Regulatory Pulse

Navigating the regulatory rollercoaster

December 2019

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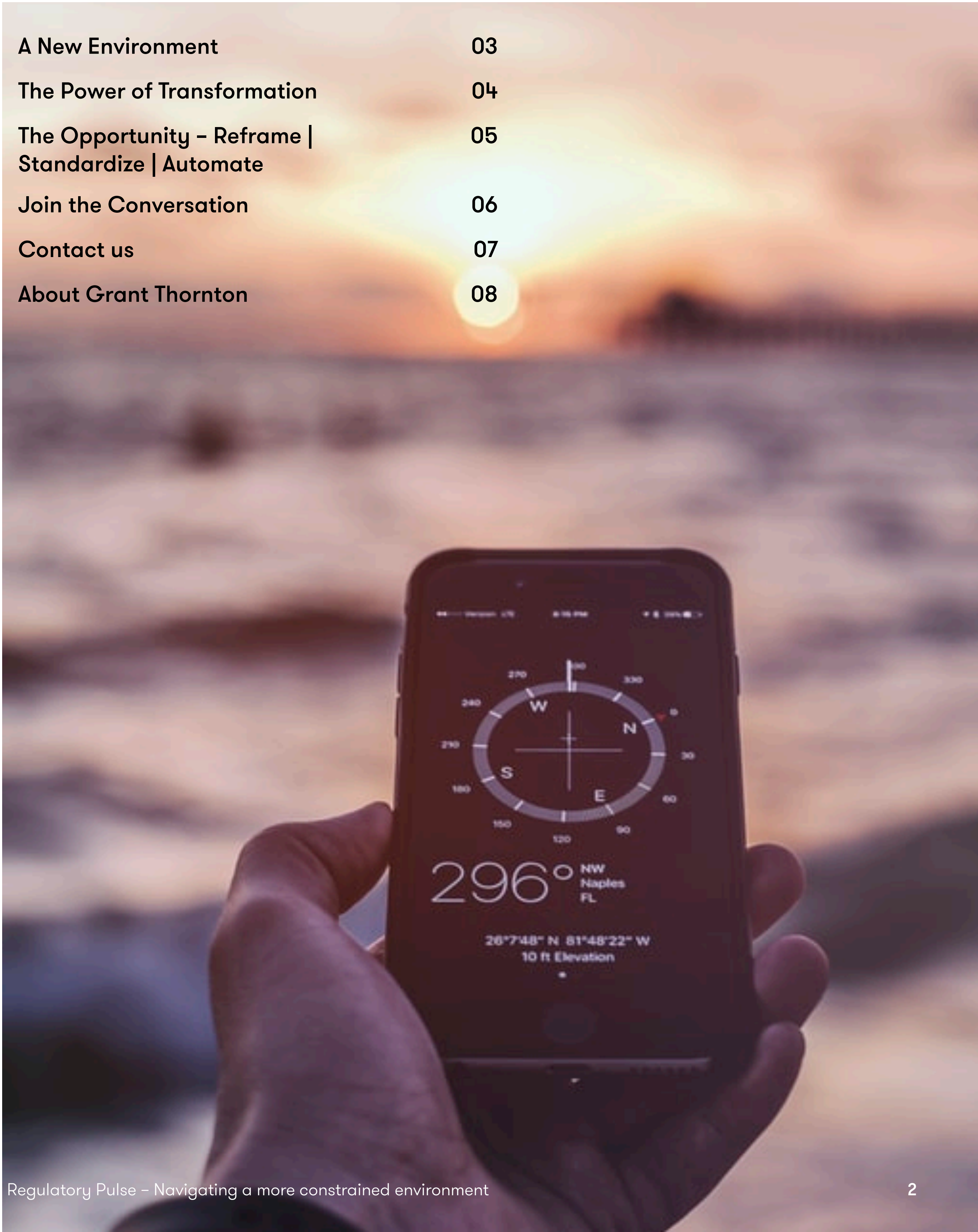
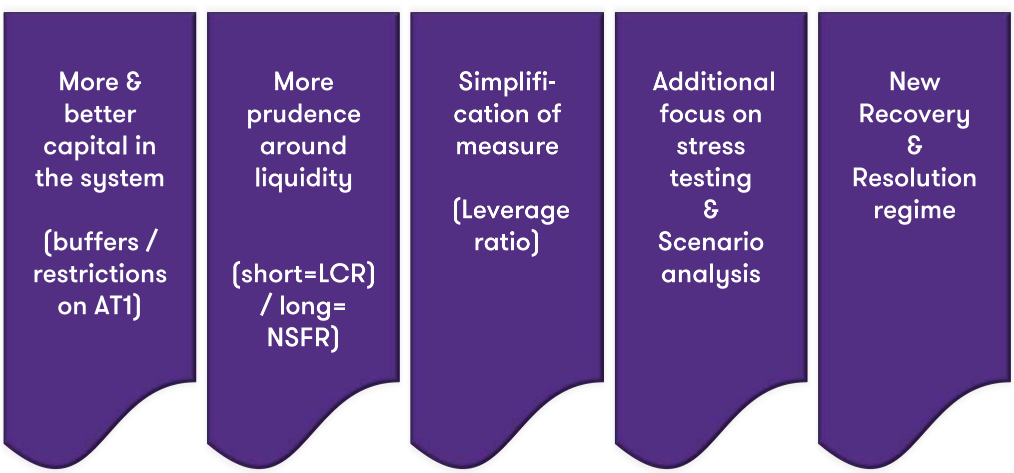


