CONSULTATION PAPER NO. 5

September 2023

Law of Security and Financial Collateral Regulations

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Why are we issuing this paper?

1. The Dubai International Financial Centre Authority ("**DIFCA**") proposes to enhance the law concerning secured transactions in the DIFC.

2. This regime is currently legislated for through the:

   - Law of Security, DIFC Law No. 8 of 2005 (the "**Current Law**");
   - DIFC Securities Regulations 2019 (the "**Securities Regulations**"); and
   - DIFC Financial Collateral Regulations 2019 (the "**FCRs**").

3. As set out in this paper, DIFCA proposes the enactment of a new Law of Security, DIFC Law No. [x] of 2023, which amalgamates updated financial collateral provisions within it (the "**Proposed Law**") and, repeals the FCRs. Amendments have also been made to the Personal Property Law DIFC Law No. 9 of 2005, (the "**Personal Property Law**"). The Securities Regulations shall continue under the Proposed Law, with minor consequential amendments.

4. This Consultation Paper No. 5 of 2023 ("**Consultation Paper**") seeks public comments on the Proposed Law and should be read in conjunction with Consultation Paper No. 4 of 2023 on Digital Assets. Consultation Paper No. 4 of 2023 sets out DIFCA's proposal on the enactment of a Digital Assets Law and related amendments to existing DIFC Legislation.

Who should read this paper?

5. This Consultation Paper would be of interest to persons conducting or proposing to conduct business in the DIFC. In particular:

   - banks and financial institutions;
   - investment companies and fund managers;
   - entities involved in hedging and other financial market sales and trading transactions;
   - those involved in secured transactions relating to digital assets;
   - entities involved in acquisition financing;
   - creditors of DIFC counterparties;

- legal advisors; and
- any other relevant stakeholders.

How to provide comments

6. All comments should be provided to the person specified below:

Jacques Visser

Chief Legal Officer

DIFC Authority

Level 14, The Gate, P. O. Box 74777

Dubai, United Arab Emirates

or e-mailed to: consultation@difc.ae

7. You may choose to identify any organisation you represent in your comments.

8. DIFCA reserves the right to publish, on its website or elsewhere, any comments you provide, unless you expressly request otherwise at the time the comments are made.

What happens next?

9. The deadline for providing comments on the proposals in this Consultation Paper is 5 November 2023.

10. Once we receive your comments, we will consider if any further refinements are required to the proposed amendments. Once DIFCA considers the changes to be in a suitable form, the Proposed Law will be enacted, to come in to force on a date specified and published.

11. The Proposed Law is in draft form only. You should not act on it until it is formally enacted. We will issue a notice on our website when this happens.

Defined terms

12. Defined terms are identified throughout this paper by the capitalisation of the initial letter of a word or of words in a phrase and are defined in the Proposed Law or **Appendix 1** of this Consultation Paper. Unless the context otherwise requires, where capitalisation of the initial letter is not used, the expression has its natural meaning.

Background

13. Given the importance of personal property security law to and the rapid developments in international trade and financial markets arising from technological developments, it is important that the relevant law is periodically examined and, if necessary, updated.

14. The Current Law was enacted in June 2005. Subsequently, there has been innovation in secured transaction regimes in various countries, which has in turn influenced other countries' personal property security legislation (which we refer to generally as a 'Personal Property Security Act', or "**PPSA**"). For example:

- In 2007, UNCITRAL approved a Legislative Guide on Secured Transactions ("**LG"**).[1]

- In 2009, Australia enacted a PPSA that drew heavily on Canadian and the New Zealand secured transactions regimes (themselves based on earlier versions of UCC Art 9, but diverging from the UCC's wide-reaching 1999 revisions) and was also influenced by the 1999 revision of the UCC and the LG.

- In 2016, UNCITRAL published the Model Law on Secured Transactions (2016) ("**UML"**).[2] The UML puts into legislative form most of the recommendations made in the LG. In 2017, UNCITRAL published the Guide to Enactment ("**EG"**).[3]

- In 2017, the Working Group of the Canadian Conference on Personal Property Security Law ("**CCPPSL"**) published its Report on Proposals to Changes to the Personal Property Security Acts, which addressed (among other things) perceived omissions and recent changes in business practices[4] and which influenced changes to legislation in Canadian jurisdictions.

- There has been rapid spread of new secured transactions regimes in numerous other jurisdictions, many of which have sought to improve upon extant templates.[5]

[1] See here.
[2] See here.
[3] See here.
[4] As summarised in the Preface to: Cuming R, Walsh C & Wood R (2022). *Personal Property Security Law*. (3rd ed.). Irwin Law.
[5] See Wood, R (10 January 2019). *Identifying Borrowed Sources in Secured Transactions Law Reform* (page 4, final paragraph). This article also provides an overview of PPSA markers adopted by different regimes. Available at SSRN: https://ssrn.com/abstract=3313756.

15. Since 2005, we have also observed:

- the emergence of businesses and platforms that enable the extension of credit in and secured or covered by Digital Asset collateral arrangements; and
- increasing recognition of the need to digitalise international trade.

16. Accordingly, following consideration of regimes in other jurisdictions and UNCITRAL's work in this area, and in conjunction with our work on Digital Assets, DIFCA proposes to significantly amend and enhance the law concerning secured transactions in relation to Movable Assets to bring the regime in line with international best practice and provide clarity in relation to Digital Assets. In doing so, we have also taken into account specific factors relating to the DIFC.

17. In summary, for the reasons in this Consultation Paper (below), the Proposed Law is substantially, but not entirely, based on the UML.

18. We explain differences between the Proposed Law and UML below. Particularly notable are the following:

- Unlike the UML, which excludes security rights in intermediated securities and financial contracts governed by netting agreements,[6] Part 8 of the Proposed Law includes them, following the matters currently covered by the FCRs. The FCRs will be repealed with the enactment of the Proposed Law. Part 8 of the Proposed Law, while concerning matters presently covered by the FCRs, is in substantially different terms to the FCRs.
- The Proposed Law also covers Security Rights in Digital Assets and Electronic Trade Documents.

Key features of the Proposed Law

19. The Proposed Law, in common with the UML, is designed to achieve the following objectives:[7]

- to promote credit at reasonable cost by enhancing the availability of secured credit;
- to allow debtors to use the full value inherent in their assets to support credit;
- to enable parties to obtain security rights in a simple and efficient manner;

[6] See EG p.12/para 12.
[7] See LG, p.18-22/para 43-59.

- to provide for equal treatment of diverse sources of credit and forms of secured transaction;
- to validate non-possessory security rights in all types of assets;
- to enhance certainty and transparency by providing for registration of a notice in a general security rights registry, while recognising that, in relation to specific types of assets, other rules (not involving registration) are also appropriate;
- to establish clear and predicable priority rules;
- to facilitate efficient enforcement of a secured creditors' rights;
- to allow parties maximum flexibility to negotiate the terms of their security agreement;
- to balance the interests of persons affected by a secured transaction; and
- to promote the harmonisation of secured transactions laws, including conflict of laws rules.

20. While there are numerous provisions in the Proposed Law, for the most part, they can be derived from the above objectives and the following, fundamental, legal policies, summarised in the LG:[8]

- **Comprehensive scope** - secured credit is promoted when restrictions concerning who may be a grantor or a secured creditor, what types of assets may be encumbered and what kinds of obligation may be secured are minimised. Therefore, legislation should be comprehensive in scope.[9]
- **Functional, integrated and comprehensive approach** - to the maximum extent possible, transactions that create a right in any type of asset meant to secure the performance of an obligation should be considered secured transactions and regulated by the same rules or the same principles.
- **Security rights in future assets of a grantor** - any benefit from a restriction to protect debtors from over-committing their assets, especially future assets, to one secured creditor, is outweighed by the benefits from enabling businesses to obtain the many types of credit predicated upon a stream of future assets;[10]

[8] See LG, p.22-26/para 60-72.
[9] See further LG, Ch I.
[10] See further LG, Ch 1.

- **Extension of a security right into proceeds** - because the economic value of the encumbered asset is the creditor's ultimate source of payment, the security right should be extended into proceeds received upon its disposition.[11]

- **Distinction between effectiveness as between the parties from effectiveness against third parties** - absent imposition of additional requirements beyond those typically required for contracting, there is likely to be insufficient notice to third parties. Therefore, we distinguish between creation of a security right (effectiveness as between the parties) and effectiveness against a third party.

- **Availability of multiple security rights in the same assets** - this is to enable a grantor to use the full value of its assets to obtain secured credit.

- **Temporal basis for priority among multiple security rights** - clear rules are required for ordering the priority of competing security rights, typically based on the order of achieving third-party effectiveness.

- **Priority between security rights and other rights** - clear rules are required to govern the myriad types of priority conflict between competing claimants. Most notably in the context of security rights, this involves the competing claims as between a secured creditor and a buyer of the encumbered asset or the insolvency representative in a grantor's insolvency.

- **Facilitative rather than formalistic** - in general, parties should be free to design their own security agreements. Any mandatory rules should be aimed solely at ensuring fairness and protecting legitimate third party interests.

- **Extrajudicial enforcement** - on the basis that a secured transactions regime strikes the appropriate balance and fairness in terms of protecting the interests of the parties and third parties, a secured creditor in appropriate circumstances should be able to enforce out of court.

- **Equality of treatment for all providers of credit to enable grantors to acquire tangible assets** - some states draw a distinction between sellers' and lenders' rights, with special rights being given to seller (typically by permitting them to retain title to the asset sold until the purchase price is paid in full). In our view, in order to enhance competition and lower the cost of acquisition credit, sellers and lenders should be treated equally.

[11] See further LG, Ch 2.

21. In addition to the UML's objectives and fundamental legal policies aligning with DIFCA's, we consider that the UML provides an appropriate template because:

- secured transactions are often international and cross-border in nature. This is particularly important in relation to transactions concerning the DIFC, an international financial hub. Due to the nature of such transactions, lawyers advising parties to such transactions come from a wide range of legal traditions and require straightforward, modern terminology to facilitate their understanding of the relevant law. The UML's use of neutral, modern terminology and avoidance of unfamiliar legal terms drawn from other jurisdictions are of particular assistance in this respect;

- the UML follows a unitary approach using one concept for all types of security interest, a functional approach under which the UML applies to all types of transaction that fulfil security purposes, such as a secured loan, retention-of-title sale or financial lease, and a comprehensive approach under which the UML applies to all types of assets, secured obligations, borrowers and lenders. In this way, the UML is intended to address the main problem of secured transactions laws around the world, that is, the multiplicity of regimes which creates gaps and inconsistencies;

- the LG and EG provide ready-made tools to aid users' and the DIFC Courts' interpretation of the Proposed Law, subject to our departures from the principles and rules set out in those documents. In this context, it is apposite to note the description of the LG as:

  "a direct descendant of Article 9 of the [UCC] and of Chapter 11 of the US Bankruptcy Code 1978 … It is a splendid and massive opus of legal art and intelligence, representing more than 70 years of effort in the US and elsewhere in developing this approach to security interests."[12]

- many of the objectives and policies described above are in common with a number of modern PPSA regimes.[13]

22. Part 8 of the Proposed Law, concerning Financial Collateral Arrangements, is similar in structure to the FCRs, but is subject to some notable differences, as explained in this Consultation Paper.

