

UAE: Attention All Banks and Financial Institutions - Security Enforcement Alert

Federal Decree Law No. 16 of 2021 on Factoring and Transfer of Accounts Receivables

In Brief

One of the prominent forms of collateral for creditors nowadays is obtaining a transfer of a client's accounts receivables. This form of collateral is often referred to as an 'assignment of receivables' ("**Assignment**"), under which the creditor (the "**Assignee**") becomes permitted to collect from any pre-existing or future debtors that the client (the "**Assignor**") has receivables.

The Assignment, although never codified in law (unlike the Novation codified under Articles 1106 et seq. of the Civil Code) has always been consecrated by the UAE courts and required a mere notification of the debtor to be considered valid and allowed the debtor to free itself of its obligations by paying the Assignee.

The issuance of Federal Decree Law No. 16 of 2021 on Factoring and Transfer of Accounts Receivables (the "**Law**") has clarified a number of points for all parties involved including:

- Serving the debtor the Notice of Assignment is required for the Assignment to be valid against them, while seeking the debtor's consent to the Assignment is not.
- The Assignee is entitled to claim any 'Additional Rights' associated with the Assignment "*including security rights established on goods, guarantees and credit insurance*".
- The debtor is entitled to invoke any defenses available to them under the 'Original Contract' governing the relationship between the Assignor and the debtor unless expressly waived by the debtor.
- Enforcement against accounts receivables without the consent of the Assignor can only be sought if the Assignor commits a default on their borrowing obligations. If the accounts receivables are sold (instead of being collateralized), enforcement can be initiated at any time and without the Assignor's consent.
- The Assignee has senior status in collecting the assigned receivables after registration in the Emirates Movable Collateral Registry (EMCR).
- The Law only applies to commercial assignments and therefore consumer and retail assignments are excluded.
- It is still unclear however whether the Assignment under the Law constitutes a true sale and this will be a matter of merit that will be decided on a case-by-case basis by the UAE courts.

In Depth - Key Takeaways from the Law

1. Notice of Assignment and debtor's consent - are they required?

As mentioned above, prior to the Law, the assignment of receivables was governed by jurisprudence, under which, the debtor must have been notified of the Assignment for it to be valid against them.

This jurisprudential finding is asserted (albeit indirectly) in Article 15(1) of the Law, which states that the debtor will not be considered to have breached the Assignment in the event payment is made to the Assignor instead of the Assignee if no notice of the Assignment was received.

2. What is the scope of Assignments?

The definition of Assignment only refers to monies. However, Article 1 of the Law also contains a definition for 'Additional Rights' as "*any personal or in-kind rights that guarantee the payment of the amount of the assigned Account Receivable, including security rights established on goods, guarantees and credit insurance*".

Moreover, Article 6 of the Law assures that the Assignee is entitled to claim the Additional Rights.

As such, creditors should perform a due diligence exercise before entering into factoring arrangements and/or obtaining Assignments from their clients for the purpose of identifying any Additional Rights that may be associated with the assigned receivables - especially since Article 20(3) provides the Assignee with the option to enforce those Additional Rights as well.

3. Does the debtor have the right to invoke defenses of the Assignor? And can this right be waived?

Further to the Law providing that the Assignor can take legal action against the debtor to claim the Assignee's transferred receivables, Article 16 states that the debtor is entitled to invoke any defenses available to them under the 'Original Contract' governing the relationship between the Assignor and the debtor.

However, this right can expressly be waived by the debtor (under Article 17 of the Law), but such a waiver cannot exclude defenses arising out of fraudulent acts committed by the Assignee as well as defenses pertaining to the debtor's absence of capacity when having entered into the Original Contract with the Assignee.

4. When can the Assignee enforce against the receivables?

Under Article 20 of the Law, if the Assignee takes the Assignment as a form of security, then legal action without the consent of the Assignor can be initiated only if the Assignor (or the client) commits a default on their borrowing obligations. If however, the accounts receivables are actually sold to the Assignee (instead of being collateralized), then enforcement steps against the debtor can be taken at any point of time.

5. Does the Law provide an easier and faster way to enforce?

Under Article 21 of the Law, the means of enforcement against the receivables is made as agreed upon in the Assignment Agreement or as per the Federal Law No. 4 of 2020 governing Pledged Rights in Moveable Assets ("**Moveable Pledge Law**"). This allows creditors to enforce against receivables immediately by bypassing the normal litigation proceedings.

6. Does the Assignee have senior status vis-à-vis the receivables?

Yes. According to the Article 7 of the Law, the Assignment will have effect towards third parties after registration in the Emirates Movable Collateral Registry (EMCR) and in accordance with Chapter 5 of the Moveable Pledge Law, which in turn asserts the Assignee's (or the creditor's) senior status in collecting the assigned receivables.

7. Does the Assignment envisaged by the Law constitute a true sale?

As it is well known, a true sale could exist in a securitization issuance whereby the assets of an originator are transferred to a Special Purpose Vehicle for the purpose of the issuance of securitization notes and such transfer of assets may not be nullified by any insolvency of the originator, particularly as a result of a claw-back during a suspect period. So does the Assignment under the Law constitute a true sale that could override the provisions of Article 168 of the Bankruptcy Law? There are unfortunately still no clear answers to this question and the legislator seems to believe that this will be a matter of merit that should be decided on a case-by-case basis by the UAE courts.

This is still unsatisfactory, especially since UAE judges, and similar to any other civil law judges, have to abide by the statutory provisions that were promulgated. We therefore anticipate an amendment to the Law to clarify this point as a recognition of true sale could potentially allow securitization operations to flourish in the UAE (especially since it is known as a tax efficient jurisdiction).

8. Does the Law apply to any kind of assignments?

It seems that the Law only applies to commercial assignments and therefore consumer and retail assignments are excluded. The Law is in line with the UAE Central Consumer Protection Regulations and Standards, which prohibit any assignment of consumer receivables without the consent of the consumer.

Expected Impact

- Conventional and Islamic banks are more likely to mandate that their clients (the Assignor) include a waiver of defenses clause in the Original Contracts on behalf of the debtors (the Assignee's contract counterparty).
- Creditors (or the Assignee), and particularly conventional and Islamic banks, have obtained more clarity on the mechanisms and avenues available for fast and robust enforcement against assignments. We therefore expect more frequent enforcement actions upon this specific form of security in the future.

- We expect (and advise) creditors to register their assignments in the EMCR registry as soon as possible to be able to enforce against the assigned receivables when the need arises.

To speak to us in relation to the new Law, any financial services related matters, or issues generally, please feel free to contact one of the team members below or your usual Baker McKenzie contact.

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