Egypt Introduces for the First Time a Secured Transactions Law

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They decided to borrow $5,000 from a bank. The start-up that they originally named Starbucks Coffee, Tea, and Spice (now Starbucks) was able to get the financing it needed to grow and expand; eventually becoming the Fortune 500 company it is today.

Credit is the lifeblood of business. All firms, large and small, need it to grow and thrive. However, access to credit can be constrained, especially in developing countries. According to the World Bank, more than half of private firms in emerging markets have no access to credit. That figure reaches 80 percent in the Middle East and sub-Saharan Africa.

Banks in developing countries are usually reluctant to accept movable assets as collateral due to the inadequate legal and regulatory environment in which banks and firms co-exist. In this context, movable assets become “dead capital”. Movable assets, as opposed to fixed assets such as land or buildings, often account for most of the capital stock of private firms and comprise an especially large share for micro, small and medium-size enterprises (“SMEs”). For example, in the developing world, up to 80 percent of the capital stock of businesses is typically in movable assets such as machinery, equipment or receivables, and only 20 percent is in immovable property.

The availability of collateral is a constraint on financing, and in underdeveloped financial markets insufficient collateral is one of the main reasons firms are rejected when they apply for bank credit.

The above applies to Egypt to a great extent. Adding to that, banks in Egypt have excesses of unutilised liquidity and despite many initiatives to encourage SME lending and micro-finance such initiatives have yielded very limited return on the lending rate. One of the main reasons for this is the lack of sufficient collateral.

On November 15, 2015, Egypt passed law no.115/2015 regulating the taking of security over movable assets (the “Movables Security Law”). The Movables Security Law is considered a major reform in the area of secured transactions in Egypt.

The Movables Security Law allowed for the first time non-possessory charges over movable property to exist and introduced collateral registries for movable assets as well as special enforcement of securities. Over the next couple paragraphs we shed light on the main features of the law.

Scope of the Law

The Movables Security Law is primarily concerned with non-possessory pledge/charge over movable property. Under the Movables Security Law a variety of movables, whether existing or future physical assets or moral rights, can be used as collateral. This includes: receivables and credit notes, bank deposits or accounts, equipment, tools, stock, trees, agriculture produce, farm animals, birds, and metals, as well as intellectual property rights.

Who can benefit

The Movables Security Law is limited to banks and other financing institutions/corporations.

The Registry

The Egyptian Financial Supervisory Authority (EFSA) will establish an electronic registry for collaterals made pursuant to the Movables Security Law and any amendments or cancelations thereof. The registry will fulfil two key functions: to notify parties about the existence of an existing security interest in movable property and to establish the priority of creditors with regard to third parties.

Effects of Registration

Upon registration, collaterals become effective with regard to third parties on the date and time of registration. Any party, who has a legitimate interest on the movable property, may object to the registration before summary courts. Further, in an insolvency event, movables subject to a registered collateral will not form part of debtor’s assets, provided registration occurred prior to commencement of the insolvency procedures. Finally, registering collateral grants the secured creditor first rank security over the asset, which ranks higher than all other forms of security or pledges provided by any other law with the exception of judicial expenses and enforcement expenses of the security itself and without prejudice to the rights of possessory creditors under the Civil Code.

Enforcement

The enforcement regime introduced by the Movables Security Law represents a breakaway from the standard Civil Law system of enforcement. The Movables Security Law allows creditors to directly recover their debt from third party debtors of the borrower or directly sell the pledged movables without court order as well as direct set-off in the case of bank accounts. In the absence of contractual authorisation for the aforementioned actions, the creditor can always obtain a court order in a process which is simplified compared to the normal enforcement of debt or securities created under other laws.

Creditor’s Liability

It is noteworthy that, as the Movables Security Law provides banks with flexibility and discretion when it comes to enforcement, the law also requires banks to indemnify the debtor/guarantor and other rights holders against any damage caused by breach of the enforcement procedures.

The executive regulation is expected to be issued by February 2016 following which there will be a substantive amount of work to be done to implement the law and establish the registry. We are hopeful that the implementation will be at the same level of innovation as the law itself as great laws may become ineffective or useless if not properly implemented.

Overall, studies have shown that introducing collateral registries for movable assets increases firms’ access to banking finance. There is also evidence that this effect is larger among smaller and younger firms.