LEXOLOGY
Getting The Deal Through

Banking Regulation

in United Arab Emirates

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Timeframe for approval

UPDATE AND TRENDS

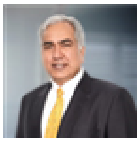
Key developments of the past year

LAW STATED DATE

Correct on

Contributors

United Arab Emirates



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REGULATORY FRAMEWORK

Key policies

What are the principal governmental and regulatory policies that govern the banking sector?

The principal governmental and regulatory policies that govern the banking sector (except in the Dubai International Financial Centre and Abu Dhabi Global Market free zones, which are subject to their own legal and regulatory regimes and financial services regulators) are:

- UAE Federal Law No. 14 of 2018 concerning the Central Bank and Organisation of Financial Institutions and Activities (the Banking Law);
- UAE Federal Law No. 18 of 1993, as amended (the Commercial Code); and
- various circulars, notices and resolutions issued by the UAE Central Bank, from time to time.

Primary and secondary legislation

Summarise the primary statutes and regulations that govern the banking industry.

The Banking Law contains detailed provisions on the role of the UAE Central Bank, which, among other things, includes:

issuance of currency;

- organising, promoting and supervising banking;
- directing the credit policy;
- advising the government on financial and monetary issues;
- acting as the government's bank;
- provisions for Islamic-licensed financial institutions;
- maintaining gold and foreign exchange reserves; and
- acting as bank for other banks in the United Arab Emirates.

The Banking Law also contains detailed provisions on the registration, licensing and operation of:

- banks;
- Islamic-licensed financial institutions;
- exchange houses;
- monetary intermediaries; and
- other financial institutions.

The Banking Law is, however, not applicable to:

- public credit institutions set up by law;
- governmental investment institutions and agencies;
- governmental development funds;
- private savings and pension funds; and
- insurance and reinsurance companies and agencies.

The Commercial Code contains detailed provisions on banking operations, which include, among others, provisions governing:

- bank deposits;

- bank accounts;
- guarantees;
- documentary credits;
- bills of exchange;
- loans;
- promissory notes; and
- cheques.

The various circulars, regulations, notices and resolutions issued by the UAE Central Bank deal with various aspects of banking including:

bank accounts;

- maintaining certain reserve ratios;
- capital adequacy norms;
- measures to combat money laundering; and
- reporting requirements to the UAE Central Bank.

Regulatory authorities

Which regulatory authorities are primarily responsible for overseeing banks?

The UAE Central Bank is primarily responsible for overseeing banks in the United Arab Emirates, except in the Dubai International Financial Centre (DIFC), where the regulatory authority is the Dubai Financial Services Authority and in the Abu Dhabi Global Market, where the regulatory authority is the Financial Services Regulatory Authority.

Government deposit insurance

Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

Deposits are not insured in the United Arab Emirates. In practice, the government has intervened on occasions to ensure that depositors do not suffer a loss. From time to time, the governments of various emirates of the United Arab Emirates or entities owned by such governments have taken ownership interests in the banking sector. Such interests have not increased or decreased as far as we are aware.

Under article 122 of the Banking Law, the Central Bank is permitted to issue regulations for protection of deposits and the rights of depositors. This is a significant development.

Transactions between affiliates

Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

In this regard there are prescribed percentages of maximum exposure that a bank may incur to its parent company or subsidiaries or other subsidiaries of its parent company. A subsidiary is a company in which a bank holds a minimum of 40 per cent of share capital or has controlling influence (eg, through the composition of the board of directors).

Also, Circular No. 16/93 issued by the UAE Central Bank, governs large exposures incurred by banks. Large exposures are funded exposures (fewer provisions, cash collateral and deposits under lien). Banks are restricted from exceeding the maximum exposure per client or group. Circular No. 32/2013 dated 11 November 2013 has been issued by the UAE Central Bank to replace Circular No. 16/93. Revised restrictions have been imposed with regard to lending to government and government-owned entities. Banks cannot lend sums exceeding 100 per cent of their capital to governments or their related companies or more than 25 per cent to an individual borrower. The rules also prescribe the manner in which different categories of assets are to be risk-weighted. The 2013 Circular provided five years to the banks to meet the exposure limits set out in the circular. Given the current banking situation, the deadline is likely to be extended.

With respect to permissible activities of a commercial bank, under the Banking Law, a commercial bank is a juridical person licenced in accordance with the Banking Law to primarily carry on the activity of taking deposits, and any other 'licensed financial activities'. The list of licensed financial activities is set out in article 65 of the Banking Law and it includes activities such as providing credit facilities, monetary intermediary services and currency exchange and money transfer services. In addition, new activities such as virtual banking, services and stored values services, electronic retail payments and digital money services were introduced which are in line with the recent technological development in the banking space.

