

# Implications of CBUAE Credit Risk Management Regulations & Guidelines

## In brief

The Central Bank of the UAE (CBUAE) has introduced Credit Risk Management Regulations and Guidelines, setting minimum standards for Licensed Financial Institutions (LFIs).

These regulations comprise of articles and enforceable standards, aimed at strengthening governance, risk oversight, and operational resilience within the LFIs.



The objectives of the guideline are summarised below:

- Strong oversight mechanisms to promote accountability, transparency and provide assurance
- Align credit risk appetite to overall business and strategic objectives of the LFI
- Ensure consistency and standardisation of credit risk management
- Enable data-driven decision making
- Enhance credit monitoring and risk mitigation
- Establish clear performance metrics, accountability and incentive mechanisms

LFIs must align their credit risk strategies with these new regulatory requirements, ensuring compliance and long-term financial stability.



## In detail

The CBUAE Credit Risk Management Regulation establishes a comprehensive risk framework to enhance financial resilience in the UAE's banking sector. It applies to all LFIs operating within the UAE, including foreign subsidiaries and affiliates.

We expect the impact of this regulation across four key themes:

- **Governance, oversight & strategy** - Aligns credit risk management with business goals, ensuring accountability, transparency, and regulatory compliance
- **Framework, policies & procedures** - Standardises and streamlines credit risk processes, enhancing operational efficiency and adaptability
- **Data, analytics & infrastructure** - Enables data-driven decisions and real-time risk monitoring, supporting scalability and competitive advantage
- **People, culture & performance**: Promotes skill development and a risk-aware culture, driving engagement and effective risk management



# How can LFIs derive value?

## 1. Governance, oversight and strategy

- To enable **informed decision-making** through advanced data analytics and robust infrastructure.
- Effective data aggregation and analytics tools allow for **enhanced monitoring** of credit exposures and early identification of emerging risks.
- A strong data and infrastructure foundation supports the **scalability** of credit risk management practices.
- Leveraging cutting-edge analytics and technology provides a **competitive edge** by enabling more sophisticated risk management strategies.

## 2. Framework, policies and procedures

- **Strong oversight** mechanism to promote **accountability and transparency** within the LFI.
- **Appetite & strategic alignment** with the overall business objectives and risk appetite of the institution.
- Proactive **risk mitigation** approach to reduce the likelihood of unexpected losses and enhance the LFI's resilience.
- To ensure regulatory compliance, thereby **avoiding legal and regulatory penalties** as well as reputational damage.

## 3. Data, analytics and infrastructure

- Investing in the development of risk management **skills and competencies** among employees ensures that the institution has the necessary expertise to manage credit risk effectively.
- Fostering a **risk-aware culture** within LFIs to promote a proactive approach to risk management.
- Establishing clear **performance metrics and accountability** for risk management roles ensures that employees are aligned with the institution's risk management objectives.
- A strong focus on people and culture enhances **employee engagement** and morale.

## 4. People, culture and performance

- To ensure **consistency and standardisation** in credit risk management practices for maintaining quality and reliability in risk assessments and decisions.
- Clear policies and procedures to streamline processes, reduce ambiguities, and enhance **operational efficiency**.
- Robust **credit risk control** to manage various aspects of risk, including underwriting, monitoring, and mitigation.
- Having a structured framework allows institutions to **adapt** to changing market conditions and regulatory environments more effectively.

# Governance, oversight & strategy

## Overview

The subject of robust governance and strategy is reflected throughout the published articles and the involvement of board and senior management is a recurring key theme. Achieving the key objectives of the guideline for a more robust credit risk management approach starts with a well-defined credit risk governance, oversight and strategy.

## Key concepts emphasised

- **Active role for the board:** Board approval is required for more capital-related decisions.
- **Granular risk appetite & alignment:** Align credit risk strategy with the LFI's capital strength.
- **Enhanced credit control:** Actively involve internal and external auditors in credit risk management.
- **Independence & conflict of interest:** Ensure independence in credit decisions and establish a mechanism to manage conflict of interests.
- **CRO veto power:** The CRO must have veto over credit risk decisions.



