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Mortgages of Movable Property: a welcome update

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This article examines the implementation of the Mortgage Law (as defined below) and its potential impacts on the UAE debt finance market.

A high-level summary of the Mortgage Law is contained in Schedule 1 to this article.

Take-away:

Federal Law No. 20 of 2016 on the Mortgage of Moveable Property to Secure Debt (the "**Mortgage Law**")[1] represents a welcome change for creditors both in the UAE and abroad. Improved enforcement mechanisms, a publically searchable register of existing security interests and the ability to easily take security over assets without taking possession, together means that creditors are now able to give weight to movable assets when structuring transactions in the UAE.

While some of the initial questions surrounding the Mortgage Law remain, Cabinet Decision No. 5 of 2018 Concerning the Implementing Regulation of Federal Law No. 20 of 2016 on Mortgaging Moveable Properties to Secure a Debt (the "**Implementing Regulations**") has provided some clarity as to steps that are required in order to register a mortgage under the Mortgage Law. While the Implementing Regulations are relatively untested, as the Registry is now accessible, financial institutions should pro-actively work to register all applicable mortgages as quickly as possible.

Why was the Mortgage Law needed?

Traditionally, creditors looking to take security against movable assets in the UAE have had to rely on the provisions of the UAE Civil Code (Federal Law 5 of 1985 (as amended)) and the Commercial Code (Federal Law 18 of 1993 (as amended)) (together, the "**Existing Law**"). Under the Existing Law, a pledge over moveable assets was only able to be created by a pledgee taking possession of such assets.

The Existing Law had numerous limitations that impacted on the commercial practicality of taking security over moveables in the UAE, including:

- The inability to create security over future assets.
- A requirement that the pledgee takes possession of the secured assets. While a pledge under the Existing Law requires possession, this is often not possible commercially. As a result, parties would commonly adopt an approach of constructive possession (where physical possession would stay with the pledgor, subject to the pledgee controlling their dealings in the asset, often by way of a bailee structure). The effectiveness of this approach remains uncertain under UAE law.

[1] Published in the Federal Gazette no. 609 dated 15 December 2016 and came into effect on 15 March 2017

- A lack of an efficient and commercially practical enforcement regime. As a result of there being no recognised "self-help" remedies, all enforcement steps for possessory pledges were required to be undertaken through the Courts (which can be burdensome and lengthy).

What does the Mortgage Law apply to?

The Mortgage Law applies to any contract creating a security interest[2] over tangible or intangible moveable assets, whether present or in the future. The Mortgage Law applies to both commercial and civil transactions. In order for a valid mortgage to be created under the Mortgage Law, the following conditions must be met:

- **Be documented in writing**: The mortgage contract shall be in writing, as specified in the Implementing Regulations. The Implementing Regulations state that a mortgage can be created in writing (including in counterparts by way of fax or e-mail), without a requirement for notarisation. In addition, the Implementing Regulations also make it clear that the written approval of the mortgagor must be obtained for the registration of the mortgage.

- **Capacity**: The mortgagor must be competent to dispose of the mortgaged property or be authorised to create a mortgage over the mortgaged property.

- **Certainty**: The mortgage contract must include a description of the mortgaged property, in accordance with the requirements of the Implementing Regulations. Importantly, the Implementing Regulations allow for general descriptions of mortgaged property (provided that such description still clearly identifies the Secured Assets), allowing a creditor to easily obtain mortgages over effectively all present or future movable assets or classes of assets.

- **Declaration**: The mortgage must include a declaration by the mortgagor as to the presence of any third party rights over the mortgaged property.

- **Notification**: The principal debtor or the mortgagee must notify the owner of the mortgaged property of the mortgage, where the mortgagor is not in possession of the mortgaged property. Notification may be affected through the Registry, if so chosen.

- **Consideration**: The mortgagee must pay, or commit to pay, the fees covered in the mortgage contract. It is currently unclear whether the reference to "mortgage contract" in this provision is actually intended to refer to the contract documenting the secured obligations (such as a facility agreement). If this is indeed the intention, this requirement may prevent a financial institution from creating a valid mortgage where the secured obligations relate to uncommitted loans that have been entered into but not yet been drawn. If this is the case, financial institutions should ensure that (a) an "in principle" acceptance to create a mortgage is registered prior to advancing funds (as described below) and (b) in the period between signing an uncommitted loan agreement and registering an "in-principle" creation of a mortgage, no subsequent security has been taken over the proposed mortgaged property.

What the Mortgage Law does not apply to:

The Mortgage Law does not apply to movables for which existing laws already require registration or for which a separate registry specific or relevant to that form of movable asset exists. While there is no set test of when this will be the case, a common sense interpretation suggests that the Mortgage Law will therefore not apply to movables where there is an existing register (for example vehicles registered with traffic departments, ships and shares).

