

Being better informed

FS regulatory, accounting and audit bulletin

PwC FS Regulation

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In this quarter's edition:

- Changes to capital adequacy regulations
- CBB Handbook updates and consultations
- New Central Bank of Oman provisions for restructured loans
- Focus on deposit insurance in the GCC
- A number of updates to the TLAC rules
- Updated list of systemic banks



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Executive summary

Welcome to this edition of “Being better informed”, our quarterly FS regulatory, accounting and audit bulletin, which aims to keep you up to speed with significant developments and their implications across all the financial services sectors.



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Banks and financial services regulators experienced an increase in uncertainties due to the slowing of economic growth globally. Lower oil prices and the nervousness and volatility that came with it also led to tightening of liquidity.

This meant that the central banks in the region had to keep a close watch on the impacts from a financial stability and a monetary policy perspective as well from a financial soundness perspective. The year end results declared by banks do not however show material cause for concern I would think; nonetheless, ensuring access to credit (for customers) and liquidity (for banks) is likely to be important themes.

2016 will see most banks in the region play catch up as they transition into yet another year of increased focus on Basel III capital, risk, liquidity.

If banks have not done much in terms of transformation to support the Basel III requirements, then 2016 is a year when Banks must now act. Basel III would push banks to review their performance from an economic capital consumption perspective. Use of technology and digitization which otherwise was more relevant to front end business, growth and customer relationships management would be equally relevant in strategically managing risk, capital and liquidity management.

All leading banking regulators, particularly in the GCC have now a view on how they would want to supervise DSIBs.

I saw little in terms of substantive changes in the insurance regulatory space in the region in the recent past. Markets such as Saudi Arabia and the United Arab Emirates which pretty much dominate the insurance sector in the region saw added pressure on margins with premiums softening in many classes of business. Regulators should keep an eye on the developments and intervene when necessary.

The regulatory frameworks for asset management and private equity also did not see too many changes in the region except that regulators and central banks involved in clearing and settlements and depositories must look at what the future landscape should look like particularly in terms of whether these arms should be spun off into independent entities. Adherence to the Financial Market Infrastructure (FMI) principles would require greater.

Further afield, the FSB has finalised the TLAC (the loss absorbing capital) standards for G-SIBs and the

principles laid out have some far reaching consequence on such banks doing internationally.

On the AML front, the FATF press release in October sheds light on how regulators may address the issues around de-risking by the industry.

As I pointed out in earlier editions of our bulletin, these Being Better Informed (BBI) publications are not necessarily exhaustive but intended to provide a flavour of what is changing in our compliance world in the region. We will endeavour to increase coverage in future publications in relation to the significant regulator announcements in the financial services.

Thank you

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Middle East announcements

Capital and liquidity

UAE to start Basel III implementation

The UAE Central Bank will start engaging UAE based banks for full compliance with Basel III global banking regulations it was announced in December 2015. It aims to implement the new requirements in full by the end of 2018.

At present the average Tier 1, or core, capital in the UAE banking system was 16.5% at the end of September according to Central Bank data.

The UAE had previously announced liquidity management rules in May of last year but this firm commitment and date sets out a clear timeline for implementation.

Oman issues rules on Capital buffers

The Central Bank of Oman comprehensive rules around capital buffer requirements following industry consultation.

A roadmap for Basel III was issued in August 2012, following which two concept papers (i) Regulatory Capital under Basel III (CP-1), and (ii)

Composition of Capital Disclosure Requirements (CP-2) were issued in November 2013.

In April 2015, a draft concept paper was issued for industry consultation outlining the mechanisms to implement the Capital Conservation and Counter Cyclical buffers.

The new capital buffer requirements are aligned to the standards issued by Basel Committee on Banking Supervision and customised to the local market.

The 32 page document comprehensively covers the different elements of the framework covering:

- Step by step guide to calculating the buffer requirement
- Capital conservation range table
- Capital conservation range table including the countercyclical buffer
- Parameters relevant to countercyclical buffer and criteria for release of buffer
- Treatment of surplus when buffer returns to zero
- Interaction with Pillar 1, Pillar 2 and Oman's Prompt Corrective Action (PCA) framework

- Thresholds for Oman and calibration.

The requirement apply to banks and must be calculated at the consolidated level and sets out the reciprocity arrangement requirements in the case of banks with overseas operations.

Insurers

Proposals relating to the Insurance Regime

The DFSA has launched a consultation paper of proposals relating to its insurance regime.

The paper has been issued because the DFSA are proposing changes to the current regime for regulating insurance. It is ripe for renewal having not been substantially reviewed since 2003, and since this time the industry has gone through growth, particularly in the reinsurance market.

The DFSA would like to:

- specify what activities can be undertaken by different types of insurance intermediaries
- make clearer where regulation is not required through clear exclusions, refine the conduct of business requirements applicable to insurers, insurance

intermediaries and insurance managers to make the regime more risk based

- remain compliant with the Insurance Core Principles.

Supervision

Loan loss provisioning on restructured loans

On 27 December 2015, Central Bank of Oman issued a rule suggesting a 15% specific provision on restructured loan balances. Following a dialogue with the industry, however, the central bank agreed on a phased implementation of the rule in its letter to banks dated 20 January 2016.

