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Prudential Risks – Agenda

Opening Remarks
Arvind Baghel, Director, Supervision

Banking Supervision Update
Arvind Baghel, Director, Supervision

- Overview of the updated capital requirements
  Edel Brewer, Senior Manager, Supervision

- Overview of the updated liquidity requirements
  Shafiq Ghawi, Senior Manager, Supervision

Insurance Supervision Update
Andrew Bojkowski, Senior Manager, Supervision

- VAT Update
  Deloitte Indirect Tax Team
Opening Remarks

Arvind Baghel
Director, Supervision
The DFSA’s Role and Approach

**DFSA Objectives – DIFC Law #1 -8 (3)**
- Fairness/ Transparency/ Efficiency
- Confidence in financial Services
- Financial stability and reduction of systemic risk
- Reputation of DIFC
- Protect direct and indirect users
- Promote public understanding

**DFSA Guiding Principles - DIFC Law #1 -8 (4):**
- International best practices
- Cooperation with other regulators
- Minimising adverse effect of competition
- Efficiency
- Regulation proportionate to benefits
- Transparency
- Principles of good governance

**What it means for Authorised Firms – Principles – Gen 4.2**

1. Integrity
2. Due skills, care and diligence
3. **Management systems and controls**
4. Resources
5. Market Conduct
6. Information and interests
7. Conflicts of interest
8. Suitability
9. **Customer Assets and Money**
10. Relationship with Regulators (and compliance)
11. **High standard of Corporate Governance**
12. Remuneration Practices
Enterprise Wide Risk Management

Risk Management – a structured approach to managing uncertainty

- Proactive and iterative approach
- Risk Identification
- Risk Assessment
- Risk Management and Mitigation – transferring, avoiding, reducing or accepting
- Risk Governance
Corporate Governance
Key DFSA Expectations

Corporate Governance and Management Oversight

- Board and Senior Management
- Third Line of defence - Internal Audit
- Second Line of Defence - Risk Management Functions
- First Line of Defence - Operational Controls

External Audit – Independent Opinion
Supervisory Framework

Overview of Firm and Impact Assessment

Continuous Monitoring

Preliminary/Revised Risk Assessment

Documentation RIS/EPRS/Risk Matrix

RMP Intervention

Risk-focused onsite examination

Risk assessment and Report

Supervisory Plan
Supervisory Approach

- Risk based
  - Continuous supervision
  - Improved analytics
  - Thematic reviews
  - Online filing through portal
- Transparency
- Co-operation
- Accountability
- Enforcement
Banking Supervision Update

- DIFC Prudential Indicators
- Key Prudential Risks
- Latest Prudential Rules Change
- Upcoming Rules Change
- Risk Assessments Highlights
- Regulatory Reporting – EPRS
Distribution of Assets >98% in banks

Assets by Legal Status

- Branches
- Domestic Firms

US$ Millions

<table>
<thead>
<tr>
<th></th>
<th>Assets</th>
<th>Deposits</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>US$ Millions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

12
Assets & Liabilities Mix in DIFC

**Assets Mix**
- 2015:
  - Cash: 16%
  - Loans & Advances: 75%
- 2016:
  - Cash: 15%
  - Loans & Advances: 69%
- 2017:
  - Cash: 14%
  - Loans & Advances: 72%
- Q1 2018:
  - Cash: 15%
  - Loans & Advances: 70%

**Liabilities Mix**
- 2015:
  - Deposits: 7%
  - Debt Securities: 19%
  - Other Borrowed Funds: 75%
- 2016:
  - Deposits: 8%
  - Debt Securities: 16%
  - Other Borrowed Funds: 64%
- 2017:
  - Deposits: 7%
  - Debt Securities: 14%
  - Other Borrowed Funds: 63%
- Q1 2018:
  - Deposits: 7%
  - Debt Securities: 14%
  - Other Borrowed Funds: 63%
Source of Deposits

