DLPC Working Group
of the
Innovation Council

DLPC
Distributed Ledger Payment Commitment

Business Best Practices
Proposed Specifications for Trial Use

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Foreword

The Distributed Ledger Payment Commitment Working Group (DLPC Working Group) was established by the BAFT Innovation Council in 2016 to address the payment commitment within the context of trade instruments being processed on a distributed ledger network. Upon feedback from BAFT members, the working group looked into the needs for the digitalization of the full spectrum of trade instruments, from a simple Draft to a complex Letter of Credit. Based on this research, the working group has created best practice specifications for an atomic component of a trade transaction processed on a distributed ledger, the DLPC, which enables a digitized implementation of a wide range of trade instruments involving a promise to pay. BAFT believes that the DLPC component should be an industry standard and is a legally enforceable means to realize electronic negotiable instruments.

The specifications consist of this document together with the accompanying Technical Best Practices. The current release of these specifications is titled Proposed Specifications for Trial Use, to reflect the fact that we are, as an industry, at an early stage in the implementation of trade instruments on distributed ledger. The workgroup requests feedback from early implementers of these specifications to help advance them into industry standards.

BAFT would like to express its gratitude to the DLPC Working Group captains and other members who generously contributed their expertise, time, and effort to develop these DLPC Business Best Practices. These contributors and their affiliations are listed below.

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Definitions

Any term that is not defined in this document shall have the meaning given to that term in the Uniform Commercial Code as adopted by the US State of Delaware or in the Uniform Electronic Transactions Act of the US State of Delaware and the terms below shall have the following meanings:

Committee: The party to the DLPC who is proposed to become or is actually an obligee, to which effect the DLPC carries the required attestations.

Committer: The party to the DLPC who is proposed to become or is actually an obligor, whose attestation to that effect is carried in the DLPC.

DL: Distributed Ledger

DLT: Distributed Ledger Technology

DLPC: A record of a Payment Commitment on a Distributed Ledger that conforms to these Business and Technical Best Practices. A DLPC has a life-cycle comprising the following states: (1) DLPC Created (2) Contingent DLPC (3) Actual DLPC and (4) DLPC Discharged. This life-cycle is described in more detail in Section 2.2.

Network: A DL Business Network is a group of parties that use a Distributed Ledger to conduct business transactions among themselves. As a precondition to joining the Network, these parties must all agree to conduct such business on the Distributed Ledger compliant to the Network rules and governance.


1. Overview and Purpose

As Distributed Ledger Business Networks form to support digitalized trade instruments, maximizing their utility requires that standards be developed to support interoperability across business networks, independent of the underlying DL technology used or the specific participants in those networks. The DLPC specifications are best practices to facilitate interoperability for a range of digitalized trade instruments that embody a promise to pay.

1.1. General Problem Statement

International trade is heavily reliant on paper documents as compared to domestic trade. One of the primary reasons for the greater reliance on paper is that the legal and regulatory framework for certain payment obligations (including negotiable instruments as defined by the Uniform Commercial Code (UCC) and Bills of Exchange as defined by the Bills of Exchange Act) either explicitly requires paper documents, or lacks any explicit support for a digital version of the obligation.

The Distributed Ledger Payment Commitment (DLPC) proposes a solution to allow companies to register digital representations of payment commitments on a distributed ledger. Supported by a legal and regulatory framework that seeks to provide protections for banks and corporations as provided for existing trade obligations, the DLPC will facilitate companies to interact digitally with respect to trade obligation documents.

In addition, in Trade Finance today, the same set of data is replicated multiple times between transaction parties because each party keeps instrument data in their own trade and general ledgers systems. Communication between parties involved in a trade transaction is conducted via SWIFT messages, emails and paper documents to process lifecycle events, i.e., issue, amend, exam and pay. This situation creates time lags and opportunities for data to become out-of-sync or subject to fraud.

Several distributed ledger technologies and networks are being pursued to address the problems above, which introduces the challenge of interoperability across these solutions. The best practices put together by the DLPC working group address this interoperability challenge.

