

CENTRAL BANK OF THE UAE

To : All Banks and Finance Companies in the UAE

Attn: Chief Executive Officer / General Manager

Sub Response to the Consolidation inquiries on Circular 12/03

Date: 6th July, 1993

Ref.: BSD/1263/93

Dear Sirs,

The following highlights the responses given to the consolidated inquiries received from banks regarding Circular No.12/93, "Interest rates & fees applicable to Personal Loans, plus fees & charges on services provided to personal customers". Meetings were held with the Chief Executives/General Managers of Banks in Abu Dhabi and Dubai on Sunday, 16th May 1993 and 17th May 1993, respectively, to clarify the points raised by all banks in regards to Circular No. 12/93. A detailed summary of all the inquiries with the related responses is attached in Appendix 1.

PERSONAL GUARANTEES

The objective of Circular No.12/93 is to reduce risk. A bank's decision to lend should be based on the credit worthiness of the expatriate borrower without the reliance of a guarantee. A reliance on the personal guarantee may compel a bank to lend more than a borrower is able to repay. A bank should not be compelled to lend any more than the amount deemed prudent or within the borrower's own ability to pay.

Banks may accept personal guarantees of UAE Nationals for loans granted to other UAE Nationals. A bank, however, cannot accept a personal guarantee of an expatriate for loans granted to another expatriate. A personal guarantee from an expatriate for a loan granted to a UAE National is also not permissible. Transferring a guarantee given by a UAE National on behalf of another UAE National is permitted, however, transferring a UAE National to guarantee the loan of an expatriate is not permitted. If the bank feels its security or repayment is threatened as a result of an unforeseen circumstance, such as expatriate guarantor who has to leave the country, then the bank should ask for the full repayment of the loan. If the bank does not consider itself at risk, then the bank should allow the borrower to continue with the repayment schedule.

INTEREST RATES

A bank can charge a range of interest rates for the same loan category. (i.e. personal loans) depending on the financial strength of the customer, however, the highest interest rate charged for the category of loan has to be posted on the board. Banks are free to charge a lower rate of interest than the interest rate which is displayed on the board, but cannot charge a higher rate of interest than the rate displayed. A bank can only charge the interest rate of a personal loan if such an arrangement is agreed to by the borrower and is made part of the loan agreement. Interest is charged on personal loans should be calculated on the number of days in the month based on a 365 day year.

PENALTY INTEREST

A bank may apply penalty rates of interest as long as the amount or rate of penalty interest is disclosed to the borrower and is displayed on board. The bank should charge penalty interest based on the balance in default and the bank should always try to recover its legal costs. The bank can also waive penalty charges on prepayments, but such a waiver should be displayed on the board. In such cases, the bank should display "0" (zero) on the board regarding penalty charges on prepayments.

PERSONAL LOAN CEILING

The purpose of the personal loan ceiling is to reduce risk. Similarly, the European Community has proposed ceiling of ECU 20,000 while Kuwait has instituted a ceiling of Dinar 10,000. The ceiling on personal loans does not include credit card facilities. Credit cards are usually unsecured and are not considered to be personal loans, that are defined as loans secured by salary and service indemnity. All personal loans granted to an individual borrower, however, should be viewed on a consolidated risk basis and be within the aggregate ceiling limit of Dhs. 250 thousand would be in violation of the Circular if both loans were secured by the salary and end of service indemnity. Such loans are considered personal loans and are subject to an aggregate limit of Dhs. 250 thousand.

LOANS INSTALLMENT

Banks should be prudent with the principal amount of the loan as well as monthly installments requirements in proportion to the individual's salary. The courts have given banks only a limited amount, as a percentage of monthly salary, that can receive as repayment of a personal loan, well below the 50-60% level. The Circular should be carefully studied for guidance on loan installment.

HOUSING LOANS / HOUSE AS SECURITY

The basic definition of a personal loan is a loan by salary and end of service indemnity. If a housing loan scheme is secured only by salary and the end of service indemnity, then this may result in a National having to save more money before the purchase of a house. A bank can take a mortgage over a house in which a National was granted a housing loan, if the concerned municipality agrees. A bank may also take a mortgage of property rented out against loans to UAE Nationals if the concerned municipality agrees to the renting of the property.

CAR LOANS

Car loans are personal loans to the extent that the repayment is based on and secured by an individual's salary and end of service indemnity. If the car, however, is not for personal use but for a commercial use (i.e. truck or car rental), then such a loan may not be considered personal loan.

DISPLAY BOARD

Printed matter cannot be substituted for the disclosure of items on the display board. The objective of using a display board is to divert the blame from banks on hidden charges, fees and interest. The items required by the Circular to be displayed on the board are limited and there should be sufficient space on the board to display all of the required items.

CIRCULAR 197

In view of the changes that have taken place since Circular 197 was implemented, the Central Bank has decided its role is not longer to regulate competition amongst banks rather than Central bank's role is to supervise banks.

OTHER MATTERS

The Circular related to loans secured by salary and end of service indemnity "Personal loans" is just a title, its meaning, however, is clearly defined by the Circular.

