

GCC  
Special Report

# GCC Banks: Risks from Retail Lending

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## Related Research

- *Impact of the Global Economic Crisis on GCC Bank Ratings (December 2008)*
- *Bank Systemic Risk Report (October 2008)*

**Table 1: Fitch Assessment of Risks from Retail Lending to GCC Banking Systems**

Bahrain	Moderate
Kuwait	Moderate
Oman	High
Qatar	Moderate
Saudi Arabia	Low
United Arab Emirates	High

Source: Fitch

## Summary Opinion

Fitch Ratings believes that the more challenging Gulf Cooperation Council (GCC, consisting of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE) operating environment will negatively affect prospects for GCC retail banking, but the degree of severity will vary. Fitch's assessment of the risks posed to individual GCC banking systems by their respective retail sectors are summarised in Table 1. Factors that Fitch considered in this assessment include the size of the overall retail sector compared with the total banking system, the severity of the impact of the global recession on the local economy, the rate of retail loan growth in recent years, the quality and effectiveness of regulation, levels of leverage available to retail customers, the size of overall and expatriate populations and the prevalence of retail credit available through non-bank financial institutions.

A key factor in assessing risks from GCC retail banking is that the market is untested. Fitch estimates that GCC-wide retail loan balances grew 19% in 9M08 to USD166bn (2007: 18%; 2006: 13%). Retail credit growth has been very rapid in recent years in most GCC states but from a low base and in previous downturns, retail loans had not been a major part of most banks' risk profiles. Fitch believes that it is during periods of rapid growth that risk management systems may come under stress, lending criteria may not be properly implemented and bad lending decisions made.

Another key factor in assessing the severity of risks from retail lending is the varied level of regulation. Some GCC regulators have taken steps to curb the growth of retail credit and the levels of leverage available, which Fitch views positively. High leverage in terms of debt coverage ratios had been available to consumers, although debt burden ratios may be higher in the GCC as there is no income tax and a large part of the local population is often employed by the state. The most common tool used to manage retail risks is salary assignment, but the effectiveness of this tool breaks down when dealing with large expatriate populations with rising redundancies; as an expatriate's residence visa is nearly always linked to employment in the GCC, rising redundancies are likely to result in higher defaults as expatriates leave ("skips"). GCC banks are also likely to have exposure to the stock market through retail loans, though the severe 2006 regional stock market corrections did not seem to have a large impact on most GCC banks' asset quality.

Fitch believes that the negative impact could be most severe in the UAE, particularly in Dubai, as: the UAE has an exceptionally high proportion of expatriates, at more than 80% of the local population (90% in Dubai) leading to high risk from "skips"; the Dubai economy is coming under pressure from the global recession, with rising redundancies in the property, trade, tourism and financial services sectors, which form the backbone of the local economy; Dubai's residential property market is suffering increasing stress; regulation of retail loans is not as tight as in certain other GCC markets; and 2008 growth in retail loans has been most rapid in the UAE. This is likely to result in increasing defaults on retail loans.

In the agency's view, the negative impact from retail banking is likely to be least severe in Saudi Arabia, where: the market is relatively strictly regulated; demand is expected to be sustained by a large and increasing young indigenous population rather than an expatriate population; and the local economy has been more insulated from the impact of the global recession than certain other GCC states, although the recent decline in energy prices will negatively impact Saudi government revenues and local liquidity.

**Table 2: Average Annual Inflation**

	(% yoy)
Bahrain	5.0
Kuwait	10.8
Oman	12.4
Qatar	15.1
Saudi Arabia	9.9
United Arab Emirates	13.0

Source: Fitch

**Table 3: Population**

Bahrain	1.1m
Kuwait	2.9m
Oman	2.7m
Qatar	0.9m
Saudi Arabia	25.4m
United Arab Emirates	4.5m

Source: IMF

**Table 4: Total Retail Loan Balance**

	(USDbn)
Bahrain**	4.6
Kuwait*	29.2
Oman**	9.3
Qatar*	15.5
Saudi Arabia*	47.5
United Arab Emirates*	61.0

Source: Fitch, \*end-9M08, \*\*end-2008

**Table 5: Retail Loan Balance/Total Banking System Loan Balance**

	(%)
Bahrain**	***29.5
Kuwait*	33.7
Oman**	38.5
Qatar*	25.4
Saudi Arabia*	18.5
United Arab Emirates*	24.7

Source: Fitch, \*end-9M08, \*\*end-2008, \*\*\*Retail loans/"retail" bank total loans (as defined by the CBB)

## The GCC

Fitch Ratings provides ratings for 50 financial institutions in the GCC; the vast majority of these are commercial banks which also provide substantial retail banking services. In the following analysis, "retail" loans refer to personal instalment loans, credit cards, residential mortgages, car loans etc. Islamic retail balances are included within total retail balances.

