THE NEW MOVABLES PLEDGE LAW: AND WHAT IT MEANS FOR SECURED LENDING IN THE UAE

4 SEPTEMBER 2018 • ARTICLE

In March 2017, a new Federal law came into effect providing a legislative framework for taking, perfecting and enforcing security over certain classes of movable assets in the United Arab Emirates ("UAE"). Federal Law No. 20 of 2016 on the Mortgage of Movable Property to Secure Debt (the "Pledge Law") is an exciting step in the legal landscape of the UAE that should promote greater certainty in commercial lending practices.

In March 2018, secondary legislation supplementing the Federal Law was published, and an online registry for registering mortgages under the Pledge Law, the Emirates Movable Collateral Registry (the '"Registry"), went live. The Registry provides for a centralised, federal, publicly-accessible online register that records and prioritises secured assets, which can be searched by the public.

The Instructions Concerning the Registry of Interests over Movable Property (Ministerial Decree No. 42 of 2018, the "Instructions") and the Executive Regulations for the Pledge Law (Council of Ministers Decree No. 5 of 2018, the "Executive Regulations") provide details as to how the Registry will be administered. Still, a number of questions remain unanswered over how the new system will work in practice. Emirates Development Bank ("EDB") has been tasked with managing the new Registry, and we have been in dialogue with EDB for guidance on some of the areas of the Pledge Law that require further clarification.

In the table below, we set out what the Pledge Law provides for, areas of uncertainty that remain as well as answers received from the EDB in response to our queries.

	POSITION UNDER THE EXISTING REGIME	**POSITION UNDER THE PLEDGE LAW**
Overview & types of security	**Possessory pledge**	**Movable & intangible assets**

In general, prior to the onset of the Pledge Law, the principal means of granting security over movable assets in the UAE has been by means of a possessory pledge under the relevant provisions of the UAE Civil Code (Federal Law 5 of 1985 (as amended) (the "Civil Code") and the UAE Commercial Code (Federal Law 18 of 1993 (as amended) (the "Commercial Code").

Commercial mortgages

Commercial mortgages over the movable assets of a business are provided for under Article 49 of the Commercial Code. This type of mortgage is a form of non-possessory lien and can be granted over tangible and intangible movable property; however it can only be granted to financial institutions licensed in the UAE.

Chattel mortgages

Tangible movable assets can also be pledged in the form of a chattel mortgage. The pledgee does not need to be a financial institution but it (or a third party acting on its behalf) must take custody of the asset.

Assets with 'special Registers'

The Pledge Law applies to a range of movable property including equipment and other tangible commercial assets and raw materials, as well as intangible assets such as receivables, bank accounts and shares. Article 3 provides a list of assets which may be subject to a security interest under the Pledge Law.

Non-possessory & possessory liens

The Pledge Law introduces a new form of non-possessory registered security over movables assets, so that mortgaged assets can now remain with the borrower (Article 5). However, it also recognises possessory liens and allows for them to be registered in the Registry (Article 44).

Proceeds of sale

A pledge can extend to the proceeds of mortgaged property. By registering a mortgage right, a mortgagee obtains a secured right to the proceeds of the mortgaged property (Article 19).

Bank accounts & fluctuating balances

Pledged property can include changing property too, such as bank accounts with fluctuating balances.

Exclusions

Property that may not be the subject of a mortgage under the Pledge Law includes objects intended for personal or home use (unless these are being mortgaged in order to finance their purchase), insurance entitlements, wages, public funds (which are not defined) and future rights under a will (Article 4). Specific assets such as vehicles, ships and aircraft, for which special 'Registers' already exist, are also excluded from the Pledge Law (Article 2(3)).

Security granted over specific assets, such as vehicles, ships and aircraft, is effected by way of registration of a mortgage in special registers with their own registration requirements. For instance, mortgages over ships (over a certain tonnage) are registered with the National Transport Authority; aircraft mortgages are registered with the General Civil Aviation Authority (the “GCAA”) and security interests can also be registered with the International Registry (the “IR”) under the Cape Town Convention (the “CTC”).

Existing laws governing mortgages and pledges under the Civil Code and the Commercial Code remain in place and the Pledge Law has not repealed them, so pre-existing mortgages and pledges remain valid (though see the ‘Existing security’ section below).