A New Environment

The influx of regulatory initiatives in the UAE is having the dual effect of bringing the jurisdiction into alignment with international regulatory standards, while making many Financial Institutions ("FIs") reconsider their cost of capital / cost of funding, and reposition themselves in relation to risk, governance, compliance and associated costs.

Included in the multiple regulatory changes that have been implemented are the Basel III requirements, where the international framework has been adapted (as is the case in various jurisdictions), based on the UAE regulatory priorities and financial stability considerations.

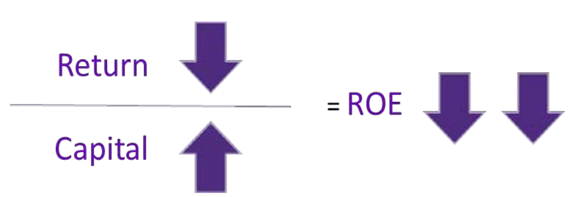
The Basel III framework, came as a reaction to the 2008 Financial Crisis; as such, it introduced many new "constraints" and various layers of additional analytical and reporting requirements. Amongst other things, the framework requires key areas of regulatory adoption, as listed below:



In the UAE, the new regulatory reality needs to be taken into account, in parallel to other constraints related to the region and macro-economic cycle.

These include the opportunity cost related to the additional capital buffers required, the impact of sustained low oil price on the availability of liquidity, the drop in interest rate –and resulting lower yield on assets, the rise of non-performing loans and impairment– particularly within the context of a softer real estate market, and the risks from financial crime activities.

The Basel III implementation, holding everything else constant, has generally meant a higher cost of funding / capital and lower returns;



The Power of Transformation

Adjusting to a new environment requires "out of the box" thinking and agility. FIs need to re-focus their businesses and reconsider strategies to respond to the large amount of regulation, in an economic environment that is fundamentally more restraining.

We see a future where processing and understanding large amounts of data quickly is crucial. Tasks and document submissions that are repetitive in nature can be standardized, at their lowest-level of complexity, and mechanized.

This is achieved via various transformative approaches and automation, and provides exciting new opportunities to synergize risk, finance and compliance functions and increase efficiencies.

The Opportunity – Reframe | Standardize | Automate

Ultimately, FIs need to determine whether their capital is commensurate with their firms' risks, during "Business as Usual" and stress conditions. While this is a vastly complex question, driving practical, focused approaches that answer this question is essential.

In our opinion, there is a unique opportunity to transform, by focusing on key, organization-wide risks and controls, streamlining processes, standardizing and automating, while reducing costs for the long run. This can be achieved via five key areas of transformation for 2020 and beyond.

