

Banking &amp; Finance

# The UAE Factoring Law

## A step into the future for receivables financings

November 2021

*The UAE Factoring Law was issued on 29 August 2021, published on 9 September 2021 and comes into effect on 7 December 2021. It builds on the UAE Movable Security Law and clarifies that future receivables can be sold prior to their coming into existence. This clarification will greatly assist those participating in the UAE trade finance market, bringing ever-greater certainty to CFOs, corporate treasurers and trade financiers alike.*

*This memorandum sets out the key features of the UAE Factoring Law.*

### Speed read

UAE federal law No.20 of 2016 in relation to the charging or pledging of movables as security for indebtedness (the **Old UAE Movable Security Law**) was a significant development in the UAE banking and finance legal landscape. It gave rise to a significant change in the practice of taking security over movable property in UAE banking and finance transactions (including trade receivables) and it expressly permitted the ability

to take a security right over future specified movable property, as well as present specified movable property. However, it also went further and allowed true sales of receivables to be registered on the UAE movable security register (the **UAE Movable Security Register**) and Article 11 of the Old UAE Movable Security Law stated that such registrations produced the same effects in their effectiveness against

third parties, the procedures for their enforcement and prioritisation in their recovery of rights from the returns on them from the proceeds of their enforcement as if the sale of receivables was a security right registered on the UAE Movables Security Register.

That being said, it implied that future receivables could be subject to a true sale without expressly clarifying this. UAE federal law No.16 of 2021 in relation to factoring and the assignment of receivables (the **UAE Factoring Law**) makes this clear and sets out the requirements in order to do so under UAE law. Key features of the UAE Factoring Law and considerations arising include:

- Helpful confirmation that future receivables can be assigned or sold prior to them coming into existence and without further action upon them coming into existence if adequately defined in the receivables assignment agreement (as well as associated notice of assignment, acknowledgments and registration in the UAE Movables Security Register).
- Parties to a receivables assignment agreement will want to consider whether to register their receivables assignment agreement in the UAE Movables Security Register in order to obtain priority over any subsequently registered receivables assignment agreement in respect of the same receivable. In particular, historic

receivables assignment agreements can maintain their priority based on their date of execution if registered prior to 7 June 2022. It is recommended that such agreements be registered where possible and practical.

- If parties send a notice of assignment to a receivable's debtor, that receivable's debtor may only effect a good discharge of the receivable if it pays in accordance with the notice of assignment. This enhances the protection to assignees even if the receivable's debtor does not acknowledge the notice of assignment (although that is, of course, useful evidence that the receivable's debtor has received the notice of assignment) or refuses to countersign it.
- Confirmation that the assignee may want to continue to insist on the receivable's debtor signing an acknowledgment of the notice of assignment to ensure that the receivable is free from set-off and other competing rights.
- Helpful confirmation that an assignment of receivables includes a transfer of any ancillary rights, although there may continue to be sound reasons for taking a catch-all assignment of contractual rights, where financiers are concerned with more than just the receipt of the receivable (and rights ancillary to that receivable) generated by the original contract.



# Introduction

Receivables assignment agreements are a significant tool used by participants in the trade finance industry. Unlike loans that may be secured against receivables and sit on the balance sheet of the borrower as a debt obligation, receivables assignment agreements generally permit the assignor to receive funds from the assignee once the assignor's receivable comes into existence without the amount received by the assignor from the assignee for such assignment sitting on the balance sheet of the assignor as a liability. This helps corporates with their cash flow and liquidity.

The Old UAE Movable Security Law was a significant development in the UAE banking and finance legal landscape. It gave rise to a significant change in the practice of taking security over movable property in UAE banking and finance transactions (including trade receivables) and it expressly permitted the ability to take a security right over future specified movable property, as well as present specified movable property. However, it also went further and allowed true sales of receivables to be registered on the UAE Movable Security Register and Article 11 of the Old UAE Movable Security Law stated that such registrations produced the same effects in their effectiveness against third parties, the procedures for their enforcement and prioritisation in their recovery of rights from the returns on them from the proceeds of their enforcement as if the sale of receivables was a security interest registered on the UAE Movable Security Register.

That being said, it implied that future receivables could be subject to a true sale without expressly clarifying this. The UAE Factoring Law makes this clear and sets out the requirements in order to do so under UAE law.