Figure 1: How data is currently stored for an LC process
1.2. **The Solution**

a. In addition to each party's internal data (data silo), a single source of trusted data is needed to which all the permissioned parties may have access. It would reflect the real-time state of that instrument, terms, payment commitments, and lifecycle activities. The resulting solution would provide the parties with the confidence to transact digitally and in real-time.

b. Distributed Ledger Technology (DLT) provides the capability to realize this solution. DLT provides:

c. trusted source of data (immutable audit log, tamper-proof, cryptographically secure, etc.)

d. visibility to all authorized parties

e. one common view of the trade instrument’s terms, payment commitments, lifecycle events, etc.

f. support for real-time processing across the transaction parties

**Message and Documents exchanges**

![Diagram](image)

*Figure 2: How data will be stored under a DLPC model*

1.3. **Key Benefits for Financial Institutions, Banks, Insurers and Banking Regulators**

a. Customer satisfaction gains; supports the digital journey of most banks and corporates

b. Contributes to the digital transformation of the bank’s back office

c. Reduces some risks, disputes, clerical errors, etc.

d. Speeds up processing

e. Potential reduction of overhead and costs associated with audit and regulation (e.g. real time, reliable data and records)

f. Accelerated automation and efficiency in transaction processing and reconciliation can help to reduce counterparty credit risks

g. Potential simplification, which will be facilitated by DLPC process
1.4. **The Role of Distributed Ledger Payment Commitment (DLPC)**

Trade instruments of many types result in a commitment to make a payment (conditional, unconditional) to other parties of the instrument. However, the way that those commitments are determined for each type of trade instrument can widely vary, depending on an instrument’s terms and conditions and lifecycle events. Therefore, a standardized and common way to represent payment commitments for any trade instrument will facilitate individual instrument commitments, aggregation of commitments in portfolio views across groupings of trade instruments, etc. Together with standardization of the trade instruments themselves, the DLPC will facilitate the interoperability between networks.
2. DLPC Lifecycle and Accounting Methodology

2.1. Instrument Lifecycle and G/L Accounting

Payment commitments are created, modified and extinguished by the lifecycle events of trade instruments. Each instrument has product specific terms and lifecycle. However, despite the diversity of trade instruments, a bank recognizes payment commitments in a standardized way by making liability entries to its books. In the same way, the DLPC records the payment commitments related to trade instruments in a standardized way on a shared distributed ledger.

![Figure 3: Current GL model vs DLPC GL model](image)

Whereas G/L liability entries primarily record just the liability arising from a payment commitment, a DLPC records additional details. It identifies a party making the commitment (identified in the DLPC fields in this document as the “committer”), a party the commitment is made to (identified in the DLPC fields in this document as the “committee”), amount, start and end dates of the commitment, and more.

Like G/L liability entries, there can be more than one DLPC entry related to the same trade instrument. This is because within the same instrument, there may be bilateral payment commitments made between different parties or a single party may have more than one bilateral commitment. The Payment Commitment Relationship Diagrams and Figures in Section 3 illustrate the possible commitments commonly existing between the involved parties.
2.2. DLPC Lifecycle

A DLPC goes through the lifecycle shown in Figure 4. A DLPC comes into existence only when some of the specified data fields for it have been recorded on a distributed ledger. To reach the DLPC Created state, at a minimum, the record must contain the DLPC ID field. The DLPC ID is a globally unique ID which is designed to be unique across networks and ledgers. The DLPC is linked to a specific instrument via the Parent Instrument ID. Prior to reaching the DLPC Created state, any preparatory stages that maintain DLPC data fields in the internal IT systems of any party, are pre DLPC stages as shown in Figure 4.

Once created, if a DLPC does not meet the minimum requirements to be legally binding specified in Section 3 of this document, it can continue to be updated without restriction, until the minimum requirements are met. When the minimum requirements to be legally binding are met, the DLPC would become either a Contingent DLPC or an Actual DLPC. Contingent DLPCs and Actual DLPCs allow only Compliant Changes as specified in Section 3 of this document. One such Compliant Change is the negotiation of an Actual DLPC upon the requisite attestations being made, which could result in a new person being designated as the Committee. The conversion of a Contingent DLPC to an Actual DLPC is another example of a Compliant Change. When a DLPC becomes Actual, it becomes an “unconditional promise to pay” and, from that point onwards, if the parties wish, it may benefit from the legal protections described in Section 4 (“Contractual Relationships”) below.

An Actual DLPC transitions to a Discharged DLPC when the Committee indicates that they have received the promised payment or are otherwise relieving the Committer of their promise to pay.
3. Trade Products that would utilize the DLPC

Some examples of existing products that would be digitalized using the DLPC, are shown in Table 1 below. The DLPC would be equally applicable to new trade products that include payment commitments.