Under the rule, banks are required to make a 10% specific provision for year 2015 on restructured loans. An add-on of 5% would be required in 2016 for the same loans with a view to bringing the level of specific provision to 15% as per the December circular.

Similar rules also apply to restructured loans in the books of non-bank finance and lease companies in the Sultanate.

With this, the Central Bank sought to remove anomalies arising from lack of a consistent approach to loan loss provisioning on restructured and "special mention" loans and removed

the ability of banks to use discretion and judgment.

Proportionate and risk sensitive penalty regime

Central Bank of Oman earlier in the year, on 12 March 2015 sought to revise its penalty structure for non-compliance introduced in 2003. The revised framework establishes the concept of proportionality and aligns the regime to the risk based supervision framework it introduced back in 2009.

The new rule establishes a matrix that sets out three broad non-compliance levels (high, medium and low) and assigns a percentage to the standard penalty amount per violation. The ceilings stipulated are OMR 20,000 per violation with a discretion to impose OMR 2000 per day of non-compliance issue.

The central bank felt that the previous framework did not sufficiently achieve credible deterrence and that licensed institutions had not fully embraced "compliance culture" that is needed today. It clarified this is notwithstanding its powers under Banking Law to withdraw the license, suspension of licensee's operations, and or its branches and denial of access to credit facilities of the Central Bank.

Banks have been advised to make sure there is appropriate systems, procedures and controls in place ensure compliance with the provisions of Banking Law, Regulations, Directives, Policies, Circulars and other instructions of CBO and other applicable laws of the Sultanate.

The basis for implementing the new penalty structure would be the annual examination structure starting 2015.

Among other requirements, the following are noteworthy:

- The level of risk will be established based on a number of relevant factors
- Low risk issues may not attract a penalty at CBO's discretion. A letter of warning will however be issued.
- Major failures will attract a 50% assignment
- Payment of penalty does not absolve the bank from remediation efforts.

Wrongful pecuniary gain arising from non-compliance would attract additional fines not exceeding the gain. Pecuniary gain includes avoidance of loss.

Banks and non-bank finance and lease companies shall disclose the penalties in their annual reports or otherwise immediately upon occurrence as advised by the central bank if the violation of serious nature.

CBB updates its handbook

The CBB has made changes to *Bahrain's regulatory handbook* through the third quarter of 2015. The changes are as follows:

- [Volume 1 \(Conventional\) and Volume 2 \(Islamic\)](#)

Amendments made to the Business and Market Conduct (BC) Module, to allow Islamic Banks to waive the 'cooling off period' if they received written confirmation from the customer that he/she wishes to waive his/her right to the 'cooling off period'. Other amendments to clarify fees levied on pensioners.

Amendments made to the Credit Risk Management (CM), to reflect additional approval requirements by the CBB for write-offs exposures to connected counterparties of the bank, any business entity for which the bank or any of its approved persons is a related party, exposures to any controller of another CBB licensee.

Amendments made to the Operational Risk Management (OM) Module, to clarify that the CBB will not permit licensees to outsource their internal audit function to the same firm that acts as their external auditor.

Amendments made to the Training and Competency (TC) Module to add the securities market regulation certification as a relevant certification for heads of functions.

- [Volume 3 \(Insurance\)](#)

Amendments made to the General Requirements (GR) Module, to embed the requirements governing control in insurance licensees under Resolution No (27) of 2015.

Amendments made to the Financial Crime (FC) Module, to clarify that groups must implement group wide programmes against money laundering and terrorist financing, including policies and procedures for sharing information within the group for AML/CFT purposes. Also clarified that Insurance licensees must conduct ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship and other enhancements to reflect FATF recommendations.

Amendments made to the CBB Reporting (BR) Module to reflect changes to the General Requirements (GR) Module.

- Volume 4 (Investment Business)

Amendments made to the General Requirements (GR) Module, to embed the requirements governing control in insurance licensees under Resolution No (27) of 2015.

Amendments made to the Financial Crime (FC) Module, to clarify a rule in case of incomplete customer due diligence.

Amendments made to the Training and Competency (TC) Module, to add the securities market regulation certification as a relevant certification for financial instruments traders.

Amendments made to the CBB Reporting (BR) Module to reflect changes to the General Requirements (GR) Module.

- Volume 5 (Specialised Licensees: Financing Companies)

Amendments made to the Business and Market Conduct (BC) Module, to clarify fees levied on pensioners

Amendments made to the CBB Reporting (BR) Module to reflect XXX.

CBB consultations

- Open consultations:

Module PD and Composition of capital disclosure requirements: Following the release of Module CA in respect of IFSB-15 and Basel III pillar 1 in January 2015. CBB is issuing a draft Module PD and related appendices dealing with disclosure of composition of capital. The proposed changes and revisions include among others, Bahraini Islamic bank licensees to use a common template to describe the main features of regulatory capital instruments issued, disclose full terms and conditions of all outstanding regulatory capital instruments on their website and breakdown of their regulatory capital.

The consultations close on 14 January 2016

- Closed Consultations:

Volume 1 & 2 - Module Credit Risk Management (CM) amendments for Banks: As part of CBB's continuous efforts to maintain full compliance with Basel revised core principles for banking supervision, CBB proposed some amendments to Module CM for volume 1 & 2 specifically "The monitoring and control of large exposure of banks licensed by the CBB"

chapter. Some of the amendments among other include, banks notifying the CBB of any acquisition or investment that constitutes 5% or more of the Bahraini conventional bank licensees consolidated total capital.

