مصرف الإمارات العربية المتحدة المركزي
CENTRAL BANK OF THE U.A.E.

United Arab Emirates

FINANCIAL STABILITY REPORT 2017

PREFACE

A key objective of the Central Bank is to ensure a stable and resilient financial system, which will in turn continue to support the growth, diversification and further development of the UAE economy. The Financial Stability Report provides information to financial system participants and the public on the strengths and vulnerabilities of the UAE financial system and the regulatory and policy measures introduced by the Central Bank. The Financial Stability Report also includes an assessment of key macro-financial and banking-sector developments that may affect financial stability in the United Arab Emirates.

The UAE banking sector remains resilient, with robust capital ratios, liquidity buffers, profitability, and stable sources of funding. Nonetheless, the Central Bank remains vigilant to mitigate potential challenges and risks. To address idiosyncratic and systemic risks, the Central Bank is moving towards a risk-based supervisory framework, enhancing its banking and financial system surveillance, and implementing more comprehensive stress-testing and macro-prudential frameworks.

The Central Bank continues to be committed to further enhance banking regulation in line with international standards and best practices. Among the key regulatory developments, the Central Bank has issued the UAE Basel III capital standard (which enhances the levels and robustness of bank capital requirements) and the IFRS 9 guidance note (which aims for the consistent and prudent implementation of IFRS 9 in the UAE). Furthermore, the Central Bank designated four Domestic Systemically Important Banks, which are required to hold additional capital buffers.

The improved economic outlook as well as more favourable financial market conditions remain supportive of financial stability in the UAE. Nonetheless, financial system participants must continue to adequately manage financial risks and remain mindful of potential global and regional macro-financial uncertainties.

I would also like to express my gratitude to the Insurance Authority and the Securities and Commodities Authority for the assessment of the key developments in their respective sectors which form separate chapters of this Financial Stability Report.

Mubarak Rashed Al Mansoori

Governor

> The UAE banking sector remains resilient, with robust capital ratios, liquidity buffers, profitability, and stable sources of funding. Nonetheless, the Central Bank remains vigilant to mitigate potential challenges and risks.

TABLE OF CONTENTS

Rate this Report

EXECUTIVE SUMMARY

Macroeconomic and financial-market conditions remained supportive of financial stability in the UAE. The global and domestic economic growth and outlook improved during the year. The non-oil GDP growth increased in the UAE in 2017 with improved growth projected by the Central Bank for 2018.

In financial markets, the money market spreads, dirham-dollar forward points and credit market spreads narrowed. These developments reflected ample liquidity and confidence in the UAE financial system, notwithstanding the increases in the Central Bank's policy rate in line with the monetary policy tightening in the United States.

Improved economic conditions did not translate into a credit expansion in the domestic retail and corporate sectors. The financial cycle and real estate prices remained in contractionary phase. Credit growth slowed down, in particular due to weaker bank lending, also reflected in a lesser use of non-core funding.

The UAE banking sector remained well capitalised, with solid liquidity buffers, stable funding, and improved profitability. The liquid assets of the banking sector increased and stable funding indicators improved. Nonetheless, bank lending growth slowed down during the year, although lending exposures to the real estate sector increased.

The general and specific loan loss provisions remained adequate at above 100%, despite the slight deterioration in asset quality during the year reflected in an uptick in the non-performing loans ratio. Banking sector external exposures remained stable, increasing only slightly, and banks' use of foreign funding moderated.

The Central Bank conducted a regulatory stress test in 2017 to assess the resilience of the UAE banks to adverse macro-financial shocks covering a time horizon of three years. It showed that the banking system has sufficient capacity to withstand a severe yet plausible deterioration in macroeconomic and financial market conditions.

The UAE payment systems, operated and supervised by the Central Bank, remained resilient during the year and continued to operate without major disruptions. Furthermore, financial and investment companies licensed by the Central Bank retained a stable risk profile, while their total assets remain small relative to the size of the banking system.

The Central Bank is fully committed to the timely adoption of international standards. The Central Bank's Guidance Note on IFRS 9 aims at its prudent implementation in the UAE, while the UAE Basel III capital framework was published in 2017. Furthermore, four UAE banks were designated as domestic systemically important with higher capital buffer requirements.

MACRO-FINANCIAL CONDITIONS

The macroeconomic and financial market conditions were supportive of financial stability in the UAE.

1

MACRO-FINANCIAL DEVELOPMENTS

Macroeconomic and financial-market conditions remained supportive for the financial stability in the UAE. The global and domestic economic growth and outlook improved during the year. In financial markets, the money market spreads, dollar-dirham forward points and credit market spreads narrowed. Nonetheless, improved macro-financial conditions did not yet translate into an improvement in credit growth, which decelerated during the year, in particular due to a slowdown in bank lending. Although the improved macro-financial outlook is supportive of financial stability, the financial system participants need to remain mindful of potential global and regional macro-financial risks.

GLOBAL ECONOMY

The global economic recovery continued to build momentum in 2017, with growth estimates revised upward worldwide. In the United States (US), the recovery reflected a pickup in investment and consumer confidence, on the back of planned large tax cuts and higher public spending, while in Japan and in the euro area, the recovery was owed mostly to continued accommodative monetary policy.

The recovery in commodity prices, supported by OPEC production cuts and improved global growth, boosted the growth prospects in resource-rich emerging economies. This, in turn, benefited other economies through higher exports, remittances from migrant workers, and capital inflows. The two largest emerging economies, China and India, succeeded in safeguarding robust rates of growth.

Meanwhile, steps towards monetary policy normalization took place in the US resulting in lifting up policy interest rates to the range of 1.25 – 1.5% during 2017. This resulted in increasing divergence in monetary policies among the developed economies, with the European Central Bank and the Bank of Japan maintaining the policies of negative interest rates and quantitative easing.

DOMESTIC ECONOMY

Improving oil prices, a supporting fiscal stance, sufficient bank liquidity and a well-diversified and export-oriented economy, led to a moderate recovery in non-oil GDP growth in the UAE. It is projected that growth will further accelerate in the following years, supported by the pickup in the global economy, including relatively higher growth in the main non-oil export markets for the UAE.

UAE non-hydrocarbon exports increased by 3% in 2017 in tandem with an increase in hydrocarbon exports by 25%, which resulted in a trade balance surplus of 21.4% of the GDP and a current account surplus of 7.3% of the GDP.

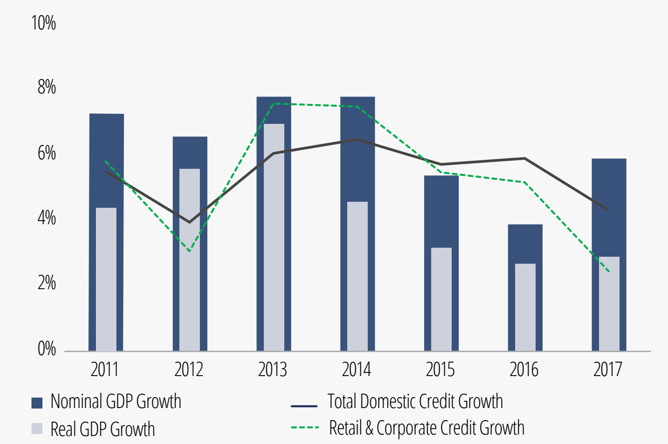
The positive external position and the growth recovery in the UAE were achieved in an environment of moderate inflation, reaching an average of 1.8% in 2017, the same rate as in 2016. This was the result of 3% inflation for tradables, partially due to the depreciation of the Dirham against the Indian Rupee, the Euro, and the South Korean Won. Meanwhile, non-tradables' inflation was 1.6% due to a softening in the housing sector.

DOMESTIC CREDIT

Total domestic credit[1] expanded by 4.3% in 2017 compared to 5.9% a year earlier. Despite the improved global and domestic economic environment, credit demand slowed down in some economic segments. Certain sectors, such as some government-related corporate entities, benefited from higher oil-price and improved efficiency due to consolidation.

Improved economic conditions did not translate into a credit-funding expansion in the domestic retail and corporate sectors. The growth of domestic retail and corporate lending moderated to 2.5% compared to 5.2% in 2016. Credit to government expanded during 2017 driven by strong bond issuance.

CHART 1.1: GDP Growth and Total Domestic Credit Growth



Source: CBUAE, FCSA, Bloomberg

Approximately, two-thirds of the total domestic credit is provided by UAE based banks, with the remaining one-third split between borrowing from abroad and bonds issued by UAE borrowers. Domestic credit is predominantly in the form of bilateral loans from UAE banks, followed by syndicated loans with active participation of foreign financial institutions, and subsequently the bond markets.

DOMESTIC FINANCIAL MARKETS

In financial markets, the money market spreads, dollar-dirham forward points and credit market spreads narrowed; underpinned by ample liquidity in the financial system, notwithstanding the increases in the policy rate by the Central Bank in line with the tightening of monetary policy in the US.

The LIBOR – EIBOR money market spreads narrowed during the year; the 3-month spread reached 10 basis points compared to the average of 45 basis points during the previous two years.

The currency market dollar-dirham forward points also narrowed during the year and were among the lowest in the GCC region; the 12-month forward points narrowed to 35 basis points during the year from above 80 basis points at the end of 2016.

The Central Bank increased its 1-week CD base rate three times during the year following the monetary policy rates set by the US Federal Reserve (FED). The 3-month EIBOR interest rates increased by around 30 basis points during the year while the yield curve flattened.

On the credit markets, the traded CDS spreads of the largest UAE banks declined to the lowest levels since the global financial crisis, with a similar trend observed in the CDS spreads of the two largest emirates.

While the overall ADX and DFM equity indices declined slightly during the year, the banking sector sub-indices, comprising of listed UAE banks, increased in both Dubai and Abu Dhabi.

GLOBAL MACRO-FINANCIAL RISKS

The global outlook points toward a gradual recovery for both advanced and emerging countries. In the UAE, the real-non oil GDP growth is also estimated by the CBUAE to improve.

Nonetheless, several macro-financial risks to the global economic outlook remain, including a faster than anticipated rise in FED policy rates, vulnerabilities in emerging markets with weak fundamentals, volatility in commodity markets and asset prices, concerns of trade wars due to increases in trade tariffs, and an escalation of global and regional geopolitical risks.

1. The total domestic credit represents funds borrowed by non-bank UAE entities and comprises of UAE bank loans, issuance of bonds, and borrowing from abroad.

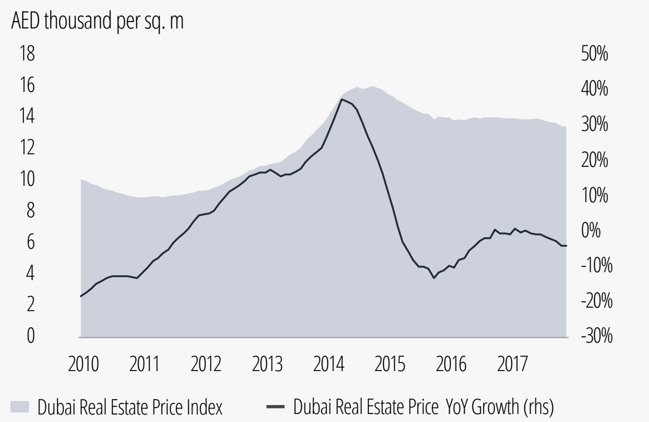
REAL ESTATE MARKET

Residential property prices and rents decreased in 2017 for a third consecutive year. In the commercial real estate sector, office space rents and average daily revenues per hotel room also experienced declines. Notwithstanding these developments, the growth of the supply of newly completed real estate properties increased and bank real estate lending accelerated. Amid expectations of a rise in US Federal Reserve policy rates whilst property prices are in a contractionary phase, market participants need to adequately manage the risks related to their real estate exposures.

RESIDENTIAL REAL ESTATE MARKET

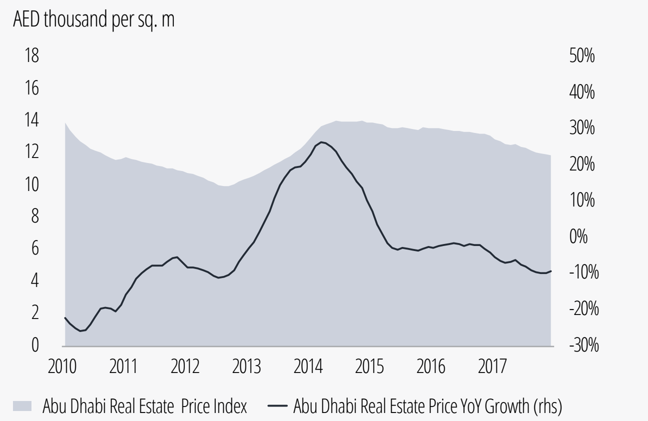
The decline in residential properties sale prices continued during 2017 in both Dubai and Abu Dhabi for a third consecutive year. The residential properties prices decreased during the year by 3.8% in Dubai and by 9.1% in Abu Dhabi, which was a higher pace of decline compared to 2016 when the price indices declined by 0.4% and 3.8%, respectively. While residential property prices declined, the growth of the residential property supply accelerated during 2017, increasing by 7.7% in Dubai and 6.7% in Abu Dhabi.[2,3]

CHART 1.2: Dubai Residential Real Estate Price Index



Source: REIDIN, CBUAE

CHART 1.3: Abu Dhabi Residential Real Estate Price Index



Source: REIDIN, CBUAE

Similar to the trend in residential properties sales prices, rental prices also decreased in both Dubai and Abu Dhabi during 2017. Residential rental prices in Dubai continued in a three-year downward trend declining by 7.4% during the year. In Abu Dhabi, residential rental prices decreased for a second year by 11.4% in 2017. As residential sale prices and rent prices declined in tandem, the gross yield[4] on residential property investment remained relatively stable in the two largest emirates at around 7%.

2. The figures are estimates based on real estate market data sourced from REIDIN.
3. The changes in residential real estate sales prices are calculated on a year-on-year basis comparing the monthly figures for December 2016 to December 2017.
4. Residential Gross Yield is the total yearly gross rent divided by the sales price.

CHART 1.4: Monthly Residential Rental Prices

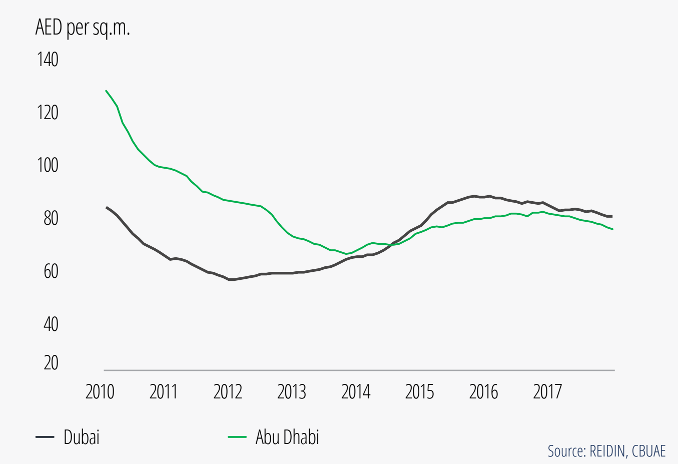
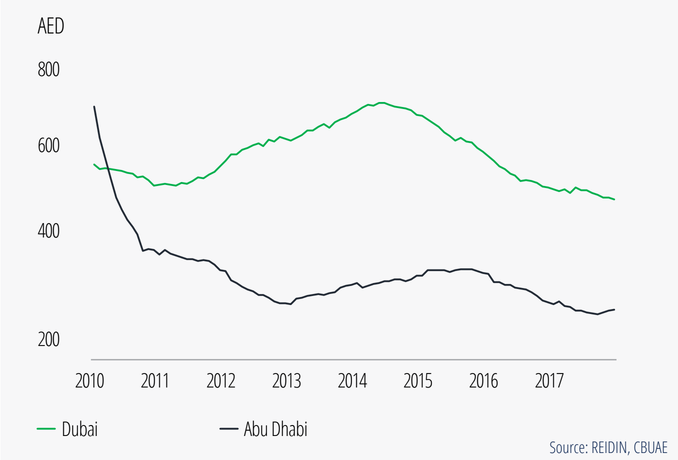


CHART 1.5: Average Daily Revenue per Hotel Room



COMMERCIAL REAL ESTATE MARKET

In commercial real estate, the available data suggests that office space rent prices and average hotel revenues per room decreased in 2017 in both Dubai and Abu Dhabi.

Office space rents declined in 2017 by 3.3% in Dubai and 7.3% in Abu Dhabi. The supply of completed office space increased in 2017, growing by 2.9% in Dubai, and 6.3% in Abu Dhabi, however, at a slower pace compared to residential real estate. Office occupancy rates remained stable in the two largest emirates at around 80%.[5]

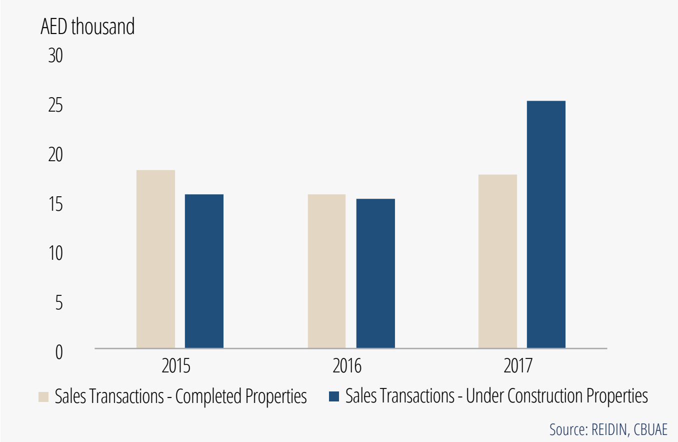
While the number of hotel guests increased in both Dubai and Abu Dhabi, the average daily revenue (ADR) per hotel room decreased in both emirates. In Dubai, the ADR declined by 3.7% in 2017 to AED 492.[6] The hotels in Abu Dhabi experienced in 2017 a 7.3% decrease in the ADR per hotel room to AED 369.[7]

The hotel occupancy rates in both Dubai and Abu Dhabi remained stable in 2017 at 78% and 73%, respectively. The number of hotel rooms grew in Dubai by 4.5% to 107,431 and remained stable in Abu Dhabi at 30,574 rooms. Both emirates succeeded in increasing the number of hotel guests, which grew in 2017 by 6.2% in Dubai to 15.8 million guests and by 9.8% in Abu Dhabi to 4.9 million guests.

