

DEVELOPMENTS RELATING TO SUFFICIENT OR ADEQUATE SECURITY REQUIREMENT UNDER AMENDED UAE BANKING LAWS

On 2 January 2023 a series of new laws came into force in the UAE, including Federal Law No. 23 of 2022 which amended certain provisions of Federal Law No. 14 of 2018 (the "UAE Banking Law") and Federal Law No. 50 of 2022 (the "New Commercial Transactions Law") which repealed and replaced Federal Law No. 18 of 1993 (the "Old Commercial Transactions Law").

The UAE Banking Law (as amended) and the New Commercial Transactions Law, both introduced a requirement obliging financial institutions and/or banks to obtain "sufficient" or "adequate" security for credit facilities granted by them. Despite a number of recent developments, including explanatory guidance by way of official circulars from the Abu Dhabi Judicial Department and a string of caselaw on the subject, there remains considerable uncertainty surrounding the scope of the requirement for sufficient or adequate security.

In this briefing, we consider the interpretation of the sufficient or adequate security requirement, in light of the recent developments, focussing on three main elements:

- (1) The meaning of "sufficient" or "adequate";
- (2) The scope (in particular, temporal scope) of the new requirements; and
- (3) The types of facilities to which the requirements apply.

We also highlight the practical implications financial institutions should keep in mind, in light of the new requirements.

Key takeaways

- Amendments to the UAE Banking Law and the New Commercial Transactions Law have introduced an obligation on financial institutions to obtain "sufficient" or "adequate" security against loan facilities.
- The legislative changes are not entirely clear, including ambiguity regarding the central question of what will be deemed "sufficient" or "adequate" for the purposes of the law.
- Whilst the scope of the new measures remains unclear, developments have indicated that in the context of the UAE Banking Law (i) the new measures may be applied retrospectively; and (ii) the new measures are likely intended to afford protection to consumer borrowers, i.e., individuals or sole proprietorships, as distinct from corporate borrowers. The position with respect to the New Commercial Transactions Law remains untested.
- Financial institutions operating in the UAE should closely monitor further developments and consider the implications of the new requirements on both existing loans and any new facilities being entered into.
- Financial institutions should also be aware that the new measures in the UAE Banking Law have been interpreted and applied differently by the Abu Dhabi courts and Dubai courts.

AMENDMENTS TO THE LAW

Federal Law No. 23 of 2022 introduced several amendments to the UAE Banking Law, including the enactment of a new Article 121 bis under Chapter 6 "Consumer Protection". Pursuant to Article 121 bis, "Licensed Financial Institutions" ("LFIs") are required to obtain "sufficient guarantees" (security) for facilities granted to natural clients and private sole proprietorships, in accordance with the amount of the relevant facilities being granted and the income of the customer.

Article 121 bis also provides that, where LFIs fail to obtain such "sufficient" security, any application, action or plea filed before competent judicial authorities or arbitral tribunals, in relation to the credit facility granted, will be rejected and such LFIs may be subject to administrative and financial sanctions imposed by the Central Bank. In other words, if LFIs fail to procure "sufficient" security from consumer borrowers, they will be unable to advance claims to enforce the terms of any facility granted.

A similar requirement was introduced by the New Commercial Transactions Law. In this case, the new measures are not limited to facilities provided to natural clients and sole proprietorships and arguably extend to corporate borrowers. More specifically, by virtue of Article 409(2), banks "*shall obtain adequate securities or collaterals against loans granted by them*". Notably, this provision imposes a strict obligation on banks to obtain "adequate" security, in contrast with the predecessor provision contained in the Old Commercial Transactions Law, which merely provided that Banks "may" obtain security for loans provided. Further, Article 409(2) provides simply that "banks" must obtain adequate securities against loans granted by them. Given that the commercial transactions law has always governed *all* commercial transactions carried out within the UAE (including banking activities), it may be that Article 409(2) extends to all banks providing loans within the UAE, in contrast with the UAE Banking Law, which only applies to loans provided by banks regulated by the UAE Central Bank.

