

Lending and taking security in the United Arab Emirates: overview

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OVERVIEW OF THE LENDING MARKET

1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

As the market continues to recover from the 2008 financial crisis, the United Arab Emirates (UAE) is starting to see a steady increase in bank and company appetite for lending. There is a growing trend for acquisition, project and working capital financing through dual-tranche (conventional and Islamic finance) structures. We have also seen increased instances of UAE and overseas companies approaching UAE financial institutions to fund their overseas construction projects and expansions plans (for example, financing retail outlets overseas).

The creating of security interests in the UAE (outside the free zones) is principally governed by:

- UAE Federal Law No. 5 of 1995 relating to the law of Civil Transactions (Civil code).
- UAE Federal law No. 18 of 1993 relating to the law of Commercial Transactions (Commercial Code).

There are several free zones in the UAE and each free zone has its own regulations for creating security interests by entities licensed within that zone and/or over property located within it. However, aside from the creation and enforcement of security interests in the UAE, this chapter is restricted to security in the Jebel Ali Free Zone Authority (JAFZA), the first free zone in the UAE, around which the laws and procedures of most other free zones are modelled. For security interests created in the Dubai International Financial Centre (DIFC), see *Question 2, Security in the DIFC*.

FORMS OF SECURITY OVER ASSETS

Real estate

2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real estate

Real estate constitutes land and permanent structures on land that cannot be moved without suffering damage or alteration.

The most common categories of real estate and real estate interests over which security can be granted are:

- Freehold land.
- Buildings and construction on freehold land.
- Leasehold interests in land.

- Buildings and construction on leasehold land.
- Usufruct (that is, the right to use (including develop), enjoy and occupy land or property belonging to another person for a fixed term).

Mortgages over freehold land are generally registered with the land department in the relevant Emirate (for example, in Dubai, this would be the Dubai Land Department). In addition, some free zones provide their own mechanism for registering a mortgage over freehold/leasehold interest relating to property located within that free zone.

Common forms of security

Depending on the type of financing and the nature of the borrower or obligors, common forms of security include:

- Guarantees (personal and corporate).
- Assignment (over income, receivables, insurances (for example, personal or project), contracts and project guarantees).
- Chattel mortgage also known as a commercial pledge (over movable assets of a company).
- Real estate mortgage (over freehold interest, leasehold interest or building constructed over leased land).
- Business or commercial mortgage (includes tangible and intangible assets of a company).
- Pledges (over shares, accounts (including DSRA, collection accounts or project accounts)).

There are three types of mortgage over real estate in the UAE, a mortgage over:

- Land and buildings.
- A leasehold interest in real property.
- A building constructed on leased land.

A mortgage is defined in the Civil Code as a contract by which a creditor acquires the right to be satisfied from the proceeds of the sale of the mortgaged real estate in priority to unsecured creditors and other secured creditors of the debtor. To have effect, a mortgage must be registered. The time of registration of the mortgage determines priority among mortgages over the same real estate.

The mortgagor must be the owner of the mortgaged property. It is not essential that the mortgagor be the principal obligor of the debt that is secured by the mortgage; the mortgagor can be a guarantor of the debt.

Legislation now exists in Dubai that, among other things, governs the registration of property and security interests by expatriates in certain demarcated zones. The Dubai Land Department has exclusive jurisdiction to register the following three types of title in the name of foreign nationals and foreign-owned companies in

certain demarcated areas (*Law No. 7 of 2006 on Registration of Real Property in the Emirate of Dubai and its implementing regulations*):

- Freehold.
- Long-term lease (99 years).
- Usufruct (*musataha*), to receive the benefit from the property (up to 50 years).

The developer must register any disposition of an off-plan property in the Interim Register, which is maintained by the Dubai Land Department (*Law No. 13 of 2008 regulating Initial Property Registration in the Emirate of Dubai*). The disposition of a completed property must be registered in the Real Property Register, also maintained by the Dubai Land Department. It is unclear, however, which party is responsible for registration. Both parties must attend the Dubai Land Department to complete registration. A disposition that is not registered in the Interim Register or the Real Property Register is invalid.

