

Banking & Finance

# The New UAE Movables Security Law

## What hasn't changed...

October 2020

The New Law (as defined below) was issued on 28 May 2020, came into effect in June 2020 and replaces the Old Law (as defined below). This memorandum is the first in a series of four memoranda and summarises the areas that have not changed. Our subsequent memoranda will look at the positive changes brought in by the New Law, the key issues for financiers and (for those wanting to get into the detail) a more detailed summary of the New Law.

### Speed read

UAE federal law No.20 of 2016 in relation to the charging or pledging of movables as security for indebtedness (the **Old Law**) was a significant development in the UAE banking and finance legal landscape. It gave rise to a significant change in the practice of taking security over movable property in UAE banking and finance transactions.

UAE federal law No.4 of 2020 in relation to securing the rights in movables (the **New Law**) repealed the Old Law. It continues to grant a number of welcome benefits enshrined in the Old Law (as amended by UAE federal law No.24 of 2019 (the **Old Amendment Law**) including:

- generally speaking, assets that were pledgeable under the Old Law continue to be capable of being the subject of a security right under the New Law and a number of assets that were not pledgeable under the Old Law continue not to be capable of being the subject of a security right under the New Law;
- the ability to take better quality security over bank accounts and (to the extent previously required for obtaining financier-friendly security) should spell the end of the need for an offshore account pledge;
- the ability to grant security over qualifying property in favour of natural persons, corporates and non-licensed banks or financial institutions (whether nationals or not) as well as licensed banks or financial institutions (although, generally, we have referred to them as security agents in these memoranda for ease of reference);
- the ability to take security over future qualifying property;
- permitting non-possessory pledges and reducing other administrative issues (including the need for security contracts to be in Arabic or notarised);
- a movables registry that is searchable by third parties and grants the right of priority of proceeds of enforcement based on the order of registration;

- maintaining the principle of the self-help regime enacted under the Old Law for the enforcement of qualifying security (as well as the court enforcement and auction process); and
- continuing to provide a more useful form of security interest than a commercial mortgage, making it preferred by financiers.

However, the New Law continues to require new security contracts over certain replacement security assets.

## Introduction

The New Law was issued on 28 May 2020, published in the Official Gazette in June 2020 and came into force with immediate effect. The New Law replaces and repeals the Old Law, which was issued on 12 December 2016, published in the Official Gazette on 15 December 2016, came into force on 15 March 2017 and was subsequently amended by the Old Amendment Law.

A number of the legal and practical issues that we had identified in the Old Law were remedied by the Old Amendment Law. For example, whilst Article 10(1) permitted (for the first time in the UAE) the ability to take security over future assets, Article 10(3) was originally drafted to require the re-registration of any such assets once they came into the possession of the security provider. In our view, this left a question mark over whether financiers had effective security over such assets without the need for further action. The amendment to Article 10(3) under the Old Amendment Law that removed the requirement for re-registration was a welcome clarification.

In our view, those involved in UAE finance transactions should take comfort that the New Law continues to provide the following features brought in by the Old Law:

- generally speaking, assets that were pledgeable under the Old Law continue to be capable of being the subject of a security right under the New Law and a number of assets that were not pledgeable under the Old Law continue not to be capable of being the subject of a security right under the New Law;
- it maintains the better quality security over bank accounts enacted under the Old Law and (to the extent previously required for obtaining financier-friendly security) should spell the end of the need for an offshore account pledge;
- it continues to allow the grant of security over qualifying property in favour of natural persons, corporates and non-licensed banks or financial institutions (whether nationals or not) as well as licensed banks or financial institutions (although, generally, we have referred to them as security agents in these memoranda for ease of reference);
- it continues to permit security over future qualifying property;
- it continues to permit non-possessory pledges and reduces other administrative issues;
- generally speaking, the contents of a security contract remain the same;
- it continues to permit a publicly searchable registry, granting the right of priority of proceeds of enforcement based on the order of registration;
- it continues to require new security contracts over certain replacement security assets;
- it maintains the principle of the self-help regime enacted under the Old Law; and
- it continues to provide a more useful form of security interest than a commercial mortgage, making it preferred by financiers.

