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Program and Budget Committee

Twenty-Fifth Session
Geneva, August 29 to September 2, 2016

FURTHER UPDATE ON PROPOSAL CONCERNING HEDGING STRATEGY FOR PCT INCOME

Document prepared by the Secretariat

BACKGROUND

1. In January 2015, the International Bureau issued a Circular (C.PCT 1440 "*PCT Fee Income: Possible Measures To Reduce Exposure to Movements in Currency Exchange Rates"*) to all Patent Cooperation Treaty (PCT) stakeholders, setting out various possible measures which could be taken to reduce the exposure of PCT fee income to movements in currency exchange rates. One of these possible measures was the proposal to commence the hedging of PCT fee income in certain currencies, based on a recommendation by an independent consulting firm, FTI Treasury of Dublin, Ireland.

2. Under the hedging proposal developed by FTI Treasury, equivalent filing fees in Japanese yen (JPY), euros (EUR) and United States dollars (USD) would be set in October of each year beginning of the 1st of January of the following year and remain in effect for the following calendar year. The rate would be set at a blended hedge rate derived from the contracts negotiated with counter-party banks to sell excess funds in these currencies and purchase Swiss francs. Since funds are sent to the International Bureau by receiving Offices on a monthly basis, the International Bureau would enter into monthly contracts to purchase forward Swiss francs (CHF) at rates negotiated in advance with at least two counter party banks for each currency. The monthly amounts to be sold in each currency would be based on forecasts of PCT revenue received prepared internally by the International Bureau. The amount of the forward purchase would also take into consideration any payments the International Bureau incurred that must be paid in one of the three currencies, as only the net balance of revenue less payments would be available to be converted into CHF using the forward contracts.

3. Equivalent amounts of fees in the remaining unhedged currencies would be set at the exchange rate existing on the 1st of October of the previous year. The equivalent amounts of fees would remain fixed for the entire year and the existing mechanism to adjust the equivalent amount would be discontinued. Under this arrangement only the portion of the PCT revenues received in each currency that can be covered by the forward contract would be protected from exchange rate risk. Therefore, the lower the percentage of hedge cover, the higher the risk of a loss of budgeted income due to exchange rate fluctuations which are not offset by the forward contracts.

4. A proposal to commence hedging of international filing fees as far as the risk resulting from transactions in EUR, JPY and USD was concerned, together with the FTI Treasury report and recommendations, were submitted to the PCT Working Group at its eighth session, held in May 2015 (see document PCT/WG/8/15 "PCT Fee Income: Possible Measures to Reduce Exposure to Movements in Currency Exchange Rates"). Document PCT/WG/8/15 emphasized, in paragraph 26, that the hedge need not cover the full amount of the forecast income but "would be established at a certain percentage level per currency (say, between 70 and 90 per cent)." The upper limit was drawn from a recommendation in the report by FTI Treasury and the lower limit attempted to allow for variances between income forecast and income actually received. It is primarily for this reason that the FTI Treasury report contained the recommendation to "develop currency cash flows forecasts for on balance sheet exposures".

5. The PCT Working Group at its eighth session agreed on the proposal by the International Bureau set out in document PCT/WG/8/15 (see paragraph 78 of the report of the session, document PCT/WG/8/26) with a view to its submission to the Assembly for consideration at its October 2015 session.

6. Prior to the October 2015 session of the PCT Assembly, the International Bureau provided an update on the implementation of the proposed hedging strategy for PCT fee income to the twenty-fourth session of the Program and Budget Committee (PBC), held from September 14 to 18, 2015, based on document WO/PBC/24/INF.3. Document WO/PBC/24/INF.3 identified several risks and concerns related to that strategy which, in the view of the Secretariat, required further research and thorough analysis before committing to a particular hedging strategy and entering into contractual relationships with hedging counterparties. The document indicated that such work would require time and resources and that the time involved could be significant, given the complexity of the issues involved. The document further indicated that, if the hedging strategy were to be implemented without having limited the risks associated with the issues identified, the potential financial cost to the Organization could be considerable.

7. After consideration of the document, the PBC agreed on the following recommendation to the PCT Assembly (see document WO/PBC/24/17, under agenda item 10):

> "With regard to the recommendation of the PCT Working Group contained in document PCT/WG/8/15, the Program and Budget Committee (PBC) was informed through document WO/PBC/24/INF.3 of several issues regarding the implementation of a hedging strategy for PCT fees. After careful consideration of the issues contained therein, the PBC recommended to the Assembly of the PCT Union:
>
> > "(i) to allow for more time for the Secretariat to further analyze these issues in detail in order to properly assess all the challenges associated with the implementation of such a hedging strategy; and accordingly,
> >
> > "(ii) to postpone its decision with regard to the recommendation quoted above until such analysis has been undertaken."

