

Taking security in the UAE: Comparing the taking security in the UAE to China

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This article sheds some light on the taking and enforcement of security (which is always of essence to banking business) in the UAE in comparison with that under the law of the People's Republic of China ('PRC') .

Source of Law

Security-related matters in PRC were primarily governed by the Security Law of the People's Republic of China (1995) ('PRC Security Law') and the Property Law of the People's Republic of China (2007) ('PRC Property Law') which together set out the main structure of the security legal system under PRC law. In the UAE, unlike that of PRC, while there are a few laws governing the taking and enforcement of a specific type of security (such as Law No. 14 of 2008 Concerning Mortgage in the Emirate of Dubai) no comprehensive laws have been promulgated to govern security-related matters as a whole. In practice, relevant provisions of the Federal Law No. 18 of 1993 issuing the UAE Commercial Transaction Law ('UAE Commercial Code') and Federal Law No. 5 of 1985 issuing the Federal Civil Transaction Law ('UAE Civil Code') will be taken into account in respect of matters related to the taking of security.

Types of Security Interest

PRC law generally provides for three types of security, namely mortgage, pledge and lien, the perfection of which enables the secured party to enjoy a priority right over secured property above unsecured creditors and secured creditors subsequent in rank. In comparison, generally under UAE law security would either be a mortgage or pledge without necessarily guaranteeing the right of priority (except for registered mortgage and pledge). In practice, six types of security (or documents used for security purpose) are widely used based on the type of property to be secured, which are discussed below.

Mortgage over immovable property

Under UAE law, very similarly to that under PRC law, immovable property comprises land, buildings and fixtures and a mortgage over immovable property is perfected by signing a written mortgage contract and registering the same with the relevant authority. Furthermore, once a mortgage is registered, the mortgagee obtains a priority right over the mortgaged property above unsecured creditors and secured creditors subsequent in rank to that of the mortgagee. However, a mortgage over immovable property under UAE law differs from that under PRC law in the following aspects:

1. Under UAE law, an interest in land could be freehold, leasehold, usufruct, musataha, granted or gifted, which will dictate what type of mortgage is possible and impacts the interest and value a mortgagee will obtain from the mortgage. But under PRC law, mortgages can only be granted over land use rights because all lands in China are owned by the state while individuals or entities can only hold land use rights (for a limited term);
2. A mortgage over land under UAE law will automatically extend to any building or structure to be constructed on the land in the future, which is not possible under PRC law; and
3. Under UAE law, certain registered leases can be mortgaged, which does not exist under PRC law.

Mortgage/Pledge over movable property

There are two types of mortgages over movable property in the UAE: registered mortgages and unregistered pledges.

Registered mortgages under UAE law can be granted over registered properties such as vehicles, ships and aircraft and such registered mortgages are perfected by signing a mortgage contract and registering the same with the relevant authorities. While the perfection requirement of a registered mortgage (or its equivalent) under PRC law is very similar to that under UAE law, the scope of mortgageable properties is more extensive, as registered mortgages can also be granted over machinery, raw materials, semi-finished products and finished products, as well as ships and aircrafts under construction. Furthermore, the PRC Property Law makes the list of mortgageable property nonexclusive by providing that a mortgage can be granted to any property that is not explicitly prohibited by laws and regulations.

Under UAE law, very similar to that under PRC law, a possessory pledge can be granted over movable property (i.e. not permanently affixed to an immovable property) and the same can be perfected by signing a written pledge agreement and delivering the relevant property by the pledgor to the pledgee (either actual or constructive). Pledged assets must be in existence and identified and security cannot be granted to future assets.

Mortgage over commercial business

Under UAE law, commercial business comprises tangible elements (goods, tools, machines and equipments) and intangible elements (trade name, goodwill, intellectual property rights, contracts with clients and the right to let and licenses). A mortgage over commercial business can be perfected by signing and notarising an Arabic (or bilingual) mortgage contract and registering the mortgage with the relevant Commercial Registry. For the ease of reference, a mortgage so created is referred to as a “Commercial Business Mortgage”.

