

Banking Regulation

In 27 jurisdictions worldwide

Contributing editor
David E Shapiro



2015

GETTING THE
DEAL THROUGH

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Banking Regulation 2015

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Published by
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First published 2008
Eighth edition
ISSN 1757-4730

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Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112



CONTENTS

Austria	5	Luxembourg	82
Christoph Moser and Stefan Weber Weber & Co		Denis Van den Bulke Vandenbulke	
Brazil	12	Mexico	90
Rodrigo de Campos Vieira, Alexei Bonamin and Marcus Fonseca TozziniFreire Advogados		Andrés Nieto Von Wobeser y Sierra, SC	
Canada	16	Norway	95
Pat Forgione, Ahsan Mirza, Darcy Ammerman and Sean Brandreth McMillan LLP		Klaus Henrik Wiese-Hansen and Tore Jetmundsen Advokatfirmaet Steenstrup Stordrange DA	
Curaçao	21	Peru	100
Maike Bergervoet Spigt Dutch Caribbean		Juan Luis Avendaño Miranda & Amado Abogados	
Cyprus	24	Philippines	106
Elias Neocleous and George Chrysaphinis Andreas Neocleous & Co LLC		Rafael A Morales SyCip Salazar Hernandez & Gatmaitan	
Dominican Republic	30	Portugal	110
Mariángela Pellerano Pellerano & Herrera		Pedro Ferreira Malaquias and Hélder Frias Uría Menéndez - Proença de Carvalho	
France	35	South Africa	115
Pierre Casanova Darrois Villey Maillot Brochier		Ina Meiring Werksmans Attorneys	
Germany	43	Spain	120
Christoph Schmitt and Rainer Süßmann Beiten Burkhardt		Emilio Díaz Ruiz, Pilar Lluesma Rodrigo and Isabel Aguilar Alonso Uría Menéndez Abogados, SLP	
Hungary	49	Switzerland	128
Zoltán Varga and Balázs Baranyai Nagy és Trócsányi		Patrick Hünerwadel, Shelby R du Pasquier, Marcel Tranchet and Maria Chiriaeva Lenz & Staehelin	
Indonesia	56	Turkey	136
Emalia Achmadi, Robert Reid and Aziizah Soerjadi Soemadipradja & Taher		Hasan Tanyol Birsell Law Office	
Italy	62	Ukraine	141
Marcello Gioscia, Gianluigi Matteo Pugliese and Benedetto Colosimo Ughi e Nunziante - Studio Legale		Oleksander Plotnikov Arzinger	
Japan	70	United Arab Emirates	147
Yoshiyasu Yamaguchi, Hikaru Kaieda, Yoshikazu Noma, Tae Ogita and Ken Omura TMI Associates		Bashir Ahmed and Vivek Agrawalla Afridi & Angell	
Lebanon	76	United Kingdom	152
Souraya Machnouk, Hachem El Housseini and El Sayegh Abou Jaoude & Associates Law Firm		Isabel Paintin and Ben Kingsley Slaughter and May	
		United States	164
		Richard K Kim Wachtell, Lipton, Rosen & Katz	

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Regulatory framework

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

The principal governmental and regulatory policies that govern the banking sector are UAE Federal Law No. 10 of 1980 concerning the Central Bank, the Monetary System and the Organisation of Banking (the Banking Law), UAE Federal Law No. 18 of 1993, as amended (the Commercial Code), UAE Federal Law No. 6 of 1985 concerning Islamic banks, financial establishments and investment companies (the Islamic Banking Law) and the various circulars, notices and resolutions issued by the board of governors of the UAE Central Bank, from time to time.

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

The Banking Law establishes the UAE Central Bank and 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; maintaining gold and foreign exchange reserves and acting as bank for other banks in the UAE. The Banking Law also contains detailed provisions on the registration, licensing and operation of commercial banks, investment banks, financial institutions, monetary and financial intermediaries and representation offices. 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 Islamic Banking Law contains provisions relating to the establishment and operation of Islamic banks. Islamic banks shall also be subject to the provisions of the Banking Law, with certain exceptions.

The various circulars, regulations, notices and resolutions issued by the UAE Central Bank deal with various aspects of banking including bank accounts, maintaining of certain reserve ratios, capital adequacy norms, measures to combat money laundering and reporting requirements to the UAE Central Bank.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The UAE Central Bank is primarily responsible for overseeing banks in the UAE, except in the Dubai International Financial Centre (DIFC), where the regulatory authority is the Dubai Financial Services Authority (DFSA).

4 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 UAE. 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 UAE 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.

