UAE Credit Risk Standards

Best Practice Implementation

November 2024

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Executive summary

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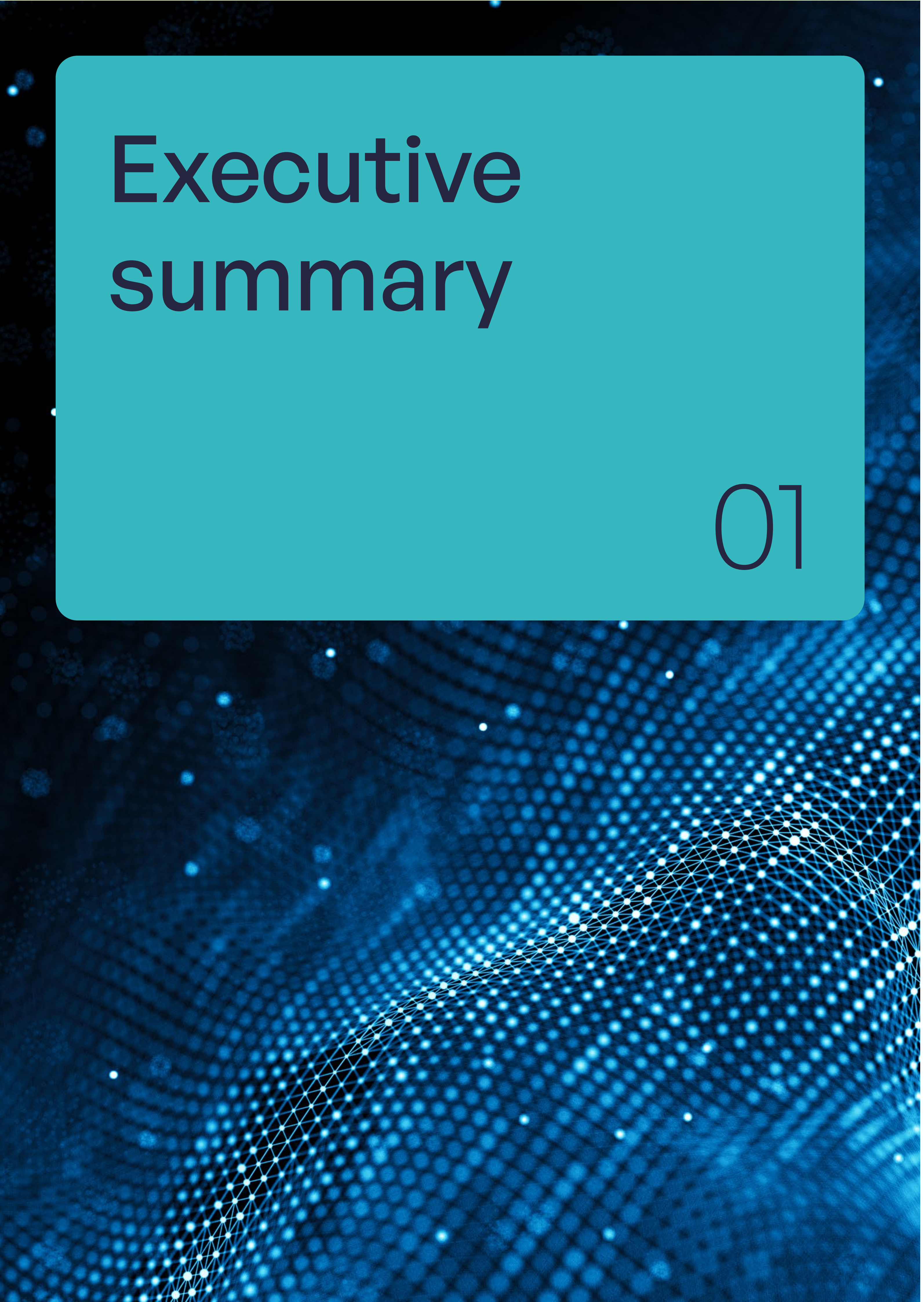

Foreword

The Central Bank of United Arab Emirates (CBUAE) has released the final version of the Credit Risk Standards and some Licensed Financial Institutions (LFI's) have started to mobilise project teams to address this.

