مصرف الإمارات العربية المتحدة المركزي

CENTRAL BANK OF THE U.A.E.

CREDIT RISK MANAGEMENT STANDARDS

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INTRODUCTION AND SCOPE

1. These standards form part of the Credit Risk Regulation and both documents must be read together. All LFIs must comply with these standards, which expand on the regulation. These standards are mandatory and enforceable in the same manner as the regulation.

2. The standards follow the structure of the regulation, with each article corresponding to the specific article in the regulation.

ARTICLE 1: DEFINITIONS

These standards follow the definitions as set out in the Credit Risk Regulation.

ARTICLE 2: CREDIT RISK GOVERNANCE

Board of Directors

2.1 The Board must regularly review, and approve, the Credit Risk management strategy, framework, significant policies, tolerances/limits and processes for identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating Credit Risk. The Board must also ensure these are consistent with the Risk Appetite and capital strength and other relevant parameters that they set. At a minimum, it must approve the organisation of the LFI's Credit Risk Management Functions, including the credit underwriting process, the independent review of such underwriting, the portfolio management of credit exposures and the management of distressed assets.

2.2 The Board must oversee and ensure that Senior Management is fully capable of managing the Credit Risk bearing activities conducted by the LFI and that such activities are within the Risk Appetite, strategy, policies and tolerances reviewed and approved by the Board. In addition, the Board must oversee and ensure that policies and processes are implemented effectively and fully integrated into the LFI's overall risk management process.

2.3 The Board must ensure the comprehensive inclusion of Credit Risk and credit concentration risk in the stress testing programme for risk management purposes of the LFI.

2.4 For LFIs incorporated in the UAE, the aforementioned includes policies and processes that provide a comprehensive group-wide view of significant sources of Credit Risk and concentration risk with appropriate consideration of the LFI's Risk Profile, nature, and size as well as the complexity of its business and structure.

2.5 The Board is responsible for ensuring that the LFI has appropriate processes, methods and systems to identify problem assets and to determine adequate provisions and reserves in accordance with the LFI's stated policies and procedures, with the applicable accounting framework and in compliance with relevant supervisory regulations and standards.

2.6 The Board, not a Board sub-committee, must approve material Facilities including any subsequent write offs. Material Credit Facilities must be approved by the Board at least every three years. The materiality thresholds must be defined by each LFI based on its Risk Appetite and the size and creditworthiness of the facility. At a minimum, material Facilities must include the following:

a. Any Facility leading to an exposure greater than 10% of the LFI's Tier 1 Capital, and

b. Any Facility granted towards a Related Party, a Related Party's spouse, and their Group of Connected Counterparties. Board members or other members of staff must be excluded from the approval process of granting and managing transactions for which they have a conflict of interest.

2.7 For Credit Facilities below the materiality threshold defined in Article 2.6.a, the Board may assume the approval authority as outlined below or alternatively, delegate to a Board Credit Committee, which must be distinct and independent from a Board Risk Committee and Board Audit Committee. Such a committee must set appropriate thresholds and criteria for the purpose of identifying and reviewing significant Facilities that may generate a higher level of risk and may not be consistent with the Risk Appetite of the LFI. At a minimum, the approval authority for this committee must include any Credit Facility computed as the lower of the following:

a. Any Credit Facility resulting in an exposure to an Obligor greater than 5% of the LFI's Tier 1 Capital, or

b. Any Credit Facility resulting in an exposure to an Obligor greater than AED 1 billion.

2.8 For branches of foreign LFIs operating in the UAE, the requirements in 2.6 and 2.7 must be fulfilled with formal approval from Senior Management or the Board outside of UAE to which the UAE based Senior Management have a formal reporting responsibility.

2.9 For Credit Facilities that do not require Board approval, the Board must define and approve a formal delegation matrix that articulates the roles and responsibilities of Senior Management for the approval of these Facilities.

2.10 In order to fulfil its oversight role, the Board and Board credit committee, if any, must regularly receive timely and appropriate information on:

a. The credit worthiness of the LFI's asset portfolio, material concentrations, the restructured portfolio, as well as significant individual credits, including classification of assets,

b. The level of provisions and reserves and major problem assets.

c. The classification of Credit Facilities, their associated provision level, the expected trend of credit quality and potential losses.

d. The key drivers and the actions taken by the management to mitigate Credit Risk.

2.11 The information must include, at a minimum, summary results of the latest asset review process, trends related to problem assets, and measurements of existing or anticipated deterioration in asset quality and expected losses.

Senior Management

2.12 The business line heads and their direct reports are responsible to ensure robust credit underwriting consistent with the Risk Appetite of the LFI. They must act as the first line of defence against Credit Risk, which requires appropriate identification, allocation and pricing of Credit Risk.

2.13 The LFI must ensure that Credit Risk is adequately mitigated by robust underwriting, provisions, reserves and, when possible, by collateral. LFIs must have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic Repayment and recovery expectations, taking into account market and macroeconomic conditions and computed in compliance with the regulations, standards and generally accepted accounting principles. The CRO must form an independent opinion on the appropriateness of provisions and regularly report their view to the Board.

2.14 The Senior Management team is responsible and accountable for the implementation of the Board approved strategy and Risk Appetite and is also responsible for the day-to-day management of the LFI. Regarding Credit Risk, this includes:

a. The robust implementation and communication of the strategic direction and principles set by the Board regarding the management of Credit Risk throughout the LFI and documented in the Credit Risk framework.

b. The robust implementation of the Risk Appetite of the LFI within the Credit Risk framework.

c. The acquisition, administration, underwriting and mitigation of Credit Risk within the Credit Risk framework.

2.15 The Senior Management, including the CEO, the CCO and the CRO are collectively responsible for:

a. The development and implementation of sound and effective processes, policies, procedures and systems designed to manage Credit Risk in accordance with the Credit Risk framework approved by the Board, across the LFI's portfolios and geographies.

b. Ensuring that credit exposures are within levels consistent with prudential standards and internal limits.

c. The establishment and enforcement of internal controls to ensure that exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action.

d. Additional responsibilities and roles as included in Article 4.

Control and Oversight

2.16 Internal Audit: The internal audit function is responsible to review and report on the suitability and efficiency of the implementation of the Credit Risk framework across the entire LFI, in accordance with the strategic direction set by the Board. At a minimum the scope must include the following:

a. Material Credit Facilities (based on thresholds as formally determined by each LFI).

b. All Wholesale Restructured Credit Facilities.

c. The Credit Facilities for which it has been determined that no SICR has occurred, as per Article 7 of these standards. Evidence supporting the decision must be reviewed in light of relevant regulations and policies/Risk Appetite of the LFI.

d. Material Credit Facilities classified in Stage 3, as defined in Article 9 on classification and provisioning.

e. Any breach of this regulation and these standards.

2.17 Compliance: The compliance function must ensure that this regulation and these standards are understood, communicated and correctly followed for Credit Risk underwriting and management throughout the LFI. For this purpose, it must implement a process to review the compliance of all the internal parties involved in Credit Risk acquisition and management.

2.18 External Audit: External auditors are responsible to review and verify that classifications and provisions are accurate and comply with accounting and regulatory standards.

2.19 The LFI must at all times provide full access to all information in the credit and investment portfolios to the LFI officers involved in assuming, managing, controlling and reporting on Credit Risk.

ARTICLE 3: CREDIT RISK MANAGEMENT FRAMEWORK

3.1 The Credit Risk management framework must be designed to support effectively the acquisition and mitigation of Credit Risk. It must be consistent with the Risk Appetite, Risk Profile, systemic importance and capital strength of the LFI. It must take into consideration the current and forward-looking market factors and macroeconomic environment, with the objective to ensure prudent standards of underwriting, evaluation, administration, monitoring, measurement and control of Credit Risk.

3.2 The framework must include key components to be effective including, but not be limited to: the scope of instruments and geographies, Risk Appetite, controls, limits, underwriting process, credit administration process, monitoring, management of Past Due Facilities, remediation, provisioning methods, collateral management, system, models and exception management.

3.3 The Credit Risk management framework must enable the LFI to obtain a comprehensive group-wide view of Credit Risk exposures. and significant sources of concentration risk, it must cover the entire organisation and must be comprehensive in terms of products, activities and geographies, as well as including a robust methodology for the early identification and appropriate measurement of credit losses.

3.4 Scope: The Credit Risk management framework must enable the LFI to obtain a comprehensive group-wide view of Credit Risk exposures and significant sources of concentration risk, it must cover the entire organisation and must be comprehensive in terms of products, activities and geographies. The Credit Risk management framework must cover all financial instruments generating Credit Risk, including on- and off- balance sheet Facilities, receivables, capital market instruments and derivatives. LFIs must ensure that the risks arising from products or activities new to them are subject to adequate controls before being undertaken, and approved in advance by the Board of directors or its appropriate committee.

3.5 Risk Appetite: The Credit Risk management framework must be consistent with the Risk Appetite, Risk Profile, and systemic importance of the LFI. It must take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring. This includes risk management policies and processes that establish thresholds for acceptable concentrations of risk and requirements related to Credit Facility structuring, legal due diligence, product-specific controls and underwriting standards.

3.6 Climate-related Credit Risk: The Credit Risk management framework must include prudent policies and processes to identify, measure, monitor, report and mitigate the impacts of material climate- related risk drivers on their Credit Risk exposures (including Counterparty Credit Risk) on a timely basis. LFIs should consider a range of risk mitigation options to control or minimise material climate-related Credit Risks. These options may include adjusting credit underwriting criteria, deploying targeted client engagement, or imposing limitations or restrictions such as shorter-tenor Lending, lower loan-to-value limits or discounted asset valuations. LFIs could also consider setting limits on or applying appropriate alternative risk mitigation techniques to their exposures to companies, economic sectors, geographical regions, or segments of products and services that do not align with their business strategy or Risk Appetite.

3.7 Country Risk: LFIs that provide Credit Facilities susceptible to Country Risk must implement adequate policies and processes for the appropriate identification, measurement, evaluation, monitoring, reporting and mitigation of Country Risk, comprehensively addressing the implications on Credit Risk. Exposures to Country Risk must be consistent with the Risk Appetite and risk profile of the LFI. The management and control of Country Risk must be incorporated into the key steps of Credit Risk management, covering the origination, underwriting, monitoring and provisioning processes. Relative to the magnitude of foreign Lending, an LFI must review and establish additional provisioning percentage ranges for each country, considering prevailing conditions that may be applicable to its individual exposures.

3.8 At a minimum, the Credit Risk management framework must include the following components: Risk Limits, underwriting process, credit administration, monitoring, measurement of Past Due Facilities including problem assets, remediation process, Counterparty Credit Risk, provisioning methodology, collateral management, information systems, analytical tools, provisioning methodologies as well as exception management. The corresponding minimum requirements are articulated below.

Risk Acquisition

3.9 Risk Limits: LFIs must implement prudent and appropriate credit limits based on adequate metrics and at a suitable level of segmentation granularity. These limits must be consistent with the Board-approved Risk Appetite statement, Risk Profile and capital strength. Risk Limits should be understood by, and regularly communicated to, relevant staff.

3.10 Underwriting process: LFIs must implement a clear credit underwriting framework commensurate with their Risk Appetite and Lending strategy. LFIs must follow the minimum requirements presented in the dedicated section of these standards.