REAL ESTATE TRANSACTIONS

In addition to the above-mentioned increases in real estate supply, and despite the moderation in real estate asset prices, the number of sales transactions (of completed and under construction properties) accelerated in Dubai. Transaction data is not available in Abu Dhabi. Property sales transactions of completed properties increased in Dubai by 13.0% in 2017. Furthermore, off-plan sales, which represent sales of properties under construction, accelerated sharply during the year. In 2017, off-plan sales were more than a half of total sale transactions at 59%, compared to 49% in the previous year.[8]

CHART 1.6: Sales Transactions of Completed & Under Construction Properties in Dubai



5. The figures are estimates based on real estate market data sourced from REIDIN.
6. Department of Tourism and Commerce Marketing, Dubai
7. Department of Culture & Tourism, Abu Dhabi
8. The figures are estimates based on real estate market data sourced from REIDIN.

BANK REAL ESTATE LENDING

In contrast to the continued decline in real estate prices and rents, bank real estate lending – in both residential and commercial properties – accelerated during 2017 growing by 18.1%. Real estate lending accounted for 19.9% of UAE bank loans in 2017, compared to 16.4% a year before. For more information on real estate bank lending and exposures in the UAE please refer to Box 2.1: Bank Real Estate Exposures.

FINANCIAL CYCLES

The financial cycle in the UAE remained in a contractionary phase during 2017. The credit-to-non-oil-GDP gap, which is a key indicator of the credit cycle, widened during 2017 due to a higher nominal non-oil GDP growth and a further slowdown in credit growth. The funding cycle, measured by non-core liabilities to core liabilities of the banking sector, was stable, remaining at 24% during 2017, close to its historical average, while the growth of capital market funding slowed down during the year.

CREDIT CYCLE

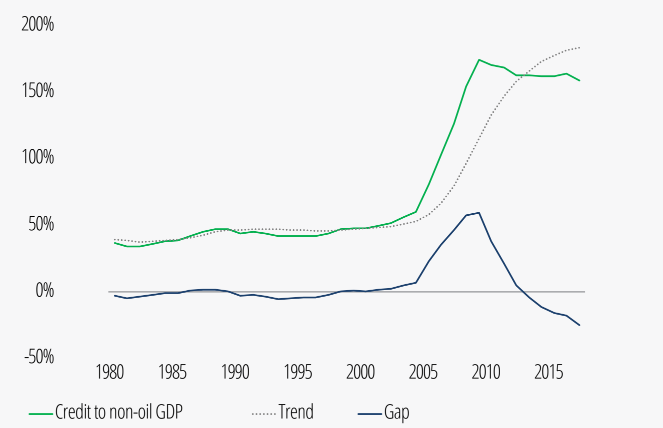
Financial cycle is a key concept for macro-prudential policy, because its booms preceded several systemic banking crises internationally. Financial asset prices and credit creation tend to follow recurrent ebbs and flows. This is called the financial cycle and it is usually longer, and has a larger amplitude, than the traditional business cycle. Financial cycles can be analysed by the behaviour of credit, funding and property prices.

Credit cycles similarly go through periods in which funds are relatively easy to borrow followed by a contraction in the availability of credit or stricter conditions for credit. Central Bank's Credit Sentiment Surveys, showed a marginal increase in demand for business loans (mainly attributable to the strengthening of demand in Dubai), while demand for personal loans in aggregate was flat during 2017. The surveys showed a moderate tightening of credit standards for business loans during the year, while credit standard for personal loans remained on aggregate unchanged.

In the UAE, the ratio of credit-to-GDP remained at moderate levels until the early 2000s when credit expansion along with GDP picked up, characterised by greater use of private credit in the development and diversification of the UAE non-oil economy. However, coinciding with global developments heightened risk-taking resulted in an excessive growth of credit with private-credit-to-non-oil-GDP ratio reaching a peak of 175% in 2009. This ratio was at 159% as of December 2017.

The credit-to-GDP[9] gap is one of the main indicators for analysing credit cycles and to guide the build-up of countercyclical capital buffers as a part of an assessment under the draft macro-prudential policy framework.

CHART 1.7: Total Private Credit to Non-oil GDP



Source: CBUAE, FCSA, Bloomberg

The gap metric demonstrates excessive credit growth reaching around 60% in 2009 and falling thereafter as the credit cycle turned. At the end of 2017, the gap was -25%, a further decline from a year before (2016: -16%) because credit growth remained weak, while the growth of nominal non-oil GDP increased in 2017.

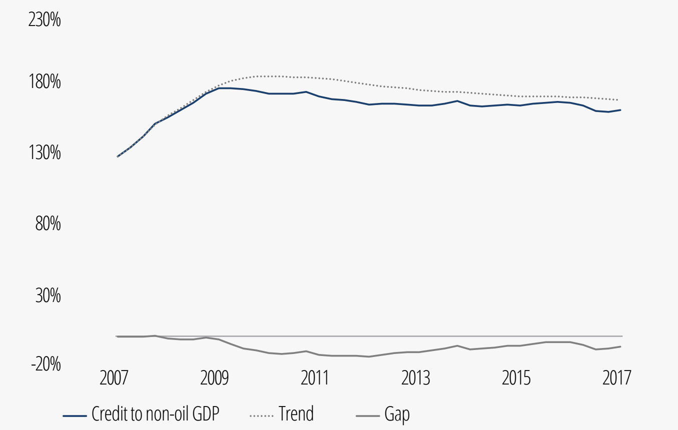
The gap analysis is a statistical method and it has some shortcomings discussed heavily in the related literature. In addition, in the case of the UAE, the credit growth coincided with significant structural changes in the (non-oil) economy

9. Credit is defined as monetary financial institutions' lending to the private non-financial sector and the outstanding stock of debt securities issued by the UAE private non-financial sector. GDP is in nominal terms, however, in the UAE, oil GDP is excluded from the private-credit to GDP ratio and non-oil GDP is used instead; including the oil GDP would result in an even lower private-credit to GDP ratio amounting to 129%. The statistical trend is calculated using a one-sided HP filter with the smoothing parameter equal to 400,000.

and financial deepening. For this reason, the expansionary phase of the credit cycle might be biased upwards by the structural changes[10] in the non-oil economy and thus the current negative credit-to-non-oil-GDP gap is overstated.

An estimation of the credit-to-non-oil-GDP gap as of the regime shift in 2007 suggests that the gap in 2017 would be around -7%, an increase from -4% a year earlier.

CHART 1.8: Total Private Credit to Non-oil GDP



Source: CBUAE, FCSA, Bloomberg

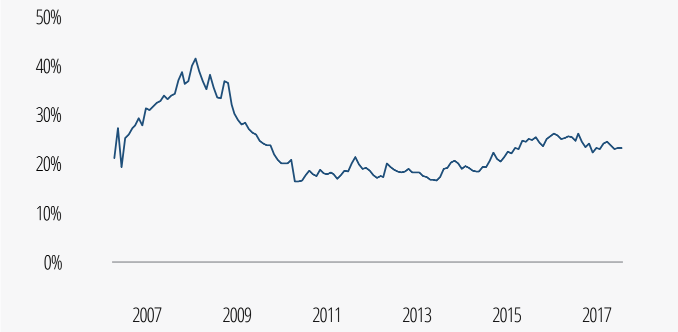
FUNDING CYCLE

Changes in the funding cycle are often linked with the credit cycle. For instance, a credit boom is often reflected in the composition of bank liabilities as traditional retail deposits (core liabilities) usually cannot keep pace with bank asset growth and therefore banks turn to other funding sources (non-core liabilities).

A large stock of non-core liabilities may serve as an indicator of a build-up of systemic vulnerabilities arising from the funding cycle of the banking system in the UAE.

The non-core liabilities to core liabilities ratio, represents non-resident deposits, interbank liabilities and resident non-banking financial institutions deposits as a ratio of resident stable deposits. The ratio remained around 24% throughout 2017 and indicated a stable phase of the funding cycle in the UAE banking system.

CHART 1.9: Non-Core Liabilities to Core Liabilities in the UAE Banking System



Source: CBUAE

Furthermore, changes in the levels and composition of capital market funding in the UAE banking system complements the picture of the funding cycle. The capital market funding growth slowed down to around 5% during 2017 from double digit figures during the previous five years. Capital market funding amounted to less than 10% of total liabilities of the UAE banking system.

10. Application of econometric and clustering methods suggest that a structural shift occurred approximately between 2006 and 2007.

FINANCIAL STABILITY TREND INDEX

The Financial Stability Trend Index (FSTI) improved in three out of the four quarters of 2017 reflecting improved financial stability conditions. The uptick in the FSTI can be mainly attributed to higher liquidity buffers of the UAE banks and lower stock market volatility. In contrast, other factors had negative effects on the overall index such as higher non-interest expenses of banks.

The FSTI is a composite quantitative measure of financial stability developed by the CBUAE. The index combines eighteen macro-financial indicators that represent three main areas with effects on financial stability, starting with the UAE banking system, followed by economic trends, and financial market developments with indicators that capture their potential implications for financial stability.

An FSTI value above zero suggests that the macro-financial conditions are broadly supportive of financial stability, and vice-versa. The index does not intend to predict the occurrence of a crisis but rather assesses if the current macro-financial conditions are supportive of financial stability.

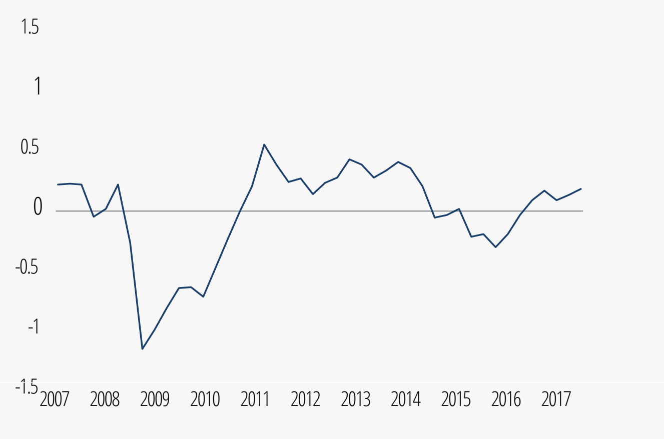
The index stood at 0.18 as of December 2017, the highest value for three years, and remained in the positive territory though out 2017, with a positive (upside) momentum in three out of the four quarters reported. This compares positively to the previous year, as the index was in the negative territory through the first three quarters of 2016 following a drop below zero during 2015.

The main indicators of the improvement in the FSTI during 2017 were the significantly stronger liquidity conditions in the UAE banking system, lower impairment charges, and an improvement of the overall banking sector market developments. Furthermore, the overall stock market was less volatile than a year ago and the sovereign CDS spreads narrowed.

On the other hand, the banking sector experienced higher non-interest expenses as a percentage of gross income, economic growth and oil prices rising at a slower pace than in 2016.

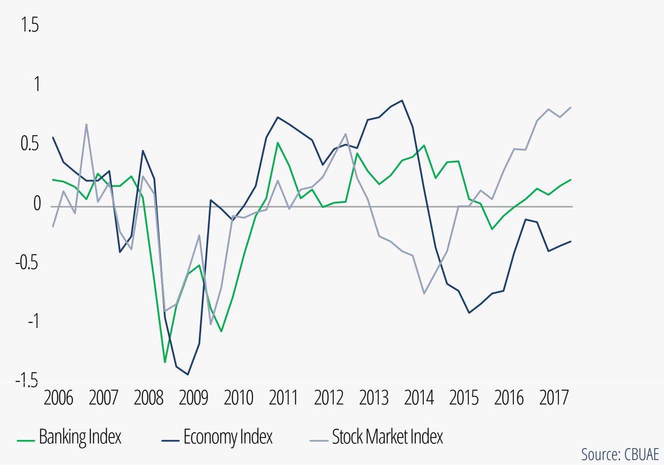
In conclusion, it is important to emphasise the index is better interpreted when looked at a lump sum rather than its specific components. In 2017, the FSTI suggested more supportive conditions for financial stability than a year ago. The banking sector and the stock market sub-indices have remained in the positive territory, while the economy sub-index remained in negative territory during 2017, however at better levels than it was at during 2015 and 2016.

CHART 1.10: UAE Financial Stability Trend Index



Source: CBUAE

CHART 1.11: Sub Indices of UAE Financial Stability Trend Index



Source: CBUAE

TABLE 1.1: THE FSTI METHODOLOGY[11]

The following set of eighteen macro-financial variables currently comprises the FSTI composite index for the UAE.

Sub index	Category	Indicator
Banking Index	Capital Adequacy	Capital adequacy ratio
	Asset Quality	Ratio of impairment charges-to-total assets
		Y-o-Y growth of non-performing loans
	Liquidity	Ratio of net foreign interbank-to-total loans
		Ratio of liquid assets-to-total liabilities
		Ratio of total loans-to-total deposits
	Profitability	Return on assets
		Ratio of non-interest expense-to-gross income
	Market Developments	Index for market implied probability of default for banks
		Volatility of banking sector
Economy Index	Real Estate	Deviation of real estate prices from long term trend (Dubai)
		Deviation of real estate prices from long term trend (Abu Dhabi)
	Real Sector	Economic Composite Indicator[12]
		Y-o-Y change in spot oil price
		One year forward rate of USD/AED
Securities Market Index	Stock Markets	Price – earnings ratio
		Realized market volatility – 90 days
	Credit Markets	Five year credit default swaps for government bonds

11. Further details on the methodology and the variables can be found in the Financial Stability Reports 2016 and 2015.

12. Further details on the methodology of the Economic Composite Indicator can be found in the CBUAE working paper 'Constructing an Economic Composite Indicator for the UAE'.

FINANCIAL SYSTEM ASSESSMENT

Banking sector remained well capitalised with solid liquidity buffers, stable funding and improved profitability.

BANKING SECTOR ASSESSMENT

The UAE banking sector remained well capitalised, with solid liquidity buffers, stable funding and improved profitability. The non-performing loans increased slightly during the year, although the banks maintained adequate loan loss provisions. Bank lending growth slowed down during the year, while exposures to the real estate sector increased.

BANKING SYSTEM LENDING

Lending growth of 1.7% was a marked slowdown compared to the previous year (2016: 6.0%). Lending growth moderated across most economic segments.

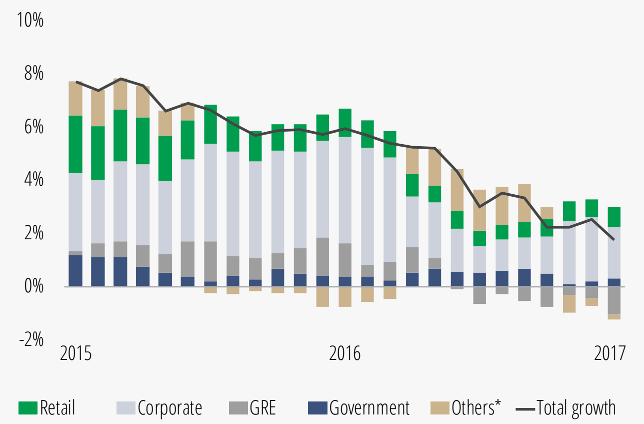
Bank lending to corporate entities remained relatively strong, as it expanded by 5.5% in 2017, although slower compared to the previous year (2016: 11.2%). Lending to the corporate sector mostly contributed to the total loan growth.

Retail sector lending continued to grow in 2017, albeit at a more moderate pace. Loans to the sector expanded by 3.6% in 2017 (2016: 4.8%). Despite the moderate expansion of retail loans retail mortgage loans continued to grow at 33.8%.

Lending growth in corporate and retail sectors was mainly driven by real estate lending. For more details on bank real estate lending refer to Box 2.1: Bank Real Estate Exposures.

Lending to Government Related Entities (GREs) contracted in 2017, in part, due to shrinking demand. Loans extended to the sector contracted by 8.3% in 2017 (2016: +10.5%).

CHART 2.1: Total Lending Growth



* SME , Trade Bills, NBFI

Source: CBUAE

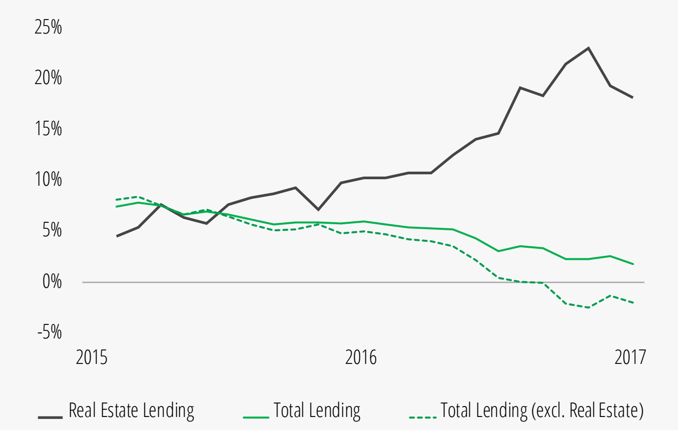
Loans to residents grew slower in 2017 at 1.5% (2016: 5.2%). The growth was mainly driven by domestic corporates and retail customers.

Non-resident loans registered a higher growth rate of 6.0% (2016: 15.9%). However, the share of non-resident loans on the total loan portfolio remained relatively small at 8.1%, which limits the external exposure risks of the UAE banking system.

BOX 2.1: BANK REAL ESTATE EXPOSURE

Bank lending to the real estate sector (including both residential and commercial real estate) grew in 2017 at 18.1% (2016: 10.3%), a much faster pace compared to lending to other economic sectors. Excluding the real estate sector, the aggregate loan growth contracted by 2%.

CHART 2.2: Real Estate Lending Growth

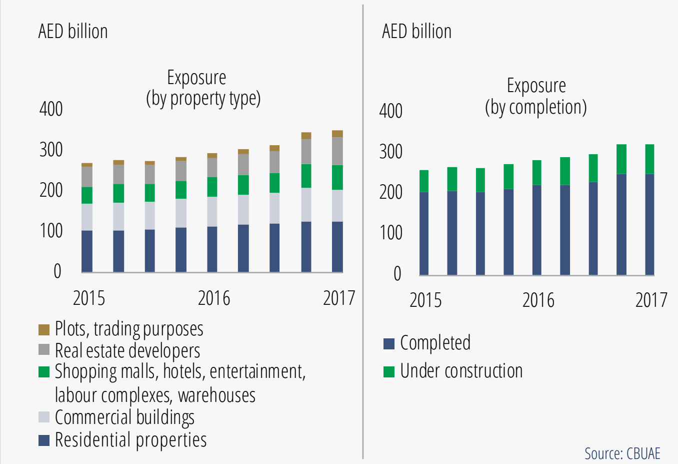


Source: CBUAE

As a result, bank exposure to the real estate sector gained more prominence. Measured as a share of total loans, real estate exposure of the UAE banking sector accounted for 19.9% in 2017 (2016: 16.4%).