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[12] See section 54-002 of: Wood P. (2019). *Comparative Law of Security Interests of Title Finance. (*3rd ed.). Sweet & Maxwell.

[13] As explored in Wood, R (10 January 2019). *Identifying Borrowed Sources in Secured Transactions Law Reform* (e.g. page 5-6).

23. The Proposed Law contains specific provisions to cater for Digital Assets, including in relation to their creation, effectiveness against third parties and priority. Further, the enhanced security regime in Part 8 of the Proposed Law applies to Digital Assets which also fall within the definition of Financial Collateral.

24. The EG provides an article-by-article commentary on the UML, and cross-refers to the LG. Due to the availability of the EG and LG, this Consultation Paper does not address the Proposed Law on an article-by-article basis.

25. Instead, we take a thematic and selective approach and focus on how and why we diverge from the UML.

26. The themes we explore below are categorised as follows:

- Movables, Immovables and Fixtures;
- Acquisition financing;
- Negotiable Instruments/Documents and Electronic Trade Documents;
- Receivables;
- Financial Collateral Arrangements;
- Digital Assets;
- Transfer of title to property;
- Consumer protection;
- Conflict of laws;
- Security Registry, filing and registration;
- Regulations; and
- Transitional provisions.

27. At the start of each theme, we provide the main definitions and Articles relevant to that theme.

Derivation Table

28. We provide, at Appendix 2 to this Consultation Paper, a table which provides the UML Articles which correspond to the those in the Proposed Law, and refers to

corresponding parts of the EG and LG ("**Derivation Table**").

29. When interpreting the Proposed Law, practitioners should consult the paragraphs of the EG and LG referred to in the Derivation Table, taking into account the definitions in Schedule 2 of the Proposed Law and any differences in approach between the UML and the Proposed Law.

Movables, Immovables and Fixtures

Schedule 2 definitions: Encumbered Asset, Fixture, Future Asset, Intangible Asset, Lot, Movable Asset, Real Property, Real Property Interest, Real Property Law, Real Property Register

Articles 4, 9(1), 15, 16(2), 20(3)(a), 21(2), 108 and Part 7

Introduction

30. The UML applies only to movable assets. Article 2 of the UML defines a "movable asset" as a "tangible or intangible asset, other than immovable property" but does not define "immovable".

31. UNCITRAL justifies the UML's application to only movable assets on the basis that movables and immovables raise different issues. For example, there are often separate registration systems with registration indexed by asset, not grantor. Further, there is a lack of harmonisation at the international level on immovable property law.[14]

32. While we agree with this in broad terms, in our view it is also necessary, in the DIFC context, to:

- define precisely what constitutes a movable asset;
- define how the regime under the Proposed Law, the Real Property Law and the Leasing Law should interact, and in particular to consider the appropriate approach to Security Rights:
  - in "fixtures" (or, to use the EG's and LG's terminology, "attachments"); and
  - in a bare rent Receivable in respect of real property; and

[14] EG para 34, LG p.40-41.

- insofar as the Proposed Law provides for the creation of Security Rights in Movable Assets which are attached to real property outside the jurisdiction of the DIFC, establish rules for conflict of laws.

Definitions

33. The following definitions in Schedule 2 of the Proposed Law underpin our approach to the above issues:

Movable Asset	means a Tangible or Intangible Asset, other than Real Property;
Real Property	is defined as including land, buildings, and items placed in, on or under the land comprising a Lot with the intention that such buildings and fixtures should remain in position permanently or indefinitely, whether or not such property is within the jurisdiction of the DIFC, and a Real Property Interest;
Lot	has the meaning given in the Real Property Law, save that it also applies to Real Property outside the jurisdiction of the DIFC insofar as the law of that jurisdiction so permits;
Real Property Interest	means any ownership interest in Real Property, including a Fixture forming part of the Real Property;
Real Property Law	means the Real Property Law DIFC Law No.10 of 2018;
Real Property Register	has the meaning given in the Real Property Law or, in relation to Real Property outside the jurisdiction of the DIFC, a register that serves a functionally similar purpose;
Fixture	means a thing that was originally a chattel, but which has become part of the Real Property to which it is attached. Whether the chattel has become attached so as to become part of the real property is to be determined in accordance with English common law principles in relation to 'fixtures' in the context of real property.

Movable Asset

34. Article 9(1) of the Proposed law provides:

"This Law applies to Security Rights in Movable Assets and Fixtures".

35. As set out above, "Movable Assets" means all assets, other than Real Property.

36. The definition of "Real Property" in the Proposed Law mirrors the definition of "Real Property" in the Real Property Law, save that it includes land, buildings etc both within and outside the jurisdiction of the DIFC.

37. The Real Property Law already adopts the concept of a 'fixture' in English Law (see e.g. the definition of Real Property Interest). This is reflected in the definition of "Fixture" in the Proposed Law.

38. Accordingly, we contemplate a scenario in which a lender could take security over (say) machinery/equipment, which then becomes a Fixture to Real Property outside the DIFC. Simple examples of such "Movable Assets" are an air-conditioning system or elevator machinery.

Q1. Do you agree that, subject to conflict of laws issues, the Proposed Law should cover Security Rights in movable assets that become fixtures (attached) to real property outside the jurisdiction of the DIFC? If not, please explain why not.

Treatment of Fixtures

39. While the UML does not contain provisions concerning the treatment of fixtures (attachments), the EG refers to recommendations in the LG.[15] We have largely adopted these recommendations in Part 7 of the Proposed Law (Fixtures).

40. We refer to the Derivation Table for the LG references corresponding to provisions in Part 7.

[15] EG para

41. We appreciate the complexities that can arise from conflict of laws issues, not least in the context of real property. Accordingly, Article 98 (which applies to Real Property outside the DIFC) provides that the rules in Section 1 (which apply to Real Property within the DIFC) apply unless this is inconsistent with a provision in Part 9 (Conflict of Laws), in which case the latter shall prevail.

42. As to Conflict of Laws, see paragraphs 175-182 below.

Q2. Do you agree with Articles 90 to 97 of the Proposed Law? If not, please explain why not and any alternatives/modifications you may suggest?

Rent as a Receivable

43. As explained below at paragraphs 98 - 105 below, we propose that the UML's approach to receivables be adopted.

44. The Proposed Law defines a "Receivable" as:

> *"a right to payment of a monetary obligation, excluding a right to payment evidenced by a Negotiable Instrument, a right to payment of Money credited to a Bank Account and a right to payment under a Non-intermediated Financial Property".*

45. Article 9(2) of the Real Property Law provides that nothing in the Current Law affects Real Property governed by the Real Property Law.

46. Accordingly, questions arise as to the position of a transferee of a bare rent Receivable in respect of Real Property, pursuant to an outright assignment of that Receivable.

47. It would be undesirable to risk any confusion as to whether such a transferee of a rent Receivable in respect of Real Property thereby also gained e.g. any rights of the Lessor in relation to Security Deposits (see Article 22 of the Real Property Law), termination of the Lease (see Article 55(4) of the Real Property Law and 54 of the Leasing Law) or any right to call for transfer of the Lease or the underlying reversion (the Real Property Interest being a freehold), such as might conflict with rights of Mortgagees and the security arrangements set out in the Real Property Law.

48. Therefore, we propose restricting the right of a transferee of any such bare rent Receivable in respect of Real Property to the contractual right to sue the Lessee for the unpaid Rent.

49. Our suggestion is already contemplated by Article 33 of the Real Property Law (Nature and priority of unregistered Real Property Interests and Real Property Rights), which provides:

"Nothing prevents an unregistered Instrument from operating as a contract between the parties or being otherwise enforceable according to its terms."

50. Our proposal is effected by Article 21(2) of the Proposed Law (Personal or property rights securing or supporting payment or other performance of encumbered Receivables or other Intangible Assets, or Negotiable Instruments). Article 21 provides:

"(1) Subject to Article 21(2), a Secured Creditor with a Security Right in a Receivable or other Intangible Asset or in a Negotiable Instrument has the benefit of any personal or property right which secures or supports payment or other performance of the Encumbered Asset without a new act of transfer. If that right is transferable under the law governing it only with a new act of transfer, the Grantor is obliged to transfer the benefit of that right to the Secured Creditor.

(2) Article 21(1) does not apply to a Receivable comprising the right to receive rent in respect of Real Property, to the extent that any personal or property right which secures or supports payment of that rent arises under or is subject to the Real Property Law or the Leasing Law."

Q3. In relation to Article 21(1) of the Proposed Law, do you agree our (1) rationale for and (2) proposed wording?

If not, please explain why not and what improvements do you suggest?

Acquisition Financing

Schedule 2 definitions: Acquisition Secured Creditor, Acquisition Security Right, Acquisition Security Collateral, Acquisition Security Obligation, Commercial Consignment, Tangible Asset

Articles 31, 41(9), 45-49, 97

51. Chapters I (section C) and IX of the LG consider "acquisition financing" and the rationale for related provisions in the UML. Subject to our departures from the LG, we encourage practitioners to consider these parts of the LG.

52. "Acquisition financing" refers to transactions that can be deployed to enable buyers to acquire assets on credit. An acquisition financing transaction exists whenever a person (a seller or a lender) may claim a property right in assets to secure another person's obligation to pay any unpaid portion of their purchase price (or its economic equivalent). A transaction under which a seller retains ownership of or title to the assets sold for such a purpose is also an acquisition financing transaction. Relatedly, in very broad terms, an acquisition security right ("**ASR**") is the security right over the asset acquired by the debtor where the seller takes a security right to secure the unpaid purchase price or a lender advances the price and takes security over the asset.

53. Notwithstanding that very general description, we refer to the definition of 'Acquisition Security Right' in the UML. The UCC and other PPSAs also address the similar concept of a 'purchase money security interest' ("**PMSI"**).

54. We endorse a functionally equivalent approach to ASR, the rationale being that:[16]

- acquisition financing is important to both buyers and sellers;
- there is no overriding economic policy reason why a manufacturer or distributor of tangible assets should have monopoly on credit provision or why incentives should favour one subset of financiers over another; and
- the law should foster competition among all suppliers of credit, leading to credit availability at the most affordable rates and provision of alternative sources of credit.

55. The method we propose for achieving a functionally equivalent outcome is the adoption of a unitary approach to ASR, which collapses the distinctions between various devices (e.g. retention of title, hire-purchase, etc) and adopts a single characterisation. Two main consequences flow from this. First, all acquisition financing devices, irrespective of form, are considered as security devices and subjected to the same rules that govern any other Security Right which is not an ASR (except in relation to priority). Secondly, a creditor's right in assets in a retention-of-title sale, hire-purchase agreement, financial lease or similar transaction is considered to be an ASR and regulated by the same rules that would govern an ASR granted to a lender. [17]

56. We refer to the description of the corresponding UML provisions in the EG and LG and below focus solely on:

[16] See LG p.319, para 1-4, p.33, para 59 & p.335-6, para 67-73.
[17] See LG Ch IX, para 74-78.

- our proposed definition of Acquisition Security Right and departures from the UML. The definition of an Acquisition Security Right is important, not least because it determines whether super-priority extends to the Security Right; and

- our proposal in relation to the super-priority nature of the Acquisition Security Right.

57. Consumer protection in the context of Acquisition Security Rights is considered at paragraphs 164 - 171 below.

Definition of Acquisition Security Right

58. We refer to our definition of Acquisition Security Right in Schedule 2 of the Proposed Law. Below, we consider seven issues in relation to this definition.