Risk Management

3.11 Credit administration: LFIs must establish effective credit administration policies and processes to address the operational requirements of Credit Facilities throughout their lifetime. These must support the monitoring process of Credit Risk and mitigate operational risks linked to Credit Risk management and must include at a minimum: continued and forward-looking analysis of a Obligor's (and potentially, a wider borrowing group's) ability and willingness to repay under the terms of the financial obligation including but not limited to evaluation of underlying assets, robust data gathering, monitoring of documentation, financing covenants, contractual requirements, collateral and other forms of CRM and an archiving mechanism.

3.12 Monitoring: LFIs must have policies and processes to continuously monitor the total indebtedness of Obligors, their financial performance and any risk factors that may result in the increased risk of Default, including significant unhedged foreign exchange risk. The above must incorporate the continuous and forward-looking analysis of each portfolio/Obligor's ability and willingness to meet its obligations under the terms of its contracts, while taking into account the current and future economic environment. This should include regular reviews of credit exposures (at an individual level or at a portfolio level for credit exposures with homogeneous characteristics) to ensure appropriate classification, detection of deteriorating exposures and early identification of problem exposures. This process must be established at several levels of granularity.

a. For each level, suitable metrics and early warning indicators must be put in place. At a minimum, for Wholesale Obligors the monitoring process must be implemented at the following levels of granularity (a) Credit Facility level and Obligor level, (b) consolidated group level for large conglomerate, and (c) segment, portfolio level.

b. The monitoring process must analyse, understand and document the links between Obligors. This must include economic connectivity and correlated factors such as suppliers and/or customers of the Obligor. This must also capture the common sensitivity to the business cycle, the industry risk and any other systemic risks.

c. For Retail Obligors, monitoring should be performed at portfolio levels or at a more granular level, determined by the LFI.

d. The monitoring process must include a regular review and assessment of the impact of Country Risk. In the case of exceptional Country Risk events, dedicated analysis must be performed and reported to Senior Management and the Board. Pro-active mitigating actions must be identified to respond promptly to such events.

3.13 Days-Past-Due: Each LFI must have a clearly documented policy compliant with these standards, addressing the method to count Days-Past-Due. Particular attention must be given to the re-ageing of Facilities, whereby the Days-Past-Due counter is reset at zero. This applies only to non-distressed restructuring as defined in these standards. At a minimum, the re-ageing policy must include:

a. The internal approval process and subsequent reporting requirements;

b. Eligibility criteria including minimum performance and a minimum age of a Facility to be eligible for re-ageing;

c. A maximum number of re-ageing occurrence per Facility; and

d. A process to reassess the Obligor's capacity meet the new terms of its Credit Facility.

3.14 Remediation: Any Obligor that has triggered the definition of Default must be managed by individuals not involved in the origination of that Credit Facility, including both relationship management and credit approver for that Credit Facility. The provisions related to distressed assets must be decided independently from the underwriting process. Consequently, each LFI must be in a position to demonstrate that (i) it complies with such independence, irrespective of its specific organization circumstances and (ii) management of provisions on distressed assets are determined according to the LFIs delegated authorities with the oversight of the appropriate committee, or for branches of foreign banks the delegated authority from the head office.

3.15 Counterparty Credit Risk: The Credit Risk framework must be adequately designed to manage Counterparty Credit Risk ("CCR") arising from all derivative transactions. At a minimum the following requirements apply.

a. Each LFI must have a centralised management and Risk Appetite pertaining to CCR across the entire LFI in order to manage the identification, measurement, monitoring, reporting and mitigation of such risk. At a minimum, limits must be established at Obligor level against potential future exposures arising from derivatives.

b. Reporting should include a consolidated view at Obligor level of exposures arising from derivatives and from other financial instruments such as Credit Facilities, bonds and/or Sukuks.

c. The framework must capture all the key drivers of CCR including, but not limited to: (i) current and future exposures, (ii) market risk drivers, (iii) client ratings, (iv) potential netting and collateral agreement, and (v) potential wrong-way risk. All these drivers should be included in the reporting framework.

d. The CCR framework must ensure that adequate legal documentation is place to manage and mitigate derivative exposures. Such documentation should be reviewed and approved by qualified internal or external legal teams.

e. The management of CCR must be supported by adequate documented methodology and analytical tools. Each LFI should identify, analyse and report the market risk factors driving the potential exposure and hence responsible for potential limit breach in the case of market volatility.

f. Finally, as CCR is driven by both Credit Risk and market risk factors, it is essential that the CCR management framework relies on appropriate collaboration and allocation of responsibilities between the Market Risk function, the Credit Risk function and the business lines.

Risk Mitigation

3.16 Provisioning methodologies: LFIs must establish robust governance and control framework for the estimation and reporting of provisions, consistent with actual recovery of collateral if any, and must be able to substantiate the recoveries with documented evidence. This framework must include the minimum requirements of these standards and ensure that the LFI can demonstrate prudent and effective estimation and reporting of provisions.

3.17 Collateral management: Policies must be in place to determine the preferred type of collateral (at a level of specification relevant to the nature of the collateral) and legal charge.

a. There must be robust processes and procedures relating to collateral management, which should be managed by a specialist team. These policies and procedure should include, where relevant, but not be limited to, filing of legal charges, ensuring legal enforceability in a timely manner, collateral valuation methodology and value monitoring, collateral insurance, possible assignment of income derived from any collateral and the ability to inspect the asset. For Wholesale exposures, the credit review function must approve changes in collateral valuation or legal enforceability.

b. The process must also include regular reviews of the performance of underlying assets in the case of securitization and asset-backed Lending/financing.

Risk Analytics

3.18 Information systems: LFIs must implement effective information systems for the accurate and timely identification, aggregation, data storage and reporting of Credit Risk exposures to Senior Management and the Board on an ongoing basis. Such systems must cover exception tracking, limit breaches and early warning measures to ensure prompt action at the appropriate level of the organisation, when necessary. Processes must be in place to ensure

the collection of adequate information on the composition of the credit portfolio, including key financial information, financing metrics and the Repayment history of each Credit Facility and facilitate active management of exposures creating risk concentrations and large exposures to single counterparties or groups of connected counterparties. Credit management systems must be of appropriate sophistication in order to facilitate this data collection and enable appropriate portfolio-level analysis across key risk drivers.

3.19 Analytical tools: LFIs must implement analytical tools commensurate with the size and complexity of the organisation to support the measurement and reporting of Credit Risk and provisions. The design, management and validation of these tools must comply with Article 13 on Credit Risk models.

Exceptions

3.20 Exceptions management: LFIs must implement a clear process to adequately identify and manage exceptions from credit policies and underwriting standards. All exceptions must be reviewed and documented by the CRO. Conclusions and analyses must be supported by clear rationales, prior to submission for approval by the appropriate level of authority within the LFI. Such review and approval must be achieved at Credit Facility level for Wholesale Obligors and at portfolio level for Retail Obligors.

a. LFIs must define materiality criteria for each level of approval of exceptions to credit related policies. Depending on these criteria, exceptions must be approved by either Senior Management, the Credit Risk committee and/or the Board Risk Committee. These criteria must be documented and substantiated by a thorough analysis. Exceptions must represent only a small portion of the credit portfolio.

b. Any Credit Facility granted with deviations from either the credit policy, underwriting standards or Risk Appetite, must be subject to active monitoring and consolidated reporting to Senior Management and the Board on a regular basis. The CRO is responsible for the review, identification and escalation of exceptions to credit policy.

c. Any issuance or the acquisition of credit exposures in breach of the LFI's Board approved Risk Appetite must always be formally approved by the Board and each approval must contain the written signature of every Board member involved in the approval process.

ARTICLE 4: CREDIT RISK OVERSIGHT FUNCTIONS AND ROLES

4.1 The corresponding Article of the regulation outlines the main principles. Detailed requirements are presented below.

Credit Review Function

4.2 Each LFI must have a CCO supported by a Credit Review function or equivalent to fulfil the duties as defined below.

4.3 The CCO is required to review Obligors and associated exposures every year. For Wholesale Obligors, this review must take place at Obligor level. For Retail Obligors, this review must take place at portfolio level. This must include an updated risk rating of the Obligor(s) based on recent financials, at a minimum annually. LFIs must set the conditions triggering more frequent risk rating, and the conditions triggering technical amendments to a Facility.

4.4 The CCO's key responsibilities are as follows:

a. Heading the credit review function which will review all credit proposals.

b. Ensure that all credit proposals are:

   i. Comprehensive and suitable to make a view on Credit Risk,

   ii. In compliance with the underwriting principles in these standards, and

   iii. In accordance with the Risk Appetite and underwriting standards of the LFI.

c. For approvals up to the authority level of the CCO, to review and approve each individual transaction either directly or in accordance with the LFIs approved delegation matrix.

d. For approvals required above the authority level of the CCO as per the delegation matrix, the CCO must submit credit proposals to the Credit Committee or its alternative.

e. Ensure that exceptions and their justifications are referred to the CRO for review.

f. The function responsible for underwriting Credit Risk must be independent of the business. Therefore, the CCO must not report to the head of a business line.

Credit Risk Management Function

4.5 In the context of credit acquisition, each LFI must have an independent Credit Risk Management Function within the Risk Management Function headed by the CRO.

4.6 The Credit Risk Management Function, must not have a decision-making role in the acquisition of Credit Risk.

4.7 The Credit Risk Management Function is responsible to safeguard the LFI from acquiring Credit Risk not consistent with the LFI's Risk Appetite and/or policies, that may cause a threat to the LFI, in which case he must raise his concerns at the appropriate level.

4.8 The Credit Risk Management Function has the responsibility and authority to protect the LFI from Credit Risk, while maintaining an arms-length and independent oversight of Credit Risk acquisition. To perform this duty, the Credit Risk Management Function must have the following powers and responsibilities:

a. To own the LFI's Credit Risk policies. The Credit Risk Management Function must define policies, procedures, systems and controls to monitor and report Credit Risk upon commencement of any Credit Facility, and throughout the Credit Risk life-cycle.

b. To ensure that the Credit Risk management framework, and/or any subsequent change is adequate to meet the aforementioned objectives.

c. To ensure that Credit Risk is identified, measured, reported, mitigated, and remains within the LFI's Risk Appetite. To ensure that, for material Facilities, the metrics pertaining to Credit Risk provision and capital are accurately reflecting the Risk Profile of these Facilities.

d. To review material defaulted Credit Facilities and the associated rationale for provisioning based on appropriate discounted future cash flows and eligible collateral, in compliance with relevant regulations. For this purpose, materiality is defined by each LFI.

e. To ensure that regular updates are provided to Senior Management and the Board or to a Board Committee as per a pre-established schedule, or more frequently when required. Such reporting must cover the portfolio Risk Profile, exceptions and early warning signals.

f. The authority to attend credit committee meetings as a non-voting member. The right to be fully informed of all proposals, renewals, amendments to acquire or renew Credit Facilities.