The GCC banking sector had benefited from a benign operating environment, where considerable government spending, largely on infrastructure, has been driven by high oil and gas prices. This favourable operating environment helped to improve diversification of the local economy and the concurrent expanding GCC labour market required retail banking services. The provision of retail banking services is attractive to GCC banks as they support the funding profile through the collection of retail deposits, which tend to be stickier and less costly than wholesale deposits. There are also higher margins for retail loans, particularly for credit cards, than for the more competitively priced corporate banking market.

However, GCC economies are coming under increasing stress from the global recession. The negative impact of the global credit crisis on GCC banking system liquidity, the negative impact on GCC government spending from declining energy prices, volatility in regional stock markets, high inflation, a regional property market bubble coming under stress and regional political instability have all negatively affected GCC economies. This could lead to increasing unemployment, which would add to stress on the retail banking sector.

Systems for managing retail credit risks across the GCC are of varying degrees of sophistication. However, the dominant retail product is personal loans where the customers' salary is assigned to the bank. Fitch believes that this mechanism works well in countries with relatively small expatriate populations like Saudi Arabia. However, salary assignment does not work if the salary ceases to be paid, either if the customer "skips" or if the customer is made redundant; clearly, the risks are highest in markets with high risks of "skips" like Dubai, where the relative expatriate population is the highest in the GCC, and in markets which have been more impacted by the global recession and where the risk of redundancy is higher.

Risks from retail lending are compounded by the non-bank financial institution (NBFI) sectors in the GCC. NBFIs are restricted from accepting retail deposits but can extend retail credit in most GCC states; they are subject to varying degrees of regulation and disclosure requirements are typically low. Risks arise for GCC banks from these NBFIs as they are nearly always reliant on local interbank markets for funding.

Fitch notes that analysis of GCC retail lending is made difficult by the relatively low level of disclosure. Impaired loans are not disclosed separately for retail loans across the GCC. Most GCC states do not require disclosure of retail loans by product. Levels of disclosure for non-bank financial institutions are lower. Official population statistics are often out of date. The quality of data-gathering on inflation is uneven but improving. The UAE only releases inflation figures once a year (the authorities plan to rectify this). Qatar publishes inflation data every quarter. Kuwait publishes inflation data monthly, but with a lag of several months. Bahrain started publishing monthly figures in 2007, although its former historical series is annual. Saudi Arabia and Oman are the only ones to publish timely monthly data.

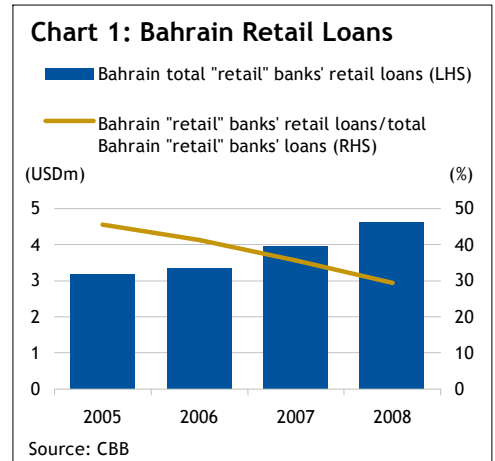
## Bahrain

Bahraini banks are regulated by the Central Bank of Bahrain (CBB). In Bahrain, local regulation defines banks as "retail" or "wholesale". Retail banks are permitted to carry out all types of banking activities whereas wholesale banks may also undertake transactions without restriction, when dealing with the government of Bahrain and its agencies, CBB bank licensees and non-residents; they may only

undertake transactions denominated in BHD and/or with a resident of Bahrain, if these transactions are wholesale in nature, defined as transactions of a credit or deposit nature of BHD7m or greater, or are investments of at least BHD250,000.