(1) Scope of inclusion of intangible property

59. Art 2(b) of the UML provides that an "acquisition security right" means a security right in a tangible asset, or in intellectual property or the rights of a licensee under a licence of intellectual property, which secures an obligation to pay any unpaid portion of the purchase price of an asset, or other credit extended to enable the grantor to acquire rights in the asset to the extent that the credit is used for that purpose. For the purpose of Art 2(b) UML, a tangible asset does not include money, negotiable instruments, negotiable documents and certificated non-intermediated securities (all as defined in the UML).

60. The question arises as to whether the definition of ASR should cover intangible property more broadly. In this regard, we have considered the approaches taken under other regimes. Canadian and New Zealand regimes confer super-priority in respect of both tangible and intangible property. The approach under the UCC is more limited (tangible property and software). Under the Australian PPSA[18] the ASR regime applies to collateral comprising goods, document of title to goods or intangible property other than accounts (so most importantly, intellectual property). Uniquely among PPSAs, the Australian PPSA excludes security rights in collateral that the grantor intends to use predominantly for personal, domestic or household purposes (although this is mitigated by s.14(2A)).

61. We prefer the UML approach, which covers tangible assets and intellectual property (or the rights of a licensee under a licence of intellectual property), to which very different policy and rules generally apply as compared to wider categories of intangibles. We also propose that it is appropriate to limit intangibles to intellectual property (or the rights of a licensee under a licence of intellectual property) as, in our view (and particularly given our

[18] S.14. See also Australian PPSA, 3rd Ed., Duggan, Ch 8.

definition of "Intellectual Property"), this provides for a tighter and therefore clearer definition than the UCC approach.

Q4. Do you agree that, subject to our proposed definition of Acquisition Security Right more widely, the assets falling within the scope of the ASR regime should be limited to Tangible Assets and to Intellectual Property or the rights of a licensee under a licence of Intellectual Property? If not, please explain why not.

(2) Leases[19]

62. We propose that the interest of a lessor of tangible assets under a lease for a term of more than one year should be included in the definition of an Acquisition Security Right. See paragraph (2) of our definition.

63. We note that the UML and UCC only include asset leases if in substance they secure payment/performance of obligation. However, the Canadian PPSAs and New Zealand PPSA also apply more broadly to leases of goods if the term is for over one year. The Australian PPSA covers any interest in a 'PPS lease'. In essence, subject to some exceptions, this also applies to a non-security lease of goods and bailment of goods for term of more than two years. The Canadian, New Zealand and Australian PPSAs reflect the widespread adoption internationally of inclusion of long-term non-security leases.[20]

64. In line with this international trend, we propose the inclusion of long-term leases. Most importantly, this reduces litigation over whether or not a transaction constitutes one that falls within the secured transaction regime.

65. We propose that leases of a term of one year or less are excluded. This excludes short-term rentals that are less likely to be disguised security agreements and less likely to generate litigation. Further, we have concluded that it would not be cost-effective to subject very short leases to registration requirements.

Q5. Do you agree that the interest of a lessor of Tangible Assets under a lease should be included within the definition of an Acquisition Security Right?

Q6. Do you agree that the threshold for inclusion should be leases over one year?

[19] On this topic, see Australian PPSA, 3rd Ed., Duggan, 3.34 et seq.

[20] See *Wood, Identifying Borrowed Sources in Secured Transactions Law (Jan 19),* Tables 1A & 1B.

(3) Commercial consignments[21]

66. We propose that the interest of a consignor who delivers tangible assets to a consignee under a commercial consignment be included within the definition of an ASR. See paragraph (3) of our definition of Acquisition Security Right and the definition of Commercial Consignment.

67. A '"true consignment" is not brought within the UML. As regards what constitutes a "true consignment":

> *"A true consignment transaction involves the entrusting or delivery of goods by the owner, the consignor, to another party, the consignee, with the understanding that the consignee will attempt to sell the good on behalf of the consignor. Generally, owners use consignments to avoid the risk associated with finding a market for, and to maintain control over the pricing of, their goods. In a "true consignment," the consignor maintains control over the pricing of the consigned good and retains title and ownership of the good. The good is delivered to the consignee who is authorized to sell the good based on the consent of the consignor, and the consignor establishes the price at which the consignee must sell the good. Any time prior to sale of the good, the consignor can demand return of it, and when the consignee does sell the good, the consignee is paid a set commission by the consignor, rather than receive a profit. The consignee must return the good if it is not sold, and at no time is the consignee obligated to pay for the good.*
>
> *The operative word in the term true consignment is the term true because, even though parties may title their agreement a consignment, a court may conclude that the agreement is an entirely different type of commercial transaction such as an outright sale, sale or return, true bailment, or even a security interest securing an obligation."*[22]

68. True consignments are brought within the scope of the UCC, New Zealand PPSA, Canadian PPSA and Australian PPSA. For example, in the Australian PPSA, s.12(2)(h) applies to consignments which in substance secure payment or performance of an obligation but s.12(3) extends the application to any commercial consignment irrespective of whether it secures payment or performance of an obligation.

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[21] On this topic, see: (1) *Wood, Identifying Borrowed Sources in Secured Transactions Law (Jan 19)*: p.13/para (b); p.18/para (b); p.22 (para (b)); p.23 (final para) plus tables showing markers; (2) Gibson W, *Untangling the Web of Consignment Law: The Journey from the Common Law & Art 2 to Revised Art 9 (Aug 2018)*, William & Mary Business Law Review, Vol 10, 2018; (3) Ontario Bar Association Submission to Ministry of Government & Consumer Services 25.3.21; (4) Australian Personal Securities Law, 3rd Ed., Duggan, 3.8-3.10; 3.32-3.33; (5) New Zealand Personal Securities Law, 3rd Ed. (numerous references).

[22] Gibson W, *Untangling the Web of Consignment Law: The Journey from the Common Law & Art 2 to Revised Art 9 (Aug 2018)*, William & Mary Business Law Review, Vol 10, 2018.

69. We also propose that such consignments are included within the definition of Acquisition Security Right. UNCITRAL itself recognises that some states grant super-priority to commercial consignments, because absent registration, third parties dealing with tangible assets in the possession of a commercial enterprise have no objective means of determining whether those assets belong to the enterprise or the consignor.[23] Further, it can be difficult to show what is or is not a true consignment, so bringing true consignments within the scope of an ASR reduces litigation on this point.

70. However, this should not be extended to private individuals or one-off consignors, in order to prevent them from being taken by surprise and losing priority. In this regard, we note that the UCC requires only that the consignee must ordinarily deal in such goods, while the New Zealand and Canadian PPSAs' definition of commercial consignment provides that both the consignor and the consignee must ordinarily deal in such goods. We have adapted the wording in the New Zealand PPSA.

> **Q7. Do you agree that the interest of a consignor who delivers Tangible Assets to a consignee under a Commercial Consignment should be included in the definition of an Acquisition Security Right? If not, please explain any aspect of this which you disagree.**

(4) Cross-collateralisation[24]

71. The UML does not provide for cross-collateralisation in the context of ASR arrangements. We propose, however, that limited cross-collateralisation be recognised in the context of ASR arrangements involving inventory.

72. This issue is explored in the Report to Canadian Conference on PPSA – Proposals for Changes to the PPSAs (**CCPPSL**).[25] In particular, the provision of limited cross-collateralisation addresses the issue that arises when a secured financier provides purchase money inventory financing under a series of transactions with one debtor. Over time, inventory is sold and payment made, but neither party can demonstrate which payments relate to which specific inventory. Alternatively, it would require an enormous amount of administration to keep track of this, which is unrealistic and inimical to the provision of inventory financing.

73. We refer to paragraphs (4) and (5) of our proposed definition of Acquisition Security Right.

[23] LG p.113, para 44.
[24] On this topic, see Australian PPSA, 3rd ed., Duggan, 8.27.
[25] Section titled "PMSIs and Cross-Collateralisation".

Our suggested wording is based on the CCPPSL recommendations, which is more limited than the UCC formulation[26] in that it restricts cross-collateralisation to a 'related' transaction, for the reasons explained in the CCPPSL:

"Purchase-money security interest cross-collateralization is supportable where there is some relationship between the pmsi transactions. However, where the transactions are unrelated, general 'background' lenders might be reluctant to extend secured financing to small businesses without assurance that their debtors' interests in property formerly subject to purchase-money security interests will not be subject to new purchase-money security interests created under entirely separate transactions entered into after the original pmsi obligation has been paid out. In order to address this concern, the proposal would not recognize ex post facto consolidation of pmsi obligations. In other words, it would not be possible for the parties to enter into a consolidation agreement providing full pmsi cross-collateralization of obligations arising under prior separate agreements. The proposal would facilitate cross-collateralization only where there is a continuing relationship that involves purchase-money security interests so that the secured party need not keep separate accounts for each separate sub-transaction as the current definition requires. Beyond this, there is a risk of prejudice to prior secured parties of the same debtor."

Q8. Do you agree with our provision for cross-collateralisation in accordance with paragraphs (4) and (5) of the definition of Acquisition Security Right? If not, please explain why not or suggest improvements that may be made.

(5) Retention of ASR status upon refinancing etc[27]

74. In our view, the loss of status as an ASR on renewal, refinancing, consolidation or restructuring is uncommercial and frustrates the objective of facilitating the provision of credit. We therefore propose inclusion of wording in paragraph (8) of the definition of Acquisition Security Right to address this. This wording follows the approach in the Australian PPSA. Our approach is also consistent with the UCC.

Q9. Do you agree with the retention of status as an ASR on renewal, refinancing, consolidation or restructuring? If not, please explain why.

[26] UCC §9-103(b).

[27] See: (1) Report to Canadian Conference on PPSA – Proposals for Changes to the PPSAs (section on Refinancing and PMSIs); (2) Australian PPSA, 3rd ed., Duggan, 8.28-8.33; (3) *Nowka R, Allowing Dual Status for Purchase-Money Security Interests in Consumer-Goods Transactions*, 13 Tenn. J. Bus. L.13 (2011).

(6) Mixed securities[28]

75. We further propose amendments to the UML to allow for a "dual status" rule, whereby an ASR does not lose its status as such if the collateral also secures a non-ASR obligation. Such mixed financing is relatively frequent. This follows the approach taken in the UCC, Australian PPSA and the Saskatchewan PPSA (broadly following recommendations in the CCPPSL).

76. See paragraphs (6) and (7) of the definition of Acquisition Security Right for our proposed wording, which, again, follows closely the wording in the Australian PPSA.

Q10. Do you agree that an ASR should not lose its status as such if the collateral also secured a non-ASR obligation?

Q11. If you agree, are there any improvements you would suggest to paragraphs (6) and (7) of the definition of Acquisition Security Right?

(7) Payment allocation rule

77. Assuming that provisions for 'dual status' are adopted, it follows that rules are required to address the allocation of payments.[29]

78. See paragraph (9) of the definition of Acquisition Security Right for our proposed wording to address this. Our proposal follows closely the wording of the Australian PPSA (s.14).

Q12. Do you agree with our proposed payment allocation rule at paragraph (9) of the definition of Acquisition Security Right? If not, what improvements doyou suggest?