4.9 The CRO has the following powers and responsibilities with regard to Credit Risk:

a. To ensure that the LFI has adequate resources and skilled employees dedicated to Credit Risk management.

b. To ensure that the approved Credit Facilities conform to the Board approved Risk Appetite of the LFI. For this purpose, the CRO must undertake prior reviews of all material credit applications and renewals in order to express and document independent views on their Risk Profile in the context of the LFI's Risk Appetite and policies, and communicate these views to Senior Management and the Board.

c. The Board of the LFI must establish formal materiality thresholds (based on the total exposure amount) above which the CRO review must take place.

d. At a minimum, the materiality threshold must include the following principles.

   i. The CRO must review all Credit Facilities requiring approval from the Senior Management credit committee or equivalent, and above.

ii. For Credit Facilities considered as higher risk (this must include at a minimum all Credit Facilities rated non-investment grade or equivalent) by the LFI, the materiality threshold for the CRO review must be set at 20% below the delegated authority of the Senior Management committee or equivalent, i.e. a delegated authority of AED 100 million means a threshold of AED 80 million and above for high-risk Facilities to be reviewed by the CRO.

iii. For Wholesale Obligors, the review must take place at the Obligor level.

iv. For Retail and SME Obligors, the review can be performed at portfolio level or individual level, provided that the LFI outlines its approach in its policy.

e. The power and the responsibility to veto credit proposals when necessary in accordance with his responsibilities. In the case of veto:

i. If the observations are fully addressed and formally agreed to by the CRO, the transaction may be re-submitted to the relevant approvers.

ii. If CRO's concerns are not fully addressed, the proposal must not proceed without escalation to the Board for approval. The proposal should contain the reasons to support the transaction and include the rationale for the veto from the CRO.

4.10 In the case of LFIs offering Islamic Financial Services, the Credit Risk Management Function must discharge its responsibilities in compliance with the Shari'ah rules and principles.

ARTICLE 5: CREDIT UNDERWRITING

5.1 In order to comprehensively address the Risk Profiles of its portfolios, each LFI must operate with a sound and granular credit underwriting policy based on its Lending strategy in accordance with its Board approved Risk Appetite. The Risk Appetite and the credit underwriting policy must incorporate sufficient risk-return discipline, consistent with the LFI's business model.

5.2 The underwriting process must ensure a thorough understanding of the Risk Profile and characteristics of the Obligors and the drivers of their credit performance. For that purpose, the LFI must establish well defined criteria within its policies and processes for approving new Facilities, renewing and refinancing existing Facilities. This decision process must be supported by a clearly defined approval authority based on the size and complexity of the Facilities.

5.3 Materiality thresholds must be established to govern decisions surrounding the issuance of each Credit Facility. All financing to existing and new Obligors must be assessed against risk acceptance criteria during the initial credit evaluation process and during the continuous Obligor/portfolio monitoring phase, as per Article 3.12.

5.4 LFIs must ensure that the underwriting framework and respective criteria, policies and procedures are implemented effectively and are subject to regular audit reviews.

Decision-making process

The decision-making process must include the following key elements:

5.5 Credit Committee: Decisions to issue Credit Facilities are expected to be governed by a management credit committee or individual(s) with the appropriate sanctioning authority where appropriate. The credit committee is expected to be a forum to analyse and discuss in detail the risk drivers, the pricing and the structure of Credit Facilities or, pools of Credit Facilities. Robust documented evidence must be retained to demonstrate that underwriting decisions are sufficiently challenged. Underwriting decisions must clearly document an appropriate balance between risk and commercial considerations.

5.6 Depending on their materiality, their rating and other criteria, some Facilities may be delegated for approval at levels of authority that report to the CCO and are below that of the credit committee. However, those delegations must be clearly documented and approved.

5.7 As an alternative to a credit committee, LFIs may structure underwriting approvals through individual delegations, however they must have in place a clearly documented and approved delegation matrix setting out delegations from Board level down to Senior Management (excluding control functions), CCO and individual credit officers.

5.8 LFIs must ensure that the approval of Credit Facilities is achieved through a continuous accountability framework for each step of the underwriting process. LFIs must define the roles of executive committees and senior executives involved in the process of underwriting of Credit Facilities.

The following principles apply:

a. The Board and/or Senior Management must be directly involved in the approval of Credit Facilities with the following characteristics: (i) materially large Facilities relative to the LFI's capital and (ii) Facilities with a high Risk Profile as explicitly defined in the policy.

b. The authority to approve Credit Facilities must flow through a mandate from the Board of directors or a designated body in the Board. The delegation must be vested with the highest executive committee/individual in the LFI that oversees the underwriting of Credit Facilities.

c. The delegation process must consider, at a minimum, the Obligor risk captured by Obligor rating, Facility amount and structure, the experience and qualifications of staff, the business segment of the Credit Facility to be approved, and the ranking of the financial obligation.

d. The staff delegated to make credit decisions have the adequate level of experience, qualifications and abilities.

e. The individuals responsible for underwriting must remain accountable for their decisions and should be subject to performance indicators reflecting the quality of their underwriting decisions.

5.9 LFIs must establish a performance assessment mechanism for all stakeholders involved in the acquisition and the management of Credit Risk which is aligned with the long term sustainability of the LFI. The mechanism must be articulated differently for the business lines and the control functions, based on the following principles:

a. The mechanism must enforce accountability amongst employees who make decisions that commit the LFI over several years and/or that result in material risk taking activities.

b. All internal employees involved in the acquisition and the management of Credit Risk including employees from the business lines must be subject to key performance indicators reflecting the quality of their underwriting decisions i.e. demonstrated by the credit worthiness of the Obligors after the underwriting process.

c. Each LFI should put in place deferred compensation mechanisms that align with the risk outcomes for the employees who benefit from the completion of large transactions that expose LFIs to long term risks.

d. Staff in the control functions involved in Credit Risk management must be compensated in a way that makes their incentives independent of the performance of the business. Their performance incentives must be based on achievements assessed against the objectives of the control functions, so as not to compromise their independence.

5.10 Independence: All credit decisions must be made free of conflicts of interest and on an arm's length basis. In particular, Related Party transactions must be governed by internal policies, to prevent potential conflicts of interests. They must be authorised by the Board of the LFI, and regularly monitored. The policies and processes must be articulated so as to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction. All Credit Facilities to Related Parties must be formally approved and signed-off by each Board member.

Key components of underwriting

5.11 The underwriting process must be structured to adequately support the decision-making process for the issuance and the acquisition of Credit Facilities, consistent with the LFI's Risk Appetite and strategic objectives. The underwriting process must enable the LFI to form a view on the suitability of the Risk Profile of each Credit Facility in light of the associated risk-adjusted return objective of the LFI. Consequently, this process must be clear and comprehensive, fully documented, and enforced in accordance with its internal policy.

5.12 In addition, the underwriting process is expected to include the following at a minimum:

a. Limits: The underwriting process must be controlled adequately with Risk Limits established at a suitable level of granularity. LFIs must establish overall credit limits at the level of individual Obligors and counterparties, and groups of connected counterparties that aggregate different types of Credit Facilities in a comparable and meaningful manner. The limits must be structured around the drivers of Credit Risk, including but not limited to Obligor rating, industry type, product type, geography, Credit Facility tenor and Credit Facility structure. LFIs must define acceptable

terms in accordance with the limits, (for example: Credit Facility covenants, legal requirements, leverage, tenor, amortization, pricing and/or minimum security).

b. Due diligence: LFIs must ensure that they implement a robust and comprehensive credit due diligence process (including legal aspects as appropriate) in order to fully capture all the relevant information necessary to assess the Obligors' credit worthiness. They must demonstrate a robust documented understanding of the purpose of the Credit Facility and the associated risk measured by key financial parameters such as leverage, debt service coverage ratio, liquidity, net worth and operating cash flows. This process must include quantitative and qualitative information over a period of time suitable to make informed credit decisions. It must also cover the assessment of the ownership structure of the Obligor and related group and the identification of the ultimate beneficial owner. Finally, LFIs must define a set of criteria triggering an enhanced due-diligence process with a larger and deeper scope of investigation.

c. Risk drivers: The underwriting process must incorporate a comprehensive identification and analysis of the key drivers of Credit Risk, typically separated into systemic risks and specific risk (or 'idiosyncratic' risk). Systemic risks should include Country Risk and industry risk. Specific risk should include business risk, financial risk and management risk.

d. Financial information: LFIs must collect comprehensive financial information and cash flow projections from their Obligors, contingent Obligors and guarantors. They must ensure that the due diligence process captures all financial obligations of their Obligors (including other LFIs and Related Parties). LFIs must refrain from making underwriting decisions mostly based on subjective information.

   In addition, for Wholesale Obligors:

   i. Credit analysis must be forward-looking incorporating macro-economic forecasts considering business cycle effects, the sector in which the Obligor operates, the Obligor's relative position and expertise within that sector and associated downside scenarios.

   ii. Affordability analysis throughout the Credit Facility should include a sensitivity analysis based on stressed market benchmark rates and profitability.

   iii. For Credit Facilities that are not fully amortising, an assessment of the LFI's exposure to re-finance risk, including possible exit options for the LFI, should be undertaken.

   iv. The LFI should have a formal documented process to ensure that the financial analysis of an Obligor is based on financial statements that have been audited by reputable auditing firms.

5.13 Documentation: The credit files must be well documented and include all information necessary to ascertain the current financial condition of the Obligor, including but not limited to the rationale and computations upon which classification and provisioning has been determined. In addition, files must contain sufficient information to track the decisions made and the history of the credit. For example, the credit files should include current financial statements, financial analyses and internal rating documentation, internal memoranda,

reference letters, appraisals and forward-looking financial projections. The credit review function must determine that the credit files are complete and that all Credit Facility approvals and other necessary documents have been obtained. Documents must include the evidence of the perfection of the LFI's legal interest as well as evidence of the ability to collect / exercise their creditor interest in collateral taken in support of the Credit Facility.

5.14 Collateral: LFIs must ensure that the collateral used as risk mitigant in the underwriting process is appropriately identified and valued. In addition, LFIs must monitor, control and assess the implications of multiple Lending against the same collateral. For that purpose, the following actions must be undertaken, at a minimum:

a. When appropriate, LFIs must ensure that collateral used as mitigation are registered with the relevant official body: (i) the land department for real estate collateral and (ii) the Emirates Integrated Registries Company LLC for other collateral.

b. The types of collateral covered in the registers are likely to evolve through time. Therefore LFIs must verify all collateral types.

c. Prior to the disbursement of any secured Lending, LFIs must verify the registration of collateral and ensure that the priority of their claim is reflected in underwriting and provisioning.

5.15 Facility structure: LFIs must ensure that amortization schedules and Facility tenors are suitably designed to meet the needs of Obligors and their Repayment abilities. The amortization structure should include the following principles:

a. The depth and breadth of credit analysis should increase with the Facility tenor, i.e. additional justifications and business rationale should be provided to support Facilities with long tenors.

b. The Repayment schedule should match the business cyclicality.

c. Tenors and amortization profiles should be within acceptable Risk Appetite and risk-reward relationship.

d. In the case of project finance, the Repayment schedule should match the expected development schedule of the project.

5.16 Legal due diligence: The LFI must ensure that the legal documentation of the Credit Facility is adequate to support the right of the LFI over the recoverability of the debt, including but not limited to, the liquidation of collateral, enforceability of guarantees, access of overseas assets. In addition, the LFI should review and evaluate the right to use Credit Facilities as collateral to raise liquidity, and ensure the conclusions of such evaluation are reflected in the legal documentation.

ARTICLE 6: DEFINITION OF DEFAULT

6.1 LFIs must employ the criteria presented herein to identify an event of Default. These are applicable to all Credit Facilities and all Obligors, including Retail Obligors and Wholesale Obligors. For Islamic Financial Services, the definition must also comply with Shari'ah requirements including the Shari'ah contract terms and conditions.

6.2 In the case of Default measurement, each LFI must monitor and assess the Defaults of Obligors by considering the obligation of a given Obligor across all the legal entities of a banking group incorporated in the UAE and abroad, including the Parent company, its branches and Subsidiaries.

