Being better informed

FS regulatory, accounting and audit bulletin

PwC FS Regulation

Q2 2015

In this quarter's edition:

- UAE Central Bank updates liquidity rules
- DFSA updates conduct rules
- Basel implementation progress report
- Managing liquidity in the GCC
- UAE Insurance Authority issues new rules

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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A number of headlines locally and internationally dealing with rules and regulations for financial services to keep C-Suite and boards of financial services firms busy through the summer and beyond.

Liquidity management will remain centre stage for compliance, risk, treasury and finance personnel at banks with the dilemma on how to maintain high quality liquid assets (HQLA) to meet the liquidity coverage ratios (LCR) being implemented internationally and regionally in a phased in manner. The new Basel rules will impose on asset liability managers and treasurers sufficient rigour on how short term liquidity, longer term funding structure, pricing, and indeed risk adjusted returns are managed by banks.

Most recently, in May 2015, the UAE Central Bank issued its new liquidity rules in compliance with Basel III.

As highlighted in my last summary, the UAE Insurance Authority issued the new prudential regulations for insurance and Takaful companies licensed in the UAE. A 'helicopter view' of the rules is included in this edition for readers. As noted earlier, this has been the single most transformational regulatory instrument issued by the UAE Insurance Authority since it was established in 2007 under a new law issued then.

The Central Bank of Bahrain has issued a number of important consultation documents in order to upgrade its rulebooks in keeping with local requirements or international practice.

IAIS's relook at the Insurance Core Principles in its consultation paper of June 2015 was imminent. Basel revised its Core Principles in 2012 post the global financial crisis. IAIS and IOSCO had to follow suit in order to have a greater alignment with FSB's mandates.

This edition as always also covers developments outside of our region. I found IOSCO's announcement of some 43 initiatives as part of its strategic direction through 2020 quite profound. The priority areas included, research and risk identification, standard setting and guidance development, implementation monitoring, capacity building, cooperation and information exchange, collaboration and engagement with international organisations. The Board of IOSCO also considered what work might be needed to address misconduct by firms and individuals in the retail and wholesale markets. I am thinking, well what is left, is this a Basel III of some sorts? A massive overhaul of the regulatory machinery that overhangs capital market and investment activities is imminent.

Regionally, we have a long way to go in terms of sophistication of the markets, infrastructure as well as regulatory frameworks. It would be useful for markets that are in the process of upgrading their frameworks also attempt what is on IOSCOs agenda so important gaps can be fixed with any new risks or principles that IOSCO might be considering in their planned overhaul.

Lastly we have included some of the recent consultations, changes or announcement made by IASB in its arduous journey to make lasting changes to the accounting standards. The changes IFRS 9 brings to the accounting and risk world is expected to be phenomenal. The transition from the IAS 39 incurred-only model to a more pragmatic expected loss model would mean meticulous planning and execution well ahead of the 1 January 2018 deadline.

I appreciate any feedback in order for us to continue to make this bulletin more meaningful to its readers.

How to read this bulletin?

Review the Table of Contents and relevant Sector sections to identify the news of interest. We recommend you go directly to the topic/article of interest by clicking in the *active links* within the table of contents.

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Middle East announcements

Capital and liquidity

Central Bank of the UAE circular enacts regulations and monitoring of liquidity at banks

The Central Bank of the UAE announced new liquidity management rules for banks on 27th May 2015. In drafting the new rules, the Central Bank reviewed international best practices and followed the Basel Committee's recommendations before issuing Central Bank Circular No. 33/2015 to ensure liquidity risks are well managed at banks.

Banks will have to adhere to either the Eligible Liquid Assets Ratio (ELAR) or Liquidity Coverage Ratio (LCR). The ELAR ratio came into effect on 1 July 2015 and the initial compliance level is 10%. The Central Bank will periodically review this ratio to ensure consistency between banks in the application of liquidity requirements in the country. The transition to LCR ratio will come into effect on 1 January 2016.

Banks must demonstrate both the qualitative and quantitative measures have been adequately addressed before adopting the ratio. All banks approved to move to the LCR are expected to implement it by 1 January 2019, the final Basel III implementation. These banks will also be required to comply with the NSFR when the ratio comes into effect on 1 January 2018.

Central Bank Circular No. 30/2012 on liquidity is revoked from the date the new Circular comes into effect. A guidance manual to accompany the Circular will be issued at a later date. The Circular will be published in the Official Gazette.

Saudi Arabia as emerging market?

The Saudi Arabian CMA now allows foreign investors to invest and own shares of Saudi Basic Industries and Saudi Telecom from June 2015, as stated on *Zawya* on 14 May 2015.

"In terms of timing, if all stars were to align, one could imagine the introduction of Saudi stand-alone index into MSCI's flagship index of emerging markets would be in June of 2017", Sebastien Lieblich, head of index research at MSCI told Gulf News.

If this reclassification to emerging markets were to take place, analysts predict that the KSA weighting would be equal to the likes of Poland or Turkey, with a weightage of around 7%.