4most is in discussion with various LFIs and initial feedback suggests there is a range of views when it comes to understanding the regulation and the required solution needed to comply.

This presentation draws on the wide range of experience and expertise within 4most and demonstrates our ability in successfully implementing similar regulatory requirements across the world.

For any further information, please contact our Director, UAE based, Nicoleta Remmlinger at **nicoleta.remmlinger@4-most.co.uk.**

- **The CBUAE has released thirteen articles of Credit Risk management for LFIs to follow. These principles cover a wide range of topics.**
- **4most has successfully delivered numerous regulatory change projects across multiple LFIs and jurisdictions.**
- **4most can mobilise a team of experienced, capable and highly skilled consultants to develop a compliant solution in the required timescales.**
- **The implementation of the CBUAE's thirteen articles of Credit Risk contains a wide scope of guidance that LFIs will need to consider. These include corporate structures, model risk management, IT capabilities and control assurance frameworks.**

What's included in the Credit Risk regulation?

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The CBUAE's Credit Risk Standards contain thirteen articles which seek to address a wide variety of topics within Risk Management. The articles can be grouped into five key themes. These themes are consistent with various regulators across the world.

Article 1 identifies that these standards form part of the overall Credit Risk Regulation.

Governance Articles

- **Article 1** Definitions
- **Article 2** Credit Risk Governance
- **Article 3** Credit Risk Management Framework

Credit Risk Roles and Usage

- **Article 4** CR Functions and Roles
- **Article 5** Credit Underwriting

Credit Risk Management and Monitoring

- **Article 6** Definition of Default
- **Article 11** Portfolio Management and Internal Reporting
- **Article 12** Non-Performing Assets and Write-Off

Financial Risk Management

- **Article 7** Significant Increase in Credit Risk
- **Article 8** Restructuring
- **Article 9** Classification and Provisioning
- **Article 10** Credit Risk Mitigation

Models

- **Article 13** Credit Risk Models

What is the standard encouraging?

The primary goal of this regulation is to help promote financial stability within the UAE by encouraging LFIs to improve their capabilities in various areas. However, the focus of those implementations needs to be in four key areas (see next page for more details). If an LFI focuses on these outcomes, it will have the ability to prove to stakeholders that it meets the expectations of the Credit Risk Standards.

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Objective	Description
Frameworks	Credit Risk should be integrated with other risks as part of a Risk Management Framework. This framework should clearly specify how risks are identified, measured, mitigated and monitored.
Policies, Standards and Procedures	The management of Credit Risk will need to have clear standards and procedures. This will ensure that there is a definable and auditable way to manage credit risk in agreed procedures.
Monitoring, testing and reporting of controls	The performance of Credit Risk needs to be monitored in a way that it is performing within expected controls. The controls should be linked to other elements of the business i.e. pricing, capital management, provisioning etc.
Training and compliance	Ensuring training of staff is essential to a successful and coordinated implementation of the Credit Risk Standards. An effective, well-staffed team will be able to exhibit a clear line of sight between the LFI's Credit Risk management and compliance with the regulation.
Evidence, justification and assurance	The evidence of the credit risk management (and portfolio performance) will need to be linked back to the original framework to give justification and assurance to the decisions made.

What are some of the outcomes of the regulation?

LFIs should have clear goals to achieve as part of the implementation of the Credit Risk Standards. At a minimum, they should include the following items...