Super-priority

79. A super-priority rule for ASR is a feature of the law of most states. In broad terms, this

[28] Key reading: (1) Report to Canadian Conference on PPSA – Proposals for Changes to the PPSAs (section on Refinancing and PMSIs); (2) Australian PPSA, 3rd ed., Duggan, 8.17-22, 27-33; (3) *Nowka R, Allowing Dual Status for Purchase-Money Security Interests in Consumer-Goods Transactions*, 13 Tenn. J. Bus. L.13 (2011); (4) Tracey A, *Purchase Money Security Interest Refinancing in New Zealand: A Case for Retention of Super-Priority* (Sept 2019), Victoria University of Wellington Legal Research Paper No.15/2020.

[29] See *Nowka R, Allowing Dual Status for Purchase-Money Security Interests in Consumer-Goods Transactions*, 13 Tenn. J. Bus. L.13 (2011)., section VI, for a discussion of this issue.

rule provides that an ASR has priority over a competing Security Right that is not an ASR in the same encumbered asset, including a prior Security Right that would otherwise have had priority over the ASR under general priority rules.[30]

80. We have considered the arguments both for and against such super-priority.[31]

81. The main arguments against super-priority are that it is typically banks which have universal charges over buyer's assets. A typical retention of title supplier is a short-term creditor not representing depositors and not providing medium-term stable credit, who is unable to contribute new money on a rescue, and is typically paid out of bank money until the position is hopeless. Further, the supplier inserts a new and competing priority both in respect of the goods supplied and receivables flowing from the sale of the goods, a priority which is more difficult to order by an intercreditor agreement.

82. However, we are persuaded that such arguments are outweighed by those in favour of super-priority, the most important of which are (1) where the buyer has granted a security right over its inventory or its assets generally, the buyer's secured creditor would receive a windfall in the shape of the new assets which swell the assets available to the buyer's secured creditor, but at the expense of the seller or its purchase money secured creditor who in effect has paid for the asset; and (2) supplier and trade credit is to be encouraged.

83. That said, we support the view reflected in the UML that, for policy reasons, there should be different super-priority rules for different types of encumbered assets. In particular, we recommend that Option A of Article 38 of the UML is adopted. For a detailed analysis of Article 38 of the UML and the two options suggested in the UML, see EG para 322-329.

84. Of particular note are the reasons at para 325 of the EG for the different requirements for super-priority in the case of inventory or its intellectual property equivalent as compared to the conditions for super-priority in the case of equipment or its intellectual property equivalent.

Q13. Do you agree that Acquisition Security Rights should benefit from super-priority as provided in the Proposed Law? If not, please explain your reasoning.

[30] In states that do not treat retention of title and financial lease rights as security rights, relative priority is determined by reference to the sellor's or lessor's right of ownership, with the sellor or lessor prevailing in relation to assets sold over other competing claimants (except certain good faith buyers).

[31] In addition to discussion in the LG, see that in Wood P, *Comparative Law of Security Interests and Title Finance*, Vol 3, 3rd Ed., Ch 28 and 48.

Q14. Do you have any further suggestions on how our proposals in relation to Acquisition Security Rights might be improved?

Negotiable Instruments/Documents and Electronic Trade Documents

Schedule 2 definitions: Control (with respect to a Digital Asset), Electronic Trade Document, Negotiable Document, Negotiable Instrument, Possession (in relation to an Electronic Trade Document), Receivable, Tangible Asset

Articles 21, 23, 26(1), 34, 48, 53, 54, 74, 76, 106, 117, 119, 122

85. The main differences between the Proposed Law and the UML are that the Proposed Law:

    - provides definitions for Negotiable Document and Negotiable Instrument; and
    - provides for security rights in 'Electronic Trade Documents', alongside associated proposed amendments to the Law of Obligations, to cater for the digitalisation of international trade.

86. In this section, we focus on amendments we propose to the Law of Obligations and Articles in the Proposed Law concerning Electronic Trade Documents.

87. Save in relation to these differences, we largely follow the UML. Please refer to the Derivation Table for the reasoning in the EG and LG underpinning the UML's treatment of Negotiable Documents and Negotiable Instruments in paper form.

<u>Digitalisation of international trade and Electronic Trade Documents</u>

88. Following the Law Commission of England and Wales' law reform project on electronic trade documents, in July 2023 its recommendations became law in England and Wales, with the enactment of the Electronic Trade Documents Act 2023 (the "**ETD Act**").

    We have adopted much of the ETD Act's wording.

89. The Law Commission explained the issue that needed to be addressed in its document

titled “Electronic trade documents: Report and Bill” (the “**ETD Report**”):[32]

> *“[I]nternational trade still relies to a large extent on a special category of document that entitles the holder to claim performance of the obligation recorded in the document, and to transfer the right to claim performance of that obligation by transferring (physical) possession of the document. The document is said to “embody” the obligation, which may be to deliver goods or to pay money. For example, simply handing over a bill of lading can be sufficient to give the new holder a right to the goods described in the bill.*
>
> *The legal rules governing these documents are premised on the idea that they are physical documents which can be physically held or “possessed”. […] Industries using these documents are therefore prevented by law from moving to a fully paperless process. To give a sense of the enormous amount of paperwork global trade generates, consider that the world’s largest containerships can carry 24,000 twenty-foot containers at any one time on any one voyage. For each one of those cargoes, paper transport documentation has to be produced, and must be processed manually to go from the shipper of the goods to the ultimate buyer at destination, sometimes through numerous intermediaries. The effect of the current law is that much of the documentation needs to be in hard copy. The Digital Container Shipping Association (“DCSA”) has estimated that 16 million original bills of lading were issued by ocean carriers in 2020, and that more than 99% of these were in paper form.*
>
> *This is clearly archaic, inefficient, and wholly unsuited to a world in which processes and transactions are increasingly in digital form. Allowing for electronic versions of certain trade documents could lead to significant cost savings and efficiencies, together with improvements in information management and security.*
>
> *The emergence over the past two decades of central registry systems and more recently of technologies such as distributed ledger technology (“DLT”) has made paperless trade increasingly feasible. The push for digitalisation became particularly acute in 2020 and 2021, with the introduction of global restrictions on movement and human-to-human contact in response to the COVID-19 pandemic. Stakeholders pointed to the risk of delays in receipt of paper documents disrupting supply chains for essential goods such as food and medical equipment. DCSA has recently observed that DLT could eliminate the risk of a single catastrophic failure or attack that would compromise the security of an electronic bill of lading.”*[33]

[32] See here.
[33] ETD Report, para 1.3 – 1.6.

90. Like the Law Commission, we recommend that to facilitate the digitalisation of international trade, the law should be reformed so that:

- Trade documents in electronic form should be capable of being possessed as a matter of law, provided that they meet certain criteria which ensure that they can replicate the salient features of paper trade documents (see further below in relation to the functionality of the relevant system).

- Subject to certain explicit exclusions, legislation should provide for electronic forms of trade documents, possession of which is required as a matter of law or commercial practice for a person to claim performance of the relevant obligation, to be treated in law as equivalent to their paper counterparts.

- Excluded from the scope of the regime should be documents used in financial markets outside of the international trade in goods.

- In order to qualify as an electronic trade document, a document in electronic form must contain the same information as would be required to be contained in the paper equivalent.

- Where a trade document in electronic form comprises separate, but linked elements – a data structure consisting of functional code, and a human readable part which contains or specifies certain rights – these elements together should comprise "the document".

- A reliable system must be used to ensure the documents contain certain functionality designed to replicate the salient features of paper trade documents and legislation should include a non-exhaustive list of factors which may be taken into account when determining whether a system is reliable.

- In order to qualify as an electronic trade document, a document in electronic form must be protected against unauthorised interference or alteration.

- A person should be taken to exercise control of a trade document in electronic form when the person uses, transfers or otherwise disposes of the document (regardless of whether they have the legal right to do so).

- "Use" of a trade document in electronic form should comprise utilising or retaining the document to achieve a particular purpose. It should include causing something to happen (or preventing something from happening) to the document, but exclude merely reading or viewing the document.

- In order to qualify as an electronic trade document, a trade document in electronic form must also be:

  - susceptible to exclusive control – i.e. only one person (or persons acting jointly) must be able to exercise control of a document in electronic form at any one time;

  - divestible – i.e. after the document is transferred, any person who before the transfer was able to exercise control of the document is no longer able to do so (except to the extent that a person is able to exercise control by virtue of being a transferee);

  - identifiable as "the document" so that it can be distinguished from any copies; and

  - capable of being uniquely associated with the person or persons able to exercise control of it.

- Legislation should provide expressly that an electronic document is capable of being possessed.

- An electronic trade document should be treated in law as equivalent to a paper trade document, and anything that can be done to a paper trade document should have the same effect if done to an electronic trade document.

- Electronic trade documents should be capable of being the subject matter of not just a non-possessory, but also a possessory, security.

Implementation in the Law of Obligations

91. Part 6 of the current Law of Obligations concerns negotiable instruments. Please refer to the proposed changes to the Law of Obligations contained in the proposed DIFC Laws Amendment Law, DIFC Law No. 2 of 2023 (the "**DIFC Amendment Law**") at Annex C[34], in relation to electronic trade documents. As can be seen, this comprises amendments to current Articles in the Law of Obligations as well as a new Chapter dealing specifically with "electronic trade documents". As also discussed in Consultation Paper No. 4 of 2023 on Digital Assets:

    - Articles 77, 78 and 80 make it clear that a negotiable instrument, bill and

[34] The DIFC Amendment Law primarily forms part of the consultation process for Consultation Paper 4 of 2023. Please also refer to this Consultation Paper.

promissory note may be in the form of an "electronic trade document".

- The new Chapter 5A of Part 6 of the Law of Obligations is largely modelled on the ETD Act:

    a. Article 153A defines a "paper trade document".[35]

    b. Article 153B defines an "electronic trade document" by reference to, among other things, a "paper trade document" and the reliability of a system used to identify, protect and secure the document. A list of factors that may be taken into account when determining whether a system is "reliable" is provided. Note the difference between our proposed Article 153B(2) and s.2(2)-(3) of the ETD Act. Our wording is drafted to mirror "control" within the meaning of the DAL. We suggest that our drafting captures satisfactorily all the points covered in ETD, s.2(2)-(3).

    c. Article 153C then defines "control" (which, as above, mirrors the meaning given in the DAL).

    d. Article 153D clarifies that a person may possess, indorse and part with possession of an electronic trade document, it has the same effect as an equivalent paper trade document and that anything done in relation to an electronic trade document has the same effect as the equivalent action would have had in relation to an equivalent paper trade document. In this regard, we have considered whether it is necessary to make further amendments to ensure that the language in Part 6 of the amended Law of Obligations is appropriate for electronic trade documents.[36] After reflection, we suggest that our proposed Article 153C is sufficient to address any such concerns.

    e. Article 153E makes provisions for conversion from a paper trade document to an electronic trade document and vice versa.

    f. Article 153F(1) emphasises the importance of contractual autonomy in relation to the application of Article 153D.

    g. Article 153F(2) excludes Financial Collateral and Non-Intermediated Financial Property (as defined in the Proposed Law) from the application of the new Chapter 5A (the purpose of which is to exclude from the scope of

[35] Note that we provide fewer examples of paper trade documents than provided in s.1(2) of the ETD Act.
[36] See the ETD Report at para 8.59 et seq., and e.g. s.89A of the (England and Wales) Bill of Exchanges Act 1882.

the regime documents used in financial markets outside of the international trade in goods). This also means that Financial Collateral and Non-Intermediated Financial Property do not constitute an "electronic trade document" for the purposes of Part 6 of the amended Law of Obligations and the Proposed Law.

h. Article 153F(3) confers upon the Board of Directors of DIFCA the power by regulations to add to, remove or amend the list of exclusions in Article 153F(2).