Conduct

DFSA updates Conduct of Business (COB) rules

The DFSA Board issued the *Conduct of Business Module (COB) Instrument (No. 149) 2015* on 3 April 2015, which repeals and replaces the existing COB module in the DFSA Rulebook with an updated version.

The Instrument updates the COB module that applies to Authorised Firms that are controlling or handling Client assets/money or are appointed Custodians of Client Investments. The COB includes client classification, safeguarding/protecting rights of clients, proper disclosures, management of conflicts of interest and recordkeeping activities. COB does not apply to a Representative Office.

The new module came into force on 1 April 2015.

Consumer protection

Credit and Charge cards

In April 2015, the SAMA in KSA issued a *regulation* for issuance and operations of credit and charge cards with the purpose of protecting cardholder rights. These regulations cover the following:

- issuance of cards and replacement cards
- approval and modification to credit limits
- disclosures to be used in advertising campaigns
- disclosure of fees, commissions and charges
- customer transactions and dispute resolution.

These regulations apply to all regulated entities (such as Banks, Finance Companies and other Credit and Charge Card Issuers) as licensed and authorized by the SAMA. This includes VISA, MasterCard, Union Pay & AMEX.

Investment funds

DFSA issues updated Collective Investment Rules (CIR)

The DFSA Board issued the *Collective Investment Rules (CIR) Instrument (No. 150) 2015*, which repeals and replaces the Collective Investment Rules (CIR) module of the DFSA Rulebook with an updated version.

CIR apply to every Person who is, or intends to be a Fund Manager, member of the Governing Body, Eligible Custodian, Trustee or an oversight provider. CIR also applies to

Authorised Firms other than a Representative Office (except only the Rules in chapter 15 apply) and to a Fund whether or not it has a separate legal personality.

CIR covers the core rules relating to establishment and management of domestic funds including constitution, management and operation provisions, accounting, audit and periodic reporting. Additionally CIR covers marketing and disclosures of domestic and foreign funds, as well as prospectus provisions.

The updated rules came into force on 1 April 2015.

Supervision

CBB updates its handbooks

The CBB made changes to Bahrain's regulatory handbooks through the second quarter of 2015. The changes are as specified below:

Volume 1 (Conventional Banks) and Volume 2 (Islamic Banks):

- Clarifications on caps for the board of director's remuneration in the Higher Level Controls (HL) module. The remuneration must be capped such that the total remuneration is in line with the Article 188 of the Company Law, which states that *"the manner of determining the remuneration of the chairman and members of the board, the total of which shall not exceed 10% of the net profits after deducting the legal reserves and distributing a profit of not less than 5% of the company's paid-up capital."*
- Clarifications on the Capital Adequacy (CA) module pertaining to the following:
  - Intangible assets other than goodwill and mortgage service rights are subject to transitional arrangements and are phased out as regulatory adjustments;
  - Any shares of the Bank (Conventional & Islamic) licensee held as collateral against exposures are considered to be held indirectly and subject to deduction.
- Existing exemptions for all Bahraini (Conventional and Islamic Banks) licensees in respect of Prudential Information Reports review will cease as at 31 December 2014. Additionally, amendments to the deadline for submission of semi-annual reports on private placements to within three months of the reporting period.

Closed Consultations (5th May 2015):

The CBB issued a *consultation document* to align High Level Control (HC) module of volume 2 with the following international standards:

- Principles for enhancing corporate governance issued by the Basel Committee in October 2010.
- Guiding principles on corporate governance for institutions offering only Islamic financial services issued by the IFSB in December 2006.
- Compliance and compliance functions in banks issued by the Basel committee in April 2005.

Open Consultations (20th May 2015):

Amendments to Operational Risk Management (OM) module for Banks:

- CBB is proposing amendments to the operational risk management module, volume 1 and 2 specifically the Outsourcing chapter by introducing rules pertaining to outsourcing of services containing customers' information. CBB is also proposing additional developmental requirements as part of "Security Measures for Banks" in order to be in line with best international practices.

Amendments to Operational Risk Management (OM) module for Financing Companies:

- CBB is proposing amendments to the operational risk management module of the CBB rulebook Volume 5, specifically the Outsourcing chapter by introducing rules pertaining to outsourcing of services containing customers' information.

Insurance regulations

UAEIA issues comprehensive prudential rules for insurance companies

In February 2015, the UAE Insurance Authority issued the new regulations for insurers and Takaful companies operating in the UAE.

Decision no 25 and 26 of the Board of Directors of UAE IA represent the prudential regulations which must be complied with from 1 January 2015, but Firms will have between one and three years to implement some of the key aspects of the new regime.

These regulations come in line with the Insurance Authority's efforts to enhance the regulations in the UAE for its insurance sector and upgrade its competitiveness at the regional and international levels.

The new regulations cover seven key regulatory 'sections' or chapters, which include separate sections on technical provisions, investment limits, accounting treatment and record-keeping requirements, amongst other areas of insurance regulation.