## We examine each of these issues below.

### What assets can be subject to a security right?

Generally, under Article 3 (*Property that may be subject of a security right*) of the New Law, the types of assets that were capable of being pledged under the Old Law can still be subject to a security right under the New Law, including:

- receivables;
- accounts in credit with banks (including current and deposit accounts);
- bonds and documents transferable through delivery or endorsement, which prove the entitlement to an amount or ownership of goods (including the commercial paper, bank deposit certificates, documents of carriage and goods deposit certificates);
- equipment and work tools;
- material and moral elements of the business undertaking;
- goods intended for sale or renting, raw material and under manufacturing or transformation;

- agricultural products, animals and their products (including fish and bees);
- “Immovable Property by Allocation” (similar to the English law concept of a fixture located on real estate); and
- movables that UAE laws stipulate are capable of being the subject-matter of security under the New Law.

As was the case under the Old Law, the most important point is that Article 3 (*Property that may be subject of a security right*) of the New Law permits the creation of a security right over all specified property. It does not refer to all “rights”. This is an important distinction, because (in relation to contractual rights) it is the right to the proceeds or receivables of a contract and the right to claim the proceeds or receivables that is capable of being the subject of a security right. In our view, other contractual rights continue to be outside the scope of the New Law and any security in relation to such contractual rights should continue to be taken by way of an assignment.

Under the Old Law (prior to the Old Amendment Law), we considered that if an account goes into overdraft it would no longer be subject to the security right. This was because the Old Law referred to “accounts in credit”. As such, we recommended that a fresh security right be taken once the account went back into credit in order to have an effective security right. In practice, most commercial banking and finance transactions expressly prohibit bank accounts from going into overdraft, so this was unlikely to give rise to a major concern for financiers. However, the amendment to Article 10(3) (*Effectiveness of the pledge right in relation to third parties by registration*) of the Old Law by the Old Amendment Law meant that, since the ability to take security over future assets became more certain, retaking such security became unnecessary. The New Law reflects the Old Amendment Law in this respect.



### What assets cannot be subject to a security right?

As was the case under Article 4 (*Assets over which the creation of no pledge right is allowed*) of the Old Law, Article 4 (Property excluded from provisions of the law) of the New Law provides that the New Law does not apply to:

- movables which the applicable legislation requires the registration of security rights in registers specific to such movables (which has been moved from Article 2.2 (*Scope of Application*) of the Old Law);
- workers’ expenses, wages, salaries and compensation; and
- public property, waqf endowments and funds of foreign diplomatic and consular missions and international governmental organisations.

Movables that are required by law to be registered in a specific register would include shares and share pledges that are registered at the relevant department of economic development, vehicles registered at the traffic department and ships or aircraft, taking these assets outside the New Law. In addition and as was generally the case under the Old Law, the New Law only applies to certain qualifying movable property and so will not apply to immovable property such as land interests (other than “Immovable Property by Allocation”).

### Better security over bank accounts

The Old Law also sought to answer some of the issues surrounding taking security over fluctuating account balances. In the past, there was concern that, when an account balance changed, the account balance became a different asset requiring the account balance to be repledged in order to grant effective security over the bank account. This was a rather burdensome task in relation to bank accounts that fluctuate regularly... and a pointless task at that. It was also challenging for financiers to get the full benefit from account security, given that the hardening periods on insolvency would potentially restart from the date of the repledging. This meant that the security was unlikely to be effective at the very moment it was needed by the security agent.

Article 3 (*Assets that may be pledged*) of the Old Law sidestepped this issue and made it clear that an account in credit (rather than the balance of the account) can be pledged, meaning that an effective pledge over accounts in credit could now be taken. The New Law affirms this position.

## The end of the offshore account charge?

Prior to the Old Law and as a result of the issues surrounding the ability to grant security over fluctuating account balances under UAE law (as described above), internationally financed transactions in the UAE often required the borrower to open bank accounts in more creditor-friendly jurisdictions where security over fluctuating balances was effective (such as England). The purpose was to sweep the excess cash from UAE bank accounts to that new bank account and to grant security over that new bank account. Apart from the fact that there were additional transfer fees to be paid and additional account bank roles on transactions to be paid, this structure had economic consequences for the UAE – by taking this cash offshore, it deprived UAE banks of the ability to make returns on the additional deposits or to use the deposits towards their capital adequacy ratios.