Q15. Are there any aspects of the proposed amendments to the Law of Obligations in relation to electronic trade documents that can be improved?

Implementation in the Proposed Law

92. "Electronic Trade Document" is defined by reference to the amended Law of Obligations.

93. A Negotiable Document may be in the form of an Electronic Trade Document.

94. We consider that in the context of secured transactions, the concept of "possession" in relation to Negotiable Instruments and Negotiable Documents is analogous to the concept of control in the context of those documents that are also Electronic Trade Documents.

95. Therefore, the definition of "Possession" in relation to an Electronic Trade Document is by reference to its "control" within the meaning of the amended Law of Obligations (which, as mentioned above, mirrors the concept of control in the DAL). This means that those provisions of the Proposed Law in relation to Negotiable Instruments and Negotiable Documents which refer to "Possession" thereby import the concept of "control" in relation to Electronic Trade Documents.

96. For example:

- a Negotiable Instrument that is an Electronic Trade Document can be made effective against third parties by registration or control (Article 25);

- a Negotiable Instrument that is an Electronic Trade Document and which is made effective against third parties by control has priority over a Security Right in the instrument made effective by registration (Article 53); and

- Article 54 applies to Negotiable Documents and Tangible Assets covered by Negotiable Documents, if the Negotiable Documents are in the form of an Electronic Trade Document.

Q16. Do you agree with our proposals in the Proposed Law in relation to Negotiable Instruments and Negotiable Documents that are Electronic Trade Documents?

Q17. Are there any aspects of the Proposed Law in this respect which could be improved?

97. As to conflict of laws in relation to Electronic Trade Documents, see paragraphs 177 to 182 below.

Receivables

Schedule 2 definitions: Debtor of the Receivable, Encumbered Asset, Grantor, Notification of a Security Right in a Receivable, Receivable, Security Agreement, Secured Creditor, Security Right, FCR Receivable and all definitions insofar as relevant to FCR Receivable

Articles 9(2), 20, 21, 26, 48(2)(a), 63-65, 67-72, 88-89, 99(1)(c), 99(3), 108

98. Consider the following scenario: A is a creditor to whom a receivable is owed (e.g. a seller of goods);

- D is A's debtor in relation to that receivable (e.g. a buyer of goods);
- B is a person extending credit to A; and
- TP is a third party.

A wishes to utilise the receivable as an asset to secure credit/lending provided by B (and thereby improve the prospect of credit and/or its terms). How can A do so?

99. The potential mechanisms differ across states, and can be categorised as:

- an outright assignment/transfer of the receivable from A to B;
- an assignment by way of security (i.e. A transfers to B A's rights, title and interests in the receivable, subject to an equity of redemption);

- a transaction that creates a security right in the receivable (e.g. a charge – A's rights, title and interests in the receivable remain with A, but the charge affords B

  the right, in the event of default by A, to appropriate monies raised from the charged receivable towards payment of secured liabilities).

100. In addition to the potential mechanisms differing across states, the effect of a security right on the obligor of the receivable which is subject to the security right is not well developed in all states.

101. In many states, it is not possible to grant a security right in the receivable and the only mechanism available to A is to assign the receivable to B. Further, in some states, it is not possible to assign the receivable by way of security, i.e. to make B's right to collect the receivable contingent upon A itself continuing to owe an obligation to B: in such states, only outright assignments of the receivable is possible.

102. The UML, like many modern secured transactions regimes, treats all forms of transfer of receivables between A and B in broadly the same way, irrespective of whether the transfer secures payment. The main reasons for this are:

- the legal mechanisms that establish the mutual rights and obligations of A and B and their rights against a TP are similar;
- the practical mechanics at the point of collection of the receivable are identical; and
- sometimes it is difficult to determine the exact nature of the underlying transaction between A and B.

103. We endorse this approach and largely adopt the drafting in the UML.

104. In light of our endorsement of the approach to receivables in the UML, when interpreting provisions in the Proposed Law that correspond to UML provisions, regard should be given to corresponding parts of the EG and LG (as to which, see the Derivation Table).[37]

105. Due to the comprehensive coverage of receivables in the EG and LG, our comments on our approach to receivables are limited to those below.

[37] The LG's consideration of receivables can be found at (page/para): 37/25-31; 92/106-122; 135/128-131; 255/69-80 261/9-26; 305/93-101; 308/107; 439/67.

Outright transfer

106. Note that our (and the UML's) approach does not convert an outright transfer of a receivable to a secured transaction: that would be undesirable and harmful for practices such as securitisation.

Rent as a Receivable

107. For the reasons explained at paragraphs 46 - 50 above, we make special provision in relation to bare rent Receivables in respect of Real Property.

FCR Receivables

108. We refer to the definition of FCR Receivable. This is considered below in relation to Financial Collateral Arrangements. In short, in relation to an FCR Receivable, by reason of Article 99(2) of the Proposed Law, in the event of conflict between a provision in Part 8 and any other provision of the Proposed Law, the former shall prevail.

Amendment to the Contract Law

109. Article 20 of the Proposed Law concerns contractual limitations on the Security Rights of specific types of Receivables. We refer to the explanation in the EG at para 109-115.

110. In order to ensure that Article 20 of the Proposed Law is consistent with the Contract Law, we propose the following (underlined) amendment to Article 94(1) of the Contract Law:

"A contractual right can be assigned unless:

(a) […]; or

(b) assignment is precluded by contract and not made effective by the Law of Security 2023."

Q18. Do you agree with the proposed amendment to Article 94(1) of the Contract Law?

Current Law

111. We note the exclusions at Art 9(3)(b) to (e) of the Current Law. In our view, and taking into account our recommendation of the UML approach, we do not consider the replication of such exclusions necessary or desirable. For example, Art 9(3)(c) of the Current Law excludes assignment of receivables which is for the purpose of collection only. As receivables transactions often give rise to subtle questions about how the underlying transaction should be characterised, this type of exclusion would give rise to precisely the type of problems which the UML approach is seeking to avoid.

Q19. Taking into account the Proposed Law in relation to receivables, do you agree that the Proposed Law should not follow the exclusions at Art 9(3)(b) to (e) of the Current Law.

Q20. Do you have further any suggestions on how the Proposed Law in relation to Receivables might be improved?

Other

Financial Collateral Arrangements

Schedule 2 definitions: Authorised, Account Provider, Bank, Bank Account, Close-Out Netting Agreement, Commodity Contract, Control, Control Agreement, Entitlement Holder, Equivalent Collateral, FCR Receivable, Financial Collateral, Financial Collateral Arrangements, Financial Property, Financial Property Account, Investment, Investment Entitlement, Investment Intermediary, Money, Recognised Financial Services Provider, Redelivery Obligation, Right of Use, Security Financial Collateral Arrangement, Title Transfer Financial Collateral Arrangement

Part 8 (Articles 99-104)

112. As explained in our Consultation Paper No.2 of 2019, the main aim of financial collateral legislation is to create a creditor-friendly legal regime relating to cash and securities collateral, under both security right and title transfer structures. That

Consultation Paper also explains some of the benefits of such legislation.[38]

113. Part 8 of the Proposed Law concerns Financial Collateral. The FCRs will be repealed and replaced by Part 8 of the Proposed Law. The application of the Proposed Law in relation to Financial Collateral is modified and supplemented by Part 8 and in the event of conflict between a provision in Part 8 and any other provision in the Proposed Law, the former prevails.[39]

114. Below, we highlight key differences between Part 8 and the FCRs and UML.

Definition of Financial Collateral

115. Under Article 99(1) of the Proposed Law, Financial Collateral is defined as:

"(a) Money credited to a Bank Account; or

(b) Financial Property held in an account with an Account Provider; or

(c) an FCR Receivable."

Money credited to a Bank Account

116. The first category is "Money credited to a Bank Account". This category is based on '"Money" under Reg 2.1(a) of the FCRs, but is narrower, as it only covers a credit balance in a bank account.[40]

117. "Money credited to a Bank Account" does not cover (1) claims by the Account Provider in respect of cash, nor does it cover (2) "sums due or payable arising in connection with a close out netting arrangement". Hence, to cover these two categories, we have created a third category of "FCR Receivable" (see below).

118. We note that the UML definition of "money" is limited to money in tangible form. The definition of "Money" in the Proposed Law is wider. It is defined by reference to the proposed amendments to the definition in the Contract Law (discussed in Consultation Paper No. 4 of 2023 on Digital Assets) as:

[38] Consultation Paper No.2, March 2019, Proposed New Financial Collateral Regulations and Security Regulations. See para 13-14.

[39] Article 99(2).

[40] Money' under Reg 2.1(a) of the FCRs covers: "*cash in any currency or claims for payment or repayment in respect of money in any currency credited to an account a claim of, or against, the Account Provider in respect of that Money or an account, including money market deposits and sums due or payable arising in connection with a close out netting arrangement*" (in Regulation 1.1.3 of the FCR 2019).

"something that functions as a medium of exchange, store of value, and unit of account, and includes a Digital Asset that satisfies these three requirements".[41]

119. The UML addresses rights to payment of "funds credited to a bank account".[42] We have replaced "funds" in the UML (which is not in any event defined) with "Money" in corresponding articles in the Proposed Law. However, as mentioned above, in the event of conflict between a provision in Part 8 and any other provision of the Proposed Law, the former prevails.

Financial Property

120. The second category is "Financial Property", which, subject to the definition of "Account Provider", mirrors the "financial property" category under Reg 2.1(b) of the FCRs.

121. As to "Account Provider", see below in relation to "Collateral providers and collateral takers".

FCR Receivable

122. The third category is "FCR Receivable". This covers the residual types of assets that fall within "Money" under the FCRs but outside "Money credited to a Bank Account". Namely, it covers (a) a money claim by the Account Provider against its customer; or (b) a money claim that is due or payable and arises in connection with a Close-Out Netting Arrangement.

123. The creation, effectiveness against third parties and Priority of a Security Right in a FCR Receivable is unaffected by the rules in the Proposed Law on Receivables due to Article 99(2) of the Proposed Law.

Q21. Do you agree with our proposed asset classes for an "FCR Receivable"? If not, what types of asset classes should be removed or added?

Collateral providers and collateral takers

124. The question arises as to which categories of parties may benefit from the security regime afforded by Part 8 of the Proposed Law.

125. The ultimate source of the FCRs was the EU Financial Collateral Directive, which

[41] The Proposed Law carves out Money in tangible form as a subset of Money by way of the definition of "Physical Money".

[42] See in particular UML Art 2(c), 2(dd), 2(g), 10, 15, 19, 25, 41, 47, 69, 82, 97, 98.

became part of UK law as the *Financial Collateral Arrangements (No.2) Regulations* 2003 ("**UK FCARs"**).[43]

126. The EU Financial Collateral Directive applies either to arrangements between a non-natural person and a public or regulated institution, or between two public or regulated institutions.[44]

127. The UK FCARs have a wider ambit than the Directive, in that they apply to any relevant financial collateral arrangements between "non-natural persons". This wider ambit, and the wider applicability of the UK FCARs more generally, has, however, been the subject to judicial comment and doubt.[45]

128. The FCRs:

- contain no limitation on who may be a collateral provider; and
- require the collateral taker to be authorised by the DFSA.

