

Mortgage of Moveable Assets: A Welcome Change

Ayen Biar - Senior Associate - Litigation
- Abu Dhabi

Ali Awad - Senior Counsel - Banking and Finance
a.awad@tamimi.com - Dubai International Financial Centre

Mustafa Ahmed - Associate - Banking and Finance
- Dubai International Financial Centre

February 2017

In this article, we consider the implications of this recent law which we consider will add value for lenders across the UAE, namely; Federal Law No. 20 of 2016 concerning the Mortgage of Moveable Assets to Secure a Debt (the “Law”). The Law was published in the Federal Gazette no. 609 dated 15 December 2016 and is due to come in effect 90 days after the publication (the “Effective Date”).

The Law is a welcome change as it provides lenders with the ability to register effective security over moveable assets, a problem both lenders and debtors have struggled with for some time. The Law applies to pledges over tangible or intangible moveable assets that exist at present or in the future. The Law does not apply to moveables for which existing laws already require registration or for which a special register already exists. For example, such as a pledge over shares registered with the Economic Department in an Emirate or a pledge over vehicles registered with the applicable traffic departments in each Emirate.

What are the main implications?

Prior to the Law, lenders relied on the provisions of the Civil Code to create a possessory pledge over moveable assets. Under the Civil Code, such a pledge over moveable assets was only valid if:

- the assets were capable of delivery at the time the pledge is made, and capable of being sold by public auction;
- the assets were in the possession of the pledgee or a neutral third party as bailee; and
- the pledgor was the owner of the assets pledged and competent to make dispositions over it.

The Law has perhaps most significantly, changed this position by allowing a mortgage of moveable assets without the need to transfer the possession to the mortgagee or third party as bailee, if the mortgage is registered in the registry to be established under the Law (“Security Registry”) – see further below. Some other significant changes that the Law has introduced are:

- **Definition of Moveable Assets** – Article 3 of the Law defines the assets that can be mortgaged. The definition in the Law encompasses all moveable assets including, among other things (i) any moveable tangible or intangible assets, existing or in the future; (ii) “indebtedness” (ie accounts payable owed to the pledgor); (iii) credited and deposits bank accounts including the current accounts; (iv) documents of title (including bills of lading); and (v) property accessory to immovable property. Prior to the Law, the Civil Code did not allow for future assets to be pledged. This is a notable change however caution is necessary—the extent to which the UAE Courts consider the Law must be reconciled with the position

under the Civil Code will not be known until a case where the issue is raised is determined. Bank accounts were also pledged by relying on generic provisions of the Civil Code which was not well suited to accounts with fluctuating balances. The ability to specifically deal with the indebtedness, future assets, documents of title, fungible assets and also bank accounts (among others) under the Law should afford greater comfort to Lenders interested in such security. The Law does not apply to moveable assets that require registration in a special register under an existing law (like listed shares, vehicles, ships, aircraft and certain free zone security).

- **Security Registry** - The Law requires the registration of mortgages over moveable assets in the Security Registry. The Security Registry is yet to be created and the Law provides for it to be created by a Cabinet resolution. The Cabinet resolution will likely give more insight into the structure of the Security Registry, where it will be located, who will manage it and specific registration requirements. We understand the Ministry of Finance is in discussion with potential parties to manage the Security Registry and there will likely be developments in this regard in the next few months.
- **No possession** - As discussed, the Law permits the mortgage of moveable assets without the need to transfer the possession to the mortgagee or third party. This will be significant in certain trade finance transactions, where it was not always possible to arrange for a third party bailee to take possession of the goods. Under the previous Civil Code regime, in pledges over the assets of a borrower, the borrowers usually appointed an employee or director of the shareholder of the borrower to act as the bailee. This arrangement was often tenuous and lenders often faced difficulties holding the bailee responsible. In addition, there was often hesitation to appoint a bailee as there was a possibility of criminal sanctions on the bailee for misconduct which affected the pledged assets. With the removal of this requirement, the Law streamlines the practical process of taking a pledge over the moveable assets.
- **Other security** - The Security Registry can accept the registration of other rights, such as (i) the lessor's right over the assets in the case of operational lease agreements, if the agreement is for one year or more; and (ii) the lessor's right under finance lease agreements.
- **Registration in the Security Registry** - Article 10 of the Law provides that a pledge over moveable assets shall only be effective against third parties if it is registered in the Security Registry. It is not clear at the moment how the registration process will work practically and it is expected that more details of how the process of registering a pledge in the Security Registry will be specified in the Cabinet Resolution establishing the Security Registry. Article 10(2) also specifies that once a pledge has been registered in the Security Registry in accordance with the Law, no further pledge or charge shall be created on the same assets unless it is registered on the Security Registry. This provision, along with with Article 17 of the Law, allow for ranking charges to be registered on the Security Registry. The priority in the ranking shall be determined based on the date and time of registration of the pledge in the Security Registry.
- **Enforcement** - The registration of pledges will make the right of recourse and enforcement more easy and clear. The registration will establish priority and allow the trace of goods in custody of third parties (except where goods are sold in the ordinary course of trade); thereby eliminating the risk of fraud and disposition. This is relevant especially to financing by way of trust receipt where, in our experience, it is often difficult to enforce the trust receipt if goods are sold to third parties.
- **Public Searches** - A notable issue that lenders previously faced was that there was no way to verify if any charges existed on the assets that they intended to take a pledge over. This issue has been resolved by the Law by allowing for public searches of the Security Registry. Article 7 of the Law allows third parties to search the Security Registry and obtain basic information from the Security Registry. Such information will be usable as evidence when undertaking enforcement. The parties to the pledge may decide how much of the information relating to the pledge will be available to the public on the Security Registry, however the Law provides that in all cases some basic information will be searchable. There is a concern that the ability to restrict information may offset the benefits of the public searches, with contracting parties imposing overburdensome restrictions which may lead to information not being consistent between registrations. We hope that the proposed Cabinet Resolution will clarify this issue by restricting parties' right only to only limit information that is commercially sensitive and ensuring the basic information includes the parties, the assets that are subject to pledge, its value and duration as a minimum requirement.