- The rules set out the investment of policyholders' rights, management of insurance companies' investment and selection of suitable investment instruments by emphasizing diversity of investments, while considering the limited scope of local markets and set limits on high-risk investments such as unlisted shares, real estate investments and foreign investments. The rules enhance the role of Boards of Directors in supervising the investment performance and promote the role of specialists such as the actuary, and consequently, emphasizing the principles of corporate governance, enterprise risk management and so on.
- The insurance companies will need to assess risks and evaluate their solvency in key risk areas including risks related to underwriting, investment, credit, liquidity and operational risks, under the risk management framework system.
- The Solvency Margin rules are in line with requirements imposed by the IAIS, where the UAE is an active member. The Regulations on Solvency Margin include provisions related to the Solvency Margin, Minimum Capital Requirements, Minimum Guarantee Fund, Solvency Capital Requirements, and assessment of Solvency in key risk areas through IA can identify the ability of companies to provide the funds needed to meet their obligations as per the Solvency model, which is based on predefined factors.
- The prescribed Minimum subscribed and paid-up capital is at 100 million UAE Dirhams for insurance companies and 250 million UAE Dirhams for reinsurance companies. The Minimum Guarantee Fund is set at no less than one third of the Solvency Capital Requirement. The Minimum Guarantee Fund is calculated on the basis of the minimum amount required to be maintained to cover any class of insurance underwritten by the company, which includes a minimum limit and a percentage of the net earned premiums or an equivalent percentage, whichever is higher as determined by the IA.
- All companies shall comply at all times with the Solvency Margin Requirements to ensure maintaining own funds that meet the higher amount of the Minimum Capital Requirement, Solvency Capital Requirement and Minimum Guarantee Fund.
- The basis for calculating technical provisions are in line with the international trends in the insurance industry that the companies must maintain adequate and appropriate technical provisions that reflect the nature of operations of the insurance companies, and to avoid variance in the estimates of technical provisions made by the companies and the corresponding underwriting obligations, whether in terms of their value or time of occurrence. Assessment of technical provisions by an Actuary is required.
- The rules can be found on the UAE IA's website.

International announcements

Capital and liquidity

Basel implementation progress report

On 27 April 2015 the Basel Committee published its *Eighth progress report on adoption of the Basel regulatory framework*. The report assesses how 19 Basel members have implemented Basel requirements and looked at nine EU countries as well as Australia, Brazil, Canada, China, European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland and the USA. It found the LCR had the lowest level of full implementation. This was driven in part by the EU where the LCR ratio will not be implemented until 1 October 2015.

The Committee is conducting additional analytical work on RWA variation in the banking and trading books which it expects to publish during the second quarter of 2015. In addition it is developing measures to address excessive variation and the Basel Committee expects to publish its progress later this year. The Committee is also considering a proposal for ongoing monitoring of RWA variation from 2015.

Standardising Basel approaches

On 21 April 2015 the Basel Committee *reported* that it has removed six national discretions from the Basel II capital framework. These include:

- treatment of past-due loans
- definition of retail exposures
- transitional arrangements for corporate, sovereign, bank and retail exposures
- rating structure standards for wholesale exposures
- internal and external audit
- re-ageing.

The move was taken to enhance comparability across jurisdictions and reduce variability in RWAs. The Basel Committee also responded to a question on the funding valuation adjustment in Basel III. It clarified that for derivative liabilities, banks are not permitted to offset valuation adjustments due to their own credit risk against those due to counterparties' credit risk.

Basel Committee targets interest rate risk

The Basel Committee published a *consultation paper* on assessing Interest Rate Risk in the Banking Book (IRRBB) on 8 June 2015.

The Basel Committee points out that banks are more vulnerable to interest rate risk now because interest rates have been very low for several years and are likely to rise at some point in the future. Also, it want to limit opportunities for arbitrage by requiring a broadly similar treatment of interest rate risk in the banking book and the trading book.

The paper proposes two approaches to assessing IRRBB and invites comments from the industry on each:

- moving the IRRBB assessment from its current home in the subjective Pillar 2 framework to a more prescriptive calculation that would form part of Pillar 1
- leaving the IRRBB component in Pillar 2 but making it more prescriptive.

Once finalised, the new Basel IRRBB policy will apply to 'large internationally active banks'. National regulators will be able to extend the new treatment to smaller banks if they wish.

The consultation runs until **11 September 2015**.

Tackling credit risk

The Joint Forum (BCBS, IOSCO and IAIS) published *Developments in credit risk management across sectors: current practices and recommendations* on 2 June 2015. The report gives views on the current supervisory framework around firms' credit risk management and the implications for the supervisory and regulatory treatments of credit risk. It warns that supervisors should be cautious against over-reliance on internal models for credit risk management and regulatory capital.

New disclosure templates

The Basel Committee published a set of NSFR *disclosure templates* on 22 June 2015.

National regulators must incorporate the new disclosure templates into their rules and require internationally active banks to complete and publish them annually from 2018 onwards. The new disclosure process will ultimately be aligned with the existing Pillar 3 disclosures. Regulators can extend their application to smaller and/or domestic banks if they wish.