The outstanding balance of real estate loans at the end of 2017 reached AED 350.4 billion, (2016: AED 296.8 billion). Loans extended in 2017 to the commercial properties segment grew 14.9%, compared to 10.4% for residential properties (2016: 22.4% and 13.3%, respectively). In addition, loans to real estate developers also expanded at a fast pace during the year.

CHART 2.3: Real Estate Lending by Type of Properties



Source: CBUAE

The growth in exposure to commercial properties were primarily driven by the increase in lending to the hotel segments, which grew 25.3% in 2017 (2016: 30.0%). Within commercial properties, the hotel segment accounted for more than 25% of the exposures.

Given the rapid growth of exposures to the real estate sector, banks should maintain prudent lending policies and risk management practices.

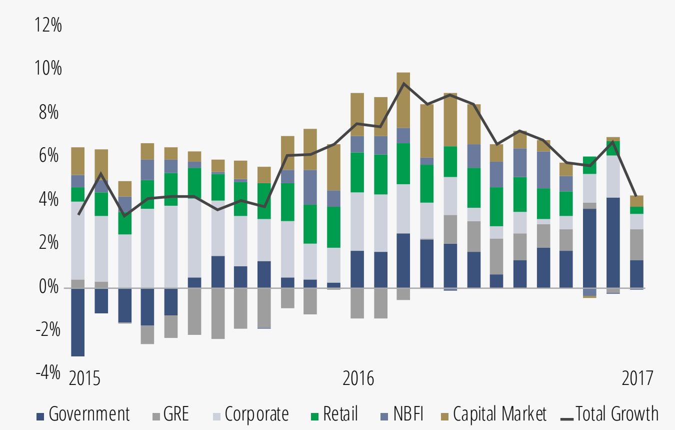
BANKING SYSTEM FUNDING

Overall funding conditions in the UAE banking system remained solid, underpinned by a continued growth in deposit funding.

UAE banks' funding base consists predominantly of deposits. The profile of depositors was generally unchanged with corporate and retail categories accounting for the largest share. Deposits continued to support bank funding growth, increasing during 2017 at a rate of 5.5% (2016: 6.2%).

The growth in government and GRE sectors deposits rebounded from the negative and slow growth rates recorded in 2015 and 2016, in part, due to the sustained recovery of the crude oil prices.

CHART 2.4: Deposit and Capital Market Funding Growth



Source: CBUAE

Retail and corporate deposits recorded in 2017 growth rates of 1.4% and 1.9% respectively, a marked slowdown compared to last year (2016: 7.5% and 6.9%).

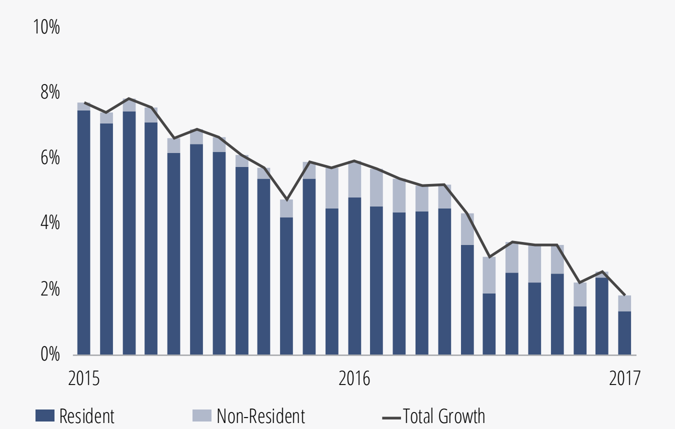
Supporting the deposits growth was the higher growth in resident deposits of 4.6% (2016: 6.9%) mainly due to the domestic corporate and government sectors. Non-resident deposits negatively contributed to the growth, declining by 3.7% at end of 2017 (2016: 16.0%).

The share of interbank funding continued to be relatively small. As at the end of 2017, interbank borrowing amounted to AED 158.1 billion, declining by 13.0% since the end of 2016. UAE banks remained a net lender with a net foreign interbank position of AED 34.8 billion (2016: AED 32.8 billion).

Capital market funding grew 5.0% to AED 189 billion in 2017 of which more than 80% were in foreign currencies as the dirham debt markets remained shallow. US dollar denominated issuance accounted for 67.8% of total bank debt issuance.

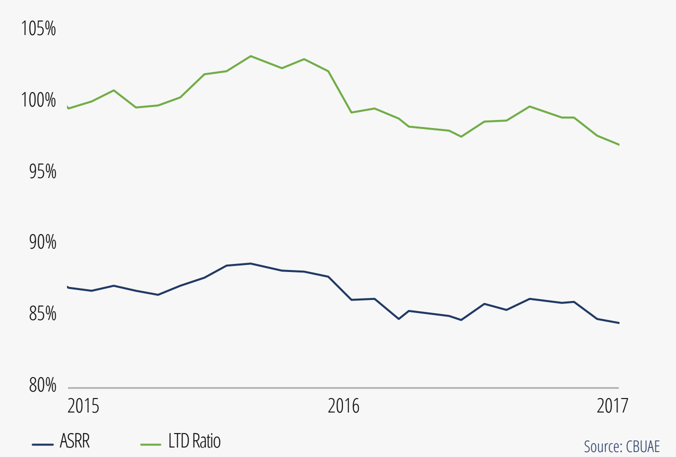
Reflecting the increase in stable resources, particularly in deposit funding relative to the moderation in lending, the Advances to Stable Resource Ratio (ASRR) improved to 84.5% at end of 2017 (2016: 86.2%). Similarly, the overall loan-to-deposit ratio decreased to 97.1% (2016: 99.4%).

CHART 2.5: Lending Growth by Residency



Source: CBUAE

CHART 2.6: ASRR and LTD Ratio

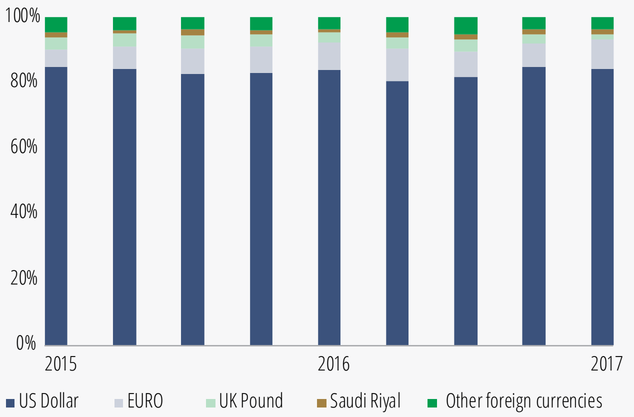


Source: CBUAE

BOX 2.2: BANK FOREIGN CURRENCY EXPOSURES

Foreign currency (FCY) denominated assets of the banking system grew at a moderate pace by 1.7% in 2017 and accounted for 39.4% of total banking system assets. Of this amount, FCY loans and investment assets accounted for 32.9% and 25.8% respectively (2016: 35.2% and 24.1%).

CHART 2.7: Breakdown of Foreign Currency Assets

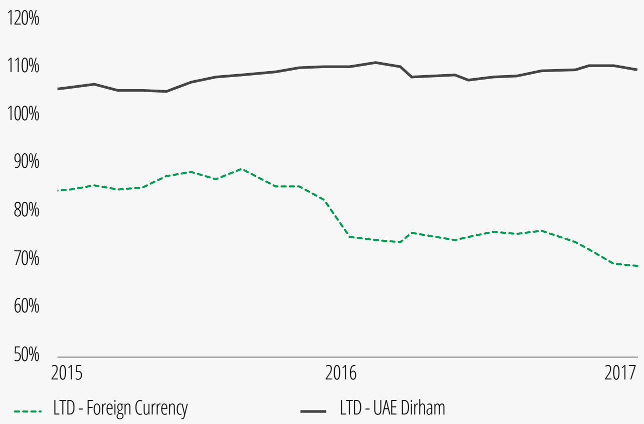


Source: CBUAE

The growth in FCY assets was primarily due to the increase in holdings of FCY denominated investment assets. Investment in debt securities increased by 11.0% in 2017 (2016: 27.7%). FCY denominated loans, however, contracted by 5.0% in 2017 (2016: +4.8%).

FCY liabilities accounted for 36.7% of total banking system liabilities and primarily comprised of FCY deposits. The slow growth in FCY liabilities of 1.0% in 2017 (2016: 9.2%), was a consequence of the marked slowdown in FCY denominated deposit growth. These deposits grew by 3.4% in 2017 compared to 18.1% in 2016.

CHART 2.8: Loans-to-Deposit Ratio



Source: CBUAE

Reflecting the contraction in FCY denominated loans during 2017 compared to the growth in FCY denominated deposits, the FCY loan-to-deposit ratio edged lower to 69.0% (2016: 75.1%).

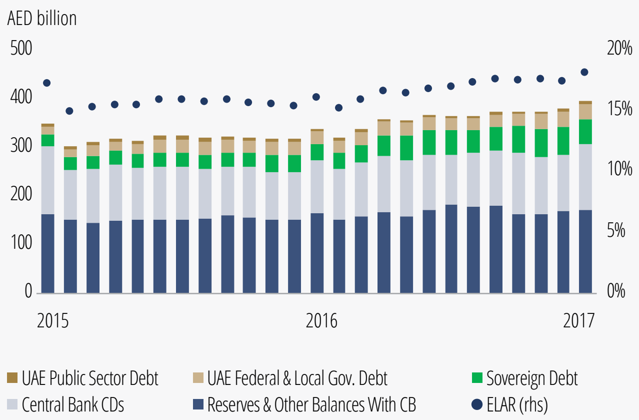
Banks' foreign currency assets and liabilities are predominantly denominated in US dollars and the composition of main currencies remained stable.

BANKING SYSTEM LIQUIDITY

Reflecting the slowdown in lending and sustained funding conditions over the year, the UAE banking system asset allocation shifted toward liquid assets. As a result, the liquidity conditions of the UAE banking system improved in 2017.

This is evidenced by the increased liquidity buffers above the 10% regulatory requirements. The Eligible Liquid Asset Ratio (ELAR) increased by 2 percentage points to 18.2% at the end of 2017 (2016: 16.2%). The increase was primarily due to the expansion in banks' holdings of Central Bank CDs and sovereign bonds during the year.

CHART 2.9: High Quality Liquid Assets

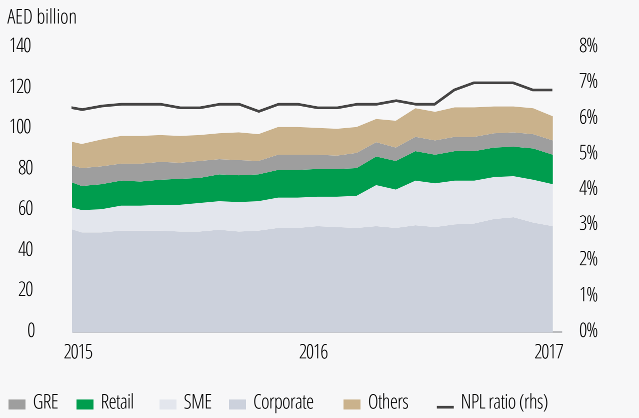


Source: CBUAE

ASSET QUALITY

The non-performing loans (NPL) ratio edged slightly higher in 2017 to 6.7% compared to 6.4% in 2016, reflecting both the increase in the outstanding amount of NPLs and the slower loan growth during the year.

CHART 2.10: NPL Ratio and Stock of NPL



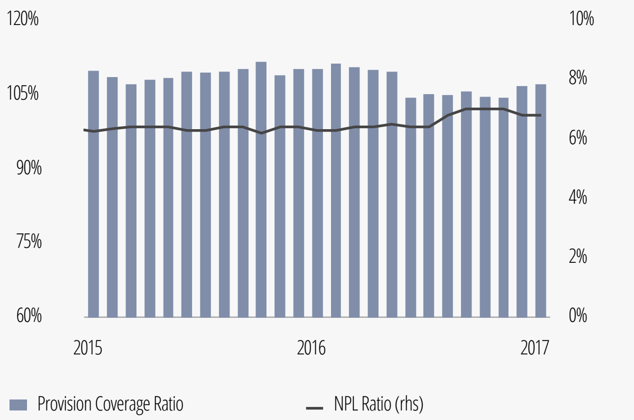
Source: CBUAE

The lending portfolio quarterly default rates remained at similar levels to the previous year at 0.6%, whilst the default rates were higher for the Small and Medium Enterprises (SME) and retail sectors compared with the other sectors.

Asset quality of retail lending has gradually declined, notably in mortgage lending and credit card segments. NPL ratio for retail sector deteriorated to 4.6% in 2017 (2016: 3.8%). The developments in the retail NPLs, have highlighted some signs of potential vulnerabilities in the sector.

UAE banks continued to maintain prudent total loan loss provisions at above 100% of total non-performing loans. The provision coverage ratio, which includes both specific and general provisions, decreased slightly to 107.1% in 2017 from 110.2% at the end of the previous year. While non-performing loans increased in 2017 by 5.6%, the specific and general provisions increased by 1.2% and 6.2% respectively (2016: 8.9% and 8.3%).

CHART 2.11: NPL Ratio and Provision Coverage Ratio



Source: CBUAE

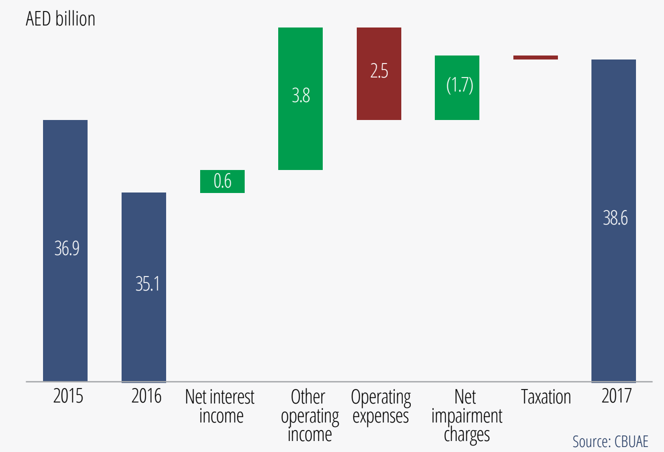
PROFITABILITY

UAE banking system profitability rebounded in 2017 resulting in an improved return on assets, although the cost to income ratio edged higher compared to the previous year.

The UAE banking system profitability increase by 10% during 2017 was largely driven by a higher non-interest income which grew 13.0%.

The net interest income was less of a contributor to the overall profitability in 2017, although growing by 0.6% compared to its level during the previous year (2016: -1.3%).

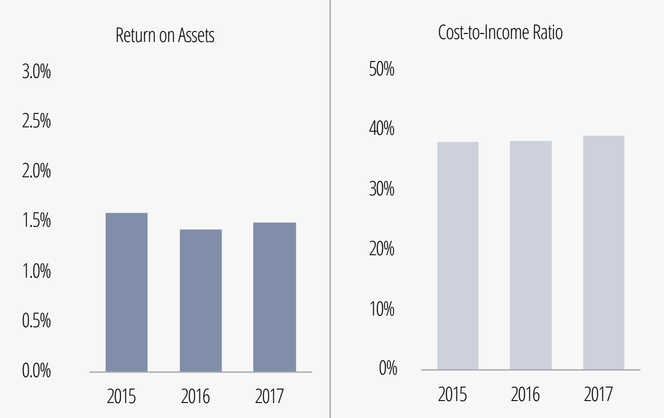
CHART 2.12: Profitability



Source: CBUAE

As a result, the return on assets (ROA) of the UAE banking sector improved to 1.5%. Nonetheless, the cost-to-income ratio edged higher to 39.1%, as operating expenses grew at a higher rate compared to total operating income.

CHART 2.13: Return on Assets and Cost-to-Income Ratio



Source: CBUAE

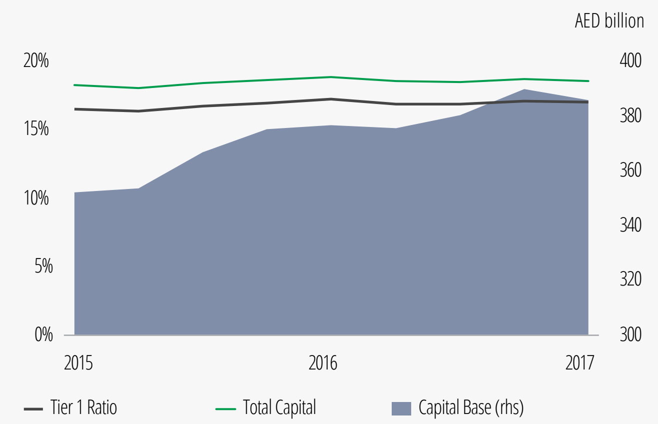
CAPITAL

Banks remained well capitalised with adequate buffers above the minimum capital[13] requirements. Capitalisation of the UAE banking sector continued to be strong, although the capital ratios edged slightly lower in 2017 with aggregate Common Equity Tier 1 (CET-1) ratio falling slightly from 17.3% in 2016 to 17.0% in 2017 and total capital ratio from 18.9% to 18.6%.

The aggregate UAE banking system capital base comprised primarily of CET-1 capital (80.5%), and less of additional Tier-1 (11.1%) and Tier-2 capital (8.4%).

The decrease in aggregate CET-1 ratio was in part, due to the higher growth in Risk Weighted Assets (RWA) compared to the growth of CET-1 capital.

