

C. PCT 1440

January 19, 2015

Madam,
Sir,

PCT FEE INCOME: POSSIBLE MEASURES TO REDUCE EXPOSURE TO MOVEMENTS IN CURRENCY EXCHANGE RATES

1. This Circular is addressed to your Office in its capacity as a receiving Office (“RO”), International Searching Authority (“ISA”) and International Preliminary Examining Authority (“IPEA”) and/or designated/elected Office under the Patent Cooperation Treaty (PCT). It is also being sent to Geneva-based missions and foreign ministries of PCT Contracting States, as well as to certain organizations that are invited to attend meetings of the PCT Working Group as observers.

2. The purpose of the present Circular is to consult on proposed measures to reduce the risk of exposure of PCT fee income to movements in currency exchange rates, with a view to providing greater predictability to the budgetary process and thereby adding to the financial stability of the World Intellectual Property Organization (WIPO).

BACKGROUND

PAYMENT OF FEES IN LOCAL CURRENCY¹

3. The filing of an international application under the PCT requires the payment by the applicant of different fees for the benefit of different recipients. Among the fees to be paid, and of particular importance in the present context, are the international filing fee, which is for the benefit of the International Bureau (“IB”), and the search fee, which is for the benefit of the ISA. These fees are paid by the applicant to the RO, that is, the Office with which the international application is filed. The RO subsequently transfers the international filing fee to the IB and the search fee to the ISA.

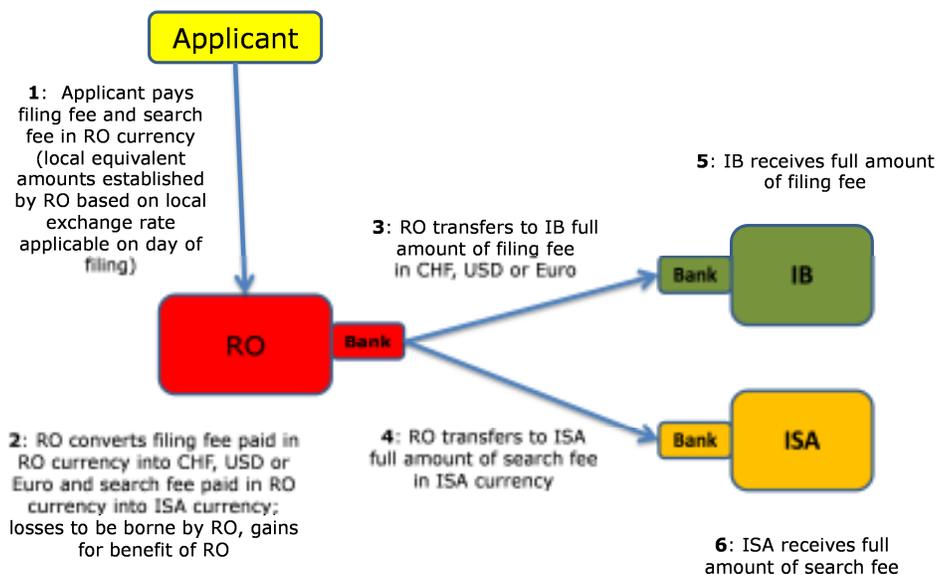
¹ Some of the issues set out in the present Circular also arise in the context of the handling fee (which is for the benefit of the IB) and of the supplementary international search fee (which is for the benefit of the Supplementary ISA). However, so as to not overcomplicate the issues set out in the present Circular, this Circular does not cover those fees. Should the proposals set out in the present Circular find sufficient support in general, the IB will include more detailed proposals also covering the handling fee and the supplementary international search fee in any further Circular or any document for consideration by the PCT Working Group.

4. While both the international filing fee and the search fee are fixed in one currency (the international filing fee is fixed in Swiss francs, the search fee is fixed in the currency of the country in which the ISA has its headquarters), these fees are usually paid by the applicant not in the “fixed currencies” but in the local currency accepted by the RO with which the international application is filed.

LOCAL CURRENCY IS NOT FREELY CONVERTIBLE²

5. Where the local currency in which the applicant is required to pay PCT fees is a currency which is not “freely convertible”, the RO is required to transfer the full amount of the international filing fee in Swiss francs, United States dollar or euro and the full amount of the search fee in the currency in which the ISA has its headquarters to the IB and the ISA, respectively.