The Basel Committee acknowledged that excessive disclosure can lead to undesirable market effects but have nevertheless decided to proceed with these new disclosure requirements.

Credit rating agencies

IOSCO consults on alternatives to credit rating agencies

On 7 May 2015, IOSCO issued a *consultation report - Alternatives to the use of credit ratings to assess creditworthiness.* It outlines draft best practices to assist market intermediaries to move away from relying on CRAs and instead develop their own robust, internal credit worthiness assessments. The report also covers draft corporate governance practices that are already widely adopted across industry to manage and monitor credit risk, both at counterparty and instrument level.

IOSCO considered survey responses and presentations by large market intermediaries. It proposes a number of 'draft sound principles,' including:

- establishing an independent credit assessment function
- developing a coherent oversight function
- adequately informing governing committees
- incorporation of qualitative measures
- subject non-investment grade financial products to enhanced scrutiny.

The consultation closes on **8 July 2015.**

Financial crime

FATF to assess de-risking

FATF's 26 June 2015 press release *Drivers for "de-risking" go beyond anti-money laundering/terrorist financing* outlines the work it will undertake on evidencing the causes, scale and impact of de-risking by financial institutions. FATF received intelligence that financial institutions are terminating or restricting relationships with categories of customers in situations beyond AML and counter-terrorist financing.

FATF is going to:

- clarify the relationship between its standards on correspondent banking (FATF Recommendation 13) and other intermediated relationships with standards on customer due diligence (FATF Recommendation 10) and wire transfers (FATF Recommendation 16)
- consult with regulators and the private sector to inform its work
- consider the efforts of supranational organisations on account closure and correspondent banking - including CPMI, the Union of Arab Banks, the IMF and BCBS
- develop guidance on the risk-based approach to money or value transfer services.

Financial institutions are reminded by FATF that a *risk-based* approach to de-risking is a fundamental requirement of its standards. FATF's statement comes three months after the *FCA warned* banks that wholesale de-risking was not a legal or regulatory requirement of domestic or international standards.

Risk-based approach to virtual currencies

The FATF have *published guidance* for a risk based approach to virtual currencies. The 48-page document states that virtual currencies represent economic benefits such as decreased transaction costs and the facilitation of micro-transactions however, they also carry risks of money laundering and terrorist financing that must be identified and mitigated.

FATF identifies currency exchanges as the greatest area of risk and requests its members to better understand how virtual currencies function, the risks they represent and allocate resources.

The report recommends that all exchanges should be registered and licensed through a similar process to other financial institutions including due diligence processes and record retention of senders and beneficiaries. Where exchanges do not comply with the above requirements, FATF prescribes a "range of effective, proportionate and dissuasive sanctions".

It acknowledges there are, however, difficulties due to the largely anonymous nature of a decentralized and irreversible blockchain, including the inability to prevent payments for certain prohibited goods or person-to-person transactions.

FATF states that the guidance will help the private sector identify money laundering and terrorist financing risks, and for national authorities to develop legal and regulatory frameworks for addressing that risk.

Financial stability

IMF warns of shadow banking risks

The IMF issued its *Global Financial Stability Report April 2015* on 15 April 2015. The IMF identifies a shift of financial stability risks from advanced economies to emerging markets, from banks to shadow banks, and from solvency to market liquidity risk. Weak European mid-sized life insurers face a high and rising risk of distress should interest rates remain low.

The IMF suggests that measures above and beyond the use of monetary policy are needed to fully recover from the crisis. These include unclogging credit channels by encouraging banks to develop capacity for handling the stock of non-performing assets, to actively manage their provisions, and write off their non-performing assets. It also recommends diversifying sources of funding away from banks and towards capital markets while putting in place regulations to transform shadow banking into a stable source of market-based finance.

The IMF also suggests that different supervision of asset managers is needed to better handle the financial stability risks they pose to the market.

IOSCO focused on asset management risks

On 17 June 2015, IOSCO released *IOSCO: Meeting the Challenges of a New Financial World*, covering developments from its annual conference in London. It has decided that a full review of asset management activities and products in the global financial context should be the immediate focus of international efforts to identify potential systemic risks and vulnerabilities. It thinks this review should take precedence over further work on methodologies for the identification of systemically-important asset managers.

The IOSCO Board discussed its strategic direction through 2020, which will be implemented via 43 initiatives covering priority areas such as:

- research and risk identification
- standard setting and developing guidance
- implementation monitoring
- capacity building
- cooperation and information exchange
- collaboration and engagement with other international organisations.

IOSCO also dedicated time during the conference to discuss proposals for work on OTC retail leveraged products and the functioning of the ISDA Credit Determinations Committee and CDS auction processes.

Finally, the Board also agreed to consider what work IOSCO should undertake to further strengthen the current global framework to address misconduct by firms and individuals in retail and wholesale markets.