Retail loans accounted for a significant 29% of end-2008 total “retail” bank loans, as seen in Chart 1. However, the “retail” bank sector constituted a low 9.5% of total consolidated banking system assets, which includes “retail” and “wholesale” banks. Hence, retail loans constitute a small proportion of total loans in Bahrain and the lowest proportion in the GCC, which mitigates the potential for risks from retail lending. The importance of wholesale banks in the local banking system reflects Bahrain’s position as a regional financial hub, particularly in Islamic and investment banking and insurance.

Growth in retail loans in Bahrain (2008: 16%; 2007: 19%; 2006: 5%) has been relatively modest compared with that in many other GCC states. Additionally, retail loans declined to 29% of total “retail” bank loans at end-2008, as seen in Chart 1. Fitch notes that retail loan balances had been rising rapidly (2005: 18%, 2004: 24%). Concerns about a potential overheating in the Bahraini economy due to this rapid growth were addressed by the CBB through new regulations, which came into effect on 1 January 2005 and were intended to curb retail credit growth by limiting such loans’ monthly repayments to 50% of the borrower’s monthly salary, tenors to seven years and loan renewals to twice. Previously, no such limits existed, a situation which had the potential to cause asset quality problems. The 50% maximum debt servicing ratio can be relaxed for ‘high earners’ at the bank’s discretion, where a high earner is defined as a person earning over USD8,000 per month. Credit cards are factored into this monthly calculation by taking 5% of total credit limits available to the customer as part of the 50% sum. Most banks have stricter lending criteria for expatriates. Fitch notes that it nonetheless considers a 50% debt service coverage ratio (DSCR) as high. A mitigating factor is that Bahrain has the lowest inflation in the GCC.



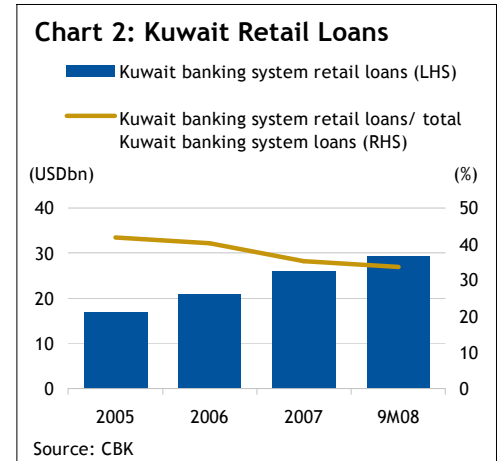
An independent credit bureau was established in Q105 under the CBB’s auspices, with mandatory membership for financial institutions providing consumer finance; this should improve the retail lending sector’s risk profile. However, as with other GCC jurisdictions, grey areas exist in the definition of consumer finance so, for example, certain forms of financing are not currently recorded by the credit bureau. Most banks require salary assignment for retail loans, but Fitch notes that Bahrain has a moderately large expatriate population for a GCC state, which increases the risk of “skips”. The Bahraini mortgage market is undeveloped, with the major Bahraini retail banks, Ahli United Bank (‘A-’/Outlook Stable), BBK (‘A-’/Outlook Stable) and National Bank of Bahrain (‘A’/Outlook Stable), having only recently entered this market; overall balances are currently low.

Bahrain’s robust regulatory framework largely provides licences to financial institutions which offer credit as either “retail” or “wholesale” banks. NBFIs offering retail finance are also regulated by the CBB but are few. At March 2009, the CBB has issued 118 bank licences but there were only five financing companies. The largest is Bahrain Commercial Facilities Company, which was established in 1983 and had loans outstanding of USD398m at end-2008.

Fitch views the regulatory measures taken by the CBB positively and they should help limit potential risks to Bahraini banking from retail lending. The agency believes that the Bahraini banking system is moderately exposed to such risks given its tighter regulation, relatively low exposure to retail loans and the economy's fairly high level of diversification within the GCC.

### Kuwait

Kuwaiti banks are regulated by the Central Bank of Kuwait (CBK). The CBK has been proactive in tightening regulation for consumer finance, as concern began to grow that the local market could become overheated. The maximum DSCR was reduced to 40% from 50% in Q208 (30% for retirees). The leverage available to a Kuwaiti retail customer is therefore lower than in many other GCC states. The CBK has imposed a customer borrowing ceiling of KWD70,000 (around USD250,000) and a maximum tenor of 15 years on retail loans. It also regulates interest rates that banks are able to charge retail customers.