## Implications & benefits

- **Improve oversight:** Enhance board engagement and information sharing.
- **Define risk appetite:** Align credit risk strategy & appetite with business objectives.
- **Risk mitigation:** Establish enhanced risk governance with other control functions to manage risks.
- **Regulatory compliance:** More collaboration with internal and external auditors to enhance compliance.



# Framework, policies & procedures

## Overview

Establishing a strong foundation for credit risk management hinges on comprehensive frameworks, well-defined policies, and clear procedures. These ensure consistency, transparency, and alignment with the institution's risk appetite while adhering to regulatory standards. The importance of these elements is woven throughout the standards, emphasising their role in operationalising credit risk frameworks effectively across all levels of the LFI.

## Key concepts emphasised

- **Comprehensive credit risk frameworks:** Establish frameworks covering the full credit life cycle, supported by key enablers such as systems, data & analytics.
- **Formalisation of new policies:** Create policies to manage emerging risks like climate, counterparty, and country risks.
- **Integration of policies:** Standardise policies across credit management, ensuring alignment in key areas like credit ratings and provisioning.
- **Cross-functional collaboration:** Encourage collaboration between departments (business, risk, finance, legal) for cohesive risk management.
- **Embedding performance management:** Link underwriting performance to employee accountability for credit decisions.

## Implications & benefits

- **Consistency & standardisation:** Integrated frameworks to ensure consistent credit risk management.
- **Enhanced concepts:** New frameworks such as ESG, country risk are integral part of credit risk management
- **Operational efficiency and adaptability:** Clear procedures and resource allocation to help LFIs adjust to changing conditions and regulations.
- **Risk-based approaches:** Design frameworks that optimise risk-return objectives in decision-making and performance management



# Data, analytics & infrastructure

## Overview

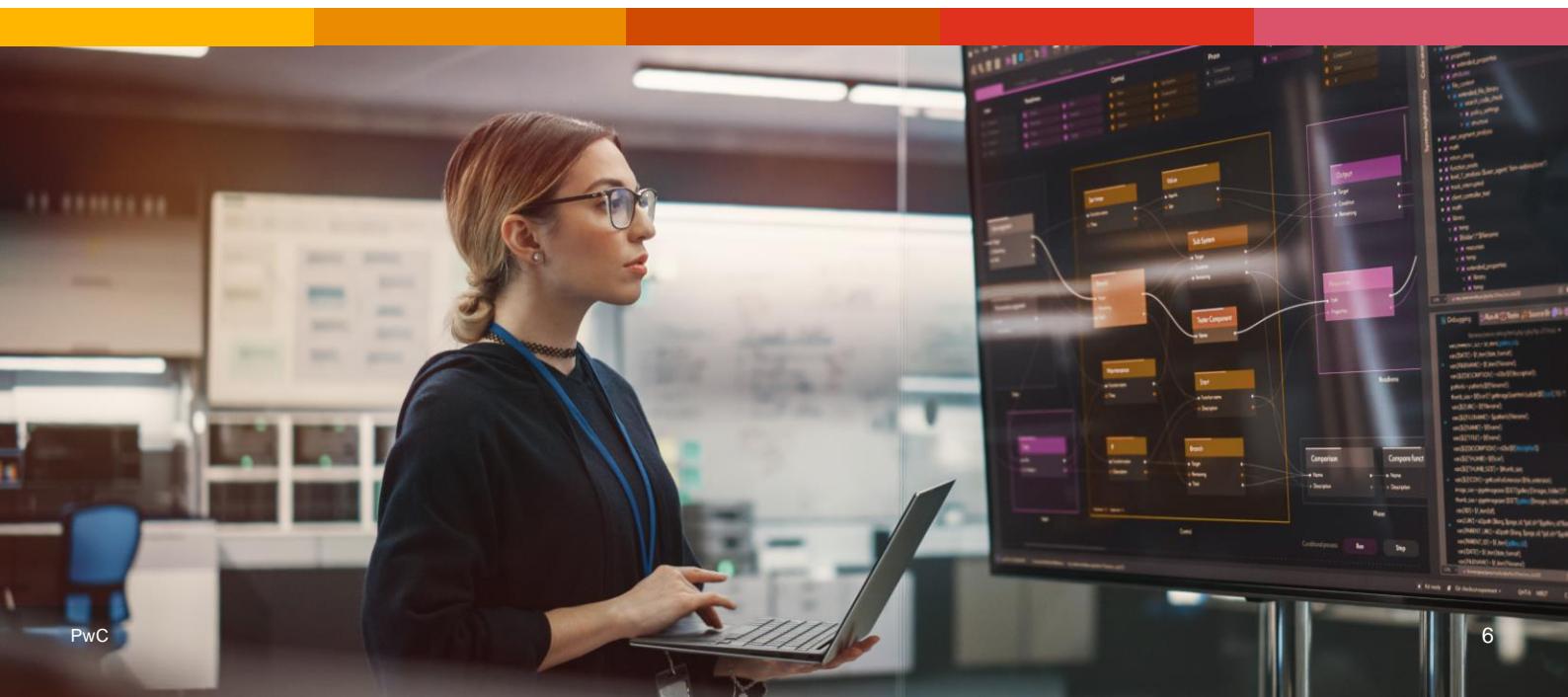
Effective credit risk management relies on access to high-quality data, integration of analytics, and advanced technology. LFIs must move away from subjective decision-making and adopt data-driven approaches to enhance risk assessment and compliance.