6.3 A Default is considered to have occurred with regard to a particular Obligor when either or both of the following events have taken place: non-payment and/or unlikeliness to pay.

Non-payment

6.4 The Obligor is Past Due for a period greater than 90 days on any material credit obligation to the LFI. In this context, materiality must be measured with respect to the total exposure of the individual Obligor. A Facility or a group of Facilities with an Obligor is considered material if their combined exposure is greater than 5% of the total funded exposure of that Obligor to the LFI. In the case of multiple Credit Facilities, for Wholesale Obligors, the Days-Past-Due ("DPD") counter must start from date of the first Credit Facility becoming Past Due. In other words, the DPD counter must be computed across Credit Facilities with a consecutive day count.

6.5 Overdrafts will be considered Past Due once the Obligor has breached a contracted or internal limit, or been advised of a limit smaller than the current outstanding. In addition, Default must be considered when the outstanding balance is consistently in excess of the agreed upon limit. 'Consistently' is defined as a period that exceeds 90 continuous days, in addition, for Wholesale Obligors only, a total of more than 90 days in any 6 months period.

Unlikeliness to pay

6.6 The LFI considers that the Obligor is unlikely to pay its credit obligations in full. This evaluation should be based on a holistic evaluation of creditworthiness supported by factual evidence, whereby the LFI must forms a balanced view on the current and future overall performance of the Obligor. The classification of an Obligor as 'defaulted', due to a perceived unlikeliness to pay, is not automatic.

6.7 For the purpose of the evaluation of the unlikeliness to pay, LFIs must establish a set of criteria, including the requirements provided herein. These criteria would be most applicable to Wholesale Obligors with high Credit Risk, such as Obligors involved in Facilities with Interest only obligations, Obligors that are routinely Past Due with Repayments and/or Obligors with a bullet Repayment at maturity.

6.8 Indicators of unlikeliness to pay may include, but are not limited to, the indicators listed below. LFIs must clearly evaluate and document whether any of these situations apply (or others specific to the LFI) prior to forming an overall conclusion on the likeliness to pay of the Obligor:

a. The LFI makes an account-specific provision due to a significant decline in credit worthiness of the Obligor, subsequent to the origination of the Credit Facility.

b. The Interest and/or fee relating to the Credit Facility is Past Due more than 90 days.

c. The LFI sells part of a Credit Facility at an economic loss exceeding **30%** of the amount which is the greater of the current outstanding balance and the net present value of the Credit Facility.

d. The LFI has filed for the Obligor's bankruptcy or a similar order with respect to the Obligor's obligation to the LFI. Alternatively, the Obligor has become insolvent, has sought voluntary liquidation, or has been placed into bankruptcy by any other party.

e. The Obligor is classified as defaulted by another LFI.

f. There is evidence that the Obligor is capable but unwilling to meet its contractual credit obligations.

g. The LFI has to liquidate collateral due to a decline in the Obligor's credit worthiness.

h. The Obligor is classified in the default grade by approved credit rating agencies included in the Capital Adequacy Regulations.

i. Material concessions to the Credit Facility's original contractual obligations have been granted formally in writing, or informally, in the context of a restructuring, including but not limited to a bullet Repayment, significant grace periods, payment holidays or low Repayment at the beginning of the Repayment schedule.

j. For Wholesale Obligors based in the UAE, one of the owners of the company has left the UAE without a clear rationale, for a period greater than **6** months.

6.9 For Wholesale Obligors in particular, unlikeliness to pay can be indicated by a clear material decline in credit worthiness evidenced by the following circumstances:

a. A significant deterioration in financial performance of the Obligor leading to financial difficulty,

b. A high likelihood that the Obligor will enter bankruptcy or other material financial reorganisation,

c. Crisis in the Obligor's sector,

d. A breach of a material covenant included in the Credit Facility structure.

e. Repeated restructurings granted to the Obligor due to financial difficulties faced by the Obligor,

f. The Obligor's sources of income to repay the Obligor's Credit Facility are no longer existent or are distressed,

g. A significant deterioration in the quality of Obligor's operating assets leading to an inability to operate these assets efficiently. For asset-based Lending, this should include the ability of the assets to generate sufficient cash flows,

h. A significant deterioration in the value of collateral,

i. Pending litigations or regulatory changes resulting in material negative consequences,

j. The Default of a Subsidiary for which the Obligor provides a guarantee,

k. A loss of key staff to the Obligor's organisation,

l. Breach of major terms and conditions of the Facility and/or practice of non-payment on due dates,

m. For Wholesale Obligors, maintaining a material overdraft constantly up to or above limits with limited and irregular inflows, or

n. Other circumstances and external factor that would affect the Obligor's ability to repay.

6.10 For Retail Obligors in particular, the LFI should introduce a process to identify and evaluate Obligors that may be unlikely to pay based on specific circumstances of the Obligor, including, but not limited to, the following:

a. The Obligor's sources of income to repay the Credit Facility are no longer existent or are distressed,

b. The regulatory Debt Burden Ratio ("DBR") and/or internal DBR limits if more stringent is breached or likely to be breached when undertaking appropriate stress tests,

c. For Obligors/Obligors based in the UAE, the Obligor/Obligor has been absent from the UAE and not contactable for a period greater than 3 months, with an outstanding balance on a Credit Facility,

d. There is a significant deterioration of collateral whereby the value of the collateral falls below a predetermined minimum level, for example a significant fall in residential real estate values that brings the loan/financing-to-value ("LTV") of mortgage loans/financing above regulatory and/or internal limits.

Cross Default

6.11 Retail Obligors: The definitions of Default must only apply at Credit Facility level, therefore cross-Default does not apply automatically. The Default of a Credit Facility must neither trigger the Default of the individual Obligor nor the Default of other Credit Facilities granted to the same Obligor unless warranted due to actual Default on each Credit Facility.

6.12 Wholesale Obligors: The Default of a material Credit Facility must also trigger the Default of the Obligor. In the context of an economic group composed of multiple legal entities, and in the absence of explicit consideration of cross-Default in the legal documentation of the Facility, then the following principles must apply.

a. LFIs must establish appropriate Credit Facility materiality thresholds and/or criteria, above which cross-Default should be considered and analysed.

b. Cross-Default must not automatically apply between an Obligor and its Parent entity or other entities of the group, if the Repayment of the Obligor Facility has no legal or economic dependency towards the Parent entity or any other entity of the group, or where the Repayment of the Credit Facility is only linked to the cash-flow of a specific, clearly defined project of the Obligor.

c. Cross-Default must apply if the Repayment of the Credit Facility is economically dependent on the performance and cash-flows generated from the consolidated economic group. In this case, Default on a material Credit Facility under the economic group must trigger the Default of all Credit Facilities and entities within the economic group.

d. If the Obligor is benefiting from a guarantee from its Parent company, then the Default of the Parent company must not automatically trigger the cross-Default of the entity benefitting from the guarantee. Consideration should be given to assess whether the Obligor can continue to operate without this guarantee under the terms of its financial obligations. However, the rating of the Obligor must be immediately reassessed without the presence of the guarantee and amended if necessary.

ARTICLE 7: SIGNIFICANT INCREASE IN CREDIT RISK

7.1 The LFI must assess and document regularly whether the Credit Risk of a financial instrument has increased significantly since its initial recognition. The identification of Significant Increase in Credit Risk ("SICR") must be done in accordance with accounting standards, the LFI's internal policy on SICR and must incorporate the requirements presented in these standards. It must be based on all available, reasonable and supportable information; including forward-looking information. The identification of SICR must be employed by LFIs to determine the staging of Obligors and Facilities as explained in Article 9 below on classification and provisioning.

7.2 The indicators employed for the identification of a SICR must be regarded as early warning indicators to the identification of the Obligor's unlikeliness to pay, articulated earlier in this regulation and the these standards. Consequently, for Obligors subject to a SICR, the identification process must also consider the possibility of a further deterioration in credit worthiness leading to unlikeliness to pay. Such analysis must be fully documented. Wholesale Obligors must be considered individually not as a portfolio.

7.3 Each LFI must review forward-looking information and determine appropriate indicator to determine if an SICR has occurred. Those indicators must include, but not be limited to, the number of Deferrals granted to the Obligor and the Days-Past-Due.

7.4 For each Obligor, LFIs must implement a rigorous process to regularly assess whether a SICR has occurred. This process can be based on information at the level of each Credit Facility or at pool or portfolio level. If an LFI decides to set its SICR criteria threshold at the level of a group of Credit Facilities, the Facilities within that group must have similar Credit Risk drivers.

7.5 LFIs must ensure that the assessment of SICR is applied at different levels of granularity for connected financial instruments, e.g. Credit Facility level, Obligor level and/or group level. Such assessment must be documented.

7.6 As a precursor to SICR, LFIs should implement a watch list mechanism, employed for forward-looking Credit Risk management, appropriate to the size and complexity of the LFI.

7.7 Deferral indicator:

a. Any individual Credit Facility of a Wholesale Obligor, subject to **3 or more Deferrals** of instalments due in a rolling 24-month period, must be identified as a deteriorating asset and therefore subject to SICR, unless there is supportable and documented evidence that no SICR has occurred. This requirement applies to Credit Facilities that are material to the LFI for a given Obligor, i.e. Credit Facilities representing more than 5% of the total Obligor's financial obligations to the LFI.

b. If the Obligor has **3 or more Deferrals** of consecutive instalments then the days-past-due counter commences from the original due date of the first deferred instalment. Relevant classifications and required provisions must be applied on the basis of this day count.

7.8 DPD indicator: Credit Facilities with Repayments more than **30 Days-Past-Due** must be identified as deteriorating assets and therefore subject to SICR. If the 30 Days-Past-Due presumption is rebutted, this must be fully documented with reasonable and supportable information evidencing that no SICR has occurred.

7.9 Other indicators: For all Obligor types, in addition to the Deferral indicator and the DPD indicator, LFIs must review forward-looking information to determine if a SICR has occurred. Such a review must include a comprehensive assessment of quantitative and qualitative drivers of Credit Risk associated with each Obligor. This assessment must be fully documented and retained as evidence. During this assessment, it may not be possible to identify a single discrete event. Instead, the combined effect of several events can cause a SICR.

7.10 Exceptions: For a Credit Facility where it has been determined that no SICR has occurred despite being triggered by the indicators above, such evidence must be formally evaluated and agreed upon by the CCO and CRO before being formally approved at the most Senior Management committee.

7.11 For Wholesale Obligors, relevant indicators of a SICR may include, but are not limited to those outlined below. LFIs must be in a position to demonstrate that they have analysed these elements:

a. Deterioration of financial performance, including but not limited to, actual or expected decline in revenues or margins, increase in operating risks, deficiencies in working capital, breaching/deterioration of quantitative Credit Facility covenants and/or rising liquidity risks.

b. Deterioration in the value, quality or income-producing ability of the Obligor's assets, increase in balance sheet leverage and/or negative equity. Deterioration in the ability of the Obligor to utilise its assets, for instance caused by the loss or damage of these assets.

c. Deterioration in the competitive position of the Obligor. Disruption in the position of the Obligor vis-a-vis its clients and/or suppliers. Disruption in the business and/or economic conditions, in particular, bankruptcy of a counterparty, economic difficulty in the sector in which the Obligor operates, particularly when taking into account the Obligor's position in that sector.

d. Ineffective governance, sudden management changes, sudden change in the scope of business or organizational structure (such as the discontinuance of a segment of the business) that can result in a significant change in the Obligor's ability to meet its obligations.

e. Downgrade of the Credit Facility in publicly available information from external parties, such as rating agencies and/or a credit bureau.

f. Any other contributor to deterioration in credit worthiness, such as the following:

    i. Unavailable/inadequate financial information and/or financial statements,

    ii. Qualified report by external auditors,

    iii. Significant contingent liabilities,

    iv. Pending litigation resulting in a detrimental impact,

    v. Loss of key staff critical to the organization,

    vi. Increase in operational risk and higher occurrence of fraudulent activities which are material to impact Repayment of Facilities,

    vii. Continued delay and non-cooperation by the Obligor in providing key relevant documentation to the LFI.

g. Any other evidence that full Repayment of Interest and principal without realization of collateral is unlikely.

h. For Wholesale Obligors, where the majority owning Parent is showing stress such as SICR or worse, then there is a risk of diversion of funds from the Obligor, who should also be considered as subject to SICR.