Each unit owner (defined as a person who is registered with the Dubai Land Department as the owner, including the tenant under a long term lease, of a flat, villa, house or other real estate) can create a mortgage over that unit in favour of a bank or financial institution (*Law No. 27 of 2007 concerning the Ownership of Joint Properties (Condominiums) in the Emirate of Dubai*).

Security interests relating to real estate in demarcated zones in the Emirate of Abu Dhabi can also be registered. The following are permitted (*Law No. 19 of 2005 concerning Property Ownership in the Emirate of Abu Dhabi*):

- For UAE nationals: to own freehold title to land anywhere in Abu Dhabi.
- For nationals of the Gulf Co-operation Council (GCC): to own freehold title to land in certain demarcated areas.

Law No. 19 of 2005 was amended in February 2007 to permit non-UAE nationals to:

- Own buildings in certain demarcated areas (but not the underlying land).
- Enter into a long-term lease agreement (up to 99 years) for real property in those demarcated areas under agreements.
- Enjoy usufruct rights over real property under agreements of up to 50 years. Holders of usufruct rights in excess of ten years can sell or mortgage their interests without seeking the permission of the land owner.

In the Jebel Ali Free Zone (JAFZ), a mortgage can be created over a building constructed on leased land.

Formalities

Mortgages over real property must be both:

- In writing.
- Registered with the appropriate real estate authority in each Emirate. The registered mortgage deeds are generally pre-printed documents prescribed by the relevant authorities.

In the JAFZ, all land is owned by the government of Dubai. The JAFZ Authority (JAFZA) leases land for construction of office premises and warehouses. Under the provisions of the standard lease agreement between the JAFZA and a lessee, the lessee can assign its rights under the lease in favour of a lender. All assignments of lease rights must be registered (using prescribed forms) with the JAFZA.

Security in the DIFC

The Dubai International Financial Centre (DIFC) is unique among the free zones as it has an entirely separate body of laws and regulations. The relevant security laws include the:

- Law of Security (*DIFC Law 8 of 2005, as amended*), which, subject to certain exclusions, applies to all transactions,

regardless of their form, that create a security interest in personal or real property by contract.

- Real Property Law (*DIFC Law 4 of 2007*), which specifically covers mortgages over land.
- DIFC Security Regulations (Security Regulations).

To perfect a security interest in the DIFC, it must be filed in the Security Registry. If the security holder is a natural person, he must submit the following information to the registrar:

- His identity.
- His residence and domicile.
- Any other information required under the Security Regulations, for example, a financing statement.

The Security Regulations also govern attachment, perfection and enforcement of a security interest in financial property.

Account holders can pledge eligible securities held in the Central Securities Depository (CSD) of the Dubai International Financial Exchange (DIFX) by submitting a pledge instruction to the CSD in favour of a pledgee. The CSD designates pledged eligible securities as being held to the order of and controlled by the pledgee. The DIFX will not accept any instructions from the account holder unless otherwise instructed by the pledgee.

Tangible movable property

3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible movable property

Tangible movable property includes:

- Machinery.
- Trading stock (inventory).
- Aircraft and ships.

Under the Commercial Code, all property that is not classified as immovable is considered to be movable property. Tangible property includes goods, inventory, stores and machinery.

The Commercial Code provides for the creation of the following types of security interests over tangible (and intangible) movable property.

Common forms of security

Business/commercial mortgage. A business/commercial mortgage is a mortgage of movable assets of an entity. It can only be created in favour of banks or other financial institutions. The definition of a business mortgage/commercial includes (*Commercial Code*):

- All of a company's tangible movable property comprising:
 - goods;
 - stores;
 - machinery; and
 - tools.
- All of a company's intangible movable property, such as:
 - contract rights;
 - goodwill;
 - trade name;
 - intellectual property; and
 - licence rights.

The mortgaged assets must be described in as much detail as possible. If they are not, only the following intangible property is deemed mortgaged (*Commercial Code*):

- Trade name.
- Contract rights.
- Goodwill.

Real estate owned by the business is not covered by a business mortgage. However, the landlord of the premises has a lien over the mortgaged assets in the leased premises for unpaid rent (subject to a maximum of two years' rent) in priority to the mortgagee's rights (*Commercial Code*).

Chattel mortgage. Unlike the business/commercial mortgage, the chattel mortgage, also known as a commercial pledge cannot either:

- Be perfected through registration.
- Mortgage intangible assets of a company.