In May 2008, the CBK announced an increase in the risk weightings applied to retail lending (to 100% from 75%) and property exposure (150% from 100%), when calculating regulatory capital. These measures were designed to further slow rapid growth in two of the potentially riskier segments of the Kuwaiti banking system.

In February 2007, the CBK required all Kuwaiti banks to conduct a full internal audit of their retail loan portfolios in addition to a full audit by an external auditor. Local banks were obliged to take a charge against interest income or an impairment charge against the asset for that part of a retail loan not fully in compliance with local regulation. This resulted in substantial charges at many Kuwaiti banks in 2007; the charges at the three largest commercial banks were KWD31m at National Bank of Kuwait (NBK, 'AA-'/Outlook Stable), KWD12m at Commercial Bank of Kuwait ('A+' /Outlook Stable) and KWD20m at Gulf Bank ('A+' /Outlook Stable).

Retail loan balances have grown rapidly in recent years (9M08: 10%; 2007: 18%; 2006: 21%), as seen in Chart 2, but this growth has been curbed by Kuwaiti regulation. Chart 2 also shows that retail loans have declined as a proportion of Kuwaiti banking system exposure in the same period. However, retail loans represented 33% of total loans at end-9M08, making this sector's share of the banking system among the highest in the GCC. The sector is concentrated; NBK had a dominant 32% of Kuwait banking system assets and Kuwait Finance House ('A+' /Outlook Stable) had 27% at end-9M08, with correspondingly high retail market shares.

Fitch notes that the history of Kuwaiti government intervention in the banking system could lead to higher impaired loans. The Kuwaiti authorities have forgiven all retail loans to Kuwaiti nationals in the past. If there were an expectation among some Kuwaitis of another such intervention, this could lead to higher impaired retail loans. Exceptionally high Kuwaiti government revenue in 2007 and 2008 from high oil prices, as well as a potentially large retail exposure to the declining stock market has resulted in such requests in the Kuwaiti parliament as a wealth redistribution measure.

Personal loans are secured by salary assignment; the risk of "skips" is lower than in many GCC states as the expatriate population is small and more than 90% of Kuwaiti

citizens are employed by the state. When assessing retail credit risk, banks use pre-defined criteria, scorecards and the customer's borrowing history obtained from Ci-Net, the Kuwaiti credit bureau established in 2004 which institutions active in retail lending are required to join. The mortgage market in Kuwait is limited as financing for first mortgages for Kuwait's principal residences is through a government agency; foreigners may not own property in Kuwait.

At April 2009, there were 101 investment companies operating in Kuwait, regulated by the CBK. This sector has come under severe stress from the credit crunch and the global recession. However, the majority of these companies follow a business model where they invest their own and third party funds. Few of these Kuwaiti investment companies offer retail products, though there are some exceptions like Iskan, which offers residential mortgages. The CBK publishes aggregate data for the investment company sector; at end-2008, investment companies had aggregate total assets of USD63bn, Kuwaiti investment securities of USD17bn, foreign assets of USD24bn (in large part investment securities) and Kuwaiti loans of USD7bn. While there may be risks to the banking system from investment company retail credit, these risks are dwarfed by the risks from investment companies' investment securities portfolios, where market conditions continue to be difficult, and their reliance on wholesale funding.

Fitch considers the risks to this banking system of problems from retail lending to be moderate. This is due to tightened regulation and a relatively small expatriate population, which in spite of the high exposure of Kuwaiti banks to the retail sector and the particular dynamics of the Kuwaiti market due to past government intervention to forgive retail loans, helps to mitigate some of the risks.

