

Banking & Finance

The New UAE Movables Security Law

A further step forward

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 second in a series of four memoranda and summarises the positive changes brought in by the New Law. Our previous memorandum covered a summary of issues that have not changed and our subsequent memoranda will cover 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 practice on 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UAE federal law No.4 of 2020 in relation to securing the rights in movables (the **New Law**) repealed the Old Law (as amended by UAE federal law No.24 of 2019 (the **Old Amendment Law**)). It makes further positive changes to the Old Law including:

- confirmation of the ability to take security over future property;
- the ability to take security to secure future liabilities and potential all-moneys security up to a specified cap;
- the ability to take security over insurance proceeds (and not just insurance proceeds that relate to assets that are subject to a security right);
- the provision of an additional self-help remedy for receivables, bonds and accounts in credit;
- the potential ability to take security over foreign bank accounts (although there remain questions as to how this will work in practice);
- the removal of certain automatic cancellation of registration events and reduced liability for security agents for failure to cancel any registration; and
- clarification that any security right remains effective following the commencement of any process under UAE federal law No.9 of 2016 in relation to bankruptcy (as amended) (the **Bankruptcy Law**).

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 to remove the requirement for re-registration was a welcome clarification.

The rest of this memorandum sets out the positive changes brought in by the New Law.

Confirmation of the ability to take security over future property

Article 3 (Assets that may be pledged) of the Old Law heralded much optimism in the UAE banking and finance community. For the first time under UAE law, it raised the prospect of future property (as well as current property) being capable of being secured effectively.

Prior to this, it was not possible to create a “universal” security under UAE law (such as the English law concept of a floating charge) and instead the assets subject to security or an assignment had to exist at the time the security or assignment was granted in order to be effective.

In practice, this meant that the security provider and the security agent had to enter into periodic addenda in relation to future-acquired assets and rights once they came into the possession of the security provider in order to create effective security or assignments under UAE law. This reflects the general principles set out in UAE federal law No.5 of 1985 (as amended) (the **Civil Code**).

Whilst (as was the case under the Old Law) the concept of pledging future property and rights under the New

Law is not all-encompassing like the English law floating charge (as not all assets or rights are subject to the New Law), the potential reduction in day-to-day administration required to grant security over most future property was attractive to all in the UAE banking and finance community due to the better security interest and reduced time and cost of complying with (or monitoring compliance with) finance documents.

Article 10(3) (*Effectiveness of the pledge right in relation to third parties by registration*) of the Old Law threw doubt on this by potentially requiring the re-registration of the pledge over new assets once they came into the possession of the security provider. This ambiguity was removed by the Old Amendment Law and the New Law affirms this position.

Confirmation of the ability to take security to secure future liabilities

Article 8 (*Security right establishment*) of the New Law now permits the security contract to secure one or more liability of any kind, whether current or future, ascertained or ascertainable, immediately operative or subject to a condition, fixed or variable. This is a new provision under the New Law. Previously, it was not possible under UAE law (including under the Old Law) to take security to secure future liabilities or all-money security interests. As a result, any increase to a facility size required the security to be refreshed to attach to any security interest.



However, now all-monies security is a possibility, provided that maximum recovery from the security asset is no greater than the secured amount referred to in the registration.

In addition, Article 17.3 (*Effects of enforceability against third party*) of the New Law includes a new provision that states that “*the priority of security right shall be extended to all secured liabilities, including the liabilities resulted after the security right becomes enforced against third party*”, making it clear that a security contract secures liabilities incurred after enforcement.

As a result, financiers wishing to take “*all-monies security*” could draft the “*secured obligations*” definition to capture “*all-monies*” and include a significantly greater amount in the secured amount referred to in the registration than the amount the financier is currently advancing. Whether this will be commercially acceptable to security providers (as it may restrict their ability to raise debt with other financiers) remains to be seen.

Confirmation of the ability to take full security over insurance receivables

Article 4 (*Property excluded from provisions of the law*) of the New Law (unlike the equivalent of the Old Law) no longer excludes “*dues of the insured or the beneficiary under an insurance contract unless the dues are returns on the pledged property*” from the ambit of the New Law. This is an important development.

The rationale under the Old Law was that (if an asset was pledged under the Old Law) any insurance proceeds should attach to that asset in the same way that any cash returns on the disposal of that asset would attach to that asset. From one view, that was a logical position to take. From another view, it meant that insurances in relation to assets that were not pledgeable under the Old Law (for example, real estate interests) could not be secured under the Old Law, as well as insurances that did not attach to relevant assets (such as business interruption insurance). This was the case even though they were still receivables and even though insurances that were non-pledgeable under the Old Law were not subject to any separate security regime (e.g. an insurance of real estate would not be mortgaged under a real estate mortgage) other than potentially a commercial mortgage. As such, financiers typically took a pledge under the Old Law (to the extent the insurance was

pledgeable under the Old Law) and then an absolute assignment over the insurance proceeds that were not pledgeable under the Old Law.