A chattel mortgage is a pledge over movable property. A chattel mortgage can be created over:

- Stock in trade or inventory.
- Movable plant and machinery.
- Receivables.
- Negotiable instruments.

Other mortgages. In addition to the above, mortgages can be granted and registered over:

- Vehicles. There may be cases where the scope of the mortgage is not clear. For example, a detachable trailer attached to a vehicle, may fall outside the scope of the mortgage, depending on how the mortgage was registered.
- Vessels.
- Aircraft.

The UAE is a signatory to the (*Federal Decree No. 32 of 2006*):

- Convention on International Interests in Mobile Equipment (Cape Town, 2001) (Convention).
- Protocol to the Convention on Matters Specific to Mobile Equipment (Cape Town, 2001) (Protocol).

Security over movables in the Jebel Ali Free Zone (JAFZ). A business/commercial mortgage can be created by a JAFZ Authority (JAFZA)-licensed entity over its business and/or specific assets can be registered with the JAFZA.

DIFC. See *Question 2, Security in the DIFC*.

Formalities

Business/commercial mortgage. To be valid and effective, a business mortgage must be:

- In writing (with specific details of assets covered).
- Executed before a public notary.
- Registered in the Commercial Register (only the Emirates of Dubai and Abu Dhabi currently register business mortgages in the commercial register). Once registered, the mortgage is valid for five years.

Notice of the mortgage must be published in an Arabic daily newspaper two weeks before registration.

Chattel mortgage. To create a chattel mortgage, possession of the pledged asset must be transferred to the pledgee or a third party (that is, the bailee), who must retain possession until either:

- The debt is satisfied.
- The asset is placed in common possession to prevent the pledgor from disposing of the pledged asset without the pledgee's consent.

The transfer of possession can be actual or constructive.

Other mortgages. A vehicle mortgage is registered with the local traffic police, the road or transport authority and a notation is made in the title deed of the vehicle. The borrowing party still retains the legal ownership of the vehicle, subject to the mortgage.

A mortgage over a vessel can be created by a notarised instrument that must be registered in the register of ships (in the jurisdiction where the vessel is registered). Vessel mortgage in the UAE are created under the Commercial Maritime Law No. 26 of 2981 (as amended by law No. 11 of 1988) (Maritime Law). The Maritime Law permits the mortgage of a vessel if its total tonnage exceeds ten tonnes. A vessel being mortgaged in the UAE must be registered with the National Transport Authority (NTA) (that is, the vessel should maintain a UAE flag). A UAE vessel mortgage must be created once both:

- A notarised vessel mortgage agreement is registered with the NTA.
- The NTA has issued a new vessel registration certificate noting the mortgage registered in favour of the mortgagee.

A mortgage over an aircraft, registered in the UAE can be created by submitting a copy of the executed aircraft mortgage agreement to the UAE General Civil Aviation Authority (GCAA). However, the UAE Federal Act No. 20 of 1991 promulgating the Civil Aviation Law (Civil Aviation Law) does not specify the formalities for the creation and registration of mortgages over the UAE-registered aircraft. However, in practice, the GCAA notes a mortgagee's interest over a UAE-registered aircraft. Once the mortgage is perfected, the GCAA issues a certificate of registration confirming the details of the owner, the operator and the financing bank as mortgagee. In addition to the registration of the mortgage with the GCAA, banks and financial institutions also require the registration of an additional security over the aircraft (airframe and engines) at the International Registry pursuant to the Cape Town Convention on International Interests in Mobile Equipment 2001 as adopted under UAE law. Such registration is effected through the GCAA, which acts as an Authorised Entry Point in relation to the International Registry for the UAE.

Security over movables in the JAFZ. The business or commercial mortgage is registered by completing the JAFZA's standard mortgage registration forms.

DIFC. See *Question 2, Security in the DIFC*.

Financial instruments

4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

Financial instruments

Shares (in private or public companies) are the most common financial instruments that may be pledged as security.

Common forms of security

Commercial pledge. A commercial pledge can be granted over both (*Commercial Code*):

- Negotiable instruments.
- Nominative instruments (that is, documents with specified obligees).