- **Third Parties**
- **Related Parties**

<table>
<thead>
<tr>
<th>Year</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>Q1 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent</td>
<td>14%</td>
<td>27%</td>
<td>44%</td>
<td>47%</td>
<td>57%</td>
</tr>
<tr>
<td>USD Millions</td>
<td>86%</td>
<td>73%</td>
<td>56%</td>
<td>53%</td>
<td>43%</td>
</tr>
</tbody>
</table>
Prudential Risks – Key Focus Area

- **Credit Risk**
  - Asset Quality
  - NPL & Provisioning
  - Asset Concentration

- **Operational Risk**
  - Cyber Security
  - Technology Risk

- **Capital and Earnings**
  - Quality and composition of capital
  - ICAAP (including stress testing)
  - Profitability drivers

- **Liquidity Risk**
  - System and Controls: *Funding Strategy; Monitoring; Stress Testing; Contingency Planning*
  - Funding maturities and concentrations
Revision of the PIB Module 2017

• Capital Adequacy – PIB Chapter 3
  - Alignment with Basel III
  - Enhancements to the existing regime
  - Countercyclical Capital Buffer (CCyB)
  - High Loss Absorbency (HLA) buffer
    \((D-SIB/G-SIB\text{ Requirements})\)

• Liquidity Risk – PIB Chapter 9
  - Enhancements to the qualitative requirements
  - Revision on the Maturity Mismatch Ratio (MMR)
  - Net Stable Funding Ratio (NSFR)
Revision of the PIB Module

*Business Plan 2018/2019*

- Credit Risk
  - Counterparty Credit Risk
  - Large Exposures

- Interest Rate Risk in the Banking Book
Upcoming Rules Change

Revision of the PIB Module

Business Plan 2019/2020

• Market Risk
  - Review of Trading Book
  - Capital Requirements

• Leverage Ratio

The DFSA Rulebook
Prudential – Investment, Insurance Intermediation and Banking Module (PIB)
Risk Assessment Highlights

- Governance Arrangements
- Appropriateness of Policies and Procedures
- Quality of Human Resources
  - Authorised Individuals
  - Risk Management
  - Compliance
- Risk Management Function
- Loan Classification and Provisioning
- Funds from the UAE
Upcoming update to EPRS and PRU

- Enhancements to PIB Returns
  - New Prudential Requirements e.g. CCyB, NSFR, etc.
  - Alignment with new international accounting standards IFRS 9
  - Alignment with development in activities conducted in & from the DIFC
  - Consider feedback received from firms and auditors

- New detailed instructional guidelines
Upcoming update to EPRS and PRU

- Soft consultation conducted in Q1/Q2 2018
- Formal consultation expected in Q3/Q4 2018
- Implementation expected starting Q1 2019 reporting period
Overview of the updated capital requirements

Edel Brewer
Senior Manager,
Supervision
Introduction

• In June 2017, the DFSA consulted on amendments to the PIB module in respect of capital requirements.

• The amendments were designed to further align the DFSA’s rules with certain aspects of the capital standards developed by the Basel Committee on Banking Supervision.

• On 1 January 2018 the amendments legally came into force.

• The amendments capture:
  – The calculation and expression of Capital adequacy
  – The calculation of Capital Requirement
  – Capital buffers
Capital Adequacy

• Previously the PIB module set and monitored capital adequacy based on absolute figure terms, referred to as a Risk Capital Requirement.

• Basel III framework expresses regulatory capital as a percentage of Risk Weighted Assets (RWA). The amendments seek to align the DFSA’s rules in this manner and also improve comparability.

