Restructure and Rehabilitate in the UAE

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The slowdown in the UAE economy has resulted in a corresponding slowdown in loan growth for the UAE banks and some debt delinquencies, especially in the SME market, and that has lead in some cases to a drop in bank profits as a result of increased bad debt provisions. While we understand that contractors who were the first to be affected have largely already made arrangements, that still leaves many bank customers who are feeling the stress of making scheduled loan repayments when their own profitability and cashflows are coming under pressure. If it is not sufficient to grant a rescheduling of the debt so that payments are reduced as the tem of the loans are extended, the banks and their customers will have to start considering entering into a more formal restructuring.

The practice in the UAE has been for consensual restructuring, partly as the current laws are designed for traders rather groups of companies with complex debt structures, and partly by the desire to ensure that these businesses survived as going concerns, even if the bargain stuck through the restructuring does not reflect usual commercial terms. Other reasons for pursuing a consensual process outside of court action are that:

- the statistics that we have show that for the few formal insolvencies that have taken place, they each take approximately 3.2 years, cost 20% of the assets of the borrower, and return only 29 fils in every dirham;
- a formal insolvency process or enforcement of security is almost always value destructive to the assets of the borrower; and
- the insolvency process under UAE law can be unpredictable.

Many UAE banks learned significant lessons from the 2008/9 financial crisis — these lessons or principles are now being dusted off to be put to use again, which can be seen in the recent “mini insolvency law” announced by the United Arab Emirates Banks Federation.

The key restructuring lessons are:

- Financial creditors should work together and not pursue an “every lender for itself” policy. Taking unilateral court action may force other creditors to follow a similar approach so that any advantage of taking early court action is probably negated.
- A standstill period should be given for a limited period to allow the borrower and lenders a breathing space to reach agreement. Of course, as lenders want to keep the borrower’s feet to the fire, the period tends to be relatively short and extended at the banks’ discretion.
- In situations where there are multiple lenders, the selection of one or more of those lenders to deal directly with the borrower to coordinate a deal that is acceptable to all lenders.
- If the borrower wants the protection of the standstill period (and if necessary its extension) they should provide access to all relevant information in order for a proper evaluation to be made of its position.
- There should be fair treatment of financial creditors with no creditor receiving preferential treatment.

This will also mean the ranking of calls on a particular debtor in the group has to be preserved via priority deeds or intercreditor arrangements between the lenders.

- Provided it does not breach preserving existing priority, the movement of debt around a group to where it was incurred or where it can be repaid, or even the movement out of the group onto shareholders if the evaluation shows shareholders actually utilised the debt rather than the borrower, or have shareholders give security over the assets purchased with that debt.
- Part of the restructuring process in the UAE has been an untangling of personal assets with those of the borrower's assets, with assets purchased by shareholders or affiliated companies with the borrowers' money sometimes transferred back to the borrower to use or sell or at least to be secured in favour of the lenders. Of course, whether or not the shareholders benefitted, banks should always be looking to make sure that the shareholders are contributing to the restructuring by providing guarantees over personal assets or guarantees. Shareholders' advisors will, of course, seek to limit such guarantees (for example, by demanding that they fall away once borrowing reaches more normal leverages levels).
- The banks should have their professional advisors provide them with an analysis of the likely position on enforcement of security, guarantees and a formal insolvency process so they understand the alternative outcomes to any offer being made by the borrower. This should involve the banks checking that their securities are properly taken and perfected and their finance documentation is enforceable and complete.
- Where new security is being offered to replace old security, lenders should consider whether existing security may be confirmed as remaining in place alongside new security until any hardening period is over, at which point the existing security may be discharged and the new security "takes over".
- Although lenders may continue to allow the borrower to utilise existing working capital facilities during the standstill period, where there is a need for new working capital, such facilities may need to be given priority over the existing financial debt.
- Consider using ratchet margins to encourage concentration on the most profitable businesses and sale of other assets to reduce debt burden and hence the margin.
- Consider corporate governance oversight of the borrower by the lenders, ranging from a management committee of lenders having to agree various material decision, to minimal involvement (such as an observer appointed by the lenders to attend key meetings).
- Recognise that negative publicity affects a borrower's ability to continue to operate normally as trade creditors stop providing trade credit and subcontractors ask to be paid upfront, squeezing cashflows. Therefore, the parties should consider appointing a professional to manage press coverage or at least coordinate on positive statements and ensure that confidentiality agreements are in place (although it would be idealistic to think that the existence of confidentiality agreements will guarantee no leaks to the press or adverse publicity).

The "mini insolvency law" referred to earlier is the United Arab Emirates Banks Federation announcement that they are to suspend action against SME borrowers if they have (i) financial distress and (ii) AED50m or more of debt with two or more banks. Instead they will enter into a 90 day standstill agreement and the bank with the biggest exposure will agree how to manage or restructure the debt with that SME borrower. This is a practical example of some of the above principles being put into action on an industry-led basis for a specific area of distress.

For each restructuring there will of course be specific points of concern or pressure. The lessons and principles set out in this article may not all be applicable to every situation. However, they do provide a foundation on which creditors can build, working with the borrower to reconstruct a sound and functioning lending relationship.

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