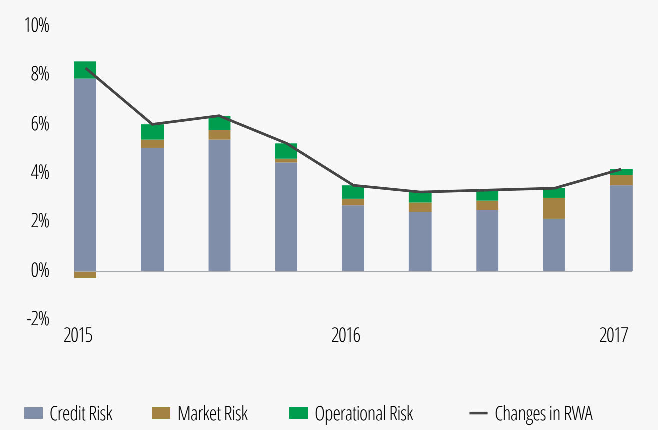
CHART 2.14: Capital Adequacy Ratio



Source: CBUAE

Total RWA grew 4.2% in 2017, and was primarily driven by changes in credit and market risks components. Credit risk RWA accounts for 88.7% of total RWA and grew 3.9% in 2017 (2016: 3.0%).

CHART 2.15: Risk Weighted Assets (Contribution to Growth)



Source: CBUAE

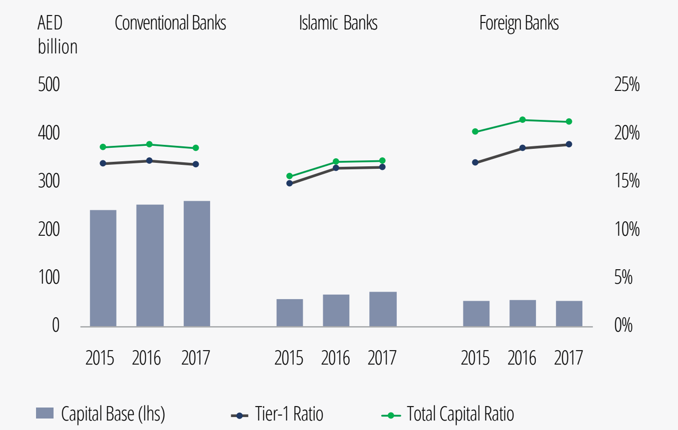
On an aggregate basis, the lower growth in banks' CET-1 capital was impacted by the smaller retained earnings and reduction in eligible reserves.

13. For UAE local banks, capital ratios are calculated on a consolidated group basis. For UAE branches of foreign banks the capital ratios are calculated for UAE operations only.

The retained earnings as at end of the 2017 grew by 0.8% (2016: 16.8%).

Higher capital adequacy ratios were recorded by foreign banks compared to national conventional and Islamic banks. During the year, capital ratios of foreign banks improved while those of conventional banks slightly decreased.

CHART 2.16: Capital Ratios by Bank Type



Source: CBUAE

EXTERNAL EXPOSURE[14] OF THE UAE BANKING SYSTEM

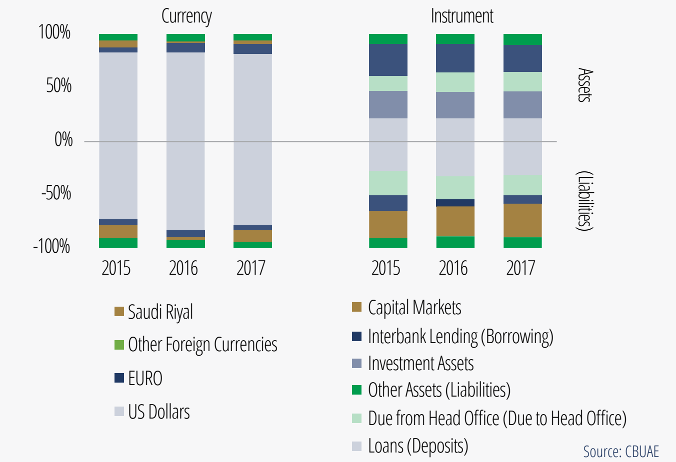
Total banking system external exposure remained stable. And accounted for 21.7% of total assets and 22.2% of total liabilities.

External exposures consist of non-resident assets and non-resident liabilities of the UAE banks. The majority of external assets were held in investment assets, while the bulk of external liabilities comprised of capital market funding. Currency wise, more than 80% of the exposures were in US dollars.

On aggregate domestic banks' external assets and liabilities growth moderated in 2017 to 8.9% and 2.4%, respectively (2016: 13.2% and 5.9%). Risks stemming from external exposures were moderate due to the decline in non-resident deposits and relatively low non-resident lending of 8.1% of total loans.

The increase in external assets was mainly due to higher holdings of debt securities issued abroad, which grew by 11.3%. More than 60% of banks holdings of foreign debt securities had credit ratings of A and above. Non-resident loans accounted for

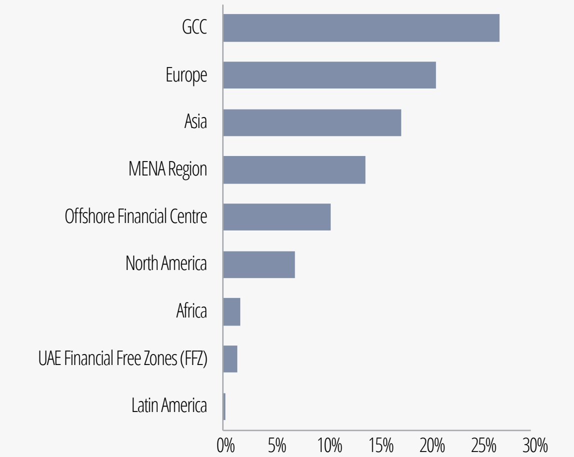
CHART 2.17: Composition of External Exposures



Source: CBUAE

8% of total loan portfolio, with majority of the loans extended to the GCC region (26%), Europe (21%), and Asia (18%). Non-resident loans grew moderately compared to the previous year at 6.0% (2016: 15.9%) and was primarily supported by the increase in FCY-denominated loans.

CHART 2.18: Non-Resident Loans by Region



Source: CBUAE

The increase in external liabilities was contributed by an 11.6% increase in the issuance of debt securities. The non-resident deposits, which accounted for 31.4% of external liabilities, declined by 3.7% (2016: +16.1%). Approximately 60% of debt securities issued by domestic banks in the international capital markets are denominated in US dollars.

Banks' exposure to the UAE financial free zones (FFZ) – Dubai International Financial Center and Abu Dhabi Global Marketplace – remained stable with the UAE FFZ share in both lending and deposits below 2%.

14. Analysis includes exposures of UAE local banks, while their foreign subsidiaries and UAE branches of foreign banks are excluded.

BOX 2.3: INTERCONNECTEDNESS IN THE BANKING SYSTEM

The UAE domestic interbank market has remained relatively liquid during 2017. The dirham interbank market processed 13% fewer payments during 2017; however, the concentration of the system remained healthy as indicated by a concentration index.

The cumulative volume of transactions in the interbank market has been slowly decreasing in the past three years reaching AED 592 billion during 2017. The number of transactions of the interbank market also declined to 3,492 from 4,517[15] in 2016. The market remained short-term oriented with an average tenor of the interbank transactions increasing to 12 days in 2017 from 9 days in 2016.

The dirham interbank market remained sound with a Herfindahl-Hirschman Index (HHI)[16] score between the 700 and 800, which indicates high competitiveness in the interbank market.[17] In last year's Financial Stability Report, the network was analyzed further with a focused analysis on the interbank network characteristics.

CHART 2.19: Value and Number of Interbank Transactions in UAEFTS Interbank Market

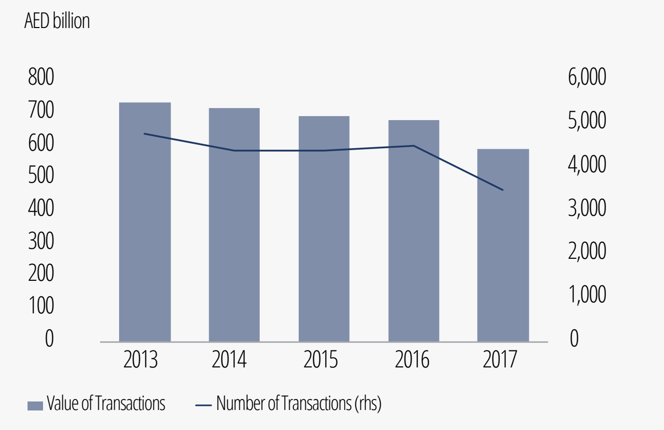
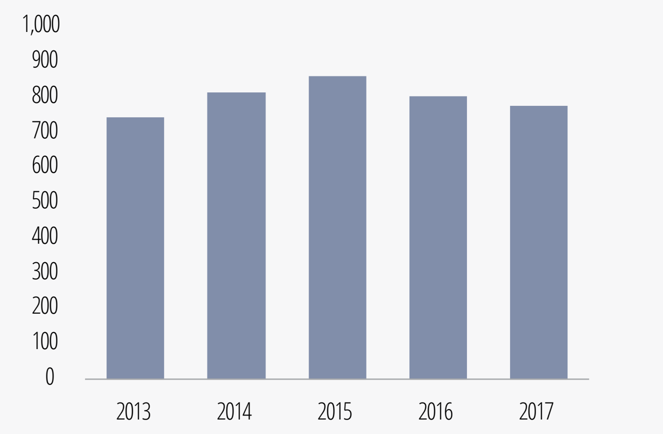


CHART 2.20: Concentration of Domestic Interbank Market



Source: CBUAE

15. The borrowing and the repayment of the same interbank transaction is considered to be one transaction in value and number.
16. The HHI is a statistical measurement of concentration frequently used to evaluate the existence of market power used here to measure the concentration of loans and borrowings on the dirham interbank market.
17. Further details and analysis of the characteristics of the UAE interbank network can be found in the Financial Stability Report 2016.

BOX 2.4: CONCENTRATION IN THE BANKING SYSTEM

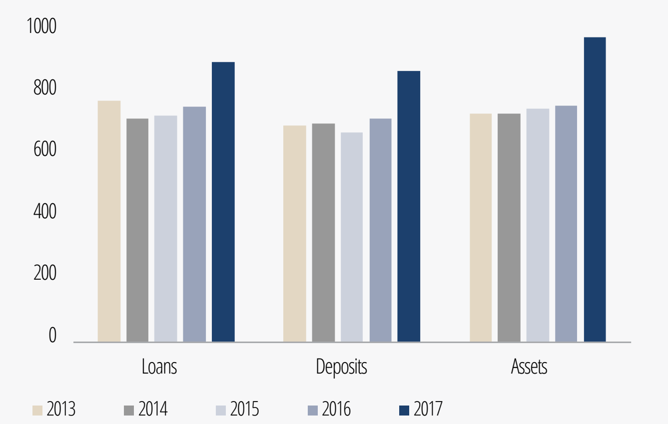
The number of banks operating in the UAE was 60, with the top three banks' assets representing 48% of the total assets of the banking sector.[18] The Herfindahl-Hirschman Index (HHI), indicates that the UAE banking system is not concentrated and remained competitive in that respect.

The Herfindahl-Hirschman index (HHI) is a statistical measure of concentration. Economic theory and empirical evidence suggest that other things equal, the concentration of firms in a market is an important element of market structure and a determinant of competition. The HHI score is used, for example, in analyzing impact of horizontal merges on market concentration.

In the UAE, a merger took place during 2017 between the National Bank of Abu Dhabi and First Gulf Bank, and subsequently, First Abu Dhabi Bank emerged with total assets of approximately AED 668 billion.

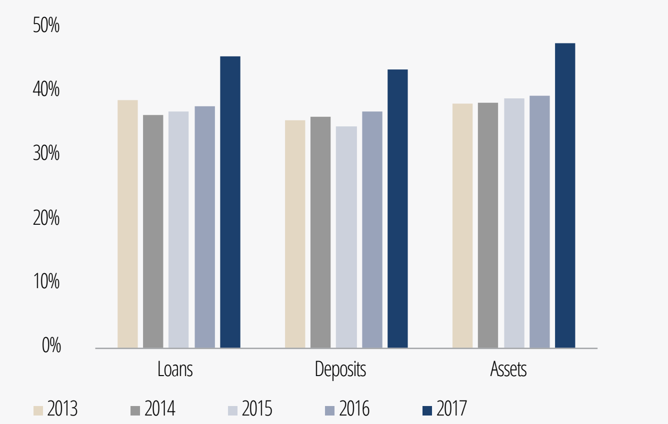
The HHI[19] index increased by 145, 153 and 223 on loans, deposits and assets respectively in 2017. The absolute values are below 1100. Despite of increase of HHI index, the UAE banking system is not considered concentrated.[20] Furthermore, the score is one of the lowest in the GCC banking markets.

CHART 2.21: Concentration Index in the UAE Banking



Source: CBUAE

CHART 2.22: Share of Top 3 Banks in the UAE Banking



Source: CBUAE

18. In terms of GDP, the combined assets of the three largest banks in the UAE represent 92% of the nominal GDP and 113% of the nominal non-oil GDP at the end of 2017.
19. Under the classification of gross exposures in 60 different banks (N=60), a perfectly even banks sizes would deliver HHI equal to 167.
20. The general guidelines indicate that a sector is not concentrated post-merger if HHI is less than 1,800 or a change in the HHI is less than 200.

REGULATORY STRESS TEST IN THE UAE

In 2017, the Central Bank of the UAE (CBUAE) conducted a regulatory stress test to assess the capacity of UAE banks to withstand a severe yet plausible deterioration in macroeconomic and financial market conditions covering a time horizon of three years. The bottom-up stress test included credit risk and market risk and was conducted through a common methodology. The results showed that the UAE banks were resilient and able to withstand a severe adverse macro-financial condition with a 3-year cumulative capital adequacy ratio (CAR) reduction of 410 basis points (bps) to 14.8%, above the 12% regulatory minimum level.

INTRODUCTION AND OVERVIEW

As part of the regulatory stress testing framework, the CBUAE conducted a bottom-up stress test in 2017 to assess the capacity of UAE banks to withstand severe yet plausible macro-financial shocks. The objective of the stress test is to facilitate analysis of the financial stability in the UAE banking sector and to provide a forward-looking capital adequacy assessment of individual banks and the UAE banking system.

The 2017 stress test was built on common scenarios and methodological guidelines with the goal of contributing to the convergence of best practices of stress testing in the UAE banking sector. The stress test was run at the consolidated group level covering 20 UAE local banks with a time horizon of three years from 2017 to 2019.

THE STRESS TESTING SCENARIOS

The stress testing scenarios consisted of a baseline scenario and an adverse scenario. The baseline scenario was based on the CBUAE economic growth forecast for the next three years, whereas the adverse scenario reflected a stressed economic and financial conditions and addressed two potential threats to financial stability in the UAE:

- More significant than expected monetary tightening in the United States, amplified by capital outflows in the UAE triggers severe negative effects on asset prices.
- A prolonged low oil price affects oil and non-oil GDP growth in the UAE.

The adverse scenario was designed to reflect each of the risks and shocks on macroeconomic variables were calibrated accordingly. For example, real GDP growth rates over the three years were at -2.6%, -1.1% and 1.3% respectively, an average deviation of 3.6% from the baseline scenario. The average Brent oil price decreased over the three years by 33%, 39%, and 25% compared to the starting point of the stress test.

In addition to the shocks in macroeconomic variables, two notches downgrade of all emirates sovereign ratings were assumed. Furthermore, market risk shocks on exchange rates, interest rates and equities were developed to assess the risks stemming from banks' trading books under the adverse scenario. A summary of the market risk shocks is presented below:

TABLE 2.1: SUMMARY OF MARKET RISK SHOCKS

Interest rates	
AED and USD	+200 bps
The rest of the world	+100 bps
Foreign exchange rates	
JPY	+10%
The rest of the world (against USD)	-10%
Equities	
All Countries	-10%

THE STRESS TESTING METHODOLOGY

The 2017 regulatory stress test mainly focused on the assessment of the impact of risk drivers on the solvency of banks. The participating banks were required to stress a common set of risks such as credit risk, market risk, and counterparty risk. Additionally, the banks were requested to project the impact of the scenarios on their pre-impairment profits. The table below gives an overview of the methodology used in the stress test.

TABLE 2.2: SUMMARY OF THE 2017 STRESS TESTING METHODOLOGY

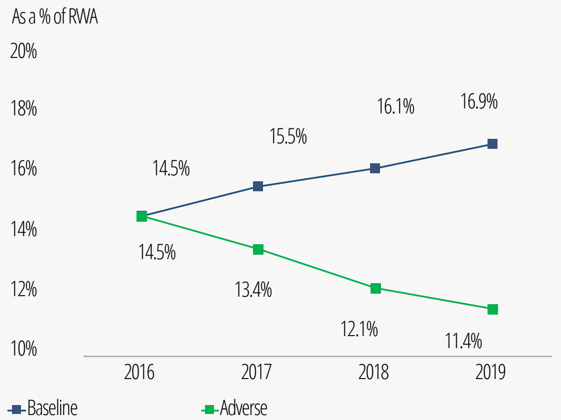
Sub index	Category	Indicator
Credit risk	Profit and Loss (P&L)	• Credit risk losses for loans and advances through banks' stress testing models • Prescribed haircuts for debt securities • Largest foreign derivative counterparty default
	Risk Weighted Assets (RWA)	• Credit rating transitions through transition matrices
Market risk	P&L	• Full revaluation based on the market risk shocks • The largest derivative counterparty default with 60% loss given default • Prescribed haircuts on debt securities • The losses are fully realised in the first year of the adverse scenario
	RWA	• Basel 2 Standardised Approach
Operational risk	P&L	• No Change
	RWA	• Basel 2 Standardised Approach
Pre-impairment profit	Net interest income	• Based on banks' internal estimation and CBUAE imposed caps
	Non-interest income	• Based on banks' internal estimation and CBUAE imposed caps
	Operating expenses & other operating income	• Based on banks' internal estimation and CBUAE imposed floors

THE STRESS TEST RESULTS

The UAE national banks increased their capital base in recent years, which led to a starting point capital position of 18.9% CAR at the end of 2016. This was 59 bps higher than in 2015 and 74bps higher than in 2014.

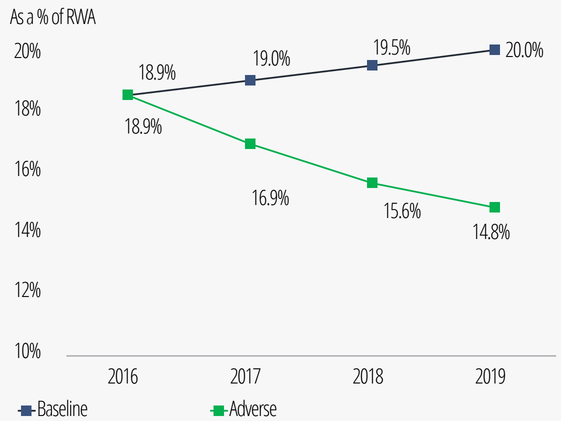
Under the baseline scenario, the UAE banking sector continued to improve its capital position, CAR increased from 18.9% to 20.0% in three years. The hypothetical adverse scenario resulted in a 3-year cumulative stressed impact of 410 bps on CAR, bringing it across the sample from 18.9% to 14.8% at the end of 2019. The aggregated Common Equity Tier 1 (CET-1) ratio declined by 310 bps post stress from 14.5% to 11.4%.