• Overview of changes:

<table>
<thead>
<tr>
<th>Capital Available</th>
<th>Previous rules pre 1 January 2018</th>
<th>Amended rules from 1 January 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Capital Requirement:</td>
<td></td>
<td>RWAs:</td>
</tr>
<tr>
<td>• CET1 equates to at least 60%</td>
<td></td>
<td>• CET1 equates to at least 6%</td>
</tr>
<tr>
<td>• Tier 1 equates to at least 80%</td>
<td></td>
<td>• Tier 1 equates to at least 8%</td>
</tr>
<tr>
<td>• Tier 2 equates to a maximum 20%</td>
<td></td>
<td>• Tier 2 equates to a maximum 2%</td>
</tr>
</tbody>
</table>
Capital Requirements

• To align with the Basel III framework and to facilitate the changes to the calculation of capital adequacy, capital requirements will be expressed as RWAs going forward.

• Overview of changes:

<table>
<thead>
<tr>
<th>Risk Capital Requirement</th>
<th>Previous rules pre 1 January 2018</th>
<th>Amended rules from 1 January 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Capital Requirement</td>
<td>Sum of Risk Capital Requirement for:</td>
<td>Risk Capital Requirement = 10% of RWAs.</td>
</tr>
<tr>
<td></td>
<td>• Credit Risk</td>
<td>RWAs are calculated by multiplying the Risk Capital Requirement by 12.5 for:</td>
</tr>
<tr>
<td></td>
<td>• Market Risk</td>
<td>• Credit Risk</td>
</tr>
<tr>
<td></td>
<td>• Operational Risk</td>
<td>• Market Risk</td>
</tr>
<tr>
<td></td>
<td>• Displaced Commercial Risk</td>
<td>• Operational Risk</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Displaced Commercial Risk.</td>
</tr>
<tr>
<td>Credit Risk Capital Requirement</td>
<td>Calculated as 10% of Credit Risk RWA</td>
<td>Calculated as 8% of Credit Risk RWA</td>
</tr>
</tbody>
</table>
Capital Buffers

• From 1 January 2018, a firm’s minimum Capital Requirement will include applicable Capital Buffers.

• Capital Buffers include any one or more of the following:
  – Capital Conservation Buffer (‘CCB’)
  – Countercyclical Capital Buffer (‘CCyB’): or
  – A Higher Loss Absorbency Capital Buffer (‘HLA’)

• The CCB previously applied to CAT 1, 2, 3A and 5 firms. From 1 January 2018, it does not apply to CAT 3A firms.

• The CCyB applies to CAT 1, 2, and 5 firms.
  – Macro prudential policy goal but introduced by the DFSA for the purposes of cross border cooperation and reciprocity.
  – Applies to credit exposures in the jurisdiction which imposes the CCyB
  – Requirement set upon application: up to 2.5% of RWA held in CET1. Rate based on weighted average of CCyB that apply in jurisdictions in which the firm has non-financial private sector credit exposures.
Capital Buffers

- The **HLA** applies to CAT 1 and 5 firms.
  - Targeted at Globally Systemic Important Banks (‘G-SIBs’) and Domestically Systemically Important Banks (‘D-SIBs’).

**HLA for G-SIBs:**

<table>
<thead>
<tr>
<th>Scope of Application</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Automatic:</strong> G-SIBs headquartered in the DIFC for which the DFSA is a consolidated</td>
<td>• Set at application</td>
</tr>
<tr>
<td>prudential supervisor.</td>
<td>• Likely to be based on that specified by the Financial Stability Board for the G-</td>
</tr>
<tr>
<td><strong>Discretionary:</strong> Domestic CAT 1 or 5 firms of G-SIBs located in the DIFC.</td>
<td>SIB i.e. 1% - 3.5% of RWAs.</td>
</tr>
<tr>
<td></td>
<td>• Held in CET1</td>
</tr>
</tbody>
</table>

**HLA for D-SIBs:**

<table>
<thead>
<tr>
<th>Scope of Application</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Discretionary:</strong> Domestic CAT 1, 2 or 5 firms of G-SIBs located in the DIFC.</td>
<td>• Set at application</td>
</tr>
<tr>
<td>Assessment of the risks poses to the local or regional banking and financial system if the firm were to fail.</td>
<td>• Range of 1% - 3.5% of RWAs in respect of jurisdictions for which it is considered to be systemically important</td>
</tr>
<tr>
<td></td>
<td>• Held in CET1</td>
</tr>
</tbody>
</table>
Overview of the updated liquidity requirements

Shafiq Ghawi
Senior Manager, Supervision
A Brief Overview of.....