UNCERTAINTIES ARISING OUT OF THE NEW MEASURES

The above requirements in the UAE Banking Law (as amended) and New Commercial Transactions Law give rise to a number of questions as to their proper interpretation and scope. In particular:

- (1) What is the proper meaning of "sufficient" or "adequate" security?
- (2) What is the scope (in particular, temporal) of the new requirements?
- (3) To what types of facilities do the new requirements apply?

Meaning of "sufficient" or "adequate" security

Despite the introduction of a new obligation to obtain "adequate" or "sufficient" security for facilities, neither the UAE Banking Law (as amended) nor the New Commercial Transactions Law offer a definition or provide definitive guidance as to what may be considered "adequate" or "sufficient" for this purpose.

While Article 121 bis does provide some limited guidance to the effect that security should be granted "according to the income of the customer... as well as the amount of the required facilities, as determined by the Central Bank", there remains uncertainty as to what will be considered "sufficient" and how this will be determined. This includes uncertainty as to the precise role of the Central Bank in determining sufficiency or adequacy. In particular, it is not yet clear

whether the Central Bank will offer guidance on a case-by-case basis, or will limit itself to providing higher-level generic guidance in this regard. We understand that the Central Bank has issued limited guidance in relation to Article 121 bis by way of a clarification letter. We have not sighted such letter but understand anecdotally that the letter does not conclusively address the specific queries raised in this briefing (save for confirming that personal guarantees are not sufficient securities for the purposes of the UAE Banking Law (as amended)). We are not aware of the Central Bank issuing any guidance on the scope of Article 409(2) of the New Commercial Transactions Law.

For the purposes of Article 409(2) of the New Commercial Transactions Law, and pending further guidance on this topic, it would seem sensible to analyse in each case whether a bank has taken enough security of enough value to support its risk of lending. For example, there may be instances in which "adequate" in the context of a strong credit could mean no collateral is taken (noting that, if some form of security is always required, this would effectively bring an end to unsecured lending altogether). However, in the absence of court, statutory or Central Bank guidance, the position remains unclear.

What is the scope of the new requirements?

There is also uncertainty as to the scope and temporal application of the new measures in circumstances where financial institutions are found not to have sufficient or adequate security.

Article 121 bis (2) provides that "*[no] application, action or plea filed to the competent judicial authorities or the arbitral tribunals by any licensed financial institution in respect of a credit facility provided for a natural person or a private sole proprietorship shall be accepted if such financial institution fails to obtain the guarantees referred to in Clause (1) of this Article.*"

However, neither Article 121 bis (2), nor (1), states whether it is intended to apply to all lending facilities, or only to facilities entered into after 2 January 2023 (being the date the amendments to the New Banking Law took effect).

Broadly speaking, there are three potential interpretations as to the temporal effect of the new measures, including the prohibition on claims:

- (1) The new measures apply only to lending facilities entered into after 2 January 2023 ("**Option 1**");
- (2) The new measures apply to all lending facilities (including those pre-dating 2 January 2023), but do not prevent enforcement of judgments obtained prior to 2 January 2023 in relation to facilities without sufficient or adequate security ("**Option 2**"); or
- (3) The new measures apply to all lending facilities (including those pre-dating 2 January 2023) and also prevent the enforcement of judgments obtained prior to 2 January 2023 in relation to lending facilities entered into without sufficient or adequate security ("**Option 3**").

As discussed further below, each of these interpretations seems to have found favour in at least one forum in relation to Article 121 bis of the New Banking Law. It is yet to be seen whether these interpretations would impact the interpretation of Article 409(2) of the New Commercial Transactions Law by the UAE courts.

To what types of facilities do the new requirements apply?

While Article 121 bis (1) expressly provides that 'sufficient' security is required for "*all types of facilities provided to natural clients and private sole proprietorships*", thereby limiting the protection afforded by the new requirements to individual customers and sole trader entities, recent developments have introduced a broader potential interpretation of the substantive scope of Article 121 bis which would extend the protection afforded by the new measures to corporate borrowing.

As discussed further below, the recent English High Court Judgement has cast doubt on the broader interpretation of the substantive scope of Article 121 bis, emphasising the inconsistency of such a broad interpretation with the express wording of Article 121 bis.