CHART 2.23: Overview of Stress Impact on CET-1 Ratio



Source: CBUAE

CHART 2.24: Overview of Stress Impact on CAR



Source: CBUAE

The reduction in capital ratios was mainly due to credit risk losses from newly defaulted assets. Under the adverse scenario, 3-year cumulative credit risk losses were AED 160 billion (on average AED 53 billion per year) of which defaults in corporate, retail and government related entities accounted around 75% of the total losses.

The market risk impact on CAR was calculated for the first time in a regulatory stress test in the UAE. The losses from market risk were relatively small mainly due to its insignificant weight in the UAE banks' total exposures. In the adverse scenario, market risk losses including counterparty credit risk losses were fully realized by the first year at AED 11 billion. The largest loss resulted from interest rate shocks which contributed around half of the total losses.

The impact on capital ratios was partially offset by pre-impairment profit flows, though these were also subject to stress and were constrained by the methodological guidelines. For example, net interest income was reduced by 10% in the adverse scenario from 2016 levels.

In summary, the stressed CAR and (CET-1) ratios in the adverse scenario were above the regulatory minimum requirement. The results of the 2017 stress test showed that the UAE banking sector is resilient and able to withstand severe adverse macro-financial shocks.

THE STRESS TEST REVIEW AND POLICY ACTIONS

The CBUAE performed a thorough review of banks' stress testing governance processes, models and reporting compliance. The results submitted by banks were compared with the CBUAE top-down stress testing calculation and benchmarked against their peers. Starting from 2018, the results of stress tests will serve as an input to the CBUAE risk based supervision for maintaining financial soundness of the banking sector. Banks that perform poorly in the stress test will be subjected to further supervisory review and will be required to submit a detailed plan to improve their capital adequacy.

NON-BANK FINANCIAL INSTITUTIONS

The non-bank financial institutions[21] in the UAE are less complex relative to the size and complexity of the UAE banking system; thus, with a rather limited potential to transmit systemic risks in the financial system. Risk profile of finance companies and investment companies, licensed by the Central Bank, remained stable, and their total asset size contracted by 3.5% in 2017, accounting for AED 59.8 billion.

UAE non-bank financial institutions (NBFIs) can be defined as entities conducting financial intermediation activities outside of the banking system. The NBFIs in the UAE mainly comprise of financial and investment companies, insurance companies and pension funds. This section focuses on NBFIs licensed by the CBUAE, which are finance and investment companies. Other NBFIs, insurance companies and pension funds, are excluded from this analysis, as they are licensed by other federal authorities.

Assessment of the insurance sector and capital market sector is further elaborated in Part III of the Financial Stability Report.

The finance and investment companies total asset size in the UAE is relatively small compared to the banking system, declining by 3.5% to AED 59.8 billion in 2017[22] (2016: AED 62.0 billion). This represents approximately 2% of the total UAE banking system assets. Finance companies represent around 70% of the NBFIs licensed by the Central Bank, of which the two of the largest finance companies in the UAE accounts for about 30% of total finance companies assets.

Credit intermediation activities represent the main transmission channels through which risks from NBFIs could affect the financial system or the economy.

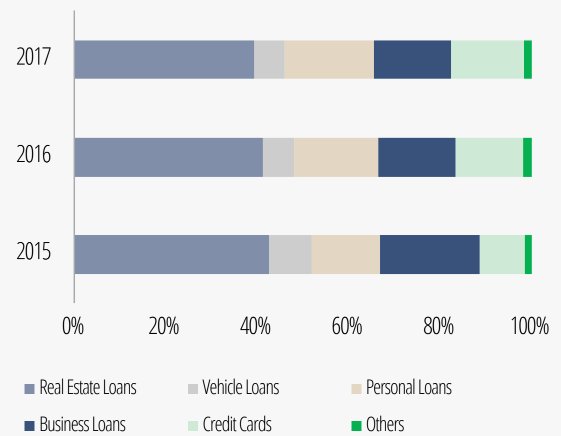
The NBFIs are also providers of liquidity in the financial system particularly to the banks through the placement of deposits. Potential risks from the volatility of their deposit placements with the banking system is low as deposit placements by NBFIs accounts for 0.2% of total banking system deposits.

FINANCE COMPANIES

Total assets of finance companies contracted by 5.7% in 2017, amounting to AED 43.0 billion. Lending activities by the finance companies continued to moderate in 2017 with total loans contracting by 1.5% (2016: -22.5%).

Finance companies' portfolios remained diversified and their composition relatively unchanged. Non-bank owned finance companies were slightly more concentrated in business loans, while bank-owned finance companies were largely exposed to real estate and personal loans.

CHART 2.25: Finance Companies' Lending Composition



Source: CBUAE

21. Assessment of this report covers finance and investment companies licensed by the CBUAE.
22. Data is as at end of September 2017.

The funding structure of the finance companies also remained stable compared to the previous year. The funding of non-bank owned finance companies was largely sourced from customer deposits. In contrast, parent banking owners constituted the key funding source for bank-owned finance companies.

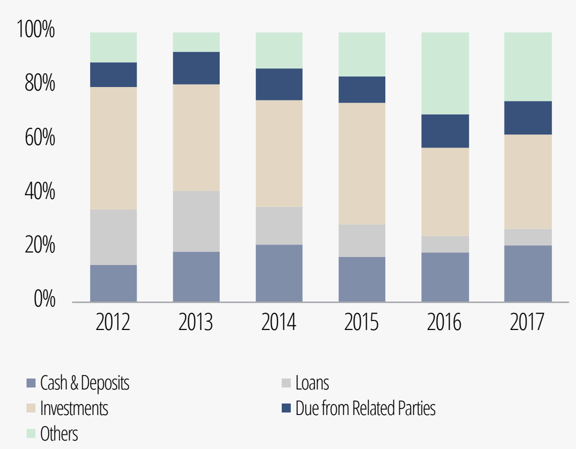
Asset quality of the finance companies remained elevated, with the aggregate NPL ratio increasing to 12.8% in 2017 (2016: 12.4%). Non-bank owned finance companies contributed to the higher aggregate NPL ratio as they are structurally more exposed to riskier asset classes than bank-owned ones.

The capital position of financial companies remained strong with a capital adequacy ratio of 30.7% in 2017 (2016: 32.6%). The leverage ratio improved to 30.7% in 2017 from 32.6%.

INVESTMENT COMPANIES

This section focuses on investment companies offering asset management and advisory services. Asset size of the sector expanded by 2.4% in 2017 (2016: 4.5%). Changes in risk taking behavior of investment companies remained limited as asset composition remained relatively unchanged. Investment assets remained largely in the form of longer-term debt securities.

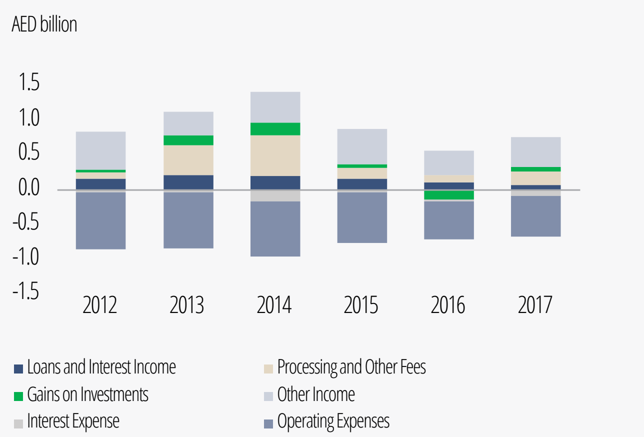
CHART 2.26: Asset Composition of Investment Companies



Source: CBUAE

Investment companies recorded a net profit of AED 0.1 billion in 2017, rebounding from the loss experienced in 2016.

CHART 2.27: Profitability Components of Investment Companies



Source: CBUAE

Capital position of investment companies remained strong with a capital adequacy ratio at 31.1% in 2017 (2016: 36.3%).

KEY BANKING SYSTEM INDICATORS

KEY INDICATORS OF THE UAE BANKING SECTOR

	2015	2016	2017
Capital Adequacy			
Tier 1 capital ratio	16.5%	17.3%	17.0%
Total capital ratio	18.3%	18.9%	18.6%
Profitability			
Return on assets	1.6%	1.4%	1.5%
Cost-to-income ratio	38.0%	38.0%	39.1%
Asset Quality			
Non-performing loans ratio	6.3%	6.4%	6.7%
Provision coverage ratio	109.8%	110.2%	107.0%
Lending Indicators			
Loan-to-deposit ratio	99.6%	99.4%	97.1%
Loan-to-deposit ratio in foreign currency	84.6%	75.1%	69.0%
Liquidity and Funding			
Eligible Liquid Asset Ratio	17.4%	16.2%	18.2%
Advances to Stable Resouces Ratio	87.1%	86.2%	84.5%

KEY INDICATORS OF THE UAE ISLAMIC BANKING SECTOR

	2015	2016	2017
Capital Adequacy			
Tier 1 capital ratio	14.9%	16.5%	16.6%
Total capital ratio	15.6%	17.1%	17.3%
Profitability			
Return on assets	1.7%	1.5%	1.7%
Cost-to-income ratio	40.0%	40.0%	37.9%
Asset Quality			
Non-performing loans ratio	7.8%	7.6%	6.3%
Provision coverage ratio	96.9%	100.0%	100.1%
Lending Indicators			
Loan-to-deposit ratio	92.2%	96.1%	92.2%
Loan-to-deposit ratio in foreign currency	86.1%	93.9%	88.9%
Liquidity and Funding			
Eligible Liquid Asset Ratio	17.0%	16.8%	20.0%
Advances to Stable Resouces Ratio	86.1%	86.7%	83.1%

REGULATORY DEVELOPMENTS

The Central Bank continues to be committed to a timely adoption of international standards in the UAE.

3

BASEL III CAPITAL FRAMEWORK IMPLEMENTATION

The Central Bank of the UAE (CBUAE) is fully committed to the adoption of internationally agreed regulatory standards, including the Basel III capital framework. The Basel III capital framework, including minimum capital requirements, supervisory review process and disclosure requirements, is a priority regulatory development initiative in the CBUAE 2017 to 2021 Strategic Plan and is to be fully implemented in the UAE by the end of 2018. Capital adequacy is a key pillar for ensuring the safety and soundness of banks. The Central Bank requires all banks operating in the UAE to comply with the UAE Basel III capital framework when assessing their regulatory capital adequacy.

BASEL III CAPITAL ADEQUACY REGULATION

The implementation of the Basel III capital framework is an important pillar in the Central Bank's new regulatory framework. The Central Bank intends to achieve full implementation of the Basel III Capital Framework in the UAE by the end of 2018. The timelines are detailed below and are in line with the timelines of the Basel III standards issued by the Basel Committee.

The Central bank issued Basel III related regulations in 2017 'Regulation re Capital Adequacy - Circular no. 52/2017' in February 2017 and accompanied standard 'Standard re Capital Supply - Notice no. 28/2018' and a related guidance 'Guidance re Capital Supply' on capital supply in January 2018. These regulations strengthen the quality of capital in line with the Basel Committee's Basel III framework, which introduces Common Equity Tier 1 (CET-1) as the capital component of the highest quality. The Basel III framework also introduces capital buffers, which are required to be fulfilled using the CET-1 capital. It is expected that banks and branches operate well above the buffer requirements. Any breach of these buffers due to market and/or idiosyncratic stress will result in supervisory actions.

To give the banking sector in the UAE time to adjust to the new capital requirements, the Central Bank has introduced a transition period. The buffer requirements will be phased in and fully implemented by 2019. The minimum capital and capital buffer requirements in the UAE are summarized in the table below.

TABLE 3.1: MINIMUM TRANSITIONAL ARRANGEMENTS

	2017	2018	2019
Minimum CET 1 ratio	7.0%	7.0%	7.0%
Minimum Tier 1 ratio	8.5%	8.5%	8.5%
Minimum CAR	10.5%	10.5%	10.5%
Capital Conservation Buffer	1.25%	1.875%	2.5%
Domestic Systemically Important Banks (D-SIB) Buffer	50%	75%	100%
	in percentage of individual capital surcharge		

While the Capital Conservation Buffer (CCB) applies to all banks as a percentage of their risk weighted assets (RWA) in the form of the CET-1 capital, the D-SIB buffer is imposed on banks that are designated by the Central Bank as systemically important in the domestic financial system. As of the end of 2017, the CBUAE designated four UAE national banks as systemically important.

D-SIB institutions are obliged to hold more capital to ensure not only their soundness and stability but also to help safeguard the stability of the UAE financial system. The development and introduction of the framework to identify Domestic Systemically Important Banks was communicated with the respective banks.

The CBUAE also developed a Basel compliant framework for Tier capital issuances to further enhance the quality of capital as part of the Basel III implementation in the UAE. The standard 'Standard re Tier Capital Instruments - Notice no. 103/2018' and related guidance 'Guidance re Tier Capital Instruments' were published in March 2018.

FURTHER BASEL III STANDARDS

The CBUAE continues to implement the Basel III framework in the UAE in line with the timelines of the Basel III standards issued by the Basel Committee. The Basel III capital project plans to implement the following capital standards during 2018 as per the table below.

The leverage ratio that serves as a backstop to the risk-based capital measures is intended to constrain excess leverage in the banking system. The leverage ratio regulation is scheduled for Q3 2018.

'Pillar 2 standard – Supervisory Review Process' and 'Pillar 3 standard –Disclosure Requirements' which form a part of the Basel III framework, are planned to be published by end of 2018.

TABLE 3.2: IMPLEMENTATION OF BASEL III CAPITAL STANDARDS IN THE UAE

Topic of standard	Planned publication dates
Tier Capital Supply	Jan 2018 (already published)
Tier Capital Instruments	Mar 2018 (already published)
OTC Derivatives / CCP / Counterparty Credit Risk	Q3/2018
Credit Value Adjustments	Q3/2018
Leverage Ratio Regulation & Standards	Q3/2018
Securitization and Equity Investments in Funds	Q4/2018
Criteria for the Eligibility of External Rating Agencies	Q4/2018
Pillar 2 standard – Supervisory Review Process	Q4/2018
Pillar 3 standard – Disclosure Requirements	Q4/2018

THE CBUAE GUIDANCE ON IFRS 9

IFRS 9 is the new international accounting standard for the classification and measurement of financial assets and liabilities. The new approach aims at more timely and forward-looking recognition of credit losses which will contribute to financial stability if implemented soundly. To ensure sound and consistent implementation of IFRS 9, the CBUAE finalised a guidance note in early 2018. The guidance prescribes the CBUAE requirement of IFRS 9 on banks' governance and control, staging and transferring, prudential treatments on impairment calculation and transitional arrangement.

IFRS 9 is the new accounting standard for the classification and measurement of financial assets and liabilities and makes fundamental changes to the methodology for measuring impairment losses. Specifically, it replaced an incurred loss approach on financial assets with a forward-looking expected credit loss (ECL) approach through a staging method. Stage 1 refers to recognising a 12-month ECL of a financial asset whose credit risk has not significantly increased. At Stage 2, a lifetime ECL is calculated for a not impaired but credit risk significantly increased financial asset. Stage 3 refers to assets already impaired and a lifetime ECL is recognised. In line with the standard, the banks in the UAE implemented IFRS 9 from 1st January 2018.

In order to ensure robust and consistent implementation of IFRS 9 in the UAE, CBUAE issued a draft guidance note on IFRS 9 and a survey for IFRS 9 impact study to all banks and financial institutions (FIs) in 2017. Based on the feedback received from the banks and FIs and discussions with audit firms, the CBUAE finalised the IFRS 9 guidance note in early 2018. The IFRS guidance note clarifies the areas where banks and FIs are expected to exercise considerable judgment and/or elect to use simplifications under the IFRS 9 Standard. To ensure banks provisioning at adequate levels under IFRS 9, the current CBUAE provisioning regulation will serve as a back stop. A brief summary of the main requirements of the CBUAE guidance note is provided in Box 3.1 CBUAE Guidance Note on IFRS 9.

The CBUAE guidance note aims at sound and prudent implementation of IFRS 9 in the UAE which will contribute to financial stability by introducing greater levels of transparency and a more timely and forward-looking recognition of credit losses. The adoption of IFRS 9 entails significant effort and investment in data collection, modelling, human and IT capitals for UAE banks in a short term. However, from a long-term perspective, IFRS 9 will require UAE banks to become more sophisticated in credit risk modelling and monitoring and create synergies with other regulatory modelling requirement (e.g. stress testing).

BOX 3.1: CBUAE GUIDANCE NOTE ON IFRS 9

Governance and Control

Banks and FIs should set up robust governance and control processes on IFRS 9.

- Banks and FIs should have at least 5 years of historical credit data and should gradually extend the data to a period of 10 years.
- Restructured exposures due to borrowers facing financial difficulty should be reported under Stage 2 at minimum. Restructured accounts will also include cases where an exposure is fully settled for subsequent disbursement as a new loan.
- Banks and FIs should endeavor to develop robust models to determine ECL and should put in place procedures to periodically assess the quality of their models.
- Banks and FIs' relevant Board Committees should oversee the banks effectiveness and reliability of reporting under IFRS 9.

IFRS 9 Transitional Arrangement

In order to mitigate the impact of the impairment requirements resulting from IFRS 9 on capital ratios, the CBUAE has the following transitional arrangement.

- A bank or FI may approach the CBUAE to apply for transitional approval of the initial IFRS 9 impairment requirement if the amount to be recognised is greater than 5% of its capital base.
- The approval by the CBUAE will be on a case-by-case basis and the maximum transitional period will be 5 years.

Staging and Transfer Criteria

Banks and FIs may transfer exposures from one stage to another according to IFRS 9 requirement. The following set up a minimum requirement on upgrading between stages.