129. We see no reason to depart from the lack of limitation in the FCRs as to collateral providers.

130. However, we take a different approach to collateral takers. We do not propose the wide category of collateral takers as under the UK FCARs, because there needs to be a degree of assurance as to the reliability of the collateral taker. Rather:

- An "Account Provider" may be a Bank or an Investment Intermediary.
- We do not limit an "Account Provider" to DFSA-authorised entities.
- To fall within the Part 8 security regime, an "Account Provider", must be "Authorised".
- "Authorised" means "authorised by a Recognised Financial Services Regulator to carry on the business which it carries on".
- In turn, "Recognised Financial Services Regulator" means "the DFSA and any regulator of financial service activities established in a jurisdiction other than the DIFC recognised by the Registrar of Companies appointed pursuant to Article 6 of

[43] SI 2003/3226.
[44] Article 1(2).
[45] [2015] UKSC 63, *Cukurova Finance International Limited v Alfa Telecom Turkey Ltd* [2013] UKPC 2.

the DIFC Operating Law DIFC Law No.7 of 2018 as applying equivalent standards of regulation as those applicable in the DIFC".

- This would enable entities authorised in other jurisdictions, e.g. mainland UAE, to adopt DIFC law in their agreements.

Q22. Do you agree with the proposed lack of limitation on collateral providers? If not, what modifications/alternatives do you suggest?

Q23. Do you agree with our proposed limitation on collateral takers? If not, what modifications/alternatives do you suggest?

Effectiveness against third parties

131. Under Reg 4.3(b)(iii) of the FCRs, "a security interest in Financial Collateral … remains perfected until the earliest of" various events, one of which is "the secured party ceasing to have Control over the Financial Collateral". As such, registration does not assist in enabling a secured party to perfect its security interest, and therefore obtain priority over other security interests.

132. The Proposed Law, however, allows registration to play a role in relation to Financial Collateral. In particular:

- a Security Right in Financial Collateral can be made effective against third parties by either Control (as defined in the Proposed Law, on which see below) or registration (Articles 25(1), 99(2 and 101(4));

- a Security Right remains effective against third parties even if the Secured Creditor ceases to have Control, as long as by the time that Control is lost, the Secured Creditor has registered a notice with respect to the Security Right (Article 101(5)(c)); and

- a Security Right in Financial Collateral made effective by Control will always have Priority over a Security Right in the same Financial Collateral made effective by registration. However, if competing Security Rights have been made effective against third parties by registration, Priority as between those Security Rights is determined by the order of registration (Article 102). As such, a Secured Creditor who has only registered its Security Right still has Priority against subsequent registered Security Rights (absent the subsequent Secured Creditor having Control of the Financial Collateral).

133. We appreciate that, under the Proposed Law, many Secured Creditors are unlikely to register such Security Rights. Due to the fast-moving nature of markets involving Financial Collateral, it may be impractical; and due to the Priority accorded to Security Rights over which Secured Creditors have Control, registration may be thought to be of little practical benefit. However, some Secured Creditors may seek the further assurance that registration provides.

Q24. Do you agree that a Secured Creditor with a Security Right in Financial Collateral should be able to make that right effective against third parties by registration?

Q25. Do you agree that a Secured Creditor with a Security Right in Financial Collateral should also be able to benefit from the Part 8 regime, by reason only of registration (subject to the rules on Priority in Article 102, which are considered below)?

Priority and types of Control

134. We refer to Article 102 of the Proposed Law, which provides rules determining Priority between conflicting rights in the same Financial Collateral. Of particular relevance to this Article are the definitions in Schedule 2 of Control and Control Agreement.

135. The question arises as to the appropriate prioritisation as between competing Security Rights made effective against third parties by different types of Control.

136. We propose that three types of Control are relevant in determining such questions:

- the Secured Creditor is the Account Provider with which the account containing the relevant Financial Property is maintained;
- a Control Agreement is entered in respect of the relevant Financial Property; and
- the Secured Creditor is the Account Provider's customer with respect to the relevant Financial Property in the Investment Account.

137. In considering the appropriate Priority as between conflicting rights in the same Financial Collateral, but which are made effective against third parties by different types of Control, we have considered, among other approaches, those in Article 47 of the UML, the FCRs and the UCC.

138. Article 47 of the UML provides for Priority in relation to rights to payment of funds credited to a bank account. See further, EG p.107-8/para 352-356 and LG p.226-7/para 157-163 and the recommendations at 103-105.

139. As explained below, we do not wholly agree with the UML's proposed waterfall for different types of Control in relation to rights to payment of money credited to a Bank Account.

140. However, we suggest that in principle the same policy issues should apply to Financial Property as to rights to payment of funds credited to a bank account.

141. If Article 47 of the UML is applied to Financial Property, this gives the following waterfall for different types of Control (in decreasing order of Priority):

a. The Secured Creditor is the Account holder;

b. The Secured Creditor is the Account Provider;

c. The parties have entered a Control Agreement, with first in time applying in the unlikely scenario of competing Control Agreements.

142. The rationale provided in the LG (para 161/p.227), for (a) taking priority over (b) is that, by accepting the competing Secured Creditor as its customer, the bank should be deemed to have released its claim in the deposit agreement that it enters with its customer. We agree that (a) should take priority over (b).

143. However, in our view, (b) should not take priority over (c). In this regard, we prefer the approach under Reg 5.1.2 of the FCRs. This provides that a Control Agreement takes priority over a subsequent Security Right in favour of an Account Provider. This seems sensible to us; if the Account Provider has entered a Control Agreement, it should be deemed to have subordinated its Security Right.

144. This logic should also extend to a situation in which the Account Provider obtained a Security Right prior to the other Secured Creditor entering a Control Agreement or becoming the Account Provider's customer.

145. Therefore, we propose a waterfall which gives Priority over the Account Provider to Secured Creditors who have entered a Control Agreement or who are the Account Provider's customer.

146. We also propose that the above logic should apply rights to payment of Money credited to a Bank Account and have so provided.

147. In the above respects, we therefore depart from the UML in relation to Money credited to a Bank Account.

148. Finally, we would add that we considered §9-328 of the UCC. §9-328(3) provides for

super-priority of a Security Right held by a securities intermediary in respect of securities in an account maintained with it. We decided against following the UCC approach, because we consider that a Security Right of an intermediary should not take priority over a Security Right of a Secured Creditor who has direct factual control through being the account holder.

Q26. Do you agree with the Priority rules in Article 102 of the Proposed Law? If not, why not and what modifications/alternatives would you suggest?

Digital Assets in the context of Part 8

149. We highlight as follows:

- Certain types of Digital Assets may fall within the categories of Money credited to a Bank Account (Article 99(1)(a)) and Financial Property (Article 99(1)(b)) and thus fall under the Part 8 regime.

- Title Transfer Collateral Arrangements concerning Financial Collateral that is a Digital Asset will need to satisfy the requirements in the DAL in relation to transfer of title (on which, see Consultation Paper No. 4 of 2023 on Digital Assets).

- Insofar as Part 8 is engaged in relation to Digital Assets, by reason of Article 99(2), in event of conflict between any provision in Part 8 and any other provision in the Proposed Law, the former shall prevail.

150. On Digital Assets more broadly, see below.

Q27. Do you agree that Digital Assets that are also Money Credited to a Bank Account or Financial Property should be treated in the same way as such Financial Collateral that are not Digital Assets?

Q28. If you disagree, what modifications/alternatives would you suggest?

Other

Q29. Do you have any further comments on any other aspects of Part 8 of the Proposed Law, including how it may be improved?

Digital Assets

Schedule 2 definitions: Control, Digital Asset, Electronic Trade Document

Articles 17, 26, 33, 57, 122, 134 and Part 8

151. We refer to Consultation Paper No. 4 of 2023 on Digital Assets.

152. In Schedule 2 of the Proposed Law, "Digital Asset" is given the meaning in the DAL.

153. We have already considered Digital Assets in the context of Financial Collateral Arrangements. However, there will be Digital Assets that do not fall within the Part 8 regime and there is a corresponding requirement for rules governing secured transactions concerning these assets.

Effectiveness against third parties

154. We consider that Control, in the context of secured transactions, is analogous to the concept of possession in the context of secured transactions concerning tangible assets. Accordingly, Article 33 provides that a Security Right in a Digital Asset may also (i.e. in addition to registration under Article 25) be made effective against third parties by the Secured Creditor having "Control" of the Digital Asset. "Control" has the meaning given in the DAL.

Q30. Do you agree that it should also be possible to make a Security Right in a Digital Asset effective against third parties by Control of the Digital Asset?

Priority

155. Due to the fast-moving and international nature of markets in many types of Digital Assets, it seems unrealistic in most cases to expect a person who is considering taking a Security Right in a Digital Asset to search the Security Registry.

156. Accordingly, while we allow for effectiveness against third parties by way of registration, as with Financial Collateral, a Security Right in a Digital Asset made effective by Control has Priority over a competing Security Right made effective by registration. See Article 57 of the Proposed Law. Our approach aligns with Principle 16 of the UNIDROIT Principles on Digital Assets and Private Law.

Q31. Do you agree that a Security Right in a Digital Asset made effective by Control should have Priority over a competing Security Right made effective by registration?

Articles 17 and 26

157. In addition the application of both Article 17(2) and Article 26 extends to Digital Assets (which may also constitute Financial Collateral). We do not see any obvious reason why Digital Assets should not be included.

Q32. Do you agree that Articles 17(2) and 26 should also apply to Digital Assets?

See further below in relation to Digital Assets in the context of conflict of laws rules.

Transfer of a Digital Asset

158. We refer to the section titled "Bona fide purchase" in Consultation Paper No. 4 of 2023 on Digital Assets. The issue of bona fide purchase arises when A has title to a Digital Asset in which B has an interest, and A transfers his title to C. The bona fide purchase rules govern the circumstances under which C takes free of B's interest.

159. The question arises as to the circumstances in which C takes free if B's interest is a Security Right.

160. Article 14 of the proposed amended Personal Property Law provides:

"Save as otherwise provided in the Law of Security, a transferee of title to property takes free of a Security Right if such transferee gives value without actual knowledge that the transfer violates the rights of the Secured Creditor under the Security Agreement."

161. Accordingly, the proposed default rule in the Personal Property Law provides that knowledge of the existence of a security agreement does not of itself prevent a transferee from taking free. The setting of the default threshold as actual knowledge follows the approach taken in the UML in relation to:

- exceptions to the general rule in relation to transactions in the ordinary course of business (UML Article 34(4)-(6) and reflected in the Proposed Law at Article 41(4)-(6));

- money credited to a bank account (UML Article 47(6)) and physical money (UML Article 48(1)); and

- negotiable instruments and tangible assets covered by negotiable documents (UML Article 49(3)).

Q33. Do you agree with our proposed approach in Article 14?

Consumer protection

Schedule 2 definitions: Consumer Goods, Equipment, Inventory

Articles 9(4), 31, 41(9), 45(3)

Consumer Goods

162. The Proposed Law follows the UML's definition of Consumer Goods, i.e.:

"goods primarily used or intended to be used by the Grantor for personal, family or household purpose".