A similar provision can be found in Article 181 of the PRC Property Law which provides that an enterprise, individual industrial and commercial household or agricultural production operator may mortgage the manufacturing facilities, raw materials, half-finished products and products it owns now or in the future, and the mortgagee shall be entitled to enforce the mortgage and seek preferred payments from the chattels that exist at the time of the enforcement. For the ease of reference, a mortgage so created is referred to as a “Chattel Mortgage”.

It is worth noting the following fundamental differences between the above-mentioned mortgages:

- a Chattel Mortgage can only be granted over tangible assets such as manufacturing facilities and inventories, but a Commercial Business Mortgage can also be granted over intangible assets such as intellectual property rights which is secured by way of pledge under PRC law;
- chattels secured by a Commercial Business Mortgage (such as goods) should be existing and identified and cannot be changed after the perfection of the mortgage, but the chattels secured by a Chattel Mortgage may include future chattels and are to be identified at the time of enforcement. In China, the Chattel Mortgage has been generally considered as a type of floating charge recognised by law for the first time. The concept of a floating charge is not recognised under UAE law.

Pledge over bank accounts

As a general principal under UAE law, very similarly to that under PRC law, funds in an account subject to an account pledge must be ascertained and identified at the time of perfection of the pledge. Therefore, practically pledges over operating accounts or accounts with fluctuating balances are problematic. To overcome the problem and as a common practice in the UAE, it is preferable to hold cash flows in an account held under the name of the pledgee (i.e. the lender) or look at alternative structures (such as sweep mechanisms, reserve accounts or an offshore account, including the DIFC). In China it is possible to

overcome the problem by pledging a deposit certificate or pledging a “special account” pursuant to the Interpretation of the Supreme Court regarding the PRC Security Law.

Pledge over shares

Only four types of companies may issue shares in the UAE and can therefore be pledged: public joint stock companies, private joint stock companies, partnerships limited by shares and free zone companies. One notable feature of share pledges under UAE law is that the equity interest (or quota) in a limited liability company may not be pledged (this will be changed, however, with the introduction of the new companies law).

However, pledges over shares, equity interest and fund units are commonly recognized and widely used in China. Shares or equity interest (as the case may be) in most types of companies under PRC law, including domestic companies, foreign invested enterprises and list companies, are capable of being pledged.

The perfection requirements under both jurisdictions are similar to each other which involve the signing of a written agreement and registration of the pledge with the relevant authorities.

Assignment of rights

Under UAE law, contractual rights under an underlying agreement, including receivables, are typically secured by way of assignment. For finance transactions, it is common for banks in the UAE to take assignments of customer’s rights to receive rentals from property, insurance proceeds, rights under construction contracts, management contracts, payments under invoices and so on. Perfection of assignment requires a written assignment agreement to be signed, a notice to the counterparty under the underlying agreement and (as the case may be) the consent of such counterparty. In essence, assignment of rights is merely a contractual arrangement between the parties and there is no priority right granted by law that can be enjoyed by the assignee (although in practice, the assignee can secure its rights under assignment by a setting off or sweeping mechanism).

Very differently, receivables are pledgeable according to PRC Property Law. Perfection of a pledge of receivables requires a written pledge contract and registration of the pledge with the Credit Reference Centre maintained by the China Central Bank.

Enforcement of security

The concept of “self help” is not recognized under UAE law and an order from a UAE court will be required to enforce a security. Enforcement involves the secured party filing a claim for the entire amount outstanding on a debt and then requesting the court to both acknowledge the security and confirm the secured party’s preferred position. Following a court order, the security interest can either be realized by way of public auction (in respect of a mortgage) or otherwise.

In contrast, enforcement of security in China is much less onerous. In terms of mortgages, the PRC Property Law permits the mortgagee to enter into an agreement with the mortgagor with respect to the method to realize the mortgage, failing which a court order will be required. In terms of pledges, the PRC law encourages the parties to realise a pledge between themselves (either by agreement or by public auction), the court will be involved only when a pledgee refuses to enforce a pledge.

Conclusion

While this article is not intended to be a comprehensive analysis of the taking and enforcement of security in the UAE and China, it does serve to highlight material differences in each jurisdiction, which should be kept in mind when doing business in the UAE. Should you have any inquiry in relation to the issues discussed herein, please feel free to contact us.