• Changes to Liquidity Systems and Controls
• Introducing the Net Stable Funding Ratio
• Revised Liquidity Reporting in EPRS (B80)
• Simplification of the Maturity Mismatch Ratio
• LCR Implementation
The DFSA Liquidity Regime Has Evolved Inline With International Standards

A history of 40 years...

1975: BCBS Mandate: «to help ensure bank solvency and liquidity»

1992
«A framework for measuring and managing liquidity»

2000
«Sound practices for managing liquidity in banking organisations»

2004/2006: (Basel II, Pillar 2)
“Int’l convergence of capital measurement and capital standards: a revised framework”

2008
“Principles for sound liquidity risk management and Supervision”

2010: (Basel III)
“Int’l framework for liquidity risk measurement, standards and monitoring”

2013: (Basel III)
“The liquidity coverage ratio and liquidity risk monitoring tools”

2013:
“Monitoring tools for intraday liquidity management”

2014: (Basel III)
“The net stable funding ratio”

Before the financial crises:
• Liquidity requirements were no a focus topic of the BCBS (as well as for most of the supervisory authorities and central banks)
• Qualitative requirements for liquidity risk management
• Capital add-ons if liquidity is not managed adequately

But: No stand-alone liquidity requirements

As a consequence of the crises:
• (Minimum) liquidity standards similar to minimum capital requirements (Liquidity Coverage Ratio, LCR and Net Stable Funding Ratio, NSFR)
• Complementary Data Collection:
  • Liquidity Monitoring Tools:
    • Contractual maturity mismatch
    • Concentration of funding
    • Available unencumbered assets
    • LCR by significant currency
    • Market-related monitoring tools
  • Intraday liquidity monitoring
  • Disclosure framework for quantitative & qualitative information

4 | Basel, Seminar on management and supervision of liquidity risk
24/1/2017
Liquidity Systems and Controls

- Updated in 2017, to enhance the DFSA liquidity regime inline with BCBS “Sound principles for liquidity management and supervision”. The changes were explained in CP 114.

- Key changes are requirements & guidance in relation to :-
  - Manage collateral and encumbered assets
  - Manage intra-day liquidity flows
  - Allocate liquidity costs, benefits and risks to products and business lines.

- Implemented on a proportionate basis
Net Stable Funding Ratio

Aim
To promote more medium and long term funding of on and off B/S assets by establishing a minimum amount of stable funding. (i.e. Prudent structural funding of the B/S).

How?
• Assign Required Stable Funding (RSF) for on and off B/S assets based on their liquidity characteristics, and
• Assign Available Stable Funding (ASF) based on the stickiness of the liabilities (tenor and source).
• NSFR assumes a prolonged (1 year) stress, milder than LCR
RSF

- **Support resilient credit creation** – Some stable funding for lending to real economy to ensure continuity (e.g. mortgages & corporates loans).
- Banks will **roll over** significant portion of maturing loans to **preserve relationships**.
- **Assets tenor** – Shorter tenor require **less stable** funding as banks will allow some portion to mature.
- **Assets quality** and liquidity value – e.g. HQLA can be readily sold, therefore require less stable funding.
- **Off-B/S commitments** – stable funding required for a portion of potential calls on liquidity

ASF

- **Less sophisticated more stable** (e.g. Retail Vs W/S)
- **Longer tenor more stable** (>1year)
Liquidity Mismatch Report (B80)

B80 : Completely overhauled to:

• Captures cash inflows and outflows inline with LCR level granularity and across a more detailed timeline.