Insurance update

IAIS revises Insurance Core Principles

The IAIS published a *Consultation on revision of Insurance Core Principles (ICPs)* on 17 June 2015. It first developed the ICPs as a global framework for the regulation and supervision of the insurance sector in 2011. It is consulting on some minor clarifications and amendments to its ICPs following the 2014 Self-Assessment and Peer Review and to align them with corresponding FSB and Basel Committee principles, standards or principles. It has also strengthened its approach to group-wide supervision and amended various key definitions related to governance and group supervision.

The consultation closes on **17 August 2015**. The IAIS plans to adopt the final ICPs in November 2015.

G-SIIs holding more capital

The IAIS published *Consultation on Higher Loss Absorbency (HLA) requirements for G-SIIs* on 25 June 2015. The FSB defines G-SIIs as insurers 'of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries.' The IAIS is developing a capital requirement for G-SIIs made up of a basic capital requirement (BCR) plus an uplift (presently estimated at 33% of BCR) plus HLA, split between insurance and non-insurance (NI) elements. It developed the BCR and *HLA principles* in 2014 and has now published several options of a draft HLA for consultation.

The IAIS is not focussing on specific formulas for the HLA in this consultation, but is instead concerned with risk sensitivity, robustness and simplicity. It proposes that the HLA capital requirement, for both insurance and NI will be calculated by multiplying an exposure by a factor. It has identified three main areas for consultation:

- bucketing (to specify which factor to apply to which G-SII) and how many buckets to have
- choice of HLA formulas (to specify the exposure) and how much emphasis should be placed on Non–Traditional Insurance (NT) and NI activities
- calibration of outcomes (to specify the size of the factors) and what extent the impact of the HLA is to have on G-SIIs, both on average and in particular.

The IAIS does not expect the HLA required capital to be more than 20% of the sum of the BCR and uplift for the average G-SII. The HLA capacity requirements are to be met by the highest quality capital. The consultation closes on **21 August 2015**. The HLA is due to be endorsed by the G20 in November 2015 for implementation from January 2019.

Conduct in inclusive insurance market

The IAIS published *Draft issues on conduct of business (COB) in inclusive insurance* on 19 June 2015. It defines inclusive insurance as '*all insurance products aimed at the excluded or underserved market…. In developing countries, the bulk of the population often classify as un- or underserved.*' It considers the difference between the inclusive insurance market and the conventional insurance market and the fair treatment of customers buying these policies. The differences that the IAIS examines include their development as a product, distribution, disclosure of information, customer acceptance, premium collection, and claims settlement to the handling of complaints by the insurer.

The IAIS concludes with recommendations for regulators and supervisors when designing and implementing inclusive insurance conduct of business supervision in their jurisdictions. The consultation closes on **6 August 2015**.

Islamic microinsurance consultation

Following a joint initiative of the IAIS and the Islamic Financial Services Board (IFSB), the IAIS published for consultation a *Draft paper on issues in regulation and supervision of MicroTakāful (Islamic Microinsurance)* on 19 June 2015. It discusses Microtakāful (also known as Takāful or Islamic Insurance for the low-income population) and access to insurance in Islamic communities and regions. This research paper also considers how current regulatory issues can be addressed and potential improvements in:

- corporate governance
- financial and prudential regulation
- transparency, reporting and market conduct
- supervisory review process.

The consultation closes on **6 August 2015**.

Investment funds

Standardising fees

IOSCO published *Consultation report on elements of international regulatory standards on fees and expenses of investment funds* on 25 June 2015. It originally issued fees and expenses recommendations in 2004 and is now seeking comment on how these recommendations could be updated. IOSCO notes that there have been a number of investment fund regulatory and market developments in the period which may need to be reflected, including more disclosures and low interest rates.

It focuses here on a number of key areas where new recommendations could be made:

- types of fees permitted - regulators could specify the fees that can be taken out of a fund's property, new fees should only be charged once approved by the responsible entity (such as executive board of the operator or a regulator) and the scope of fees taken from funds should be disclosed to investors
- performance fees - there should be a local regulatory regime setting standards on how a performance fee should be calculated and disclosed to investors
- disclosure - these should be easily understandable by investors and can be provided via electronic media as long as investors can get hold of hard copies of documents on request
- transaction costs - regulators should define what activities are caught within transaction costs and this should be disclosed to investors
- hard and soft commissions - transactions should only be entered into if they benefit the fund, not to generate order flow or commissions and regulators should consider providing guidance on the services and activities that commissions can

and cannot pay for whilst operators should implement procedures aimed at avoiding conflicts of interest in their dealing activities

- investing in other funds - management fees of both funds should be disclosed to investors
- changes to a fund - investors should be given suitable notice of a change happening before that change takes effect.

The consultation closes to comments on **23 September 2015.**

Market infrastructure

FSB wants FX progress report

In his capacity as FSB Chair, Mark Carney *wrote* to the Chairman of the London Foreign Exchange Joint Standing Committee on 20 March 2015.

Carney requested the Committee's support in reporting on market participant's progress in implementing the FSB's recommendations on FX benchmarks, published on 30 September 2014. The Committee must report on the status of its members as at 30 June 2015, and provide this report to the FSB no later than 31 July 2015.

