

A Law to Regulate Finance Leases in the UAE

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Leasing has become an increasingly important mode of finance for companies, particularly in the case of financing of expensive capital equipment (such as machinery, equipment, vehicular assets, vessels, aircrafts) and for individuals, particularly in the case of financing of real estate and motor vehicles.

Historically, such activities relied on the general principles of UAE law without a defined regulated framework. The UAE Federal Law No. 8 of 2018 on Finance Lease ('Law'), which came into effect on 1 January 2019 ('Effective Date'), has addressed this uncertainty by introducing a legislative basis on which the sector can rely.

Scope and Application of the Law

The Law provides the regulatory framework for conducting finance lease business in the UAE and is applicable to all finance leases in relation to any immovable and movable assets (including real estate, aircraft, vessels, vehicles, plant, machinery equipment etc) which provide an option to the customer to own the leased asset.

Finance leases are defined in the Law as *“a relationship between lessor and lessee, whereby the lessor shall own the leased asset for the purpose of leasing it. The lessor shall lease the asset to the lessee for a limited period and through an independent contract with an option to the lessee to own the leased asset according to the provisions of this law”* ('Finance Lease'). The lessor must be a Central Bank licenced financial institution leasing the leased asset and the lessee is the customer taking the leased asset on lease with the option to own the leased asset. The ownership option is the feature that differentiates regulated finance lease activities from operational leases, which are not captured by the Law.

Ijara financing, currently undertaken by the Shari'a compliant UAE financial institutions, would come within the ambit of the Law.

Salient Provisions of the Law

Highlighted below are the salient provisions of the Law that are relevant to financial institutions in the UAE.

Licensing

Any person or an entity intending to undertake Finance Lease business in the UAE is required to obtain a licence from the Central Bank.

It is not clear from the Law whether existing banks and finance companies, which are practising Finance Lease business in the UAE under an existing licence from the Central Bank, require a

separate licence under the Law. On consultation with the Central Bank, we understand that such banks and finance companies are not required to apply for a separate licence under the Law.

Any Finance Lease contract entered into with an unlicensed entity is void.

Registration of Finance Lease Contracts

All Finance Lease contracts (and any amendments thereto) entered into after the Effective Date must be registered; otherwise they are void. This is an important consideration for banks and finance companies that have structured their Finance Lease documentation under an Ijara mortgage model (i.e. customer as owner and bank or finance company as mortgagee), as opposed to a Ijara ownership model (bank or finance company as owner and customer as lessee).

Finance Lease contracts for:

1. immovable land (including off-plan sales) must be registered at the relevant land department. The Dubai Land Department has had such a system for some time, whereas other Emirates will need to implement new systems to cater for this;
2. movable assets must be registered in a registry to be established and regulated under a resolution to be issued by the UAE Cabinet. As of the date of this update, the movables assets registry has not been established. Further, at this stage, it is not clear what role the Emirates Movable Collateral Registry will play as it already allows for registration of finance leases over moveable assets; and
3. special movable assets (such as vehicles, aircraft and vessels) must be registered at the existing special register for that type of asset.

The obligation to register the Finance Lease contract (and any amendments thereto) lies with the lessor.

A Finance Lease contract, registered in accordance with the Law, is considered as evidence against third parties.

Prescriptive Provisions of Finance Lease Contracts

The Law is, in many respects, quite prescriptive as to the components that should be included in a Finance Lease contract and, unless otherwise agreed in the Finance Lease contract, the rights and obligations of the lessor and the lessee. These include:

Key components of Finance Lease contract:

1. names and details of the lessor and the lessee;
2. detailed description of the leased asset;
3. term of the Finance Lease contract;
4. purpose for the use of leased asset and the limits of such use;
5. rent, number of payments and due dates;
6. terms and conditions of the delivery of the leased asset to the lessee;
7. lessee's right to own the leased asset;
8. material rights and obligations of the lessor and lessee;
9. particulars of the supplier (i.e the person or entity supplying the leased asset to the lessor) ('Supplier'); and
10. the party that selected the Supplier.

