities at the national level. The Basel Committee requires the parameters to be transparent and made publicly available.

DFSA proposals

28. The DFSA has reviewed in detail, through the observation period, the likely impact of the introduction of the LCR on Firms in the DIFC. As would be expected, the nature of liquidity risk, and the potential impact of the LCR, is not uniform across the population of Firms.

29. We have considered three different options available for the DFSA in respect of the LCR as follow:

Option 1 - Maintain DFSA's existing liquidity framework unchanged;

Option 2 - Implement a simplified LCR; or

Option 3 - Implement the LCR as per Basel III liquidity framework.

30. Having considered the purpose of the LCR, namely to increase the resilience of banks, our commitment to implementation of standards agreed by international standard setters, and the potential impact on Firms, we propose to implement the LCR in full, so Option 3 set out above. Please see Appendix 1 Rules 9.3.3 to 9.3.9 and section A9.2 in App 9 for the proposed Rules and Guidance.

31. However, the DFSA does not propose to apply the LCR to Category 2 firms. The observation period reporting, and our analysis, suggests that there would be insufficient regulatory benefit to justify introducing the requirements for this particular set of firms.

Issues for consideration

Q1 Do you have any concerns about the DFSA's proposals to implement the LCR? If so, what are those concerns and how should they be addressed?

Subsidiaries and branches

32. The LCR standard is designed to apply to all internationally active banks on a consolidated basis. We have considered three options available for the DFSA in respect of the scope of application of the LCR, as follows:

Option 1 – Limit the scope of the LCR to apply to domestic banks (subsidiaries) only;

Option 2 – Apply the LCR to all banks operating in the DIFC and grant banks operating as branches liquidity concessions, subject to certain conditions; or

Option 3 – Apply the LCR to all banks operating in the DIFC with no exception.

33. We propose Option 2, so the LCR would - in principle – apply to all banks in the DIFC. However, those banks operating as branches would, as now, be able to apply to the DFSA for a concession if they (and the head office of which they are a part) meet certain conditions (see Appendix 1 Rule 9.3.2 and Section A9.1 in App 9 for the conditions).

34. In most of the jurisdictions we benchmarked, branches of foreign banks will not be subject to the LCR requirement, as long as the head office is subject to the LCR on a consolidated basis. The approach we propose for branches in the DIFC reflects the DFSA's longstanding approach to the liquidity supervision of branches and is similar to the approach adopted by the UK PRA. We feel this is the most appropriate way to address the potential liquidity risks that branches face, rather than a blanket disapplication of the rules.

35. The treatment by the DFSA of branches as regards liquidity risk differs from the treatment of branches for capital adequacy purposes. The LCR, as a liquidity risk measure, is amenable to local (i.e., branch level) measurement and control. Liquidity held at the head office is not always adequate to give the desired level of supervisory comfort (see also paragraph 65).

Issues for consideration

Q2 Do you have any concerns about the DFSA's proposals to apply the LCR to all banks? If so, what are those concerns and how should they be addressed?

Q3 Do you have any comments about the conditions proposed for global liquidity concessions for branches?

Islamic Financial Institutions - Shari'ah Compliant Firms

36. Assets recognised as HQLA and available for Authorised Firms licensed as Islamic Financial Institutions ("IFIs") operating under Prudential Category 5 are very limited. IFIs face Shari'ah prohibitions against holding certain types of HQLAs, such as interest-bearing debt securities. A significant impediment to the ability of Shari'ah compliant banks to meet the LCR requirement exists.

37. There are, in fact, few Shari'ah-compliant in which an IFI can invest that meet the eligibility criteria for inclusion in the IFI's liquid assets buffer. These include cash and Sukuk issued by the Islamic Development Bank (Moody's: Aaa; Standard & Poor's: AAA) recognised under Level 1 Assets. For Level 2 Assets, only Sukuk issued by corporates rated higher than AA- (subject to 15% haircut) or by corporates rated A+ to BBB- (subject to 50% haircut) are available. However, access to these types of instruments in financial markets is limited to relatively very few issuers.