Other registrable rights

In addition to mortgage rights, other rights can be registered under the Pledge Law, including:

- the rights of a lessor in relation to assets leased under an operating lease of at least one year (Article 11(1)(a));
- the rights of an owner of goods placed for sale (Article 11(1)(b)); and
- the rights of a lessor in a financing lease (Article 11(1)(c)).

Future property

Future property (as well as changing property, such as inventory or fluctuating balances on a bank account) are not capable of being pledged or mortgaged; pledged or mortgaged assets have historically had to be described very specifically to avoid the pledge or mortgage being void for uncertainty.

It has been common for periodic supplemental agreements to be drawn up to update security packages when pledged assets have changed or new assets need to be secured, which involves considerable administration and cost given that each addendum is required to be notarised, published and registered.

Future property can now be pledged as security for a loan (Article 3).

The Executive Regulations provide guidance on describing future assets in the mortgage agreement including, by way of example, the following asset description: “*a statement indicating the creation of Pledge Interest over a specific category or class of movable property, whether present or future, such as the phrase ‘all equipment’ or ‘all present and future accounts receivable’*” (Article 4(1)(d)).

According to EDB, defining future property is a matter of agreement between the parties, and descriptions can be specific or generic.

The registration of all such pledges and mortgages must be renewed every five years, adding to the burdensome nature of this form of security

Free zones

The Civil Code and Commercial Code apply in the free zones other than the financial free zones (the Dubai International Financial Centre ("DIFC") and the Abu Dhabi General Markets, ("ADGM")), which have their own legal regimes.

Some other non-financial free zones have their own regulations for creating security interests. For example, in the case of Jebel Ali Free Zone ("JAFZ"), the Regulatory Decision for the Creation of a Register to Record Commercial Business Mortgages issued in February 2002 expressly provides for the application of various provisions of the Commercial Transactions Law to apply to commercial mortgages in the free zone.

Any reference to free zones is noticeably absent from the Pledge Law. EDB has, however, confirmed that, in its view, the Pledge Law applies neither to the financial free zones, nor to non-financial free zones such as JAFZ, the Dubai Multi Commodities Centre ("DMCC") or Dubai Silicon Oasis ("DSO").

EDB has also confirmed that the nexus for considering the application of the Pledge Law turns on the location of the pledged asset in question, so that an asset located in a free zone does not come within the definition of property that may be subject to a mortgage under the Pledge Law, even where the asset belongs to a company registered in mainland UAE. Conversely, a free zone company with a movable asset located on the mainland can pledge the asset as security under the Pledge Law.

Formalities

Creation of security & forms

Commercial mortgages are subject to stringent and cumbersome formalities. They must be:

1. written in (or translated into) Arabic;
2. executed before a notary public;
3. registered, by physical attendance, in a Commercial Register to be established by each of the seven Emirates (not all of the Emirates have done this); and
4. notice of the charge must be given by publication in at least one Arabic-

Creation of security & forms

To create a valid mortgage under the Pledge Law, the security agreement must:

1. be in writing;
2. include a description of the mortgaged property; and
3. include a declaration by the mortgagor relating to the rights of any other parties.

It is also worth noting that the formalities involved in respect of commercial mortgages under the previous regime do not apply to mortgages or pledges under the Pledge Law.

language newspaper two weeks before registration.

Where the pledged asset is not in the possession of the pledgor, one of the parties must also notify the owner of the asset, and the lender must then pay the mortgage fee (Article 8 of the Pledge Law).

The Executive Regulations provide detailed guidance on the forms that need to be completed in order to register security in the Registry; the Instructions provide even greater detail on the mechanics of the Registry (including in relation to fee payment methods and managing a client account balance). 'Publicity' and 'Notice' forms should include information about the parties and the pledged asset, including the duration of the Notice; the parties can elect whether to make all of the information available to the public or rather a selection of basic information only.

Anyone can access the Registry by creating an account.

Identity of mortgagee

A commercial mortgage can only be granted to financial institutions; chattel mortgages can be granted to mortgagees other than financial institutions.

Identity of mortgagee

The mortgagee is defined very generally in the Pledge Law as *"the creditor benefiting from the mortgage right"*. EDB has confirmed that the mortgagee can be a UAE or foreign entity or person. The nexus for the application of the Pledge Law turns on the pledged assets being located in the UAE.

