FALAK CONSULTING

Compliance & Control

The new MANTRA of the MENA regulators

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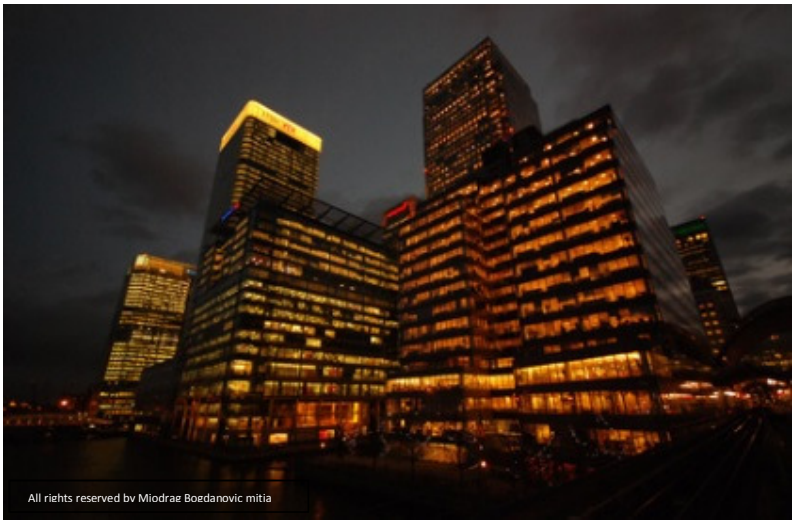
The Current Scenario



We are now 5 years into the worst financial crisis to ever hit the world's financial markets and global financial system still remains fragile. The regulatory reform agenda is on overdrive but the regulators across have a very time to innovate as they shuffle between managing growing liquidity concerns and making the system stronger and protective.

The genesis of the post 2008 reforms undertaken by most regulators across the world was to make the financial institutions and markets more transparent and less complex. The key for the reforms to be successful was the deleveraging of these institutions. However, the progress is rather slow mainly because some of the reforms are in initial stages of implementation and will be able to show conspicuous benefit only over a period of time, while others still have to see the day of light and are currently just being engineered.

The IMF stated in the Global Financial Stability Report of October 2012, "Although there has been some progress over the past five years, financial systems have not come much closer to those desirable features."

There have been a large number of financial institutions in the MENA region that have gone bust in the past 5 years. The primary reason behind this has been the absence of compliance and risk frameworks in these banks. Even the business models of most of these banks were not well thought out and lacked basic diversification. This has led to a dramatic shift in the regional markets, from being typically unregulated markets, where laundered funds found their way easily in and out, and banks operated with almost no transparency. We have come a long way indeed since then.

Most nations have set up progressive regulators who are busy churning out regulations after regulations aiming to introducing control and transparency, governance as well as investor and shareholder protection.

There is increased focus on FATCA compliance, harmonised regional regulatory approaches, risk management, anti-money laundering, international sanctions, data security, new international core principles (Basel III, IAIS, IOSCO), and GCC securities activities and trends.

Un-focussed Approach – The banks do not know what to focus on, the regulators want them to be rational, deleveraged and sound.

Customer Focus – The customers want low banking costs.

Creditability – Creditors want protection and their money back.

Profitability – Shareholders want profits at all cost.

The Banking Predicament

With such diverse objectives and the power shifting from the management to the hands of the external stakeholders, there are constant trade-offs the banks have to make to manage expectations.

The banks are facing significant regulatory reforms – both individually and collectively. They are having to make important decisions with regards to their strategies and business models keeping in mind the necessary regulations and other business drivers.

The focus is thus divided between two different aspects of the financial business:

- Internal Re-engineering of Risk and Compliance Functions.
- Focus on demands by the external stakeholders as described above.

And this has to be undertaken at a time when the global growth is excruciatingly slow.We believe that the institutions that are looking to tackle this head on and move swiftly in the right direction are the ones that will succeed. That brings us to what the future of the banks looks like in the MENA region, but before that let's look at the regulators in some of the important nations in the region:

Country	Financial Regulator
Bahrain	Central Bank of Bahrain
Egypt	Egyptian Financial Supervisory Authority
Jordan	Central Bank of Jordan
	Jordan Securities Commission
Kuwait	Central Bank of Kuwait
	Kuwait Monetary Authority
Lebanon	Banking Control Commission of Lebanon
Morocco	Conseil déontologique des valeurs mobilières
Oman	Central Bank of Oman
Qatar	Qatar Central Bank
	Qatar Financial Centre Regulatory Authority
	Qatar Financial Markets Authority
Saudi Arabia	Saudi Arabia Monetary Authority
UAE	Central Bank of UAE
	Dubai International Financial Centre

On closely studying the current direction of regulations that most of the authorities are taking in the region we see strong resemblance to the regulatory framework set up by the FSA in UK. Having said that, the authorities in Kuwait and Saudi have been extremely conservative over the years and have now become even more stringent.