We examine the key features of the UAE Factoring Law below.

## Does the UAE Factoring Law apply to all receivables?

Article 2 (*Applicability*) of the UAE Factoring Law provides that it applies to receivables under any transaction carried out in the context of commercial or civil transactions (even if through a regulated financial market) and whether involving the right to recourse against the assignor or not. However, it does not apply to:

- transactions carried out by any person for their personal, family or household purposes;
- financial contracts regulated by netting agreements;
- foreign exchange transactions;
- systems and agreements of interbank payment, netting systems and adjustment relating to securities, assets or other financial instruments;
- buyback of securities, assets or financial instruments deposited with a broker;
- the right to payments proven under endorsable instruments;
- the right to payments deposited into credit accounts with banks; or
- the right to payments under securities, documentary credits and letters of guarantee.

In particular, whilst the UAE Factoring Law does not apply to receivables set out above, we are of the view that it is still possible to take a security interest over them to the extent permitted to do so under UAE federal law No.4 of 2020 in relation to securing the rights in movables (the **UAE Movable Security Law**) and (to the extent not) a traditional assignment

of the relevant rights in accordance with the UAE Civil Code (UAE federal law No.5 of 1985 in relation to civil transactions (as amended)).

## Can future receivables be assigned?

One of the most important features of the UAE Factoring Law is the confirmation of the principle that receivables assignment agreements can be effective in relation to future receivables. In this regard, Article 4(5) (*Validity of assignment*) of the UAE Factoring Law provides that (where there is an assignment of future receivables) the assignment becomes effective with no need to engage in any new assignment as and when they come into existence. This creates much welcomed certainty to the UAE trade finance market.

## Right to enter into receivables assignment agreements

Generally, UAE law recognises the principle of freedom of contract. This is reflected in Article 3 (*Will of the parties*) of the UAE Factoring Law, which provides that the assignor, the assignee and the receivable's debtor may enter into an agreement regulating their respective rights and obligations, provided that such agreement may not prejudice the rights of third parties not party to that agreement. This restriction may be overridden by the consent of such third parties. However, please see our comments below on Article 5 (*Other contractual rights*) of the UAE Factoring Law in relation to the impact a receivables assignment agreement has on any restriction on assignment in the original contract.



## Content of receivables assignment agreements

### In writing

The rights and obligations of the assignor and assignee must be set out in an agreement in accordance with Article 9 of the UAE Factoring Law. Whilst there is no express requirement in Article 9 of the UAE Factoring Law for the agreement to be in writing, in our view it is implied and, in any case, it clearly would help to evidence the receivables assignment agreement. In addition, there are certain other requirements that need to be in writing to be effective, such as:

- an instrument executed by the assignor under Article 15(8) (*Discharge of receivable's debtor through repayment*) of the UAE Factoring Law in order to confirm the validity of any notice of assignment sent by the assignee to the receivable's debtor (as to which, please see below); and
- any waiver under Article 17 (*Agreement to not invoke defences or set-off rights*) of the UAE Factoring Law.

### Description of receivables

The overarching principle (which is set out in Article 4(4) (*Validity of assignment*) of the UAE Factoring Law) is that the receivables covered by the receivables assignment agreement must be generally or specifically described in such a way that helps identify them in order for it to be effective. In this regard, it is possible to assign the entire present receivables of the assignor, the entire future receivables of the assignor or a specific or general category or type of such receivables.

### Representations and warranties

The receivables assignment agreement must also include the following representations and warranties on the part of the assignor (Article 10 (*Assignor's acknowledgment*) of the UAE Factoring Law):

- that it has the authority to assign the receivable;
- that it has not assigned the receivable to any other assignee; and
- that the receivable's debtor has no right to raise any defences or make a set-off (although this is subject to Article 16 of the UAE Factoring Law, as to which please see below).