As a result of the issues highlighted above, the fact that accounts in credit (rather than balances of accounts) can now be subject to a security right, together with the self-help enforcement remedy under Article 28(1), should mean that (absent other considerations) the offshore account charge is also a thing of the past in relation to UAE financings. Again, we have seen this become an increasing norm since the Old Law and expect this to continue to be the case under the New Law, although not all international project financings have reflected this structure.

## Security over future movable property

Article 3 (*Property that may be subject of a security right*) of the New Law states that “any movable property or a part thereof may be under Pledge or an indivisible right therein, whether current or future.” This is drafted particularly widely. The reference to future movable property means the ability to grant security over future movable property remains a key cornerstone of the New Law.

Article 17.4 (*Effects of enforceability against third party*) of the New Law includes a new provision that was not included in the Old Law (namely “the priority of security right shall include all movables constituting the property serving as security and described in the registration registered in the [movables registry], whether owned by the security provider or established before or after the date of registration”). This simply re-enforces the ability to

take security over future assets established under Article 3 of both the New Law and (following the Old Amendment Law) the Old Law.

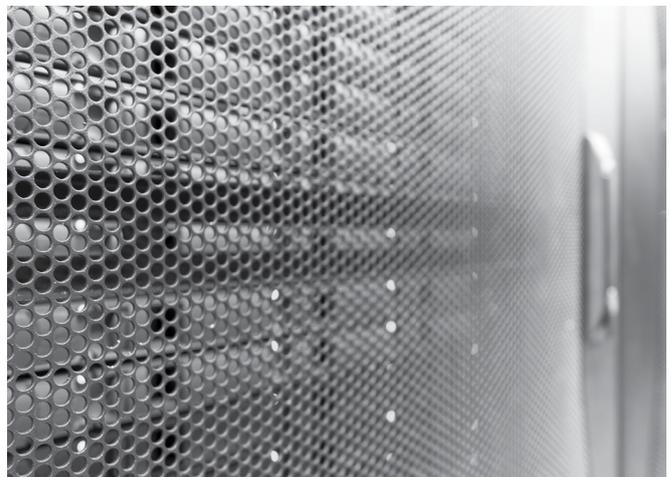
## Who can benefit from a security right?

Historically, registered security interests in the UAE could only be granted in favour of banks and financial institutions licensed in the UAE. As a result, foreign-registered financial institutions, corporates (whether incorporated in the UAE or abroad) and individuals (**Excluded Beneficiaries**) could not benefit from registered security interests. Instead, where Excluded Beneficiaries wanted to benefit from UAE law security that required registration, the practice to date has been to appoint a bank or financial institution licenced in the UAE to act a security agent on its behalf.

However, as was the case in under the Old Law, the New Law is silent as to the identity of the beneficiary of a security contract, meaning that it is now possible to grant security over qualifying property in favour of Excluded Beneficiaries (as well as UAE licenced banks or financial institutions). Notwithstanding this, we have referred to security agent in these memoranda for ease of reference as that is still likely to be the most common beneficiary of a registered security contract.

## Who can grant a security right?

The New Law defines a security provider as “a person having a right or authority to effect dispositions over the property serving as security who creates the security right in order to secure his obligations or the obligations of a third party.” As a result, as was the case under the Old Law, it remains possible for a non-UAE person or entity (as well as a UAE person or entity) to grant a security interest over relevant assets.





## Removal of the need for possession and other administrative issues

Prior to the Old Law, the only way to take security over certain assets was:

- by way of a possessory pledge, which required the security agent to take possession of that asset under Article 165 of the Commercial Code and Articles 1307 to 1332 of UAE federal law No.5 of 1985 (as amended) (the **Civil Code**), but this was often not commercially acceptable or practicable (especially when that asset was required by the security provider in the operation of its business) and so was often unperfected; or
- (more often used in financing transactions) by way of a commercial mortgage under Articles 49 to 56 of the Commercial Code, but this was cumbersome to execute and perfect due to the need for advertisement in newspapers, notarisation, registration and the maximum registration period being five years (albeit renewable).

