UAE Supreme Court Sets Precedent: Bans Compound Interest in Financial Transactions

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The UAE Federal Supreme Court's ruling on the restrictions of compound interest represents a significant shift in the legal landscape governing financial transactions within the country. This judgment, detailed in case number 1254 of 2023 dated 10 January 2024, highlights the court's firm stance on the prohibition of compound interest, drawing upon specific provisions within the Federal Decree-Law No. 23 of 2022 and the Federal Law No. 50 of 2022.

Understanding the Legal Provisions

Federal Decree-Law No. 23 of 2022 – Article 121/4: This article is a cornerstone in the court's decision, explicitly prohibiting licensed financial institutions from charging any interest on frozen interests, commonly referred to as compound interest, on the facilities granted to customers. The decree mandates that such practices must adhere to the controls and rules stipulated in the control regulations issued by the Central Bank, emphasizing the protection of customers and ensuring fair financial practices.

Federal Law No. 50 of 2022 – Article 88: Complementing the provisions of the Federal Decree-Law No. 23 of 2022, Article 88 of this law reinforces the prohibition of compound interest. It states, "The creditor may not claim compound

interest – which is interest on compounded interests – or claim those interests as supplementary compensation.” This provision further solidifies the legal framework against the application of compound interest in financial transactions, ensuring that creditors adhere to a simple interest model.

Implications of the Supreme Court’s Ruling

The Supreme Court’s ruling, grounded in these explicit legal provisions, marks a pivotal move towards enhancing consumer protection in the financial sector. By prohibiting compound interest, the court aims to prevent the undue accumulation of debt on borrowers, promoting transparency and fairness in lending practices.

For Financial Institutions: The ruling necessitates a significant shift in how interest is calculated and applied to loans and credit facilities. Financial institutions must now ensure their practices are aligned with the stipulated legal framework, moving away from compound interest calculations to a simple interest model as mandated by the Central Bank’s regulations.

For Borrowers: This decision is a significant win for consumer rights, offering borrowers protection against the potential financial strain caused by compound interest. It ensures that loan and credit facility repayments are more manageable and predictable, reducing the risk of escalating debt burdens.

The Broader Legal and Economic Context

The prohibition of compound interest by the UAE Federal Supreme Court reflects a deliberate effort to strengthen the legal and regulatory framework surrounding financial transactions. It underscores a commitment to ensuring ethical lending practices, safeguarding consumer interests, and maintaining the integrity of the financial sector.

In the broader economic landscape, this ruling may influence lending and credit practices, potentially leading to more conservative risk assessments by financial institutions. However, it also promotes a more sustainable and equitable financial environment, encouraging responsible lending and borrowing practices.

Conclusion

The UAE Federal Supreme Court’s decision to restrict compound interest, as articulated in Article 121/4 of the Federal Decree-Law No. 23 of 2022 and Article 88 of the Federal Law No. 50 of 2022, sets a new legal precedent in the financial sector. This landmark ruling not only enhances consumer protection but also aligns the UAE’s financial practices with global standards of fairness and transparency. As the implications of this ruling unfold, it is expected to have a lasting impact on the financial industry, promoting a more stable and equitable economic environment for both financial institutions and consumers alike.

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