Basel Committee
on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel large exposures framework – Kingdom of Saudi Arabia

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BANK FOR INTERNATIONAL SETTLEMENTS

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Contents

Glossary

BCBS	Basel Committee on Banking Supervision
BCL	Banking Control Law
BIS	Bank for International Settlements
C	Compliant (grade)
DNB	Netherlands Bank
D-SIB	Domestic systemically important bank
FAQs	Frequently asked questions
G-SIB	Global systemically important bank
GCC	Gulf Cooperation Council
KSA	Kingdom of Saudi Arabia
LC	Largely compliant (grade)
LCR	Liquidity Coverage Ratio
LEX	Large exposures framework
MNC	Materially non-compliant (grade)
NC	Non-compliant (grade)
OECD	Organisation for Economic Co-operation and Development
RCAP	Regulatory Consistency Assessment Programme
SAMA	Saudi Arabian Monetary Authority

Preface

The Basel Committee on Banking Supervision (BCBS or Basel Committee) places a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only accrue if these are implemented fully, consistently and in a timely manner by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel framework.

This report presents the findings of an RCAP Assessment Team on the domestic adoption of the Basel large exposures framework (LEX) in the Kingdom of Saudi Arabia (KSA). The assessment focused on the completeness of the domestic regulations in force on 30 June 2018, as applied to KSA domestic banks, and their consistency with the Basel LEX standard. Issues related to prudential outcomes, the resilience of the banking system or the supervisory effectiveness of the KSA's authorities were not in the scope of this assessment. The assessment relied on regulations and other information and explanations provided by the KSA's authorities and ultimately reflects the view of the Basel Committee.

The RCAP Assessment Team was led by Olaf Sleijpen, Supervision Policy Director at the Netherlands Bank (DNB). It comprised four technical experts from Mexico, the European Central Bank – Banking Supervisory, Indonesia and Turkey (see Annex 1). The main counterpart for the assessment was the Saudi Arabian Monetary Authority (SAMA). The work was coordinated by the Basel Committee Secretariat with support from staff from the Netherlands Bank.

Starting in February 2018, the assessment comprised three phases: (i) self-assessment by the SAMA; (ii) an assessment phase (February to May 2018), including an on-site assessment involving discussions with SAMA and representatives of KSA banks; and (iii) a review phase (June to August 2018), including a technical review of the Assessment Team's findings by a separate RCAP Review Team, the Committee's Supervision and Implementation Group, the RCAP Peer Review Board and the Basel Committee. More information on the RCAP assessment process is available on the Committee's website.[1]

The RCAP Assessment Team acknowledges the cooperation received from SAMA counterparts throughout the assessment process. In particular, the team thanks the staff of SAMA for playing an instrumental role in coordinating the assessment exercise.

1 See www.bis.org/bcbs/implementation.htm.

Executive summary

SAMA implemented the Basel LEX standard consistently with the internationally agreed timeline. SAMA implemented the LEX as a minimum standard on 1 January 2016, three years ahead of the implementation date provided in the Basel standard. The KSA LEX standard is applicable to all 12 locally incorporated banks on a consolidated basis. Overall, as of 30 June 2018, the LEX regulation in the KSA is assessed as compliant with the Basel LEX standard. This is the highest possible grade. Each component is also assessed as compliant.

The Assessment Team recognises the efforts made by SAMA to improve the consistency of its LEX regulation throughout the course of the assessment process. These amendments became effective prior to 30 June 2018 (see Annex 3 for a complete list of the amendments), the cutoff date for the assessment.

The KSA LEX regulation is super-equivalent to the Basel LEX standard in several areas: the definition of eligible capital as Common Equity Tier 1 capital, the early implementation date, a more conservative large exposures limit of 15% and additional requirements on individual, sole proprietors and intra-group exposures. The stricter rules have not been taken into account as mitigants for the overall or component-level assessment of compliance.