By way of contrast, Article 409(2) does not provide for any express limitation in relation to its substantive scope and provides that banks shall obtain adequate securities or collaterals "against loans granted by them". So, in theory, this could apply to **any loans** (including loans to corporates) to which the New Commercial Transactions Law applies, even if extended by offshore financial institutions that are not otherwise covered by the UAE Banking Law.

RECENT DEVELOPMENTS

Since coming into force on 2 January 2023, there have been several developments in relation to the interpretation of the measures introduced by Article 121 bis of the UAE Banking Law (as amended).

Unfortunately, the developments have, to date, not served to clarify the meaning and intent of Article 121 bis or indeed Article 409(2) of the New Commercial Transactions Law. If anything, the picture has been blurred further, making it difficult for financial institutions definitively to assess and manage their positions – either current or future. In response to a clarification request by the Undersecretary of the Abu Dhabi Judicial Department on 24 January 2023, the Governor of the Central Bank issued a letter dated 22 February 2023 that considered the interpretation of Article 121 bis.¹

Subsequent to the clarificatory letter of the UAE Central Bank, the Judicial Department of Abu Dhabi issued Circular No. 9 of 2022 and Explanatory Circular No. 3 of 2023 (the "AD Circulars"). The AD Circulars advised that Article 121 bis has retrospective application and therefore applies to all credit facilities regardless of the date they were entered into. Further, the AD Circulars opined that a "pure personal guarantee", as distinct from an "in kind guarantee", is inadequate security for the purposes of Article 121 bis. Finally, the use of the phrase "individual institutions **and companies**" in Explanatory Circular No. 3 of 2023, may suggest an interpretation whereby Article 121 bis extends to corporate borrowing in certain circumstances. However, this would appear to contradict the clear language of Article 121 bis as well as the characterisation of such provision within Chapter 6 "Consumer Protection" of the UAE Banking Law (as amended).

The Abu Dhabi Courts have on several occasions given full effect to the AD Circulars, suspending litigation proceedings and refusing execution measures in circumstances where banks had obtained a pure personal guarantee (as opposed to an in-kind guarantee) prior to lending to natural persons or sole proprietorships, despite the fact that relevant lending arrangements were entered into, and judgment on the facilities had been procured, before the

¹ As noted above, we have not sighted such letter.

measures outlined above were introduced. This approach is consistent with **Option 3**, above.

For example, in Execution Case No. 17/2023 the Abu Dhabi Court of Appeal, in direct reliance on the AD Circulars, prohibited the claimant bank from executing two final UAE judgement debts that had been awarded in its favour (prior to 2 January 2023). The judgments were in respect of the defendant's liability under two personal guarantees given in 2016, in return for credit facilities granted by the bank.

By contrast, two other recent decisions of the Abu Dhabi Court of Cassation (Appeal No. 102/2023 and Appeal No. 111/2023) appear to conclude - in direct contradiction of the AD Circulars - that Article 121 bis does **not** apply retrospectively. More specifically, in Appeal No. 102/2023, the Abu Dhabi Court of Cassation rejected the appellant's argument that the appellee bank's case should be dismissed because the bank had failed to obtain sufficient security in accordance with Article 121 bis to guarantee the personal loans granted to the appellant. The Court ruled, consistent with **Option 1** above, that Article 112 of the UAE Constitution precluded the retrospective application of Article 121 bis to a loan that had been obtained in advance of 2 January 2023.

Further, the Dubai Court of Cassation in Appeal No. 995/2023 recently declined to extend Article 121 bis to corporate borrowing as suggested in the AD Circulars, expressly providing that the circulars of the Judicial Department/Council of another Emirate, such as Abu Dhabi, have no legal force in Dubai. On the facts of the case, the Dubai Court of Cassation concluded that Article 121 bis was not intended to extend to credit facilities granted to a limited liability company, and therefore upheld enforcement against such a borrower and its personal guarantor. Interestingly, the Dubai courts did not seek to address the question as to whether Article 409(2) of the New Commercial Transactions Law would apply.