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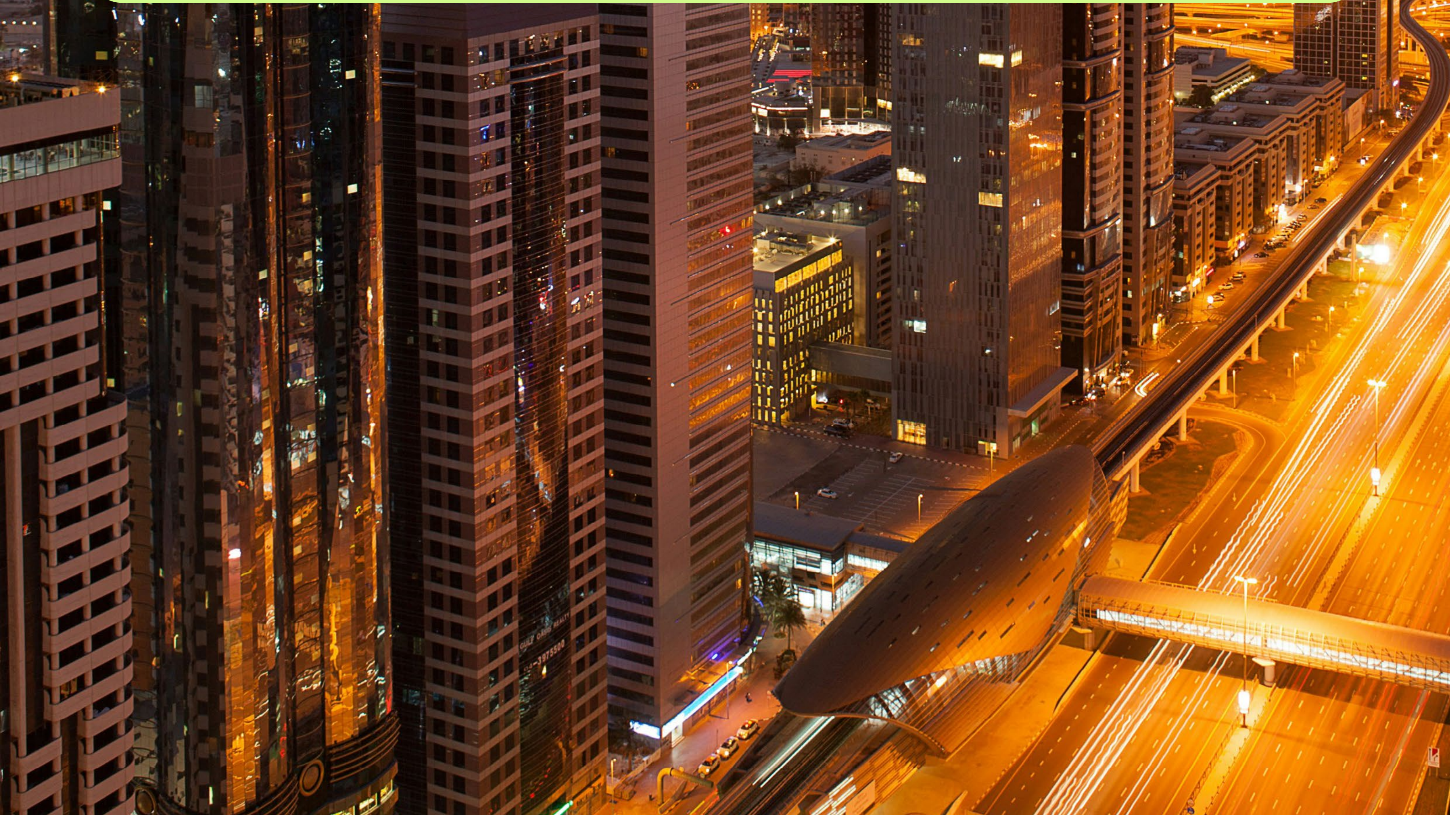

Increased confidence	Improved frameworks and policies will help an LFI have clear ownership and approaches to Risk Management issues. This way, the Board, audit functions and regulators will have confidence in the Executive Committee and Risk Management's ability to manage Risk.
Robust credit granting	Robust credit decisioning will help prevent downstream financial risk issues by preventing credit losses. This should enable the LFI to have more competitively priced products and greater market share.
Improved risk measurement	Improving the quality of Risk models should improve the quality of Risk measurement and decisions. However, their use requires rigorous monitoring to avoid model risk issues adversely impacting management decisions.
Protective controls	Enhanced controls will ensure that LFIs are making correct decisions based on accurate information. Furthermore, it should enable a more efficient management and review process between 1st, 2nd and 3rd lines of defence in the organisation.

What questions are the articles asking of LFIs?

Each of the CBUAE's thirteen articles investigates different aspects of Risk Management. Based on these articles, LFIs will need to have auditable answers to a series of key questions.

Many of the articles overlap on what is trying to be achieved (i.e. good governance practices over robust Risk Management practices that are accurately incorporated into a pricing strategy). Based on the answers to these critical questions, the next steps will become clear.