The Circular did not mention foreign exchange boards because most banks have foreign exchange boards for quite some time. The Central Bank will review the impact of Circular 12/93 on or before year end 1993.

Yours faithfully,

Sultan Bin Nasser Al Suwaidi
Governor

APPENDIX 1

CIRCULAR NO. 12/93 - RESPONSES TO INQUIRIES RECEIVED FROM BANKS

INQUIRIES

PERSONAL GUARANTEES

Some bank feel that they should be permitted to take **personal guarantees** (from expatriates) as security, as it is their prerogative to set security conditions. These banks feel that the risk profile of personal loan portfolio **would increase** if personal guarantees cannot be taken as security.

Q 1.: The Circular is instructing banks to exercise less caution than this type of lending dictates - this could lead to high level of bad debts. (No. of Banks : 12)

Ans.: The objective of Circular No. 12/93 is to reduce risk. A bank's decision to lend should be based on the credit worthiness of the expatriate borrower without reliance on a guarantee. A bank should not be compelled to lend any more than the amount deemed prudent or within the borrower's own ability to repay. A reliance on a personal guarantee may compel a bank to lend more than a borrower is able to repay.

Q 2.: Some banks have questioned the rationale behind disallowing personal guarantees (from expatriates) as security. (No. of Banks : 3)

Ans.: As noted above, the purpose of the Circular is to reduce risk.

Q 3.: Clarification sought on whether banks can accept personal guarantees of UAE Nationals (no. of Banks: 16):

1. for loans to other
2. for loans to UAE nationals

Ans.:

1. Banks may accept personal guarantees of UAE Nationals for loans granted to other UAE Nationals.
2. Accept personal guarantee of expatriates for loans to other expatriates.
3. A bank cannot accept a personal guarantee of an expatriate for loans granted to another expatriate.

Q 4.: Are personal guarantees of expatriates and UAE Nationals acceptable against loans given to UAE Nationals ?

Ans. : Guarantees from UAE Nationals for loans to UAE Nationals are acceptable, however, guarantees from expatriates for loans to UAE Nationals are not acceptable.

Q 5.: Is it possible to replace the existing personal guarantee of an expatriate with the personal guarantee of a UAE National if such a transfer becomes inevitable due to unforeseen circumstances e.g. expatriate guarantor has to leave the country ?

Ans. : Transfer of a guarantee given by a UAE National on behalf of another UAE National is acceptable, however, the transfer of a UAE National to guarantee the loan of an expatriate is not acceptable. If the bank feels its security or repayment is threatened as a result of an unforeseen circumstance, such as the expatriate guarantor, who has to leave the country, then the banks should ask for the full repayment of the loan prior to the guarantor's departure. If the bank does not consider itself at risk, then the bank should allow the borrower to continue with the same repayment schedule.

INTEREST RATES

Q 1.: Range of interest for different customers - Is it allowed ?

Ans.: A range of interest rates for different customers is allowed, however, the highest interest rate has to be posted on the board.

Q 2.: Can banks charge lower interest rates than displayed on the board ? eg. Staff loans.

Ans.: Banks can charge a lower interest rate than that displayed on the board, however, as noted

before, the highest rate should be displayed on the board.

Q 3.: Can interest be calculated on the basis of number of days in a month ?

Ans.: Interest can be calculated on the number of days in the month because the Circular states that the basis for calculating interest is based on the 365 day year.

Q 4.: Does the Circular permit change in the interest rate during the period of the loan ? Especially, if it is written into the personal loan application form.

Ans.: A bank can change the interest rate if such an arrangement is agreed to and is made part of the loan agreement with the borrower.

Q 5.: Are all interest calculations for Dirhams be based on 365 days? What about C.D.'s and overdrafts ?

Ans.: For personal loans all interest calculations are to be based on 365 days.

Q 6.: Can banks use the reducing balance method only ?

Ans.: Yes, if the method is the same as the one highlighted in the Circular.

PENALTY INTEREST

Q 1.: Circular is silent on penalty interest for late payment or default. Can the banks apply any penalty rates on this ?

Ans.: The bank may apply penalty rates as long as the amount or rate of penalty interest is disclosed and displayed on the board.

Q 2.: Can the bank charge penalty interest at the rate of 2% above the loan area ?

Ans.: The bank may charge penalty interest at the rate of 2% above the loan rate as long as such penalty interest is disclosed on the board.

Q 3.: Can Central Bank define the rules for dealing with default cases or irregular payments ? E.g. penalty interest, legal charges, etc.

Ans.: The bank should charge penalty interest based on the balance in default. As long as the loan is in default the Bank should try to recover its legal costs. The bank has the right to recover its legal cost.

Q 4.: Can the bank waive the penalty charges on prepayments at their discretion ?

Ans.: Yes the bank can waive penalty charges on prepayments, but such a waiver should be displayed on the board. In such cases, the bank should display "0" (zero) on the board regarding penalty charges on prepayments.

PERSONAL LOANS CEILING

Some banks have questioned the ceiling of Dhs. 250 thousand Amount of personal loan should be at the discretion of the bankFor borrowers with.....Salaries or having other sources of income.

