

UPDATE AND INSIGHTS: UAE FINANCIAL LEASING LAW

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Further to our April 2019 Briefing on the issuance of UAE Federal Law No. (8) of 2018 on Finance Leases (the “Law”), we summarise some recent developments in the implementation of the Law, including under Cabinet Decision No. 56/2019 on the Record of Registration of Finance Lease Contracts on Movables (the “Decision”) and areas which still require further clarification.

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DEVELOPMENTS UNDER THE DECISION

- **Management of the Record:** By Article 2 of the Decision, Emirates Development Bank (“EDB”) has been appointed as the entity to manage the “Record” (i.e. the register being established for the registration of finance lease contracts concluded with respect to any movable property (“Contracts”) under Article 5(1) of the Law). This is useful as EDB also manages the Emirates Movable Collateral Register (the “EMCR”, being the register of securities under the UAE Movables Pledge Law (UAE Federal Law No. (2) of 2016) (the “Movables Law”). The Movables Law does allow for the “rights of a lessor in a financing lease” to be registered with the EMCR (Movables Law Article 11(1)(c)), so there was some concern that this would result in parallel registration regimes for finance leases under both laws. However, it is our

understanding that the existing EMCR software will be adjusted to accommodate registrations under the Law, so EDB will have oversight of registrations under both regimes within the same website or portal.

- **Record Data:** Article 3 of the Decision specifies the data to be recorded on the Record, which shall include (i) the subject of the Contracts, (ii) the Contract parties and their particulars, (iii) a description of the object of the Contract, (iv) the period of the Contract, (v) the Contract amount, (vi) the rights associated with the Contract and (vii) any other date required by EDB.
- **Record Fees:** Article 4 of the Decision states the fees payable to EDB in relation to actions taken on the Record, ranging from AED500 for a one-off registration of the lessor in the Record for the first time, to AED200 for the issuance of a registration certificate for a Contract, AED100 for applications to register a Contract in the Record, amend the Contract data in the Record, register an ownership transfer or lessee substitution in the Record and an extension of a Contract’s registration in the Record, and AED50 for the cancellation of a Record. These fees are broadly in keeping with the fees payable to EDB for actions taken on the EMCR under the Movables Law.

MATTERS FOR FURTHER CLARIFICATION

- **Parties' ability to derogate from requirements of the Law:** Parties to a Contract need the freedom of contract to derogate from the requirements of the Law, where agreed between them or where the leasing structure requires this, including the following:
 - While some provisions of the Law do specify that they apply "*unless otherwise agreed in the contract*", this is not the case in relation to one of the more contested provisions of the Law – the requirement for the lessor and the lessee is to give each other 60 working days' notice to terminate the Contract. While such a grace period may be useful for SME leasing transactions (which the Law appears to be aimed at), it is not suitable for highly structured, cross-border leasing transactions which will also be caught within the ambit of the Law, in which a lessor may wish to move quickly following a lessee default and a lessee should only have very limited termination rights (for example, for breach of the quiet enjoyment covenant from the lessor); and
 - In the context of an *Ijara* (i.e. an Islamic lease), Sharia' law does not allow a lessor to collect rental if the lessee loses the benefit of the leased asset (for example, following a total loss of that asset); however, Article 5(2) of the Law obliges the lessee to pay rent even if it does not have used of the leased asset, unless such failure is caused by the lessor. It is therefore unclear how the lessee can fully comply with its obligations under the Law when an *Ijara* does not require it to do so. On the subject of Sharia' structures, it is also unclear whether the leasing aspects of a *Suku* structure (i.e an Islamic bond) would fall within the scope of the Law.
- **Pre-existing lease transactions:** It is unclear if the Law will apply to pre-existing lease transactions. Article 38 of the Law does provide for anyone who engages in finance lease activity before the issuance of the Law to "regularise his status" in accordance with the provisions of the Law within one year from its effective date, but this deadline passed in December 2019 with no Record established, so existing lessors were unable to register themselves prior to that. It remains to be seen if this transition period will be extended once the Record has been set up (or the EMCR software has been amended to allow for Records under the Law to be added to that portal).
- **Accounting treatment of finance leases:** The definition of a "Finance Lease" under the Law is inconsistent with the typical definition used for accounting purposes. Under the Law, whether a lease constitutes a "Finance Lease" is predicated primarily on the existence of a purchase option in favour of the lessee. As drafted, if a lease does not include a purchase option in favour of the lessee, it does not constitute a "Finance Lease" and, therefore, the Law would not apply to that lease. For accounting purposes, there are a number of other factors involved, including in relation to the term of the lease as against the economic life of the asset and where the risks and rewards of ownership sit (i.e. with the lessee). The Law, however, requires the lessor to insure and carry out "necessary maintenance" on the leased assets. There is clearly an inconsistency here.
- **Aviation and maritime assets:** As noted in our April 2019 Briefing, whilst the Law appears to be aimed at the SME market, as drafted it may (perhaps unintentionally) extend to aircraft and aircraft assets (such as engines) as well as ships and other maritime assets (such as container boxes). However, market sentiment since the Law was initially published appears to be that this is not the intention or expectation so this may still (and should) be clarified further in subsequent implementing regulations or Cabinet decisions before the Record goes live.
- **Questions remain:** The questions we posed at the end of our April 2019 Briefing also remain still need to be clarified.

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We will continue to monitor developments in this area and issue a further update on the Law and any further implementing regulations in due course.

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