The "Old" Way	2020 and beyond		Regulatory Muscle Flex
Risk and control approaches have often been decentralized, siloed, duplicative, with limited automation and/or centralized solutions (and various, individual uses of excel spreadsheets).	1 Automated / Standardized	FIs to address risks as a whole, not in a compart-mentalized manner; platforms built to process large amount of data and focus on key material risks – standardize / integrate MIs and dashboard monitoring.	There has been a wide increase of regulation internationally and in the UAE. The order of magnitude is unprecedented in terms of volume and levels of complexity. Timelines to deliver have not been extended.
FIs have tended to focus on current risks – Not enough consideration was given to shocks / emerging risks and their impact on Balance Sheet and earnings.	2 Forward Looking	New approaches allow to build platforms with a view to the future – connecting analytics & one sourced-data to budgets, stress Tests, ICAAPs, RRPs and capital optimization strategies.	Basel III and the CBUAE have increased focus on stress testing, with a UAE-wide stress test run yearly. New Recovery resolution regime coming to the UAE.
The collective mindset remains focused on regulatory compliance, hence incurring increased cost of compliance.	3 Strategic	Focus on capturing key benefits of effective risk infrastructure by aligning regulatory requirement with strategic, risk / reward decisioning, optimization etc. There is more volume & greater complexity of reporting.	More prudence around risk taking is required, with increased governance and control requirements to produce and report on various metrics and frameworks.
Capital evaluation has largely been based on regulatory capital. Business performance may not have been evaluated based on capital / balance sheet consumption—no cost of capital charged.	4 $$$ Cost of Capital	Capital adequacy grounded in forward looking resilience to shocks. Capital consumption and funding costs to be considered in determination of strategic business direction & evaluation of performance.	Basel III and the CBUAE require capital management in relation to shocks and stresses. Capital must be managed with buffers, taking account of cyclicality, as per guidelines.
In instances FIs embarked on complex or impractical approaches with compliance focus and limited consideration for proportionality.	5 Practical / Balanced	A strong focus is necessary, as it relates to prioritization and driving practical and long lasting change in key emerging / forward looking risks and control weaknesses.	Proportionality in regulation is not new. The core principles for banking supervision call for a risk-based (proportional) supervisory approach, that takes into account banks' risk profile, resilience and systemic importance.

Join the conversation

At Grant Thornton we will continue to support our clients and discuss best ways forward, given the economic cycle and regulatory requirements. If you are interested in learning more on the topic, join us.

Watch for our up-coming Regulatory Pulse Coffee Chat

Contact us

We help our clients drive change to improve on their risk and regulatory management capability. To explore how we can assist, please contact one of our member specialists.

Samer Hijazi
Partner, Head of Financial Institutions

samer.hijazi@ae.gt.com

George Stoyanov
Partner, Transformation Advisory

george.stoyanov@ae.gt.com

Fadwa Sahly
Director, Risk / Regulatory Transformation

fadwa.sahly@ae.gt.com

Avik Chandra
Assistant Director, Technology Transformation

avik.chandra@ae.gt.com

About Grant Thornton

In 1966, Grant Thornton UAE was founded by Farouk Mohamed who is now the Chairman of Grant Thornton UAE. The UAE firm offers 3 locations in the UAE: Dubai, Abu Dhabi and Sharjah, and Azerbaijan – Baku; we are now over 300 people strong, providing Audit, Advisory and Taxation services to our clients.

At Grant Thornton UAE, we believe that a deep engagement at a business and social level is needed in order to ensure that we play an active role in developing individuals technical and professional skills as well as supporting the wider economy. Making a difference is at the heart of what we do.

Our mission is to make a difference to our clients, our colleagues, our profession and our communities.

We have actively encouraged and organized a number of social programmes which continue to support the community and the economy at the micro-level and the economy at a macro-level.

We support **Reach** who is a not-for-profit Mentoring Program dedicated to helping young professional women in developing their career through structured mentoring and professional support.

We're a network of independent assurance, tax and advisory firms, made up of 53,000+ people in 135 countries.

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We work with our clients to help them solve their most complex challenges, so they can focus on what matters.

Hisham Farouk
CEO Grant Thornton UAE