7.12 Economic environment: LFIs must analyse and document the relationship between macroeconomic conditions and Obligors' Credit Risk drivers for the purpose of SICR assessment. This requirement applies to all types of portfolios. Such analysis can be performed at the level of individual Obligors or pools of Obligors, provided that jointly assessed Obligors share similar risk drivers. LFIs must also demonstrate that adequate economic analysis is performed to support this process. In addition to macroeconomic analysis, the SICR assessment must be supported by industry-level analysis, both current and forward-looking, including implications of any geopolitical, environmental and operating risks.

ARTICLE 8: RESTRUCTURING

8.1 Article 8 of the Credit Risk Management Regulation requires LFIs to implement an appropriate process to identify, execute and manage Restructured Credit Facilities.

8.2 For the purpose of this regulation and these standards, restructuring events are categorised into two distinct groups:

a. Distressed restructuring, and

b. Non-distress restructuring.

8.3 Distressed restructuring: A Credit Facility must be regarded as a distressed restructuring if any of its terms are amended in a context of financial difficulty of the Obligor. This includes restructuring that commences or concludes after a Credit Facility becomes Past Due more than 90 days or falls within the unlikeliness to pay status. The assessment of financial difficulty must incorporate at a minimum the same criteria as outlined in this regulation and these standards for the assessment of SICR, and in particular the number of Deferrals as required by Article 9 on classification and provisioning.

8.4 Non-distressed restructuring: A Credit Facility must be regarded as a non-distressed restructuring if any of its terms are formally amended for commercial or regulatory reasons, including the intention to mitigate future financial difficulties, but excluding situations of financial distress at the time of restructuring. Such type of restructuring includes Credit Facilities for which the contractual obligations and Repayments have been made, without any history of Past Dues on the Credit Facility.

8.5 Examples of non-distressed restructuring are as follows:

a. A change in the contractual Interest rate to better reflect the credit worthiness of the Obligor and/or the market pricing,

b. A change in the contractual tenor and/or the Repayment schedule to better align such Repayments with the Obligor's future cash flows. This includes restructuring for which early identification of a lower Repayment capacity from the Obligor is observed because inadequate terms for Repayment were originally approved, as long as there is no Default at any time during the restructuring process.

c. A change in the contractual tenor and/or the Repayment schedule to take into account a modification of the sources of income of a Retail Obligor in order to meet a debt burden ratio requirement. For instance, this may apply in the case of change in employment or voluntary early retirement.

d. Rescheduling prior to an event of Default, provided as a concession with a modification in the Repayment dates of the principal amount. However, when a Facility is rescheduled after a Default event as defined in Article 6, the Obligor falls into the distressed restructuring category described above.

8.6 Restructured accounts also include cases where a Credit Facility is fully settled by a simultaneous or subsequent disbursement of a new Credit Facility.

8.7 Standstill: In some circumstances, the restructuring process may take time to reach its completion. Such a situation is sometimes referred by LFIs as 'standstill'. Any type of restructuring that is in standstill for more than 90 days, during which the Obligor is not meeting its financial obligations as per the terms of the original Facility, falls within the definition of Default defined above and, therefore, must be considered a Default event.

Restructuring Process

8.8 The restructuring process must be defined by LFIs for Retail Obligors and Wholesale Obligors separately. All distressed restructuring must follow the principles described for remediation in Article 3.14. It must follow a rigorous governance with clear accountability and must be subject to annual internal audit review. The approving authorities (whether a committee or individual) of a restructuring must be accountable for ensuring compliance with the LFI's internal policies and procedures.

8.9 Approval process: LFIs must define a clear process to approve Credit Facility restructuring, including a clear delegation of authority to allow terms and conditions beyond the normal course of business. This process must mirror the process employed for issuing new Credit Facilities as articulated in Article 5 on underwriting principles.

8.10 Eligibility of restructuring: LFIs must design and document minimum conditions to evaluate the viability of a proposed restructuring taking into consideration the following:

a. Criteria outlining the number of times a Credit Facility may be restructured. Robust underwriting practices suggest that the number of restructuring has a practical limit as eventually the LFI must suitably forecast the Obligor's activity. The LFIs policy must deter restructurings that are poorly designed and not workable from the outset where the LFI can reasonably determine that the Obligor will not perform. LFIs must implement a documented framework to restructure Facilities to control such practice.

b. The economic rationale for not meeting the original Repayment schedule.

c. The viability of future Repayment plan.

d. In addition, certain causes of the Obligor's financial distress requires a more in-depth assessment for the eligibility for restructuring. LFIs must identify these causes, including but not limited to,

   i. Any occurrence of fraud by the Obligor in relation to past or present business or financial activities, and

   ii. Any occurrence of fund diversion or inappropriate usage of funds by the Obligor.

8.11 Credit Facility structure: The structure of a new Credit Facility must be designed to (a) maximise the Repayment likelihood from the Obligor while (b) minimizing the losses and expenses incurred by the LFI. LFIs must design and enforce a policy to govern restructuring principles, focusing on the amortization schedule and with adequate controls over unfunded Facilities. In the case of a deterioration in the Obligor's credit worthiness, the extension of overdraft limits or other similar Facilities for the Obligor to repay existing Facilities should be treated as a strong indicator of distress restructuring.

8.12 Viability analysis: For Wholesale Obligors in particular, LFIs must assess the viability of the Obligor upon restructuring by conducting a rigorous forward-looking analysis, based upon both quantitative and qualitative assessments. This must involve a transparent assessment of the economic environment, the state and prospects of the sector in which the Obligor operates, the Obligor's position in that sector and the business conditions and the specific circumstances of the Obligor. The analysis must also include forecasted cash flows under several economic and business assumptions both baseline and stressed. The results must be presented to the credit committee as part of the decision-making process. The LFI must maintain and perform analysis on the Repayment history of the Credit Facility from inception of the original Facility.

8.13 LFIs performing Islamic Financial Services must carry out the structuring process in accordance with Shari'ah rules and principles and take into considerations the controls imposed in doing so.

ARTICLE 9: CLASSIFICATION AND PROVISIONING

Classification Principles

9.1 Each LFI must establish a process to assess, monitor and determine a classification to reflect the current and expected credit worthiness of each Credit Facility and/or each portfolio of Facilities, except for those measured at fair value. Upon this classification, LFIs must determine provisions based on the application of this regulation and these standards. This process must be proactive, forward-looking and supported by adequate policies, systems, data, analytical tools and by adequately trained employees.

9.2 The classification process must be fully documented based on the provisioning policy approved by the Board, or in the case of foreign entities, the Board of the head office or the Senior Management committee of the branch.

9.3 The classification process must be based on the assignment of internal risk ratings. LFIs must develop and utilize internal risk rating systems to manage Credit Risk. Where external credit assessments are used, the LFI must exercise appropriate due diligence to ascertain that the rating reflects the Risk Profile of the Obligor and the Facility. Particular attention must be paid to Credit Facilities that have been restructured and/or for which the outstanding Interest is capitalized. LFIs must be in a position to present evidence of undertaking this classification process to the CBUAE upon request.

9.4 At a minimum, this classification process must incorporate the following elements:

a. The principles presented in these standards.

b. The regular review of exposure creditworthiness performed at Facility level, Obligor level and/or portfolio level, depending on the nature of the Obligor and the product type.

c. The regular update of internal ratings, at a minimum every 12 months. Such a review should take place more frequently in the case of credit related events. For Wholesale Obligors, such rating update must be performed at Facility level or Obligor level.

d. The early identification of deteriorating credit worthiness of a Credit Facility and the continuous oversight of such Credit Facilities.

e. The timely record of past-due information for all Facilities.

9.5 LFIs must classify each Facility according to the three Stages and sub-Stages outlined below, inferred from accounting principles, whereby the likelihood of Default increases through the Stages. The classification described in these standards does not preclude LFIs from developing their own more granular and robust grading system, which must be clearly mapped to the categories outlined herein. The onus will be on the LFI to justify their assessment.

a. Stage 3: Defaulted Credit Facilities as per the definition of Default included in Article 6. In addition, this Stage is further split into three sub-categories as defined below, where each Obligor must be allocated based on his number of Days-Past-Due. Such a split is required for CBUAE reporting purposes.

Table 1: Stage 3 sub-categories, based on Days-Past-Due (DPD)

Stage	Wholesale Obligors	Retail Obligors
3.a	Not Past Due but unlikely to pay	Not Past Due but unlikely to pay
	91 to 180 DPD	91 to 120 DPD
3.b	181 to 365 DPD	121 to 180 DPD
3.c	365+ DPD	180+ DPD

b. Stage 2: Credit Facilities subject to deterioration in credit worthiness as explained in the section on the SICR, included in these standards.

c. Stage 1: Any financial instrument not allocated to Stage 2 or Stage 3, that is currently fully performing and with robust expectation regarding the Obligor's future credit worthiness.

9.6 LFIs must establish a policy governing the criteria to allow migration between Stages. These must follow accounting principles, the principles articulated in Article 7 dedicated to SICR, and the rules as set out in this Article.

9.7 Stage 3 to Stage 2: Credit Facilities must remain in Stage 3 until all arrears are settled. In addition, for Wholesale Obligors, at least **3 instalments** must have been made for monthly Repayment schedule, and at least **1 instalment** for any other Repayment schedule of longer intervals. Instalments must be composed of principal and/or Interest as per the original applicable Facility agreement, and must not be funded via a new Facility provided by the LFI or other means than the Obligor's own cash flows.

9.8 Stage 2 to Stage 1: For Wholesale Obligors, Credit Facilities must remain in Stage 2 until SICR criteria, as defined in Article 7, are no longer observed. In addition, each financial instrument subject to migration to Stage 2 must be monitored closely and remain in Stage 2 until the following Repayments of principal and/or Interest as per the original applicable Facility agreement have been met. This is referred to as the probation period. After completion of this period, the Facility can return to Stage 1. Interest-only payments are sufficient to migrate back to Stage 1 only if the original Facility agreement provided for a period allowing service of Interest only. The following minimum Repayment frequencies must be applied as from the date of last overdue instalment payment:

a. 6 instalments in the case of monthly Repayment (i.e. 6 months),

b. 2 instalments in the case of quarterly Repayment (i.e. 6 months),

c. 2 instalments in the case of half yearly Repayment (i.e. 12 months),

d. 2 instalments in the case of yearly Repayment (i.e. 2 years),

e. 12 months minimum in the case of any other frequency.

