New large exposure regulations in the UAE

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Lending standards and concentrated exposures, in particular to Government Related Entities ("GREs") were put in the spotlight globally during the global financial crisis.

Concerns about the scale of banks' domestic and foreign exposures to companies owned or partly owned by governments cascaded through developed and developing markets alike. Locally, a recent study conducted by Bank of America Merrill Lynch found that UAE banks' exposure to government debt was at its highest level since the late 1970s and the exposure of all banks to GRE was at 104%, most of which was built up when local banks were obliged to take on extra debt after international banks curtailed lending in the region.

In recognition of the risks arising from banks' heightened exposure to GREs, the UAE Central Bank proposed rules in April 2013 to, limit exposure to GREs and local governments to 100% of their capital. After further coordination and consultation with the banks and the UAE Banks Federation, the Central Bank issued the Regulations re Monitoring of Large Exposure Limits (the "LER") as well as the Guidelines to Monitoring of Large Exposures ("Guidelines") on 11 November 2013 via Circular 32/2013. These regulations govrn in lending to both public and private entities.

Circular 32/2013 was published in the Federal Gazette dated 31 December 2013 and came into force one month thereafter, at which time Circular 16/1993 and its amendments ("Previous Regulations") were cancelled. The importance of these regulations was made clear by H E Sultan Bin Nasser Al Suwaidi, Governor of the UAE Central Bank, who identified the LER as one of the most important regulatory developments (the other being the recently-issued mortgage regulations – see Law Update Issue 265).

Large Exposures

The LER have defined a large exposure as "those funded and unfunded exposures and unused committed lines (less provisions, cash collaterals, bank guarantees and Federal Government guarantees) to a single borrower or its group, which in total is equal to or exceeds 10% of the bank's capital base". Capital base is as calculated in accordance with Central Bank Circular 27/2009 dealing with BASEL II.

There are two major developments under the LER as opposed to the Previous Regulations in respect of the definition of 'large exposure':

1. under the Previous Regulations, large exposures are limited to funded exposures, while the LER has expanded the definition to cover unfunded exposures and unused committed lines; and
2. under the Previous Regulations, there was no threshold limit for certain exposures to be considered as a large exposure. The LER provides that exposures to a single borrower or its/his group that exceeds 10% of the bank's capital base is to be considered as a large exposure, however the large exposure category limit for that borrower or its/his group may not be exceeded. This can be practically important as, in accordance with the LER, banks are requested to report large exposures to the Central Bank quarterly, however, exposures that exceed any large exposure category limit shall be reported to the Central Bank immediately.

Large Exposure Limits

The LER provides different large exposure limits for different categories of borrower group. Furthermore, under each borrower group, the LER provides an aggregate limit of large exposures which applies to the borrower group as a whole as well as an individual limit of large exposures which applies to each individual borrower under such borrower group.

Governments and GREs

Exposures to Federal Government and their non-commercial or commercial entities which are fully guaranteed by the Federal Government are exempt from large exposure limits.

Aggregate exposures to local Governments and their non-commercial entities shall not exceed 100% of a bank's capital base. Exposures to each non-commercial entity owned by local Governments are subject to a further 25% individual limit.

Commercial entities of Federal Government which are not fully guaranteed by the Federal Government and commercial entities of local Governments are subject to an aggregate limit of 100% and an individual limit of 25% of a bank's capital base.

Single borrower or a group of related borrowers

A single borrower or a group of related borrowers is subject to an individual limit of 25% and no aggregate limit is applicable.

Banks

Exposures between banks within the UAE are exempt from large exposure limits if the tenures are less than 1 year, otherwise a 30% individual limit will apply. While the rationale behind this exemption is understandable in the context of large exposures, it is to be noted that many of the high profile international examples of banking failures were primarily relying on short term interbank lending prior to their demise.

Exposures to banks operating outside the UAE, irrespective of their maturity, are not allowed to exceed 30% of the bank's capital base. The same applies to exposures of (i) branches of foreign banks to their head offices and other branches abroad, as well as to foreign subsidiaries and affiliates of such head offices and (ii) UAE incorporated banks vis-à-vis their foreign subsidiaries and affiliates. It will be interesting to see how these rules affect local banks' ability to expand outside the UAE. Certainly, how banks fund offshore expansion and the transaction structure used will need to be carefully considered against the LER.

Notwithstanding the above, exposures of a bank to its parent company or to other subsidiaries of its parent company are subject to a 10% individual limit and a 25% aggregate limit.

Others

The LER also provides limits in respect of exposures to a bank's board members, shareholders, employees and professional consultants.

The table below sets out the details of applicable large exposure limits:

Table of Maximum Large Exposure Limits

Borrower	Aggregate Percentage	Individual Percentage
Federal Government	N/A	N/A

UAE Local Governments and their non-commercial entities	100%	No cap for local governments; 25% for each non-commercial entity
Commercial entities of Federal and Local Government	100%	25%
A single borrower or a group of related borrowers	N/A	25%
Shareholders who own 5% or more of a bank's capital and their related entities	50%	20%
Inter-bank exposures-over 1 year	N/A	30%
A bank's subsidiaries and affiliates	25%	10%
Board members	25%	5%
Bank's employees	3%	Maximum 20 month's salary
A bank's external auditors, consultants and lawyers	Not allowed	Not allowed

While the above provides a high level summary of the thresholds to be applied by the Central Bank, the Guidelines provide additional rules and procedures that must be adhered to by banks. These must be considered with equal importance when determining how to implement the LER into practice as it contain a greater level of detail not included in the LER.

Exempted Exposures

In addition to those exempted exposures mentioned in section 3 above, the LER also provides several other types of exposures that can be excluded from the calculation of large exposures. A major development of the LER compared to the Previous Regulations is that a bank's investment in marketable bonds or sukuks rated not less than AA-, which are held to meet the Central Bank's liquidity requirements or are held in the trading book without the intention to hold such bonds or sukuks to maturity, shall be excluded from calculation of its exposure.

Reporting and Management Responsibility

The board of directors of a bank (including any similar designated body) is vested by the LER with the responsibility for, among other matters, monitoring and controlling large exposures and exposures to its members.

As mentioned above, all large exposures and exposures to members of a bank's board of directors shall be reported to the Central Bank quarterly. In the event of certain exposures of a bank exceeding one of the designated limits, the bank shall report this to the Central Bank immediately.

Importantly a unanimous resolution passed by the board of directors is required prior to incurring a large exposure. In case of lending to a board member, a unanimous resolution (excluding the member concerned) is also required.

Implementation and Grace Period

The LER became effective on 31 January 2014 (being one month after being published in the gazette), however banks who have exposures exceeding the limits specified by the LER are given a grace period of 5 years to improve such exposures at the rate of 20% per annum at a minimum in order to reach full compliance.

Conclusion

As a long-awaited and bargained set of rules, the LER aims to reduce excessive concentration of exposures to a single borrower or a group of related borrowers, in particular to GREs, and ensure the sound functioning of the banking system within the UAE. The effort required by banks within the UAE market to comply with the LER will largely depend on their current policies and procedures, their capital base and, most importantly, the status of exposures that fit within the scope of the LER's provisions. In our view, understanding how to categorise loans that may not have been caught by the Previous Regulations and implementing appropriate policies or revising existing policies to ensure ongoing compliance with the LER will be critical first steps. Our banking team can help with this process and all other issues that may arise.