Volume 5 Money Changers – Module High Level Controls (HC): For the purpose of aligning Module HC for money changers with the corporate governance code issued by the Ministry of Industry and Commerce, the CBB is issuing an updated Module HC for consultation. The updated module advocates principles of sound governance while taking into account the uniqueness of the business of money changers.

Volume 1 & 2 – Proposed changes to Module Credit Risk Management (CM) concerning CBB's prior approval requirements of writing off exposures: The CBB proposes to introduce changes to Module CM concerning write-offs of exposures. Currently the rules are only applicable to Bahraini bank licensees, however, the proposed changes widen the scope of the rules to be applied to all branches of foreign banks operating in Bahrain too. Under the proposed changes, all conventional and Islamic bank licensees must obtain CBB's written no objection before writing off

exposures outlined in the module paragraph 7.1.3 and must notify CBB of any exposure outlined in the paragraph that are classified as non-performing loans.

Offering banking and financial services to the disabled customer: CBB is proposing new draft directives on banking and financial services offered to the disabled customers in Bahrain as part of their objective to protect the interests of customers and to ensure equal opportunity and access to financial services for all customers. The proposed amendments to the Business and Market Conduct Module (BC) emphasizes on special measures and procedures like ATM services, in branch services, special measures for visually and hearing impaired customers, personal banking etc. when providing services for disabled customers.

Ad-hoc communications:

CBB wishes to assess the impact of the introduction of IFRS 9 as well as the preparedness of banks and financing companies in order to meet the effective implementation date of 1st January 2018 of this new accounting standard. As IFRS 9 brings together classification, measurement,

impairment and hedge accounting phases, the implementation of IFRS 9 requires major changes in the way banks and financing companies assess impairments.

The CBB has requested banks and financing companies to undertake a quantitative impact assessment (QIA) of IFRS 9 focusing on financial impact of the impairment and other components of IFRS 9, which is to be reviewed by their external auditor.

Banks must submit the results of the QIA and their implementation plan by no later than 29th February 2016.

International announcements

Capital and liquidity Updated list of systemic banks

On 3 November 2015 the FSB published lists of *G-SIBs* and *G-SIIs* (G-SIIs). These institutions are subject to higher loss absorbency and resolution planning requirements in addition to enhanced supervision. In both lists one institution was added and one was taken away, as compared to the lists in 2014. The lists are updated annually.

On the same day the Basel Committee issued *additional information* on the identification of banks including:

- a list of all the banks in the assessment sample
- the denominators used to calculate the scores for banks in the exercise
- the cut-off score that was used to identify the updated list of G-SIBs
- the thresholds used to allocate G-SIBs to buckets for the purposes of calculating the specific higher loss absorbency requirements for each institution
- links to the disclosures of all the banks in the assessment sample in 2015.

The IAIS intends to publish a paper for public consultation in late November 2015 on the planned development of the G-SII assessment methodology which it expects to apply starting from the 2016 designation.

Subordination challenge for TLAC

On 9 November the FSB *summarised Findings from the TLAC Impact Assessment Studies*. Its work included:

- a Quantitative Impact Assessment
- an Economic Impact Assessment

- a market survey
- a verification of historical losses and recapitalisation needs.

The FSB found that market participants (including G-SIBs, other market participants such as asset managers and CRAs) expect the TLAC requirements to cause bond spreads to rise 30 basis points from their current levels. On average, they expected G-SIBs to hold a TLAC buffer equivalent to 1.8% of RWAs above the minimum TLAC requirement. In their responses, G-SIBs most frequently cited subordination as a challenge in meeting the TLAC requirements.

A significant number of market participants considered that market conditions were currently attractive for G-SIBs as issuers due to unconventional monetary policies prompting a search for yield by investors.

FSB finalises TLAC

On 9 November 2015 the FSB released *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution and TLAC Term Sheet*. The foremost policy objective for TLAC is that G-SIBs have sufficient loss absorbing and recapitalisation capacity to ensure an orderly resolution in the

event of failure. It also aims to minimise the impact on financial stability, ensure the continuity of critical functions and avoids exposing tax payers to loss.

The TLAC principles concern the:

- calibration of TLAC
- availability of TLAC to facilitate the resolution of cross-border groups
- determination of instruments eligible to meet TLAC requirements
- interaction with regulatory requirements and consequences of breaching TLAC
- disclosure of information
- limitation of contagion and the need for a review over the medium-term to ensure consistent implementation and any further modifications to the Term Sheet.

The Term Sheet remains consistent to the November 2014 consultation, adopting a phasing in approach for implementation, setting the minimum requirement at 16% of RWAs and 6% of the Basel III leverage ratio denominator (LRE Minimum) from 1 January 2019. This will increase to 18% of RWAs from 1 January 2022 and 6.75% of the LRE Minimum from 1 January 2022. For G-

SIBs in emerging market economies (EMEs), the lower requirement applies from 1 January 2025 and the higher threshold must be met by 1 January 2028. But, this can be accelerated if the amount of an EME G-SIB's financial and non-financial corporate debt securities or bonds outstanding, exceeds 55% of its home jurisdiction GDP. As these are minimum standards, local regulators can still set a firm's TLAC to be higher than the requirements (which we've already seen by prior announcements from the Swiss authorities and US Fed).