- An exposure can only be upgraded from Stage 3 to 2.
- For restructured exposures, banks and FIs are expected to observe a probationary period of a minimum of 3 instalments (for repayments which are on a quarterly basis or shorter) or 12 months (in cases where instalments are on a longer frequency) before upgrading from Stage 3 to 2.
- If there were evidence on significant reduction in credit risk, banks and FIs would continue to monitor such financial instruments for a probationary period of a minimum of 12 months before upgrading it from Stage 2 to Stage 1.

Prudential Treatment on Impairments

- In the initial years of IFRS 9 implementation, the existing CBUAE regulation on provisioning will be maintained in parallel. Banks and FIs should recognise any shortfall in IFRS 9 impairments when compared to the CBUAE provisioning regulation.
- If the general or specific provision as per the CBUAE regulation is higher than the impairment allowance computed under IFRS 9, the difference should be transferred to an Impairment Reserve from retained earnings. The Impairment Reserve should be split to the difference in general provisions and to the difference in specific provisions.
- The Impairment Reserve will not be available for dividend distribution.
- In the case where the IFRS 9 provision is higher than the CBUAE requirement, the IFRS 9 provision will be recognised.
- Under CBUAE discretion, the Impairment Reserve may be utilised by the bank or FI to address impairments in the future. However, the reserve must be topped up if the CBUAE provisioning requirements is greater than the IFRS 9 impairment requirements.
- The details of the difference between impairments as per IFRS 9 and CBUAE requirements should be disclosed.

MACRO-PRUDENTIAL POLICY FRAMEWORK

The CBUAE has been developing macro-prudential policy framework in line with international best practices and is working towards operationalising the framework. The goal of the framework is to avoid disruption of large-scale supplies of financial services that would entail serious negative consequences for the real economy, i.e. systemic risks. This is aimed at by using specific macro-prudential instruments to mitigate build-up of vulnerabilities based on financial system-wide surveillance and an established set of early warning indicators.

The objective of the macro-prudential policy is to contribute to the stability of the financial system as a whole. This includes strengthening the resilience of the financial system and decreasing the build-up of systemic vulnerabilities, thereby ensuring a sustainable contribution of the financial sector to economic growth.

Macro-prudential policy addresses both the cyclical and structural dimensions of systemic risks. The cyclical dimension reflects the changes of systemic risks over time and the structural dimension reflects the distribution and concentration of systemic risks within the financial or other economic sectors.

In order to make the macro-prudential policy operational, more concrete intermediate goals are defined. These goals provide the basis for the implementation and activation of the macro-prudential policy.

In operational terms, macro-prudential measures seek to:

i. Mitigate effects of excessive credit growth and leverage;
ii. Mitigate effects of excessive maturity mismatch and market illiquidity;
iii. Limit effects of direct and indirect exposure concentrations; and
iv. Limit the systemic impact of misaligned incentives with a view to reducing moral hazard.

These intermediate goals will be pursued by the assessment of evolving systemic risks and the consequent activation of macro-prudential instruments to mitigate identified risks with the aim at strengthening the resilience of the financial system and limit the build-up of the identified vulnerabilities.

Macro-prudential instruments refer to measures within the Central Bank's powers, aimed at preventing systemic risk realisation in the financial system and mitigating the effects. Countercyclical–capital buffer was introduced as part of the Basel III framework[23] and kept at 0.0% as the overall credit growth in the UAE remains lackluster.

23. Circular No 52/2017: Regulations re Capital Adequacy was published by CBUAE in February 2017.

DOMESTIC SYSTEMICALLY IMPORTANT BANKS

The Central Bank of the UAE (CBUAE) designated three banks in 2016 as systemically important, comprising First Abu Dhabi Bank (FAB), Emirates NBD (ENBD), and Abu Dhabi Commercial Bank (ADCB). In 2017, the CBUAE designated Dubai Islamic Bank (DIB) as the fourth Domestic Systemically Important Bank (D-SIB) in the UAE as part of the annual review of the D-SIBs. D-SIBs are subject to higher capital requirements with transitional arrangements.

Central Bank's annual review of D-SIBs considered all of the four criteria recommended by the Basel Committee on Banking Supervision (BCBS), size, interconnectedness, substitutability and complexity. In addition, supervisory overlay criterion has been added to adjust for the UAE local market characteristics. The assessment covered national banks at their consolidated group level; while foreign banks were assessed at their UAE branch level.[24]

To ensure a higher level of loss absorbency, D-SIBs are subject to higher capital requirements. Depending on the different buckets[25] of systemic importance, the banks will be required to hold from 0.5% to 2.0% additional Common Equity Tier 1 (CET-1) starting in 2017 with a transitional period until 2019 when Basel III capital requirements are fully phased-in.

TABLE 3.3: TRANSITIONAL ARRANGEMENTS: ADDITIONAL CET-1 CAPITAL

Bucket	Banks in the bucket	Score range	2017	2018	2019
			(50%)	(75%)	(100%)
Bucket 1	DIB, ADCB	601 – 1,200	0.25%	0.375%	0.5%
Bucket 2	-	1,201 – 1,800	0.50%	0.75%	1.0%
Bucket 3	ENBD, FAB	1,801 – 2,400	0.75%	1.125%	1.5%
Bucket 4	-	2,401 – 3,000	1.0%	1.5%	2.0%

24. For more information regarding the framework, please refer to the Financial Stability Report 2016.

25. A bucket is a range of scores where it signals the level of their Systemic Importance Scores of the D-SIB, depending upon that score, a D-SIB is placed in a specific bucket, which clarifies how much an additional common equity requirement has to be applied to it.

PAYMENT SYSTEMS, CAPITAL MARKETS AND INSURANCE SECTOR

The payment systems, capital markets, and the insurance sector have a key and vital role in the UAE financial system and the economy.

4

UAE PAYMENT SYSTEMS

The UAE payment systems remained resilient and continued to operate without major disruptions. All payment systems including the primary ones, UAEFTS and ICCS, showed an increasing availability in 2017. The Central Bank has a principal role in the development, operations, management and oversight of key UAE payment systems.

UAE PAYMENT SYSTEMS LANDSCAPE

The UAE payment services ecosystem is well-established and diversified. The Central Bank provides payment and settlement services, oversees financial market infrastructures and payment instruments and works with market stakeholders to achieve financial market integration. The reform agenda in payment systems involves managing the overall risk effectively, promoting the use of electronic payment means and increasing efficiency of the settlement arrangements for all type of payment transactions.

Several initiatives were undertaken to enhance payment and settlement systems operated by the CBUAE in order to increase the efficiency of the non-cash payments, and to provide necessary infrastructure to support innovation and diversity in the different payment channels.

FRAMEWORK FOR STORED VALUES AND ELECTRONIC PAYMENT SYSTEMS

In the UAE, the retail payments platform is undergoing a permanent transformation with the introduction of multiple innovative payment means that satisfy customer needs and promote the adoption of financial technologies (FinTech). Hence, in addition to traditional channels of payment such as payment cards, new products using mobile technologies have emerged, laying the ground for an increasing cashless ratio.

In this regard, the Central Bank has given a high priority to the implementation of the Regulatory Framework for stored values and electronic payment systems issued in January 2017, as an important tool that supports the emergence of innovative retail instruments.

The CBUAE provided support to selected market players to ensure compliance with this new regulatory framework, with the objective of ensuring that these players complete the requirements before getting their license from the CBUAE based on the nature of their solutions and the type of services offered to the public.

COURT CASES MANAGEMENT SYSTEM

The CBUAE launched the new Court Cases Management System that links the UAE courts to the banking community through the CBUAE, with the objective of allowing for better transmission, processing and monitoring of execution of court orders and decisions issued by the various UAE courts, which were time-consuming and required extensive manual processing.

PAYMENT GATEWAY SYSTEM

Pursuant to the launch of the UAE Payment Gateway System in July 2016, the on-boarding of merchants and banks continued in 2017. The UAE Payment Gateway System allows the processing of e-commerce transactions at merchants level by using current and saving account held at any bank in the UAE without the need for bilateral agreements between the two sides.

REGIONAL DEVELOPMENT INITIATIVES

At the regional level, the CBUAE played an important role in strengthening the use of the AED as a settlement currency in cross-border transactions at the GCC and the Arab region level. In this context, the CBUAE was involved in the process of implementing two key systems: the GCC-RTGS project that aims at enabling real-time processing of cross border payments among GCC countries using their domestic currencies, and the Arab Regional Payment System project that envisages integrating the clearing and settlement of cross-border payments in the Arab region by facilitating the clearing and settlement of intra-regional cross border payments.

RENMINBI CLEARING CENTRE

The CBUAE has launched in 2017 the Renminbi Clearing Center in the UAE, which will enable economic operators to benefit from simplified measures in completing their transactions in Chinese currency. The improved economic cooperation between China and the UAE will have a positive impact on the UAE economy and support a wider internationalisation of the Renminbi.

DISASTER RECOVERY AND BUSINESS CONTINUITY

In 2017, the Central Bank undertook an important project to ensure that all payment systems can be operated from the Disaster Recovery site, in a preliminary step towards completing the finalisation of the Business Continuity Plan (BCP) for all the payment systems operated by CBUAE.

PAYMENT SYSTEMS OPERATED BY THE CENTRAL BANK

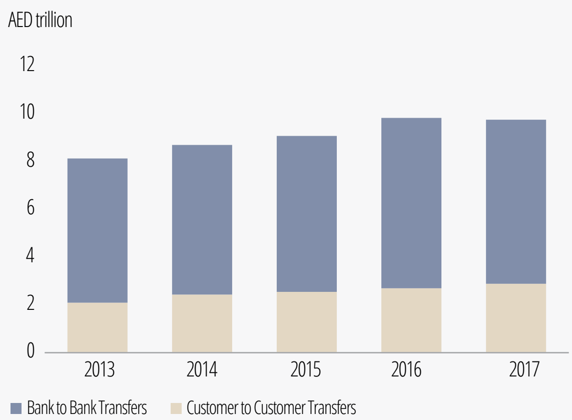
The CBUAE operates the following payment systems, which continue to function smoothly and have maintained high system availability:

1. UAEFTS (UAE Funds Transfer System)
2. ICCS (Image Cheque Clearing System)
3. UAEDDS (UAE Direct Debit System)
4. WPS (Wages Protection System)
5. UAEPGS (Payment Gateway System)
6. UAE Switch (UAE ATM network)

UAE FUNDS TRANSFER SYSTEM (UAEFTS)

The UAEFTS system continued to perform smoothly in 2017 at 100% availability. The total number of bank-to-bank transfers were around 447,000 with a turnover of AED 6.9 trillion. The volume showed a marginal increase of 3.2% from the previous year whereas the total transaction value decreased by 3.9% compared to the previous year.

CHART 4.1: Value of Transactions in the FTS System

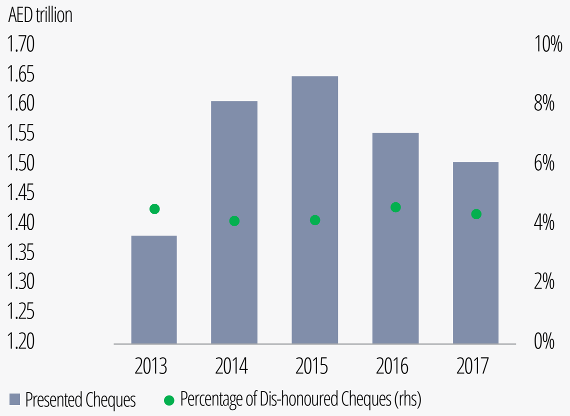


Source: CBUAE

IMAGE CHEQUE CLEARING SYSTEM (ICCS)

The ICCS reduces the dependence of the payment infrastructure on physical movement of paper and therefore facilitates shorter clearing and settlement cycles. It also facilitates quicker realization of funds on these items. In 2017, the value of cheques presented through the system decreased by 3.9%, while the share of dishonoured cheques decreased from 4.6% to 4.4%.

CHART 4.2: Total Value of Presented Cheques and Share of Dishonoured Cheques (%).

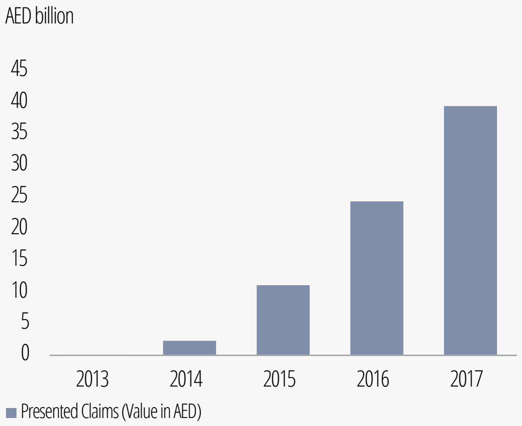


Source: CBUAE

UAE DIRECT DEBIT SYSTEM (UAEDDS)

The amount of presented claims increased by 61% in 2017 to approximately AED 40 billion.

CHART 4.3: UAEDDS Presented Claims

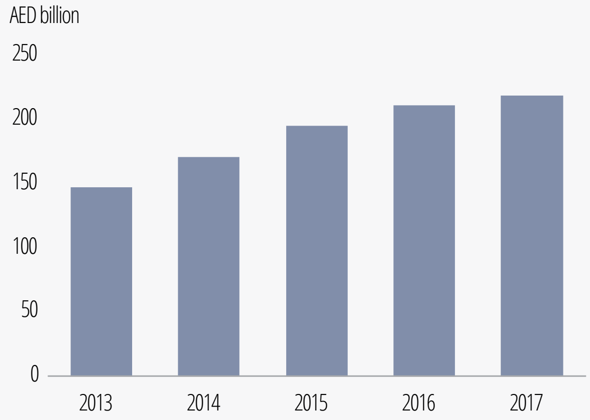


Source: CBUAE

WAGES PROTECTION SYSTEM (WPS)

The objective of the WPS is to provide a safe, secure, efficient and robust mechanism to streamline the timely payment of wages to employees. Usage of the WPS improved since its inception with the value of transactions gradually increasing to AED 219 billion during 2017.

CHART 4.4: Value of Transactions on the Wage Protection System

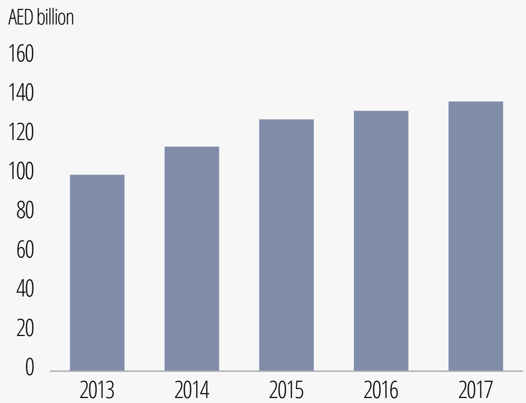


Source: CBUAE

UAE SWITCH

Use of the network has grown over the years so that during 2017, the number of transactions was over 95 million with cash withdrawals worth AED 137.4 billion.

CHART 4.5: Cash Withdrawals Made by UAE Card Holders in the UAE



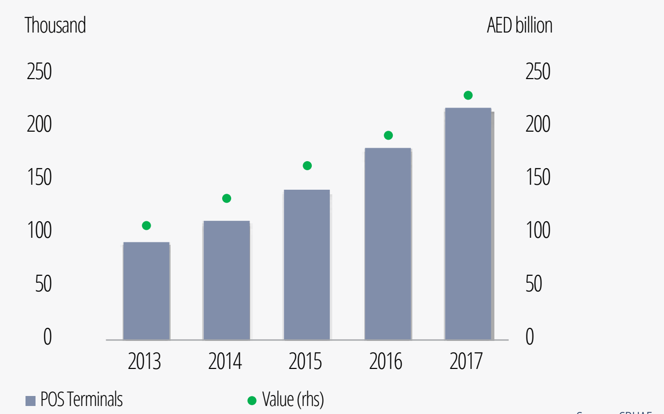
Source: CBUAE

PAYMENT CARDS IN THE UAE

The CBUAE monitored payment cards activity in the UAE to ensure that appropriate security measures for payment cards are implemented towards overcoming any risk of fraud. In 2017, the share of debit and credit cards compliant with the EMV standards with Chip and PIN technology reached around 99%. Regarding prepaid cards issued by UAE banks, the compliance with the EMV standards increased to 44%.

The number of point of sale terminal (POS) terminals in the UAE increased in 2017 to over 200 thousand with the transaction volume exceeding AED 200 billion.

CHART 4.6: Value of PoS Transactions and Number of PoS Terminals



Source: CBUAE

ASSESSMENT OF THE UAE PAYMENT SYSTEMS

The overall assessment conducted by the CBUAE of the major payment systems using the Principles for Financial Market Infrastructure (PFMI) methodology showed that the UAE payment systems are relatively sound and are not a source of any potential risk that might affect the stability of the financial system in the UAE.

The CBUAE conducted a full assessment of the two systemically important payment systems: the UAEFTS and the ICCS, based on the PFMIs to ensure that the infrastructure meets the required global standards. The assessment showed that UAEFTS and ICCS are fully compliant with most PFMI principles and broadly or partially compliant with some of the principles. The CBUAE prepared action plans to implement required measures to ensure a full compliance of the payment systems.

In 2017, a similar assessment exercise was performed on the retail payment systems such as the UAEDDS (UAE Direct Debit System), UAESWITCH (ATM network) and UAEWPS (Wage Protection System). The outcome of this exercise showed a good level of compliance, despite few minor aspects that need to be addressed.

In June of 2015, CBUAE issued Notice No. 151/2015 instructing banks to upgrade ATM Security to counter ATM Skimming. Consequently, the skimming attacks and related financial loss decreased substantially making this CBUAE initiative to limit ATM frauds successful.

NEW INITIATIVES PLANNED FOR 2018

The Central Bank's priorities in payment systems field for the year 2018 are:

1. Finalization of the Business Continuity Plan (BCP) for all the payment systems operated by CBUAE.
2. Continue providing support to the Payment Services Providers to ensure the implementation of the new regulatory framework for stored values and electronic payment systems effective since 1 January 2017.
3. Strengthening the position of the UAE in the regional payment ecosystem. The CBUAE will work during 2018 towards achieving the milestones set in the two regional projects at the GCC level and at the Arab regional level.
4. Enhance the integration of the various payment processes in the UAE. The focus during 2018 will be on the integration of the cash leg of the securities settlement in the UAEFTS being the RTGS system of the country.
5. Launch Phase 2 of the UAE Payment Gateway System that would allow the use of debit card as a source of funding for e-commerce transactions.
6. Incorporate cyber-resilience guidelines issued by the Committee on Payments and Market Infrastructures of the BIS to assess payment systems and ensure that they are well protected from any type of cyber infiltration and disturbance.