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Governance Articles

Article 1
Definitions

Article 2
Credit Risk Governance

Key question

Does the LFI Board have the right governance in place to have awareness, responsibility, monitoring and mitigating of all risks?

Article 3
Credit Risk Management Framework

Key question

Does the LFI have a clear framework in place to measure, manage and price for the current and future risks?

Credit Risk Roles and Usage

Article 4
CR Functions and Roles

Key question

What are the roles and functions of the Chief Risk Officer (CRO) and Chief Credit Officer (CCO)? How do they ensure the Credit Risk Frameworks are working effectively?

Article 5
Credit Underwriting

Key question

How is the Credit Committee structured to ensure that the decision-making process is consistent with the LFI's Risk Appetite and strategic objectives?

Credit Risk Management and Monitoring

Article 6
Definition of Default

Key question

Is the Definition of Default (DoD) applied correctly across the business, including Financial Risk, Modelling, Provisioning and Credit Risk Management?

Article 11
Portfolio Management and Internal Reporting

Key question

What are the key risks of the business and what evidence is available to monitor performance against tolerances?

Article 12
Non-Performing Assets and Write-Off

Key question

How are Non-Performing Assets (NPAs) and Write-Offs (W/O's) performing, and is this in line with tolerances and pricing?

Financial Risk Management

Article 7
Significant Increase in Credit Risk

Key question

Has the increase in risk been defined, recognised and accounted for correctly?

Article 8
Restructuring

Key question

Has restructuring of the credit agreement materially changed the financials / risks of the contract?

Article 9
Classification and Provisioning

Key question

Has the expected loss been correctly accounted for throughout the credit risk lifecycle?

Article 10
Credit Risk Mitigation

Key question

Has the Credit Risk Mitigation (CRM) had the right level of controls applied?

Models

Article 13
Credit Risk Models

Key question

Has the risk of an account been accurately measured across all possible economic conditions? Have the model risk issues been considered and the commercial impacts been accounted for?

What capability is needed to achieve compliance?

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To achieve compliance with the Credit Risk Standards, LFIs will need to have various capabilities. The diagram below highlights examples of the functionality banks will need to employ in order to demonstrate their compliance with the Standard to the Regulator. The complexity and size of the LFI will materially impact the dynamics of the capabilities.

Governance Articles	Credit Risk Roles and Usage	Credit Risk Management and Monitoring	Financial Risk Management	Models
1 Risk Management Framework and Credit Risk Framework	1 Credit Risk manuals and underwriting policy	1 Credit Risk monitoring capabilities	1 Accounting policies linking Credit Risk to Financial Risk	1 Model Risk Policy and Relevant Standards
2 Enterprise Risk Management framework and relevant policies / standards	2 Credit Risk Management structures and ownership Matrix	2 Various Policies including Significant Increase in Credit Risk (SICR) as well as linking Expected Credit Losses to Pricing Management	2 Credit Risk Mitigation policies, governance and mandates	2 Analysis, data and IT environment to support advanced analytics (including relevant frameworks and policies for data management, control and quality)
3 Governance structure, mandate levels and a responsible, accountable, consulted, and informed (RACI) Matrix	3 Credit committee and relevant authorities	3 Collateral valuation and disposal processes	3 Advanced provisioning capabilities linked to wider portfolio management	3 Model monitoring and relevant governance

How long will it take to implement changes?