### Recourse

The assignor is not permitted to guarantee the ability of the receivable's debtor to make present or future payment of the receivable. This may give rise to some concerns from trade financiers, who often structure their receivables assignment agreements on a full recourse, limited recourse or non-recourse basis. Whilst there should not be any concerns in relation to non-recourse structures, in our experience these are the exception rather than the norm, with most receivables assignment agreements being on a full recourse or a limited recourse basis. Any receivables assignment agreement structured on a full recourse basis is likely to fall foul of this requirement and it is also unclear whether a limited recourse structure would also fall foul of this requirement – such limited recourse structures would typically require the assignor to repurchase the receivable in certain scenarios (e.g. if a commercial dispute arose between the assignor and the receivable's debtor in relation to the underlying receivable, such that the underlying receivable did not become due and payable).

That being said, Article 2(1) expressly notes that the UAE Factoring Law applies to transactions “whether involving a right to recourse against the assignor or not” and so (in our view, although we cannot be definitive in this regard) as long as the nature of the recourse to the assignor was not akin to a guarantee of the debt, then the recourse to the assignor should be acceptable.

## What is the effect of a receivables assignment agreement?

Once created, the receivables assignment agreement shall become a binding contract as between the assignor and the assignee, unless either party retains the right to unilaterally rescind the same (Article 4 (*Validity of assignment*) of the UAE Factoring Law). This applies even if the receivable's debtor does not receive any notice of the assignment (as to which, please see below) or if the receivables assignment agreement is not registered in the UAE Movables Security Register (as to which, please see below).

Article 4(3) (*Validity of assignment*) of the UAE Factoring Law also provides that the receivables assignment agreement becomes effective against the receivable's debtor and any competing claimant and the assignee will retain its priority rights even

if the assignment involves more than one receivable or divisible or indivisible rights over a receivable.

Article 5 (*Other contractual rights*) of the UAE Factoring Law further clarifies that the assignment shall secure one or more present or future obligations that are defined or capable of being defined, conditional or unconditional, fixed or changeable, although (unhelpfully) this mixes up the concept of security over the receivable and the true sale of the receivable, the latter being a typical technique used in trade financings (as set out above).

Article 5 (*Other contractual rights*) of the UAE Factoring Law also provides that any restriction on the assignor's right to assignment of the receivables shall neither take effect nor affect the validity or enforceability of the assignment and the assignee shall not be liable for any breach of restriction on assignment provided for in the original contract. However, the receivable's debtor may still invoke any set-off rights or interests vis-à-vis the assignee (as to which, please see below).

## Registration and priority of claims against competing claimants

There is no requirement to register a receivables assignment agreement. However, as under the UAE Movable Security Law, there are clear benefits of doing so.

At first glance, it is a strange concept that a receivable subject to a true sale (unlike security over a receivable) can have an order of priority because, once the receivable has been sold, the assignor no longer owns it and, therefore, should not be capable of subsequent dispositions. However, even under English law there are similar concepts where assignments will only bind third parties where the assignments have been perfected (i.e. by serving notice on the receivable's debtor) – in this case they will be "legal" assignments, with an unperfected assignment being an "equitable" assignment that is at risk of being subordinated in priority to a claim of a subsequent legal assignment.

In this regard, Article 7 (*Enforceability vis-à-vis third parties by registration and priority of assignee's rights*) of the UAE Factoring Law confirms that the

enforceability of assignments against third parties is as set out in the UAE Movable Security Law. Article 8 (*Priority among competing claimants*) of the UAE Factoring Law also provides that the provisions of the UAE Movable Security Law relating to priority of claims over the receivable shall apply in relation to the priority of:

- rights of the assignees over the receivable in accordance with registration priority (broadly speaking, those rights first registered in the UAE Movable Security Register will have priority over a subsequent registered assignment even if such subsequent registered assignment was effective earlier);
- obligations assumed by the assignor and which arise following the registration and on the future receivable; and
- the assignment of non-contractual rights (including the rights of a bankruptcy trustee, judgment creditors, debts due to the state and the assignor's employees).

## Do existing receivables assignment agreements need to be registered?

Again, there is no requirement to register any existing receivables assignment agreement. However, Article 24 (*Prior transactions and adjustment of affairs*) of the UAE Factoring Law provides that the assignee may register any receivables assignment agreement entered into prior to 7 December 2021 (the date of entry into force of the UAE Factoring Law) in the UAE Movable Security Register without the approval of the assignor until 7 June 2022. In this regard, the order of priority against third parties will take effect by reference to the effective date of the receivables assignment agreement rather than by reference to the date of registration in the UAE Movable Security Register.