Registration

Commercial registers for recording commercial mortgages have been created on an Emirate by Emirate basis, although not in all of the seven Emirates, and some of the free zones have their own registers (as is the case with JAFZ, see above). However, there is no federal registration system which can be searched.

Registration

	Special Registers for specific classes of movable assets, such as vehicles and aircraft, exist and have their own registration requirements.	Registration of the mortgage in the online Registry is not a requirement to create a valid mortgage, but it is required in order to perfect the security and make it effective against third parties (Article 9). The Pledge Law provides that no subsequent mortgage can be granted over the same property without giving notice of the first mortgage in the mortgagor's declaration (Article 10(2)).
	Priority There is no system for determining priority amongst mortgages and pledges.	**Priority** Priority is determined as follows: • for new mortgages, according to the date and time of registration in the Registry (Article 17(1)), unless the mortgagee waives its priority in writing and registers such waiver; and • for security interests that pre-date the Pledge Law and are subsequently registered, according to the date of creation (not registration) (Article 44(3)).
		Assignability A mortgage right created under the Pledge Law can be assigned by a mortgagee (without obtaining the consent of the mortgagor) and is registrable as an amendment to the existing registration (Article 14).
		Fees These are generally expected to be in the region of AED100 to AED200 per registration/declaration (but the exact amount will depend on the service requested).
Existing security	The co-existence of pledges made under laws other than the Pledge Law and those made and registered under the new system	Article 44 provides that possessory pledges which predated the Pledge Law could be registered in the Registry within one year of the coming into force of

	remains unclear. If pre-existing possessory pledges are not registered in the Registry, they presumably remain valid but risk losing priority against subsequent registered pledges made over the same asset.	the Pledge Law (i.e. by 15 March 2018) in order for those pledges to benefit from the provisions and protections of the Pledge Law. In such a case, priority is determined according to the date of creation of the mortgage right (not its registration in the Register). Given that the initial deadline for registering pre-existing (i.e. pre-15 March 2018) possessory pledges lapsed prior to the Registry going 'live', EDB have confirmed that that deadline has been extended until 28 February 2019.
Enforcement and self-help remedies	Enforcement of possessory pledges must usually be sanctioned by the court; secured assets must be sold via public auction; self-help remedies are generally not permitted under UAE law.	Self-help remedies are also available for the first time. In the event that the mortgagor violates obligations under the mortgage contract or if the contract is not implemented for any other reason, the Pledge Law provides for the sale of the movable property with agreement. In relation to movable assets generally, a mortgagee can seize the mortgaged assets and sell them at market value within ten days of being notified of the mortgagor being in violation of the pledge agreement (Article 27). The position is slightly different with regard to written bonds and bank accounts (Article 28), whereby self- help remedies are only available where the mortgagor or principal debtor has violated obligations under the mortgage contract (not where the contract is not implemented for other reasons). The mechanics of enforcing the security differ according to the type of asset in question, including: i. in the case of a pledged bank account, the mortgaged amount can be set-off or claimed

from other balances held by the mortgagee as the account bank;

ii. bonds or written documents are to be delivered or endorsed (only where their value is equivalent to the mortgage right).

Judicial remedies remain available too (Chapter 8 of the Pledge Law).

FOCUS: SHIPPING

As regards the shipping industry, we do not anticipate the Pledge Law having a significant impact, given that it is generally expected that ships are one of the asset classes that would be deemed to have their own separate 'Register' (in the UAE, the register maintained by the Marine Affairs Department of the Ministry of Communications).

However, the position as regards mortgages on ships that are not eligible for registration in the UAE under Article 18(1) of the UAE Commercial Maritime Law No. 26 of 1981, as amended by law No. 11 of 1988 (the "UAE Maritime Code"), is not entirely clear. The issue relates most importantly to ships that are owned by non-UAE entities but that call at ports in the UAE. Arguably, as such mortgages cannot be registered in a special 'Register' (i.e. under the UAE Maritime Code), they should fall within the scope of the Pledge Law. That, however, would leave us with the (quite unattractive) proposition that some, but not all, shipping mortgages would be registrable under the Pledge Law. This would also create potential conflict with the laws already in place dealing with priorities of claims over ships docked in the UAE. The general consensus, therefore, seems to be that the Pledge Law is not intended to apply to ships.