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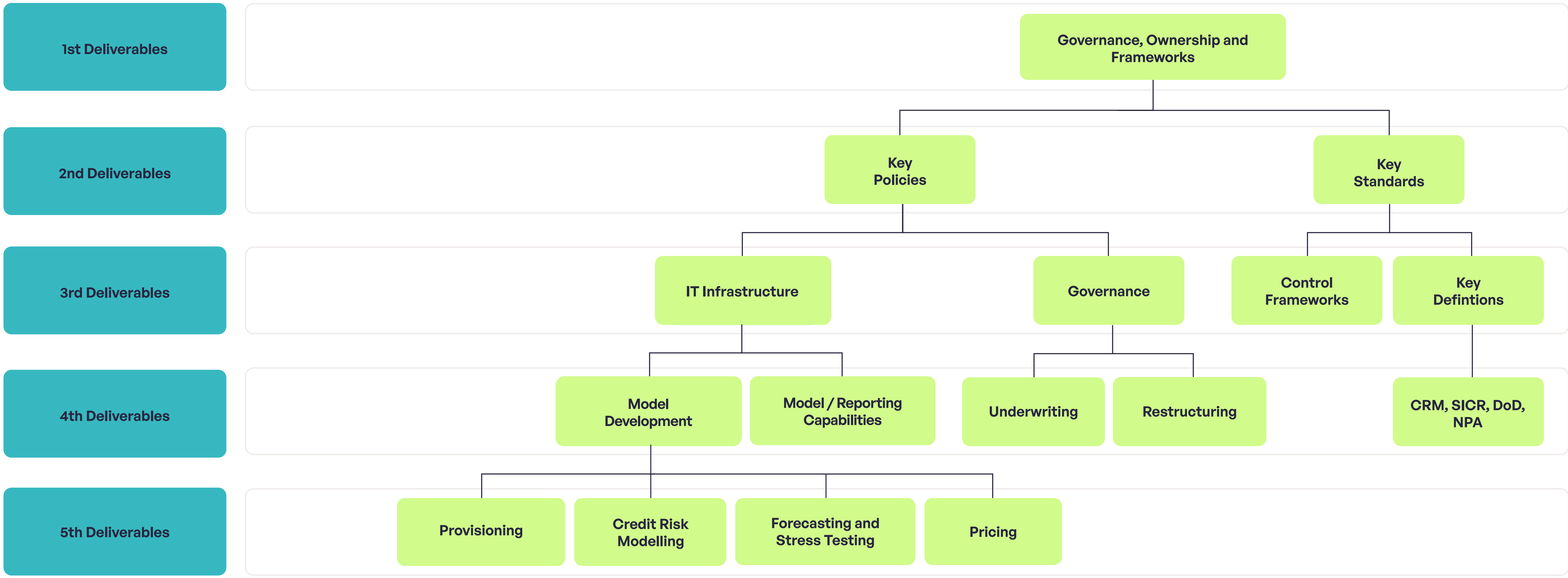
The timescales needed to implement the project will be dictated by various factors. One of the main challenges will be the scope expected for larger LFIs. The standards make it clear that the items identified are a minimum requirement rather than a target for all. LFIs are advised to make the scope and design clear as soon as possible to ensure all key stakeholders are comfortable with what is being delivered.

The table below outlines the typical timescales that LFIs take to implement the changes being suggested by the CBUAE. The time taken is very individual to each Bank, but the main factors that will dictate timescales are the level of IT infrastructure already available, the quality of existing model architecture, and internal governance levels.

Credit Risk Articles	Small Changes Needed	Medium Changes Needed	Large Changes Needed
Governance Articles (Articles 1 and 2)	**1 to 2 Months**	**2 to 3 Months**	**3 to 4 Months**
Credit Risk Roles and Usage (Articles 3 and 4)	**2 to 4 Months**	**3 to 5 Months**	**4 to 6 Months**
Credit Risk Management And Monitoring (Articles 5, 10 and 11)	**2 to 4 Months**	**3 to 5 Months**	**12 to 24 Months** **Note:** This includes material IT / Analytical platform changes
Financial Risk Management (Articles 6, 7, 8 and 9)	**2 to 4 Months**	**3 to 6 Months**	**6 to 12 Months**
Models (Article 12)	**2 to 4 Months**	**3 to 6 Months**	**6 to 12 Months**