- **Payment in Kind** - The Law gives the mortgagee the right during the mortgage, or at maturity of the debt, to agree with the mortgagor to receive the title of the mortgaged assets (wholly or partly).

Direct Enforcement (Out of Court)

The Law introduces another important process of enforcement – the right of self help. This allows the pledgee direct recourse against the pledged goods in certain limited circumstances. Article 27 and 28 of the Law specifies that limited circumstances in which such enforcement is possible.

In order to undertake direct enforcement against pledged assets generally, the pledge must notify all concerned parties (pledgor, the bank, the holder of bonds or documents subject of the pledge etc.). The Law does not give time limit for such notice; therefore (unless regulations specify otherwise), the parties are free to agree on a suitable period for the notice; unless expressly waived. Certain types of collateral have bespoke direct enforcement mechanisms.

The direct enforcement can be effected in respect of the following specific collateral as follows:

Type of Pledge	Means of Direct Enforcement
Moveable assets (generally)	By private sale, subject to prior agreement, notification to relevant parties and no other security interest existing.
Claims and Receivables.	Set off if the pledgee is a bank and by claim if the account is held at another bank.
Bonds and written instruments that are negotiable and transferable by way of delivery or endorsement.	Through delivery or endorsement if their value is equal to the right of pledge.
Written papers that are negotiable and transferable by way of delivery or endorsement if it is related to goods.	By application to the summary judge for the issuance of an urgent order.

Enforcement through the Court

The Law grants authority to summary judges to issue orders for enforcement of a registered pledge. In order to do so the pledgee must submit the following documents:

- Copy of the pledge contract and the details of the pledged property as per the register;
- Name and address of the execution applicant;
- Names and addresses of the pledgor and the debtor;
- Name of the proprietor of the pledged asset if it is in possession by a third party;
- Name and address of the owner of the moveable asset to which the right of pledge is attached;
- Proprietor of such asset;
- Owner of the asset on which the subject of the pledge exists and proprietor of such asset, as appropriate.

Process of Sale

- **Penalties** - The Law penalizes the pledgor, the pledgee, the debtor or the possessor of the mortgaged assets in case of the disposal or damage to the mortgaged assets contrary to the mortgage agreement. The penalty is potential imprisonment and a fine of not less than AED 30,000. If such criminal actions are committed by a corporate entity, the penalty shall be applied to the board members, the joint shareholders and appointed employees at the corporate entity committing such acts. This is significant as it imposes penalties on the pledgor and its staff for unauthorized disposals, but also implies that even officers of banks may be subject to penalties for non-compliance of the Law.

- **Compliance period** - The Effective Date is noted above. There are also certain regulations that are to be issued and published, which will likely lay down the more operational aspects of the Law. These regulations are to be published within six months from the Law coming in to force. The Law also allows a period of one year from the enactment of the Law for existing mortgages to be registered. For many banks this will mean reviewing all existing security packages to assess whether all or part of the security should be registered on the Security Register.

In summary, the Law has introduced substantial and welcome changes in the market for secured lending while also providing lenders with better information on borrowers and providing them with greater comfort in taking security over moveable assets. Although there are many aspects of the implementation of the Law that remain uncertain at this point, one thing is abundantly certain - the Law is a welcome addition to the legal landscape of the UAE.