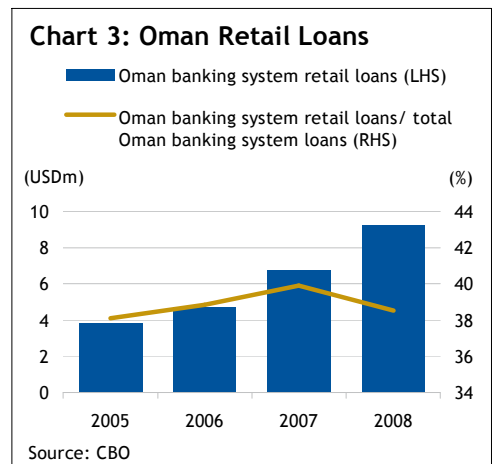
### Oman

Omani regulation limits local banks' retail lending to 40% of their respective total loan books, a reduction from 42.5% in Q107. Residential mortgage lending is capped at an additional 10% (increased from 5% in April 2008). The Central Bank of Oman (CBO) also regulates interest rates that local banks can charge for retail loans. The cap on the interest rate chargeable on personal loans is 8% per year; this had been reduced by 50bp in both April and June 2008.

As shown in Chart 3, retail loans in the banking system have remained just under this regulatory limit in recent years. As a result, most banks' retail exposure is around 40% of their loan book and constitutes their largest sector exposure. This is the highest level of banking system exposure to retail lending in the GCC. While these exposures are relatively granular, this exposes them to sector concentration risks. The Omani banking system is also dominated by one player, Bank Muscat ('A-'/Outlook Stable), which at end-H108 held a high 41% of Omani banking system assets, with a correspondingly high share of retail loans.

Other major Omani retail banks include Bank Dhofar ('BBB+'/Outlook Stable), National Bank of Oman, Oman Arab Bank ('BBB+'/Outlook Stable) and Oman International Bank ('BBB+'/Outlook Stable).

Retail loans are mainly salary-assigned personal loans. As Oman does not have a particularly large expatriate population compared with certain other GCC states, its retail sector should not be as heavily affected by expatriate redundancies in the more challenging operating environment leading to increasing numbers of "skips".



Expatriates constituted 30% of the total population at end-2007. Credit cards and car finance are the other main retail loan products. Mortgages are fairly underdeveloped in Oman, but Fitch expects growth to pick up.

The CBO does not regulate personal loan tenors, DSCRs or absolute loan values. Personal loans are typically granted at around 50x monthly salary with tenors of more than 10 years and a monthly debt burden of around 65% of the borrower's salary. Omani banks usually also require a guarantee from a local guarantor from whom the bank takes a secondary salary assignment, although local guarantors may perform this role for a number of borrowers. Risks from high leverage are compounded by high inflation of 12.4% yoy in 2008. Banks target government employees, which constitute the bulk of local employees, or private sector employees working for an approved employer. Retail borrowers are subject to a credit check at the Banking Credit and Statistical Bureau and the CBO blacklist, but Oman lacks a credit bureau to assist in retail credit decisions.

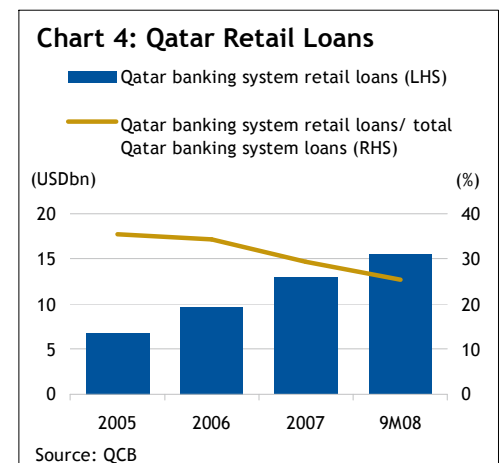
Retail loans grew by a rapid 37% in 2008 (2007: 42%; 2006: 23%). As with other markets, during periods of rapid growth internal risk management systems may come under stress, lending criteria may not be properly implemented and bad lending decisions may be made.

Non-bank finance companies are licenced and regulated by the CBO. There are currently five such finance and leasing companies in Oman, mainly active in car, property and equipment finance, offering both retail and commercial products. The largest such company, United Finance Company (rated 'BBB'(omn)/Outlook Stable) had total financing of USD402m at end-2008. Three of the five finance companies are publicly listed on the Muscat Securities Market and so issue audited financial statements.

Fitch views the level of leverage available to Omani retail customers as among the highest in the GCC, in the absence of a credit bureau and tight regulation and in an inflationary environment. Furthermore, Oman did not benefit from high oil and gas revenue to the same extent as certain other GCC states and Fitch considers the Omani economy as relatively undiversified. Fitch believes these factors result in a high risk of potential problems from retail lending for Omani banks in the medium term.