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<td>Letter of Indemnity</td>
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<td>Promissory Note</td>
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*Table 1: Some of the products that would utilize the DLPC*

3.1. Draft

Drafts support trade acceptances and bankers’ acceptances, and are used independently or in the context of Letters of Credit and Documentary Collections. Because the laws governing drafts, such as UCC Article 3 and the Bills of Exchange Act, focus on a paper realization, drafts represent a significant obstacle to the digitization of international trade.

A draft is a simple instrument, made up of a short list of data elements (typically less than 20). An electronic version of the draft can be created using a single DLPC, with the addition of draft specific data elements. This single DLPC representing the draft’s commitment can then be used to support electronic presentations of drafts, given a supporting legal framework.

*Figure 5: Outline of data fields for an electronic Draft based on DLPC*
3.1.1. Accepted Draft life cycle with DLPC

![Figure 6: Lifecycle of a DLPC based electronic Draft that is accepted](image)

3.1.2. Accepted and Endorsed Draft life cycle with DLPC

![Diagram](image)
3.2. Documentary LC

To model how a documentary LC can be designed with DLPC, the starting place is to identify the payment commitments that may occur during the lifecycle of a letter of credit. We document that in a Payment Commitment Relationship Diagram (Figure 8), where the possible LC parties are identified and the payment commitments between them indicated. There is no implied workflow in the diagram, so the payment commitments represent what would exist, if created during the instrument’s lifecycle.

Each arrow represents a payment commitment between two parties; it records that commitment with the data shown in the blue box. The attribute names in the DLPC are generalized to represent bilateral payment commitments in the variety of contexts that exist in trade products. As such, the parties are identified as a Committer and Committee, rather than the party type of those parties in the context of the parent instrument, e.g., Issuing Bank and Beneficiary.

Below is an example of a syndicated LC with assigned proceeds. The resulting bilateral payment commitments are identified in Figure 9.
On the DL these DLPCs would be related to the LC and its instrument parties as shown in Figure 10.

**Figure 10: Relationship of DLPCs and the parties to the LC in the syndicated LC example**

By having all payment commitments represented by a standard DLPC embedded in the trade instrument, it is easy to access them across populations of trade instruments residing on the DLT. This permits aggregation of payment commitments by committer, committee, end date, commitment type, currency, amount, etc. Through its association to its parent instrument and parties, aggregation could include the trade instrument types or other characteristics of the parent, while maintaining the separate identity of the DLPC.

Payment commitments can change over the lifecycle of an instrument. Some events create new instruments with their own lifecycle and payment commitments. For instance, when an LC is created it will reflect the conditional payment commitment specified by the original terms of the LC, but a subsequent amendment, revolve, payment, etc., may increase or decrease that commitment. In the case of a time payment, the conditional payment...
commitment of the LC is reduced and a banker’s acceptance or deferred payment is created. Those instruments will have their own actual payment commitment due at maturity.

3.2.1. Documentary Letter of Credit (At Sight) Lifecycle with DLPC

*If the letter of credit has been confirmed by the confirming bank and the documents are clean, the issuing bank has an actual commitment with the confirming bank.*
**Figure 13:** DLPC 3 and the issuing bank and beneficiary relationship under the DLPC

*If the letter of credit is not confirmed and issuing bank accepted the documents, then issuing bank has an actual commitment to the Beneficiary.*

**Figure 14:** DLPC 4 and the confirming bank and beneficiary relationship under the DLPC
* If the letter of the credit is confirmed, and the documents are clean, the confirming bank has an actual commitment to the Beneficiary.

3.3. Invoice

An Invoice would generally need only one DLPC within it. In section 3.3.1 we illustrate the lifecycle of such an invoice with reference to the lifecycle of the DLPC within it.

