Pledge through DMCC Tradeflow Platform

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In this article, we briefly discuss the operation of the DMCC tradeflow and the procedure for creation of a pledge through the DMCC tradeflow.

The DMCC operates an electronic central registry of ownership of commodities called the Trade Flow (‘Tradeflow’). The platform has been developed with extensive interaction from the DMCC members alongside advice from key regional financiers and commodity owners. The access to the Tradeflow is under the DMCC Tradeflow Corporate Access Agreement dated 11th February 2013 (the ‘Corporate Access Agreement’). This registry uses negotiable electronic title documents called DMCC Tradeflow warrants (‘Warrants’) to provide interested parties with the undisputed proof of ownership and security interests attached to UAE based inventories. The Warrants are issued by storage operators (in the DMCC) in accordance with the DMCC Warrant Rules annexed to Corporate Access Agreement (the ’Warrant Rules‘) and provide evidence of specified goods (quantity and quality) being stored therein. Ownership of DMCC Tradeflow Warrants can be electronically transferred between members using the web-based, secure interface.

The use of collateral management in trade finance is increasingly seen as a tool that gives financiers a way to reduce and mitigate risk and offers much needed capital relief. With this in mind, the DMCC has developed a pledge structure which allows commodity owners and their financiers to register pledges on the DMCC Tradeflow being collateral in return for working capital financing. The advantage of a pledge for financiers is that it creates a security interest over the assets, allowing them to be used to secure the performance of an obligation, i.e. a trade finance loan. The pledge is created electronically in accordance with the DMCC Security Rules annexed to Corporate Access Agreement (the ‘Security Rules’). The process involves registration of parties as participants with DMCC which is done by way of acceptance of the DMCC Tradeflow Corporate Access Agreement (and all the Rules appended thereto including the Security Rules and Warrant Rules). Each participant (pledgor, storage operator and the finance party) would sign a document called ‘Letter of Adherence’.

Security is created electronically by way of electronic issuance of a standard format Security Notification (as defined in the Corporate Access Agreement) and Security Acceptance (as defined in the Security Rules). In order to enter into subsequent transactions over the DMCC Tradeflow evidencing a pledge over future Warrants (issued by the storage operator as and when additional goods are deposited), the pledgor (as the legal owner) is required to issue a new Security Notification to the DMCC on the DMCC Tradeflow in relation to the new Warrant(s) instructing the DMCC to hold the new Warrant(s) by way of pledge for the pledgee. Upon receipt of the Security Notification on the DMCC Tradeflow, the DMCC would hold the said Warrant for the benefit of the pledgee. The pledgee upon the receipt of the Security Notification is required to issue and transmit the Security Acceptance on the DMCC Tradeflow within seven (7) days of receipt thereof. The creation of security by way of pledge over the Warrant(s) is subject to cancellation by the DMCC without notice if, within seven (7) days after the date of the Security Notification, a Security Acceptance has not been received from the pledgee.

The Security Rules also provide for a close out mechanism which permits enforcement of the pledge by way of sale of the Warrants by the DMCC (and the goods it represents) without recourse to the pledgor or a court order on receipt of a Close Out Settlement Instruction (as defined in the Security Rules) as prescribed in Rule 3 of the Security Rules. However the recognition of the close out mechanism under UAE law requires detailed examination as the concept of "self help" is not recognised under UAE law and an order of a UAE court may be required for enforcement of any security created under any of the security documents. Further, any default by the pledgor may not automatically give the pledgee any right to attach the Warrants (or the goods). It may, however, instruct the DMCC on the DMCC Tradeflow by way of a Security Enforcement Instruction (as defined in the Security Rules) to hold the goods in favour of the pledgee and not to release the same until the successful conclusion of the proceeding or any judgment or appealable order issued by a UAE Court in relation to the pledgor's default.

The storage operator warrants or guarantees to hold the stored commodity by way of safe custody implying that although they are legally liable for any value lost through theft or damage, they have no legal ownership in them except for the storage operator lien as highlighted below. As such, in case of liquidation, the storage operator's creditors will be unable to seek recourse to the commodities stored since the legal title remains with the holder of the Warrants – as registered on the DMCC Tradeflow central registry. It is also important to note the Rule 3.3 of the Security Rules which provides the following order of priority in relation to any monies realised pursuant to the enforcement of security:

- first, in or towards satisfaction of any Storage Operator's lien which is duly annotated on the relevant Warrant at the time of sale; and
- second, in or towards satisfaction of all costs, charges and expenses incurred, or payments made, by and evidenced in writing by DMCCA in connection with such sale of the Warrant (or the Goods represented by the Warrant) (including the agency fee referred to in Clause 3.5); and
- third, in or towards satisfaction of all costs, charges and expenses incurred, or payments made, by and evidenced in writing by the Tradeflow Finance Party in connection with such sale of the Warrant (or the Goods represented by the Warrant); and
- fourth, in or towards satisfaction of the Secured Obligations to which the relevant Warrant relates; and
- fifth, as to the surplus (if any), to the person or persons entitled thereto.'

Therefore apart from the cost of the DMCC for the sale of the Warrant (or the Goods represented by the Warrant), the realisation under the pledge documents will also be subject to any limitation arising from the storage operator's lien over the goods and such lien shall rank ahead of the pledgee's claim and shall include all lawful storage charges, money claims, insurance, transportation, labour, weighing, coopering and any advertisement charges for auction of the goods in the event of a default. Accordingly, the storage operator may have priority in the insolvency of the pledgor for unpaid rentals and other charges for the storage of goods in their vault.

The DMCC Tradeflow platform provides for pledge over commodities stored in the DMCC registered warehouses and is an important step in the trade financing for the companies having storage of their goods in the DMCC. While the pledge through the DMCC Tradeflow platform is still at a stage of infancy, it holds great promises for trade financing in future.