The interpretation of Article 121 bis has also recently been considered by the English High Court in *Invest Bank P.S.C v Ahmad Mohammed El Hussein, Joan Eva Henry & ors* [2023] EWHC 2302. The High Court was asked to consider whether it was able to enforce the two UAE judgement debts that the Abu Dhabi Court of Appeal had refused to enforce in Execution Case No. 17/2023 (see above). The High Court concluded that the UAE judgement debts were enforceable within the English jurisdiction on the basis that the UAE judgement debts had *res judicata* effect in the UAE and there was no rule of common law that a foreign judgement with *res judicata* effect in its original jurisdiction cannot be enforced in the English Courts merely because it is not fully enforceable in the foreign jurisdiction itself. In coming to this conclusion, it was necessary for the English Courts to consider the "*correct meaning and effect of Article 121 [bis]*". The High Court opined that:

- Article 121 bis is not likely intended to have retroactive effect in the fullest sense. More particularly, while Article 121 bis *may* apply to prevent enforcement in respect of certain credit facilities granted before 2 January 2023, a distinction should be drawn in relation to credit facilities where the lender had already obtained a final monetary judgement against the debtor (and therefore had an accrued property interest) before 2 January 2023.
- It was more probable than not, that the substantive scope of Article 121 bis does not extend to cover corporate borrowing, i.e., borrowing

by a limited liability company as distinct from a sole enterprise or joint stock institution.

In relation to the interpretation of the temporal scope of the new measures, the High Court therefore followed **Option 2** above.

It will be interesting to see whether the UAE courts follow the same approach to the temporal scope of the new measures under the New Commercial Transactions Law.

KEY QUESTIONS

Meaning of "sufficient" or "adequate"

As a result of the absence of any formal definition or legislative guidance as to the meaning of "sufficient" or "adequate" security, there remains uncertainty regarding the amount and type of security required to satisfy the new measures.

The Abu Dhabi Judicial Department and various Courts have sought to grapple with the meaning of "sufficient" and/or "adequate". However, beyond a consensus that pure personal guarantees are not likely to be deemed sufficient security for the purposes of Article 121 bis, there has been limited clarity offered to date. It is noteworthy that the UAE courts have not yet had to determine the issue under Article 409(2) of the New Commercial Companies Law.

Accordingly, numerous questions remain unanswered including: How will adequacy or sufficiency of security be determined? Are there any circumstances in which no security may be deemed "sufficient" or "adequate"? And what is the precise role of the Central Bank in the context of determining the adequacy or sufficiency of security?

Temporal scope

As set out above, each of the three options for interpretation of the temporal scope has been adopted by at least one forum in the context of the UAE Banking Law (as amended).

Of the three options, Option 3 – whereby all claims and actions in relation to any lending facility without sufficient or adequate security would be prohibited (including execution of existing judgments) – is the most restrictive and would seem to go beyond the likely intention of the new measures. It is also arguably inconsistent with Article 112 of the UAE Constitution, which provides clearly that "*[a] law shall only apply from the date it comes into force and shall not apply regressively. In non-criminal matters, a law may, when necessary, provide otherwise.*" Nonetheless, it has been adopted in two cases by the Abu Dhabi Courts.

Option 2 – whereby all new claims would be prohibited, even for facilities entered into before 2 January 2023 – could also be argued to have a retroactive effect, in the sense that it effectively assesses pre-2 January 2023 facilities by reference to the newly imposed requirements. It therefore risks rendering facilities entered into prior to 2 January 2023 unenforceable by financial institutions if they failed to procure sufficient security, despite this not having been a requirement at the time of entry into the facility. Nonetheless, it is the interpretation adopted by the English High Court.

Option 1 – whereby the new requirements would not be imposed in relation to any facilities existing prior to 2 January 2023 (such that security procured in support of those facilities would be enforceable, even if not "sufficient" or "adequate") – would no doubt be the interpretation preferred by financial institutions, as it would provide greater certainty, and not involve historic

facilities now being assessed by reference to newly imposed requirements. It has been adopted in a number of cases, as discussed above.

In view of the above, clear guidance at a Federal level would prove helpful in confirming the correct approach and ensuring consistency. Pending any such guidance being issued, there is a danger of differing approaches being adopted in different courts. It also leaves open the risk that the position in relation to Article 121 bis of the Banking Law (as amended) will be used to interpret Article 409(2) of the New Commercial Transactions Law as to which there is currently no other guidance.