Rights and obligations of the Lessee:

1. receive the leased asset from the lessor (or the Supplier);
2. use the leased asset for the purpose permitted in the Finance Lease contract;
3. pay rent to the lessor;
4. maintain the leased asset and carry out ordinary maintenance;
5. pay any financial costs applicable to or imposed by any government authority on the leased asset;
6. procure, renew and maintain any licence required for utilisation of the leased asset. Such issued licence must include the name of the lessor and include a statement that the leased asset is in the possession of the lessee;
7. transfer its rights and obligations under the Finance Lease contract to a third party, subject to the Lessor's consent; and
8. be responsible for the use of the leased asset and any damages to the leased asset, lessor or any third party because of such use or possession of the leased asset.

Rights and obligations of the Lessor:

1. deliver the leased asset to the lessee;
2. notify the Supplier of the existence of the lease on the leased asset;
3. insure the leased asset;
4. carry out major maintenance on the leased asset;
5. inspect the leased asset;
6. repossess the leased asset on default of the lessee. This appears to be a self-help remedy and the lessor is not required to initiate court proceedings to exercise its rights of repossession of the leased asset (assuming, of course, that it can legally repossess the asset). The Law does not however stipulate any other rights or remedies the lessor has, such as enforcing the purchase of the asset, damages and so on; and
7. transfer its rights under the Finance Lease contract or transfer the leased asset to any third party without the lessee's consent.

Improvements

If the lessee does not exercise its option to take ownership of the leased asset and returns the leased asset to the lessor, if any improvements have been made to the leased asset, where they can be removed the lessee must remove them. However, where they cannot be removed, and the lessor consented to the improvements, the lessor must pay compensation to the lessee for the improvements unless otherwise agreed in the Lease Finance contract.

Delivery of the Leased Asset

On delivery of the leased asset to the lessee, a delivery receipt must be signed by the Supplier or the lessor and the lessee. The lessee can only refuse to take delivery if the leased asset does not meet the agreed specifications or if the Supplier or the lessor refuses to issue a delivery receipt. The delivery receipt must state the condition of the leased asset and whether or not the leased asset meets the requirements and specifications agreed upon in the Finance Lease contract.

Selecting the Supplier and the Leased Asset

It is essential to determine the party who has selected the Supplier of the leased asset and

determined specifications of the leased asset as the Law provides corresponding rights to the lessor and the lessee accordingly. In particular:

1. whoever selects the leased asset and determines its specifications will be responsible for its appropriateness for purpose; and
2. the lessor will not be responsible to the lessee for any violation by the Supplier of its obligations under the supply contract (i.e. the contract under which the leased asset is supplied by the Supplier to the Lessor) ('Supply Contract'), unless the lessor selected the Supplier or the Supplier was in violation of its obligations under the Supply Contract due to any reasons attributable to the lessor.

The lessee is entitled, under the Law, to select the Supplier and determine the specifications of the leased asset.

Liability for defects in the leased asset rests with the Supplier. Without prejudice to the lessor's right to recourse against the Supplier, save for a claim in relation to the termination of the Supply Contract (for which only the lessor will have direct recourse against the Supplier), the lessee has direct rights against the Supplier in relation to the Supply Contract of the leased asset. The lessee accordingly can directly deal with the Supplier in connection with any warranties, service arrangements, etc.

Ownership of the Leased Asset

The lessor is the owner of the leased asset, however subject to the lessor's approval, the lessee may own the leased asset during the term of the Finance Lease contract. If the lessee exercises its option of ownership, subject to the lessee paying all amounts agreed under the Finance Lease contract, the lessor must convey the leased asset to the lessee in the following manner:

1. where the leased asset is real estate, the lessor must convey the leased asset to the lessee at the relevant land department within 15 working days from the date of the lessee notifying the lessor of exercising the option to own the leased asset;
2. if the leased asset is special movable assets (such as vehicles, aircraft and vessels), the lessor must assign the leased asset to the lessee at the relevant government authority within 15 working days from the date of the lessee notifying the lessor of exercising the option to own the leased asset; and
3. if the leased asset is anything other than real estate or special movable assets (which do not require registration with any government authority), the lessee shall be deemed owner of the leased asset from the date of the lessee notifying the lessor of exercising the option to own the leased asset.