38. This limitation of available HQLAs for IFIs increases concentration risk, as the regulatory buffers of the Shari'ah-compliant firms will be composed entirely of limited assets. Recognising only few assets as eligible might also potentially limit the growth of existing Shari'ah-compliant firms and creates barriers to entry for new Shari'ah-compliant firms, due to the difficulties that could be experienced obtaining HQLAs.

39. The Basel Committee has given national supervisors in jurisdictions in which Shari'ah compliant banks operate the discretion to define Shari'ah compliant financial products as alternative HQLA applicable to such banks only, subject to such conditions or haircuts that the supervisors may require.

40. In the UK, the PRA has proposed to allow Shari'ah compliant firms to include a wider set of assets in their liquid assets buffers. These include sukuk issued by sovereigns with lower credit ratings and other sukuk that are not issued by a member of the financial sector, subject to haircuts and caps.

41. The DFSA proposes rules that would allow it the flexibility to define Shari'ah compliant financial products as alternative HQLA applicable to such banks only, subject to such conditions or haircuts that the supervisors may require, in line with the discretion allowed by the Basel Committee. Please see Appendix 1 Rule A9.2.9 in App 9 for the proposed Rules and Guidance.

Issues for consideration

Q4 Do you have any concerns about the DFSA's proposals on HQLA for Islamic Financial Institutions? If so, what are those concerns and how should they be addressed?

42. The DFSA is also aware that the Islamic Financial Services Board (IFSB) published, on 27 October, for consultation a draft Guidance Note on Quantitative Measures for Liquidity Risk Management for IFIs. The DFSA will review this draft and will consider whether, once the Guidance Note is finalised by the IFSB, further proposals to amend the DFSA rules in this area need to be brought forward.

Implementation timeline

43. The Basel Committee has proposed a phase-in arrangement to implement the LCR. A banking organisation is required to maintain an LCR of at least 60% beginning on 1st January 2015. The minimum requirement will be increased in equal annual steps of 10% in each following year to reach 100% on 1st January 2019 as shown below:

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

44. This graduated approach is designed to ensure that the LCR can be introduced without disruption to the orderly strengthening of banking systems or the ongoing financing of economic activity.

45. Different national regulators are adopting different timelines for the implementation of the LCR in their jurisdictions. While HKMA and MAS are following the Basel III timeline, the EU and the US have introduced their own phase-in arrangements which are shorter and more stringent than under Basel III. APRA and OSFI have requested banks in their jurisdictions to comply with a minimum 100% LCR by 1st January 2015. Despite these different regulatory implementation timelines, many banks around the world have decided to comply with a 100% LCR at the earliest date possible to satisfy financial markets' expectations.

46. The Basel Committee Regulatory Consistency Assessment Programme ("RCAP") monitoring shows that, as of March 2014, more than half of the Basel Committee member jurisdictions have adopted the LCR standards in their domestic regulations, while others are reportedly in the process of consulting and adopting final LCR rules in time for the 1 January 2015 deadline.

47. The DFSA proposes to introduce the LCR using the graduated approach proposed by the Basel Committee (please see Appendix 1 Rule 9.3.4).

Issues for consideration

Q5 Do you have any concerns about the DFSA's proposals for the LCR implementation timetable? If so, what are those concerns and how should they be addressed?

National Discretions for Stress Parameters

48. As mentioned earlier, there are a number of national discretions in the LCR framework. Although most roll-off rates, draw-down rates and inflow rates used for

the calculation of the cash outflows and inflows are specified by the Basel Committee, discretion is given to national supervisors to determine a number of parameters (eleven in total).

49. The DFSA has considered each of these parameters, noted the approaches being adopted in other relevant jurisdictions, and made our own assessment of whether, for the cash flow in question, a bank should take into account all or a proportion of the flows. The DFSA's proposals for each of these parameters are set out in the draft rules in Appendix 1 (please see Appendix 1 Rules A9.2.15 and A 9.2.18).