UAE CAPITAL MARKETS - CONTRIBUTED BY THE SECURITIES AND COMMODITIES AUTHORITY

The total market capitalisation in Abu Dhabi and Dubai stock markets reached AED 882.7 billion in 2017, with the banking, telecommunications, and real estate sectors representing the largest share. On the primary markets, the capital raised through initial public offerings in the UAE during 2017 surpassed other GCC countries. On secondary markets, stock markets declined during 2017 in both Abu Dhabi and Dubai, in part due to the impact of geopolitical tensions in the region.

STOCK MARKET PERFORMANCE AND DEVELOPMENTS

PRIMARY MARKET DEVELOPMENTS

The United Arab Emirates (UAE) topped the list of countries in the GCC in terms of raising capital through initial public offerings in 2017. The total capital of the 5 companies that were registered with SCA as Public Joint Stock Companies (PJSC) during the year exceeded AED 74 billion. SCA also approved the offering of shares of Emaar Development Company as a public shareholding company with a capital of AED 4 billion. The company's 800 million shares had a total value of AED 4.8 billion. The shares were listed in Dubai Financial Market (DFM) with a market capitalisation of AED 24.1 billion. SCA also approved Abu Dhabi National Distribution Company (ADNOC) as a local public shareholding company with a capital of AED 1 billion divided into 12.5 billion shares, with issuance of 1.25 billion shares valued at AED 3.125 billion. The company's shares were listed on the Abu Dhabi Securities Exchange (ADX) with a market capitalisation of AED 31.25 billion.

SECONDARY MARKET PERFORMANCE

The total number of listed companies on the Abu Dhabi Securities Exchange is 66, representing 51% of the total publicly listed companies listed in the UAE market. The number of companies listed on the Dubai Financial Market is 64.

Stock markets during 2017 declined in both Abu Dhabi and Dubai. Most sector indices in the Dubai market, however, rose with the best performing sector being the services sector, while four sectors led by consumer goods sector showed a decline. In the Abu Dhabi Securities Exchange most sectors showed a decline with the exception of the energy, industry and insurance sectors, the best performing being the energy sector. The reason for this is that the year 2017 witnessed geopolitical tensions in the region which undoubtedly affected the local markets, as well as the trend of groups of foreign and local investors liquidating some of their stock holdings in favor of investing in new investment trends such as virtual currencies, as well as the rise in prices of the US dollar and gold during the year.

AVERAGE DAILY TRADING VOLUME

The average daily trading volume of the Abu Dhabi Securities Exchange and the Dubai Financial Market for 2017 reached AED 652.46 million for both markets combined. The combined average total volume of daily trading declined in 2017 by about 11% compared to 2016.

TABLE 4.1: AVERAGE DAILY TRADING VOLUME* (AED MILLION)

ADX	192.36
DFM	460.1
Total	**652.46**

Note: * Includes locally listed companies, dual listing companies, bonds, and private companies

SECTOR PERFORMANCE

The following tables and charts show the performance of stock prices and trading values of listed companies by sector for Abu Dhabi and Dubai financial markets:

The highest value of traded shares was in the real estate sector followed by banks with AED 57.6 billion and AED 48.4 billion traded value, respectively.

TABLE 4.2: STOCK MARKETS – SECTOR PERFORMANCE

Abu Dhabi Securities Exchange	2016 Close	2017 Close	% Change	Market capitalisation	Traded value
Banks	7,549.49	7,494.70	-0.73%	205,529,193,795	15,301,074,911
Telecommunications	4,657.70	4,335.63	-6.91%	180,171,014,743	5,689,518,583
Energy	1,087.38	1,443.48	32.75%	42,112,529,972	5,142,471,462
Real Estate	4,282.97	3,567.98	-16.69%	20,459,271,376	12,635,336,554
Industry	2,026.28	2,050.17	1.18%	10,470,881,812	997,813,078
Insurance	1,904.32	2,163.44	13.61%	9,211,906,132	721,943,191
Services	2,727.32	2,444.74	-10.36%	8,716,280,348	302,943,426
Consumer Staples	2,982.54	2,206.57	-26.02%	4,386,860,000	2,146,115,152
Investment and Financial Services	2,664.59	2,647.03	-0.66%	4,330,356,215	830,536,315
Dubai Finacial Market	**2016 Close**	**2017 Close**	**% Change**	**Market capitalisation**	**Traded value**
Transport	826.04	820.99	-0.61%	24,223,561,293	4,947,884,441
Banks	2,262.95	2,333.21	3.10%	165,205,351,294	33,144,326,214
Real Estate	7,164.40	6,719.75	-6.21%	132,038,848,008	44,975,998,091
Telecommunications	1,046.51	860.84	-17.74%	23,635,093,715	4,498,162,408
Investment and Financial Services	3,730.41	3,737.61	0.19%	22,867,387,063	11,736,443,545
Services	569.30	718.82	26.26%	9,062,263,006	5,952,945,099
Consumer staples	779.38	366.85	-52.93%	7,298,513,745	4,535,969,116
Insurance	1,527.70	1,556.93	1.91%	5,711,579,957	4,427,410,913
Industry	119.40	119.40	0.00%	3,719,430,558	4,947,884,441

TOTAL MARKET CAPITALISATION

More than 80% of the UAE market capitalisation was in the banking, telecom and real estate sectors. The total market capitalisation by the end of 2017 (including dual listing, private companies and debt instruments) reached AED 882.670 billion combined in both markets.

DIVIDEND YIELDS[26] AND PRICE-TO-EARNINGS[27]

The dividend yield during 2017 increased to 5.3% in ADX while declining to 3.3% in DFM. The price-to-earnings multiple during 2017 declined in ADX to 14.5 and increased in DFM to 12.61.

TABLE 4.5: DIVIDEND YIELD

2016	2017	% Change
	ADX	
4.89	5.33	9%
	DFM	
3.69	3.32	-10.03%

TABLE 4.6: PRICE-TO-EARNINGS MULTIPLE

2016	2017	% Change
	ADX	
18.96	14.50	-23.52%
	DFM	
11.11	12.61	13.50%

NET FOREIGN INVESTMENT INFLOW

The below data show net foreign investment inflows in the UAE stock markets during 2017, with a total market value of AED 132.5 million.

TABLE 4.5: NET FOREIGN INVESTMENT INFLOWS IN AED DURING 2017 (IN AED)

ADX	1,745,526,420
DFM	-1,613,013,092
Total	**132,513,327**

NET INSTITUTIONAL INVESTMENT

The following table shows the net institutional investment in the UAE stock markets in 2017. These investments witnessed a positive flow of AED 2,862.28 million during the year.

TABLE 4.6: TABLE NET INSTITUTIONAL INVESTMENT FLOW DURING 2017 (IN AED IN 2017)

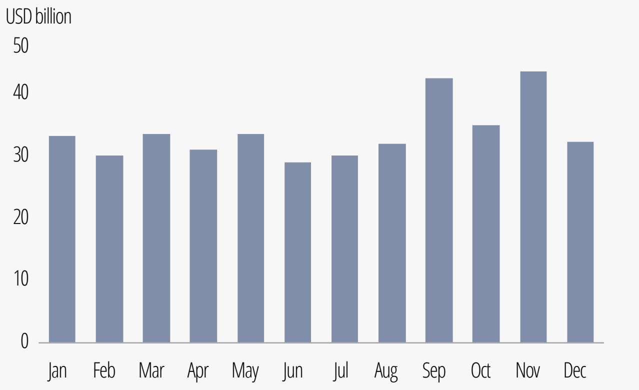
ADX	1,931,298,047
DFM	930,976,234
Total	**2,862,274,281**

COMMODITIES MARKET

The Licensing Department of SCA continued to work with the Compliance Department of the Dubai Gold and Commodities Exchange (DGCX) with the aim of achieving better efficiency in the process of granting, renewing and revoking licenses to brokerage companies. Three new brokerage companies were licensed by the SCA during the year. The SCA approved during 2017 a variety of listing contracts on the DGCX including 44 single equity futures contracts based on listed Indian equities, the inclusion of a future contract for Dubai Gold Shanghai.

26. Which is an indicator of the return gained from dividends, and is calculated as follows: Dividends per share/ price per share.
27. Which is an indicator of how much investors are willing to pay per dirham of earnings, and is calculated as follows: Price per share / earnings per share,

CHART 4.7: Total Value of Traded Contracts on DGCX during 2017



Source: Securities and Commodities Authority

RISKS

In 2015, the Federal Law No. (2) for the year 2015 was issued on commercial companies. Among the articles of the law is that companies must adjust their conditions in accordance with the provisions of the new law and amend their articles of association accordingly. The period has been extended for another year, so that the deadline has expired during the first half of 2017. The challenge was for the Authority to review the Articles of Association of all public shareholding companies in a very short period of time. The Authority shall act as a coordinator with the other regulatory bodies to approve these amendments

Rapid industry developments: The Authority has developed different scenarios for future changes and how to deal with them under different market conditions. These scenarios have been translated into initiatives that SCA can undertake in light of future challenges.

Oil prices: The oil market improved in 2017 as prices rose for the second year in a row. However, the pace of the rise was much slower than in 2016. It is known that there is a negative sentiment impact of lower oil prices in the sense that the small increases in prices do not stimulate the rest of the sectors, including the securities markets.

US interest rate hike: The US Federal Reserve increased the interest rate to 1.5%, and is expected to continue raising the interest rate 3 times again during the year 2018 by a quarter percentage point, and will result in a higher interest rates in a similar manner in the UAE because of the UAE dirham pegged to the US dollar, which may lead to pressure on stock prices.

The emergence of new and innovative financial products, services and technology companies: These developments and innovations in the capital markets and the financial industry generally pose a challenge to regulators in keeping pace with these developments and assessing their impact on the industry, markets, and regulatory objectives, while taking into account the need to allow for positive innovation for the benefit of markets and consumers. Such technological innovations entail many risks, the most important of which are regulatory and legal risks due to the classification, licensing and supervision, the difficulty of monitoring cross-border transactions, the operational risks of enterprises adopting these technologies, the risks of electronic security, privacy and data protection.

The emergence of a wave of digital and virtual currencies: SCA noticed that many entities were promoting digital currencies, 'Initial Coin Offerings' and 'Initial Token Offerings' locally by publicly inviting investors, whether online or through conferences and industry gatherings. Risks associated with investing in these products include: fraud and lack of regulations; risk of foreign laws and regulations; recovering or tracing invested funds may prove extremely difficult in practice; ICO trading in secondary markets may be subject to opaque and volatile pricing and insufficient liquidity; many investors especially retail may not be able to understand the risks. As part of the Authority's keenness to achieve the goal of protecting investors, the Authority issued a cautionary statement alerting investors and making them aware of the risks involved in these transactions and drawing the attention of investors to the need to exercise maximum caution against all activities of fund-raising based on investments in digital assets, cryptocurrencies, and token tools. SCA also confirmed that at the moment it does not regulate or control these instruments or even recognize them, and does not provide any legal or regulatory protection, and it is necessary for the investor to realize that the consequences of engaging in these types of activities rests with the investor and he/she is fully responsible for his/her decision. In addition, all issuers of digital products / instruments referred to above, and intermediaries engaged in or advising on brokerage activities, as well as platforms for distribution of these instruments, should seek legal advice and consult with regulators to ensure compliance with all laws and regulations in this regard.

SCA continued to address the risk of electronic threats, updating and replacing security and protection devices, which increases the security level of internal and external systems and websites from penetration.

The promotion of financial products and services provided by companies in the free zones or outside our jurisdiction to local investors poses clear regulatory risks in the area of investor protection and the protection of the integrity of local markets.

Due to the fact that some companies or natural persons not subject to the supervision of SCA or local authorities conduct some financial activities or provide some financial services to the public within the State without obtaining a license or approval or approval by SCA were in violation of the regulations in force. A decision has been made to issue warnings to protect the public from such practices that may be misleading, suspicious or fraudulent.

REGULATORY DEVELOPMENTS AND INITIATIVES

SCA introduced the Promotion and Introducing Regulations: which state that the promotion of financial products to persons in the UAE requires an SCA licence. Licensed promoters (other than funds) will only need to notify the SCA of any promotions they make in the UAE.

In the area of regulation of the funds industry: SCA issued regulations pertaining to specialized funds such as private and venture capital funds, general/ limited partnership funds, real estate funds. It has also made important updates to the investment management regulations.

SCA continues to work closely for a smooth transition of our local exchanges/markets into the SRO-model with a trust in its potential in enhancing the quality and efficiency of regulatory and supervisory functions, which will help play a role upgrading the classification of our financial markets as developed markets.

SCA has recently entered into an agreement with PricewaterhouseCoopers to develop a regulatory framework for financial and regulatory technology in the UAE capital markets to provide a safe environment for experimenting with new ideas that have potential to create benefits for the markets and consumers of financial products and services. SCA is also constantly participating in dialogues with other international entities through leading organizations such as the IOSCO on these matters.

In line with the direction of the UAE vision to build sustainable economies, SCA has taken the initiative to develop a comprehensive roadmap for developing and promoting sustainable and green capital markets that provide projects and ventures with the necessary funding channels through capital markets.

SCA is now working on updating its corporate governance rules in line with international best practices with a special focus on sustainability and ESG-related matters, risk management, the effects of technological developments, and executive compensation.

In an effort to instill trust in the markets, SCA launched recently a program to assess and classify financial intermediaries that fall under its regulatory remit, and announced that registration is open for those interested to take part in the program.

SCA continues to support the thriving Islamic finance sector and promote our vision of making the UAE a global centre of the Islamic economy, SCA recently launched comprehensive strategy for Islamic capital market development which covers: SCA's supervisory role played by SCA (legislation and powers), the role played by self-regulatory organizations (SROs) (i.e. financial markets), and the challenges encountered that need to be addressed.

In the areas of market infrastructure: SCA's had issued CCP Regulations for clearing houses and central clearing counterparties for commodities and stocks. SCA is working to separate clearing and settlement operations from trading operations on the local exchanges as we move to enhance the UAE equity market's infrastructure in line with MSCI's developed market upgrade requirements. Separate General Clearing Membership is being created for firms wishing to conduct clearing activities in local financial markets, with higher prudential requirements.

As part of its efforts to reduce the number of violations in the licensed capital markets in the country, SCA has intensified the proactive regulatory procedures through the inspection of licensed entities and publicly listed companies operating in the country as well as by means of periodic verification of financial reports to verify the validity and integrity of the procedures followed.

SCA issued rules for publishing the names of violators and a summary of their violations on SCA's website, issuing warnings to the public about those who carry out financial activities or provide services without obtaining the necessary approval or authorization from SCA, as well as the referral of serious violations to the competent judicial authorities.

Countering financial crime remains a top priority for the SCA and SCA have issued last year enhanced AML regulations that are in line with international developments; incorporated into new Act harsher penalties for violations and working on regulations pertaining to investor protection schemes, and whistleblower protection.

A Decision Regarding Controls for Publishing Warnings: Given that some corporations or natural persons, who do not fall under SCA's supervision, undertake financial activities or provide capital market-related services to the public without a license or an approval to do so, thus violating SCA's regulations in force. SCA may publish the name of the natural or legal person, local or foreign, who engages in unsound or illegal capital market-related practices, such as fraud or deception.

SCA monitored the existence of bodies working in the field of collective funding Crowdfunding without a license, and in coordination with the concerned authorities in the State, such as the Ministry of Economy and the Central Bank to coordinate the legislative and regulatory efforts.

SCA has reviewed several rules proposals by exchanges including: DFM's Murabaha transactions guidelines, DFM's Repo transactions guidelines, Securities Lending and Borrowing, shot selling, Direct Market Access, Margin trading, Proprietary trading rules, Derivatives trading rules, and others.

UAE INSURANCE SECTOR - CONTIBUTION OF THE INSURANCE AUTHORITY

The insurance sector of the United Arab Emirates has a vital role in the economy and a key function in addressing risk exposures, as well as protecting persons, corporates, and properties against potential risk events. The UAE insurance market maintained a first rank in the Middle East and North Africa (MENA) in terms of the Gross Written Premiums over the past 10 years, which also demonstrates the strength of the UAE insurance market.

LEGISLATIVE LANDSCAPE

Last year, the Insurance Authority was keen to complete the promulgation of the legislations regulating the insurance sector in order to ensure an appropriate environment for its development and to enhance the role of the insurance industry, as follows:

FULL IMPLEMENTATION OF THE FINANCIAL REGULATIONS ON INSURANCE COMPANIES

At the end of 2014 Board of Directors of the Insurance Authority, issued Decision No. (25) Of 2014 Pertinent to Financial Regulations for Conventional Insurance Companies and Decision No. (26) of 2014 Pertinent to Financial Regulations for Takaful Insurance Companies, which regulate the financial, technical, investment, and accounting operations of Conventional and Takaful insurers operating in the UAE.

These Financial Regulations which cover the financial, investment, technical and accounting operations of UAE insurance companies were seen as a significant move ahead in developing the regulatory principles and technical rules for the development of UAE insurance market performance, and to protect the rights of policyholders and shareholders; and they represent an advanced and key step toward regulating the operations of Conventional and Takaful insurance companies operating in the UAE and boosting their performance as per the best competitive standards worldwide.

The issuance of the Financial Regulations put the UAE at the forefront of the Middle East with regard to adopting the latest solvency requirements similar to the European model.

The Financial Regulations required a significant upgrade of almost all internal systems and procedures for insurance companies operating within the UAE and in recognition of this, there were alignment periods of from one to three years for various components of the regulations. While many of the key features of the Financial Regulations have been in effect since year-end 2015 or year-end 2016, the final stages of the alignment period during 2017 was focused on the Investment Limits and the Solvency Requirements. The Financial Regulations are now in full force for all financial reporting beginning with year-end 2017.

During 2017, the Insurance Authority held numerous workshops for the Industry, issued a circular regarding the interpretation of the investment limits, issued new regulations for actuaries, issued updates to the standardized financial reporting forms (eForms), and continued in depth inspections of all insurance companies with the goal of helping companies comply with the new regulations. By the end of 2017, all companies needed to have all of their systems and procedures updated so that they were ready to publish financial statements for year-end 2017 in compliance with the new regulations.