FOCUS: CONTAINER BOXES

The position as regards container boxes is also unclear. At any given point in time, a pool of container boxes financed by, and mortgaged in favour of, a lender, could be located in multiple jurisdictions around the world and/or in international waters. The sensitivities and considerations surrounding container boxes are therefore significantly different to other maritime assets.

For the purposes of the potential application of the Pledge Law, if this does in fact turn solely on the location of the asset, it would seem that the mere presence of a container box in the UAE would require registration in order to protect the mortgagee's interests and to enable the mortgagee to enforce against that box under the Pledge Law while it is located in the UAE. This may well be an unintended consequence of the Pledge Law which has been prepared without this particular asset class in mind.

FOCUS: AIRCRAFT

As with ships, it is generally expected that aircraft would be deemed to be outside the scope of the Pledge Law, on the basis that aircraft (and aircraft mortgages) are registrable in dedicated aircraft registers (in the UAE, with the GCAA). Mortgages over such aviation assets are, of course, also registrable under the CTC. This is the case with respect to both fixed-wing aircraft (whether commercial aircraft or corporate jets) and helicopters as well as, in the case of the CTC, aircraft engines.

The position may, however, be different with respect to other aviation assets that are not so registrable. For example, there is no specific engine register in the UAE, although dispositions in relation to aircraft engines are registrable with the IR under the CTC. Depending on whether or not the concept of the special 'Register' is interpreted so as to include international registries such as that under the CTC will determine whether security over aircraft engines should be registered under the Pledge Law.

A similar analysis is required with respect to helicopter engines, which may constitute an 'aircraft object' and, as a result, be registrable, under the CTC, depending on whether or not it is installed on the helicopter itself.

QUESTIONS TO BE CLARIFIED

Despite the promulgation of the Pledge Law and the Implementing Regulations, various substantive questions remain unanswered.

2. **Special 'Registers'**: As noted above, the scope of the concept of special 'Register' in the Pledge Law needs to be clarified, primarily which special 'Registers' and which 'dispositions' are foreseen by Article Does reference to special 'Registers' include national registers (such as the GCAA), international registers (such as the IR) for aircraft and international registers such as those operated by, for example, the Marshall Islands, the Bahamas, Panama and Liberia for the registration of ship mortgages? The fact that the Pledge Law refers only to 'electronic' Registers only adds to the confusion.
3. **Shipping and aviation assets and container boxes:** How will the Pledge Law be applied to these assets, in light of the difficulties noted above? The scope of the definition of special 'Registers' will directly affect whether aviation, maritime and other assets are intended to be registrable under the Pledge

- **Future assets:** Despite the fact that it is now possible to pledge future property as security for a loan, how will such pledging work in practice, as it is not entirely clear whether a floating charge (which crystallises over a changing pool of assets on default) can be registered?

1. **Self-help remedies:** How free of judicial sanction will the self-help remedies actually be (i.e. will the courts need to intervene in determining the market value of an asset subject to sale, or where a secured bond or written document that is being enforced exceeds the value of the mortgage right)?
2. **Existing legislation:** How will the Pledge Law co-exist with pre-2016 legislation, since the older legislation has not been repealed?

There is no doubt that some of these questions will only be resolved with time, as the new system is tested and utilised in practice, perhaps needing additional clarifying regulations to be issued.

CONCLUSION

The Pledge Law does bring the promise of a more modern and efficient system for registering and enforcing security over a range of movable assets, which is more in line with other developed jurisdictions.

For lenders, the Pledge Law should give comfort as to which assets can be secured, the process for securing such assets and clarity as to the priority of liens.

While self-help remedies are a welcome addition to the enforcement options available to lenders, it remains to be seen how the courts will support the concept in practice.

UAE companies should, as a result, find it easier to secure financing. They should also find it easier to pledge their movable assets as this can now be done without the need for physical delivery.

The fact that rights of lessors under both operating and financing leases can also be registered should be of benefit to parties involved in project and other structured finance transactions where such leases are frequently utilised.

That said, it is too early to tell how the Pledge Law will be implemented in practice by EDB, and interpreted by the courts, so it may take time before the regime in practice reflects that which the Pledge Law seeks to introduce.

This article was authored by Finance Partner Michael Savva and Alice Atkinson, a paralegal in our Dubai office.

KEY CONTACT

MICHAEL SAVVA
PARTNER • DUBAI

T: +971 4 278 2304

msavva@wfw.com

DISCLAIMER