3.3.1. Invoice Lifecycle with DLPC

![Diagram of Invoice Lifecycle with DLPC]

3.4. Logical DLPC state

Different distributed ledgers will represent the DLPC fields and the transactions that change them through different mechanisms. However, implementations of this specification must specify how the logical state that is referenced in this document can be inferred from transactions recorded on their distributed ledger. Please see section 3.2 of the Technical Best Practices Specification for further details.
4. Contractual relationships A Digital Promise

The DLPC is a promise to pay in digital form embedded in an electronic trade related instrument realized on a distributed ledger, irrespective of the type of instrument in which the DLPC is embedded. To provide a legal foundation for the roles, obligations and processes within the lifecycle of a DLPC, all participants of a network utilizing the DLPC will be bound by the contractual terms governing the network and the DLPC as a requirement in order to conduct business within the network. The DLPC Contract Terms appear in section 4.2 below and include three components: (a) agreed contract terms describing the rights and obligations of parties to a DLPC; (b) an incorporation of a residual body of law to govern the resolution of issues not resolved by the agreed contract terms; and (c) a choice of forum and service of process arrangements for suit in the chosen forum. The DLPC may originate as a “conditional” payment obligation when the Commitment Type field in the DLPC shows “Contingent” and over its lifecycle it may become “unconditional”, when the Commitment Type field in the DLPC shows “Actual”. From that point onwards, it is an “unconditional promise to pay” and, under the DLPC Contract Terms in section 4.2, the parties accept that the DLPC is a “Note” that should benefit from the legal protections summarized in the following paragraphs.

4.1.1. Agreed Contract Terms

The DLPC has been designed to benefit from the provisions of established legal frameworks for negotiable instruments, in particular, Article 3 of the Uniform Commercial Code (UCC) as adopted by the State of Delaware and Section 116 of the Uniform Electronic Transactions Act (UETA), also of the State of Delaware. These Delaware statutory provisions have been chosen because the Delaware UCC provides an up to date rule set defining the rights and obligations of parties to negotiable instruments that is detailed and is as close to self-contained as one finds in a common-law environment. Furthermore, it is derived from the international law merchant, and consequently its principles are generally similar to those of the laws of other civil-and common-law jurisdictions, thereby making it attractive to a wide spectrum of banks operating globally. Moreover, the Delaware UETA provides a legal environment that expressly facilitates electronic transactions and, in particular, enables legally binding and enforceable negotiable promises to pay in digital form, which is precisely what the DLPC is. The Delaware UETA also confers on the person to whom the obligation was originally issued, or the most recent transferee, of an electronic record (as defined in UETA) the same rights and defenses as a holder of an equivalent negotiable instrument under the UCC, including those of a holder in due course, as if the electronic record were a negotiable instrument in written form. Accordingly, experts familiar with these laws have drafted the contractual language in paragraph 4.2 below for the application of the Delaware UCC and UETA to the DLPC. In the normal course of trade finance transactions, it is expected that use of the DLPC will in fact satisfy the requirements of UETA and will therefore benefit from the statutory protections of the UCC and UETA. Even if a particular DLPC does not in fact satisfy all of the statutory requirements, all parties to a DLPC on a network using the contractual language in paragraph 4.2 below, agree among themselves that the DLPC should be treated like notes or transferable records under the Delaware UCC and UETA. However, in such a case a third party who has not agreed to the contractual language in paragraph 4.2 could assert claims or rights based on the DLPC not being a negotiable instrument or not having been properly transferred.

4.1.2. Residual Law

To resolve interstitial issues not covered by the Delaware UCC and UETA, Delaware law has been chosen as the governing law for the DLPC. Delaware law is generally recognized as providing a sound legal environment for banking and financial transactions and our legal experts advise that Delaware law allows virtually complete party autonomy in choice of law for commercial transactions without the requirement of a nexus or connection of the
parties or the transaction to Delaware, provided that the parties have submitted to the jurisdiction of the courts of Delaware and have agreed to the service of legal process.

4.1.3. **Choice of Forum**

A further benefit in choosing Delaware law as the governing law for DLPC transactions is that the Delaware UETA expressly permits the parties to an “electronic contract” (such as the DLPC) to choose an exclusive judicial forum for the adjudication of any disputes concerning use of the DLPC.

4.2. **DLPC Contract Terms**

Each person, whether in the capacity of the issuer, obligor, obligee, transferee (being identified as committer or committee in the DLPC) or otherwise who is a party to, or who seeks to derive an interest in or a benefit from, the Distributed Ledger Payment Commitment (DLPC) on this network agrees that;

a. an Actual DLPC is an electronic record of an unconditional promise to pay,

b. the Actual DLPC, if it were in writing, would be a note under Article 3 of the Uniform Commercial Code of the State of Delaware in the United States of America,

c. the Actual DLPC is a transferable record under Section 116 of the Uniform Electronic Transactions Act of the State of Delaware,