Systems and Controls for addressing Liquidity Risks

50. In addition to the new LCR framework, the Basel Committee proposes a number of further enhancements to the systems and controls required by Authorised Firms to address liquidity risks. These include requirements for developing and reviewing funding strategies, stress testing to identify liquidity strains and developing contingency funding plans. These requirements are imposed on Firms in Categories 1, 2 and 5. The DFSA proposes to introduce these enhanced requirements. Please see Appendix 1 section 9.2 and 9.2A of the Rules for the proposed Rules and Guidance.

Issues for consideration

Q7 Do you have any concerns about the DFSA's proposals for introducing the additional system and control requirements addressing liquidity risks? If so, what are those concerns and how should they be addressed?

Part C: Proposals relating to the Leverage Ratio

Background

51. This section sets out our proposals to implement the reporting and disclosure requirements of the Basel III Leverage Ratio (LR) framework. These proposals follow from the publication by the Basel Committee of the final standards in January 2014.

52. It was observed from the financial crisis that banks built up excessive leverage in their balance sheets while apparently maintaining strong risk-based capital ratios. At the height of the crisis, financial markets forced the banking sector to reduce its leverage in a manner that amplified downward pressures on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling bank capital and shrinking credit availability. As a result the Basel III framework introduced a simple, transparent, non-risk based LR to act as a supplementary measure to the risk-based capital requirement. The purpose of the LR is as follows:
    a. restrict the build-up of excessive leverage in the banking sector to avoid destabilising deleveraging processes that can damage the broader financial system and economies; and
    b. reinforce the risk-based requirements with a simple, non-risk based "backstop" measure.

53. The Basel implementation proposes an observation phase, before introduction of a 'hard' minimum requirement for the LR into Pillar 1 of the Basel capital framework. The observation phase will include public disclosure by banks of their

LR, starting from 1 January 2015. Full implementation of the LR as a Pillar 1 standard is anticipated to start from January 2018.

54. The purpose of the lead-in time is to enable internationally active banks to meet the new requirement and also to enable the Basel Committee to observe the implementation, and calibration, of the ratio in the interim. The current expectation is that the Pillar 1 minimum requirement for the LR will be set at 3%.

Benchmarking

55. We have considered and reviewed the implementation of the LR standard in Singapore, Hong Kong and UKPRA and have identified nothing that suggests that the DFSA should do anything other than implement the Basel standard in full.

Overview of the LR

56. The LR is defined as the Capital Measure (the numerator) divided by the Exposure Measure (the denominator), with this ratio expressed as a percentage. The current standard has set a "testing minimum of 3%" during a parallel run period until 1 January 2018, following which it will become a binding Pillar 1 requirement. Until that date the 3% minimum ratio is not a required Pillar 1 limit.

57. The calculation of the LR is a straightforward and simple calculation. It is designed to be a non-risk based backstop and to provide support for other Pillar 1 metrics. The Ratio has two components:
   a. Capital Measure - the Tier 1 capital[2] of the risk-based capital framework as required under the standardised approach. This would be calculated in accordance with PIB 3.12 – Risk Capital Requirement;
   b. Exposure Measure - calculated in accordance with accounting requirements[3], subject to the following adjustments:
      i. on-balance sheet, non-derivative exposures are included in the exposure measure net of specific provisions or accounting valuation adjustments (e.g. accounting credit valuation adjustments);
      ii. netting of loans and deposits is not allowed; and
      iii. Firms are not permitted to take account of physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the exposure measure.

   The ratio is expressed as:

$$\mathrm{LR} = \frac{\mathit{Capital\ measure}}{\text{Exposure measure}} > 3\%$$

58. The total exposure measure is the sum of the following exposures:
   a. on-balance sheet exposures;
   b. derivative exposures;
   c. securities financing transaction (SFT) exposures; and
   d. Off-balance sheet (OBS) items.

[2] The Basel Committee is also intending to monitor the impact of the calculation based on the Core Equity Tier 1 (CET1) or total regulatory capital as the capital measure.

[3] For all DIFC Domestic Firms the applicable accounting treatments are IFRS.