Capital used to satisfy minimum regulatory capital requirements can also count towards TLAC - subject to certain conditions. But CET1 contributing to minimum TLAC should not be used to meet regulatory buffers. The FSB intends to conduct a review of the technical implementation of the TLAC standard by the end of 2019 which coincides with a review to be undertaken by the EU authorities for the MREL.

Tweaking TLAC

The FSB published an [Overview of the post-consultation revisions to the TLAC Principles and Term Sheet](#) on 9 November 2015. It sets out the changes it made to its TLAC term sheet as a

result of comments received to its 2014 consultation. These changes include an adjustment where the sum of TLAC requirements for the multiple point of entry resolution entities is more than would be the case for the hypothetical minimum requirement under a single point of entry resolution strategy.

The new Term Sheet has adopted the concept of a material sub-group rather than a material entity in relation to internal TLAC. It also provides for a small allowance for firms pursuing structural subordination where the presence of liabilities in holding companies which rank equivalent or junior to TLAC will be unavoidable. This allowance is not permitted to exceed 5% of the resolution entity's external TLAC. There is an allowance of 2.5% of RWAs for liabilities that could count as external TLAC which will rise to 3.5% of RWAs in 2022.

The FSB maintained its expectation that 33% of TLAC must be met by long-term debt in the final Term Sheet and structured notes' ineligibility to be held for TLAC. The internal TLAC requirement of 75-90% also remains unchanged. Finally, the FSB introduced a new disclosure requirement for entities that are part of a material sub-group and issue internal TLAC to a

resolution entity to disclose liabilities which rank equivalently with or junior to its internal TLAC.

Holding other banks' TLAC

On 9 November 2015, in parallel with its paper on TLAC term sheets, the Basel Committee released [TLAC Holdings - consultative document](#). It sets out the proposed approach for the deduction treatment of banks' investments in TLAC, and proposals on the extent to which instruments that rank equivalently to TLAC should be subject to the same deduction treatment. The proposals are intended to limit the effects of contagion through banks holding the TLAC of other banks. The Basel Committee proposes that all internationally active banks, not just G-SIBs, should be required to deduct their net TLAC holdings, where these do not qualify as Basel III capital, from their own Tier 2 capital.

This is the same approach adopted under the Basel III framework for bank's investments in the Tier 2 capital of other banks. The term 'TLAC holdings' is defined by the Basel Committee and may include those instruments that would otherwise have counted as TLAC but don't because they have less than one year until maturity, and also subordinated instruments that

rank *pari passu* with TLAC instruments but never qualified as TLAC. The Basel Committee further suggests that instruments eligible for an exemption from the subordination requirements which rank equivalently with excluded liabilities, must have an original maturity of more than one year to qualify as TLAC.

Good implementation of Basel III

The Basel Committee published [Implementation of Basel standards - a report to G20 Leaders on implementation of the Basel III regulatory reforms](#) on 13 November 2015. It found implementation of the Basel III capital and liquidity standards has been timely in general. Quantitative monitoring of Basel III regulations show that banks are on track to meet the Basel standards. All Basel Committee members had implemented risk-based capital regulations by the end of 2013 and all but two members had published final regulations to implement the liquidity coverage requirements.

Of the 27 Committee members as at the end of September 2015, 23 had issued final or draft rules on or for the leverage ratio, with 25 issuing final or draft rules for their global or domestic SIB

framework. Only four had issued final rules for NSFR.

The report found substantial progress in non-Basel Committee jurisdictions adopting Basel III standards and concludes that regulations are more consistent with the Basel III framework because of the Committee's efforts to monitor and assess implementation. The Annex to the report contains an assessment of the consistency of capital regulations in the EU, Hong Kong, Saudi Arabia, South Africa and the US.

Post-crisis reform update

On 13 November 2015 the Basel Committee published *Finalising post-crisis reforms: an update - A report to G20 Leaders*. Describing the post crisis financial reforms, it covers efforts to increase the quality and level of capital, enhance risk capture, limit leverage and concentration and the addition of macro-prudential tools to the policy tool-kit. The Basel Committee identifies three areas for ongoing reforms:

- enhancing the risk sensitivity and robustness of standardised approaches
- reviewing the role of internal models in the capital framework

- finalising the design and calibration of the leverage ratio and risk weighted capital floors.

It plans to issue final standards covering the outstanding revisions to the regulatory framework by the end of 2016. The Basel Committee expects to consult soon on a package of reforms to enhance the comparability of risk weighted assets calculated using internal ratings-based approaches for credit risk. Around the end of the year it expects to finalise the revised market risk framework which includes greater standardisation of traded market risk model requirements.

Capital requirements for securitisations

The Basel Committee consulted on *Capital treatment for "simple, transparent and comparable" (STC) securitisations* on 10 November 2015. The EC proposed broadly similar *regulations* on the structuring and capital requirements for such securitisations in September 2015.

