

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 document]