Q 1.: Is the ceiling of Dhs. 250 thousand to be considered on consolidated risk basis including any facilities under credit cards ?

Ans.: The ceiling in the Circular does not include credit card facilities. Credit cards are usually unsecured and therefore are not considered to be personal loans, loans secured by salary and service indemnity, as defined by the Circular. All personal loans granted to a borrower, however, should be viewed on a consolidated risk basis and be within the aggregate ceiling limit of Dhs. 250 thousand.

Q 2.: Is the ceiling of Dhs. 250 thousand for principal only or principal plus interest ?

Ans.: The ceiling of Dhs. 250 thousand related to principal only.

Q 3.: Can bank exceed the ceiling of Dhs. 250 thousand possibly under a different loan category ?

Ans.: The bank can exceed the ceiling of Dhs. 250 thousand under different loan categories, for example, trading and real estate loans to an individual who also has a personal loan. The total amount of loans may be in excess of Dhs. 250 thousand. However the amount of personal loan(s) to the borrower cannot exceed the ceiling.

Q 4.: Two separate loans given to the same customer aggregating over Dhs. 250 thousand. Would these loans..... of the Circular ?

Ans.: Two loans aggregating over Dhs. 250 thousand would be inCircular. If both loans were secured by the salary and end of service indemnity. Such loans are considered personal loans and are.....in aggregate limit of Dhs. 250 thousand.

LOAN INSTALLMENT

Q 1.: Not clearly defined

Ans.: The Circular carefully defines the loan installment.

Q 2.: Should be upto 50% to 60% of borrowers salary at the discretion of the bank.

Ans.: Banks should be careful with these high level because if the borrower goes into default, the courts would give a bank only a limited amount as a percentage of salary, well below the 50-60% level.

HOUSING LOANS/HOUSE AS SECURITY

Q 1.: Housing Loans come under the personal loan circular and therefore subject to the terms and conditions of that Circular ?

Ans.: The basic definition of a personal loan that it is a loan secured by salary and end of service indemnity. If the housing loan is a personal loan, this may result in a National having to save more money before purchasing a house.

Q 2.: Can the bank take mortgage of overseas property against loans to expatriates and UAE Nationals and mortgage of property rented out against loans to UAE Nationals ?

Ans.: A bank should not take a mortgage of overseas property against a loan to an expatriate or UAE National. A bank can take a mortgage of property rented out against loans to UAE Nationals if the concerned municipality agreed to renting of the property.

Q 3.: If a housing loan is given to a national staff, can the bank take mortgage over that house ?

Ans.: A bank can take mortgage over a house in which a National was granted a housing loan, if the concerned municipality agrees.

CAR LOANS

Q 1.: Are car loans personal loans ?

Ans.: Car loans are personal loans to the extent that the repayment is based on and secured by salary and end of service indemnity. If the car, however, is not for personal use but for commercial use (i.e. truck or car rental), then such a loan is not considered a personal loan.

Q 2.: Can the bank give a car loan and also a general purpose personal loan ?

Ans.: The bank can grant a car loan and also grant a general purpose personal loan provided that combined both loans are not in excess of the Dhs.250 thousand limit.

DISPLAY BOARD

Q 1.: Banks feel that there are too many items requiring display on the Board. Should all these items be displayed on the Board especially where a bank has a range of rates ?

Ans.: The bank should display all items on the board.

Q 2.: In view of the above, one bank suggest the use of printed matter (booklet) as an alternative to the display board. **Ans.:** Printed matter cannot be substituted for the display board. The objective of using the display board is to divert the blame from banks on hidden charges, fees and interest.

Q 3.: It is not practical to display all the information on the board and therefore can limited information be displayed ?

Ans.: It is practical to display all the information on the board because the items identified in the Circular are limited.

CIRCULAR NO. 197

Q 1.: Some bank feel that Central Bank should continue to regulate the conduct of banking business, perhaps through modification of Circular No. 197 after proper study this would ensure fair competition amongst banks.

Ans.: In view of the changes that have taken place since Circular No. 197 was implemented, the role of the Central Bank is not to regulate competition amongst banks, ather the Central Bank is in the business of supervising banks.

Q 2.: Are all the provisions of Circular No. 197, 49 and 328 cancelled or only those parts relating to personal loans.

Ans.: All provisions of Circular No. 197, 49 and 328 that relate to personal loans are cancelled.

Q 3.: Banks have sought information that minimum and maximum tariffs on services provided by the Bank are not longer applicable.

Ans.: The minimum and maximum tariffs on services provided by the Bank are no longer applicable.

OTHER MATTERS

Q 1.: Reservation on the use of the term 'Personal Loans' -suggest 'Consumer Loans' or ' Salary Loans'.

Ans.: The Circular relates to loans secured by salary and end of service indemnity, "Personal loans" is just a title.

Q 2.: Should banks have a foreign exchange rate board also. Circular does not mention Foreign Exchange board.

Ans.: Foreign exchange boards are common in most banks and have been used for some time by most banks in the UAE.