The Basel Committee recommends equalising the total capital required for a securitisation with that required for the underlying assets, justifying this on the basis that STC transactions have

reduced structural risk. Its approach is similar to the EC's, but stricter:

- the Committee requires investors to independently validate originator compliance with STC criteria whereas the EC places compliance responsibility with issuers (which means an investor would be required to make the determination before applying alternative capital treatment independently of the originator's certification under the Committee's approach)
- the Committee would exclude asset-backed commercial paper from its proposed capital benefits whereas the EC includes such products, subject to some additional requirements
- the EC allows synthetic securitisations to apply more favourable risk weights in certain circumstances when backed by a pool of loans to SMEs, while such an approach is not available under the Committee's framework.

The Basel Committee recommended that regulators reduce the risk weight floor for senior tranches of STC securitisations to between 10-12%, from the current 15% requirement. This is in line with the EC's proposals where the

floor for senior tranches is reduced to 10% and a 15% floor is retained for mezzanine tranches in light of their increased risk. Both the Basel Committee and EC propose permitting STC securitisations to apply the same risk weights that they would enjoy for internal ratings-based approaches to external approaches.

The consultation period closes on **5 February 2016**.

Conduct

Reducing misconduct risk

The FSB published a *progress report* on the work it is co-ordinating to address misconduct in the financial industry on 6 November 2015. It sets out the actions the FSB and international standard setters are taking here.

In looking at the role of incentives in reducing misconduct, the FSB states that it will further examine the effectiveness of mechanisms like malus and clawback to determine their impact as deterrents to conduct risks. It will also establish a working group to exchange national good practices on the use of governance frameworks to address misconduct risks.

In relation to the international co-ordination on conduct in FICC markets, the FSB notes that work is underway in a number of national jurisdictions to address the gaps in standards of market practice. IOSCO established a Task Force on Market Conduct in October 2015, which will publish its final report in June 2016. The FSB will also publish a monitoring report at this time on progress in implementing its work plan on interest rate benchmarks. In May 2017, the BIS Markets Committee is due to finalise its FX code of conduct standards and principles.

On co-ordinating the application of conduct regulation, senior officials from prudential and conduct financial authorities will share information on their respective powers and approaches to supervision and enforcement of conduct rules on an ongoing basis. This will include ensuring enforcement action acts a credible deterrence.

Financial crime

Improving global AML compliance

FATF sets out the details of jurisdictions which have developed an action plan to address their AML and CFT deficiencies in a *public statement* on 23 October 2015. FATF states it hasn't yet reviewed a significant

number of jurisdictions as part of its on-going review of global compliance with the AML and CFT standards, but Sudan and Ecuador will no longer be monitored due to the substantial progress made in their respective AML and CFT regimes.

FATF's de-risking initiative

In a *press release* on 23 October 2015, FATF outlined the actions it's taking as a priority to address de-risking.

So that AML and CFT measures are implemented effectively, FATF is currently clarifying regulatory expectations in four areas relevant to de-risking by:

- developing guidance to clarify how to identify and manage risk in correspondent banking and remittances
- developing guidance to help money remitters identify and manage their risks (this guidance will also help banks evaluate and manage risks of providing financial services to money remitters)
- developing best practices on customer due diligence to promote inclusion in a way which complements AML and CFT objectives

- revising the relevant standard to help governments identify non-profit organisations which are most vulnerable to terrorist financing abuse and address those risks proportionately.

FATF aims to complete this work in 2016.

Insurance

Updated list of global insurers

The FSB published the 2015 update of list of global systemically important insurers (G-SIIs) on 3 November 2015. It comprises a total of nine insurers (same as 2014) but one new insurer, AEGON, is added and Generali is removed. The updated list was compiled using 2014 data and the methodology published by the IAIS in July 2013. At present, only primary insurers are included on the list. The FSB plans to publish an updated list in November 2016. But by then the list might fundamentally change because the IAIS published two related consultations on 25 November 2015:

- Global Systemically Important Insurers: Proposed Updated Assessment Methodology
- Non-traditional Non-insurance (NTNI) Activities and Products

It proposes to revise the assessment methodology for identifying G-SIIs including:

- use of a five-phase assessment approach including both quantitative and qualitative elements
- adjustments to certain indicators to address issues related to indicator responsiveness, normalisation and data quality (including reliability) across both insurers and jurisdictions
- adoption of absolute reference values for certain indicators to allow the methodology to be more responsive to changes in the insurance industry's systemic profile in certain areas
- establishment of specific procedures for an insurer's entry and exit from the G-SII list.

The methodology proposed in this consultation is planned to be used to identify G-SIIs from 2016 and we would expect to see reinsurers included in the list alongside primary insurers for the first time.

The second consultation considers how NTNI activities and products are treated in the assessment methodology

and their use in determining the Basic Capital Requirement and Higher Loss Absorbency requirement for G-SIIs. In particular, the IAIS wants feedback on an analytical framework to classify insurance products and activities as non-traditional based on contractual features.

The consultations close on 25 January 2016.

Developing global capital standards for insurers

On 5 October 2015, the IAIS published the first version of its *Higher Loss Absorbency Requirement (HLA) for G-SIIs and a Basic Capital Requirements (BCR) and HLA fact sheet*. The development of the HLA is part of a long-term project to develop risk-based, group-wide global insurance capital standards which are due to be adopted by the end of 2019. It builds on the BCR and addresses additional capital requirements for GSIIIs reflecting their systemic importance in the international financial system. The HLA required capital is calculated using a factor-based approach and is currently expected to be about 10% of the BCR.