As a result, it is advised that any assignee under any existing receivables assignment agreement take advantage of this grandfathering regime in order to mitigate the risk that an existing receivables assignment agreement is not subordinated in priority to any other existing or future receivables assignment agreement.

## Does a notice need to be served and an acknowledgment received?

There is no requirement to send a notice of assignment or receive an acknowledgment of that notice. However, again, there are clear benefits of doing so.

Whilst priority over the receivable is determined by the order of registration in the UAE Movables Security Register, that does not help the receivable's debtor to know that the receivable has been assigned to the assignee, so the receivable's debtor may simply continue to make payments to the assignor in accordance with the original contract to which it is a party. As a result, the assignee may well want to ensure that payments are made directly to it rather than the assignor (as to which, please see below). That being said, Article 13 of the UAE Factoring Law provides that the assignment shall not affect the rights and obligations of the receivable's debtor (including the payment terms set out in the original contract) unless accepted by the debtor. This is without prejudice to the other provisions of the UAE Factoring Law, so the only payment term that can be amended without the receivable's debtor's consent is the instruction to pay the receivable into the account (including the name of the person, address or account) to which the assigned receivables shall be paid, but other provisions (e.g. the amount of time required to pay any receivable) cannot be amended without the receivable's debtor's consent and (in any event) it appears that the currency or the country of payment cannot be amended (even with the receivable's debtor's consent).

Article 14 (*Notice to receivable's debtor*) of the UAE Factoring Law goes on to provide that the notice of assignment or payment instructions become effective once received by the receivable's debtor if they are executed in the same language of the original contract or in any other language of which the notice recipient is expected to be aware. Further, it helpfully clarifies that a notice of assignment or payment instruction is effective even if it relates to a receivable that comes into existence after the notice is served. And, if there is more than one notice relating to the same receivable (e.g. the original assignee then assigns the receivable to a second assignee),

the notice of subsequent assignment constitutes a notice for all prior assignments.

Linked to the above, there may well be some provisions of the original contract that the assignee would require to be amended in order to accept the assignment (and pay the related purchase price). In particular, an assignee would typically wish to remove any rights of set-off or counterclaim etc. that the receivable's debtor has against the assignor. In this regard:

- Article 16 (*Defences and set-off rights of receivable's debtor*) of the UAE Factoring Law expressly provides that (if the assignee claims settlement of the receivable assigned) the receivable's debtor may invoke against the assignee (a) all legal defences and set-off rights arising out of the original contract or any other contract that is deemed part of the same transaction, and as such the receivable's debtor shall take advantage as if the assignment has never taken place and that the claim has been made by the assignor and (b) any other netting right established in favour of the receivable's debtor once the notice of assignment is received.
- Article 17 (*Agreement not to invoke defences or set-off rights*) of the UAE Factoring Law provides that the receivable's debtor may enter into a written agreement with the assignor to waive the right to invoke any objection or to invoke the set-off against the assignee. However, the receivable's debtor may not waive any objections arising out of fraudulent acts committed by the assignee or any defences relating to the lack of capacity of the receivable's debtor. Any such waiver may be amended (although any amendment will be subject to the principles relating to the amendment of the original contract).

Finally, the serving of a notice of assignment may prevent the original contract from being amended by the receivable's debtor to the detriment of the assignee without its consent (as to which, please see below).

As a result, the provision of a notice of assignment and receipt of an acknowledgment dealing with these points may be an important consideration in the structuring of any receivables assignment agreement.

## How does a receivable's debtor validly discharge its obligation to pay?

Article 15 (*Discharge of receivable's debtor through payment*) of the UAE Factoring Law provides that the receivable's debtor shall effect a good discharge of its obligation to pay the relevant receivable (being different from the order of priority of interest in any receivable) as follows:

- (before the notice of assignment is received by it) if the receivable's debtor pays the receivable in accordance with the original contract;
- (subject to the following bullets) if the receivable's debtor receives a notice of assignment upon the payment of the receivable to the assignee or in accordance with the payment instructions set out in the notice of assignment or any subsequent written notice sent from the assignee to it;
- (if the receivable's debtor receives multiple payment instructions relating to the same receivable and from the same assignor) upon payment in accordance with the last payment instructions received from the assignor before payment is made;