Recovery and resolution

Comparing resolution regimes

The FSB launched its *Second Thematic Peer Review on Resolution Regimes* on 13 April 2015. The FSB is aiming to:

- take stock of bank resolution powers, recovery and resolution planning requirements and related requirements for resolvability assessments
- evaluate progress since the first resolution peer review in implementing reforms
- review the range of approaches taken to implement resolution powers and evaluate how far existing powers are likely to achieve the intended outcomes
- highlight good practices and lessons of experience in reforming national resolution regimes, including any challenges arising from implementation of these reforms
- identify material inconsistencies or gaps (compared to the *Key Attributes for Effective Resolution Regimes for Financial Institutions*) in areas that are common across jurisdictions and would need to be addressed
- identify ways to further improve the explanatory notes and guidance in the draft assessment methodology on the necessary characteristics of resolution powers.

The primary audience for the peer review was local regulators, although it was also open to industry feedback on local recovery and resolution regimes and any challenges presented by local differences in approaches. The FSB plans to publish the final peer review report in early 2016. The consultation closed on 8 May 2015.

IOSCO provides recommendations on business continuity plans

On 7 April 2015 IOSCO published a *consultation report - market intermediary business continuity and recovery planning.* Regulators should require market intermediaries to create written business continuity plans (BCPs) and expect updates if intermediaries experience any material operational changes.

IOSCO also recommended that firms voluntarily adopt a series of "sound practices" in respect to their plans, including:

- taking into account client needs, such as prompt access to funds and securities during a major disaster
- include regional specifications for globally active firms
- establishing back-up sites for critical operations
- conducting exercises to test BCPs.

The consultation closes on **6 June 2015.**

Accounting

Financial accounting

New revenue standard deferred

On 28 April 2015 the IASB *voted to defer the effective date of the new revenue standard*, IFRS 15 'Revenue from Contracts with Customers', from 1 January 2017 to 1 January 2018. This is a joint standard issued by both the IASB and FASB in May 2014. The FASB also delayed the effective date on 1 April 2015, following consideration of implementation issues by the joint FASB and IASB Transition Resource Group (TRG). The IASB now plans to formally consult on the proposed deferral and address the concerns of the TRG.

See our publications *In brief 'FASB proposes one year deferral of new revenue standard'*, *In transition 'TRG debates revenue recognition implementation issues'* and *In* *transition 'FASB and IASB decide on additional changes to revenue standard'* for further details of the implementation issues.

Pension accounting amendments proposed

The IASB published *ED/2015/5: Remeasurement on a plan amendment, curtailment or settlement/availability of a refund from a defined benefit plan (Proposed amendments to IAS 19 and IFRIC 14)* on 22 June 2015. It sets out proposed narrow-scope amendments for pension accounting when a defined benefit plan is amended, curtailed or settled. It proposes that entities will have to update assumptions on the obligation and fair value of plan assets to calculate costs related to changes during a reporting period. They will have to use this updated information to determine current service cost and net interest for the remainder of a period following these changes. It has also clarified how these changes interact with the limit on a defined benefit asset.

The IASB is also proposing to amend IFRIC 14: 'IAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction', to address how the powers of other parties, such as the Trustees of the plan, affect an entity's right to a refund of a surplus from the plan.

The consultation closes on **19 October 2015**.

Historic cost or fair value

The IASB published a speech *'Historical cost and fair value are not as far apart as they may seem'* on 29 June 2015. It considers the benefits and challenges linked to various measurement models: historical cost and current value, including fair value. It concludes that the approaches are not as different as they may initially seem and gives high-level, general observations on when historical cost and current value measurement could be most appropriate.

Significant decisions on insurance contracts

The IASB made several significant decisions relating to participating contracts on 25 June 2015:

- the variable fee approach will be required for direct participation contracts
- the definition of direct participation contracts was agreed
- the recognition of the contractual service margin (CSM) in profit or loss for contracts following the variable fee approach should be based on the passage of time.

It also considered:

- issues surrounding the adoption of IFRS 9 'Financial Instruments' by insurers before the new insurance standard is adopted and requested more input from users with a view to potentially changing the measurement of liabilities
- accounting mismatches that could result from the variable fee approach when an entity hedges against changing market variables using derivatives.

See our *Insurance alert: IASB meeting on 23 June and 25 June* for further details.

Challenges for insurers implementing IFRS 9

The IASB finished revising IFRS 9 Financial Instruments (replacement of IAS 39) in July 2014, to be effective from 1 January 2018. IFRS 9 introduces significant changes for some insurers, particularly those who currently hold amortised cost assets and make significant use of the Available for Sale category ("AFS") under IAS 39. To highlight these changes and assist insurers in their preparations, we published *IFRS 9 for insurers* on 25 June 2015. It considers the effects of IFRS 9 on insurers and what they should be doing now to meet the deadline. It also gives an overview of the new classifications under IFRS 9 and a useful summary of tools and accelerators that can be used to help with implementation.