163. As such, the definition of this term in the UML and the Proposed Law differs to that in the LG, so as to clarify that the term:

- includes goods *primarily* used or intended to be used by the Grantor for personal, family or household purposes and only incidentally as Equipment or Inventory; and

- excludes goods primarily used or intended to be used by the Grantor as Equipment or Inventory and only incidentally as Consumer Goods.

Therefore, it is the primary use or primary intended use of goods that determines whether they will be classified as Consumer Goods, Equipment or Inventory.

Acquisition Security Rights

164. The distinction between Consumer Goods, Equipment and Inventory are mainly relevant to the Articles in the Proposed Law on Acquisition Security Rights.

165. Article 31 provides that an Acquisition Security Right in Consumer Goods with an acquisition price below a threshold amount is effective against third parties without any further act.

166. Article 31 should be read in conjunction with Articles 41(9) and 45(3).

167. Article 41(9) protects a buyer or lessee of low-value Consumer Goods that are subject to an Acquisition Security Right that was made effective against third parties automatically under Article 31 (so not, e.g. by registration). In this situation, the buyer or lessee acquires its rights free of or unaffected by the Security Right. In order to avoid this risk, the Secured Creditor should register a notice of the Acquisition Security Right.

168. Article 45 concerns Priority as between Acquisition Security Rights and competing non-Acquisition Security Rights. We refer to the explanation of Article 45 in the EG (para 320-327).[46]

169. As explained in the EG, under Article 49(3) of the Proposed Law an Acquisition Security Right in Consumer Goods or their Intellectual Property equivalent automatically has priority over a non-Acquisition Security Right which is created by the Grantor in the same Encumbered Asset, even if the latter was made effective against third parties before the Acquisition Security Right. Accordingly, a Security Right in Consumer Goods, other than low-value Consumer Goods, needs to be made effective against third parties by registration or possession. Once effective, that Acquisition Security Right has Priority. However, a non-Acquisition Security Right may have Priority if the Acquisition Secured Creditor fails to register notice of its Security Right altogether – unless the low-value exemption in Article 31 applies.

170. Therefore, the question arises as to the appropriate level for the threshold sum in Article 31. This should be high enough that a Secured Creditor is not dissuaded from entering transactions; but low enough for a consumer to be able to obtain credit.

171. We suggest that a threshold sum of USD 50,000 or its equivalent but welcome your views on this.

Q34. What is the appropriate threshold for the purposes of Article 31 of the Proposed Law?

Q35. Subject to your views on the appropriate threshold for Article 31, do Articles 41 and 46 strike the correct balance between the interests of consumers and providers of acquisition financing?

[46] We have chosen Option A.

Receivables

172. Article 9(5) of the Proposed Law provides:

"Nothing in this Law affects the rights and obligations of the Grantor and the Debtor of the Receivable under other laws governing the protection of parties to transactions made for personal, family or household purposes."

173. Subject to feedback, the Proposed Law may provide specific provisions concerning consumer protection in relation to Receivables.

174. Therefore, we are interested to hear from you on what consumer protections you consider are appropriate in the context of Receivables. Without seeking to limit in any way the consumer protections you may suggest, we consider the following areas may merit consideration in the context of Receivables:

- restrictions on the creation and/or enforcement of Security Rights in:
    a. all present and future assets;
    b. employment benefits up to certain amount;
    c. necessary consumer household items;
    d. pension entitlements; and
- a prohibition against collecting encumbered receivables directly from a consumer debtor.

Q36. What (if any) consumer protections should be introduced in relation to Receivables?

Other

Q37. Do you have any further comments on how the law in relation to consumer protection and security rights might be improved?

Conflict of laws

Part 9 (Articles 105-122) and Article 98

175. Part 9 contains rules for determining the state whose substantive law is applicable to

issues dealt with elsewhere in the Proposed Law.

Adoption of UML provisions

176. Subject to special rules in relation to Digital Assets and Electronic Trade Documents, we adopt the UML conflict of laws provisions. Accordingly, in interpreting Articles 105 to 121 of the Proposed Law, regard should be had to the corresponding parts of the EG and LG (see the Derivation Table).

Q38. Do you have any comments on the conflict of laws in Articles 105-122 of the Proposed Law?

Digital Assets and Electronic Trade Documents

177. As the Law Commission of England and Wales observes, Digital Assets and Electronic Trade Documents are often distributed internationally and there are inherent difficulties in determining the geographical location of such intangible assets, and associated acts and actors:

"For example, when a digital asset is hosted on a decentralised, distributed ledger – such as a blockchain – where is it located? And if transferred or misappropriated, where has it moved from, and where has it moved to? Digital assets (especially when combined with distributed ledger technology) have the potential to generate multiple (and potentially inconsistent) assertions of applicable law and jurisdiction."[47]

178. While there are undoubtedly complexities and uncertainties in this area, the courts of England and Wales have not shied away from grappling with such issues and the body of case law is growing.[48] Nor have academics who are experts in the field of Digital Assets shied away from considering such issues.[49] In addition, we note that there is a school of thought that the complexities concerning Digital Assets do not warrant the abandonment of an international PIL framework. Rather, one should look to understand the technical aspects and then use existing legal mechanisms.[50]

179. We also note that the Law Commission is currently undertaking a project aiming to set out the current rules on private international law as they may apply in the digital asset

[47] See the Law Commission's project page here.
[48] See the summary of some such decisions in Hurst S, *Decrypting conflict of laws*, March 2023, JIBFL.
[49] See e.g. Fox D & Green S, Cryptocurrencies in Public and Private Law, 1st ed. (2019), Oxford University Press (see Chapter 5).
[50] See e.g. Bana A and Osmanourtashi A, Blockchain and Private International Law: Implications for Crypto, Payment Systems, Digital Wallets and Jurisdictional Concerns, published by the International Bar Association here.

context and, if they consider it appropriate, make recommendations for reform. The Law Commission states that it aims to publish a consultation paper in the second half of 2023.[51]

180. We anticipate that we will also consult on conflict of laws and do not pre-judge at this stage the outcome of that consultation. However, pending the outcome of the consultation, we have sought to reduce uncertainty in relation to conflict of laws rules concerning Digital Assets and Electronic Trade Documents.

181. In particular, Article 122 of the Proposed Law contains the following asset-specific provisions:

"(1) This Article 122 applies to:

(a) *Security Rights in Electronic Trade Documents or Digital Assets; and*

(b) *Security Rights in assets other than Electronic Trade Documents or Digital Assets but which are conferred by or embodied in Digital Assets; and*

(c) *Security Rights in Financial Collateral that are not rights to payment of Money credited to a Bank Account.*

(2) In the event of conflict between this Article 122 and any of other Article in this Part 9, this Article 122 shall prevail.

(3) The law applicable to the creation, effectiveness against third parties, Priority and enforcement of Security Rights shall be determined by the laws of England and Wales, save insofar as the Board of Directors of the DIFCA makes Laws or Regulations in relation to such matters (pursuant to its powers under Part 12 or otherwise)."

182. Therefore, we propose that, unless the Board of Directors of DIFCA makes Laws or Regulations to the contrary, in relation to the Security Rights set out in Article 122(1) the law of England and Wales (which means both legislation and common law) shall apply to the determination of the creation, effectiveness against third parties, Priority and enforcement of Security Rights.

[51] See the Law Commission's project page here.

Q39. Pending the outcome of our anticipated consultation on conflict of laws in the context of Digital Assets and Electronic Trade Documents, do you see any downsides to the adoption of Article 122 of the Proposed Law?

The Security Registry, filing and registration

Schedule 2 definitions: Financing Statement, Security Registry

Article 6(2) and Part 11

183. Part 11 of the Proposed Law largely adopts the existing provisions concerning the Security Registry, filing and registration as provided in the Current Law. The main change is that provisions concerning the making of Regulations are now contained in a separate, Part 12 (see below on the revised provisions). Further, we have added a new provision concerning reference of disputes to the DIFC Courts (Article 133).

184. Further, the Securities Regulations 2019 are continued under the Proposed Law.

185. Accordingly, we do not adopt the UML's Model Registry Provisions.

Q40. Are there any aspects of Part 11 that could be improved?

Transitional provisions

Article 5(1) and Schedule 1

186. Any new law requires fair and efficient transition rules. In this regard, we propose that the transitional provisions in the UML are adopted. Accordingly, in interpreting these provisions, regards should be had to the corresponding parts of the EG and LG (see the Derivation Table).

Transitional period

187. Paragraph 7 of Schedule 1 provides a qualified exception to the general applicability of the third-party effectiveness requirements of the Proposed Law to prior Security Rights under paragraph 8 of Schedule 1.

188. Under paragraph 7, a prior Security Right that was made effective against third parties under the Current Law remains effective against third parties for a specified transitional

period after entry into force of the Proposed Law even if the conditions for third-party effectiveness under the Proposed Law have not been satisfied.

189. The transitional period expires at the earlier of the time when the third-party effectiveness of the Security Right would have ceased under prior Law (see paragraph 7(a)) or the time when the transitional period expires (see paragraph 7 (b)).

190. The length of the transitional period should be sufficient to allow secured creditors to familiarise themselves with the Proposed Law and take the steps required by the Proposed Law to make their Security Rights effective against third parties. We propose that the specified transitional period should be one year.

Q41: Is a transitional period of one year appropriate?

Other

Q42. Are there any aspects of Schedule 1 that could be improved?

Regulations

191. We appreciate that users of DIFC Law seek stability and certainty as to the law. We are, however, also mindful that the law of secured transactions and concerning emerging technologies needs to be kept under review, particularly given the rapid pace of development of emerging technologies. Accordingly, under Article 134, the Board of Directors has the power to make Regulations to further the purpose of the Law of Security (as to which, see Article 4) or facilitate its administration. Article 134 mirrors Article 16 of the DAL.

Legislative Proposal

192. This legislative proposal contains the following:

a. the Law of Security (at Annex A);

b. the DIFC Securities Regulations (at Annex B)

c. the Personal Property Law (at Annex C);

d. the DIFC Amendment Law (as Annex D);

e. a table of comments to provide your views and comments on the Proposed Laws (at Annex E).