Response from SAMA

SAMA welcomes the opportunity to be the first jurisdiction to be assessed under RCAP for the implementation of the Basel III large exposure standard, and to respond to the findings and comments of the RCAP Assessment Team. SAMA also wishes to acknowledge and appreciate the commitment, professionalism and expertise of the RCAP Assessment Team, under the leadership of Mr Olaf Sleijpen, and would like to thank the Assessment Team for the proficiency with which the entire RCAP exercise for Saudi Arabia was completed.

This assessment has provided a comprehensive and thorough review of the implementation of Basel large exposure standard in Saudi Arabia and we are pleased that Saudi Arabia has received an overall compliant rating.

SAMA has always considered a strong large exposures framework to be the cornerstone of a sound banking system. This important principle was embedded in the Banking Control Law, which provided for a large exposure limit for Saudi banks as far back as 1966. In the following years, SAMA led the way in this region by revising large exposure standards in June 1994 in line with Basel standards. In 2015, SAMA decided to lower large exposure limits for most entities to 15% applicable by the year 2019. In 2018, as part of a self-assessment, SAMA updated these rules in line with Basel standards to provide clear and explicit references to Basel standards.

Based on SAMA's self-assessment and as identified by the Assessment Team, SAMA has carried out 12 modifications to the existing regulations before the agreed cutoff date of 30 June 2018. We believe that these modifications will further strengthen the implementation of the Basel large exposures framework in Saudi Arabia and will confirm our commitment to the work of the Basel Committee and the consistent implementation of regulatory standards underpinning the Basel III framework.

Overall, SAMA considers the RCAP process a very useful exercise, and is supportive of the Basel objectives to promote consistency of implementation of rules among member countries. SAMA also concurs that the RCAP process promotes a level playing field among Basel member jurisdictions, which reduces regulatory arbitrage and promotes the safety, soundness and stability of the global financial system.

1 Assessment context

1.1 Status of implementation of the large exposures framework

SAMA is responsible for the regulation and supervision of the KSA's banking sector. SAMA is empowered by the Banking Control Law (BCL) 1966 and the SAMA Charter 1957 to issue banking regulations, rules and guidance to licensed banks in the KSA. The Basel LEX standard has been implemented via the issuance of circulars (see Annex 2) and has been in effect from 1 July 2015.

SAMA first issued the Circular #3610000067330 in February 2015, which superseded the SAMA Circular#BC312 dated 6 June 1994. Moreover in February 2018, SAMA updated the 2015 Circular with Circular #3910000059150. SAMA updated the KSA LEX regulation during the RCAP review through Circular #6130/41 dated June 2018. SAMA publishes the regulation in English with a cover letter in Arabic, which ensures the enforceability of the regulation per local requirements.

1.2 Regulatory system

In the KSA, all locally incorporated banks are subject to the local implementation of the Basel LEX standard. SAMA is responsible for issuing and enforcing the LEX regulation in the KSA. The circular and guidance on LEX issued by SAMA include a data collection template with the information required from each bank to identify large exposures. The submitted large exposure information is reported to and reviewed by SAMA on a quarterly basis. In case of breaches of the LEX regulations, SAMA has powers to impose corrective measures and penalties, as detailed in the BCL.

1.3 Structure of the banking sector

Twenty-five institutions are licensed by SAMA to carry out banking functions in the KSA. Twelve of these are domestic and 13 are foreign bank branches. Banks provide a range of core banking functions but not exotic products of the type that might be offered by global systemically important banks (G-SIBs) or in advanced economies. Most of the banking activities are focused within the KSA or in the general region. As noted in the International Monetary Fund's Financial Sector Assessment Program report of July 2017, "[KSA] banks follow a simple business model, mainly intermediating private sector deposits for lending to corporates and households. Among the latter, mortgage loans comprise only about one-fourth of the total while the remainder is consumer and credit card loans. Direct exposure to the government is limited."[2]

In assessing the materiality of deviations, the Assessment Team focused on a sample of the five largest banks in the KSA.[3] Together, these banks account for about 63% of the total assets of the banking sector and 65% of the assets of internationally active banks in the KSA (in terms of leverage ratio exposure data as of 30 September 2017).