In this regard:

- Article 2 (*Scope of Application of the Law*) of the New Law and Articles 5.1 and 5.2 (*Non-possessory pledges*) of the New Law make it clear that the ability to grant a security right over the qualifying property can be effected through registration rather than through the transfer of possession – as a result, the New Law applies to possessory as well as non-possessory pledges;
- Article 3 (*Conclusion of the Pledge Contract*) of UAE Council of Ministers decision no.5 of 2018 in relation to the Old Law (the **Old Regulation No.5**) (which remains in force until the new regulations are enacted) makes it clear that the

security contract does not need to be notarised - it only needs to be in writing, which includes communications exchanged by fax, e-mail or other means of communication;

- the New Law does not refer to any security contract needing to be advertised or notarised prior to registration; and
- Article 5(3)(e) (*Registration Procedures*) of Old Regulation No.5 requires a registration period to be specified - we expect this to be by reference to the maturity date of the debt rather than an arbitrary five-year period for a commercial mortgage.

## Content of security contracts

As was the case under the Old Law, the New Law sets out a number of requirements that security contracts under the New Law must contain. As a result, security contracts will need to be drafted to ensure that they comply with the requirements of the New Law and (when enacted) the new regulations in order to avoid the security provider (or unsecured third party creditors) from asserting that the security contract is void or voidable.

In light of the requirements of the Old Law, we considered that a stand-alone movables security contract that was compliant with the Old Law and the old regulations should be developed. In order to assist clients and keep legal transaction fees to a minimum, we prepared a standard form precedent for use in transactions. We have updated our standard form precedent to reflect the changes to the New Law, but it will need to be updated further once the old regulations have been replaced with then new regulations and as market practice evolves.

## A publicly searchable movables registry

Prior to the Old Law, information in the UAE corporate registries has been proprietary to the company or other entity to which it relates and has not generally been made available by way of a public company search. To the extent that any such search was carried out, it was only possible on the basis of a notarised power of attorney from the entity concerned. As a result, it was not market practice to conduct searches of registries prior to financiers taking security. Instead, financiers had to rely on representations, notaries willing to notarise commercial mortgages and share pledges (often with the requirement to advertise the security in national newspapers), land registrars willing to register mortgages over real estate interests and third parties not objecting to the notices of assignment. As a result, it was becoming increasingly market practice for the perfecting of security to be a condition subsequent to the making financing available, meaning the risk of adverse disclosures became a financier-risk.

However, Article 7 (*Right of access to the register*) of the New Law provides that:

- (in all cases) the public may have access to the basic information contained in the movables registry in accordance with the new regulations (with the old regulations applying until the new regulations come into force); and
- the public may request a paper or electronic report of the information contained in the movables registry.

As a result, the continued ability to access a public register is a welcome measure, aimed at speeding up taking security in banking and finance transactions, as well as giving financiers the ability to diligence whether qualifying assets are already encumbered.

## What assets can be registered?

Article 6 (*Register Establishment*) of the New Law (similar to the Old Law) provides that the movables registry should be created and that the new regulations will set out how the movables registry will work. Further, Article 12 (*Registering the Notice*) of the New Law provides that registration will be made through the movables registry in accordance with the new regulations.

The old regulations continue to apply until the new regulations come into force. However, we are working

on the assumption that the registry under the Old Law will continue to be the same registry under the New Law (although we will need to wait for the new regulations to be issued to confirm). However, generally, only security rights can be registered.

## Effectiveness of the security right through registration

Article 10(1) (*Means of rendering the security right effective in relation to third parties*) of the New Law provides that the security right is enforceable against third parties by registration of the notice in the movables registry.

Whilst the registration of the security right is effective against third parties, it is not clear whether security over contractual rights that are capable of being subject to a security right under the New Law will be binding against the counterparty obligor of the underlying contract. In any event, we anticipate that banks will still require confirmation from a counterparty obligor that it will make payments to the bank accounts controlled by the security agent. In practice, this is likely to mean that notices (and, where relevant, acknowledgments) of the security right will still be sent to (and, where relevant, received from) an underlying counterparty, as was previously the practice.