With respect to Islamic-licensed financial institutions, an authority, the Higher Sharia Authority, is proposed to be established under article 17 of the Banking Law. Article 78(1) states that Islamic-licensed financial institutions may conduct all the licensed financial activities mentioned in article 65 of the Banking Law in a sharia-compliant manner.

With respect to prohibited activities, article 93 of the Banking Law provides that no commercial bank shall:

- carry on for its own account commercial or industrial activities or acquire, own or trade in goods, unless the acquisition of such goods is for settlement of debts due from others, in which case the goods must be disposed of within the period defined by the governor of the UAE Central Bank;
- acquire immovable property for its own account, except immovable property required for the conduct of the bank's business or for housing or amenities for its staff, or immovable property acquired in settlement of debts, in which case, however, the property must be sold within three years (this period may be extended by decision of the governor of the UAE Central Bank);
- hold or deal in the bank's own shares unless they are acquired in settlement of a debt, in which case they must be sold within two years from the date of their acquisition; and
- purchase shares of commercial companies, except within the ratio of the bank's own funds, as set by its board of directors, unless acquired in settlement of a debt, in which case the excess must be sold within two years from date of acquisition.

Regulatory challenges

What are the principal regulatory challenges facing the banking industry?

The banks and the financial institutions in the United Arab Emirates are now required to comply with the compliance regimes including the US Foreign Account Tax Compliance Act, Common Reporting Standard and International Financial Reporting Standards 9, which has generally increased the costs of banking business.

Consumer protection

Are banks subject to consumer protection rules?

The United Arab Emirates has promulgated Federal Law No. 24 of 2006 and certain other regulations for consumer protection. However, this legislation does not expressly include 'banks' within their ambit. In addition, because the banks are supervised by the UAE Central Bank, it is unlikely that this legislation would have a bearing on the banking sector.

There are no specific customer protection rules for the banking sector. However, any complaint against a bank can be made by a consumer to the UAE Central Bank.

Article 121 of the Banking Law states that the Central Bank will establish regulations to protect bank customers, raise public awareness and prohibit banks from charging interest on accrued interest. The Central Bank also has specific and firm rules on the data protection of the customers under the Banking Law.

Under article 122 of the Banking Law, the Central Bank is authorised to issue regulations for protection of deposits and the rights of depositors.

Future changes

In what ways do you anticipate the legal and regulatory policy changing over the next few years?

With its own jurisdiction and body of modern laws, and its widening jurisdictional approach, the DIFC precipitating changes to wider UAE legal and regulatory policies. Following the success of the DIFC, a financial free zone in Abu Dhabi (Abu Dhabi Global Market) became operational from 2015, becoming, to date, quite active.

The regulatory policy for the banking industry is likely to follow a conservative approach.

In a significant development that would have wide-ranging implications, the Bankruptcy Law of the United Arab Emirates was enacted on 20 September 2016 as Decree-Law No. 9 of 2016 (the Bankruptcy Code). It came into effect on 31 December 2016. The Bankruptcy Code replaced the previous legislation on the subject, Book 5 of the Commercial Code, which was seldom used in light of its perceived shortcomings. Perhaps the most important feature of the Bankruptcy Code is the introduction of a regime that allows for protection and reorganisation of distressed businesses.

Another significant development was the introduction of value-added tax (VAT) in the United Arab Emirates from 1 January 2018. The rate of VAT is kept low at 5 per cent for most goods and services (unless exempted or zero-rated). Interest-bearing banking transactions are zero-rated, while transaction fees and margin-based transactions will attract VAT at the rate of 5 per cent. For the purposes of VAT, Islamic banking products will be generally treated at par with conventional banking products. The implementation of VAT in the United Arab Emirates has marginally increased the cost of banking for customers.

SUPERVISION

Extent of oversight

How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

Banks are supervised by the UAE Central Bank through the various reports that are required to be filed by banks with the UAE Central Bank on a periodic basis. Further, under the Banking Law, the UAE Central Bank is entitled to inspect the books, records and accounts of any bank at its discretion. In certain cases, the Central Bank has appointed administrators or representatives to temporarily manage a bank. These audits are ordinarily conducted once a year and are reasonably extensive.

Enforcement

How do the regulatory authorities enforce banking laws and regulations?

Article 137 of the Banking Law lists various administrative and financial sanctions that may be imposed on banks and individuals for breach of provisions of law, regulations, decisions, rules, standards and instructions issued by the Central Bank. The mechanism includes warnings, the requirement to rectify the violation, impose restrictions on the licence and fines.