- (if the receivable's debtor receives several notices of assignment relating to several assignments over the same receivable and from the same assignor (presumably in relation to assignments to different assignees)) upon payment in accordance with the first notice received;
- (if the receivable's debtor receives a notice relating to one or more subsequent assignments (e.g. the original assignee assigns the receivable to a second assignee) upon payment in accordance with the notice relating to the last subsequent assignment; and
- (if the receivable's debtor receives a notice of assignment relating to part or an undivided part of one or more receivables) upon payment as if it had not received any notice – for example:
  - if the original assignor assigns part of the receivable to the assignee, this would be in accordance with the original contract; or
  - if the original assignor assigns all of the receivable to the original assignee (who served a notice on the receivable's debtor) and then the original assignor assigned part of that receivable to a second assignee, this would be in accordance with the first notice) – however, (if the receivable's debtor pays the receivable in accordance with a notice of assignment relating to part or an undivided part of one or more receivables) it shall only be discharged in proportion to the part or undivided part settled by it.

Article 15(8) (*Discharge of receivable's debtor through repayment*) of the UAE Factoring Law also provides that (upon receipt of a notice of assignment from the assignee (noting that this does not apply to any notice received by an assignor)) the receivable's debtor may request that the assignee provides proof that the assignment has been created between the first assignor and first assignee and any other assignments made. If the assignee fails to do so within seven business days, the receivable's debtor is entitled to assume that it did not receive that notice of assignment. For this purpose, any written instrument executed by the assignor shall serve as sufficient evidence for the existence of the assignment and so any assignee will want to ensure that any receivables assignment agreement is executed in writing or at least the notice of assignment is signed by the assignor (as to which, please see above).





However, whether or not a notice of assignment or payment instruction is sent, Article 12 (*The right to realise*) of the UAE Factoring Law provides that the rights of the assignor and assignee shall be determined based on the following:

- (if the assigned receivable is paid to the assignee) the assignee may retain the proceeds and goods returned and which relate to the assigned receivable;
- (if the assigned receivable is paid to the assignor) the assignee shall be entitled to collect the proceeds and tangible movable assets relating to the assigned receivable and which has been returned to the assignor; and
- (if the assigned receivable is paid to a third party of a lower priority rank than that of the assignee (as to which, please see above)) the assignee shall be entitled to collect the proceeds and tangible movable assets paid to that third party and which relate to the assigned receivable.

Although, in any case the assignee may not realise any asset in excess of its rights over the receivable.

So, whilst Article 12 (*The right to realise*) of the UAE Factoring Law allows the assignee to trace the receivable into whomever's hands it has fallen, the serving of the notice of assignment on the receivable's debtor permits the assignee to require the receivable's debtor to pay the receivable over to it under Article 15 (*Discharge of receivable's debtor through payment*) of the UAE Factoring Law and then it would be up to the receivable's debtor to trace the receivable paid to the assignor or any other party and seek repayment of the amount paid from it.

## What are the effects of amendment to the original contract?

Article 18 (*Amendment of original contract*) of the UAE Factoring Law provides that any amendment to the original contract entered into by the assignor and the receivable's debtor:

- (if entered into prior to any valid notice of assignment) shall be effective vis-à-vis the assignee and shall entitle the assignee to the rights arising out of such agreement; and
- (if entered into following any valid notice of assignment) shall only be effective if approved by the assignee "or" if the assignment relates to future receivables – in this regard, we note that the word "or" is not included in Arabic, but we expect the intention is for it to be effective in any of these two cases.

As a result, an assignee may well want to ensure that:

- a notice of assignment is validly served; and
- (to the extent the assignment relates to future receivables under an original contract) the receivable's debtor agrees that no amendments will be made to the original contract in that respect without the assignee's consent,

(in each case) in order to ensure that its rights to the receivable (present and future) cannot be impaired by subsequent amendments to the original contract.



## The strengthening of ancillary rights

Article 6 (*Transfer of ancillary rights*) of the UAE Factoring Law clarifies that ancillary rights are transferred to the assignee with no new action required to be taken for their transfer, unless the UAE Factoring Law prescribes such a right requiring the assignor to take a new action for transferring the right to the assignee. Ancillary rights are transferred even if there is an agreement between the assignor and the receivable's debtor or any third party restricting the right of the assignor to assign the receivable or the ancillary rights.