The exception to this is if a previous security contract has already been registered at the movables registry. In this case, it is not clear whether (as between the parties to the security contract as opposed to third parties) the contractual rights in a non-possessory security contract remain enforceable obligations unless also registered. Our view is that they will remain enforceable as between the parties, but (unless registered) will risk being subject to being set aside on an insolvency of the security provider, making the property available to the general pool of unsecured creditors.

## What is the benefit of registering the security contract?

There continue to be a number of benefits to registering a security contract at the movables registry, which include:

- the security agent's priority over other creditors in obtaining satisfaction of its rights from the secured property under Article 17(1) (*Effects of enforceability against third party*) of the New Law – such priority is generally based on the date and time of the registration of the security contract;

- the provision of notice to third parties, so that competing security interests are less likely to be granted – in particular, Article 48 (*Past transactions and regularisation*) of the New Law provides that any security agent may register the security rights resulting from any transaction made prior to the issuance and effectiveness of the new regulations without the need of the approval of the security provider, provided that such rights are registered within six months from the date of effectiveness of the new regulations, with the priority of such rights determined from the date they become enforceable against third parties under the law governing such rights or otherwise as from the date they are registered;
- the security agent being able to track/follow the secured property to whoever is holding it under Article 18(3) (*Right of tracking*) of the New Law;
- the priority over the secured property extends to the “returns” on the secured property under Article 11(1) (*Effectiveness of the security right in relation to returns*) of the New Law (previously Article 19(1) (*Priority over the returns on the pledged property*) of the Old Law); and
- the security agent being able to exercise self-help remedies as well as enforcement through a court enforcement process.

As was the case under the Old Law, the right of tracking can be contracted-out of under Article 18(2) (*Right of tracking*) of the New Law. Generally, we expect that financiers will only agree to this at the time of disposal of the secured property rather than a blanket waiver being granted in any security contract.



## The need for an addendum for replacement security assets

As was the case under the Old Law, the priority over the “proceeds” of the secured property is not as extensive as the English text would suggest. The Arabic phrase suggests this is limited only to the “returns resulting from a disposition effected over” the secured property. Accordingly, if the secured property was a machine for rent, the rental value of the machine would be secured property under Article 11(1) (*Priority over the proceeds of the secured property*) of the New Law. This distinction is important because under Article 18(1) (*Right of tracking*) of the New Law the disposal proceeds are subject to the security right through tracking. Furthermore, under Article 11(2) (*Priority over the proceeds of the secured property*) of the New Law (previously Article 19(2) (*Priority over the returns on the pledged property*) of the Old Law) the security right over the “returns” are forfeited if the security agent’s right is not registered at the movables registry within 15 working days from “the date of receipt” of such “returns” by the security provider, unless the returns are cash and recognisable or described in the registration. As a result, financiers will want to ensure that any in rem returns generated by secured property are either covered by the original security right and registered or a new security right or addendum is required to be taken and registered each time such in rem return is generated.

## Self-help remedies

Prior to the Old Law, UAE security interests could generally only be enforced through a UAE court auction process. This increased the time for enforcement and risked the value of the secured assets reducing during the auction process (e.g. publicly traded shares) at the very time the financier needed access to the cash generated from the secured assets. Exceptions to this include assignments (noting that assignments under UAE law are normally absolute assignments (that can be enforced on a self-help basis) rather than security interests) and limited rights in relation to shares under Article 81 of the UAE commercial companies law.

Articles 26 (*The right to propose the vesting of ownership of the pledged property*), 27 (*Right of consensual enforcement against the pledged property*) and 28 (*Right to enforce where the pledged property is instruments in writing or accounts in credit*) of the Old Law permitted security interests to be enforced on a self-help basis. As was the case

under the Old Law, one of the most significant developments continues to be the rights to self-help under the New Law. We can see a world in which security agents use these as a meaningful enforcement tool. However, security agents may continue to be nervous about using them due to the potential associated liabilities.

Article 26 (*Offer to vest ownership of the secured property*) of the New Law continues to provide that the security provider and the security agent may agree to vest ownership of the secured property in the security agent.