8. In view of this recommendation by the PBC, the PCT Assembly, at its forty-seventh session in October 2015, adopted the following decision (see document PCT/A/47/5 Rev. and paragraph 23 of the Report of the session, document PCT/A/47/9):

> "23. The Assembly:
>
> > "(i) took note of the contents of document PCT/A/47/5 Rev.;
> >
> > "(ii) invited the Secretariat to further analyze the issues regarding the implementation of a hedging strategy for PCT fee income set out in document WO/PBC/24/INF.3;
> >
> > "(iii) postponed any decision on the proposed modifications to the Directives of the Assembly Relating to the Establishment of Equivalent Amounts of Certain Fees, as agreed by the PCT Working Group, until such analysis had been undertaken; and
> >
> > "(iv) invited the Secretariat to submit a progress report to the 2016 session of the PCT Working Group."

9. The PCT Working Group, at its ninth session held in May 2016, noted a progress report by the Secretariat (document PCT/WG/9/9 "PCT Fee Income: Progress Report on Analysis of Possible Measures to Reduce Exposure to Movements in Currency Exchange Rates". That progress report is reproduced in the Annex to the present document. The PCT Working Group further noted the contents of a presentation given by the Secretariat. The presentation concluded with the following observations on the way forward regarding the possible implementation of a hedging strategy:

> "The International Bureau will present further information to the upcoming August 2016 session of the PBC.
>
> "At this stage, the International Bureau does not expect to proceed with the hedging strategy based on forward contracts in the manner recommended by the treasury consultants FTI.
>
> "The International Bureau intends to further explore whether an alternative hedging strategy, utilizing a different approach from that proposed by the treasury consultants FTI, might successfully limit WIPO's exposure to exchange fluctuations."

10. The present document contains such further information and a recommendation as to a possible way forward.

ACTION TAKEN BY SECRETARIAT TO DATE

11. The Secretariat has collected the information on cash flow necessary to be able to determine the risks and advantages inherent in implementing the proposed hedging strategy. The analysis has concentrated on reconstructing detailed cash flow information in each currency for the period January 1, 2015, to May 31, 2016, for use in comparing the net USD, EUR and JPY available to purchase forward contracts to the limits proposed by the consultant explained in paragraph 4, above. Reports on cash flow have been constructed using the information available in the AIMS accounting system. The net amounts that would have been available in each of the three currencies were determined to be as set out in the following paragraphs.

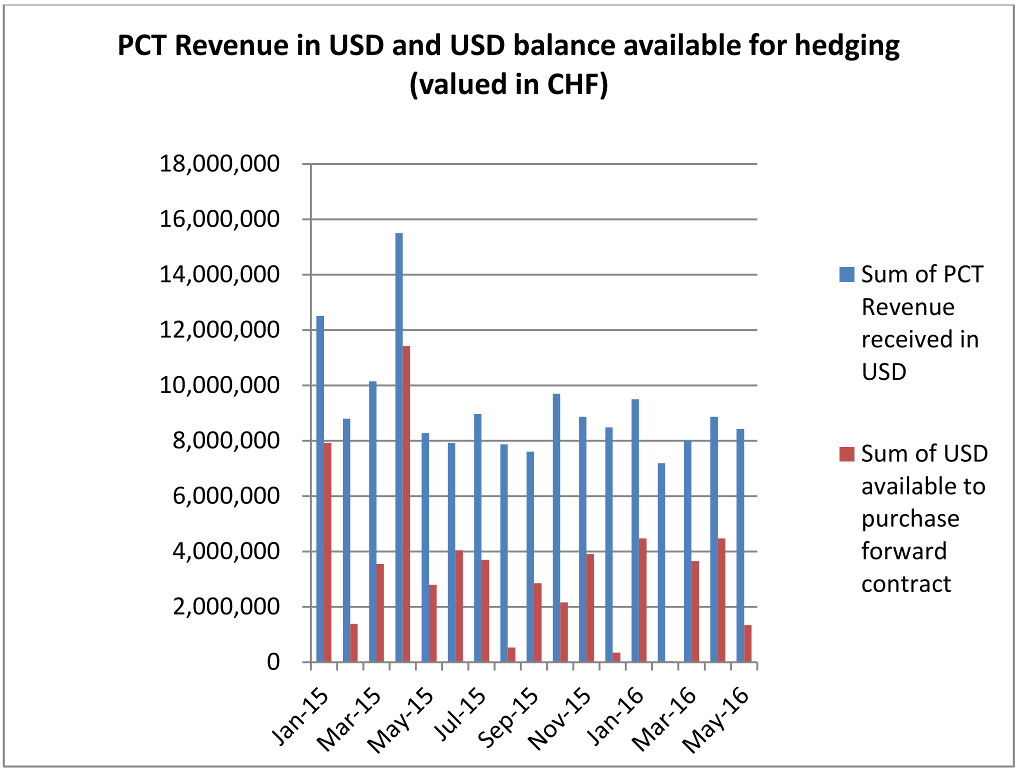
UNITED STATES DOLLARS (USD)