Security over shares under the Companies Law. The UAE Federal Law No. 8 of 1984, as amended regarding commercial companies (Companies Law), regulates the creation of mortgages and pledges over shares of public shareholding and private shareholding companies.

Shares can be mortgaged by delivering them to the mortgagee (*Article 164, Companies Law*). This is subject to the following conditions (*Article 162, Companies Law*):

- Ownership of shares is transferred on entry of the disposition in the Commercial Register (maintained by the UAE Ministry of Economy).
- The entry of the disposition must be endorsed on the shares.
- The disposition becomes effective against the company or third parties only from the date of its entry in the register.

Pledge over shares in the Jebel Ali Free Zone (JAFZ). The Implementing Regulations No.1/92 (Free Zone Establishment Regulations) and Implementing Regulations No. 1/99 (Free Zone Company Regulations) provide for the creation of a pledge over shares of Free Zone establishments and companies respectively.

Formalities

A commercial pledge is created by endorsing the relevant instrument indicating that the instrument has been pledged and perfected by delivery of the relevant instrument to the pledgee.

A valid pledge over shares of a Free Zone establishment or company requires:

- Execution of certain forms, prescribed by the JAFZ Authority (JAFZA), by the pledgor, pledgee and the company whose shares are being pledged.
- Filing executed documents with the JAFZA to register the pledge.

Under UAE law, shares are treated as movable assets. Therefore, a share pledge requires possession of the certificates for the pledged shares. This is not always possible, given that most LLC and free zone companies do not issue share certificates.

In certain free zones it is possible to perfect a share pledge by registration (over the shares of a free zone company in that free zone) with the free zone. This will prevent the free zone company from transferring the pledge shares or otherwise dealing with the pledged shares, until such pledge is released by the pledgee.

In the case of a share pledge over shares registered on stock exchanges, it will be necessary to comply with the specific requirements of the particular exchange and the relevant regulatory bodies in the UAE.

In respect of the Dubai International Financial Centre (DIFC), see *Question 2, Security in the DIFC*.

Claims and receivables

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- 5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?**
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Claims and receivables

The most common types of claims and receivables over which security is granted are receivables, income and insurances.

Common forms of security

Common forms of security include assignments of receivables, income and insurances.

Formalities

Under UAE law, an assignment of rights requires only notification from the assignor to the third party, confirming the assignment to the assignee. Where this is not possible or practical (for example, the assignment of income for a retail business), the banks may require such income to be deposited into a collection account (that will be covered by an accounts pledge).

Cash deposits

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- 6. What are the most common forms of security over cash deposits? How are they created and perfected?**
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Common forms of security

The most common form of security over cash deposits is an accounts pledge.

Formalities

The UAE does not recognise the concept of a floating charge, therefore, a pledge over an account relates to the sums standing in the pledged account on the date of the pledge agreement. Consequently, banks usually require the pledge to be amended on a periodic basis or at the request of the bank, so as to pledge the new sums standing in credit in the pledged account.

Intellectual property

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- 7. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?**
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Intellectual property

It is not common to grant security over intellectual property (IP) in the UAE. IP rights are generally only pledged by a commercial mortgage.

Common forms of security

See above, *Intellectual property*.

Formalities

See above, *Intellectual property*.

Problem assets

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- 8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?**
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Future assets

The concept of security over future assets does not exist in the UAE. Therefore, a floating charge is not permitted. The assets to be pledged must be in existence at the time of the creation of the pledge (see *Question 6, Formalities*).

Fungible assets

As the UAE does not recognise the concept of a floating charge, a pledge over assets such as raw material stock in a warehouse that will be used to manufacture end products (for example, plastic pellets used in the manufacture of plastic products) may become indistinguishable. In these circumstances, the bank requires an assignment over income generated from the sale of the end products and may ask for any pledge over such assets to be amended on a periodic basis or at the request of the bank, so as to cover any changes in the quantity of the pledged assets. This would result in a new fixed charge over the revised quantity of the pledged assets.

RELEASE OF SECURITY OVER ASSETS

9. How are common forms of security released? Are any formalities required?

Most unregistered securities can be released with a release and discharge letter from the secured party. For registered securities (such as a land mortgage or vehicle charge) it may be necessary to follow the procedure of the relevant regulatory authority. There may also be additional requirements for securities registered with free zones.