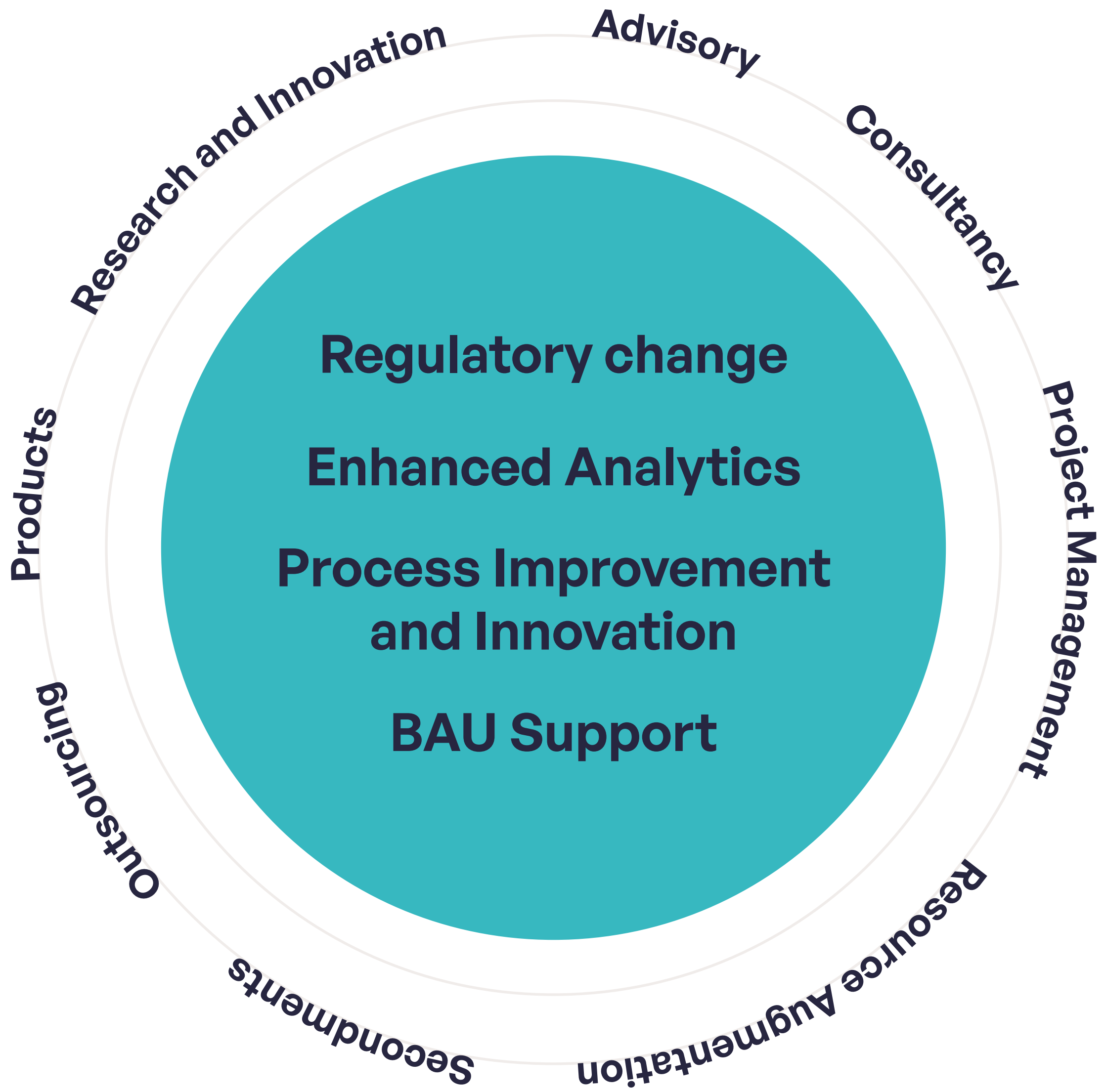
In what sequence should the changes be made?