12. WIPO's actual cash flow in USD for 2015 and 2016 through to May 31 indicates that the actual amount of USD available to purchase forward contracts was significantly lower than had been originally estimated. The update on the PCT hedging strategy submitted to the PBC in 2015 (see document WO/PBC/24/INF.3, paragraph 12) estimated, based on information from 2014 and the first half of 2015, that 45 per cent of the USD received from PCT revenue would be needed to cover WIPO's liabilities in that currency. These included the UN pension contribution, services provided by UNDP, travel reimbursement, International Computing Center services and other accounts payable, leaving 55 per cent available for forward contracts.

13. Actually, 63.2 per cent of the PCT revenue received in USD was needed to cover WIPO's liabilities in that currency for the period from January 1, 2015, to May 31, 2016, leaving only 36.8 per cent of the USD received from PCT revenue to purchase forward contracts for use in hedging PCT filing fees. The difference between the estimate submitted to the PBC in 2015 and the actual availability of USD for the purchase of forward contracts was due primarily to the fact that one major PCT receiving Office changed the currency in which it collects the international filing fee from USD to Swiss francs (CHF).

14. Also, as shown on the following chart, the cash receipts in USD for PCT revenue vary significantly from month to month, making it difficult to project the amount of forward contracts needed. While the overall forecasts of filed applications produced by the International Bureau's Data Development Section of the Economic and Statistics Division have proved to be very accurate, the variance in monthly cash receipts is more difficult to project. As will be noted from the table below, in several months less than 10 per cent of the cash received remained after disbursements were made in USD to finance WIPO's liabilities in that currency. It should also be noted that the month in which the USD available exceeded 70 per cent of the PCT revenue was the result of a one-time change in the US legal framework governing the filing of PCT applications, which caused a large increase in PCT filings and thus in PCT filing fee inflow in USD.

Month	**Percent of PCT Revenue received in USD available to purchase forward contract**
Jan-15	45.6%
Feb-15	23.0%
Mar-15	42.0%
Apr-15	71.6%
May-15	34.1%
Jun-15	49.9%
Jul-15	46.2%
Aug-15	6.5%
Sep-15	39.2%
Oct-15	24.5%
Nov-15	47.0%
Dec-15	-1.9%
Average 2015	**38.3%**
Jan-16	48.9%
Feb-16	-6.4%
Mar-16	42.5%
Apr-16	51.9%
May-16	18.6%
Average 2016	**32.8%**
Total Average	**36.8%**