### Qatar

The Qatar Central Bank (QCB) regulates Qatari banks. Regulation of personal loans was tightened in March 2008, when maximum DSCRs were reduced to 50% from 70% while the maximum tenor was maintained at seven years and the maximum potential credit extended to an individual was maintained at QAR2.5m (USD686,800). Fitch notes that leverage available to Qatari nationals has been reduced, which has contributed to slower growth in retail loans (9M08: 20%; 2007: 34%; 2006: 42%), as shown in Chart 4. However, Fitch considers a 50% DSCR as high, particularly as Qatar has the most inflationary economy in the GCC, with inflation of 15.1% yoy in 2008.



Tighter regulation has contributed to a decline in retail loans as a share of total loans, as shown in Chart 4. Retail loans accounted for 25% of total Qatari banking system loans at end-9M08, which is a fairly high exposure within the GCC. This

decline reflected slower growth of retail loan balances while overall credit growth remained very rapid. Qatar has a small local population and a relatively large number of expatriates, which increases the risk of “skips”.

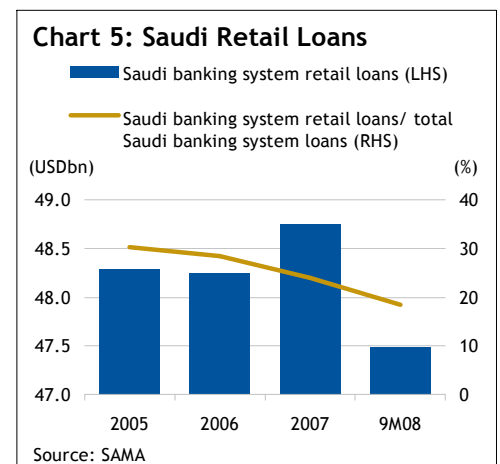
The banking system is concentrated. Qatar National Bank (‘A+’/Outlook Stable) has a dominant local market share, with 37% of Qatari banking system assets at end-2008 and a correspondingly large share of retail business. The other major banks active in Qatari retail lending are Commercial Bank of Qatar (‘A’/Outlook Stable), Doha Bank (‘A’/Outlook Stable) and Qatar Islamic Bank (‘A’/Outlook Stable).

The QCB licences NBFIs, some of which are active in consumer finance. It had licenced only two finance companies at September 2008. The largest is First Finance Company of Qatar, which was incorporated in 1999, is publicly listed and provides personal loans, car and property finance as well as equipment finance; it had total receivables of USD559m at end-2008. The second finance company, Qatar Finance House, was established in 2006 and is of modest size.

On balance, Fitch considers there to be moderate potential for risks for Qatari banks from retail lending, given the high leverage available, a relatively large expatriate population and high inflation. These risks are mitigated by Qatar’s tighter regulation and the strength of the Qatari economy, which has been somewhat protected from the global recession by its vast energy reserves.

### Saudi Arabia

Saudi banks are regulated by the Saudi Arabian Monetary Agency (SAMA). SAMA tightened regulation for personal loans, particularly due to very rapid growth in retail loans prior to 2005 (2005: 57%; 2004: 57%), which was largely driven by speculation on the local stock market. In March 2006, SAMA reduced the maximum DSCR to 33% from 40%; Fitch notes that this is the lowest regulated level of leverage available to retail customers in the GCC. For retired individuals, this limit was set at 25% of pension payments. Maximum loan tenors were set at five years. Retail lending decisions are assisted by an established credit bureau, which all banks contribute data to. Furthermore, SAMA, at its own discretion, may place a limit on individual banks whereby their retail loan portfolio may not exceed a specified percentage of its total loans.



This regulatory tightening has resulted in retail loan balances remaining stable at less than USD50bn, as shown in Chart 5. Retail loan balances declined 2.5% in 9M08 (2007: 1.1%; 2006: -0.1%). The slower growth in retail loan balances is also due to a significant fall in demand following the severe corrections suffered by regional stock markets in 2006. As overall credit growth has remained rapid in Saudi Arabia, retail loans have declined as a share of total loans; at end-9M08, they accounted for 18% of total loans.