SAMA applies the LEX regulation to all commercial banks and regulated entities in the KSA on a consolidated level as well as a standalone basis with the exception of foreign bank branches. Foreign bank branches, however, are required to report their 50 largest exposures to SAMA.

2 See www.imf.org/~/media/Files/Publications/CR/2017/cr17318.ashx.

3 National Commercial Bank, AlRajhi Bank, Riyad Bank, SAMBA and Bank Saudi Fransi.

1.4 Scope of the assessment

The Assessment Team considered the LEX regulation applicable to all of the 12 locally incorporated banks in the KSA as of 30 June 2018. The assessment had two dimensions:

- A comparison of the domestic regulation with the Basel LEX framework to ascertain that all the required provisions have been adopted (*completeness* of the regulations); and
- Whether there are any differences in substance between the domestic regulation and the Basel LEX framework and, if so, their significance (*consistency* of the regulations).

In its assessment, the RCAP Assessment Team considered all binding documents that effectively implement the Basel LEX framework in the KSA. Annex 2 lists the Basel requirements used as the basis for the assessment. The assessment did not evaluate the adequacy of large exposures framework or the resilience of the banking system in the KSA or the supervisory effectiveness of the KSA's authorities.

The Assessment Team notes that, in some areas, the KSA's rules go beyond the minimum Basel LEX requirements. Although these elements (listed in Annex 4) provide for a more rigorous implementation of the Basel LEX framework, they have not been taken into account for the assessment of compliance.

The outcome of the assessment is summarised using a four-grade scale, both at the level of each of the three key components of the Basel LEX framework and the overall assessment of compliance. The four grades are compliant, largely compliant, materially non-compliant and non-compliant.

2 Assessment findings

2.1 Assessment grades and summary of findings

Overall, the Assessment Team finds the implementation of the LEX framework in the KSA to be compliant with the Basel standard. This grade takes into account the rectifications issued by SAMA in June 2018, as described in Annex 3.

Assessment grades — Table 1

Component of the Basel LEX framework	Grade
Overall grade	C
Scope and definitions	C
Minimum requirements and transitional arrangements	C
Value of exposures	C

Assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

2.1.1 Scope and definitions

The SAMA regulation on the scope and definition requirements is compliant with the Basel standard.

The Assessment Team did not find any differences between the KSA LEX regulation and the Basel LEX framework with regard to the scope and definitions.

2.1.2 Minimum requirements and transitional arrangements

The SAMA regulation on the minimum requirements and transitional arrangements is compliant with the Basel standard.

The Basel LEX standard defines eligible capital as the effective amount of Tier 1 capital as defined under the Basel III framework. The SAMA LEX Circular, on the other hand, defines eligible capital as Common Equity Tier 1 capital, which consists of a subset of Tier 1 capital instruments. In addition, the Basel LEX standard defines an exposure as large exposure when the sum of all exposures of a bank to a counterparty or group of connected counterparties exceeds or equals 10% of a bank's eligible capital base and requires large exposures not to be higher than 25% of a bank's eligible capital base at all times. For exposures of G-SIBs to other G-SIBs, this limit is set at 15%. The SAMA LEX Circular sets the large exposures limit to 15% with the only exception being for non-domestic systemically important banks' (D-SIBs') exposures to non-D-SIBs and non-G-SIBs, for which the limit is set at 25%. Additionally, for individuals, sole proprietors and related counterparties, SAMA sets strict limits. Moreover, there is an aggregate limit of six times the bank's eligible capital base. This implementation is super-equivalent to the Basel LEX standard, as the large exposures definition is wider than, and the large exposures limits are narrower than or equivalent to, the Basel LEX standard.