Appendix 1 * - Definitions of terms in this Consultation Paper

Term	Definition
CCPPSL	Canadian Conference on Personal Property Security Law
Consultation Paper	Consultation Paper No. 5 of 2023
Current Law	Law of Security, DIFC Law No. 8 of 2005
Derivation Table	The table at p12-22, providing the UML Articles which correspond to the those in the Proposed Law, and refers to corresponding parts of the EG and LG.
DIFCA	Dubai International Financial Centre Authority
EG	UNCITRAL Guide to Enactment
ETD Act	Electronic Trade Documents Act 2023 (England and Wales)
ETD Report	Electronic trade documents: Report and Bill, Law Commission of England and Wales
FCRs	DIFC Financial Collateral Regulations 2019
LG	UNCITRAL Legislative Guide on Secured Transactions
PPSA	The personal property security legislation of a given country
Proposed Law	DIFC Law No. [x] of 2023
PMSI	Purchase Money Security Interest
Securities Regulations	DIFC Securities Regulations 2019
UML	UNCITRAL Model Law on Secured Transactions
UCC	Uniform Commercial Code

Appendix 2 – Derivation Table

Article in Proposed Law	Corresponding UML Article	Enactment Guide (page/para)	Legislative Guide (Chapter/page/para or recommendation)	Comments
PART 1: GENERAL PROVISIONS				
1	-	-	-	
2	-	-	-	
3	-	-	-	
4	-	-	-	
5	-	-	-	
6	-	-	-	
7	-	-	-	
8	-	-	-	
9	1	11/22-34	ChI/p.31/1-4 ChI/p.34/13-15 ChI/p.55/101-112 ChI/p.61/rec1-7 ChI/p.37/25-31 ChI/p.62/rec3 ChI/p.40/37-38 ChI/p.62/rec4 ChI/61/rec2(b) ChII/98/rec18	Note that the scope of application of the Proposed Law ("**PL**") differs to the UML. The EG and LG should be read in that context. Art 9(7) mirrors the Current Law.
10	3	26/72-75	ChII/63/10	Art 10(1) – note the exceptions.
11	4	27/76-77	ChVIII/278/15 ChVIII/310/rec131	
12	5	28/78-80	Intro/18/43-59 Intro/30/rec1	
PART 2: CREATION OF A SECURITY RIGHT				
13	6	31/82-90	ChII/67/12-37 ChII/97/rec13-15	Note the PL's definition of "Possession".
14	7	33/91	ChII/74/38-48 ChII/98/rec16	

Article in Proposed Law	Corresponding UML Article	Enactment Guide (page/para)	Legislative Guide (Chapter/page/para or recommendation)	Comments
15	8	4/92-94	ChII/77/49-57 & 61-70 ChII/98/rec17	
16	9	34/95	ChII/79/58-60 ChII/98/rec14(d)	
		34/96	ChII/79/58-67	
17	10	35/97-102	ChII/83/72-89 ChII/98/rec19-20	Note the wider application, including in relation to Digital Assets.
18	11	36/103-106	ChII/88/90-95 ChII/91/100-102 ChII/99/rec22 ChV/215/117-123 ChV/233/rec91	
19	12	37/107-108	-	
20	13	38/109-115	ChII/92/106-110 ChII/99/rec24	Note the PL's definition of "Netting Agreement"
21	14	40/116-118	ChII/93/111-122 ChII/100/rec25	Note the addition of Art 21(2) in the PL.
22*	15	41/119	ChII/96/123-125 ChII/101/26	Note the PL's definition of "Money".
23	16	41/120-121	ChII/97/128 ChII/101/rec28	Note the PL's definition of "Negotiable Document"
24	17	42/122	-	
PART 3: EFFECTIVENESS OF A SECURITY RIGHT AGAINST THIRD PARTIES				
25 *	18	43/123-124	ChIII/107/19-86 ChIII/143/rec32 ChIII/144/rec37	Note the PL's definition of "Possession".
26 *	19	43/125-128	ChIII/124/87-96 ChIII/145/rec39&40	Note the wider application, including in

Article in Proposed Law	Corresponding UML Article	Enactment Guide (page/para)	Legislative Guide (Chapter/page/para or recommendation)	Comments
				relation to Digital Assets.
27	20	44/129	ChIII/145/rec44	
28	21	45/130	ChIII/133/120-121 ChIII/146/rec46	
29	22	45/131	ChIII/133/122-127 ChIII/146/rec47	
30	23	45/132-133	ChIIII/132-133/117-119	
31	24	46/134	ChIX/350/125-128 ChIX/375/rec179	
32	25	46/135-136	ChIII/137/138-148 ChIII/161/rec49	Note the PL's definition of "Money".
33	-	-	-	
34	26	47/137-139	ChIII/141/154-158 ChIII/147/rec51-53	Note the PL's definition of "Negotiable Document".
35	27	48/140	-	Note the PL's definition of "Uncertificated Non-intermediated Financial Property".
PART 4: PRIORITY OF A SECURITY RIGHT				
36	29	88/285-294	ChV/195/45-54 ChV/230/rec76	
37	30	90/295	-	Note the PL does not adopt the Model Registry Provisions.
38	31	90/296	-	
39	32	91/297-298	ChV/223/144-150 ChV/234/rec100	
40	33	92/299-302	ChV/215/117-124 ChV/232/rec90-91	
41	34	93/303-311	ChV/200/60-89	

Article in Proposed Law	Corresponding UML Article	Enactment Guide (page/para)	Legislative Guide (Chapter/page/para or recommendation)	Comments
			ChV/230/rec79-82	
42	35	94/312	-	
43	36	95/313-316	ChV/209/90-93 ChV/231/rec 83 ChV/212/103-109 ChV/232/rec85-86	
44	37	96/317-319	ChV/209/94-102 ChV/231/rec84	
45	38	97/320-329	ChIX/352/131,136-137,143 & 146 ChIX/375/rec180	We propose option A of the UML's correspondin g article.
46	39	100/330-331	ChIX/363/173-178 ChIX/376/rec182	
47	40	101/332-334	ChIX/335/145-148 ChIX/376/rec183	
48*	41	102/335-340	ChIX/359/158-172 ChIX/376/rec185	We propose option A of the UML's correspondin g article.
49	42	104/341	-	
50	43	104/342-343	ChV/219/128-131 ChV/233/rec94	
51	44	105/344-346	ChV/221/135-143 ChV/233/rec97-99	
52	45	105/347	ChV/218/125-127 ChV/233/rec93	
53	46	106/348-351	ChV/225/154-156 ChV/234/rec101-102	We propose the approach in UML Art 46(2)(b).
54	49	109/358-359	ChV/228/167-169 ChV/235/rec108-109	Note the PL's definition of "Possession".
55	50	109/360-361	-	
56	51	110/362-366	-	Note PL's definition of "Certificated Non-

Article in Proposed Law	Corresponding UML Article	Enactment Guide (page/para)	Legislative Guide (Chapter/page/para or recommendation)	Comments
				intermediated Financial Property".
57	-	-	-	
PART 5: RIGHTS AND OBLIGATIONS OF THE PARTIES AND THIRD-PARTY OBLIGORS				
58	52	113/369	ChVI/240/14-15 ChVI/257/rec110	
59	53	114/370-372	ChVI/242/24-31 ChVI/257/rec110	
60	54	114/373-375	ChIV/182/rec 72 ChVI/245/35-39 ChVI/257/rec112	
61	55	115/376-378	ChVI/249/50-65 ChVI/257/rec113	
62	56	116/379-381	-	
63	57	117/382-384	ChVI/254/73 ChVI/258/rec114	
64	58	117/385-387	ChVI/255/73-74 ChVI/258/rec115	
65	59	118/388-390	ChVI/255/76-80 ChVI/258/rec116	
66	60	119/391	-	
67	61	119/392-394	ChVII/261/12 ChVII/271/rec117	
68	62	120/395-397	ChVII/262/13-16 ChVII/271/rec118	
69	63	121/398-405	ChVII/262/17-20 ChVII/271/rec119	
70	64	123/406-407	ChVII/264/21 ChVII/272/rec120	
71	65	123/408-410	ChVII/264/22 ChVII/273/rec121	
72	66	124/411-412	ChII/264/23-24 ChVII/273/rec122	

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73	67	125/413	ChVII/265/25-26 ChVII/273/rec123	
74	68	125/414	ChVII/266/27-31 ChVII/273/rec124	
75*	69	126/415-418	ChVII/267/32-37 ChVII/273/rec125-126	
76*	70	127/419	ChVII/270/43-45 ChVII/274/rec130	
77	71	127/420	-	
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78	72	129/421-425	ChVIII/277/10-12 ChVIII/278/15-17 ChVIII/284/34-35 ChVIII/311/rec133&139 ChVIII/312/rec141&143 ChIII/313/rec144	
79	73	130/426-431	ChVIII/p.280/18-20 ChVIII/p.283/29-33 ChVIII/p312/rec142	
80	74	131/432-433	ChVIII/283/31 ChVIII/311/rec137	
81	75	132/434-436	ChVIII/281/22-24 ChVIII/312/rec140	
82	76	133/437-439	ChVIII/285/36 ChVIII/313/rec145	
83	77	134/440-445	ChVIII/286/37-48 ChVIII/291/51-56 ChVII/313/rec146-147	
84	78	136/446-450	ChVIII/290/48 ChVIII/293/57-60	

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			ChVIII/313/rec148-151	
85	79	137/451-454	ChVIII/294/60-64 ChVIII/314/rec152-155	
86	80	138/455-459	ChVIII/295/65-70 ChVIII/315/rec156-159	
87	81	139/460-463	ChVIII/298/74-81 ChVIII/p.315/rec160-163	
88*	82	140/464-465	ChVIII/305/93-98 ChVIII/307/102-108 ChVIII/310/111-112 ChVIII/317/rec169-171 ChVIII/317 rec173&175	
89	83	141/466	ChVIII/306/99-101 ChVIII/316/rec167-168	
PART 7: FIXTURES				
90	-	-	-	
91	-	-	ChII/99/rec21	
92			ChIII/145/rec41	
93	-	-	ChIII/145/rec43	
94	-	-	ChIV/232/rec87-88	
95	-	-	ChVIII/316/rec164(a) to (b)(i)	Art 95(2) Proposed Law – we have not adopted LG rec164(b)(ii)
96	-	-	ChVIII/316/rec165	
97	-	-	ChIX/377/rec184	
98	-	-	-	
PART 8: FINANCIAL COLLATERAL OBLIGATIONS				
99	-	-	-	
100	-	-	-	

Article in Proposed Law	Corresponding UML Article	Enactment Guide (page/para)	Legislative Guide (Chapter/page/para or recommendation)	Comments
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102	-	-	-	
103	-	-	-	
104	-	-	-	
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106	85	145/473-479	ChX/389/28-38 ChX/405/rec203-207	
107	86	146/480-481	ChX/392/39-47 ChX/405/rec208	
108*	87	147/482	ChX/396/54 ChX/405/rec209	
109	88	147/483-485	ChX/398/64-72 ChX/407/rec218	
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113	92	151/494	ChX/386/14 ChX/408/rec221	
114	93	151/495-499	ChX/402/79 ChX/408/rec222	
115	94	152/500	ChX/402/80-82 ChX/408/rec223	
116	95	153/501-504	ChX/403/83-87 ChX/409/rec224-227	
117	96	154/505	ChX/398/62-63 ChX/407/rec217	
118*	97	154/506-509	ChX/395/49-51 ChX/406/rec210	
119*	98	156/510-511	ChX/391/34	

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			ChX/406/rec211	
120	99	157/512-514	-	
121*	100	158/515-524	-	
122	-	-	-	
PART 10: THE APPOINTMENT AND ROLE OF THE REGISTRAR				
123	-	-	-	
124	-	-	-	
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126	-	-	-	
127	-	-	-	
128	-	-	-	
129	-	-	-	
130	-	-	-	
131	-	-	-	
132	-	-	-	
133	-	-	-	
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Para 3	103(1)	163/534	ChXI/414/13-16	
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Para 5	104(1)	164/536-537	ChXI/415/17-19	
Para 6	104(2)	164/536-537	ChXI/415/17-19	
Para 7	105(1)	165/538-539	ChXI/416/20-22	
Para 8	105(2)	165/540	ChXI/416/20-22	
Para 9	105(3)	165/541	ChXI/416/20-22	
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Para 12	106(1)	166/544-545	-	
Para 13	106(2)	167/546	-	