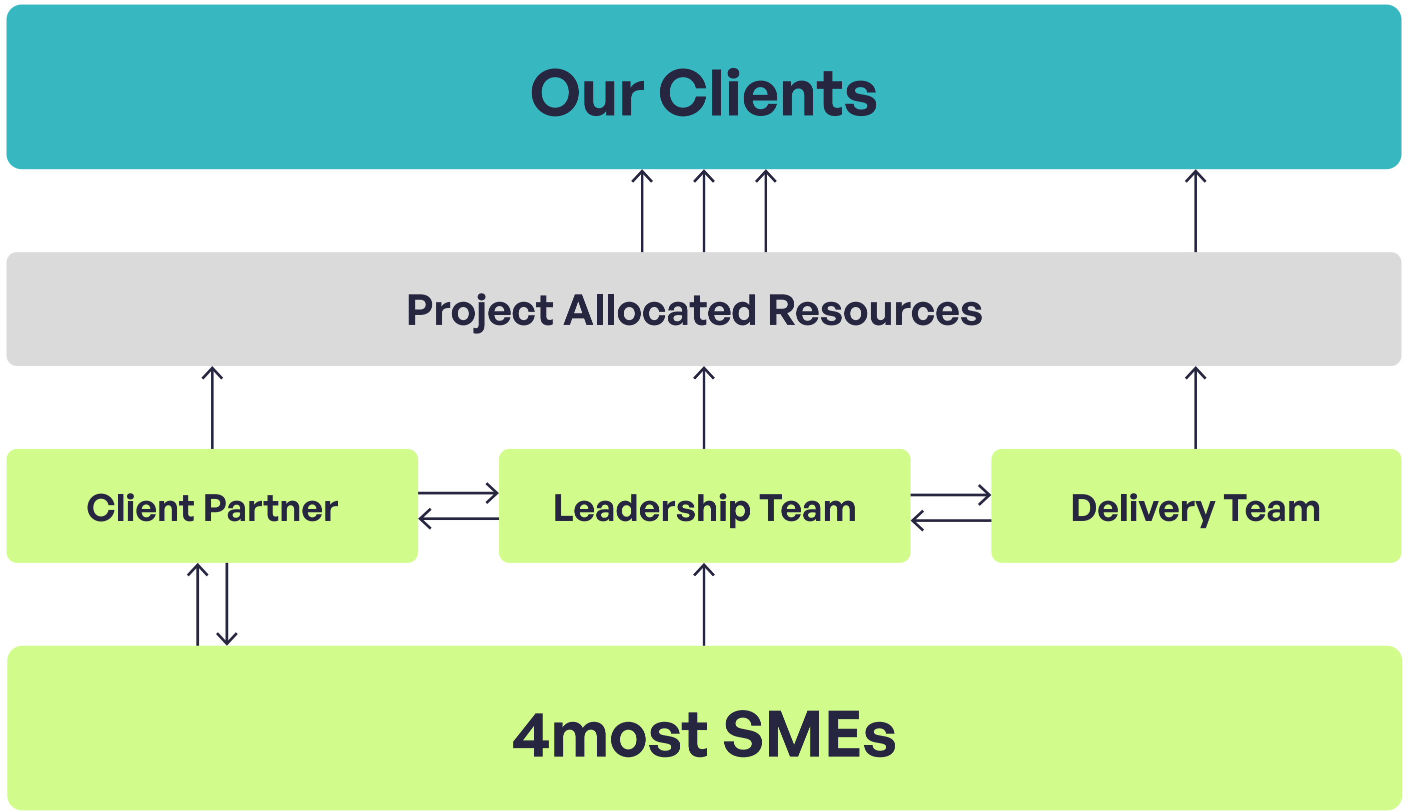
The flowchart below outlines a potential programme sequence of deliverables for the CBUAE Credit Risk Standards. This is key to a successful project. The sequence below focuses on Governance, Policy and Standards issues. These will make sure ownership and governance issues are addressed before technical deliverables are started. This will help ensure all requirements are clear from the start, rather than having constant emerging issues, therefore helping to safeguard a successful project.



4most project delivery

We bring together domain knowledge, through different execution arms, offering more than just consultancy services. Typically, we propose a structure in which a dedicated team is allocated, with the ability to call upon specific expertise and experience from the wider 4most resource pool as and when required — as illustrated below.





How can 4most support?

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1 Gap analysis

We can support LFIs by performing a gap analysis between current practices and the new regulation. This supports LFIs to understand what 'best practice' looks like with a clear report that outlines potential improvements, pathways for achieving the changes, project plans to implement compliance and stakeholder support.

2 Market and regulatory insights

4most has experience with various regulations and how LFIs are or have implemented changes. We can help LFIs implement the necessary changes in line with expectations.

3 Delivery partner

We can support LFIs to implement the necessary changes. That support can range from total outsourcing of the development to working together in order to achieve the right outcome.

4 Education support

4most can support LFIs to understand what is needed to deliver good Credit Risk practice on an ongoing basis. This support is most successful when it starts at Board level.

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