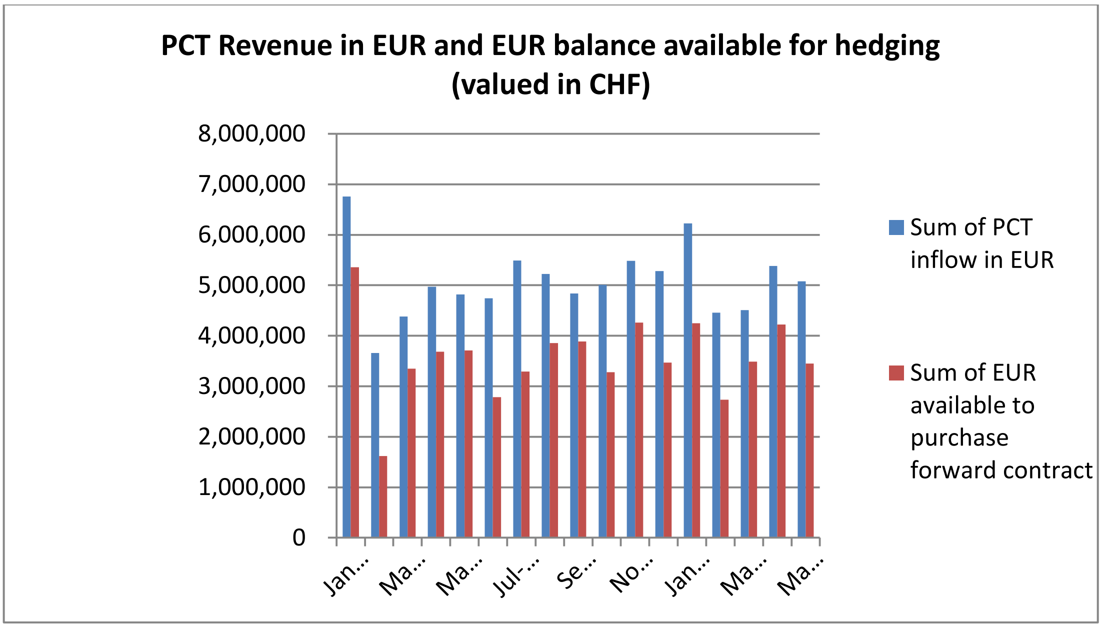
15. As noted from the table and chart set out above, in only one month during the entire 17 month period were there sufficient funds available in USD to cover even the lower limit of PCT revenues received to be hedged (70 per cent) in USD, and that was due only because of a one-time change in the US legal framework governing the filing of PCT applications. Since 40 per cent of PCT revenues are received in USD, WIPO's lack of sufficient funds in USD available to purchase forward contracts would have created a huge risk of exchange differences impacting on the stability of WIPO's budget. The risk would have been compounded by the proposed elimination of the mechanism to adjust the equivalent amounts of PCT international filing fees set in currencies other than CHF, which enables the International Bureau to respond, within a relatively short period of time, to fluctuations in exchange rates, such as the fluctuations following the decision by the Swiss National Bank in January 2015 to no longer link the CHF to the euro. Had the equivalent amount mechanism not been in place at that time and only 40 per cent of the PCT revenues received in USD had been hedged, WIPO would have suffered very significant exchange rate losses that would have impacted both on the net result for 2015 and on reserves on December 31, 2015.

EUROS (EUR)

16. The document submitted to the PBC in 2015 (see document WO/PBC/24/INF.3, paragraph 12) estimated, based on information from 2014 and the first half of 2015, that 40 per cent of the EUR received from PCT revenue were needed to cover WIPO's liabilities in that currency, including international search fee revenue collected by the International Bureau, travel reimbursements payable in that currency and other accounts payable, leaving 60 per cent available to purchase forward contracts.

17. The actual amount of net EUR available from PCT revenue and other sources, after making payments in EUR for search fees and vendor payments, proved to be somewhat higher than estimated, with an average available as hedge cover slightly lower than the 70 per cent lower range limit proposed in PCT/WG/8/15, as shown in the following chart and table:

Month	**Percent of PCT Revenue received in EUR available to purchase forward contract**
Jan-15	63.5%
Feb-15	51.4%
Mar-15	73.4%
Apr-15	74.5%
May-15	75.3%
Jun-15	59.9%
Jul-15	61.2%
Aug-15	75.8%
Sep-15	81.4%
Oct-15	64.9%
Nov-15	78.1%
Dec-15	65.4%
Average 2015	**68.9%**
Jan-16	70.1%
Feb-16	59.2%
Mar-16	76.3%
Apr-16	80.1%
May-16	68.8%
Average 2016	**71.1%**
Total Average	**69.6%**



18. As noted from the table, while there is considerable fluctuation in the receipts in EUR from month to month, they are more stable than receipts and disbursements in USD. While the net amount available for the purchase of forward contracts is close to the lower limit of the range, since 21.5 per cent of the PCT revenues are received in EUR, this would mean that 30.4 per cent of the PCT receipts in EUR (or the equivalent of CHF 26.3 million) would have

been frozen at the exchange rate set in the previous October and would not have been hedged by forward contracts.

JAPANESE YEN (JPY)

19. WIPO's liabilities in JPY are limited to the running costs of the WIPO Japan Office, so almost all of the funds received would have been available to hedge the PCT revenue received in JPY using forward contracts. However, the monthly receipts have varied very significantly (see following table). The only way to have insured against the difficulty of having to repurchase JPY in the months when insufficient PCT income was received in that currency would have been to hold a substantial amount of JPY on deposit in a current account, which would then have been subject to gains or losses from currency revaluation or to have used an alternative hedging mechanism, such as the purchase of swaps, which could have resulted in considerable cost to the Organization.