As for implementation, SAMA started implementing the large exposures standard within a year after the Basel standard was issued in 2014. While the standard provides for a five-year transition period for implementation by 1 January 2019, SAMA required the KSA's banks (excluding foreign bank branches) to start limiting their large exposures to 15% as of January 2019, down from 23% of eligible capital base starting from 1 January 2016 (see Table 2). This early adoption promoted a smooth transition and prompted banks to start reducing the concentration risks related to large exposures on their balance sheets. In addition, SAMA also set the separate limit on exposures to individuals/sole proprietors to 5% following a transition period, starting from 16% of eligible capital base, within the same time frame. Moreover, while the Basel LEX framework excludes intra-group exposures, SAMA defines these clearly and sets a 25% limit for intra-group exposures to non-banking subsidiaries.

Transition period — Table 2

Effective from	Large exposures	Individual/sole proprietor
1 January 2016	23%	16%
1 January 2017	21%	12%
1 January 2018	18%	8%
1 January 2019	15%	5%

Source: SAMA.

The Basel LEX framework is designed to serve as a backstop and complement to the risk-based capital standards. In addition to large exposure limits introduced in line with Basel LEX framework, SAMA assesses the concentration risk under its Pillar 2 approach, where banks are expected to allocate capital for regional and sectoral concentrations.

2.1.3 Value of exposures

The SAMA regulation on the value of exposures requirement is compliant with the Basel standard.

SAMA used a mixed approach in transposing the value of exposures provisions of the Basel LEX framework into its domestic regulation. While some of the provisions are directly adopted, the SAMA rule gives direct reference to Basel LEX standard regarding definition of exposure values, calculation of exposure value for trading book positions, offsetting long and short positions in the trading book, and the treatment of covered bonds, collective investment undertakings, securitisation vehicles and other structures and exposures to central counterparties within the large exposures framework. These provisions are provided in the appendices of the SAMA LEX Circular.

2.2 Detailed assessment findings

2.2.1 Scope and definitions

This component is judged to be compliant with the Basel framework. No findings were identified.

2.2.2 Minimum requirements and transitional arrangements

This component is judged to be compliant with the Basel framework. No findings were identified.

2.2.3 Value of exposures

This component is judged to be compliant with the Basel framework. No findings were identified.

Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

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Assessment Team members

Mr Alberto Munguía Cisneros	National Banking and Securities Commission of Mexico
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Supporting members

Mr Marijn de Jong	Netherlands Bank
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Review Team members

Mr Toshio Tsuiki	Basel Committee Secretariat
Mr Saurav Sinha	Reserve Bank of India
Ms Joanne Marsden	Office of the Superintendent of Financial Institutions Canada
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Annex 2: List of Basel standards and implementing regulations issued by the KSA's authorities

The following Basel standards were used as the basis of this RCAP assessment:

- *Supervisory framework for measuring and controlling large exposures*, April 2014; and,
- *Frequently asked questions on the supervisory framework for measuring and controlling large exposures*, September 2016.

Table A.1 lists the regulations issued by SAMA to implement the large exposures framework in the KSA. Previous RCAP assessments of SAMA's implementation of the Basel standards considered the binding nature of regulatory documents in the KSA.[4] This RCAP Assessment Team did not repeat that assessment, but instead relied on the previous assessment's findings. Those assessments concluded that the types of instrument described in Table A.1 could be considered as binding on banks and supervisors for the purposes of an RCAP assessment.

Overview of relevant large exposure regulations in the KSA — Table A.1

Domestic regulations	Type, version and date
Banking Control Law	(1) Article 8 of Banking Control law (issued in 1966)[5]
Large exposure rules	(1) Circular #BC 312 dated 6 June 1994 making changes in large exposure rules in line with Basel requirements. (2) Circular #3610000167330 dated 25 February 2015 introducing LEX rules from 1 July 2015 in line with Basel large exposure rules issued in 2014. (3) Circular # 391000059150 dated 08/02/2018 making changes in large exposure rules issued via circular no 361000067330 dated 25/02/2015. (4) Circular # 6130/41 dated June 2018; update to large exposure rules.[6]

Source: SAMA.