The LR Reporting and Disclosure requirements

59. As part of the phase in arrangements for the LR the standard has stipulated certain disclosures and regulatory reports should be made from 1 January 2015. Banks will be required to comply with these requirements from the date of publication of their first set of financial statements on or after 1 January 2015.

60. The purpose of the disclosure is to enable market participants to reconcile LR disclosures with banks' published financial statements from period to period, and to compare the capital adequacy of banks across jurisdictions with varying accounting frameworks. The Basel framework has already developed and published a common disclosure template to be used for both regulatory reporting and also reconciling disclosures with published financial statements, which we plan to make use of. The disclosure requirements are as follows:

Table	Summary content
Summary comparison table	A comparison of banks' total accounting assets amounts and LR exposures
Common disclosure template	A breakdown of the main LR regulatory elements
Reconciliation requirement	The source of material differences between banks' total balance sheet assets in their financial statements and on-balance sheet exposures in the common disclosure template

61. Disclosures according to the Basel standard require publication by firms at the same frequency as the publication of their financial statements. The disclosures must be included in Firms' published financial statements or, at a minimum, provide a direct link to the completed disclosures on the banks' websites or in publicly available regulatory reports.

62. In addition to the above, Pillar 3 (market discipline) of the Basel II framework also imposes Disclosure requirements on Firms in Categories 1, 2 and 5.

63. Banks can make this information available on their websites, or through publicly available regulatory reports. Irrespective of the location of the disclosure all disclosures must be made according to the templates defined by the Basel standard.

64. Reporting by firms to the DFSA of their LR will be required on a quarterly basis in the prescribed format.

DFSA proposals

65. It is proposed that the LR should only apply to Domestic Firms in Categories 1, 2 and 5. It is not proposed to be applied to Branches. As discussed in paragraph 35, the DFSA's approach to the supervision of branches for liquidity risk and for capital adequacy purposes differs, given that the control and measurement of capital for branches is not a useful concept to apply. Reflecting this, the DFSA has historically allowed branches a waiver from DFSA capital requirements. Branches would be required to report their head office LR calculated on a consolidated basis on a quarterly basis to the DFSA, in line with the existing capital reporting requirements.

66. The DFSA proposes to introduce the reporting and disclosure requirements discussed above. We do not intend to introduce the LR as a 'hard' Pillar 1 requirement until after the observation period. Please see Appendix 1 (section 2.3, Rule 3.2.4, sections 3.18 and 11 and App 2 and App 11) for the proposed Rules and associated Guidance.

Islamic Finance – treatment of UPSIAs

67. The LR, as noted above, is intended to be a simple, non-risk based measure which seeks to set a limit on the overall leverage and, hence, the size of a bank's balance sheet. Given this objective of LR, the DFSA proposes that the full amount of assets financed by funds raised through Unrestricted PSIAs be included within the exposure measure for calculating LR in the case of an IFI.

68. Use of the Alpha (α) ratio in determining the amount of UPSIA assets for inclusion in the exposure measure would result in understating the actual leverage of the IFI, as measured using the LR. Consequently, such a treatment would also permit an IFI to have leverage far in excess of the limits intended to be prescribed on banks, both conventional and Islamic. Considering the above, the proposed treatment will ensure that IFIs are treated consistently with conventional banks and precludes scope for any regulatory arbitrage.

National discretion for stress parameters

69. We do not see the need to exercise the sole national discretion included in the Basel proposals, which relates to the treatment of securitisations. More precisely, we propose not to apply a Credit Conversion Factor (CCF)[4] of 10% for service cash facilities. The weighting to be applied is to be in accordance with the existing CCF factor.

Issues for consideration

Q8 Do you have any concerns about the DFSA's proposals on the Leverage Ratio? If so, how should they be addressed?

Q9: Do you have any specific concerns about the DFSA's proposed approach to UPSIAs? If so, what are they and how should they be addressed?

[4] A Credit Conversion Factor, or CCF, is a device to translate an off-balance sheet item into an on-balance sheet item, so that the item can be included appropriately within the calculation of the bank's exposure measure.