Article 27 (*Right of unilateral enforcement against the property serving as security*) of the New Law allows the security agent to take possession of the secured property and sell it within the period specified in the notice provided to the security provider and the borrower, subject to the conditions stated in Article 27.

Article 28 (*Right to enforce where the secured property is a Receivable, written bond or account in credit*) of the New Law provides that the security agent can enforce the secured property without resort to the court:

- (if the secured property is an account in credit with a bank) through set-off (Article 28.1) or (if the account is with another bank) claimed;
- (if the secured property is a written bond or document transferable through delivery or endorsement) by disposing of the secured property through its delivery or endorsement if its value is equal to the security right or by fulfilling the amounts or owning the goods represented by such bonds and selling them and fulfilling the security agent's rights from the sale price (Article 28.2); and
- (if the secured property is an account receivable) through applying the account receivable against the secured liability or selling the accounts receivable (Article 28.3).

As was the case under the Old Law, again, the self-help remedy under Article 28 (*Right to enforce where the secured property is a Receivable, written bond or account in credit*) of the New Law is unlikely to result in a significant change to current practice, because:



- it was usually the case that the security agent and the account bank were the same (especially in structured financings) and so the security agent would simply be entitled to use its parallel debt claim and its banker's right of set-off over any bank accounts rather than through enforcement of the account security itself;
- (whilst the New Law allows the security agent to claim a secured account held by a third party account bank) it is not clear whether the account bank would still be able to apply its banker's right of set-off (unless waived) in priority to the claim by the security agent - we expect that financiers will still want to ensure the account bank and the security agent are the same where possible or notices sent to (and acknowledgments received from) the third party account bank waiving any such right; and
- (as a result of (what should now be historic) issues around granting security over fluctuating account balances) security agents took an absolute assignment of rights relating to the secured accounts, allowing them to enforce their security without recourse to the UAE courts<sup>1</sup>.

<sup>1</sup> This was questionable where the security agent and the account bank were the same person due to the doctrine of merger (i.e. if rights are assigned to the same person that owes the obligation, those rights and obligations are extinguished) even where the security agent held those rights as agent for the secured creditors (of which it was one) rather than solely for its own benefit.

As a result, this is unlikely to be game-changing in relation to account security, but an enhancement to existing practice.

As was the case under the Old Law, each of these self-help remedies is in addition to the right to resort to the UAE courts under Chapter Two (Enforcement through the courts)/Articles 29 et seq of the New Law.

### The end of the commercial mortgage?

In light of the fact that, as was the case under the Old Law:

- a security contract under the New Law does not need to be notarised or executed in Arabic (whereas a commercial mortgage does);
- a security contract under the New Law does not need to be subject to the newspaper advertisement process (whereas a commercial mortgage does);
- a security contract under the New Law does not have a maximum five-year registration period (whereas a commercial mortgage does (albeit renewable));
- the ability of a security provider under the New Law

(unlike a commercial mortgage) to grant security over future-acquired property and to afford it the same priority on enforcement as property existing on the date the security right was entered into;

- (unlike a commercial mortgage) the Movables Registry (at least certain basic details) is capable of being searched publicly;
- (unlike a commercial mortgage) the ability of the security agent to execute self-help remedies; and
- (unlike a security contract under the New Law (as was the case under the Old Law)) a commercial mortgage can only be enforced after giving the debtor eight days to pay the secured obligations following the debt becoming due and payable under Article 53 of the Commercial Code,

we consider that the Old Law has spelt the beginning of the end of the commercial mortgage. Since the Old Law, we have seen a significant shift in the UAE banking and finance community preferring to execute pledges compliant with Old Law instead of commercial mortgages. We expect this to continue under the New Law.

**Please do contact us if you would like to discuss any of the issues raised in this memorandum or in relation to the New Law generally.**

### KEY CONTACTS



**Stephen Knight**

Partner

D +971 2 613 1521

M +971 52 604 8541

[Stephen.Knight@dentons.com](mailto:Stephen.Knight@dentons.com)



**Paul Jarvis**

Partner

D +971 2 613 1519

M +971 56 683 0800

[Paul.Jarvis@dentons.com](mailto:Paul.Jarvis@dentons.com)

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