While the Mortgage Law will not apply to the financial free zones, being the DIFC and ADGM, it is still not clear as to how it applies across other free zones in the UAE. Several free zones have mandatory registration of security, whilst relying on the Existing Law. Whether such mandatory registration constitutes a "special register" is currently unclear. Regardless, the Registry (as defined below) does allow for the registration of mortgages over onshore assets by free zone entities.

[2] The English translation of the Mortgage Law refers to both "mortgage" and "pledge" interchangeably. For the purposes of clarity, we shall refer to mortgages for the purposes of this article.

What are Moveable Assets?

A broad range of movable assets are able to be subject to a mortgage under the Mortgage Law. Potential mortgaged property, as described in Article 3, includes all tangible and intangible movable assets, present and future, such as:

- Receivables (being accounts payable owed to the mortgagor);
- Deposits at licensed banks, including current accounts and deposit accounts;
- Written bonds and documents, title to which is transferable through delivery or endorsement (including bills of lading, certificates of deposit and commercial papers);
- Work equipment and tools;
- Material and moral elements of a business concern;
- Goods intended for sale or lease, raw materials and goods in the process of manufacturing or transformation;
- Agricultural crops, animals and their products, including fish and bees;
- Fixtures, provided that they can be separated from real estate without causing damage; and
- Any other movable property considered by the UAE to be valid to be subject to mortgage under the Mortgage Law.

The clarification that a mortgage can be taken over future property is a particularly welcome change to the position under the Existing Law. This is notable as it (a) allows potential creditors to look towards future asset streams in evaluating the creditworthiness of a potential mortgagor and (b) addresses the deficiencies in the Existing Law with taking security over bank accounts with fluctuating balances.

While the definition of moveable assets in Article 3 provides a much broader scope than the current position under the Civil Code, Article 4 removes certain assets from the scope of the Mortgage Law, including public property, salaries and entitlements of an insured or beneficiary of an insurance contract (unless such insurances are proceeds from moveable property that is otherwise secured in accordance with the Mortgage Law).

Registration of security

The Mortgage Law provided for the creation of the Emirates Movable Collateral Registry (the "**Registry**") by a decision of the Council of Ministers. The Council of Ministers has appointed Emirates Movables Collateral Registry Corporation as the implementing agency for the Register. The Implementing Regulations set out the logistics relating to the register, including the procedures for making a declaration on the Registry, along with the relevant fees.

While largely relevant to branches of foreign companies and foreign financial institutions, the Mortgage Law does not require the mortgagee to be a licensed UAE bank or financial institution. This is reflected in the Registry, which allows any individual or institution to make a registration (subject to signing up to the Registry and paying any relevant fees).

A. Perfection

In order for a mortgage to be effective against third parties, a declaration[3] is required to be made on the Registry. In addition, where there is a third party owner of mortgaged property that is not in the possession of the mortgagor, they must be notified of the mortgage.

Where a mortgage contract has not yet been formed, the parties may register their "in-principle" approval to create a mortgage over existing for future property. Such a registration will ensure that the eventual mortgagee will benefit from the same protection as if a mortgage had been registered, provided that the mortgage contract is entered into and registered within 5 days of receipt of the mortgaged property by the

3 For the purposes of clarity and consistency, we shall refer to declarations on the Registry as "registrations".

mortgagor or principal debtor. By allowing registration of "in-principle" mortgages, creditors can take comfort that the property that is to be secured in their favour will not be subject to any prior ranking interest, preventing the need for a race to registration.

The named mortgagor, mortgagee or principal debtor may object to the registration within 5 business days of being notified of such registration. The Courts of the UAE shall, within 10 days of the objection, make a final determination as to whether the mortgage has been improperly registered.

B. Priority

Where a mortgage has been registered with the Registry, no additional mortgage can be created on the same mortgaged property unless a subsequent registration is made in due course. As set out in Article 17, priority between competing mortgage interests will be determined by the date and time of registration on the Registry (unless a mortgagee waives their right to priority – such as in a subordination agreement – and registers such waiver with the Registry).

Registration of the mortgage will also provide a mortgagee with a secured right in the proceeds of any mortgage (unless the parties otherwise agree), with the same priority as between competing mortgage interests.

C. Duration of protection

While perfection of a mortgage will be completed on registration, the mortgage will be "ineffective" upon the expiry of the validity period specified in the Registry. While there is no specific validity period contemplated in the Mortgage Law or the Implementing Regulations, the Registry will currently only accept registrations for a certain period from the date of registration. The Implementing Regulations however allow for mortgages to be renewed by entering into a renewal of a registration under the Registry.