• Capture Securities flows in a separate section

• More guidance (line by line) in PRU

• Changes to Part 2 of B80 (MMR calculation) to reflect the revised haircuts.
Maturity Mismatch Ratio (MMR)

<table>
<thead>
<tr>
<th>Liquid Assets</th>
<th>New Haircut</th>
<th>%</th>
<th>Old haircut</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 1 (T-Bills, 0%RW Sovereigns)</td>
<td>0%</td>
<td>0%</td>
<td>0% to 10%</td>
<td></td>
</tr>
<tr>
<td>Level 2A (Corp Bonds AA, 20% RW Sovereigns)</td>
<td>15%</td>
<td>5% to 15%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level 2B (Corp Bonds BBB-, ABS, Shares)</td>
<td>25% to 50%</td>
<td>5% to 20%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other tradable assets (Investment Grade)</td>
<td>60%</td>
<td>20% to 60%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- Align haircuts of liquid assets to the LCR (for the same asset).
- Reduce complexity by removing the security maturity for haircuts.
- Non HQLA LCR eligible assets allowed at a 60% haircut.
- The net impact (+/-) is negligible given that firms are predominantly holding Level 1 LCR liquid assets.
LCR – Implementation

Ensure appropriate implementation of the LCR including:

- Characteristics of assets included in the HQLA buffer
- Location and control of HQLA
- Classification of Operational/Non operational deposits
- LCR reporting and monitoring

A supervisory thematic review is planned for 2019 to assess the implementation of LCR, including the above mentioned areas.
Insurance Supervision Update

Andrew Bojkowski
Senior Manager, Supervision
Agenda

- Insurance Stats
- Common risk-assessment findings
- Deloitte VAT presentation
Insurance Firms in DIFC: 85

<table>
<thead>
<tr>
<th>Pru Cat</th>
<th>PIN</th>
<th>PIB – Cat 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licence</td>
<td>Effecting and carrying out contracts of insurance</td>
<td>Insurance management</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>DIFC Insurer / Subsidiary</th>
<th>Foreign Insurer Branch</th>
<th>Foreign Insurer Acting as Agent</th>
<th>Cover-holder/MGA</th>
<th>Third Party Agent</th>
<th>Broker</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 2016</td>
<td>8</td>
<td>11</td>
<td>25</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Current</td>
<td>7</td>
<td>14</td>
<td>26</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Change</td>
<td>▼ 1</td>
<td>▲ 3</td>
<td>▲ 1</td>
<td>▲ 2</td>
<td>▼ ▼</td>
</tr>
<tr>
<td></td>
<td>21</td>
<td>40</td>
<td></td>
<td></td>
<td>24</td>
</tr>
</tbody>
</table>
## Insurance Sector in the DIFC

<table>
<thead>
<tr>
<th>Metric</th>
<th>2016</th>
<th>2017</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of staff employed</td>
<td>1,089</td>
<td>1,043</td>
<td>▼ 4%</td>
</tr>
<tr>
<td>Total GWP underwritten from DIFC</td>
<td>$1.41bn</td>
<td>$1.67bn</td>
<td>▲ 18%</td>
</tr>
<tr>
<td>Total GWP by Insurers</td>
<td>$520m</td>
<td>$542m</td>
<td>▲ 4%</td>
</tr>
<tr>
<td>Total GWP by Underwriting Agents</td>
<td>$885m</td>
<td>$1.13bn</td>
<td>▲ 28%</td>
</tr>
<tr>
<td>Total premium brokered in the DIFC</td>
<td>$440m</td>
<td>$450m</td>
<td>▲ 2%</td>
</tr>
</tbody>
</table>
Common Risk-Assessment Findings

- Lack of formalised Service Level Agreements with group entities and monitoring of standards
- Lack of updated business plan
- Lack of clarity around corporate governance arrangements.
- Lacking detail in BCP/DRP and not testing
- Risk management framework and risk register not customised for the Firm
- Compliance of waiver conditions / expiry
- Maintenance of robust and complete brokerage and claim files
Thank You