Saudi Arabian Monetary Agency

Banking Supervision Dept.

15 February 2011

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From : Saudi Arabian Monetary Agency

To : All Banks

Attention : Managing Directors, Chief Executive Officers and General Managers

Subject : **Announcement of the Basel III Accord and SAMA Plans for its Implementation of Basel II and III in 2011**

The Basle Committee for Banking Supervision (BCBS) issued its finalized comprehensive reforms package in December 2010 to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The objective of these reforms is to improve the banking sector's ability to absorb shocks arising from financial and economic stresses, and in this regard, this comprehensive package addresses the lessons learnt from the financial crisis.

In December 2009, the BCBS issued its initial comprehensive consultative document entitled "The Strengthening the Resilience of the Banking System". This document proposed major enhancements and amendments to the Basel II framework for strengthening the global capital framework through raising the quality, consistency and transparency of capital, institution of capital buffers, enhancing risk coverage, and the introduction of leverage and liquidity ratios. Following an elaborate consultation process, the major features of Basel III have now been agreed by the Basel Committee, and the final Basel III text was issued on 16 December 2010.

As a member of the Basel Committee, SAMA has been actively involved in developing these standards and it fully supports the package of reforms announced by the BCBS. SAMA believes that the Basel III framework will strengthen the supervisory framework by enhancing the quality and quantity of capital, introduction of liquidity and leverage ratios and by supporting greater sophistication in identification and management of risks in the banking industry. Therefore, SAMA is planning to fully implement Basel III as provided by the BCBS Reforms Package on the basis of the phase-in arrangements described in attachment – 1.

As was the case for Basel II, the implementation of Basel III in the Saudi banking system will require close coordination and collaboration between SAMA and the banks. The process will require continuous communication and feedback to ensure that the implementation of Basel III proceeds smoothly. SAMA intends to actively involve all Banks through bilateral and multilateral meetings, and SAMA sponsored seminars and presentations in the implementation of Basel III reforms. This circular is the first in a series of communiqués that SAMA plans to issue over the next few years.

P. O. Box 2992 - Riyadh 11169, Saudi Arabia - Tel.: 01-463 3000 - Telex 404390 SJ - Fax 01-466 2119

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During 2011, SAMA will continue to discuss with the Banks the implementation of Basel II projects and some new initiatives under Basel III. The main areas of work are as follows:

1. Further refinements of the ICAAP process in light of Basel III.
2. Follow up on Banks previously submitted plans for transition to the IRB approaches for credit risk.
3. Finalization of Prudential Returns and Guidance notes for IRB Approaches
4. Finalization of the Prudential Return on Capital Leverage Ratio and start of the monitoring process.
5. Finalization of the Prudential Returns for Liquidity Coverage Ratio and monitoring will start in 2012.

SAMA envisages forming a number of working groups to advance the implementation of different aspects of Basel III. These are listed in Attachment 2. All Banks are required to designate at least 2 senior persons to each Committee by 28 February 2011. Their names and contact telephone numbers should be forwarded to Mr. Fahd Al-Mufarrij, Director of Banking Supervision. We expect these Committees to commence work once further details on Basel III proposals are issued by the BCBS, and SAMA has assessed their relevance and implications for the Saudi Banking system. We expect the working groups to commence their work in the 2nd quarter of 2011.

In order to ensure a good understanding of Basel III in the Banking sector, SAMA representatives have made presentations to Managing Director of the Banks in the MD's Committee and to relevant senior managers and Basle II Team members in December 2010. SAMA may organize additional seminars during 2011 to deal with specific areas. Banks will be notified about the specific dates and details of such seminars in due course.

Banks are advised to maintain strong Basel II/III teams with a designated project leader (coordinator) to plan and execute the implementation of Basel III. The Project Leader should have overall responsibility, with the work delegated to the team members. The Project Leader should also act as the liaison person with SAMA.

