Opening Remarks by H.E. the Governor of the Central Bank of the UAE for the 20th International Conference of Banking Supervisors
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As prepared for delivery

Esteemed colleagues, ladies and gentlemen,

Welcome to Abu Dhabi and to the 20th International Conference of Banking Supervisors (ICBS). It is a privilege to host all of you during a very special year for the UAE. We are celebrating the Year of Zayed – marking 100 years since the birth of UAE's Founding Father. Consistent with the values advocated by the late Sheikh Zayed, the Year of Zayed celebrates people of all nationalities, faiths and cultural backgrounds. This event with its global participation is a true reflection of these values.

[Introduction]

On this occasion of hosting the ICBS Conference, let me emphasize that the Basel Committee's role as an international standard setter has progressively solidified over the years, and its work has become equally important for both developed and emerging market economies.

Let us remind ourselves of the major shortcomings of the Basel framework prior to the Global Financial Crisis – (1) too little capital with too little going concern loss absorption capacity, (2) excessive leverage, (3) neglect of liquidity risks, (4) weaknesses in banks' resolvability and (v) insufficient macro-prudential considerations. A decade later, tremendous efforts to remedy such fault lines have culminated in a balanced set of common standards – the Basel III.

Reaching consensus on the necessary reforms was a difficult journey. From broad consensus in 2010 to its finalization seven years later, this achievement required strong determination, leadership and coordination across the globe. I take this opportunity to applaud Basel Committee's many successes - (1) strengthening the global financial system, (2) addressing "too-big-to fail problem", (3) improving banks' risk management, and (4) providing credible tools to minimize procyclicality of prudential regulations. Significant improvements have also been made in home-host cooperation, which is the bedrock of resilience of global financial system and help minimize the scope for regulatory arbitrage.

In my remarks today, I will say a few words on our own implementation of Basel standards in the UAE, followed by a brief focus on several shared challenges for banking supervision that the Central Bank of the UAE (CBUAE) considers important.

[The UAE approach to the Basel Committee on Banking Supervision (BCBS) standards]

The UAE remains a committed advocate of the Basel reform agenda. Upon joining the Basel Committee as an observer in 2014, we became a proactive adopter of global regulatory standards. We are convinced that higher and better quality bank capital is the cornerstone of a sustainable global financial order. The UAE has indeed benefitted from the Basel Committee's outstanding efforts in many ways, supporting the evolution of our financial sector - in terms of its depth, breadth, efficiency and stability. Critics who argued that such reforms would derail global economic recovery have been proven wrong. On the contrary, it has been proven that only well-capitalized banks can continuously provide credit through the economic cycle and remain profitable.

We subscribe to the need for a good balance between risk sensitivity, comparability, simplicity and – let me add - proportionality - of the global framework. Looking back at our own implementation of the Basel framework in the UAE, we remain conservative in our approach. It takes into account the idiosyncratic risks of our banking system, and the need to mitigate their impact in a way which is appropriate for our jurisdiction:

- **First,** a wider macro-prudential overlay is applied to our regulatory framework. To address negative externalities posed by domestic systemically important banks (DSIBs), capital surcharges are imposed on DSIBs. This is largely driven by their concentrated market position, similar business models and entrenched interconnectedness with major counterparties. This surcharge also covers an implicit Pillar 2 component, while a detailed design of Pillar 2 framework is being finalized. Higher capital requirements are also motivated by UAE's institutional environment, which presented potential for improvements in areas such as resolution regime for banks and bankruptcy proceedings for corporate borrowers. I am pleased to say that concerted efforts are already underway to address them. Additionally, banks have opted to maintain significant capital buffers over and above minimum requirements. As a result, the UAE banking system has sustained high level of capitalization, as evidenced by the average Leverage Ratio of 10.5% for the four DSIBs.

- **Second,** the CBUAE has issued comprehensive requirements on large exposures, which represent a conservative approach to sovereign risk and limits excessive risk concentrations. Past banking crises globally have either led to, were accompanied by or trailed closely behind a sovereign crisis. Learning from these lessons, we came up with an appropriate response. We are fully supportive of BCBS's ongoing work on sovereign risk. Clearly, ignoring this issue is no longer an option.

- **Third,** UAE banks' capital requirements do not rely on internal models and are calculated only by using the Standardized Approach. This approach has protected us against unwarranted variability in capital levels. It may have also impacted the risk-sensitivity of the framework and given rise to competitive distortions amid the global nature of financial markets. Borrowers in the UAE may find ways to obtain credit from foreign banks which are not bound by those constraints. The CBUAE will therefore need to continuously assess its position on internal models. The backstop decided by the Basel Committee – a floor of 72.5% of Standardized Approach requirements - is hence a welcomed development. This could potentially enable the UAE to move towards greater risk-sensitivity without jeopardizing banks' capital levels.

Let me reiterate UAE's support and commitment to implement Basel III in line with the commonly agreed implementation schedule. We will use, where necessary, additional safeguards to complement these minimum standards in order to ensure that our financial system remains sound and robust. We will also enhance the level of cross-border cooperation, by establishing supervisory colleges for our DSIBs next year. This is vital to strengthen ties with supervisory authorities from jurisdictions where our banks are active, or whose banks are active in the UAE.

[Concerns about global implementation]

We all agree that the finalization of Basel III reforms is a major step forward towards a safer financial system. To fortify its continued success, a "full, consistent and timely" global implementation is the critical next phase. Deviations from the framework in the implementation phase may counteract the benefits sought under Basel III. Thus, we very much welcome the BCBS RCAP process, through which the Committee can monitor the implementation. The temptation to deviate from the minimum agreed standards will surface from time to time. And let me be straightforward - such risk is faced by developed and emerging economies alike. We have observed the desire to subject regulatory framework to divergent developmental priorities - providing support to home owners or specific economic sectors, or even facilitating trading-based business models of global investment banks.