Consumer facilities only?

Despite clear wording in Article 121 bis (1) expressly limiting the protection afforded by the new measures to individual customers and sole trader entities, the incorporation of the phrase "individual institutions and companies" in Explanatory Circular No. 3 of 2023 has introduced a broader potential interpretation of the substantive scope of Article 121 bis which would extend the protection afforded by the new measures to corporate borrowing.

However, as is apparent from the decisions of the Dubai Court and the English High Court, it appears that courts remain reluctant to extend the protection afforded by the new measures beyond consumer borrowing on the basis that interpretation would go beyond the clear language of Article 121 bis (1).

Which banks?

Whilst it is clear that the New Banking Law applies to LFI's, in relation to Article 409(2) of the New Commercial Transactions Law, the question arises as to whether it applies not only to LFI's but potentially to *any* bank (including international banks) lending to a UAE borrower.

We are not aware of any UAE court decision or Central Bank guidance which would limit the scope of Article 409(2) to LFI's only and we would recommend that *all* banks ensure that a careful analysis of creditworthiness and the nature of any security package is undertaken on each transaction involving a UAE borrower.

PRACTICAL IMPLICATIONS

Despite the lack of clarity surrounding the scope and application of the new measures introduced by Article 121 bis of the UAE Banking Law and Article 409(2) of the New Commercial Transactions Law, it is clear that the introduction of such measures has significant practical implications for banks and other financial institutions operating in the UAE.

Current facilities in place

Whilst the precise extent of the temporal application of Article 121 bis is yet to be determined, given the guidance set out in the AD Circulars and certain decisions of the Abu Dhabi courts, it is evident that there is scope for Article 121 bis to be applied retrospectively. As a result, it may prove prudent for financial institutions to undertake a review of their portfolio of lending facilities currently in place, particularly those facilities extended to natural clients and sole proprietorships. Financial institutions should consider carefully:

- What security is in place of respect of such pre-existing facilities?
- Is such security likely to be considered "sufficient" or "adequate"?
- If not, could replacement security be obtained?

When conducting their review, financial institutions should keep in mind that facilities that (i) have been extended to natural clients and sole proprietorships; and (ii) have been secured by pure personal guarantees (as distinct from in-kind guarantees), are likely to fall foul of the new measures and are at risk of being deemed unenforceable. It is unclear if the same would be the case for corporate loans to which Article 409(2) applies.

New facilities

In respect of new facilities being granted, financial institutions should closely scrutinise the terms of each loan agreement in light of the new measures, with increased scrutiny of facilities extended to 'consumers'. While it is still not possible to state with certainty what type or amount of security will be deemed sufficient to satisfy the obligation to obtain 'sufficient' or 'adequate security', financial institutions should consider:

- The express terms of Article 121 bis of the UAE Banking Law and Article 409(2) of the New Commercial Transactions Law;
- Any current official guidance in place in respect of such provisions;
- Personal guarantees are unlikely to be considered 'sufficient' to support loans to which Article 121 bis applies and therefore, the same may be the case for corporate loans under Article 409(2) of the New Commercial Transactions Law; and
- The amount of the relevant facilities being granted and the income or creditworthiness of the customer/borrower.

CONCLUSION

Although it remains to be seen whether any further official guidance (particularly at a Federal level) will be issued in respect of the interpretation and scope of the 'adequate security requirement' introduced by Article 121 bis of the UAE Banking Law and Article 409(2) of the New Commercial Transactions Law, the introduction of a requirement to obtain adequate security is a positive policy step towards encouraging responsible lending by licensed UAE financial institutions. Accordingly, Banks should be aware of the practical implications highlighted above and take these into account in considering their current portfolio of facilities and any future credit facilities offered, in particular to individual and private sole proprietorships. It may also be necessary for banks proactively to work with other UAE Bank Federation members to lobby the interests and position of financial institutions for clarity not just in relation to the meaning of "sufficient" and "adequate" in respect of collateral taken by banks but also in relation to whether all banks (including foreign banks) must comply with Article 409(2) of the New Commercial Transactions Law

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