The IAIS also updated its *FAQ's on GSII and Macroprudential Policy and Surveillance* on 5 October 2015, including how G-SIIs are identified and the requirements placed on them.

Effective resolution for global insurers
The FSB published a consultation on '*Developing Effective Resolution Strategies and Plans for Systemically Important Insurers*' on 3 November 2015. It proposes guidance to assist authorities in developing effective resolution strategies and plans for systemic insurers and assist CMGs of Global Systemically Important Insurers (G-SIIs) in their resolution planning work. It has been developed in consultation with the IAIS and builds on the implementation guidance published by the FSB in October 2014 on how provisions of the Key Attributes, including resolution powers and the details of recovery and resolution planning, should be interpreted for different types of financial institution, including insurers. The proposed guidance also incorporates guidance on the identification of critical insurance functions which reflects the responses received from the October 2014 consultation.

The comment period ends on 4 January 2016.

Reviewing global insurance supervision

The IAIS published a *Report from the expert team from assessment on supervisory measures (ICP 9, 10 and 11)* on 23 October 2015. It sets out the findings from its Self-Assessment and Peer Review (SAPR) on the implementation of its global supervisory measures by supervisors across the world.

The review considered adherence to the following insurance core principles (ICPs):

- ICP 9 (supervisory review and reporting)
- ICP 10 (preventative and corrective measures)
- ICP 11 (enforcement).

In general, many of the requirements are largely observed in the majority of jurisdictions but a number of areas for improvement remain. The expert team believes that as more jurisdictions move towards a risk based regime and Solvency II implementation advances, observance levels could improve.

Operational resilience *Implementing risk data principles*

The Basel Committee published, *Progress in adopting the Principles for effective risk data aggregation and risk reporting* on 16 December 2015, its third report since the Principles were published in January 2013. It concludes that although banks have made progress towards implementation, important challenges remain and it is expected that some banks will not meet the Principles on time. It made recommendations, including that national supervisors should conduct more-in depth and specialised examinations to evaluate weaknesses and that banks' compliance should be subject to independent evaluation in early 2016.

Banks designated as G-SIBs are required to implement the Principles in full by 2016. The BCSB also recommended that national supervisors apply the Principles to banks identified as D-SIBs within three years of their designation.

Mitigating systemic risks of shadow banking

The Basel Committee published a consultation on *Identification and measurement of step-in risk* on 17

December 2015, proposing a conceptual framework to mitigate systemic risks of the shadow banking system and their impact on banks. Step-in risk is the risk that a bank will provide financial support beyond its contractual obligations to another entity that experiences financial stress.

The proposed framework focuses on identifying entities that are outside of the regulatory scope of group consolidation, but to which a bank may provide financial support to protect itself from reputational risk arising from its connection to the entities.

Step-in risk indicators that help determine the relationship between the bank and the shadow banking entity may include criteria such as capital ties, sponsorship, decision-making or operational ties. Supervisors and banks may also consider other secondary indicators in their final assessment.

The Basel Committee sets out possible approaches to address step-in risks through prudential measures, including:

- a consolidation approach, so that the entity would be included in the scope of regulatory consolidation.

- a conversation approach, imposing quantitative requirements on the bank where the entity that poses step-in risk remains unconsolidated

The Basel Committee will conduct a QIS in the first half of 2016 to collect data on the nature and extent of step-in risks, which together with consultation responses, will inform its deliberations on the final framework.

The consultation closes on **17 March 2016**.

Improving climate change disclosures

The FSB announced in a [press release](#) that it is creating a task force to establish climate related financial disclosures. The task force will consider the physical, liability and transition risks associated with climate change and what constitutes effective financial disclosures. It will seek to develop a set of recommendations for consistent, comparable, reliable, clear and efficient climate-related disclosures. The task force intends to deliver its recommendations by the end of 2016.

Accounting

Insurance contracts project update

At its meeting on 18 November 2015, the IASB compared the general model and the variable fee approach and decided to keep the differences in the models requiring recognition of changes in financial guarantees in the contractual service margin (CSM) under the variable fee approach and in the statement of comprehensive income (SCI) under the general model. In addition, accretion of interest on the CSM would use current rates under the variable fee approach and locked-in rates under the general model.

The IASB also voted to permit the valuation of certain assets underlying contracts with direct participation features at fair value, and to apply simplified transition rules for measuring the CSM for contracts following the variable fee approach. It also decided that the option to recognise changes in the value of a hedged guarantee embedded in an insurance contract in profit or loss under the variable fee approach should be applied prospectively from the date of application of the new insurance contracts standard.

Transfers of investment property

The IASB published *ED Transfers of Investment Property Proposed amendment to IAS 40* on 19 November 2015. It proposes a narrow-scope amendment to IAS 40, 'Investment property', to clarify the guidance on transfers to, or from, investment properties. Comments are due by **18 March 2016**.

Annual improvements 2014-2016

The IASB published *ED Annual improvements to IFRSs 2014-2016 cycle* on 19 November 2015. It covers proposed amendments to IFRS 1, 'First-time adoption of IFRS', IFRS 12, 'Disclosure of interest in other entities', and IAS 28, 'Investments in associates and joint ventures'. Comments are due by **17 February 2016**.