SPECIAL PURPOSE VEHICLES (SPVS) IN SECURED LENDING

10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

It is not common to take security over the shares of a special purpose vehicle (SPV) set up to hold certain of the borrower's assets. However, in relation to financing a fleet of aircraft for airlines or private operators, the structure involves an SPV (jointly owned by the financier and the relevant airline) that is the owner of the aircraft. The SPV then leases the aircraft to the airline.

QUASI-SECURITY

11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

In the UAE, a significant number of recent financings have been structured according to Islamic Sharia law. Islamic financing structures rely heavily on the quasi-securities listed below.

Sale and leaseback

Ijarah financings are similar to conventional sale and leasebacks. The sale forms the basis of the Ijarah transaction although, for certain assets (typically land) the sale is often not registered to avoid the transfer charges.

Factoring

Factoring, hire purchase, retention of title and other forms of quasi-security are used in the UAE. The UAE courts respect the parties' decision regarding the form of the transaction. Therefore, the risk of such structures being recharacterised as a security interest is low.

Hire purchase

See above, *Factoring*.

Retention of title

See above, *Factoring*.

GUARANTEES

12. Are guarantees commonly used in your jurisdiction? How are they created?

Personal and corporate guarantees are commonly used in the UAE. Guarantees must be in writing and specify the amount secured by the guarantee.

RISK AREAS FOR LENDERS

13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

Financial assistance

The UAE Companies Law does not prohibit financial assistance. There is no doctrine requiring corporate benefit to grant security.

Corporate benefit

A parent company can guarantee, or grant a security in respect of, a loan given to a related company (that is, a company in the same corporate group), subject to two conditions:

- The parent company's constitutional documents contemplate a grant of this type of security.
- Necessary corporate approvals (that is, board resolution and, where necessary, shareholders' resolution) are obtained.

A subsidiary can also guarantee, or grant a security in respect of, a loan to its parent, subject to the conditions above.

Loans to directors

The Companies Law prohibits a company from making a loan of any kind to a director of the company and from guaranteeing the payment to a director of a loan made by any person to that director. The exception to this prohibition relates to loans made to directors by companies whose ordinary business is lending money. The exemption applies only if a loan is given in the ordinary course of the company's business and is not on more favourable terms than would be offered to an unconnected customer of the company.

Usury

The courts of the UAE generally permit the charging of interest of up to 12% per annum.

14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

A lender who holds or enforces security over a vessel may be liable for environmental damage caused by that vessel.

STRUCTURING THE PRIORITY OF DEBTS

15. What methods of subordination are there?

Contractual subordination

Subordination of debt is possible under UAE law. It is usually achieved by a subordination agreement between the senior and junior creditors.

Structural subordination

Structural subordination of loans is not common. However, banks regularly require shareholders to enter into agreements to subordinate their loans to the banks' loans to their corporate entities.

Inter-creditor arrangements

Inter-creditor arrangements are common for syndicated financing. The parties to the inter-creditor agreement would include the borrower, lenders, facility agent, security agent, lead arranger (if applicable) and the obligors.

DEBT TRADING AND TRANSFER MECHANISMS

16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Secured debt can be transferred through participation agreements. Under a participation agreement, a pledgee or registered mortgagee continues as the pledgee or registered mortgagee but transfers all or part of the loan, on a funded or unfunded basis. Participation may be disclosed or undisclosed, depending on the terms of the participation agreement.

AGENT AND TRUST CONCEPTS

17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

The concept of the facility and security agent are recognised in the UAE. The facility agent would generally act on the instructions of (and on behalf of) the lenders and/or the instructions of the majority lenders (as per standard Loan Market Association (LMA)). The security agent can enforce the security in the courts of the UAE, as agent of the lenders.

18. Is the trust concept recognised in your jurisdiction?

The UAE is a civil law jurisdiction that does not recognise a common law trust.

The concept of a local security agent, holding security for the benefit of third parties, is recognised. A trustee under a trust arrangement in another jurisdiction would be recognised as the equivalent of a security agent. Therefore, a security trustee could enforce its rights in the UAE courts.