PCT Receipts in Japanese Yen

Month	**PCT inflow in JPY (CHF value)**
Jan-15	3,815,965.13
Feb-15	4,081,877.44
Mar-15	4,927,553.00
Apr-15	0.00
May-15	3,752,036.29
Jun-15	6,082,617.44
Jul-15	4,674,292.93
Aug-15	4,487,030.57
Sep-15	4,458,539.81
Oct-15	5,051,816.00
Nov-15	4,957,470.28
Dec-15	4,687,285.73
Jan-16	5,022,062.70
Feb-16	4,341,516.95
Mar-16	0.00
Apr-16	5,465,945.33
May-16	12,119,416.59
TOTAL	**77,925,426.19**

SUMMARY

20. Therefore, based on the cash flow analysis for the 17 month period from January 2015 to May 2016, 99 per cent of the PCT revenue received in JPY, 69.6 per cent of the PCT revenue received in EUR and only 36.8 per cent of the PCT revenue received in USD would have been available for the purchase of forward contracts. This would have meant that, in that 17 month period, including receipts in all other currencies except CHF, CHF 139.2 million (or 34.9 per cent of total PCT cash receipts of CHF 398.6 million) would not have been hedged and would have been subject to gains or losses due to exchange rate fluctuation.

Currency	**% not covered by hedge**	**CHF value not covered by hedge**
Euro	30.4%	26,260,763
Japanese Yen	0	0
US dollar	63.2%	98,552,547
Other currencies (Note 1)	100.0%	14,424,808
Total		**139,238,118**
Equals percent of total PCT revenue		34.9%

Note 1 - excludes funds received in CHF

21. Based on the analysis of actual cash flow it is clear that, for the 17 month period from January 1, 2015, to May 31, 2016, the total funds available in JPY, USD and EUR for hedging the PCT budgetary income through the use of forward contracts would have been below the proposed 70 per cent to 90 per cent range and would have left WIPO exposed to significant currency risk with no possibility of adjustment that now exists through the equivalent amount process. In addition, the significant monthly variances in revenue flow would have made it difficult to predict the amount of forward contracts that should have been purchased in each currency each month, requiring the use of an average volume based on the forecast. The use of average volumes in each currency to enter into forward contracts would have resulted in the need, when insufficient funds were available in a particular currency, to either purchase FX Swaps as proposed by the FTI Treasury consultants, which can be expensive, or to purchase the currency through the sale of CHF held in WIPO's reserves, which could result in significant exchange differences.

22. It, therefore, appears questionable whether the proposed purchase of forward contracts as a hedge against WIPO's flow of PCT income in funds other than CHF could achieve the goal of limiting the risks related to exchange fluctuation. While 65.1 per cent of the revenue could have been hedged under the proposed strategy, the remaining 34.9 per cent would have been subject to much greater risk of exchange fluctuation than at present, since the current PCT equivalent amount process would no longer have been available to make fee adjustments.

CONCLUSION

23. The cash flow analysis indicates that WIPO would not have had sufficient volumes of currency in USD, would have had only the minimum volume available in EUR and would have been subject to risk due to monthly currency cash flows in all three currencies, USD, EUR and JPY. The proposal of utilizing forward contracts to hedge the budgetary PCT income flow would, therefore, not have resolved the exchange risk related to WIPO's receipt of PCT revenue in currencies other than Swiss francs. It would also appear that, based on the cash flow data, any change in the situation in the future is unlikely after reviewing the historic information on receipts and disbursements in each of the three major currencies in which PCT revenue is received and the fact that no significant changes in receipts or disbursements is anticipated. The Secretariat therefore proposes not to continue modeling of the hedging strategy proposed by the treasury consultants based on forward contracts.

24. Although the use of forward contracts does not appear to be the solution to reducing WIPO's exchange risk, the Secretariat intends to continue to monitor and analyze the cash flow in all currencies and to utilize the information to manage bank account balance so as, to the extent feasible, minimize the impact of exchange rate adjustments on WIPO's financial results. In the meantime, while the current equivalent amount mechanism only responds to large shifts in exchange rate values and cannot respond immediately, it has been effective in limiting losses even during the period of huge shifts in the value of currency to the CHF, such as the one which took place at the beginning of 2015.

25. The following decision paragraph is proposed.

26. The Program and Budget Committee noted the contents of document (WO/PBC/25/20), in particular paragraphs 23 and 24.

[Annex follows]

PCT/WG/9/9
ORIGINAL: ENGLISH
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Patent Cooperation Treaty (PCT) Working Group

Ninth Session
Geneva, May 17 to 20, 2016

PCT FEE INCOME: PROGRESS REPORT ON ANALYSIS OF POSSIBLE MEASURES TO REDUCE EXPOSURE TO MOVEMENTS IN CURRENCY EXCHANGE RATES

Document prepared by the International Bureau

SUMMARY

1. This document presents a progress report on the International Bureau's analysis of issues relating to the possible implementation of a hedging strategy for PCT fees, along with an update on developments relating to the possible introduction of a "netting structure" for all PCT fee transactions. The International Bureau proposes to continue to study both of these possible measures to reduce exposure to movements in currency exchange rates with a view to presenting proposals on whether or not to commence hedging and on whether or not to introduce a "netting structure" to the Working Group at its next session in 2017.