## Key concepts emphasised

- **Access to credit data:** Ensure availability of credit information for better risk identification, reporting, and decision-making.
- **Data integration & aggregation:** Aggregate data across different levels (counterparty, portfolio, group) to meet regulatory requirements.
- **Discouraging subjective decision-making:** Shift from subjective underwriting to data-driven financial analysis during underwriting.
- **Credit analytics & modelling:** Use advanced models incorporating macroeconomic forecasts and business cycle effects in line with regulatory standards and best practices.
- **Credit risk technology:** Strengthen technology infrastructure to support analytics, data aggregation, and risk reporting.

## Implications & benefits

- **Make informed decisions:** Proactive risk analysis reduces defaults through forward-looking insights.
- **Improve data maturity:** Investing in data aggregation and analytics tools enhances credit monitoring and risk detection.
- **Opportunity for more business acquisition:** Data-driven underwriting improves loan quality and scalability in business acquisition and risk management.
- **Implement robust technology:** Advanced analytics and technology provide a competitive edge in credit risk management.



# People, culture & performance

## Overview

Building credit risk expertise requires continuous training, awareness, and performance management. LFIIs must enhance staff skills, enforce accountability, and align incentives with risk outcomes.

## Key concepts emphasised

- **Regular training:** Ongoing training for board members, senior management, and underwriting staff.
- **Knowledge & skills:** Ensure staff have the expertise to assess and manage credit risk effectively.
- **Raising awareness:** Educate employees on emerging risks, such as climate risk in credit exposures.
- **Performance incentives:** Reward employees based on both risk and return performance.
- **Deferred compensation** mechanisms: Align long-term risk exposure with employee compensation.
- **Enforce accountability:** Define clear performance indicators for underwriting staff.
- **Unbiased assessment:** Ensure independent credit proposal reviews, separate from business functions.

## Implications & benefits

- **Implement knowledge & talent management:** Strengthen skills, establish clear metrics, and foster a risk-aware culture.
- **Design enhanced training program:** Regular training to improve competencies in credit risk management and emerging risks.
- **Revisit performance management framework:** Update KPIs to align staff incentives with responsible credit underwriting.



# Areas of potential quantitative and financial impact

The standard has set rules and guidelines that may affect LFIs differently, depending on their size, maturity, and operational complexity. LFIs must conduct a quantitative impact assessment and implement mitigation measures to reduce the impact.

## Risk appetite to capital strength

Larger LFIs with big ticket transactions and material capital level are expected to have more stringent risk appetite thresholds based on their capital strength.