9.9 For step-up Repayment structures and working capital lines, the LFI must apply the above principles to formulate relevant staging criteria, including at a minimum: (i) longer periods may be considered for step Repayments, and (ii) a revolving working capital line would need to remain as Stage 2 until the renewals have been successfully completed during a minimum period of 12 months. However, in all cases, the LFI must re-evaluate the presence of SICR based on the criteria outlined in Article 7 and determine the staging accordingly.

9.10 Where an Obligor or Facility was migrated from Stage 1 to Stage 2 for other reasons than missed instalments, then the minimum Repayment frequencies defined in Article 9.8 above do not apply for a migration from Stage 2 back to Stage 1. Instead, the LFI must methodically re-evaluate the presence of SICR based on the criteria outlined in Article 7 and determine the staging accordingly.

9.11 Stage 3 to Stage 1: For Wholesale Obligors, financial instruments subject to SICR and allocated to Stage 3 must not be upgraded from Stage 3 to Stage 1 directly. Instead, the Obligor must be upgraded to Stage 2 initially and be subject to continuous monitoring for a minimum period corresponding to the Repayment intervals defined in Article 9.8.

9.12 For Retail Obligors, LFIs must define minimum periods to govern the migrations between Stages for cases where their credit worthiness improves: (a) Stage 3 to Stage 2 (all arrears must be settled), (b) Stage 3 to Stage 1 and (c) Stage 2 to Stage 1. These minimum periods must be documented and justified based on the LFI's business model.

9.13 While the Stage 1, 2 and 3 defined above do not apply to derivatives transactions, LFIs must review and classify derivative transactions according to their associated Counterparty Credit Risk. LFIs must create their own appropriate classification based on counterparties' credit worthiness and potential exposure. Such classification must enable the LFI to manage CCR in a proactive manner, with adequate early warning to manage credit deterioration.

Provisioning

9.14 All LFIs must implement a process to estimate and document provisions associated with each Credit Facility in all Stages and in all credit portfolios, in compliance with CBUAE regulations, standards and/or guidance. Such provision must be estimated during the life of the Credit Facility and assessed annually or more frequently in light of new information and the evolution of the economic and business environment. LFIs are required to book provisions in line with these standards and deduct them from the profit and loss account, at least by the end of each quarter and not delay them till the end of the financial year.

9.15 Determining provisions in the context of Islamic Financial Services may impact the Investment Account holders' profit as provisions are deducted from profit. Consequently, LFIs performing Islamic Financial Services must ensure that the Internal Shari'ah Supervision Committee approves the provisioning policies. In addition, the determination of provisions must be approved by the committee responsible for profit and loss allocation in accordance with the Central Bank's standard regarding profit equalization for Islamic Banks.

9.16 The provisioning process must be documented, organised and approved by Senior Management and the Board. At a minimum, it must incorporate the following components:

a. The history of classifications of existing Facilities and/or Obligors,

b. Robust methodologies and rating systems for the continuous assessment of Credit Risk arising from all financial instruments,

c. A process for the appropriate estimation of provisions supported by robust analytical solutions and systems commensurate with the size and complexity of the LFI,

d. A process to manage the quality of data used as inputs to the assessment of Credit Risk and provisions.

e. The regular estimation and reporting of key performance indicators (KPIs) relating to provisions and expected credit loss (ECL).

f. Regular back testing of expected credit loss (ECL) against historical losses.

9.17 Retail Obligors: A provision of 100% of the Credit Facility net of collateral is required if the Obligor has permanently left the country where the Credit Facility was issued, without leaving sufficient funds with the LFI available to ensure the Repayment of the total outstanding. The above may not apply automatically and the LFI must evaluate the need for a provision for an Obligor who continues to service the Credit Facility from overseas and is not Past Due.

9.18 Off-balance sheet items: For Wholesale Obligors, the LFI must undertake the following process, at a minimum.

a. Each LFI must estimate the likelihood that unfunded Facilities become on-balance sheet funded Facilities. For the purpose of provision estimations, it must then convert off-balance sheet Credit Facilities to on-balance sheet Credit Facilities. This process should be achieved by using credit conversion factors ("CCF") at a minimum as prescribed in the CBUAE Capital Adequacy standards. Deviations are permitted once fully documented and approved by the appropriate governance level for each LFI. For Stage 3, if the LFI has determined that an unfunded Facility will not become an on-balance sheet Facility, then the LFI must document robust evidence supported by legal opinion to confirm such treatment.

b. Each LFI must identify and estimate its exposure to off-balance sheet Credit Facilities in the form of derivative contracts. Thereafter, the LFI must assess the net marked-to-market exposure to the Obligor, considering any enforceable netting arrangements in place and cash collateral received. The Counterparty Credit Risk arising from derivative transactions should be captured through the estimation of a fair value Credit Value Adjustment (CVA) reserve, in compliance with accounting principles. LFI must ensure that CVA is included in their Risk Appetite framework and CCR management process.

9.19 Interest and fees in arrears: For all Credit Facilities with any instalments (including principal, Interest and other fees) more than 90 Days-Past-Due, the LFI must immediately set aside full provision at 100% of any Interest and fees not received. The provision must be deducted from current year income and the Interest and fees must not be included in income eligible for distribution. The income not received must be separately tracked and identifiable as a component of the gross outstanding along with the related provisions.

9.20 Minimum provision for Stage 1 and 2: LFIs are permitted to estimate expected credit loss (ECL) and provisions via the quantification of probability of Default (PD) and loss given Default (LGD) incorporating CRM as determined by the LFI, but limited to the collateral and associated haircuts listed in the column labelled 'up to 24 months' of table 2 in Article 10. The quantification of PD and LGD must reflect the Risk Profile of each Credit Facility and/or portfolio and the experience of the LFI in terms of Default, collateral management and recovery collections. If the LFI incorporates risk mitigation as described in Article 10 for provision estimation, such mitigation must be based on robust and documented methodologies supported by data.

9.21 LFIs must ensure that the total provision corresponding to all Stage 1 and Stage 2 Credit Facilities is not less than **1.50%** of the LFI's Credit Risk weighted assets as computed under the CBUAE capital regulations.

a. If the provision computed under 9.20 above is less than the aforementioned floor, the shortfall in provision must be deducted from current year income, similarly to all other provision requirements in this standard.

b. Alternatively, the shortfall amount in provision compared to the above-mentioned floor in this Article may instead be held in a dedicated non-distributable balance sheet reserve called the 'impairment reserve-general'. The amount held in the impairment reserve-general must be deducted from the capital base (Tier 1 capital for Banks) when computing the regulatory capital.

9.22 The CBUAE may impose a floor higher than that of 1.50% of Credit Risk weighted assets mentioned above at its discretion, for reasons including but not limited to:

a. Open high-risk observations from CBUAE regarding the models used in the estimation of expected credit loss (ECL); or

b. Insufficient assurance regarding the reliability or accuracy of relevant expected credit loss (ECL) models, such as due to shortcomings in compliance with the CBUAE Model Management standards or accounting standards.

9.23 Minimum provision for Stage 3 (Wholesale Obligors): LFIs must implement a dedicated process and a methodology for the computation of provisions associated to Facilities allocated in Stage 3. The approach must incorporate the following elements.

a. The LFI must compute provisions after deducting, from the principal amount outstanding, the following items:

i. Eligible collateral as detailed in Article 10 after applying the relevant haircuts, and

ii. Any recoveries derived from expected cash flows supported by robust documentation and legal agreements as detailed in Article 10.

b. The provision computation must be based on the recovery and loss specific to each non-performing Credit Facility. For this purpose, the LFI is not permitted to use LGD derived from statistical models based on the LFIs generic recovery rates.

c. The calculation process, the methodology and the results must be reviewed and approved by the committee responsible for the oversight of provisions. This requires a formal review and support of the CRO at that committee. Ultimately, such provisions should be presented to the Board or delegated body of the Board, in accordance with the internal escalation policy of the LFI.

d. In addition, the LFI must ensure that minimum provision levels computed above are maintained against the principal of each defaulted Credit Facility and cannot be lower than the floors discussed below. (This excludes the income not yet received, which requires 100% specific provision). The application of the floors is defined separately for unsecured and secured exposures. These floors apply irrespective of the haircuts applied on collateral.

i. An unsecured exposure refers to an unsecured Facility or the unsecured portion of a secured Facility. A secured exposure refers to the portion of a Facility that is covered by an eligible collateral after haircut, as defined in Article 10 on CRM. The secured portion also means the part of the Facility equal to the value of the collateral after haircut.

ii. The application of the minimum provision is organised as shown in the table below. The unsecured portion is split in two sub-portions: (1) one part covered by expected cash flows (ECF), and (2) one part not covered by ECF. For the unsecured portion, the minimum provision floor is the higher of the minimum provision floor calculated based on the sub-portions and the minimum provision floor calculated for the unsecured portion as a whole[1].

Table 2: Stage 3 minimum provision for Wholesale Obligors

<table>
<tr><th colspan="2">Exposure portions</th><th colspan="2">Exposure sub-portion</th></tr>
<tr><th>Portions</th><th>Min provision floor</th><th>Sub-portions</th><th>Min provision floor</th></tr>
<tr><td rowspan="2">Unsecured portion</td><td rowspan="2">25% for 4 years and 100% thereafter</td><td>Covered by expected cash flows</td><td>No floor</td></tr>
<tr><td>Not covered by expected cash-flows</td><td>100%</td></tr>
<tr><td>Secured portion</td><td>No floor for 4 years and 25% thereafter</td><td></td><td></td></tr>
</table>

iii. First, the LFI must apply a minimum provision of **100%** corresponding to the unsecured portion that is not covered by expected cash-flows. Second, the LFI must apply minimum provision on the unsecured portion and secured portion respectively, as defined below.

iv. For each unsecured exposure, the provision must not be less than **25%** of the unsecured exposure up to **4 years** of becoming Stage 3, or from the date of issuance of these standards if it is already in Stage 3. After that date, any unsecured exposure must be fully provisioned at **100%**.

v. For each secured exposure, the provision must not be less than **25%** of the secured exposure **after 4 years** of becoming Stage 3. In this context, secured means mitigated by collateral as detailed in Article 10 on CRM.

e. The LFI must book provisions from the profit and loss account, at least by the end of each quarter and not delay them till the end of the financial year.

f. Provisions already held for Stage 3 accounts classified prior to the issuance of these standards may not be reduced, if the provision computed based on the requirements of these standards is lower.

[1] For instance, assume a facility of 100, with a collateral of 60 after haircut, and 35 additional expected cash flows (ECF). For the first year, the secured portion is 60 and the unsecured portion is 100 – 60 = 40. The unsecured sub-portion not covered by ECF is 40 – 35 = 5, attracting a min provision of 5 (100%). Separately, the minimum provision for the entire unsecured portion is 40 x 25% = 10, which will be retained because it is greater than 5, i.e. the min provision on the unsecured sub-portion. Overall, the floor will be 10, for the first year. This estimation must be conducted again the following year with new collateral haircuts according to Article 10.

9.24 Minimum provision for Stage 3 (Retail Obligor): For Retail Obligors as defined in the standards, each LFIs must put in place a dedicated process and a methodology for the estimation of provisions for Facilities allocated in Stage 3. Each LFI must ensure that minimum provision levels are maintained against the principal of each defaulted Facility.

Table 3: Stage 3 minimum provision for Retail Obligors net of collateral, as per Article 10

	Days-Past-Due / Classification			
	Unlikely to pay and not Past Due	**91 to 120**	**121 to 180**	**180 +**
Sub-Stage	3.a		3.b	3.c
Minimum provision	25% or higher	25% or higher	50% or higher	100%

Stage 3 provisions and accounting standards

9.25 If Stage 3 provisions computed under this standard exceed the provision computed under accounting standards, this shortfall in provision is required to be taken against current year income similarly to all other provision requirements in this standard.