ENFORCEMENT OF SECURITY INTERESTS AND BORROWER INSOLVENCY

19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

Generally, a secured creditor can enforce its security only after both:

- An event of default has occurred.
- A UAE court has granted an enforcement order. Only a pledge of cash can be enforced without a court order.

Methods of enforcement

20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

All security interests, with the exception of pledges over cash, can only be enforced through a court. The concept of self-help (or extra-judicial enforcement) is not recognised. The security must be enforced by a sale of the secured asset in a public auction.

Enforcement of a mortgage over real property is time consuming. As a matter of policy, mortgages over property, owned and occupied by a UAE national as his personal residence, generally cannot be enforced. Further, in the Emirate of Abu Dhabi, enforcement of a mortgage over real estate requires governmental

approval and approval has not been given in over two decades. However, this is expected to change in view of the Abu Dhabi and Dubai governments' support for the ownership of freehold and leasehold property by foreign nationals.

Rescue, reorganisation and insolvency

21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

No company rescue or reorganisation procedures, outside of insolvency proceedings, are available in the UAE.

22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

Legal actions cannot be brought by, or pursued against, the insolvent debtor after the pronouncement of the bankruptcy judgment, except for actions (*Commercial Code*):

- Connected with assets, rights and disposals that are specifically exempt from any distraint (that is, seizure of property for security or satisfaction of a debt) on administration or disposal under the Commercial Code.
- That the law permits the insolvent debtor to bring in connection with the bankruptcy proceedings.
- Under criminal law.
- Preparing for a judgment to close proceedings.

After the bankruptcy judgment is pronounced, all creditors (including those who are secured) must deliver to the trustee in bankruptcy:

- The documents relating to their debts.
- A statement of the debts and security interests granted in relation to them (where applicable).

Creditors who fail to submit their claims within the stipulated times are not entitled to participate in any current distribution. These creditors can file an objection to the current distributions. However, objections do not stop the current distributions ordered by the judge, supervising the insolvent debtor's estate. Rather, they entitle the creditors to participate in any further distributions.

The bankruptcy rules were enacted by the Commercial Code in 1993. In practice, these provisions remain largely untested as most bankruptcy petitions brought before the UAE courts to date have been rejected or settled outside court.

23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

Transactions entered into by the insolvent debtor during the "preference" or "suspect" period (under the Commercial Code) before the announcement of bankruptcy can be set aside by the court or trustee in bankruptcy. The duration of the preference period, however, is unclear.

The Commercial Code refers to the suspension of payments date, which is a notional date before the court's declaration of bankruptcy. Transactions by the insolvent debtor after this date can be challenged. The Commercial Code does not specify the date of suspension of payments and appears to leave determination of this date to the bankruptcy court. Therefore, a bankruptcy court

determines the date on a case-by-case basis, subject to the following basic conditions (*Articles 658 and 659, Commercial Code*):

- If the bankruptcy judgment does not specify the date of suspension of payments, the date of the bankruptcy judgment is deemed to be the date of suspension of payments (*Article 658(1)*).
- If the debtor has died, gone out of business or lost his legal capacity before pronouncement of the bankruptcy judgment, the date of the debtor's death, going out of business or loss of legal capacity is deemed to be the provisional date of suspension of payments (*Article 658(2)*).
- The court can amend the provisional date for suspension of payments to a date "ten days after the date on which the verified list of debts is deposited with the court clerk's office" (*Article 659(1)*).
- The cut-off date (that is, the date of suspension of payments) cannot precede the date of the bankruptcy judgment by more than two years (*Article 659(2)*).

However, it should be noted that the critical date is the date of the "bankruptcy judgment". Bankruptcy judgment appears to mean the court's determination that the relevant party meets the statutory bankruptcy criteria (set out in Article 645(1) of the Commercial Code), as opposed to the final decision regarding the distribution of assets to creditors.

In the bankruptcy judgment, a civil court must state that the relevant party "fails to pay his commercial debts by their due dates because his financial status has deteriorated and his credit undermined" (*Article 645(1), Commercial Code*). Considering the nature of civil court proceedings in the UAE, this statement will take a substantial amount of time after the filing of a voluntary or involuntary bankruptcy petition. Interested parties (that is, creditors) will therefore have the opportunity to present evidence regarding:

- The substantive question as to whether the relevant party should be declared bankrupt.
- The date of suspension of payments.