Further, where the receivable is assigned, the assignee shall be entitled to collect the receivable at any time once it falls due and if the assignee collects the receivable it is also entitled to any ancillary rights in accordance with Article 20 (*Collection of receivable*) of the UAE Factoring Law.

We consider that this includes the right to make a demand for the receivable, which helpfully clarifies one of our earlier observations under both the Old UAE Movables Security Law and the UAE Movables Security Law (which states that only the receivable can be subject to the security right and not the ancillary rights, such that historically we have sought to take a catch-all assignment over such ancillary rights) and potentially removes the need to grant a subsequent assignment of such ancillary rights (in addition to any security interest under the UAE Movables Security Law). However, there may continue to be sound reasons for taking a catch-all assignment of contractual rights, where financiers are concerned with more than just the receipt of the receivable (and rights ancillary to that receivable) generated by the original contract (for instance, the exercise of the right to terminate a sub-contract in a project financing, where the focus is not on security over the receivable but ensuring that the sub-contractor continues to perform the relevant services, as such rights would not be accurately described as ancillary to the receivable but which a financier would typically expect to have as part of a robust security package).

## Once received, is the assignee required to repay the receivable following a breach

Subject to any insolvency-related clawback provisions, once the receivable is in the hands of the assignee, there is no requirement for it to repay that receivable. In this regard, Article 19 (*Recovery of payments*) of the UAE Factoring Law provides that (in the event that the assignor is in breach of its obligations under the original contract) the receivable's debtor may neither request the assignee to return any amounts paid by it, nor make any claim against the assignor. This may lead to resistance from a receivable's debtor in consenting to an assignment of the receivable in the first place as (in providing their consent), they would be forfeiting any such rights as set out in Article 19) and this would need to be managed upfront by parties during the structuring of the assignment transaction.

## Collections of receivables

The general rule in relation to assignments of receivables is that the assignee is entitled to collect the receivable at any time after it falls due. However, in some cases, there may be a reason for receivables to be assigned as a form of security interest rather than with a view that the assignee shall collect and keep the receivable and treat it as its own. In this regard, Article 20(1) (*Collection of receivable*) of the UAE Factoring Law provides that:

- (in the event of a default by the assignor) the assignee may collect the payments from the receivable's debtor; and
- (prior to the assignor's default) the assignee may exercise its right to collect the receivable if so approved by the assignor.

However, in transactions where this structure is used, we would expect that both the assignor and the assignee will want to define what "default" means for this purpose, including any rights to remedy or grace periods.

## Enforcement of receivables assignment agreements over receivables

Article 21 (*Disposition*) of the UAE Factoring Law confirms that any assignee of a receivable may enforce its rights over the receivable in accordance with the receivables assignment agreement or in accordance with Chapters VII and VIII of the UAE Movables Security Law. In particular, this makes it clear that the parties can agree the enforcement methods in a receivables assignment agreement in addition to those set out in the UAE Movables Security Law.

## The need to be licensed to carry on factoring

As a final comment, Article 25 (*Regulatory Aspects*) of the UAE Factoring Law confirms that a factoring business may only be carried on in the UAE after a licence has been issued from the UAE Central Bank and in accordance with that licence. As a result, any person wishing to carry out factoring in the UAE will want to ensure that it complies with this Article.



Please do contact us if you would like to discuss any of the issues raised in this memorandum or in relation to the UAE Factoring Law generally.

### CONTACTS



**Stephen Knight**

Partner

D +971 2 613 1521

M +971 52 604 8541

[Stephen.Knight@dentons.com](mailto:Stephen.Knight@dentons.com)



**Nathaniel Armstrong**

Partner

D +971 2 613 1518

M +971 56 683 0816

[Nathaniel.Armstrong@dentons.com](mailto:Nathaniel.Armstrong@dentons.com)



**Dima Khuffash**

Associate

D +971 2 613 1531

[Dima.Khuffash@dentons.com](mailto:Dima.Khuffash@dentons.com)

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CSBrand-75271-The-UAE-Factoring-Law-article-03 — 29/11/2021