9.26 Prior to the issuance of this regulation, differences between the CBUAE regulatory provisions and accounting provisions were held in a dedicated reserve ('impairment reserve – specific'). This methodology is now removed and not permissible. An LFI that has an amount in this reserve upon this regulation coming into force, must recalculate the provisions as per the requirements of this regulation and document for each of the exposures the changes relating to this regulation coming into force. The provisions calculated as per this regulation must then be charged fully through current year income, while simultaneously transferring the full balance of the aforementioned reserve back to retained earnings.

Restructured Credit Facilities

9.27 LFIs must pay particular attention to the classification of Restructured Credit Facilities as per the additional requirements articulated in the subsequent articles.

Classification of distressed restructuring

9.28 All distressed Restructured Credit Facilities for which the unlikely to pay criteria have been met, or that are Past Due more than **90** days at the conclusion of the restructuring process must be classified as **Stage 3.** Subsequently, staging transition rules must be applied as for any other Facilities.

9.29 Any Credit Facility that has been restructured **3 times** or more in a context of financial difficulty as defined under the SICR section of these standards must be migrated to **Stage 3**.

9.30 All other distressed Restructured Credit Facilities not captured above must be allocated to **Stage 2 or Stage 3.** These also include Facilities where the restructuring has permitted payment of Interest only, whereby the requirement of principal Repayment has been removed; such Facilities remain as Stage 2 until such time that principal Repayment is resumed.

Classification of non-distressed restructuring

9.31 All non-distressed Restructured Credit Facilities with a Repayment moratorium exceeding **6 months** must be classified as **Stage 2,** unless the LFI can demonstrate that no SICR has occurred, in which case the same process as outlined under Article 7.10 must be followed. These Facilities must be reviewed annually by the CRO and any necessary action must be documented.

9.32 All non-distressed Restructured Credit Facilities greater than **3 years** in tenor after the restructuring and with a bullet Repayment, must be classified as **Stage 2** at the start of the restructuring period, if any of these features are met:

a. For the purpose of these standards, a Repayment structure should be considered as bullet (balloon) Repayment if a material proportion of the principal Repayment is allocated at the end of the maturity of the Facility, in such a way that the ability of the Obligor to meet these annuity Repayments with its current cash flows is uncertain.

b. The bullet Repayment (or balloon Repayment) exceeds **40%** of the outstanding. For the purposes of this limit, the bullet/balloon must be computed by combining any of the **3 largest** Repayment amounts throughout the tenor. This does not apply to Facilities with formal UAE Local/Federal government guarantee or a UAE local Bank or bank guarantee rated AA or above.

c. Any non-distressed restructuring, without a bullet Repayment and without any Repayment moratorium can be allocated to **Stage 1**.

Applicable to all restructuring

9.33 Subsequent to all distressed and non-distressed restructuring, the Facility/Obligor must be classified as **Stage 3** if the definition of Default explain in these standards is met, at any time until the end of the restructured Facility.

Staging transitions for restructured Facilities

9.34 Stage 2 to Stage 1: Restructured Credit Facilities are subject to the same rules applicable to any other Credit Facilities for migration from Stage 2 to Stage 1.

9.35 Stage 3 to Stage 2: For Restructured Credit Facilities classified in Stage 3, a return to Stage 2 is dependent on the proportion of the bullet Repayment:

a. Where a bullet Repayment (or balloon Repayment) represents **40%** or less of the outstanding, the Facility will remain in Stage 3 until **3 instalments** have been made and all arrears are settled. Instalments must be composed of principal and Interest. For the purposes of this limit, the bullet/balloon must be computed by combining the 3 largest Repayment amounts throughout the tenor.

b. Where a bullet Repayment (or balloon Repayment) represents more than **40%** of the outstanding, under no circumstances may such a Credit Facility be migrated to Stage 1 even after being migrated to Stage 2. The Stage 3 classification will remain until the following Repayment of principal and Interest have been fully met by the Obligor (from its own funds without borrowing or financing from the LFI) and may then be reclassified as Stage 2.

   i. 6 instalments in the case of monthly Repayment (i.e. 6 months),

   ii. 2 instalments in the case of quarterly Repayment (i.e. 6 months),

   iii. 2 instalments in the case of half yearly Repayment (i.e. 12 months),

   iv. 2 instalments in the case of yearly Repayment (i.e. two years),

   v. 12 instalments in the case of any other frequency.

9.36 The above criteria will apply to every subsequent restructuring.

9.37 Particular attention should be paid to Facilities that are “Purchased or Originated Credit Impaired” or “POCI”. This process involves the de-recognition of the original Credit Facility and the recognition of a new Credit Facility, that is now credit-impaired. The new Credit Facility is recognised in the LFI’s financial statements at reduced fair value and routinely monitored for further deterioration in value with appropriate provisions made accordingly.

9.38 For any of the cases outlined above, LFIs that extend further Lending/financing to a defaulted restructured Obligor must retain the Stage 3 classification for an additional **12** months to the timeframes outlined above.

ARTICLE 10: CREDIT RISK MITIGATION

10.1 LFIs may account for the presence of CRM when determining the appropriate level of provisions, but only to the extent permitted as per these standards. The haircuts applied to collateral are only for the purpose of computing the provision amount; these haircuts have no impact on the legal rights of the LFI with respect to any collateral.

10.2 The measurement of CRM must be based on realistic and documented assumptions supported by robust data, in particular for collateral valuation and discounted cash flows. The approach must include at a minimum the eligibility of collateral, recovery cash flows, time to recovery, the cost of recovery and the discounting method. The Credit Risk Management Function must review and form an opinion on the adequacy of the associated provisions from a risk perspective and escalate as appropriate.

Discounted future cash flows

10.3 Where LFIs take into account discounted future cash flows, these must be measured in a conservative manner. For Facilities to Wholesale Obligors in Stage 3 this must be done on a case-by-case basis and only to the extent as set out in the below Articles 10.4 to 10.6.

10.4 Future cash flows of high certainty can be considered as forms of risk mitigation provided they meet the requirements herein. All cash flows used for risk mitigation must be discounted to the present and formally validated by external auditors, and hold a formal independent legal opinion to confirm the right of enforcement and ability to obtain those cash flows.

10.5 Future rental income under a formal lease agreement, and with the rental income assigned to the LFI from commercial real estate under lien is permitted to be used as risk mitigation when computing the required provision. Other cash flows from defined and distinct sources may be considered within the principles articulated in Article 9.23.

10.6 To be eligible for CRM, the future cash flows must not be from the same source as the cash flows expected when the Obligor failed to fulfil its Repayment obligation, unless legal certainty can be established regarding the recovery of such cash flows.

Collateral

10.7 Collateral is eligible for risk mitigation if the LFI holds the first right of legally enforceable lien and if the collateral meets the minimum requirements presented herein. LFIs must implement processes and systems to identify, store, measure and monitor all collateral and guarantees linked to each financial instrument generating Credit Risk. LFIs must implement rigorous collateral management and valuation policies to ensure a fair assessment of CRM. They must also analyse and report concentration in some types of collateral and their associated Credit Risk, to Senior Management and the Board, as necessary.

10.8 The value of the eligible collateral must be based on the net realizable value, market conditions and haircuts reflective of all material uncertainties, including but not limited to liquidation uncertainty, legal uncertainty, valuation uncertainty, costs associated with the liquidation of collateral and time value of money. At a minimum, LFIs must employ the haircuts in the table below for Stage 3 accounts. All items labelled as N/A in the table must be evaluated, documented and concluded upon on a case-by-case basis. This evaluation must rely on the principles above and specific provisions must be computed accordingly. The column labelled 'up to 24 months' also applies to Stage 1 and 2 as per Article 9.20.

10.9 For Stage 3 classifications made prior to the issuance of these standards, the months should be counted from the date of issuance of these standards and not the original date of Stage 3 classification. In addition, collateral haircuts already applied by the LFI must be retained if they are higher than those specified in the table below. In other words, the LFI may not reduce the haircuts it has already applied prior to issuance of these standards. If the haircuts are lower than those specified below, they must be adjusted to meet these values.

Table 4: Minimum collateral haircuts

Eligible Collateral	**Minimum Haircut (months since becoming Stage 3)**				
	Up to 24 months*	**From 25 to 36 months**	**From 37 to 48 months**	**From 49 to 60 months**	**After 60 months ****
Cash (or cash equivalent) in AED, currencies pegged to USD and cases where there is no currency mismatch between the Facility and the collateral	N/A	N/A	N/A	N/A	N/A
Federal Government (security or guarantee)	N/A	N/A	N/A	N/A	N/A
Local Government (security or guarantee)	N/A	N/A	N/A	N/A	N/A
UAE licensed Bank (security or guarantee)	N/A	N/A	N/A	N/A	N/A
Cash (or cash equivalent) Foreign Currency	20%	30%	60%	80%	100%
Foreign sovereign government bonds/Sukuk rated [BBB-] or above	0%	20%	40%	80%	100%
Foreign bank rated [AA-] or above (security or guarantee)	0%	20%	40%	80%	100%
Foreign bank rated [BBB-] or above but below [AA-] (security or guarantee)	20%	40%	60%	80%	100%
Listed shares on a recognized stock exchange	20%	40%	60%	80%	100%
Bonds or guarantees from corporations rated [BBB-] or above	20%	40%	60%	80%	100%
Aircraft, motor vehicles and boats/vessels	20%	40%	60%	80%	100%
Real estate	20%	40%	60%	80%	100%

* For Stage 1 and 2, LFIs are expected to have a framework to compute adequate haircuts based on the Risk Profile of their portfolios. The haircuts in the column labelled 'up to 24 months' must be applied as minimum floor.

** In some circumstances, the haircut can be capped at the values corresponding to 'from 49 to 60 months', as per the table above, if the LFI has (i) a formal legal claim with respect to the liquidation of the specific collateral registered with the court, and (ii) an internal legal opinion confirming that the outcome of the legal process is likely to be in the favour of the LFI (i.e. greater chance of recovery than not).

10.10 For Islamic LFIs, the collateral must be compliant with Shari'ah rules and principles.

10.11 For some collateral types, the valuation method is subject to the following conditions:

a. Cash collateral is eligible only if it is held under a legally enforceable lien/pledge.

b. Listed shares, bonds and Sukuk are eligible if they are traded on a deep and liquid market. In this case, the average daily closing price over the previous one month must be used.

c. Real estate collateral criteria:

i. Real estate includes land and/or buildings.

ii. Incomplete properties must not be included as part of the valuation.

iii. For Wholesale Obligors, real estate assets are eligible if an independent third-party valuation has been performed. For Stage 3 Facilities, this valuation must have been performed within the last **12 months** of the reporting date. The LFI must set materiality thresholds above which the use of desktop valuations is inadequate and a more comprehensive on-site evaluation is required.

iv. For Retail Obligors with residential mortgages LFIs must rely on at least one third-party valuation. For Stage 3 Facilities, a valuation must have been performed within the last **12 months** of the reporting date. This may be supplemented with a framework to base valuations on appropriate house price indices.

v. For residential properties constructed by the borrower, LFIs may formulate a framework to value properties individually based on expert estimates of internal professional engineers and supported by municipality approvals.

d. Aircraft, motor vehicles and boats/vessels are eligible if an independent third-party valuation has been performed and the LFI must have a legal and enforceable charge over the item. For Stage 3 Facilities, the valuation must have been performed within the last **6 months** of the reporting date. For motor vehicles, the original valuation with a formal depreciation methodology is an acceptable alternative.