5 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 (for example 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 new Circular, however, provides up to five years to the banks to meet the exposure limits set out in the circular.

With respect to permissible activities of a commercial bank, under the Banking Law, a commercial bank is an institution which customarily receives funds from the public in the form of demand, under notice, time deposits, or which carries on the placement of debt instruments or deposit certificates to be used, in whole or in part, for its account and at its risk, for granting loans and advances. The Banking Law further provides that commercial banks also carry on operations relating to the issue and collection of cheques, the placing of public or private bonds, trade in foreign exchange and precious metals, or any other operations allowed for commercial banks either by law or by customary banking practice.

With respect to Islamic banks, permissible activities are not specified in the Islamic Banking Law, which provides that Islamic banks means those whose memoranda of association include a commitment to abide by the provisions of shariah law and conduct their activities in accordance therewith. Islamic banks have the right to carry on all or part of banking, commercial, financial and investment services and operations. They have the right to engage in all types of services and operations practised by banks and referred to in the Banking Law whether those operations and services were conducted for the Islamic bank's own account or for or in partnership with a third party. Islamic banks also have the right to establish companies and participate in enterprises provided that activities of the latter are in conformity with shariah. The Islamic Banking Law provides that Islamic financial institutions and investment companies shall have the right to carry out lending, credit and other financial operations. They may also participate in enterprises, invest their funds in moveable assets and receive deposits for investment thereof in accordance with the provisions of shariah law. In terms of the Islamic Banking Law, Islamic banks are subject to the provisions of the Banking Law.

With respect to prohibited activities, article 90 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, or bonds issued by commercial companies, in an amount which would raise the bank's holding thereof above 25 per cent of the bank's own funds, unless acquired in settlement of a debt, in which case the excess must be sold within two years from the date of acquisition.

Article 90 of the Banking Law further states that the prohibition shall not apply to the acquisition or holding of bonds issued or guaranteed by the government or other public sector institutions.

Article 91 of the Banking Law provides that commercial banks shall not grant loans or advance funds on current accounts to members of their board of directors, to managers of departments or to similar staff members, except by prior licence from the board of directors of the UAE Central Bank, which must be renewed annually. Article 91 further provides that this prohibition shall not include the discount of commercial paper, the issuance of bank guarantees or the opening of documentary letters of credit. Article 91 provides that no bank may offer to its customers credit facilities against the shares in the bank. Further, no bank may grant loans or advances for the purpose of constructing commercial or residential buildings, exceeding in total 20 per cent of its total deposits. This prohibition does not apply to banks specialising in real estate loans and authorised to do so by the UAE Central Bank.

Article 92 of the Banking Law provides that no commercial bank may issue travellers' cheques without prior authorisation from the UAE Central Bank. Article 93 of the Banking Law provides that no person who has been convicted of theft, dishonesty, fraud, embezzlement or the writing, with bad intent, of cheques against insufficient funds may be or remain a member of the board of directors of any commercial bank and no member of the board of directors or manager of any commercial bank may hold, without permission from the board of directors of his bank, a position as bank manager or member of the board of directors of any other bank.

The Islamic Banking Law does not contain specific provisions for prohibited activities. However, article 4 of the Islamic Banking Law provides that Islamic banks, financial institutions and investment companies incorporated in the country, along with branches and offices of foreign Islamic banks, financial institutions and investment companies licensed to operate in the country shall be exempted from the provisions of clause (a) of article 90 of the Banking Law (for discussion on which please see above). Article 4 of the Islamic Banking Law further provides that Islamic banks, financial institutions and investment companies shall also be exempted from provisions of clause (b) of article 90 of the Banking Law and in a manner not contravening established legislation in the emirate concerned.

6 What are the principal regulatory challenges facing the banking industry?

The principal regulatory challenges derive from the fact that the Banking Law has not been amended or updated since it was promulgated in 1980 and, accordingly, does not address developments in financial services that have taken place since 1980. The subsisting regulations generally lack sophistication. Draft amendments to the Banking Law were proposed a decade ago but have yet to be promulgated.

In the immediate future, the banks face the challenge of complying with Basel III norms as and when they come into effect. The compliance with the regulatory requirement may limit the resources available to the banks for active business.

In addition, the banks and the financial institutions in the UAE are now required to comply with the US Foreign Account Tax Compliance Act (FATCA). The UAE and the US reached an agreement in May 2014 to include the UAE on the list of jurisdictions to be treated as having an inter-governmental agreement (IGA) in effect. The UAE has adopted Model 1 and banks and financial institutions in the UAE have started to comply with the requirements of the IGA.