Liquidation, Bankruptcy or Death of the Lessee

In case of the liquidation or bankruptcy (or where applicable death) of a lessee, the leased asset does not form part of the lessee's estate available to creditors of the lessee and the leased asset must be returned to the lessor within 90 days from the issuance of a liquidation decision or from adjudication of bankruptcy or the death of the individual (unless the liquidator or administrator in bankruptcy has decided to continue performing the Finance Lease contract). This is a clear legislative exception to the UAE Bankruptcy Law.

Destruction of the Leased Asset

If the leased asset is destroyed to the extent that it becomes wholly or partially unfit for use for the purpose agreed in the Finance Lease contract, the Finance Lease contract shall be deemed terminated.

The lessor is entitled to claim compensation from the lessee if the leased asset is destroyed for any reason attributable to the lessor. In determining the compensation, the amount paid by the lessee as rent and insurance proceeds (if any) must be taken into consideration.

Termination of the Finance Lease Contract

The lessor and the lessee are granted certain termination rights under the Law. These include:

Lessor

1. lessee fails to maintain leased asset or carry out ordinary maintenance;
2. lessee uses the leased asset for any purpose other than that agreed in the Finance Lease contract;
3. lessee fails to pay the rent when due;
4. lessee refuses to accept delivery of the leased asset provided it is as per the specifications agreed in the Finance Lease contract;
5. lessee is in default of any of its material obligations under the Finance Lease contract; and/or
6. lessee causes material damage to the leased asset.

Prior to exercising its rights of termination, the lessor is required to provide the lessee with a 'cure period' of 60 working days to remedy the default, failing which the lessor may immediately terminate the Finance Lease contract.

Lessee

1. lessor fails to deliver the asset as per the agreed specifications;
2. lessor fails to insure the asset; and/or
3. lessor fails to carry out major maintenance of the asset.

Prior to exercising its rights of termination, the lessee is required to provide the lessor with a cure period of 60 working days to remedy the default, failing which the lessee may immediately terminate the Finance Lease contract.

The aforementioned termination rights of the lessor and the lessee are statutory rights and therefore cannot be contracted out of under a Finance Lease contract. The Finance Lease contract can, of course, provide additional termination rights.

Jurisdiction

Courts of the UAE have the jurisdiction to hear and determine any suit, action or proceeding and to settle any disputes which may arise out of or in connection with the Finance Lease contract. The Law does not deal with Finance Lease transactions that are conducted on a cross-border basis (and governed by foreign laws and foreign courts). However, according to the Law, it appears that UAE courts would assume jurisdiction if matters relating to foreign law governed Finance Lease contracts were brought before such courts. This is an important consideration for local Finance Lease transactions which may have opted for arbitration as a means of dispute resolution or the

application of foreign law.

Adjustment of position with the Law

The Law stipulates a grace period of one year for full compliance with the provisions of the Law. Effective from the Effective Date, all Finance Lease contracts must be registered in accordance with the Law. That being said, in relation to Finance Lease contracts in relation to movable assets (which are to be registered in the registry to be established pursuant to the Law) and immovable assets, while the Law is not clear, in practice since there is no register available to register a Finance Lease contract for movable assets and no systems are in place in the land departments of the relevant Emirates (other than the Dubai Land Department) to register a Finance Lease contract for immovable assets, a lessor would be unable to register, and therefore cannot comply with this requirement of the Law.

In relation to Finance Lease contracts executed before the Effective Date, the Law states that a lessor 'may' register such contracts within one year of the Effective Date. The inclusion of the word 'may' creates confusion as to whether it is a mandatory requirement or not. One interpretation is that it is providing a one-year period to register if the lessor chooses, the other being it is giving the lessor up to one year to register such contracts.

Implementing Regulations

The Law mandates the Central Bank issue regulations to regulate the Finance Lease business. On consultation with the Central Bank, we understand that the Central Bank does not intend to issue a separate set of regulations and has indicated that finance companies wishing to carry out Finance Lease business in the UAE will be subject to the Finance Companies Regulations issued by the Central Bank in 2018. Finance Leasing is a 'permitted activity' under the Finance Companies Regulations.

Conclusion

The introduction of the Law is a welcome legislative development in the UAE as it provides a framework for conducting Finance Lease business in the UAE. All entities carrying out a Finance Leasing business in the UAE are encouraged to undertake a full review of their Finance Lease contracts in order to ensure they align with the requirements of the Law and, where necessary to approach the Central Bank for guidance on adjusting their licences.

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