What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The most common issues facing the regulator and banks have included approval of investment products, issues pertaining to selling of investment products and concerns regarding institutions operating within the scope of their licences. In July 2012, the Emirates Securities and Commodities Authority (SCA) issued the much-anticipated UAE Investment Fund Regulation (Fund Regulation). The Fund Regulation transfers regulatory responsibility for the licensing and marketing of investment funds and for a number of related activities from the UAE Central Bank to the SCA. The sale, marketing and promoting of foreign securities and funds in the United Arab Emirates and the establishment of domestic funds requires SCA consent.

RESOLUTION

Government takeovers

In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

The banks may be taken over by the government or regulatory authorities in the interest of the bank's depositors. If a bank has insufficient liquidity to meet its obligations and there is risk to the bank's depositors, the bank may be taken over by the government.

While such instances are uncommon, a few such takeovers were reported recently in the wake of the financial crises. The Dubai Bank was taken over by the government of Dubai in 2011 through its majority-owned bank, Emirates NBD.

Bank failures

What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

Any commercial bank operation in the United Arab Emirates is required to maintain a minimum paid-up capital. If the bank's capital falls below the required minimum, the deficiency must be met within the time prescribed by the UAE Central Bank. There is no specific plan or similar document prescribed under UAE laws.

Are managers or directors personally liable in the case of a bank failure?

Managers or directors are not personally liable unless the bank's failure is attributable to any fraud or illegality committed by them.

Planning exercises

Describe any resolution planning or similar exercises that banks are required to conduct.

There are no such mandatory requirements.

CAPITAL REQUIREMENTS

Capital adequacy

Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

The UAE Central Bank issued Circular No. 52/2017, dated 23 February 2017, whereby all banks are obliged to comply with Basel III. Therefore, the UAE banking system has moved from Basel II to the Basel III standard. In addition, the UAE Central Bank regularly provides guidance on capital supply standards,

These regulations and the accompanying standards apply to all banks in the United Arab Emirates. Banks must ensure that these regulations and standards are adhered to on the following two levels:

- the solo-level capital adequacy ratio requirements, which measure the capital adequacy of an individual bank based on its standalone capital strength; and
- the group-level capital adequacy ratio requirements, which measure the capital adequacy of a bank based on its capital strength and risk profile after regulatory consolidation of assets and liabilities of its subsidiaries.

How are the capital adequacy guidelines enforced?

Banks are required to report compliance with the capital adequacy guidelines as per the format and frequency prescribed by the UAE Central Bank. In case of breach, the UAE Central Bank is most likely to issue a notice and seek adherence to the guidelines. If the breach continues, the UAE Central Bank has wide discretion to take appropriate actions for enforcing the guidelines.

Undercapitalisation

What happens in the event that a bank becomes undercapitalised?

If a bank is undercapitalised at any point, it must rectify the deficiency within the time notified to it by the Central Bank. Any failure to so rectify could attract consequences ranging from fines up to cancellation of its licence to conduct banking.

Insolvency

What are the legal and regulatory processes in the event that a bank becomes insolvent?

Banks in the United Arab Emirates are incorporated as public joint-stock companies or as branches of foreign banks. Other financial intuitions may be incorporated as public joint-stock companies or limited liability companies. Exchange houses and monetary intermediaries may be in sole proprietorship, or take any other legal form in accordance with the rules and conditions issued by the board of directors of the Central Bank.

Insolvency of public joint-stock companies, private joint-stock companies, limited liability companies and branches of foreign companies are governed by the provisions of the UAE Federal Law No. 2 of 2015, as amended (the Companies Law) and the provisions of the Bankruptcy Code. Additionally, pursuant to the Banking Law, a notice of liquidation of any commercial bank must be published in the Official Gazette and in at least two local daily newspapers.

The notice of liquidation shall give the bank's customers at least three months' notice to take necessary steps to enforce their rights. The notice shall also provide the name of the liquidator entrusted with the payment of the outstanding deposits and other transactions relating to the bank.

Traditionally, if locally incorporated banks faced a bankruptcy situation, they were merged with other banks.

Recent and future changes

Have capital adequacy guidelines changed, or are they expected to change in the near future?

See question 16.

OWNERSHIP RESTRICTIONS AND IMPLICATIONS

Controlling interest

Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

Under the Companies Law, at least 51 per cent of any company incorporated in the United Arab Emirates (outside the free zones) must be owned by UAE nationals or entities wholly owned by UAE nationals. Additionally, as per the relevant UAE Central Bank's resolutions, for finance companies, at least 60 per cent of the shares must be held by UAE nationals or entities wholly owned by UAE nationals.