The Saudi retail loan market is dominated by salary-assigned personal loans. The risk profile of this product is mitigated by the large relatively young indigenous population that makes up the vast majority of the retail loan market. The IMF estimated the local population at 25m at end-2008, which is by far the largest GCC population. The expatriate segment is relatively smaller than in certain other GCC states.

The Saudi banking system is not as concentrated as some other GCC states', although there are only 11 major players in the banking system, the largest of which are Al Rajhi ('A+' / Outlook Stable), National Commercial Bank ('A+' / Outlook Stable), Riyadh Bank ('A+' / Outlook Stable) and SAMBA Financial Group ('A+' / Outlook Stable).

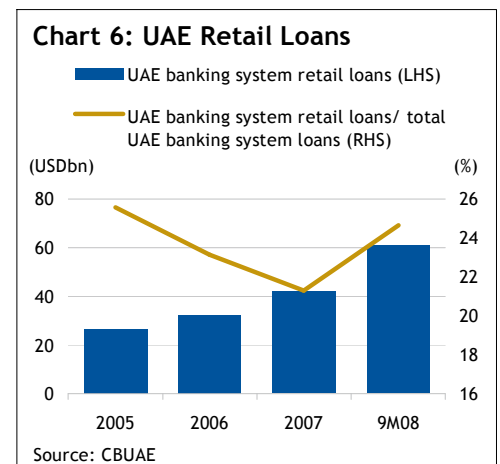
The Saudi residential mortgage market is relatively small, at around 8% of total retail loan balances at end-2008, but it has not overheated unlike certain other GCC markets. A mortgage law has been written by the Saudi authorities but this has yet to be implemented; legislation which simplifies and clarifies the ownership of property could help spur the local residential mortgage market. Foreigners are not allowed to own property in Saudi Arabia.

Saudi finance companies, active in e.g. car, property and equipment finance, are not regulated by SAMA but are licenced by the Ministry of Commerce. Fitch believes that these finance companies, particularly those providing retail products, should be more closely regulated by SAMA. Currently, these companies are mainly active in car finance, like Taajeer Company, but they are of very small size compared with the banks. There are no publicly listed Saudi NBFIs.

Fitch believes that the potential risks of retail lending to Saudi banks are lower than for other GCC countries. This reflects the prudent tightening of regulation to prevent a possible overheating of the retail loan market, low levels of recent retail loan growth, sustained demand from a large relatively young indigenous population with a lower proportion of expatriates, and an economy which has been better insulated from the impact of the global recession than certain other GCC countries.

### United Arab Emirates

Fitch believes that the UAE retail sector will be significantly affected in 2009 by the more challenging operating environment. Retail loan balances more than doubled between end-2005 and end-9M08, as shown in Chart 6. Retail loans increased by 46% in 9M08 (2007: 29%; 2006: 23%). Fitch notes that at USD61bn at end-9M08, UAE retail loan balances are the highest in the GCC, although the total population was estimated at only 4.5m at end-2008. The agency is concerned that this rapid recent growth is likely to have strained risk management, with the potential for operational risk losses and control failures. The agency notes that



overall, retail loans have remained at around 25% of total loans in the banking system, as shown in Chart 6; this is a fairly high level of exposure. Fitch notes that the UAE banking system was the only GCC banking system where retail loans increased as a share of total loans in 2008. Retail loans are often overstated in bank financial statements in the UAE due to the inclusion of retail loans for business purposes (SMEs) with consumer finance; Fitch considers these classifications opaque.

In the UAE, the major retail franchises include Emirates NBD, the largest UAE bank (Emirates Bank International, 'AA-' / Outlook Stable), National Bank of Abu Dhabi ('AA-' / Outlook Stable), Mashreqbank ('A+' / Outlook Stable), National Bank of Ras Al Khaimah (Rakbank, 'A-' / Outlook Stable) and Abu Dhabi Commercial Bank (Support Rating '1'). Rakbank is the only bank rated by Fitch in the GCC that has a predominantly retail focus. Fitch notes that Rakbank's performance in 2008 was not significantly negatively impacted by the increasing impairment charges. However, Fitch believes the full impact of rising retail defaults will be felt in 2009 and

Rakbank, and many other UAE banks, have accordingly tightened their lending criteria.