Revised Conceptual Framework

The IASB issued *ED/2015/3 - Conceptual Framework for financial reporting* on 28 May 2015. It aims to improve the Conceptual Framework used when developing IFRS. Proposed improvements include:

- measurement detail describing options (historical cost, current value and fair value) and selection criteria
- guidance on when income and expenses could be reported in other comprehensive income
- refined definitions of assets, liabilities, equity, income and expenses.

The comment period ends on **26 October 2015.**

Insurance Contracts project update

The IASB held an education session on 19 May 2015 to discuss the implications of the variable fee approach for direct participation contracts and the accounting for ‘indirect participation contracts’, such as US style universal life contracts. The Board did not make any decisions. See our *Insurance Alert: IASB education session on 19 May 2015* for notes of the meeting.

Revenue standard deferral

The IASB published *ED/2015/2 - Effective Date of IFRS 15 (Proposed amendments to IFRS 15)* on 19 May 2015. It proposes deferring the effective date of the revenue standard, IFRS, 15 from 1 January 2017 to 1 January 2018, to clarify the requirements and add examples to aid implementation. The comment period closed on 3 July 2015.

Liquidity risk management in the GCC

The GCC is an operating environment that is blessed with a high level of credible sovereign support, which helped GCC banks recover comprehensively after Lehman Brothers fell into the abyss. With the encouragement of local regulators, liquidity management since the crash has been focused on generating conservative funding structures, with Loan/Deposit ratios much reduced since 2008/9.

Banks with retail operations have increasingly focused on generating Current Account / Saving Account (CASA) growth which yields reliable funding, at a lower cost. Business has been good for the majority of GCC banks as balance sheets have been re-built, costs have gone down and profits have increased.

GCC banking sector growth in a Basel III world

As GCC banks expand, the funding of the asset side of the balance sheet with stable (e.g. ideally, insured) deposits is potentially going to be challenging – especially if GCC economies experience a reduction in GDP growth due to a (relative to recent years) lower oil price, and hence less wealth (deposit) creation. The recent introduction of the Liquidity Coverage Ratio (LCR) will affect the type of asset growth, in ways that are yet to become clear, even in jurisdictions which have not published a final draft of the LCR regulation[1].

Safe practice for banks in the GCC will therefore be to ensure strategic business planning includes adequate liquidity risk analysis, and the inclusion of Liquidity Premia in new business pricing – typically via Funds Transfer Pricing (FTP) adjustments. This would link: i) the costs of holding High Quality Liquid Assets (HQLA), and; ii) the continued migration of banks away from short-term financing, as they move further along the yield curve to create more reliable sources of funding.

Relevant of the Liquidity Coverage Ratio

LCR is the main liquidity risk management measure in the GCC, with the NSFR ratio still some way to go before National Discretions are finalised. This has made banks focus on both the numerator (High Quality Liquid Assets – unencumbered and available for bank liquidity operations) and the denominator (Net Liquidity Outflows in the next 30 days).

Banks should perhaps focus on three themes to better understand the context of the LCR calculation[2] , and its effect on GCC Banks: i) Loan to Deposit Ratios in a Basel III world; ii) GCC specifics for HQLA, and; iii) the advantages that are claimed to accrue to Islamic Banks.

Loan to Deposit Ratios in a Basel III world

Loan to Deposit ratios can be significantly different from bank to bank, often due to nothing more than customer mix. It can be argued that decreasing Loan to Deposit ratios do not provide accurate signals for banking system safety, as this measure does not take into account the type of deposit nor the counterparty. For example, where an increase in Deposits (to fund credit creation) is less stable (and therefore unreliable in periods of extreme stress), e.g. Fiduciary Time and Call Deposits, they are assigned a run-off factor under LCR of 100 %. However, where these deposits are covered by a funded insured deposit scheme, then the run-off

[1] *This is empirically unproven – see Banerjee et al (2014) BIS "The Impact of Liquidity Regulation on Banks"*

[2] *Net Stable Funding Ratio – NSFR – complements LCR under Basel III focusing on longer term Liquidity Risk management and the management of cliff effects of LCR. We aim to deal with GCC related effects of NSFR in a later paper.*

factor is a mere 3%. All deposits are not the same. So does the Loan to Deposit ratio have a place in a Basel III paradigm?

Take the case of Washington Mutual Bank (WaMu) who in June 2008[3] had a historically adequate capitalization[4], USD 148 BN in **Retail deposits** (against total deposits of USD 182BN, and total liabilities of USD283 BN) on loans of USD 231BN, which translated as a Loan to Deposit ratio of 128%. In 2008 the Office of Thrift Supervision (OFT) took control of WaMu after ~ 10 % of deposits ran-off over a 9 day period, deeming the bank unsound.

Did a Loan to Deposit Ratio of nearly 130 % mark out WaMu for an historic bank run?

"Had WaMu's liquidity crisis occurred two weeks later, there would have been no failure"[5].

This is the main point for GCC banks. There were no runs on banks in the GCC during this period, even with higher (than today) Loan to Deposit Ratios, because of the political will (and resources) to avoid idiosyncratic or systemic bank runs.