D. Registering Additional Rights

In addition to the registration of a mortgage, certain additional rights may be recorded on the Registry in order to gain the same protection as a mortgage in relation to determining priority on proceeds and regulating enforceability against third parties. In particular, the rights of a lessor in a financing lease; the rights of an owner of goods placed for sale and the rights of a lessor on funds subject to an operating lease with a duration of more than one year may be registered.

E. Public

The contents of the Registry are largely public, which allows potential creditors to verify whether security has been registered over assets that they intend to take security over. Article 7 provides for a public right of access to the basic information contained on the Registry (which ensures that mortgaged assets can be sufficiently identified), whilst preserving the ability of the parties to a mortgage to keep key information confidential. Under the Implementing Regulations mortgagees are also required to take into account any pre-agreed restrictions with the mortgagor as to what information can be shared by the mortgagee upon making a registration.

F. Possessory pledges

While the Mortgage Law offers numerous improvements over the Existing Law, Article 2 makes it clear that the Existing Law continues to apply. Given that the enforcement mechanisms under the Existing Law are not as creditor friendly as under the Mortgage Law, we expect that the taking of possessory pledges will be a rare occurrence moving forwards.

Where a possessory pledge is to be taken after the entry into force of the Mortgage Law, the relevant secured creditor is required to search in the Registry for the existence of any pre-existing registered rights over the property prior to taking any possessory pledge.

Where a creditor has a pre-existing possessory pledge, Article 44 makes it clear that such possessory pledges were required to be registered prior to 15 March 2018. Priority of existing possessory pledges that were registered within this time is to be determined by the date of creation of the pledge, in accordance with the Existing Law. The Mortgage Law does not expressly state priority will be lost (nor that a pledge will cease to be enforceable against third parties) if they are not registered within this period; although this is the widely held view of financial institutions in the UAE. While the Emirates Movable Collateral Registry Corporation has worked alongside financial institutions to have pre-existing possessory pledges registered within the 15 March 2018 deadline, the Registry itself was not accessible until after this point in time. As such, it is hoped that an extension of the 15 March 2018 deadline will be provided.

Enforcing Security

One of the biggest advantages that the Mortgage Law has is its enforcement mechanics. While enforcement of a possessory pledge occurs through a potentially lengthy court-sanctioned process, the Mortgage Law allows for self-help steps to be taken in addition to obtaining summary enforcement via the UAE Courts.

A. Self –Help

Article 27 and 28 of the Mortgage Law outline the circumstances in which self-help will be available to a mortgagee. There is a distinction between the method of self-help for bank accounts, bonds and documents from other moveable assets:

- **Movable assets other than bank accounts or bonds**: Where (a) the mortgagor or the principal debtor fail to perform their obligations; or (b) the underlying contract is not implemented for any reason, the mortgagee may exercise the self-help steps outlined in Article 27. In these circumstances, the mortgagee may – after providing written notification to the mortgagor and principal debtor of the breach – seize the mortgaged property, separate it from any attached property and sell it at a market price (no guidance is provided on how a "market price" is to be determined) no earlier than 10 business days after having given the original notice. This is only possible where:
    - there is agreement between the parties that such self-help is available (it is not expressly stated that this agreement may be a standing authority included in the mortgage contract, but this appears to be the generally held view, given that once there is a breach a mortgagor may be unwilling to agree to this);
    - the mortgaged property cannot be otherwise encumbered by another mortgage right or, if there is another mortgage right, consent of all mortgagees is required;
    - notification of the owner of the mortgaged property is provided where the mortgaged property is in the possession of a third party; and
    - where the mortgaged property is a fixture; the owner of the real estate where the fixture is attached, any mortgagee of such real estate, the owner of any movable to which the property is attached and the holder of such movable must be notified.
- **Bank accounts or bonds**: Self-help will only be available where the mortgagor or principal debtor fail to perform their obligations.
    - Where the mortgaged property is a bank account, and the mortgagee is also the account bank, they may set-off the balance of any account against the relevant secured obligations. Where the account bank is a third party, the mortgagee may claim the balance.
    - Where the mortgaged property consists of bonds or written documents for which ownership is transferred by delivery or endorsement, the mortgagee may take delivery of such property if their value is equivalent to the outstanding obligations.

B. Enforcement through the Court

Self-help remedies may not be possible in all circumstances (such as where consent from the mortgagor was not obtained). Where this occurs (or where the mortgagee deems it more beneficial) a mortgagee may obtain execution of the mortgage through the judiciary. By submitting a request containing, amongst other things, the mortgage contract and details of the mortgaged property, the mortgagee may ask the Magistrate of Summary Justice to issue an order of seizure and execution against the mortgaged property. It may take up to 31 business days for the Magistrate of Summary Justice to make a final declaration on whether the mortgaged property can be seized and executed (assuming objections to seizure are lodged and an appeal to an initial ruling is made).