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Dr. Abdulrahman Al Kalaf
Deputy Governor
for Technical Affairs

P. O. Box 2992 - Riyadh 11169, Saudi Arabia - Tel.: 01-463 3000 - Telex 404390 SJ - Fax 01-466 2119

Attachment - 1

Basel III Reforms Package
Phase-In-Arrangement

	2011	2012	2013	2014	2015	2016	2017	2018	1 January 2019
Leverage Ratio	Supervisory monitoring		Parallel run 1 Jan 2013 – 1 Jan 2017 Disclosures start 1 Jan 2015					Migration to Pillar 1	
Minimum Common Equity Capital (CEC) Ratio			3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital Conservation Buffer						0.625%	1.25%	1.875%	2.50%
Minimum Common Equity plus capital conservation buffer			3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-in of deductions from CET1 (including amounts exceeding the limit for DTAs, MSRs and financials)				20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital			4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital			8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum Total Capital plus conservation buffer			8.0%	8.0%	8.0%	8.625%	9.25%	9.875%	10.5%
Capital instruments that no longer qualify as non-core Tier 1 capital or Tier 2 capital			Phased out over 10 years horizon beginning 2013						
Liquidity coverage ratio[1]		Observation period begins			Introduce minimum standard				
Net stable funding ratio		Observation period begins						Introduce minimum standard	

[1]Reporting to regulatory authorities from January 2012.

Note: All dates as of 1 January.

Working Group (WG) to Implement Basel III

1. Working Group on Capital Reforms

Banks should be represented by a senior officer (Chief Financial Officer, Chief Risk Officer, Strategic Planning, etc). This WG would study Capital Reforms and examine the current position of Banks and assess what remains to be done for its full implementation.

2. Working Group on Global Liquidity Standards

This WG will examine the under-mentioned new Global liquidity Standards for monitoring, observing and implementation in Saudi Arabia.

- Liquidity Coverage Ratio (LCR)
- Net Stable Funding Ratio (NSFR)

The WG will particularly focus on Basel III proposals. Banks should be represented by senior staff members from Risk Management, Treasury or Finance Department.

3. Working Group on Enhanced Risk Coverage

The WG will examine the proposals for enhanced risk coverage for implementation in Saudi Arabia including the following:

- Securitization
- Trading Book
- Counterparty Credit Risk

The WG will particularly focus on Basel III proposals in relation to the above items. Banks should be represented by a senior staff members from Risk Management, Treasury or Finance Department.

4. Working Group on Enhanced Pillar 2 Reforms

This Working Group will focus on Basel III proposals on Pillar 2 related reform, and their impact on ICAAP, Supervisory Review process.

5. Pillar 3 Reforms

As in the past, SAMA will continue to develop any refinements in Prudential Templates and Guidance notes through the Chief Financial Officers' Committee

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Attachment - 3

Major Refinements and References

Components of Basel III: Major Regulatory Overhaul of Regulatory and Prudential Framework

Summary of Basel Committee Reforms:

1) Capital
    - Quality and level of capital
    - Capital conservation buffer
    - Countercyclical buffer
    - Capital Ratios Phased in
    - Regulatory deduction phased in
    - Non compliant instrument phased out

2) Risk Coverage
    - Securitizations / Re-securitizations
    - Trading book
    - Counterparty Credit Risk

3) Containing Leverage
    - Leverage ratio

4) Pillar 2
    - Risk concentration
    - Off balance-sheet items
    - Reputational risk
    - Sound compensation practices
    - Valuation and liquidity risk
    - Sound stress testing practices

5) Pillar 3
    - Enhanced exposure on securitized assets, CDO's MBS, Leverage Finance
    - Thematic Review in progress

6) Global Liquidity Standard and Supervisory Monitoring
    - Liquidity Coverage Ratio
    - Net Stable Funding Ratio
    - Supervisory Monitoring
    - Principles for Sound Liquidity Risk
    - Management and Supervision

7) Systemic Risk and Interconnectedness
    - "Gone Concern" Contingent capital
    - Risk coverage
    - Cross-border bank resolution
    - Significant Financial Institutions (SIFI's)

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