In the Banking Regulation and Supervisory Survey for 2011-12 by the World Bank, the following findings were uncovered specific to the MENA region financial institutions:

	Question	Average %
Bank Ownership	Is lack of conflict of interest a requirement for the evaluation/approval of significant bank shareholder?	100%
	Is there maximum percentage of a bank's equity that can be owned by a single owner?	57%
	What was the percentage of bank's equity that can be owned by a single owner in 2010?	24%
	Do laws or regulations require the ultimate (beneficial) owner and controller of a bank to be publicly disclosed?	79%
Regulatory Regime	Did you use Basel I as the regulatory capital adequacy regime in 2010?	36%
	Did you use Basel II as the regulatory capital adequacy regime in 2010?	64%
Disclosure of Information	Do banks disclose to the public off-balance sheet items?	100%
	Do banks disclose to the public governance and risk management frameworks?	92%
Supervisory Power	Can supervisory agency suspend or remove bank directors?	69%
	Can supervisory agency suspend or remove managers?	79%
	Can supervisory agency require commitment/action from the controlling shareholder(s) to support the bank with new equity (ex - capital restoration plan)?	71%
Capital	Can the initial disbursement or subsequent injections of capital be done with assets other than cash or government securities	0%
Foreign Entry	Are foreign entities prohibited from entering through Acquisitions?	15%
	Are foreign entities prohibited from entering through Subsidiaries?	23%
	Fraction of all commercial bank applications denied for in the past 5 years	23%

In light of this, it would be good to see what the future of the financial institutions in the region looks like.

Future of the Financial Institutions in MENA

In the coming years, we will see the financial institutions model around the following lines:

- The banks will be ***highly capitalized & locally financed***
- The primary objective will be ***client driven***
- They will have ***specialist talent pool and infrastructure***
- They will build ***good relationships*** with regulators based on trust from regulators, investors and the public at large

To model themselves in such a way, the institutions have increased their focus in the following areas:

- ***Relook at the Business objectives*** and revamp the business model to better suit these
- ***Become change ready*** and embrace transformation/optimization
- Re-examine the SBUs and ***focus on core competencies***
- Remove the complexity and ***simplify the existing structure*** with fewer focus points
- ***Invest in people*** and technology
- Actively ***look at the policy and process framework*** to make it suitable to the new structures
- ***Build trusting relationships*** based on transparency with regulators and public
- ***Engage and empower staff*** to ensure continuity and retention of talent

Regulatory Pressure

According to the experts at KPMG, in their paper "Evolving Banking Regulation EMA Edition 2013", the following are the areas where banks face significant regulatory pressure:

- Increase in quantity and quality of ***capital***, driven by the Basel III guidelines.
- Significant increase in ***liquidity*** to ensure potential run on funds.
- Increased ***supervision*** with the set-up of monitoring bodies for this specific purpose.
- Increased ***governance*** with qualified boards who assume full responsibility for the actions of the organization.
- Regulation of ***remuneration*** packages of the management to ensure there is no excessive payments.
- Increased regulation for ***customer protection*** including customer education, disclosure and profiling.
- ***De-risk*** wholesale and OTC markets.

In the Middle of the Storm

But the financial institutions that can overcome these challenges by acting swiftly and making the necessary changes will be strong, sustainable and resilient organizations. Those that cannot, will perish.

Challenges faced by banks in the MENA region today:

- Significant Uncertainty
- Complex Regulation
- Diminishing Returns
- Strategic Restructuring
- Growing Governance
- Cultural Change

What Falak can do to help?

At Falak we have the experience to assist out client understand and address new and existing regulation. We help our clients design structures that comply with Sarbanes-Oxley, FCPA, anti-money laundering (AML), privacy, and industry-specific laws and regulations.

The approach we take is as follows:

- We engage with our clients to understand the as is policy and procedures as well as systems framework.
- We do a complete gap analysis of these and then suggest solutions which enhance these as well train the relevant staff to implement these enhancements and improvements to prevent compliance violations and failures.
- Furthermore, to create a strong decision making mechanism we develop frameworks to assess and address strategic, operational, financial, and compliance risks. We assist our clients to infuse risk management practices into their existing structure.

Acknowledgements

- Evolving Banking Regulation 2013, KPMG Global
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