BACKGROUND

2. The Working Group, at its eighth session in May 2015, discussed a document prepared by the International Bureau that set out various possible measures to reduce the risk of exposure of PCT fee income to movements in currency exchange rates (document PCT/WG/8/15). The discussions are summarized in paragraphs 21 to 36 of the Summary by the Chair (document PCT/WG/8/25); paragraphs 52 to 78 of the Report of the session (document PCT/WG/8/26) give details of all the interventions.

3. The present document presents an update of work on two of the possible measures discussed in document PCT/WG/8/15, namely:

(a) hedging and setting equivalent amounts for PCT fees for a fixed period; and
(b) introducing a "netting structure" for the transfer of PCT fees.

HEDGING AND SETTING EQUIVALENT AMOUNTS FOR PCT FEES FOR A FIXED PERIOD

DEFINITION OF HEDGING

4. Hedging refers to the undertaking of offsetting positions to minimize risks such as the unfavorable changes in interest rates or, as in WIPO's case, the impact of exchange rate movements. One way to hedge the risk resulting from transactions in foreign currencies is through a forward exchange contract ("forward"), as discussed in paragraphs 20 to 22 of Annex I to document PCT/WG/8/15. A forward is a contractual arrangement between two parties to exchange amounts at an agreed exchange rate ("the forward rate") on a fixed date in the future.

5. A typical hedging strategy for a currency would involve setting up forward contracts at different dates over a fixed period. Over this period, the Swiss franc equivalent amount for the fees in the hedged currency would be set using a weighted average forward rate, known as the blended hedge rate and fixed for the period covered by the forward contracts. The fixing of the equivalent amount during the hedging period should therefore provide greater predictability of the cash-flows in the currencies where income has been hedged. Further explanation of this process with an example can be found in paragraphs 23 to 29 of Annex I to document PCT/WG/8/15.

DISCUSSIONS BY THE WORKING GROUP, THE PROGRAM AND BUDGET COMMITTEE AND THE PCT ASSEMBLY

6. The Working Group, at its eighth session held in May 2015, agreed on a proposal by the International Bureau, set out in document PCT/WG/8/15, to commence hedging of the international filing fee as far as the risk resulting from transactions in euro, Japanese yen and United States dollar was concerned (see paragraph 78 of the Report of the session, document PCT/WG/8/26), with a view to its submission to the Assembly for consideration at its October 2015 session:

> "78. The Working Group agreed on the proposed modifications to the Directives of the PCT Assembly Relating to the Establishment of Equivalent Amounts of Certain PCT Fees set out in Annex II to document PCT/WG/8/15 with a view to their submission to the Assembly for consideration at its next session, in October 2015, subject to possible further drafting changes to be made by the Secretariat or, alternatively, the submission to the Assembly of a draft Understanding setting out details of the new process for fixing equivalent amounts in the currencies proposed to be hedged based on blended hedge rates, to be adopted by the Assembly together with the Directives as proposed to be modified."

7. Prior to the October 2015 session of the Assembly, the International Bureau provided an update on the implementation of the proposed hedging strategy for PCT fee income to the twenty-fourth session of the Program and Budget Committee (PBC), held from September 14 to 18, 2015, based on document WO/PBC/24/INF.3, which identified several risks and concerns related to that strategy. After consideration of the document, the PBC agreed on the following recommendation to the PCT Assembly (see document WO/PBC/24/17, under agenda item 10):

> "With regard to the recommendation of the PCT Working Group contained in document PCT/WG/8/15, the Program and Budget Committee (PBC) was informed through document WO/PBC/24/INF.3 of several issues regarding the implementation of a hedging strategy for PCT fees. After careful consideration of the issues contained therein, the PBC recommended to the Assembly of the PCT Union:
>
> > "(i) to allow for more time for the Secretariat to further analyze these issues in detail in order to properly assess all the challenges associated with the implementation of such a hedging strategy; and accordingly,
> >
> > "(ii) to postpone its decision with regard to the recommendation quoted above until such analysis has been undertaken."

