Guiding principles
on strengthening the supervisory role of Central Banks in dealing with the risks of non-banking financial institutions in the Arab countries

Arab Monetary Fund

April 2021

Preface

The importance of the banking sector in the financial system in Arab countries does not derogate the other non-banking financial sectors, as the latter is weighed as a partner of the banking sector in promoting economic growth and financial stability of Arab countries. This sector also plays a strategic role in enhancing financial inclusion, in a way that promotes financial and economic stability. For instance, the insurance sector contributes to achieving economic growth objectives and overall development by providing protection for individual and institutional properties withal preserving sovereign wealth. Additionally, other non-banking financial institutions are progressively developing a role in promoting financial inclusion, such as: Non - deposit taking microfinance institutions, financial leasing companies, small to medium enterprises (SMEs) financing companies, and crowdfunding companies. These institutions expand access to finance and financial services by granting credit to groups facing challenges to access bank financing.

Globally, the Financial Stability Board estimated total non-banking financial assets (including pension funds and the insurance sector) at about $ 200.2 trillion at the end of 2019, making up nearly 50 per cent of the total assets of financial institutions in 2019. Consequently, attention is ought to be shifted towards potential systemic risks that may result from non-banking financial institutions, in conjunction with enhancing the awareness of supervisory authorities over the activities such institutions carry, as well as their interconnection with banking institutions' activity, thus establishing a better awareness level of the systemic risks arising from non-banking financial institutions sector through taking appropriate regulatory and supervisory measures.

In light of the above, and in sought of the Arab Monetary Fund to keep its member countries abreast with the fields of economic, financial and monetary reforms aimed at enhancing financial stability in the Arab region, in conjunction with enhancing interest in non-banking financial sector in the Arab countries, its role in financial inclusion and economic development, and to protect it from the risks that it may be exposed to it. The following guiding principles have been issued on strengthening the supervisory role of Central Banks in dealing with the risks of non-banking financial institutions in the Arab countries. It should be noted that the application of principles is subject to the situation of each Central Bank separately and its objectives contained in its regulatory framework, taking into account the legislative and legal system in each country, and the tasks entrusted to other supervisory authorities.

Guiding principles on strengthening the supervisory role of Central Banks in dealing with the risks of non-banking financial institutions in the Arab countries

Principle (1)

Coordination between supervisory authorities is the basis for effectively measuring risks arising from the non-banking financial sector, and that the supervisory authority has the mandate, power, and appropriate tools to address related risks in a way that enhances financial stability.

Principle (2)

In case the supervisory trend in the country is the existence of multiple independent supervisory bodies over the non-banking financial sector, it is appropriate to have coordination between the Central Bank and these bodies, and it may be through signing a Memorandum of Understanding (MOU) regarding aspects of interest to the Central Bank, for example, aspects of systemic risks (including contagion risk), financial consumer protection, financial inclusion and financial stability.

Principle (3)

Establishment of a crisis management or a financial stability committee under the leadership of the central bank including representatives from the Ministry of Finance, Securities Commission, Insurance Authority and Supervisory of the non-banking financial institutions, to ensure coordination between monetary policy, fiscal policy, and micro and macro prudential policy. In addition to enhancing the effectiveness of the macro-prudential policy and the optimal application of its instruments.

Principle (4)

The Central Bank, in cooperation with the relevant official authorities, sets an accurate definition of the non-banking financial institutions at country level that are presumed subject to its supervision or participate in its supervision, and the adoption of appropriate legislative frameworks that strengthen its ability to assess the risks of these institutions.

Principle (5)

In order to recognize the size, reality and challenges of the non-banking financial sector (including shadow banking)[1], it may be appropriate to conduct an in-depth study on the reality of the sector in the country, to determine its size, nature, challenges and risks.

Principle (6)

Form a specialized committee under the chairmanship of the Central Bank with the membership of the relevant official and supervisory bodies, aiming to consider the recommendations of the Central Bank regarding the study referred to in Principle (5) above, and to discussing the possibility of overcoming any legal or regulatory impediment preventing the expansion of the supervisory umbrella of the Central Bank, to include the non-banking financial institutions.