In the UAE, banks are regulated by the Central Bank of the UAE (CBUAE). There are no prudential regulations on DSCRs, maturity of exposure or refinancing. Fitch notes that regulation is not as rigorous as in certain other GCC markets. A UAE-wide credit bureau requiring mandatory membership by all providers of consumer finance has not yet been established. The agency notes that a draft law was approved in March 2009 by the UAE Federal National Council to establish a partly government-owned company to provide the services of a credit bureau to local banks. Fitch believes that the quality of underwriting in the UAE retail banking sector would benefit from access to quality data from such an institution.

The UAE has one of the highest expatriate populations in the world, estimated at more than 80% of the total. An expatriate's residence visa in the UAE is nearly always linked to his or her employment. A growing number of redundancies are occurring in sectors such as property and tourism, where prospects have been negatively affected by the global recession. This is likely to result in increasing defaults as expatriates leave the UAE. Following redundancy, expatriates normally have only one month to look for another job. The UAE authorities are considering allowing a longer grace period of three months in which people made redundant can look for other jobs.

Personal loans constitute the largest retail exposure for most UAE banks and are secured by salary assignment. High DSCRs of around 65% are available from many UAE banks. Fitch considers the level of leverage available to local retail customers to be high in the absence of a credit bureau and in a relatively high inflation environment (2008: 13.0%).

Most personal loans are made with the assignment of the customer's salary to the bank. However, as most customers are expatriates, and as redundancies increase, the benefits of salary assignment are weakened. Attempts by local banks to enforce loans overseas are legally complex and costly, and recoveries are therefore minimal. Most banks also require post dated cheques in retail loan transactions; bouncing a cheque in the UAE is a criminal offence which can result in a gaol sentence.

Fitch believes that there is significant potential for UAE banks' residential mortgage exposure to lead to increasing impairments. Amlak and Tamweel (rated 'A' / Rating Watch Evolving), the Dubai-based mortgage companies which hold the majority of the local residential mortgage market between them, have suffered severe stress to their funding and liquidity mainly due to their reliance on short-term wholesale funding. Amlak announced that it had stopped its mortgage lending in Q408. Tamweel has significantly reduced its lending. Both are being rescued by the UAE Federal Government and the Rating Watch Evolving on Tamweel's IDRs reflects uncertainty over its future ownership. This demonstrates the pressure the local mortgage market is under and Fitch expects the Dubai property market to come under increasing stress in 2009 with further price declines as the apparent Dubai property market bubble deflates. Most UAE banks offer residential mortgages; this market is mainly focused on Dubai. Fitch notes that for most banks mortgage lending is not a large part of the overall loan book, at around 5%, reflecting the nascent local market. However, many local banks were lending up to almost 100% loan-to-value mortgages in H108, although lending criteria has since been tightened in most cases. While new laws in Dubai in 2006 clarified certain legal uncertainties over registration of property ownership, this framework, as well as the young market, remains untested. UAE banks have so far suffered negligible mortgage delinquencies, but realisation of collateral may be difficult and banks' experience of collateral realisation is limited.

Amlak and Tamweel hold the majority of the UAE residential mortgage market between them. Amlak had total mortgages of USD2.7bn and Tamweel had total

mortgages of USD2.7bn at end-9M08. However, both Amlak and Tamweel are finance companies licenced by the CBUAE. Their large residential mortgage books are not included in banking system retail loans in Chart 6. Finance companies may extend retail credit but can not accept retail deposits in the UAE. There were 16 finance companies with licences from the CBUAE at end-Q108, including Amlak and Tamweel, but Fitch understands that further licences have since been granted. The CBUAE does not publish data on finance companies. Some are subsidiaries of banks, like HSBC Finance Company Ltd and Osool (a subsidiary of Mashreqbank). Some are not focused on retail lending, like Maf Orix Finance, which finances industrial equipment. However, the majority of UAE finance companies do provide personal loans, credit cards and mortgages. These companies are not as strictly regulated as the local banks and Fitch notes that they are often more aggressive in pricing and underwriting. Only five of the 16 finance companies are publicly listed and are therefore required to publish audited financial statements. Amlak and Tamweel have systemic importance to the UAE banking system but disclosure requirements are low for the finance company sector, adding an extra layer of opacity and uncertainty in analysing the UAE retail sector.

Fitch believes these factors result in a substantial risk of potential problems for UAE banks in the medium term.

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