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Basel II Implementation – Progress & Challenges

Outline

- Original Basel II Objectives
- Global Progress & Challenges
- MENA Implementation
- MENA Challenges & Opportunities
- Conclusion

Original Basel II Objectives

- **Basel II Objectives**

- i. Strengthen system stability and soundness
- ii. Maintain sufficient regulatory consistency and competitive equality
- iii. More risk sensitive capital requirements
- iv. Alignment with best practice, and encourage improvement in risk management

Global Progress & Challenges

- The Basel II Accord is in various stages of implementation internationally
- Europe is ahead of other regions, but even there Advanced IRB banks are still in the transition phase
- The USA delayed implementation, with some core banks being allowed until April 2011 to begin their transition periods
- Some emerging market countries only intend to implement Pillar II and Pillar III

Global Progress & Challenges

- The picture in MENA is no less diverse
- Added to this patchy geographic picture is a highly varied range of Operational Risk program implementation
- The ongoing crisis has highlighted areas where advanced risk management was rendered ineffective
- Process failures in areas ranging from Governance to Underwriting to Due Diligence to Compensation structures

Global Progress & Challenges

- Basel II, in spite of incomplete roll out, is being subject to various degrees of criticism
- Risk Management at some of the most advanced Banks has also been criticized
- As have been regulators and Central Banks
- While views may vary, there are some definite regulatory developments in the works
- These are anticipated to cover areas such as Securitization, Liquidity Management, Stress testing and Governance

MENA Implementation

- Implementation in MENA is clearly more advanced in the orient than in the occident of this region
- GCC countries & Lebanon appear to be ahead, with all having begun implementation by 2008
- Outside the GCC there appear to have been clear plans for implementation in Morocco, Tunisia, and Egypt

MENA Implementation

- All implementing countries have begun their banks on the Standardized Approach
- Some larger banks are expected to move to IRB in future, by their central banks
- It appears that capitalization has not been a major issue for implementation
- However, a limited number of banks have been re-capitalized due to the impact of the global financial crisis

Opportunities & Challenges

- Given that most of MENA is in the initial stages of B-II implementation, there is scope for incorporation of enhancements in regulation expected in 2009
- Notwithstanding the gaps that need to be filled, Basel II continues to represent an opportunity for major upgrades in risk management practices at MENA, and other, Emerging Market Banks, if implemented adequately

Opportunities & Challenges

- The most important challenge will be training, and awareness, at multiple levels, at MENA institutions
- Other challenges include governance, operational risk management, systems, data, and change management amidst the crisis
- The human resource challenge at regulators, is phenomenal, keeping in mind crisis issues
- Data pooling will be critical for those jurisdictions moving to more advanced approaches

Conclusions & Insights

- Basel II is still in its infancy, both within and outside MENA, hence it would be premature to conclude it is ineffective as a framework
- In fact some may consider it as having been “too little, too late”!
- Regulatory reform will be of paramount importance in the near future, and major transformation will result in the banking business model globally, with some MENA impact

Conclusions & Insights

- An important outcome of the crisis, may be the need to re-calibrate the capital model underlying Accord Adequacy requirements, in future
- Islamic banking, while creating some unique regulatory challenges, is coming out as a winner in this crisis, due to, inter alia, its relative simplicity, and relative proximity to the “real” economy

Conclusions & Insights

- Governance, risk management, & planning will be significant issues for effective implementation of B-II at banks going forward, and MENA will be no exception