Deposit insurance in the GCC

Background

Globally, the topic of deposit insurance gained prominence in the aftermath of the global financial crisis. The Core Principles for Effective Deposit Insurance Systems were developed jointly by the Basel Committee on Banking Supervision (BCBS) and the International Association of Deposit Insurers (IADI) in 2009, and later revised in 2014.

Between 2010 and 2014, IADI also published several research / discussion papers on Islamic Deposit Insurance, a relatively new but relevant topic for the GCC given the size of the Islamic finance sector.

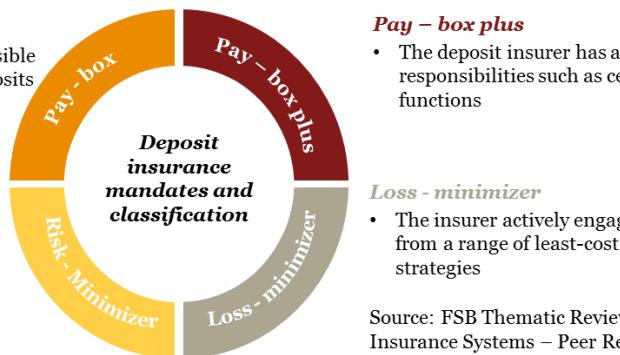
A 2007 paper by IADI identified three types of deposit insurance systems. However, a later paper by FSB identified four types of systems, as illustrated below:

Pay - box

- The deposit insurer is only responsible for reimbursement of insured deposits

Risk - minimizer

- The insurer has comprehensive risk minimisation functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases prudential oversight responsibilities



Pay - box plus

- The deposit insurer has additional responsibilities such as certain functions

Loss - minimizer

- The insurer actively engages in a range of least-cost rescue strategies

Source: FSB Thematic Review of Insurance Systems – Peer Review

GCC Situation

Within the GCC, deposit insurance schemes are at different stages of maturity. It remains an important topic on the agenda of regulators in the region, given the recommendations of the IMF and the oil price dynamics.

In 2014, an *IMF Discussion Paper* stated that “preventing the build-up of systemic risk is all the more important in the absence of effective crisis resolution frameworks and insolvency regimes. GCC countries have implicit deposit insurance schemes that provide de facto full guarantees; these have led to the understanding that banks are not allowed to fail.” Due to the challenging fiscal situation for GCC economies, a blanket state guarantee on banking deposits is increasingly being seen as an anomaly, when one considers that there are over a 100 countries have an explicit schemes in place.

Bahrain introduced deposit insurance schemes in 1993. The scheme covered both conventional and Islamic deposits (and was further amended in late 2010 to further enhance the coverage of Islamic deposits). According to IADI, Bahrain was the first country to setup an Islamic Deposit Insurance Scheme. Bahrain is also the only country in the GCC to cover Islamic deposits, which is around 18% of its banking liabilities as of June 2015.

Oman is the only other GCC country that has an explicit deposit insurance scheme which was introduced in 1995, albeit only covering conventional deposits. While theoretically the existing conventional scheme is open to the voluntary inclusion of Islamic Bank, no Islamic bank is currently a member. Recently, the Central Bank of Oman considered introducing an *Islamic Deposit Insurance Scheme* to complement its conventional scheme. Both the Bahrain and Oman schemes are pay-boxes.

FSB's peer review of KSA in November 2015, focused on deposit insurance (and two other topics; macro-prudential policy framework and bank resolution). The peer review discussed the introduction of an explicit deposit insurance scheme by 1

January 2016 and identified some recommendations that should be considered by KSA to ensure smooth implementation. The review stated that “the introduction of an explicit DIS on 1 January 2016 as a “pay box” within SAMA indicates the authorities’ commitment to implement the internationally agreed standards.

The United Arab Emirates, have *previously fully guaranteed their deposits* during the global financial crisis. IADI identified the UAE as a jurisdiction that shows some interest in explicit Deposit Insurance Scheme (DIS).

Similarly, Kuwait’s government *guaranteed their banks’ deposits* during the global financial crisis as a measure to protect public confidence. Kuwait has an earlier deposit guarantee scheme that lasted for 18 years which was *revoked in 2004* when it deemed the deposit guarantee was no longer required.

Qatar’s *Strategic Plan for Financial Sector Regulations*, strategic goal 3, covers the introduction of an explicit deposit insurance in the country to replace the current implicit regime. There was no public announcement of the timeframe for implementing that strategic goal. IADI identified Qatar as another jurisdiction that shows some interest in Deposit Insurance Scheme (DIS).

2016 and beyond

Deposit Insurance is a key theme for the GCC for the next few years, but how might the situation evolve? With the cost of short term liquidity rising through 2015 (see table for changes in EIBOR in 2015), liabilities will increase in cost and availability. Allied with lower oil prices, increasing Non-performing Loans and reducing investor appetite for emerging markets medium and long term (bank) finance, banks are facing the strongest headwinds since the end of the crisis. The fiscal position in the GCC is, however, vulnerable due to the oil price, which begs the question whether sovereign funded bail-outs of banking systems is the preferable policy option.