[1] In this regard, reference can be made to the "shadow banking supervision" paper issued in 2014 by the Arab Committee on Banking Supervision-AMF: https://www.amf.org.ae/sites/default/files/econ/amdb/%5Bvocab%5D/%5Bterm%5D.0_الظل-/pdf

Principle (7)

Determine the direction, objective, and supervisory model of the central bank in monitoring each of the non-bank financial sectors, and determine the supervisory requirements for the non-banking financial institutions and update them regularly, including, at least: Licensing and branching requirements, governance, capital adequacy and liquidity requirements, compliance and combatting money laundering and terrorist financing, recovery plans succession plans, disclosure, and periodic statements and reports.

Principle (8)

It is appropriate to allocate organizational units within the Central Bank to regulate and supervise non-banking financial institutions (that are subject to or presumed subject to its supervision) according to the nature of their business models.

Principle (9)

Developing and adopting plans on the methodology of implementing the field inspection and off-site supervision tasks of the non-banking financial institutions, and performance evaluation indicators. As for the financial institutions that are not subject to the supervision of the Central Bank due to legislative or legal obstacles, coordination with other supervisory authorities to provide the necessary information to the central bank to measure their risks in order to enhance financial stability.

Principle (10)

Taking into consideration principles (1) and (2). by the Financial Stability Department in Central Banks assess the systemic risks arising from the non-banking financial institutions, including as a minimum (depending on what applies):

a. Prepare the financial stability report.
b. Perform stress tests.
c. Calculate the countercyclical capital buffer (CCyB).
d. Implement early warning systems and financial crises management.
e. Utilizing macro-prudential policy tools such as setting limits for the Debt Burden Ratio (DBR).

Principle (11)

Consultation between the Central Bank and the supervisory authorities of non-banking financial institutions about the possibility of issuing a methodology for identifying and dealing with domestic systemically important non-bank financial institutions.

Principle (12)

Consider developing appropriate frameworks to expand the database of credit information companies to include the non-banking financial institutions.

Principle (13)

Creating appropriate mechanisms within the Central Bank to providing accurate data and the necessary disclosures on the non-banking financial institutions[2], in order to enhance the effectiveness of the implementation of the monetary and macroprudential policies, and risk assessment in the financial system.

Principle (14)

Strengthening the role of financial inclusion departments in Central Banks to enable the non-banking financial institutions performing the desired role in enhancing financial inclusion.

Principle (15)

Expand the comprehensiveness of the scope of financial consumer protection in Central Banks to cover all non-banking financial institutions clients, guiding them to establish complaints units, and implement the associated regulations and instructions thereof.

Principle (16)

Collect the lessons learnt from economic and financial crises by the Central Bank (such as the emerging coronavirus pandemic crisis and the global financial crisis of 2008) regarding their impact on the non-banking financial institutions.

---

[2] such: Liquidity volume, granted credit volume, interest rates on facilities, non-performing loans and others.

Principle (17)

Develop micro and macro performance indicators for the non-banking financial institutions according to the nature of each group within the sector, so that their overall indicators are published periodically. Provided that the indicators include, at minimum, financial soundness indicators, according to what is issued by the relevant international financial institutions in this regard.

Principle (18)

Enhancing the digital infrastructure of the non-banking financial sector, encouraging digital financial transformation and solutions for innovations in non-banking financial products, and creating development and investment opportunities in the fintech, to enhance the competitiveness of the private sector.

Principle (19)

Shifting attention to capacity building in the non-banking financial institutions, as well as the continuous development of the capabilities of central bank's staffs in the supervision and inspection departments of non-banking financial institutions.

Principle (20)

Hold periodic consultative meetings between the Central Bank and the official authorities and relevant bodies and associations of the non-banking financial sector (or representatives of the sector), to discuss the challenges facing the sector.

Principle (21)

Regular follow-up on the specialized international institutions' publications on issues related to non-banking financial institutions, such as: financial supervision, risk management, accounting standards, anti-money laundering and terrorist financing, financial consumer protection, the implications of climate change, and responsible finance. and study the extent of the need for the Central Bank to issue the necessary legislation or instructions (in coordination with the relevant supervisory authorities).

Principle (22)

Finding appropriate frameworks for how to deal with the non-banking financial sector's need for emergency liquidity, whether through open market operations or through borrowing from banks.

Principle (23)

Consider signing Memorandum of Understanding between the Central Bank (in coordination with the relevant supervisory authorities) with the supervisory authorities in other countries, if there are branches of non-banking financial institutions outside the country.

Principle (24)

Central banks, at their own discretion, apply any of the preceding principles to non-banking financial institutions owned or contributed to by the government, such as: pension funds, social security institutions, deposit insurance institutions, and others. Central Banks shall assess dealing with these institutions or the risks thereof.