8. In view of this recommendation by the PBC, the PCT Assembly, at its forty-seventh session in October 2015, adopted the following decision (see document PCT/A/47/5 Rev. and paragraph 23 of the Report of the session, document PCT/A/47/9):

> "23. The Assembly:
>
> > "(i) took note of the contents of document PCT/A/47/5 Rev.;

"(ii) invited the Secretariat to further analyze the issues regarding the implementation of a hedging strategy for PCT fee income set out in document WO/PBC/24/INF.3;

"(iii) postponed any decision on the proposed modifications to the Directives of the Assembly Relating to the Establishment of Equivalent Amounts of Certain Fees, as agreed by the PCT Working Group, until such analysis had been undertaken; and

"(iv) invited the Secretariat to submit a progress report to the 2016 session of the PCT Working Group."

9. Paragraphs 10 to 17, below, present the progress report requested by the Assembly on the analysis of the issues regarding the possible implementation of a hedging strategy set out in document WO/PBC/24/INF.3.

PROGRESS REPORT

Forward Purchase Contract Simulation

10. In November 2015, the International Bureau simulated a tender process for the sale of Japanese yen (JPY), euro (EUR) and United States dollars (USD) to acquire Swiss francs (CHF), using forward purchase agreements covering the period from November 2015 to December 2016. The purpose of the simulation was to better understand the process that would be involved in entering into such agreements if the International Bureau were to proceed with a hedging strategy. The simulation also provided valuable information on the costs that would be incurred to enter into forward purchase contracts.

Update of Cash Flow Projection by Currency

11. As indicated in paragraphs 18 to 21 of document WO/PBC/24/INF.3, WIPO's receipt of cash in each of the currencies (JPY, EUR and USD) is irregular and difficult to predict. If the International Bureau were to enter into forward contracts to sell specific amounts of each currency each month, and insufficient amounts of just one of the three currencies had been received in time to meet the contract date, possible exchange losses would result from selling CHF or other currencies to obtain the required amount of JPY, EUR or USD. In addition, exchange losses or gains can result from retaining currencies other than CHF in excess of requirements. The International Bureau has been tracking in detail currency receipts by date since November 2015. This will be compared with information from 2014/15 to enable the International Bureau to estimate the amount of each currency that it could commit to sell during each month should the PCT Assembly decide to proceed with hedging.

12. In addition, as noted in document WO/PBC/24/INF.3, the feasibility of the hedging policy is limited by the availability of sufficient funds in each of the three currencies to cover the projected expenses in each currency. WIPO has significant liabilities that must be settled in USD and EUR. Not all of the fees transmitted to WIPO in these currencies can therefore be converted to CHF through the forward contracts. As indicated in paragraph 12 of document WO/PBC/24/INF.3, 45 per cent of the receipts in USD and 40 per cent of the receipts in EUR are needed to meet WIPO's operational requirements in 2014 and the first half of 2015. Continued tracking of these requirements is ongoing and the results of the tracking will be used in determining the impact on the hedging strategy.

Update of Impact on PCT Revenue

13. Under the current PCT equivalent amount process, the International Bureau is able to periodically adjust the equivalent amounts of fees payable in currencies other than CHF with a view to keeping those amounts in line with the amounts of those fees established by the PCT Assembly in CHF. However, as described in paragraph 5, above, under the proposed hedging arrangements, the amount of each fee payable in USD, JPY and EUR would be fixed, for a period of 12 months, based upon the average exchange rate obtained through the purchased forward contracts weighted to reflect the amount to be sold in each month (the blended hedge

rate). WIPO would thus lose the ability to modify the equivalent amounts of fees during the 12 months hedging period.

14. The International Bureau has begun analyzing the impact the new approach would have had on the amount of PCT fee income since November 2015, along with an estimate of the impact the new approach would have had during the 2014/15 biennium. This analysis will be essential to enable Member States to understand the potential impact of the envisaged hedging strategy on PCT fee income and thus on the budget of the entire organization.

Development of a Matrix for Tracking Exchange Adjustments under IPSAS

15. International Public Sector Accounting Standards (IPSAS) set out significant rules about how exchange gains and losses are to be recognized in WIPO's financial statements. The use of these rules is further complicated by the necessity of utilizing the United Nations Operational Rate of Exchange (UNORE) to record transactions in currencies other than CHF, since the UNORE is set monthly or semi-monthly while the rates utilized by banks are set each day and often even several times during the day. Differences between bank rates and the UNORE therefore occur and result in exchange differences that must be recognized in the accounts.

16. With the assistance of consultants, a matrix has been developed to enable the International Bureau to track on a single spreadsheet all of the exchange adjustments which the Organization would be required to record in the accounts, and their impact on revenue and expenses and the value of assets and liabilities. The International Bureau is utilizing the matrix to track changes since November 2015 and then will retrospectively track the adjustments that would have been necessary had the International Bureau utilized hedging from November 2014 to October 2015.