We need to collectively resist such temptations. Heightened global risks are already upon us due to escalating trade wars, geopolitical tensions and high indebtedness in many economies. An additional layer of uncertainty arising from a new "race to the bottom" in prudential standards should therefore be avoided. Hence, we need to be jointly vigilant in resisting calls for diluting the commonly agreed standards. It is our common responsibility to ensure that. Let us not forget that we, as central banks, must at all times seek to counter such short-term memory of past lessons, for the collective benefit of long-term financial stability and sustainable economic growth.

[Future challenges to banking supervision and regulation]

Ladies and gentlemen, let me now turn to some remaining challenges from the perspective of developing economies. I want to focus on three specific challenges – (A) implementation of expected loss provisioning, (B) supervisory safeguards against money laundering and terrorism financing, and (C) financial innovation and cyber security.

[A. Expected loss provisioning]

One such challenge is the implementation of the expected loss provisioning rules, IFRS9. Continued involvement of the Basel Committee in its implementation is paramount. There is a clear risk that our common efforts to simplify a globally comparable prudential framework can be made somewhat more challenging by an accounting standard that is based on complex internal models. These are exactly the same models which we have opted to backstop amid concerns of arbitrage and perverse incentives. We fully support the concept of forward-looking expected loss provisioning. This is a real improvement over the incurred loss approach which proved to be inadequate - enabling banks to window-dress asset values and consequently their capital.

However, the manner in which IFRS9 is implemented creates risks comparable to those observed in the case of internal models recognized in the Basel framework. Banks have strong incentives to produce outcomes which minimize provisioning needs by relying on complex models where assumptions are not appropriately disclosed. Furthermore, supervisors need to be equipped with skills to review such sophisticated models, to ensure that provisioning is adequate and not underestimated. Having dealt with internal models in the capital adequacy context, a common challenge remains for accounting models.

In the UAE, we have opted for a more prescriptive approach to minimize potential imprudent practices by banks. The CBUAE has maintained a backstop until sufficient experience is gained, and adequate supervisory comfort has been built in this respect. I therefore welcome the fact the BCBS is devoting more scrutiny to how members conduct supervision, such that we can learn and share good practices.

[B. Supervision of anti-money laundering risks]

Another remaining challenge for supervisors in both emerging and developing markets is AML supervision. For many years, the global community has stepped up its efforts through the FATF, the EGMONT group and other initiatives to combat money laundering and terrorism financing. Nonetheless, the threat is ever evolving. The UAE is devoted to minimizing this pervasive threat. In bolstering our anti-money laundering and counter-terrorism financing defenses, we have recently enacted new legislation and revised the regulatory framework for exchange houses.

We are also strengthening our supervisory capacity via specialized risk teams and a more robust risk-based model. CBUAE has also completed a comprehensive assessment of national banks last year. The same for exchange houses is targeted for completion by this year end. The UAE is also actively exploring how best to leverage on technology to mitigate AML risks. In all of this, international regulatory cooperation is key. Clearly, AML risk is borderless. We very much appreciate further focus of the Basel Committee on AML risks, both in terms of facilitating good supervisory practices, as well as day-to-day supervisory cooperation.

[C. Challenges posed by financial technology]

Lastly, we are observing how rapid advances in digital technology are transforming the financial landscape. Most are evolutionary in nature, while some are revolutionary in their scale and potential. Those advances bring with them disruptions of various kinds - not only to the financial industry, but also to how we conduct supervision. A clear challenge is to balance the tradeoff between the efficiency and the safety and soundness of financial system in the face of such rapid changes:

- In the UAE, we see rapid growth in both onshore and in the two offshore financial centers. Regulatory sandboxes managed by financial free zones have facilitated experimentation of innovative services within pre-defined boundaries. Our startups and banks have also been actively developing a variety of FinTech initiatives - digital wallets, solutions to facilitate regulatory compliance, crowdfunding – just to name a few.

- We must be watchful in maintaining the equilibrium between sound prudential and market conduct standards, without stifling innovation. To achieve this, close engagements with regulated businesses, FinTech firms and other stakeholders in the broader ecosystem is pivotal. We believe that ongoing dialogue is the best way to ensure new players are aware and able to navigate the applicable rules. At the same time, it is our responsibility to ensure that supporting infrastructure is put in place for sustainable innovation to flourish. As we navigate through the evolving ecosystem, we must ensure that our supervisors are well-equipped to identify, assess and tackle potential risks associated with FinTech. I therefore cannot stress enough on the criticality of international cooperation in this area. We can, and should, mutually-benefit from this collective endeavor to find common approaches to such risks and share best practices. Technologies may be new, but most of the risks - within and across borders - are similar.

- In the context of financial technology, cyber security is a key risk whose importance cannot be underestimated. Against this background, we very much welcome BCBS work on sound practices to manage pervasive implications of FinTech developments for banks and bank supervisors. We also highly welcome further cross border supervisory cooperation to strengthen cyber-resilience of our firms and market infrastructures.

Ladies and gentlemen,

In closing, we firmly believe that the UAE is a reliable global partner to host a dynamic, outward-looking financial system. By that I mean financial system which is governed by robust rules, forward-looking supervision and a clear vision of the future. This is envisioned and detailed out in the UAE Financial Sector Master Plan 2018-2028, which was developed to support the nation's Post-Oil Strategy.

Let me conclude by welcoming you again to the UAE and the conference. And I wish you all a constructive and insightful discussion over the next two days.

Thank you.