The Loan to Deposit ratio remains a useful heuristic but only as a rough guide to how far withdrawals can be covered by a bank, if deposits run-off. As such, Loan to Deposit ratios should be seen only as the first line of defence against systemic illiquidity, with NSFR and LCR providing the policy tools to fine tune micro-economic funding structures.

GCC specifics for HQLA

The holdings of Level One HQLA is mostly focused around domestic coins, banknotes and central bank reserves in the GCC, with the balance derived from sovereign or quasi-sovereign[6] securities – which are normally (5-10 year) US Treasuries, due to low or non-existent sovereign issuance in the GCC. The majority of GCC bank HQLA is held within this limited spectrum of assets, thus Level 2A and 2B are mostly absent from the equation.

This low level of diversification is especially marked in the GCC – see a 2014 PwC briefing to contrast the GCC against the lively debate in the USA around HQLA (defining Levels 1 and 2) and complex issues surrounding issues like operational deposits[7].

Innovation in HQLA is inevitable as GCC banks respond to the economic impact of carrying mostly Level One HQLA with the percentage of cover increasing by 10 % per annum to end of 2018. This will increasingly affect Economic Profit, especially as rates normalize to pre-crisis levels.

Diversification of HQLA is one route whereby GCC issuance from the likes of non-financial, quasi-sovereigns (e.g. Mubadala, SABIC, Saudi Electricity, Nakilat) could provide banks and regulators with enhanced local supply, with the nascent securitization market another possible channel – including the option for Shari'ah-compliant products for real-estate etc.

Financial market improvements would also benefit the GCC, with deeper Central Bank Repo markets an obvious area for improvement. His Excellency, Dr Mohammad Y Al-Hashel, Governor of the Bank of Kuwait, delivered a speech to the International Islamic Liquidity Management Corporation (IILM) in Washington on the 15th April 2015, where he said[8]:

"*For many banks, LCR requirements are "the iceberg below the water", and these requirements will necessitate operational, financial and structural change*"

Whereby improvements to HQLA effectiveness will require improvements to interbank markets, the provision of more Islamic debt instruments and,

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[3] *Taken from the Washington Mutual 10-K for June 30th, 2008.*

[4] *Common Equity Tier 1 to RWA ratio of 7.76 %*

[5] *From US Senate Sub-committee Hearing in April 2010, on evidence from John Reich, head of the OTS when WaMu failed*

[6] *See page 18 of BCBS 238, January 2013 for exact definition*

[7] *April 2014 "LCR: No blood, but sweat and tears" in A Closer Look Magazine on www.pwcregulatory.com*

[8] *See full transcript on www.cbk.gov.kw, page 10*

"safety nets – such as Shari'ah compliant Deposit Insurance and Shari'ah compliant Lender of Last Resort arrangement".

Perceived advantages for Islamic Banks

Islamic banks are increasingly predominant in the GCC and they have a natural advantage in funding, with Loan to Deposit Ratios markedly lower than conventional banks, along with higher Retail Deposit contribution. One reason behind this could be attributed to individual preferences in the GCC for Shari'ah products.

These customers are providing a significant competitive advantage to Islamic banks, with a virtuous circle developing as these banks grow (admittedly from a low base) – with stable deposits underpinning asset growth[9].

Islamic banking is already a global market and national discretions are developing to support their compliance with LCR[10], including:

- Lower run-off rates (3%) for stable Islamic liabilities[11];
- Ability to use not only Sukuk and other Shari'ah-compliant marketable securities but also, the undrawn value of eligible Shari'ah-compliant Committed Liquidity Facilities (CLF) from central banks (level 2B)

However, the reduced access to conventional securities such as US Treasuries does mean that there is significant progress required so that Islamic firms can avoid holding excessive amounts of cash, which is an inefficient allocation of resources.

However, in the final analysis, are Islamic Deposits the anchor in the denominator of the LCR equation? Will clients start to move around their deposits into conventional accounts as rates normalize?

Summary – it is too early to predict LCR's impact in the GCC

LCR mechanics will drive much of the behaviour of GCC bank's over the next 2-3 years as different market forces affect the Liability structures of the regions banks.

What is certain is that innovation will be required to protect Economic Profit, including a focus on both the denominator and numerator of the LCR equation.

Expect to see innovation as GCC banks would want to cater for the local market specificities, adapting to changes in sovereign issuance (e.g. Saudi Arabia is likely to be coming to market to manage their fiscal gap), savings product innovation as short-term rate structure evolve and dialogue with local regulators as they come to terms with the market effects introduced by regulatory change.

[9] "What customers want – Customer insights to inform the growth strategies of Islamic Banks in the Middle East" 2014, www.pwc.com/me

[10] Islamic Financial Services Board Paper GN-6 Guidance Note on Quantitative measures for Liquidity Risk Management in Institutions offering Islamic Financial Services, www.ifsb.org

[11] See section 58 of IFSB Paper GN-6 for details

Glossary

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

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

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

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