

## UAE ENACTS FEDERAL LEVEL CLOSE-OUT NETTING LAW FOR FINANCIAL CONTRACTS

On 20 September 2018, the President of the United Arab Emirates had promulgated the much-anticipated Federal Law No. 10 of 2018 on netting for derivatives contracts and other qualified financial contracts (the UAE Netting Law), the text of which was published last week. The UAE Netting Law will come into force on 30 October 2018, one month after its publication in the Official Gazette<sup>1</sup>, and comes soon after the UAE's securities regulator, the Emirates Securities and Commodity Authority (the SCA), enacted a new regulation mandating the clearing of certain derivatives contracts.

The UAE Netting Law will apply across the United Arab Emirates, except inside the country's two financial free zones: the Abu Dhabi Global Market (ADGM) and the Dubai International Financial Centre (DIFC). The ADGM and the DIFC each have their own netting laws under their separate respective jurisdictions on civil and commercial matters.

The UAE Netting Law follows key concepts set out in the International Swaps and Derivatives Association's (ISDA) 2006 Model Netting Act. In doing this, the UAE Netting Law confers legal enforceability on pre- and post-insolvency close-out netting procedures under netting agreements in relation to natural and legal persons located in the UAE (but outside of the ADGM and the DIFC). The UAE Netting Law also contemplates legal enforceability for collateral arrangements that support netting agreements.

The UAE Netting Law specifically includes certain Shari'ah-compliant contracts or undertakings within the scope of a Qualified Financial Contract, thereby making possible the prospect of enforceable close-out netting in respect of Shari'ah-compliant transactions on a national level beyond the financial free zones.

### SIGNIFICANCE OF THE UAE FEDERAL NETTING LAW

As noted in our briefing of February 2018, "Netting: a UAE Perspective"<sup>2</sup>, the legal recognition of close-out netting provisions in financial contracts is increasingly significant to parties in the UAE as the region advances implementation of Basel III principles. The consequences of non-netting had

#### Key issues

- The new law provides UAE-wide legal recognition of netting agreements and close-out netting but leaves ADGM and DIFC netting laws in place as regards those jurisdictions
- A federal-level committee including representatives of the three UAE financial sector regulators to administer the new law is a welcome indication of intra-ministerial cooperation to supervise national recognition
- Qualified Financial Contracts within netting agreements includes Shari'ah-compliant instruments and the transaction-types in ISDA's 2006 and 2018 Model Netting Acts
- Enforceability of Collateral Arrangements relating to netting agreements of the types typically envisaged under ISDA and securities financing documentation are expressly recognised
- The Penal Code prohibition has not been specifically set aside but there is express provision in the new law that contrary or conflicting laws would be "cancelled".

<sup>1</sup> The UAE Netting Law was gazetted in edition no. 637 of the Official Gazette dated 30 September 2018.

<sup>2</sup> This briefing was first published by IFLR on 26 January 2018. Link to our February 2018 briefing: [Netting: A UAE perspective](#)

impacts on a wide range of UAE market participants beyond financial institutions.

## **SPECIFIC FEATURES OF THE UAE FEDERAL NETTING LAW**

### **Putting the fundamentals of close-out netting in place**

Article 9 of the UAE Netting Law provides that a Netting Agreement (as defined in Article 1):

- (1) shall be final and enforceable in accordance with its terms, including against an insolvent party, a guarantor or any other person providing security for any party to the Netting Agreement, even if the guarantor or security provider later becomes insolvent; and
- (2) shall not be suspended or stopped or otherwise have conditions imposed on its execution (i.e. the occurrence of netting in accordance with the terms of the Netting Agreement) based on:
  - (a) the appointment of a Liquidator, or
  - (b) any action of the Liquidator, or
  - (c) any provision of the Insolvency and Bankruptcy Procedures, including preferences, fraudulent transfers or any limitation on the operation of set-off (see Articles 12 and 13), or
  - (d) any other provision of law that may be applicable to an insolvent party.

The definition of "Insolvency and Bankruptcy Procedures" in Article 1 as comprising any procedure under the provision of insolvency laws in force in the UAE from time to time is also notable for its potential to capture insolvency proceedings beyond those under Federal Law No. 9 of 2016 regarding bankruptcy, as a number of UAE persons fall outside of the current UAE bankruptcy laws and all major corporate insolvencies to date have taken place through a decree-mandated regime.