The New Law has done away with this artificial distinction and now provides much welcome clarity and ensures that insurance proceeds can be secured without the need for an absolute assignment to be granted.

In practice, this allows undisclosed financing structures to be effected without the need for notices and acknowledgments of security to be sent to insurers (which do not always have a great record of timely return) and will certainly help to speed up transactions and reduce administration. However, on disclosed structures or where the financiers require bespoke insurance provisions (including being named as co-insured), such as project financings, the change created by the New Law may just be one that excites the academic.

Additional self-help remedy for receivables, bonds and accounts in credit

In our first memorandum, we noted that the New Law continues to provide self-help remedies to security agents. In some respects, the New Law has improved the self-help remedies. For example:

- Article 28.1 (*Right to enforce where the secured property is a Receivable, written bond or account in credit*) of the New Law not only permits a security agent to apply the principle of set-off if the secured property is an account in credit with that security agent, but goes further and allows the security agent to claim the balance in an account if that account is secured property held with another bank; and
- Article 28.3 (*Right to enforce where the secured property is a Receivable, written bond or account in credit*) of the New Law now also permits security agents to apply secured accounts receivable against the secured liability or selling the accounts receivable.

Both of these further strengthen the quality of a secured creditor’s rights and is likely to increase the willingness to lend against secured receivables.

The potential to take security over foreign bank accounts

Article 3 (*Property that may be subject of a security right*) of the New Law sets out property that can be subject to a security right and includes “*accounts in credit with banks, including the current and deposit*

accounts". Previously "accounts in credit" and deposits in "licensed banks and financial institutions including current accounts and deposit accounts" could be pledged. As a result, the New Law appears to permit security rights to be granted over international bank accounts.

Having said that:

- it is not clear whether this will change anything in practice – whilst this could potentially be seen as overriding Article 18(1) (The application of the law in relation to place) of the *Civil Code* (which states that the *lex situs* shall be the law applicable to real property and that applicable to movable property shall be the law of the place where the movable was located at the time the relevant proprietary right was acquired), in practice security over foreign bank accounts is likely to fall under the jurisdiction of foreign courts; and
- a new Article 42 (*The Law Applicable to Security Interests on Intangible Assets*) has been added to the New Law (which provides that "as specified in the [new regulations], the law of domicile of the Security Provider shall apply to the creation of the Security Interest, its enforceability against third parties, priority, and execution of Security Interests against the Security, if it is an intangible immovable asset") and (therefore) potentially permits foreign laws to prejudice the ability of a non-UAE person to the grant of a security interest under the New Law.

Removal of certain automatic cancellation of registration and reduced liability for failure to cancel any registration

Article 16.1(d) (*Cessation of registration*) of the Old Law provided that the effect of registration shall be cancelled "if the [security agent] fails to fulfil his obligations after the registration of the security contract" or "if the period set in the [movables register] is expired, unless an extension is made before its expiration date". These provisions have been deleted in the New Law, providing security agents with the certainty that:

- the security agent breaching the security contract does not automatically give rise to the draconian remedy of removing its secured claim; and
- it can remedy the failure to renew any registration after the expiry of that registration, although this does give rise to some additional uncertainty in favour of any subsequent registered security right and its priority in relation to any earlier registered security right whose registration is renewed after its expiry date.

Further, Article 16.3 (*Cessation of registration*) of the Old Law provided that "if the [security agent] fails to cancel the registration within the period specified in [Article 16(2)], [the security agent] shall be responsible for indemnifying the security provider and principal debtor, or any third parties, as applicable, for any actual damage incurred by any of them as decided by the Court". The equivalent provision of the New Law now limits the security agent's liability to just the security provider, removing any express liability towards the principal debtor and any third party. Whilst financiers would have undoubtedly preferred this to go further, this is a welcome and logical change.



Clarification that any security right remains effective following the commencement of any process under the Bankruptcy Law

Article 30 (*Bankruptcy of the Pledgor*) of the Old Law provided that “none of the provisions on enforcement procedures against the Subject of a Pledge as set forth in this law shall apply where an actual reconciliation process, bankruptcy or the like is initiated against the Pledgor in accordance with the applicable laws.” This gave rise to a concern that once any procedure under the Bankruptcy Law had commenced, none of the enforcement rights

under the New Law were applicable even after any moratorium period under the Bankruptcy Law had ended.

Article 39 (*Bankruptcy of the Security Provider*) of the New Law has provided welcome clarification in this regard and provides that “the Security Interest effective against third parties under the provisions of this Law at the time of commencement of bankruptcy proceedings of the Security Provider shall remain enforceable against third parties and will retain the priority assigned to it prior to the commencement of bankruptcy proceedings.”

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.

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