Way Forward

17. The International Bureau intends to use the services of an external consultant, who is currently being recruited to assist the International Bureau, *inter alia*, in the implementation of the new WIPO investment policy, to also assist the International Bureau on issues related to foreign exchange and a possible hedging strategy. Applications have been reviewed and selection of the consultant is expected to take place in March 2016.

18. With the help of that external consultant, the International Bureau will carefully analyze the cash flow projections and the impact of fixed equivalent amounts of PCT fees in the three currencies. The results of this analysis, the information from the simulation of forward purchase contracts and the experiences of tracking exchange adjustments in line with IPSAS rules will be taken into account by the International Bureau in submitting a proposal to the Working Group for discussion at its 2017 session on whether or not to implement a hedging strategy.

INTRODUCING A "NETTING STRUCTURE" FOR THE TRANSFER OF FEES

DEFINITION OF NETTING

19. "Netting" is a settlement mechanism used to allow a positive value (payment) and a negative value (receivable) to offset and partially or entirely cancel each other out. The netting process consolidates all transactions between participants and calculates settlement between the participants on a "net" basis, typically by means of single payment or receipt. A netting software system is used to perform the administration of the netting process.

20. A possible netting process for PCT fees would involve the receiving Office transferring the international filing fee and search fee from applicants to the International Bureau. The search fee would then be transferred by the International Bureau to the International Searching Authority. The transfer of the fees from the receiving Office would generally take place once a month on a prescribed date, and would take place in the local currency in which the fees had been collected if this was freely convertible into Swiss francs. For a receiving Office which also acts as an International Searching Authority, for each currency, the payment would consist of the difference between the total of the international filing fees collected as a receiving Office (which the receiving Office "owes" to the International Bureau) and the total search fees payable

to the International Searching Authority (which the International Bureau “owes” the International Searching Authority). In the case of a net amount in favor of the International Searching Authority in a given currency, the International Bureau would transfer the amount to the International Searching Authority shortly after it had received the payment from the receiving Office along with the necessary payment information from the receiving Office. The administration of a “netting structure” with centralized payment of PCT fees would therefore require regular timing of payments between the International Bureau and the Offices concerned. Paragraphs 37 to 44 of Annex I to document PCT/WG/8/15 give further information on “netting”.

21. Under the envisaged “netting structure”, it would no longer be necessary to use the procedure under Rule 16.1(e), since the International Searching Authority would always receive the full amount of the search fee in the currency fixed by the International Searching Authority.

DISCUSSION BY THE WORKING GROUP

22. As set out in paragraph 13 of document PCT/WG/8/15, presented to the eighth session of the Working Group in May 2015, the International Bureau had indicated that it would further develop the proposal to possibly introduce a “netting structure” for all PCT fee transactions between receiving Offices, International Searching Authorities and the International Bureau, taking into account the comments raised in response to Circular C. PCT 1440, with a view to presenting a detailed proposal for discussion by the Working Group at its next session in 2016. The discussions on the issue of “netting” at the eighth session of the Working Group are summarized in paragraphs 32 to 34 of the Summary by the Chair (document PCT/WG/8/25):

> “32. Several delegations expressed their support in general for the proposal to move to a “netting structure” for all PCT fee transactions between receiving Offices, International Searching Authorities and the International Bureau, while stating that more information was needed before being able to decide on the matter.
>
> “33. One delegation stated that it could not support the netting proposal, as it was concerned that it would result in additional work for receiving Offices
>
> “34. One delegation expressed the hope that a netting structure could be implemented quickly, citing its positive experiences, as an International Searching Authority, with an ongoing pilot project under which it received search fees from one receiving Office “via” the International Bureau. It further stated that its expectation was that the greatest benefits would be achieved if such netting structure would be combined with the electronic transfer of search copies from the receiving Offices to the International Searching Authority “via” the International Bureau (eSearchCopy).”

UPDATE

23. Progress on the possible implementation of a “netting structure” has been awaiting the recruitment of the consultant referred to in paragraph 17, above, whose assignment will include a detailed analysis of the implications of a possible “netting structure” for all PCT fee transactions between the receiving Offices, the International Searching Authorities and the International Bureau.

24. The results of this analysis will be taken into account by the International Bureau in submitting a proposal to the Working Group for discussion at its 2017 session on whether or not to implement a netting structure.

25. The Working Group is invited to take note of the contents of the present document.

[End of Annex and of document]