4 Annex 3 of the BCBS RCAP-LCR report for the Kingdom of Saudi Arabia, www.bis.org/bcbs/publ/d390.pdf.

5 This article states, "No bank shall grant a loan or extend a credit facility, or give a financial guarantee with respect to any natural or juristic person for amounts aggregating more than 25 percent of the Bank's reserves and paid-up or invested capital."

6 See www.sama.gov.sa/en-US/Laws/BankingRules/Rules%20on%20Large%20Exposures%20of%20Banks.pdf.

Annex 3: Rectifications made by SAMA

List of rectifications by SAMA — Table A.2

Basel paragraph	Reference in KSA regulations	Description of the rectification
26 and FAQ 2	Section 1.2 viii, d	Updating the SAMA LEX Circular to include the modified criterion for economic interdependence in the September 2016 FAQ.
61	Section 4.6 i	Updated SAMA LEX Circular to include statements regarding the eligibility criteria for recognition of the credit risk mitigation, which might extend the range of sovereign exemption. The exemption is extended for the portions of exposures guaranteed by or secured by financial instruments issued by sovereigns to the extent that eligibility criteria for recognition of the credit risk mitigation are met.
Various	Various	Various grammatical updates.
Various	Various	Updated various references to SAMA regulations that transpose the Basel standards and FAQs.
24	Section 1.2 vii, c	Updated reference to specific international accounting standards.
91–92	Appendix VI	Included definitions for G-SIBs and D-SIBs.
64	Appendices VII–XI	Removed references to the Basel text and instead included the Basel text directly for the definition of exposure values, calculation of exposure value for trading book positions, offsetting long and short positions in the trading book, and the treatment of covered bonds, collective investment undertakings, securitisation vehicles and other structures and exposures to central counterparties within the large exposures framework.
42 and FAQ 3	Section 4.3	Added additional bullet as revised in the 2016 FAQ for paragraph 42.
64	Section 4.4 and Section 4.6 i, e	Updated the SAMA LEX Circular to include clear references or text associated with paragraphs 43 and 57 to provide further clarity with regard to the recognition of such credit protection under the large exposures regime.
68–71	Section 4.6	Removed specific reference to GCC and OECD countries, which may have created uncertainty regarding the implementation regarding covered bonds.

Source: SAMA.

Annex 4: Areas where SAMA rules are stricter than the Basel standards

In several areas, SAMA has adopted a stricter approach than the minimum standards prescribed by the Basel Committee. These are listed below for information. The stricter rules have not been taken into account as mitigants for the overall or component-level assessment of compliance.

1. SAMA defines eligible capital as Common Equity Tier 1 capital, which consists of a subset of Tier 1 capital instruments. The Basel LEX standard defines eligible capital as the effective amount of Tier 1 capital as defined under the Basel III framework.

2. SAMA started implementing the LEX standard within a year after the Basel standard was issued in 2014. The Basel LEX standard implementation date is 1 January 2019.

3. SAMA required the KSA's banks (excluding foreign bank branches) to gradually limit their large exposures to a conservative 15% (instead of 25% allowed by Basel) of eligible capital base as of January 2019 except for non D-SIBs exposures to non-D-SIBs and non-G-SIBs, for which the limit is set to 25%.

4. SAMA set a separate limit on exposures to individuals/sole proprietors of 5% of eligible capital base following a transition period starting from 1 January 2016.

5. SAMA defines intra-group exposures and sets a 25% limit for intra-group exposures to non-banking subsidiaries. The Basel LEX framework excludes intra-group exposures.