If the mortgagee's request is upheld, the Court may authorise them to sell the mortgaged property once it has been seized. The mortgagee has an obligation to act with sufficient care to obtain a sale price that is "not lower than the market price". The Court may, if it deems fit, specify the conditions of sale or the sale method, including setting a minimum amount. The purchaser of mortgaged property that is sold in accordance with the Mortgage Law will take the mortgaged property free from encumbrances. Proceeds of any sale that are received by the mortgagee are to be deposited to the court, within two business days of the sale, for distribution in accordance with the order of priorities established under the Mortgage Law.

C. Payment in Kind

In addition to the enforcement mechanisms contained in the Mortgage Law, under Article 26 the mortgagee and mortgagor may agree that title to the mortgaged assets (in whole or in part) shall be transferred to the mortgagee in settlement of the outstanding obligations.

Summary

The publication of the Mortgage Law in December 2016 was met with quiet optimism by UAE financial institutions. The introduction of self-help remedies, coupled with the ability to take effective security over current and future property without taking possession, is a significant improvement on the Existing Law. However, until the Implementing Regulations were published, how the Registry was to be managed was a silent concern for financial institutions and lawyers alike. While some uncertainties remain, the introduction of the Mortgage Law – along with the implementation of the Registry – is a much welcomed addition to the UAE financial landscape.

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Schedule 1. Summary of the Mortgage Law

Query	Position under the Mortgage Law
How is a mortgage created?	A valid mortgage must: ▪ Be in writing, meeting the specifications set out in the Implementing regulations. ▪ Be entered into by a mortgagor with capacity to dispose of the mortgaged property or who is authorised to create a mortgage over the property. ▪ Include a description of the mortgaged property, in accordance with the requirements of the Implementing Regulations. ▪ Include a declaration by the mortgagor as to the presence of any third party rights over the property. In addition: ▪ the mortgagor must notify the owner of the mortgaged property of the mortgage, where the mortgagor is not in possession of the mortgaged property. ▪ the mortgagee must pay, or commit to pay, the underlying secured obligations.
What constitutes "moveable property"?	Movable assets are any current or future tangible or intangible movable assets, including: ▪ Receivables (being accounts payable owed to the mortgagor); ▪ Deposits at licensed banks, including current accounts and deposit accounts; ▪ Written bonds and documents, title to which is transferable through delivery or endorsement (including bills of lading, certificates of deposit and commercial papers); ▪ Work equipment and tools; ▪ Material and moral elements of a business concern; ▪ Goods intended for sale or lease, raw materials and goods in the process of manufacturing or transformation; ▪ Agricultural crops, animals and their products, including fish and bees; ▪ Fixtures, provided that they can be separated from real estate without damage; and ▪ Any other movable property considered by the UAE to be valid to be subject to mortgage under the Mortgage Law. None of public property, salaries or the entitlements of an insured / beneficiary under an insurance contract will constitute movables for the Mortgage Law.
How is a mortgage perfected?	By registering a declaration on the security registry and, where there is a third party owner not in possession of the mortgaged property, by notifying them of the mortgage.

How is priority of mortgages determined?	Priority is determined in accordance with the date and time of registering a mortgage right.
Status of pre-existing possessory pledges?	The Existing Law will continue in force. Pre-existing possessory pledges were required to be registered prior to 15 March 2018 (however this date may be extended). Priority of existing possessory pledges registered before this deadline will have priority determined by the date of such pledge.
Is the Registry searchable?	The contents of the Registry are largely public, allowing potential creditors to verify whether security has been registered over assets that they intend to take security over.
What out-of-court enforcement steps are there?	Where the assets are bank accounts or bonds, self help can be obtained in the following ways, where the mortgagor or principal debtor defaults: ▪ set-off (bank accounts where the mortgagor is the account bank) ▪ claiming account balances (bank accounts where there is a third party account bank) ▪ taking delivery (bonds or written documents where ownership is transferred by delivery or endorsement). Where the assets constitute any other form of movable, mortgagees can seize and sell (subject to certain conditions) the mortgaged property where the mortgagor or principal debtor defaults, or where the underlying contract is “not implemented”. This may occur after 10 business days from providing notice of the breach to the mortgagor and principal debtor.
What in-court enforcement steps are needed?	Mortgagees may make a request through the judiciary to obtain a declaration allowing them to seize and sell the mortgaged property, subject to certain conditions. This may take up to 31 business days from the date of the mortgagees initial request.
Does this apply to the free zones?	The Mortgage Law will not apply to DIFC or ADGM. Further clarification is required as to how the Mortgage Law will apply to other free zones, particularly where a security register is already in operation or where separate laws governing security already exist. Mortgages provided over onshore movables by free zone entities should be registered.