Table: EIBOR in 2015

2015	1D	7D	30D	90D	180D	360D	Change since Jan
Dec	0.283	0.339	0.669	1.055	1.221	1.475	0.462
Nov	0.142	0.225	0.571	0.955	1.077	1.307	0.294
Oct	0.171	0.257	0.551	0.845	1.001	1.219	0.206
Sep	0.374	0.383	0.560	0.824	0.951	1.157	0.144
Aug	0.132	0.174	0.483	0.819	0.947	1.150	0.137
Jul	0.121	0.149	0.414	0.760	0.914	1.093	0.080
Jun	0.159	0.148	0.417	0.746	0.900	1.081	0.069
May	0.100	0.141	0.409	0.739	0.886	1.067	0.054
Apr	0.091	0.129	0.409	0.739	0.886	1.067	0.054
Mar	0.201	0.180	0.420	0.730	0.884	1.057	0.044
Feb	0.095	0.133	0.381	0.690	0.849	1.010	0.003
Jan	0.100	0.138	0.381	0.677	0.843	1.013	

Glossary

ABC	Anti-Bribery and Corruption	CCPs	Central Counterparties
ABS	Asset Backed Security	CDS	Credit Default Swaps
AIF	Alternative Investment Fund	CET1	Core Equity Tier 1
AIFM	Alternative Investment Fund Manager	CFTC	Commodities Futures Trading Commission (US)
AIFMD	Alternative Investment Fund Managers Directive 2011/61/EU	CFT	Counter Terrorist Financing (translation)
AML	Anti-Money Laundering	CGFS	Committee on the Global Financial System (of the BIS)
BCBS	Basel Committee of Banking Supervision (of the BIS)	CMA	Capital Markets Authority
Basel II	Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework	CRD IV	Capital Requirements Directive 2013/36/EU
Basel III	Basel III: International Regulatory Framework for Banks	CRR	Regulation on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012
BCBS	Basel Committee on Banking Supervision	CTF	Counter Terrorist Financing
BIBF	Bahrain Institute of Banking and Finance	DFSA	Dubai Financial Services Authority
BIS	Bank for International Settlements	Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act (US)
CBB	Central Bank of Bahrain	D-SIBs	Domestically Systemically Important Banks
CBK	Central Bank of Kuwait	EBA	European Banking Authority
CBO	Central Bank of Oman		

EEA	European Economic Area	FTT	Financial Transaction Tax
EIOPA	European Insurance and Occupations Pension Authority	G30	Group of 30
EMIR	Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (EC) No 648/2012	GAAP	Generally Accepted Accounting Principles
EP	European Parliament	GCC	Gulf Cooperation Council
ESMA	European Securities and Markets Authority	G-SIBs	Globally Systemically Important Banks
FASB	Financial Accounting Standards Board (US)	G-SIFIs	Globally Systemically Important Financial Institutions
FATCA	Foreign Account Tax Compliance Act (US)	G-SIIs	Globally Systemically Important Insurers
FATF	Financial Action Task Force	IAIS	International Association of Insurance Supervisors
FC	Financial counterparty under EMIR	IASB	International Accounting Standards Board
FCA	Financial Conduct Authority	IIFS	Institutions offering Islamic Financial Services
FDIC	Federal Deposit Insurance Corporation (US)	IFRS	International Financial Reporting Standards
FMI	Financial Market Infrastructure	IFSB	Islamic Financial Services Board
FRC	Financial Reporting Council	IMF	International Monetary Fund
FSB	Financial Stability Board	IOSCO	International Organisations of Securities Commissions
FSI	Financial Stability Institute (of the BIS)	ISDA	International Swaps and Derivatives Association
FSOC	Financial Stability Oversight Council	ITS	Implementing Technical Standards
		LCR	Liquidity coverage ratio

LIBOR	London Interbank Offered Rate	RRPs	Recovery and Resolution Plans
MiFID	Markets in Financial Instruments Directive 2004/39/EC	RTS	Regulatory Technical Standards
MiFID II	Proposed Markets in Financial Instruments Directive (recast) (COM(2011) 656 final)	SAMA	Saudi Arabian Monetary Agency
MiFIR	Proposed Markets in Financial Instruments Regulation (EC) (COM(2011) 652 final)	SCA	Abu Dhabi's Securities and Commodities Authority
NAV	Net Asset Value	SEC	Securities and Exchange Commission (US)
NSFR	Net stable funding ratio	SIPP	Self-invested personal pension scheme
OECD	Organisation for Economic Cooperation and Development	SOCA	Serious Organised Crime Agency
OIC	Organization for Islamic Cooperation	Solvency II	Directive 2009/138/EC
PCBS	Parliamentary Commission on Banking Standards	SSAP	Statements of Standard Accounting Practice
PRA	Prudential Regulation Authority	SYSC	Senior management arrangements Systems and Controls sourcebook, UK regulation
QCB	Qatar Central Bank	T2S	TARGET2-Securities
QFMA	Qatar Financial Markets Authority	TR	Trade Repository
QFCA	Qatar Financial Centre Authority	UAEBCB	United Arab Emirates Central Bank
QFCRA	Qatar Financial Centre Regulatory Authority	UAEIA	United Arab Emirates Insurance Authority
QIS	Quantitative Impact Study	UCITS	Undertakings for Collective Investments in Transferable Securities
RDR	Retail Distribution Review		

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