A bankruptcy court in the UAE therefore appears to have discretion to set aside certain actions by a grantor of security during a period of up to two years before the declaration of bankruptcy under the circumstances set out in Article 696 of the Commercial Code or if the court determines that both:

- Such actions were harmful to the creditors of the grantor of security.
- The lenders were aware at the time that the grantor of the security was insolvent.

However, the following actions are not binding on the insolvent debtor's creditors if they are taken during the suspect period (*Article 696, Commercial Code*):

- Donations, with the exception of small customary gifts.
- Payment of any term facilities before the due date.
- Payment of immediate debts other than in the form agreed.
- Granting a mortgage or any other charge on the insolvent debtor's assets to secure a prior debt.

Further, an insolvent debtor's transaction (subject to Article 696) during the suspect period can be ruled as unenforceable against the creditors if the following requirements are met (*Article 697, Commercial Code*):

- The transaction is harmful to the creditors.

- The party to whom the disposal was made was aware, at the time, of the debtor's insolvency. An insolvent person is someone who "uses extraordinary or illegal means to settle his debts, thus indicating that his financial situation is bad" (*Article 645(2), Commercial Code*).

24. In what order are creditors paid on the borrower's insolvency?

On the borrower's insolvency, the following priority of claims applies:

- Statutory and mandatory claims preferred by law. These are:
 - wages and salaries due to the employees of the insolvent debtor for the 30-day period before the declaration of bankruptcy;
 - tax claims for the two-year period preceding the bankruptcy judgment.
- Secured creditors' claims. Secured creditors are entitled to receive the proceeds from the sale of the secured asset to satisfy their claim, provided that:
 - all formalities required to perfect that security interest have been complied with;
 - the creditor has lodged his claim when called for by the trustee in bankruptcy;
 - the claim is uncontested.

If a secured creditor's claim cannot be satisfied in full, he becomes an unsecured creditor for the purpose of the outstanding balance. He will be paid a pro rata share of the remaining funds of the insolvent estate.

Security is generally created by transfer of possession of the secured asset or registration of the security. The time of registration of a security interest over the same property determines priority among those interests.

If a security interest has not been validly perfected, the creditor ranks as an unsecured creditor on insolvency.

CROSS-BORDER ISSUES ON LOANS

25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders?

Security over immovable property cannot be granted to foreign banks unless they have a commercial banking licence in the particular Emirate where the immovable property is located, with the exception of the Dubai International Financial Centre (DIFC) (*see below*). In practice, however, foreign banks lending to UAE borrowers normally appoint a local security agent to hold the UAE-located security on their behalf.

Security over movable property can be granted to non-resident foreign banks, except in the following cases:

- A business mortgage, whether under the Commercial Code or in relation to assets in the Jebel Ali Free Zone (JAFZ), can only be granted to banks or financial institutions with a commercial banking licence.
- A pledge over funds in a bank account can only be granted to the account-holding bank.

In practice, foreign non-resident banks normally appoint an onshore security agent to hold the security on their behalf.

Foreign lenders can hold security in the DIFC. Foreign lenders can be mortgagees on vessel mortgages.

26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

There are no exchange controls restricting payments to foreign lenders. The UAE Dirham (AED) is fully convertible and there are no restrictions on the movement of funds (denominated in Dirhams, US dollars or otherwise) into or out of the UAE.

TAXES AND FEES ON LOANS, GUARANTEES AND SECURITY INTERESTS

27. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

Documentary taxes

There are no applicable documentary taxes.

Registration fees

Fees are payable to the local Emirate authority to register the security. Fees vary, depending on the authority, and form a percentage of the secured amount (for example, 1% for a mortgage

over land and 0.2% for a mortgage over shares). These fees can be costly.

Enforcement of a security interest triggers court fees, prescribed by the relevant courts. If a secured asset is sold by public auction, a public auction fee is also payable.

Notaries' fees

Notarial fees for documents required to be notarised are 0.25% of the secured amount, up to a maximum of AED10,000 (about US\$2,720).

28. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

There are no strategies available to minimise costs.

REFORM

29. Are there any proposals for reform?

No major reforms are anticipated in the area of security.

Practical Law Contributor profiles



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