10.12 Any collateral held in foreign jurisdictions and booked in UAE is also subject to all the above requirements. In addition, to be eligible the following is required:

a. A formal legal opinion, obtained from a third party in that jurisdiction regarding the enforceability and validity of the legal charge by the LFI over the asset,

b. A formal legal opinion from the internal legal team of the LFI regarding the relevance and acceptability of the opinion formulated by the third party, and

c. A formal third-party independent valuation of the asset validated by the LFI's external auditor.

ARTICLE 11: PORTFOLIO MANAGEMENT AND INTERNAL REPORTING

11.1 LFIs must ensure that Credit Risk acquired through underwriting, refinancing and other mechanisms is fully monitored, reported and mitigated when necessary. For that purpose, LFIs must develop and implement comprehensive procedures, methodologies and systems to monitor the credit worthiness of each financial instrument, each Obligor, and relevant segments and portfolios. Such monitoring must cover all financial instruments and portfolios generating Credit Risk.

11.2 Portfolio management must be integrated with the underwriting process so that information flows back and forth between the two processes. LFIs must demonstrate that the conclusions of portfolio management are used in the processes of risk acquisition.

11.3 LFIs must review the performance of individual Wholesale Credit Facilities at least annually. The rating of all Credit Facilities and Obligors must be reviewed at least on a yearly cycle. More frequent reviews can be necessary depending on the individual circumstances of Obligors and on the economic environment.

11.4 The monitoring process must incorporate steps to ensure that funds are used in accordance with the Facility legal agreement of each Obligor. The LFI must track the usage of the borrowed funds/financing proceeds and methodically identify their sources of Repayment. In the case of syndicated Facilities, it is the responsibility of each syndicate Lender/financier to understand the usage of funds via a monitoring process coordinated by the lead arranger.

11.5 One of the key objectives of the monitoring process is to identify occurrences of fund diversion; that is situations where the disbursed funds are not used for the purpose originally intended. The monitoring process must incorporate steps to ensure that funds are used in accordance with the Facility legal agreement of each Obligor.

11.6 <u>Aggregation</u>: The monitoring process must be performed at several levels of portfolio aggregation, so that segmentation leads to homogeneous pools of Credit Facilities with common risk drivers. LFIs incorporated in the UAE, which have branches and/or Subsidiaries, must capture and consolidate a group-wide view of Credit Risk. LFIs must implement robust systems and methods to aggregate Credit Facilities across the key risk drivers relevant to each LFI's portfolio, including but not limited to, Obligor segments, rating grades, product types, collateral type, geographies, industries, Credit Facility maturity and Obligor metrics (e.g. LTV, DSCR, gearing, leverage).

11.7 Data gathering: LFI must implement reliable and timely data processes to support appropriately portfolio management. At a minimum, LFIs must implement the following:

a. Robust systems and processes to collect and aggregate internal data in order to convey an accurate representation of Credit Facilities arising from all instruments across the organisation.

b. Robust systems and processes to collect, aggregate and process external data to support the accurate measurement of Credit Risk, including but not limited to, up-to-date financial information (including sector-specific financial performance), collateral data (including indices relevant to the collateral type) and Obligors' performance against legal covenants, where applicable. The system should be able to present the portfolio's Credit Risk Profile across a variety of underlying risk drivers, including those referenced in Article 11.6.

c. Historical Default rates and recovery rates must be collected for all material segments in order to support the accurate and prudent estimation of provisions.

11.8 Analytics: LFI must implement adequate methodologies, models and analytical tools to identify and measure Credit Risk regularly at several levels of aggregation and segmentation. This assessment must rely on Obligors' probability of Default, loss given Default, the size of their Credit Facility upon Default and the estimation of collateral values.

11.9 Reporting: A robust reporting mechanism must be put in place to analyse the characteristics of credit portfolios and to communicate the observations and conclusion of credit reviews and analysis. Management information must be provided on a frequent and timely basis to the Board and Senior Management, in formats suitable for their use and understanding. As part of this the Board must be informed on: the Credit Risk Profile's trend compared to the previous reporting period; and the change in underwriting standards, either through policy changes or actual practice, over time.

11.10 Risk mitigation: Upon the review of the performance of individual credit instruments and portfolios, LFIs must have a robust process to discuss observations, escalate concerns and implement risk mitigating actions and corrective actions, such as an additional collateral request, a rating downgrade, Credit Facility restructuring, liquidation, sell-off, hedging, portfolio rebalancing, or any other action. Such process must be rigorously documented.

11.11 Monitoring: LFIs must ensure the monitoring of the performance of each Credit Facility and Obligor upon restructuring. This process must be based on pre-defined indicators and limits specific to each Restructured Credit Facility. All distressed Restructured Credit Facilities must be subject to close monitoring as long as they remain distressed but not less than a minimum period of 12 months, supported by regular analysis and reporting. For Retail Obligors, LFIs can implement such enhanced monitoring of restructured Facilities at portfolio levels.

ARTICLE 12: NON-PERFORMING ASSETS AND WRITE-OFF

Management of Non-Performing Assets

12.1 The Board and Senior Management of an LFI hold responsibility for the asset quality of the LFIs' credit portfolios and the timely action to address credit-quality deteriorations. The Board must ensure that the LFI, at an early Stage, understands the underlying drivers of rising levels of non-performing assets and takes appropriate management actions in response.

Non-performing assets must be managed by individuals not involved in the origination of that Credit Facility in accordance with the requirements of article 3.14 of these standards.

12.2 At a minimum, the strategy should be based on the following principles:

a. It should be integrated into the Credit Risk management policy of the LFIs and be reflected into its Risk Appetite.

b. It should include a plan to manage non-performing assets over the short, medium and long terms, based on the expected flow of new asset migration to Stage 3. The plan should be forward-looking based on future expectations about asset credit worthiness and recoveries.

c. It should define the conditions and expectations of forbearance.

d. It should have appropriate methodology and systems to monitor and value collateral in a timely fashion.

e. It should have appropriate legal expertise to support the recovery process.

12.3 LFIs with elevated Stage 3 exposures will be subject to greater supervisory oversight. When at any time the total amount of Stage 3 exposures as a proportion of the total credit exposure of the LFI exceeds **5%**, the Board must:

a. Formally explain to the CBUAE the underlying causes for the high stock of Stage 3 exposure, and

b. Approve and implement a comprehensive strategy to reduce the excess within a reasonable timeframe. Such a plan should include a detailed breakdown of Stage 3 exposures and be communicated to the CBUAE semi-annually.

Write-offs and Partial Write-offs of Non-Performing Assets

12.4 When the LFI has no reasonable expectation to recover the full or part of a Credit Facility exposure as per the terms of the legal agreement, then the LFI should undertake a full or partial write-off of the exposure. A write-off constitutes a de-recognition event with the following financial implications: (a) any amounts written-off from the balance sheet must have an equivalent amount of provisions passed through the income statement; and (b) any amounts collected after the write-off must be recognised in the statement of profit and loss.

12.5 Timing: LFIs must ensure that write-offs are timely and reflect realistic Repayment and recovery expectations. For that purpose:

a. LFI must define the maximum expected recovery time for collateralised and uncollateralised exposures. Beyond such time, write-offs must be implemented. The internally determined write-off period cannot exceed the maximum permissible period set by the CBUAE.

b. The LFI must not hold a Stage 3 exposure on the balance sheet for more than **5 years** since the date of migration to Stage 3. After this time, such exposures must be subject to a full write-off in the accounts. Any exceptions to this should be subject to Board or appropriate Board Committee sign-off and oversight, based upon robust legal or accounting justification at the level of the Credit Facility, and supported by appropriate documentation available for review by the CBUAE. For the avoidance of doubt, such a write-off does not impede or limit the LFI from fully collecting the amounts due.

12.6 Process: LFI must clearly define policies and processes to support write-off actions and the periodic review of Credit Facilities subject to partial write-offs. A write-off decision must include an assessment of legal and accounting consequences. For Islamic financial institutions, it must comply with Shari'ah principles. The ultimate authority for approval of write-offs rests with the Board or an appropriate Board Committee. At a minimum, the following drivers must be included in the LFI's write-off policy, for the assessment of recoverability and write-offs:

a. Exposures with prolonged arrears: if the Obligor has been in arrears for a prolonged period of time, full or partial write-off should be performed based on realistic expectation of little recovery.

b. Exposures under an insolvency procedure: Write-off should be performed if the legal expenses are expected to consume the majority of the recovered amount.

c. Partial write-off: this may be justified when there is evidence that the Obligor is unable to repay the amount of the exposure in full and there is a reasonable expectation of recovering a part of the exposure.

12.7 Insolvency process: Where a court appoints an administrator/expert to control the business, the LFI must assist in facilitating the recovery of any profitable business component, where applicable. This component may be ring-fenced as a viable business into a new entity to facilitate the recovery of the debt. Such matters must be handled by the function responsible for account remediation and recovery within the LFI.

Recovery of Non-Performing Exposures Post Write-off

12.8 A write-off may take place before legal actions taken against the Obligor to recover the debt have been concluded in full. After any write-off, the LFI in all cases retains the legal right to recover the debt. An LFI's decision to forfeit the legal claim on the debt is a separate consideration and requires approval from the Board or the relevant authority formally designated by the Board.

12.9 An individual memorandum account must be maintained for every Credit Facility subject to write-off. This must also include accounts written-off on a portfolio-level basis. All recoveries made from the accounts subject to earlier write-off must be recognised in the statement of profit or loss. The summarized records must be maintained for the review of the CBUAE and to support claims in the courts. However, the LFI should close those memorandum accounts in the event of collecting the required amount or following a formal decision to discontinue the claims against these Obligors. The reporting of such accounts to CBUAE and other relevant bodies must be consistent with these requirements

ARTICLE 13: CREDIT RISK MODELS

13.1 LFIs must have methodologies and analytical solutions to measure, analyse and categorise Credit Risk, and compute the associated provisions. LFIs must be able to analyse Credit Risk at several granularity levels including Credit Facility level, Obligor level, segment level and portfolio level in order to identify credit concentration risk.

13.2 Each LFI must operate analytical tools with sophistication appropriate to the complexity of its portfolio, products, industries and other predominant factors. If an LFI does not use models for a given portfolio, then it must document and provide a rationale for such a decision.

13.3 Where models are used for decision-making, LFIs must articulate clearly the roles of models for the support of Credit Risk underwriting, monitoring and provisioning. They must define the modelling strategies, the limits and conditions of model usage. Particular attention must be given to any overriding of model outputs. Such practice must be justified, fully documented and reported. High frequency of overrides of model outputs should be remedied by model recalibration or development.

13.4 LFIs must establish an appropriate asset grading or classification system for the measurement of Credit Risk. All acquired and existing Credit Facilities must be assigned a rating grade based on robust justification and supported by historical analysis and analytical tools.

13.5 When an LFI makes use of models for decision-making for credit purposes, it must also comply with the modelling standards and Guidance issued by CBUAE. In addition, LFIs must ensure the establishment of effective controls (including in respect of the quality, reliability and relevance of data and in respect of validation procedures) around the use of models to identify and measure Credit Risk and set limits. Each LFI must demonstrate that its models are fit for purpose and adequately calibrated to effectively support the associated risk and business decisions.