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How are banks in the Gulf dealing with large-scale financial defaults?

Following the financial crisis of 2008-2009 and the collapse of the construction sector in the Gulf (with some exceptions), regional banks have a growing volume of non-performing loans. The majority of these loans were extended to private companies based in the region to finance large-scale projects, with credit facilities secured against either personal guarantees or equity in unquoted companies. Difficult market conditions and, in some cases, poor investment decisions by executives, have left banks in the Gulf exposed to significant liabilities.

The immediate default response has been to launch legal proceedings against the borrower. Once banks act quickly and demonstrate their willingness to pursue local assets, this can be an effective first step towards debt recoveries (and at times this can be achieved through a settlement). This strategy applies the right amount of pressure on the debtor and communicates the bank's determination and seriousness to pursue assets.

In some cases, however, local assets may not satisfy the exposure, and this will weaken the bank's ability to reach a settlement. This is either because the exposure is higher than the aggregate value of recoverable assets, or the assets to which attachment can be made have been liquidated or sold before the default occurred – a practice we have seen in the region. Although this complicates the bank's effort to make recoveries, there is an opportunity to search for assets in foreign jurisdictions to which liability can be extended, at times taking us to other countries in the Gulf, Europe or the United States, depending on the business profile and modus operandi of the debtor.

Asset search programs are often complex and involve undertaking work in multiple jurisdictions, and this requires a unique blend of investigative skills and forensic capabilities as well as knowledge of and access to markets – and some banks in the region require external support to implement a successful asset search program.

Debtors sometimes employ various schemes to shield assets from creditors and we have seen evidence of transfer of assets to third parties fronting for debtors as well as the use of sophisticated schemes to obscure ownership through off-shore vehicles and complex corporate structures. This is precisely the reason why a detailed review of available materials, including financial statements, transactional documentation as well as targeted market intelligence, are all necessary to produce an accurate chain of events to reverse engineer the transfer or concealment of assets and to pierce the corporate veil.

As banks work through the most effective strategy to pursue assets, external and independent support becomes necessary. The provision of accurate evidence and third party expert reports will only facilitate attachment orders and seizure of assets. Once assets are identified and profiled, (profiling is necessary to understand their status and value), banks will also require advice on how to obtain freezing orders against these assets in foreign jurisdictions – and some jurisdictions in the Gulf, for example, are more difficult to penetrate than others.

Our experience suggests there are numerous examples of successful international asset search programs launched by banks in the Gulf. From the outset, the key is to develop and implement an asset search and litigation support program that supports the bank's overall strategy.

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