d. the person to whom the obligation is payable is the person identified as the committee in the DLPC, to whom the obligation was issued or most recently transferred and is therefore at that time the person in control of the transferable record for purposes of Section 116,

e. the person in control of the transferable record and an obligor under the transferable record who is the person identified as the committer in the DLPC, have the rights and defenses described in Section 116,

f. the rights and obligations of parties to the DLPC are governed by the local law of the State of Delaware,

g. a state or federal court sitting in the State of Delaware has exclusive jurisdiction to resolve any dispute relating to the DLPC,

h. service of process upon it in connection with any dispute relating to the DLPC shall be fully effective if sent to and received by such party via registered or certified U.S. mail or delivery by a nationally recognized express transportation company (including, without limitation, DHL, FedEx, or United Parcel Service) at a specified U.S. address, and

i. these contract terms shall apply to all DLPC’s on all networks implementing DLPCs, regardless of whether such person is identified as an issuer, obligor, obligee, transferee or otherwise in any such DLPC or claims rights or asserts obligations with respect to any such DLPC under any other contract or law.

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1 Because the DLPC is to be governed by Delaware law (paragraph 4.2 (f)), under current law, parties can be certain that courts in Delaware will accept jurisdiction and give effect to that choice of law. If parties want to choose courts in other jurisdictions (within or outside the United States), they will want to assess whether this may increase the costs of dispute settlement or risk greater legal uncertainty.

2 Parties choosing Delaware law to govern a contract must be capable of being served with legal process in Delaware or elsewhere. This requirement may be satisfied by parties specifying, in the network data or elsewhere, a publicly accessible U.S. address for service of process, which may be in care of an agent (including, without limitation, Corporation Service Company, CT Corporation, InCorp, or National Registered Agents).
4. Security of interest

Security Interest and Perfected Security Interest are well-known credit-related concepts with a legal framework established by local jurisdiction, such as the UCC in the United States.

Below are representative general definitions:

*What is SECURITY INTEREST? An enforceable claim that is created by a security agreement or by the law that secures the fulfillment of a pledge. The lender has security interest in collateral provided by a borrower to guarantee timely payment.*

*What is PERFECTED SECURITY INTEREST? Any secure interest in an asset, which cannot be claimed by any other party. A lien might be registered against it. Known as perfected lien.*

*Black’s Law Dictionary.

For each trade instrument and transaction type that the DLPC proposes to support, there are common practices for establishing and perfecting security interest. For example, with Letters of Credit, a security or credit agreement may be established between the borrower and creditor, often covering all assets of the borrower, including Accounts Receivable and Inventory. A UCC Financing Statement may then be filed to perfect the security interest.

The DLPC does not propose to alter the rules and conditions for establishing and perfecting security interests. Corporates and banks should refer to the laws defined in each local jurisdiction and their relationship to each instrument or transaction type to establish and perfect security interest.

It is hoped that the DLPC will make transfer of interests in certain trade finance products easier and will provide a framework which could be used for modernizing the laws dealing with trade finance products.

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3 In the United States and certain other jurisdictions, the term “security interest” is also defined to include the interest of a buyer in certain payment rights including the interest of a buyer in a promissory note.
5. Risk Structure and Mitigation

For each trade instrument and transaction type that the DLPC proposes to support, there are different risk structures, and the level of risk each participant is exposed to varies depending on its role in the transaction.

For example, with Letters of Credit, the issuing bank takes on the risk of the applicant. The advising bank may elect to confirm the letter of credit, in which case it would take on the risk of the issuing bank. The beneficiary is protected from the risk of non-payment by the applicant.

Separate from the risk mitigation that may be available based on the risk structure of the instrument or transaction itself, participants may choose to mitigate risk by establishing separate agreements among the parties with covenants and other terms and conditions of performance.

The DLPC does not propose to alter the Risk Structure or the practices of Risk Mitigation that pertain to each instrument and transaction type. Corporates and banks should refer to the laws defined in each local jurisdiction and their relationship to each instrument or transaction type to determine appropriate risk mitigation techniques.
6. Compliance and AML Requirements

We consider that the best practices described in this document would not conflict with the compliance, AML and data protection requirements currently in effect. Consequently, regulated financial institutions or others subject to these requirements will continue to use processes they have in place. With respect to the increased EU data protection provisions of GDPR, we note that the DLPC will be a permissioned distributed ledger system and participants will be able to withhold data that they consider should be held confidential.