7 Are banks subject to consumer protection rules?

The UAE 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, as 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.

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

As noted in question 6, an overhaul or substantial amendment of banking legislation is overdue. The establishment of the Dubai International Financial Centre (DIFC) in the Emirate of Dubai, with its own jurisdiction and body of modern laws, and its widening jurisdictional approach, might precipitate changes to the wider UAE legal and regulatory policies. Following the success of DIFC, substantial progress has been made towards the establishment of a new financial free zone in Abu Dhabi called the Abu Dhabi Global Market.

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

The government of the UAE is also working on a draft bankruptcy law that aims to simplify the process and let troubled companies restructure their assets and liabilities.

Supervision

9 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.

10 How do the regulatory authorities enforce banking laws and regulations?

Any failure by banks to comply with the laws and regulations would be notified by the UAE Central Bank and the bank given an opportunity to rectify the breach. Continued failure would attract consequences ranging from fines to cancellation of the licence to conduct banking.

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

The most common issues for 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 new 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 UAE and the establishment of domestic funds requires the consent of the SCA. However, even under the new regulations, the ambiguity regarding registration requirements for an investment product continues.

12 How has bank supervision changed in response to the 2008 financial crisis?

In January 2009, the UAE Central Bank announced that all banks in the UAE must provide details of each loan in excess of 10 million dirhams to the UAE Central Bank to enable the UAE Central Bank to scrutinise the asset quality of the banks.

In February 2009, the UAE Central Bank created an online unit to settle disputes among banks. Banks may now lodge a complaint directly with the UAE Central Bank through this online process. Upon receipt of a complaint, the UAE Central Bank will investigate the complaint and hope to be able to notify its decision within eight weeks. However, matters that are already before a judicial process and major financial problems or criminal cases would be outside the purview of this online complaint system. The UAE Central Bank believes that this initiative will help them to better monitor the issues faced by banks in the UAE.

In March 2009, the UAE Central Bank announced that it would set up a joint task force comprised of representatives of the UAE Central Bank and the country's banks to discuss further measures to face the global crisis.

Resolution

13 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 depositors of the bank. 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.

14 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 UAE 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. This period must not be more than one year from the date the deficiency is made known to the concerned bank. There is no specific plan or similar document prescribed under the laws of the UAE.

15 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.

16 How has bank resolution changed in response to the recent crisis?

Banks have tended obviously to be more conservative and cautious in lending, particularly in relation to off plan real estate lending. In addition, the recent steep drop in the international oil prices could have a negative impact on the assets of the banks. If oil prices continue to drop, banks that rely heavily on government businesses and funds for deposits may feel the effect more than lenders that focus on individual customers.

Capital requirements

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

Pursuant to Circular No. 13/93 issued by the UAE Central Bank all banks are obliged to maintain a minimum capital base relative to the total of their risk-weighted assets, as measured by the risk assets ratio.

The capital base of a bank is defined as the sum of Tier I capital and Tier II capital, less certain prescribed deductions.

Tier I capital shall be the paid-up share capital and published reserves of a bank. Profits of the current period are not allowed to be included except in certain exceptional cases at the discretion of the UAE Central Bank. Goodwill and other intangible assets, own shares held, shortfall in

provisions, current-year losses and others (as may be prescribed by the UAE Central Bank from time to time), must be deducted from Tier I capital.

Tier II capital comprises undisclosed results, revaluation of assets limited to a maximum of 45 per cent of the excess of the market value over their net book value (revaluation reserves in respect of a bank's property assets are not to be included), hybrid (debt or equity) capital instruments and subordinated term loans.

The prescribed deductions from the aggregate of the Tier I and Tier II capital are investments in unconsolidated subsidiaries, investment in associate companies, investments in other banks or financial institutions and any other deductions as may be prescribed by the UAE Central Bank from time to time.

Risk weighting of assets is prescribed by the UAE Central Bank from time to time.

The risk assets ratio to be maintained by banks at all times is a minimum of 10 per cent, in which Tier I capital must reach a minimum of 6 per cent of total risk-weighted assets and Tier II capital must not be more than 67 per cent of Tier I capital.

Pursuant to Notice No. 3735/2006 dated 27 August 2006, the UAE Central Bank implemented the Basel II Accord. The implementation was to be in stages. In the first stage, the banks were required to be compliant with the standardised approach for credit risk by 31 December 2007. Furthermore, banks were required to adopt their own procedures for operational risk and to adopt the 1996 Amendment to Basel I for Market Risk.