NEW INVESTMENT RULES TO PROTECT THE RIGHTS OF POLICYHOLDERS AND COMPANIES AGAINST RISKS

Regulations on The Basis of Investing the Rights of the Policyholders aim at protecting the rights of policyholders and shareholders of insurance companies alike, in addition to protecting the companies themselves against future potential risks by the regulation and control of the investment activities of the insurance companies.

Such principles are intended to establish controls for investment activities of the insurance companies to ensure liquidity, profitability, safety, and diversity without engaging in investments incompatible with the nature of the company's activities and business, which may undermine its financial position. They also aim to direct the insurance companies to focus and give priority to developing and promoting their main operational activity, namely the insurance business.

The Regulations include provisions that boost the role of Boards of Directors of the companies in supervising the investment performance and diversity of investments, emphasizing the principles of corporate governance, activating risk management, and adopting stress tests when developing, implementing and evaluating the investment policy of the company.

During 2017, the Insurance Authority issued Board of Directors Decision No. (22) Pertinent to the Basis of Enforcement of the Investment Limits in Section (1) of the Financial Regulations. These new rules are designed to clarify the relationship between the Investment Limits and the Solvency Margin of the companies. For companies with a strong solvency position the rules allow more freedom in their investment activities within the risk management framework of the Financial Regulations. For companies with solvency issues, the freedoms are restricted, company actions are clarified and triggers for regulatory action are specified.

REGULATIONS ON SOLVENCY MARGIN AND MINIMUM GUARANTEE FUND

The Solvency Margin bears paramount importance in the insurance industry as it serves as an additional parameter for control and oversight and a tool to verify the company's ability to meet its obligations in the manner that ensures maintaining the soundness of the insurance companies' financial positions and detecting any flaw that may occur in such positions. Furthermore, the Solvency Margin serves as an ancillary indicator that directs the risk tolerance policy of the company, in addition to the prudent corporate management's endeavor to enhance the Solvency Margin as a key goal pursued to ensure the continuity of the company, since the higher the Solvency Margin of a company is, the safer, more secure and more reputable the company will be, which increases its opportunities to get a larger market share.

This section of the Regulations was developed based on the key principles of Solvency II (in Europe), which measure the key risks that may compromise the ability of companies to meet their obligations, due to the international requirements imposed by the IAIS, where the UAE is an active member, in addition to the multiple and diversified risks that the insurance companies are exposed to.

One of the most important objectives of issuing these Regulations is to provide an early warning system to detect flaws in the companies' financial conditions, which would increase the potentials for addressing such financial flaws in the early stages, which in turn would help fortify the control and monitoring regulations over the insurance companies. Additionally, these Regulations aim at enhancing the ability of insurance companies to accommodate potential financial shocks and crises, and thereby creating a reliable insurance market and help the financial stability in this market.

The Regulations include provisions related to the Solvency Margin which include Minimum Capital Requirements (a fixed lower limit under the Law), Solvency Capital Requirements (a risk adjusted limit based on Solvency II), and Minimum Guarantee Fund (a risk adjusted limit based on Risk-Based Capital requirements). These three limits work in combination to gradually increase the Solvency Margin requirements for each company based on their individual risk profile.

The Solvency Margin forms (included with the eForms) were developed prior to the Financial Regulations and cover underwriting, market, liquidity (investment risks), credit and operational risks. During 2017, the Insurance Authority conducted an in depth review of all the calculations, created a detailed comparison with the calculations in Solvency II, proposed enhancements to the Solvency Margin forms, and calculated the impact of these enhancements on all companies operating in the UAE, so that the enhanced Solvency Margin calculations are being used for year-end 2017 financial reporting.

As a result of the enhanced Solvency Margin calculations, the Solvency Capital Requirement (SCR) should more accurately measure the risks faced by each company operating in the UAE while keeping the overall industry SCR level unchanged. Because of the importance of the Minimum Guarantee Fund (MGF) as a lower bar for regulatory action, the requirements were strengthened by an average of 10% for each company.

REQUIREMENTS FOR QUALIFIED ACTUARIES OPERATING IN THE UAE

The Financial Regulations include numerous technical calculations, such as the technical provisions, investment risk analysis, solvency margins, etc. which are critical components for ensuring the financial health of insurance companies operating in the UAE. Because of this critical role for actuaries, the Insurance Authority Board of Directors issued Decision No. (9) of 2017 Concerning the Regulations on Licensing and Registration of Actuaries and the Regulation of their Operations.

These Regulations aim at regulating the technical capabilities and duties of the Actuary, maintaining the capacity and independence of the Actuary, and insuring that individual actuaries are not overstretched which could lead to conditions that could compromise their ability to fulfill their duties.

STRENGTHENING THE FINANCIAL REPORTING REQUIREMENTS

During 2017, the Insurance Authority continued to enhance the financial reporting standards by updating the eForms and issuing new data quality reporting requirements including a zero tolerance policy. In addition to the enhancements for the solvency requirements noted above, other key updates to the eForms include refinement of the details for many forms, additional data quality checks, and expansion of the details in many areas of data reporting.

As part of the reporting requirements, the number and quality of the reporting requirements continued to expand in 2017 with the key addition of the Financial Condition Report.

ADVANCING THE MOTOR TARIFFS

Following the minimum and maximum Motor Tariffs that were issued at the end of 2016, the Insurance Authority has been monitoring the level of premiums for Motor insurance over 2017. At the end of 2017, the Insurance Authority made amendments to the tariff that took effect from 1/1/2018. The main change was to introduce a form of No Claim Discounts, where individuals buying Motor insurance can benefit from discounts if they had no claims. Additionally, companies were provided more flexibility in setting the prices of fleet policies if the fleet has had a favorable claims experience. The Insurance Authority has also allowed companies to provide Loyalty Discounts to their customers of up to 10%, and has allowed certain discounts for vehicles running by gas or electricity.

AMENDMENT THE MINIMUM CAPITAL REGULATIONS OF INSURANCE COMPANIES

The Cabinet resolution No. (16) of 2017 states that at least 51% of the capital of a company incorporated in the Country must be owned by National persons of UAE or GCC Nationals or by Juridical persons wholly owned by citizens holding UAE or GCC nationality.

COMMON REPORTING STANDARD REGULATIONS

During 2017, the Insurance Authority issued Board of Directors Decision No. (32) Concerning the common reporting standard regulations, these regulations identified the standard for automatic exchange of financial account information developed by the Organisation for Economic Co-Operation and Development (OECD).

ORGANIZATION OF THE POINTS OF SALE AFFILIATED TO INSURANCE COMPANIES

The Insurance Authority issued Board's Decision No. (37) of 2017 concerning the Instructions for the Licensing and Registration of the Points of Sale affiliated to Insurance companies and the Organization of their Operations.

These regulations introduced conditions for Licensing and Registration to open a point of sale of insurance companies to exercise particular functions such as (issuing insurance policies in the lines of Motor Insurance, Health Insurance and Travel Insurance – Identifying damages to vehicles – Receiving documents related to the claims of the lines, in which the point of Sale is authorized to carry out).

THE WORK GUIDE OF THE INTERNAL CONTROLLER AT INSURANCE BROKERAGE COMPANIES

The job of the Internal Controller in the insurance companies and insurance brokers is one of the new jobs being created. Who plays a vital role to the insurance brokerage companies in providing assurance regarding the assessment and effectiveness of risk management, internal control systems of the company, governance and compliance with policies and regulations.

Therefore at the end of 2017, the Insurance Authority published the guideline manual of the Internal Controller at insurance brokerage companies, included the template for Internal Control report, which must be uploaded to the website of the Insurance Authority in quarterly and annually bases.

FUTURE DIRECTION AND RISKS FACING THE INSURANCE INDUSTRY

With the completion of the alignment periods, most companies have fully complied with both the letter and spirit of the new Financial Regulations, but there is a risk that some of the weaker companies may either need to discontinue operations or look to merge with or be acquired by a stronger company. In general, Financial Regulations have strengthened the entire UAE insurance market, but there is more work to be done. During 2017, a multi-year study of the Life insurance market with the aim of creating new Life insurance regulations, and draft regulations concerning capital requirements for Foreign Branches drew closer to conclusion. The Insurance Authority expects both of these to become new regulations in 2018.

For year-end 2017, the Insurance Authority expects that companies in total will report higher earnings compared to prior years, driven largely but increased profitability in the Motor segment. In the longer run, results are expected to stabilize as healthy competition leads to more transparency in the market, possibly linked to the introduction of Telematics in 2018.

MARKET DEVELOPMENTS AFFECTING THE UAE INSURANCE SECTOR

COMPULSORY HEALTH INSURANCE IN DUBAI

The implementation of compulsory Health Insurance to all person's residents in the Emirate of Dubai contributed to increase the penetration of coverages of health insurance.

VAT IMPLEMENTATION

The Federal Decree-Law No. (8) of 2017 on Value Added Tax, was issued to define the scope, percentage and responsibility of imposing taxes, and the taxes on the supply of goods and services, in their different cases. The Executive Regulations of the mentioned Federal Decree was issued to determine the scopes of the supply of goods and services and the supply of more than one component, and the exceptions related to deemed supply.

The Value Added Tax “VAT” is applied to Non-life insurance business issued after 1/1/2018, In addition to in-force insurance contracts issued in 2017 on the basis of the remaining period of the policy as of 1/1/2018 until the end of the insurance contract.

Although the Implementation of the 5% Value Added Tax (VAT) in 2018, but it is applied to in-forcing insurance contracts on the same basis and rules of the contracts in force in the other taxable sectors in the UAE.

PERFORMANCE OF THE UAE INSURANCE SECTOR

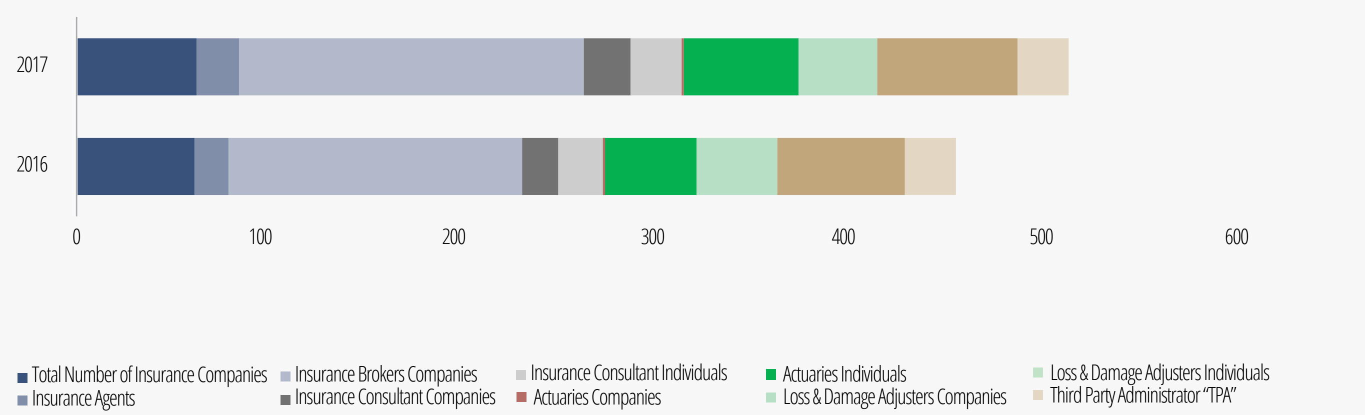
LICENSED INSURANCE COMPANIES AND RELATED PROFESSIONS

The insurance sector witnessed the entry of new players in the market as well as the insurance related professions.

TABLE 4.7: LICENSED INSURANCE COMPANIES AND RELATED PROFESSIONS

Item		2016	2017
Insurance Companies	Conventional Companies	50	50
	Takaful Companies	11	12
	Total Number of Insurance Companies	61	62
Insurance Agents		17	22
Insurance Brokers Companies		152	178
Insurance Consultant	Companies	18	24
	Individuals	23	26
Actuaries	Companies	1	1
	Individuals	48	59
Loss & Damage Adjusters	Companies	42	41
	Individuals	65	72
Third Party Administrator		27	27

CHART 4.8: Development of Licensed Insurance Companies and Related Professions



Source: Insurance Authority

KEY INDICATORS OF INSURANCE COMPANIES' PERFORMANCE

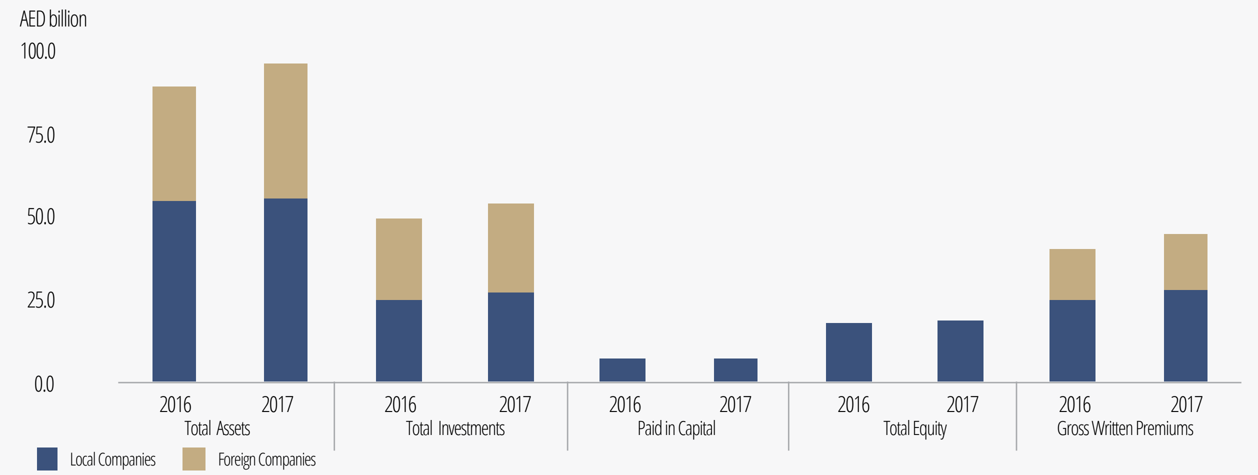
The volume of Gross Written Premiums of the insurance market increased to AED 44.7 billion, according to the preliminary data for 2017, compared to AED 40 billion in 2016. The Gross Written Premiums of Property and Liability insurance types increased to AED 32.8 billion in 2017, compared to AED 29.4 billion in 2016. The health insurance accounted for the largest proportion in P&L insurances (50.1%), followed by the Accident and Liabilities insurance (33.4%), while the Gross Written Premiums of the Life Insurances and Funds Accumulation operations increased to AED 11.9 billion in 2017, compared to AED 10.6 billion in 2016.

TABLE 4.8: KEY INDICATORS OF INSURANCE COMPANIES' PERFORMANCE

	Total Assets		Total Investments		Paid in Capital		Total Equity		Gross Written Premiums		Net Profit / Loss	
	2016	2017*	2016	2017*	2016	2017*	2016	2017*	2016	2017*	2016	2017*
Local Companies	54.9	55.8	24.8	27.0	7.2	7.5	18.1	19.1	24.9	28.1	1.2	1.6
Foreign Companies	34.6	40.1	25.0	26.9	0.0	0.0	0.0	0.0	15.1	16.6	-0.3	0.7
Total	89.5	95.9	49.8	53.9	7.2	7.5	18.1	19.1	40.0	44.7	0.9	2.3

Note:* Preliminary data for 2017

CHART 4.9: Key Indicators of Insurance Companies' Performance



LIST OF ACRONYMS

List of Acronyms

ADCB	Abu Dhabi Commercial Bank
ADNOC	Abu Dhabi National Distribution Company
ADR	Average Daily Revenue
ADX	Abu Dhabi Securities Exchange
AED	United Arab Emirates Dirham
ASRR	Advances to Stable Resource Ratio
AML	Anti-Money Laundering
ATM	Automated Teller Machine
BCBS	Basel Committee on Banking Supervision
BCP	Business Continuity Plan
BIS	Bank for International Settlements
Bps	Basis Points
CAR	Capital Adequacy Ratio
CBUAE	Central Bank of the UAE
CCB	Capital Conservation Buffer
CCP	Central Counterparty
CD	Certificate of Deposit
CDS	Credit Defaults Swaps
CET-1	Common Equity Tier 1
CPMI	Committee on Payments and Market Infrastructures
DFM	Dubai Financial Market
DGCX	Dubai Gold & Commodities Exchange
DIB	Dubai Islamic Bank
D-SIBs	Domestic Systemically Important Banks
ECL	Expected Credit Loss
EIBOR	Emirates Inter-bank Offered Rate
ELAR	Eligible Liquid Asset Ratio
ENBD	Emirates NBD
ESG	Environmental, Social and Governance
FAB	First Abu Dhabi Bank
FCY	Foreign Currency
FED	Federal Reserve System
FFZ	Financial Free Zone
FI	Financial Institution
FSTI	Financial Stability Trend Index
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GREs	Government-Related Entities
HHI	Herfindahl-Hirschman Index
HNIs	High Net Worth Individuals
HO	Head Office
IA	Insurance Authority
IAIS	International Association of Insurance Supervisors
ICCS	Image Cheque Clearing System
ICO	Initial Coin Offerings
IFRS	International Financial Reporting Standard
IOSCO	International Organization of Securities Commissions
JPY	Japanese Yen
LIBOR	London Inter-bank Offered Rate
LTD	Loan To Deposit
MENA	Middle East and North Africa
MGF	Minimum Guarantee Fund
NBFI	Non-Bank Financial Institutions
NPL	Non-Performing Loans
OECD	Organisation for Economic Co-Operation and Development
OPEC	Organization of the Petroleum Exporting Countries
OTC	Over The Counter
P&L	Profit and Loss
PFMI	Principles for Financial Market Infrastructure
PIN	Personal Identification Number
PJSC	Public Joint Stock Company
POS	Point of Sale
ROA	Return on Assets
RTGS	Real Time Gross Settlement
RWA	Risk Weighted Assets
SCA	Securities and Commodities Authority
SCR	Solvency Capital Requirement
SIFIs	Systemically Important Financial Institutions
SMEs	Small and Medium Enterprises
Sq.m.	Squared Meter
SROs	Self-Regulatory Organizations
UAE	United Arab of Emirates
UAEDDS	UAE Direct Debit System
UAEFTS	Funds Transfer System
UAEPGS	Payment Gateway System
US	United States
USD	United States Dollar
VAT	Value Added Tax
WPS	Wages Protection System

FINANCIAL STABILITY REPORT 2017