Foreign ownership

Are there any restrictions on foreign ownership of banks?

Yes. A bank incorporated in the United Arab Emirates must be majority owned by UAE nationals. There are several branches of foreign banks operating in the United Arab Emirates.

Implications and responsibilities

What are the legal and regulatory implications for entities that control banks?

The experience and expertise of an entity that acquires control of a company involved in banking and financial services will be considered by the UAE Central Bank to approve the controlling acquisition. However, there are no formal restrictions on such an entity carrying on any other business.

What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

The legal and regulatory duties and responsibilities of an entity or individual who controls the bank would be to ensure that the banking operations are conducted in accordance with the requirements of the Banking Law, the Commercial Code and the various notices, circulars and resolutions of the UAE Central Bank. There will be no express obligation on the shareholders to provide additional capital in the event that a bank becomes undercapitalised, but the Central Bank will require the capital to be increased, failing which the bank may be fined or have its licence cancelled.

What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

Generally, no legal liability attaches to the controlling entity as a result of insolvency of a bank.

CHANGES IN CONTROL

Required approvals

Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

There is no specific definition of control (save in relation to determination of large exposure). Therefore, 'control' should mean a majority shareholding interest in the bank, a right to exercise control through representation at the bank's board, or both. Any change in such a controlling entity requires the prior written approval of the UAE Central Bank. Upon receipt of the approval, subsequent approvals of the emirate's local licensing authorities where the bank is incorporated must also be obtained.

Foreign acquirers

Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

In the view of the local ownership requirements, a foreign party may not acquire a UAE-incorporated bank.

The regulatory authorities are not particularly receptive to the banks being acquired by foreign entities, as discussed earlier.

Under what circumstances can a foreign bank establish an office and engage in business? For example, can it establish a branch or must it form or acquire a locally chartered bank?

Branches of foreign banks may engage in commercial banking in the United Arab Emirates but must be licensed by the UAE Central Bank and must maintain separate accounts for their UAE operations, including balance sheet and profitand-loss accounts. Branches and sections of any licensed financial institution (as defined in the Banking Law) operating in the United Arab Emirates shall, for the purposes of bookkeeping, constitute one financial institution. The Banking Law also provides for the establishment and regulation of financial and monetary intermediaries (ie, foreign-exchange dealers and securities broker-dealers), and representative offices of foreign banks. The licence issued to a bank or other institution specifies the particular types of banking business it is licensed to do. Local banks, branches of foreign banks operating in the United Arab Emirates shall be exempt from the requirement to take the form of a public joint-stock company. Under the Banking Law, branches of foreign-licensed financial institutions (as defined in the Banking Law) must comply with the same information disclosure and reporting requirements as other licensed financial institutions (as defined in the Banking Law).

Branches of foreign banks routinely provide financing to local entities. More than 30 years ago, the UAE Central Bank established a near total moratorium on new banks owing to the large number of foreign and local banks extant at the time, which, in recent times, has been relaxed slightly to allow some Gulf Cooperation Council members and Pakistani banks to establish branches in the United Arab Emirates.

Factors considered by authorities

What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

A change in ownership or control of a bank is a relatively rare phenomenon in the United Arab Emirates. Most of the locally incorporated banks are owned by the governments or the ruling families of the relevant emirates in which they are based. In the event of a proposed acquisition, we would expect the UAE Central Bank to consider issues such as the identity of the acquirer, its track record, any conflicts of interest as well as the purpose and term of the investment.

The rules and regulations for merger and acquisition of banks are set out in the Banking Law. A proposed merger or acquisition can be rejected by the UAE Central Bank, which shall be notified to the proposed bank within 20 working days. The bank can contest the decision by applying to the Grievances and Appeals Committee under article 136. The Committee has sole and exclusive jurisdiction to decide on grievances and appeals against any decisions by the Central Bank related to licensing, authorisation of individuals, and licensing and designation of financial infrastructure systems.

Filing requirements

Describe the required filings for an acquisition of control of a bank.

See questions 26 and 27.

Timeframe for approval

What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

All approvals from the UAE Central Bank are at its discretion and no approximate time frames may be stated. However, depending on the identity of the acquirer, approval of the Central Bank would be a matter of months, rather than days or weeks. If the proposal is rejected by the Central Bank, it is required to notify the applicant within 20 working days from the date of issue of the decision. The official notice shall include the content, the rationale and the effective date of the decision.

UPDATE AND TRENDS

Key developments of the past year

Are there any emerging trends or hot topics in banking regulation in your jurisdiction?

LAW STATED DATE

Correct on

Give the date on which the information above is accurate.