## Accountable underwriting requirements

Underwriting standards mandate that LFIs should take responsibility for their underwriting decisions with incentive mechanism to compensate staff with good credit decisions. This requires changes to current incentive programs.



## Default definitions

LFIs whose default definition of retail and wholesale portfolio are currently relaxed as compared to the current measure of 90 DPD as well as triggers indicating unlikelihood to pay may witness material increase in their default pool post implementation of the standards.



## Significant increase in credit risk (SICR)

Revised SICR requirements such as multiple deferrals, use of internal ratings amongst others may lead to more stage 2 accounts where LFIs will have to maintain higher provisions.



## Provision adequacy and floors

Higher provision floor requirement compared to current levels will impact LFI's profitability level and returns to shareholders.



## Approval of material loans

The Board and Board Committees need to be provided with adequate and sufficient information to make appropriate credit decisions on material loans that significantly impact the LFI's solvency. Such loans should remain performing to maintaining good risk profile.



## More stringent credit risk mitigation standards

With more stringent requirement on credit risk mitigation, LFIs that do not step up their measurement and valuation procedures may miss the opportunity to reduce provisions through incorporation of mitigants' effect into the computation.



## Climate risk management

LFIs will need to consider the climate related risk factors in credit exposures, and may shift their lending strategy to non-climate sensitive sectors and restructure the credit terms (shorter tenor, lower LTV, stringent covenants).



## Limitation in the use of model override

The standards discourage overrides where risk measurement and reporting will be driven mostly by model outputs. This will have significant impact on LFIs with lower model management maturity.



## Compliance with CBUAE MMS

Compliance with CBUAE model management standards is required LFIs and may lead to more volatility in model outputs compared to the current practices of LFIs who are yet to fully adopt model management standards.



## Conclusion

To ensure compliance, LFIs need to revisit their operating model and key enablers of credit management across the following aspects:

- **Governance and oversight:** Improve the maturity of control functions and establish mechanisms to ensure smooth board and board committee approval of material credit decisions.
- **Strategy and appetite:** Enhance target market and risk acceptance criteria to address new risk areas and link credit risk appetite to the capital level.
- **Policies and frameworks:** All policies should be reviewed and enhanced to address all minimum requirements. Additional frameworks such as ESG, performance management, country risk, etc. needs to be formally operationalised.
- **Credit process and operations:** LFIs will need to improve the operational capabilities to ensure adequate control and compliance with the standards.
- **Risk modelling:** Overall maturity level of modelling is expected to increase given more reliance placed on models and less use of model overrides.
- **Data and technology:** Data infrastructure and robust internal or integration with external system will be required to support credit operations and risk modelling. More robust systems are required to improve the end-to-end credit lifecycle.
- **Human resources and performance assessment:** Adequate skills, performance and incentives management is crucial to fulfil the requirement of the standards. LFIs need to perform detailed assessment and planning of human resources and institute robust credit risk management framework to reap the benefits that comes with the revised regulation and standards.

### The Credit Risk Standards that complements the regulation cover key technical articles listed below:

- Article 1: Definition
- Article 2: Credit Risk Governance
- Article 3: Credit Risk Management Framework
- Article 4: Credit Risk Oversight Functions & Roles
- Article 5: Credit Underwriting
- Article 6: Definition of Default
- Article 7 Significant Increase in Credit Risk
- Article 8: Restructuring
- Article 9: Classification & Provisioning
- Article 10: Credit Risk Mitigation
- Article 11: Portfolio Management and Internal Reporting
- Article 12: Non-Performing Assets and Write-Off
- Article 13: Credit Risk Models

### How can we support?

PwC Middle East offers comprehensive advisory services to help LFIs assess gaps, implement risk frameworks, and enhance regulatory compliance. Key services include:

1. Design and implementation of credit risk frameworks
2. Gap assessments and quantitative impact analysis
3. Credit risk measurement and modelling
4. Technology implementation and infrastructure enhancement

# Meet the team



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