

## 1. Standardised Approach for UAE Banks - Summary

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To compliment the Central Bank of the United Arab Emirates (CBUAE) guidelines for implementation of the Basel II Capital Accord, this Summary of key issues has been prepared as a reference tool only. It is not exhaustive and the full CBUAE guidelines ,related Appendices and the Basel II Accord documents themselves should be referred to as the prevailing authorities.

Minimum capital adequacy ratio is 10% of Risk Weighted Asset (RWA) values inclusive of Credit, Market and Operational risks.

## 2. Pillar 1 Calculations: Credit Risk

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Assets may be risk weighted based on public ratings assigned by an approved External Credit Assessment Institution (ECAI) on the following basis:

| Rating   | GCC Sovereigns & Central Banks | Other Sovereigns & Central Banks | Banks | Banks (short term exposures) | Corporates |
|----------|--------------------------------|----------------------------------|-------|------------------------------|------------|
| AAA      | 0%                             | 0%                               | 20%   | 20%                          | 20%        |
| AA+      |                                |                                  |       |                              |            |
| AA       |                                |                                  |       |                              |            |
| AA-      |                                | 20%                              | 50%   | 20%                          | 50%        |
| A+       |                                |                                  |       |                              |            |
| A        |                                |                                  |       |                              |            |
| A-       |                                | 50%                              | 50%   | 20%                          | 100%       |
| BBB+     |                                |                                  |       |                              |            |
| BBB      |                                |                                  |       |                              |            |
| BBB-     |                                | 100%                             | 100%  | 50%                          | 150%       |
| BB+      |                                |                                  |       |                              |            |
| BB       |                                |                                  |       |                              |            |
| BB-      |                                | 150%                             | 150%  | 150%                         | 100%       |
| B+       |                                |                                  |       |                              |            |
| B        |                                |                                  |       |                              |            |
| B-       |                                | 100%                             | 50%   | 20%                          | 100%       |
| Below B- |                                |                                  |       |                              |            |
| Unrated  |                                |                                  |       |                              |            |

In addition, for particular asset classes the following risk weightings will apply:

75% - Retail Portfolios

35% - Claims secured by residential property

### **3. Pillar 1 Calculations: Market Risk**

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Banks are required to allocate capital in respect of market risk under the general guidelines and framework set out under Basel II Section VI, Market Risk, which defines this risk as the risk of losses in on and off-balance sheet positions arising from movements in market prices'.

This section deals with the Standardised Approach of measurement as most banks will not be in a position to base their calculations on a models approach which may be accepted on a case-by-case basis.

The market risks subject to a capital charge are as follows: -

- Interest Rate Risk,
- Foreign exchange Risk,
- Equity Exposure Risk,
- Commodity Risk, and
- Options Risk

The scope of the charges is restricted to 'trading book' only for interest rate risk and equity positions whilst the remaining will apply to the banks entire positions.

### **4. Pillar 1 Calculations: Operational Risk**

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Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This definition includes legal risk but excludes strategic and reputational risk.

Basel II framework outlines three methods for calculating the risk charge for operational risk: -

1. Basic Indicator Approach
2. Standardised Approach/Alternative Standardised Approach (ASA)
3. Advanced Measurement Approach

CBUAE permits banks to use any of the above approaches provided they meet the criteria laid down under Basel II and subject to approval for the Advanced Measurement Approach (AMA) for which banks would need to demonstrate to CBUAE the appropriateness of the chosen approach.

## **5. Pillar 2: Supervisory Review Process**

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CBUAE considers the Pillar 2 requirements of the Accord to be particularly relevant for banks in its jurisdiction. Consequently, notwithstanding Pillar 1 capital calculations and implied capital requirements determined there from, the supervisory review process will focus on each bank's Internal Capital Adequacy Assessment Process (ICAAP).

The ICAAP must be documented and fully integrated with the enterprise wide risk management framework. It should be undertaken annually, have the explicit involvement and approval of both Board and Senior Management, and be presented to the CBUAE as a key point of discussion between the bank and regulator.

## **6. Pillar 3: Market Discipline**

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CBUAE supports enhanced market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the institution.

In principle, banks' disclosures should be consistent with how senior management and the board of directors assess and manage the risks of the bank.

Under Pillar 1, banks use specified approaches/methodologies for measuring the various risks they face and the resulting capital requirements. The CBUAE believes that providing disclosures that are based on a common framework is an effective means of informing the market about a bank's exposure to those risks and provides a consistent and understandable disclosure framework that enhances comparability.