Further to the above, as mentioned in question 7, in 2009 the UAE Central Bank issued guidelines for implementation of the Basel II Capital Accord. These state that the minimum capital adequacy ratio of banks will be set at 11 per cent, rising to 12 per cent from 30 June 2010, as specified in Notice No. 4004/2009 dated 30 August 2009 of the UAE Central Bank. This notice provides as follows:

- banks should work towards increasing their capital adequacy to 11 per cent at the latest by 30 September 2009, of which Tier I capital must not be less than 7 per cent;
- banks must increase their capital adequacy once more to 12 per cent at the latest by 30 June 2010, of which Tier I capital must not be less than 8 per cent; and
- these percentages will be applied on a temporary basis and will be re-examined at the beginning of 2011 to determine whether they will continue. The notice shall become effective on 31 August 2009.

In July 2012, the UAE Central Bank issued a circular on liquidity regulations as part of a phased implementation of Basel III. The regulations lay down qualitative requirements, quantitative requirements and reporting requirements as part of liquidity risk management at banks. The qualitative requirements require banks to comply with 12 criteria when setting up their liquidity-risk-management and governance frameworks. The quantitative requirements require compliance with four ratios in a phased manner; a liquid assets ratio, a uses (of funds) to stable resources ratio, a liquidity coverage ratio and a net stable funding ratio. As per one of the important quantitative requirements, banks are required to hold 10 percent of their liabilities in 'high-quality liquid assets'. Under the reporting requirements, the banks will be required to complete a liquidity report to enable the UAE Central Bank to monitor effectively the liquidity positions at banks and to take appropriate and timely action on early signs of a liquidity stress. The implementation of some of the above regulations was to commence from 1 January 2013 but has been postponed pending further consideration by the UAE Central Bank.

There is no specific requirement for contingent capital arrangements. However, article 81 of the Banking Law provides that should a commercial bank's capital fall below the minimum requirement provided for in the Banking Law, the deficiency must be met within a period which was to be defined by the executive committee of the UAE Central Bank, which period shall not exceed one year from the date the bank concerned is notified of the deficiency. The executive committee alone may determine the extent of the deficiency. Article 82 of the Banking Law provides in material part that commercial banks and branches of foreign banks shall have to allocate at least 10 per cent of their annual net profits for the establishment of a special reserve until the said reserve equals 50 per cent of the commercial bank's capital or, in the case of branches of foreign banks, of the amount allocated as capital.

18 How are the capital adequacy guidelines enforced?

Pursuant to Circular No. 13/93 issued by the UAE Central Bank, all banks are required to report to the UAE Central Bank on prescribed banking return forms on a quarterly basis no later than 14 days following the end of each quarter, based on the end-of-quarter figures.

The UAE Central Bank has also issued Basel II Standardised Approach-Returns (including the capital adequacy calculation) which need to be filed by banks. In view of this, the status of Circular No. 13/93 is not clear.

Though the Basel III norms introduced by the UAE Central Bank are yet to come into force, the banking system in the UAE generally seems to be stable with a high solvency sheet.

19 What happens in the event that a bank becomes undercapitalised?

If a bank is undercapitalised at any point, it must rectify the deficiency within one year or any shorter period as may be 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.

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

Commercial banks in the UAE are incorporated as public joint-stock companies or as branches of foreign banks. Investment banks and other financial institutions may be incorporated as public joint-stock companies or private joint-stock companies or as branches of foreign investment banks and financial institutions. Monetary and financial intermediaries may be incorporated as public joint-stock companies or private joint-stock companies or limited liability companies or as branches of foreign monetary and financial intermediaries.

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. 8 of 1984, as amended (the Companies Law) and the bankruptcy provisions of the Commercial 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 any locally incorporated banks face bankruptcy situations, they have been merged with other banks.

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

See question 17.

Ownership restrictions and implications**22 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 UAE (outside free zones) must be owned by UAE nationals or entities wholly owned by UAE nationals. Additionally, for financial and monetary intermediaries and finance companies, at least 60 per cent of the shares must be held by UAE nationals or entities wholly owned by UAE nationals.

23 Are there any restrictions on foreign ownership of banks?

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

24 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 acquisition of control. However, there are no formal restrictions on such entity carrying on any other business.

25 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.

26 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**27 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). Thus 'control' should mean a majority shareholding interest in the bank, a right to exercise control through representation at the board of such bank, or both. Any change in such controlling entity requires the prior written approval of the UAE Central Bank. Upon receipt of such approval subsequent approvals of the local licensing authorities of the emirate where the bank is incorporated must also be obtained.

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28 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.

29 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 UAE. A majority 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.

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

See questions 27 and 28.

31 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.

Getting the Deal Through

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