### **Scope of a Netting Agreement under the UAE Netting Law**

The following types of agreement can be treated as Netting Agreements:

- (1) agreements concerning provisions allowing for netting of present or future payment or delivery obligations and/or entitlements arising under or in connection with one or more Qualified Financial Contracts
- (2) any Collateral Arrangement such as credit support annexes or a credit support deed related to a Netting Agreement
- (3) any Shari'ah-compliant agreement or arrangement conforming to type (1) or (2) above
- (4) certain master agreements or a cross-product netting agreement.

## **QUALIFIED FINANCIAL CONTRACTS**

These follow the list in the latest version of ISDA's 2006 Model Netting Act with the significant addition in a UAE context of Shari'ah-compliant contracts (Article 5(23)).

## **COLLATERAL ARRANGEMENTS**

Entry into title transfer collateral arrangements (such as under repo agreements and stock lending agreements) is enabled.

Similar to ISDA's 2006 Model Netting Act and 2018 Model Netting Act, the collateral assets comprising a Title Transfer Collateral Arrangement include: cash, securities, guarantees and letters of credit, and certain other assets commonly used.

While the operative provisions in Article 4(1) on Collateral Arrangements which are part of Netting Agreements would indicate arrangements under credit support annexes would be recognised, there remain some questions over whether security interests created pursuant to a UAE law pledge or mortgage over moveable property would continue to apply – including, pursuant to Article 15, in relation to the realisation and liquidation of collateral.

## **THE INSTITUTIONAL STRUCTURE SUPPORTING UAE FEDERAL NETTING**

Administration of the UAE Netting Law is the responsibility of the Ministry of Finance. Article 7 provides for a Committee for Designation of Qualified Financial Contracts (the Netting Law Committee) to be formed and chaired by the Ministry of Finance and consisting of two representatives from each of the financial sector regulators in the UAE: (a) the Central Bank, (b) the Securities and Commodities Authority and (c) the Insurance Authority. The Netting Law Committee will have power to give opinions on topics related to Qualified Financial Contracts and to add, remove or replace contracts from the list of Qualified Financial Contracts.

The formation of the Netting Law Committee is a particularly reassuring development, as it addresses previous questions from market participants on cooperation and participation between the relevant stakeholders to ensure netting enforceability. The envisaged role of the Netting Law Committee in the UAE Netting Law is also markedly different from earlier suggestions that it should approve close-out netting with respect to a party before a lump sum can be legally recognised.

The financial regulators in the ADGM and DIFC will not have membership of the Netting Law Committee. This is consistent with the treatment of persons located in either the ADGM or the DIFC as Foreign Parties under the UAE Netting Law.

## **SCA RESOLUTION NO. 22 OF 2018 REGULATING DERIVATIVES**

Following the implementation of the UAE Netting Law, it will be timely for the three UAE federal regulators to review their existing regulations with regard to the effect that the UAE Netting Law may have. One such regulation is the SCA's Resolution No. 22 of 2018 Regulating Derivatives (Resolution 22).

This Resolution 22 sets out some conditions regarding the mandatory reporting of derivatives contracts and clearing of OTC derivatives contracts. Interpretation of the scope of Resolution 22 has prompted a range of questions from market participants.

We understand that the SCA may interpret the terms of Resolution 22 more narrowly than the text of the resolution itself, which would be helpful to ensure no conflicts between the UAE Netting Law and Resolution 22.

In the longer term, it would be helpful to see new regulations from all three federal regulators taking full account of the UAE Netting Law, particularly in light of current initiatives by each of these regulators to develop recovery and resolution regimes for their respective regulated licensees. The treatment of close-out netting under derivatives contracts under the recovery and resolution regimes in the G20 jurisdictions will pose some valuable lessons on the pitfalls to avoid in the UAE.

### **THE UAE PENAL CODE**

The Federal Law No. 3 of 1987 (as amended) (the UAE Penal Code) makes gambling an unlawful criminal activity. As in many jurisdictions, there has been debate as to whether such a prohibition is applicable to speculative derivative transactions. The UAE Netting Law does not remove this concern, although Article 18 generically says that any provisions of any other law contrary to or conflicting with the provisions of the UAE Netting Law shall be cancelled.

The UAE Netting Law applies to contracts that are otherwise legal, valid and binding under UAE law. If a contract were to be found to be unlawful for being a wager or bet in contravention of the UAE Penal Code, it is arguable that the contract would not satisfy the criteria for the UAE Netting Law to be applied to it.

### **CONCLUDING REMARKS**

Clifford Chance and ISDA have worked on providing comments and guiding engagement on the relevant netting issues since early 2015 at the developmental stages of the UAE Netting Law.

The promulgation of this new law is a major step in providing a framework for netting certainty, and an important keystone in supporting the wider current legislative initiatives to advance the UAE as one of the world's leading financial hubs.

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