RO Currency is Not Freely Convertible



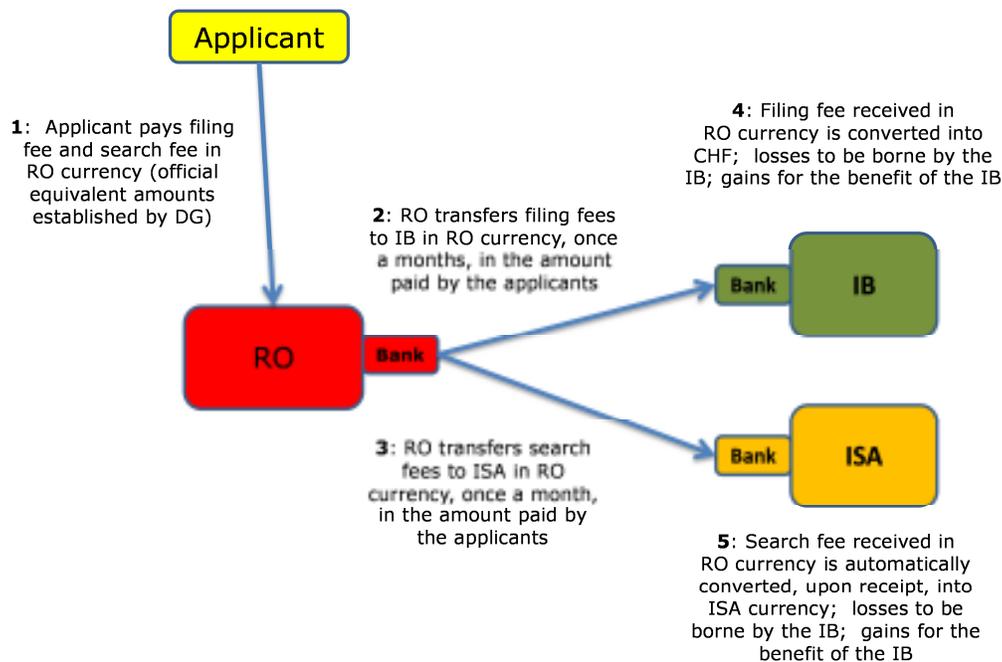
6. ROs which collect PCT fees in a local currency which is not freely convertible usually determine the amount of such fees payable in the local currency based on the local exchange rate, applicable on the day of filing, between that local currency and the Swiss franc, United States dollar or euro (in the case of the international filing fee) or the currency fixed by the ISA (in the case of the search fee). The RO then performs the conversion locally into either Swiss francs, United States dollar or euro (in the case of the international filing fee) or into the currency fixed by the ISA (in the case of the search fee) and transfers the full amount of those fees due (not the amount resulting from the conversion) to the IB and the ISA, respectively. Any losses resulting from the conversion process will have to be borne by the RO, whereas any gains resulting from that conversion process are to the benefit of that Office. Where, in the case of the international filing fee, the RO transfers not Swiss francs but United States dollars or euros to the IB, the same considerations as set out in paragraphs 7 to 12, below, apply as regards possible losses to be borne by the IB, or gains to be made by the IB, due to exchange rate fluctuations between those currencies and the Swiss franc.

² See PCT Rules 15.2(d)(ii) and 16.1(d)(ii).

LOCAL CURRENCY IS FREELY CONVERTIBLE³

7. Where, on the other hand, the local RO currency in which the applicant is required to pay PCT fees is a “freely convertible” currency, the Director General of WIPO establishes official “equivalent amounts” of both the international filing fee and the search fee in the local RO currency. The applicant then pays the equivalent amounts of those fees in the local currency to the RO, and the RO simply transfers those equivalent amounts paid by the applicant in the local currency to the IB and the ISA, respectively.

RO Currency is Freely Convertible



8. In this case, applicants pay the international filing fee and the search fee in the local RO currency according to the equivalent amounts applicable on the date of filing. However, the amounts of those fees resulting from the conversion by the IB and the ISA from the RO currency into the “fixed currencies” (Swiss franc and ISA currency, respectively) may be different from the amounts of those fees as set out in the PCT Schedule of Fees (in the case of the international filing fee) or as fixed by the ISA (in the case of the search fee). This is due to fluctuations in exchange rates between the date on which the equivalent amounts of these fees have been established and the date on which these fees are transferred to the IB and the ISA, resulting in gains or losses for the IB and (initially) for the ISA. In the case of the ISA, any losses incurred are to be reimbursed by the IB, whereas any additional amount received over the fee in the fixed currency belongs to the IB (see PCT Rule 16.1(e)).

9. Delays in the transfer of fees from the RO to the IB and the ISA may further contribute to such gains or losses due to exchange rate fluctuations. Such delays exist for various reasons, including:

³ See PCT Rules 15.2(d)(i) and 16.1(d)(i).

(a) delays in the payment of fees by the applicant; under the PCT Regulations, the applicant is required to pay the international filing fee and search fee within one month from the date of receipt of the application⁴; if the applicant has not paid these fees within this time limit, the RO will invite the applicant to pay those fees within one month from the date of the invitation, against a surcharge (which is for the benefit of the RO)⁵; and

(b) delays in the transfer of the international filing fee and search fee by the RO to the IB and the ISA, respectively.

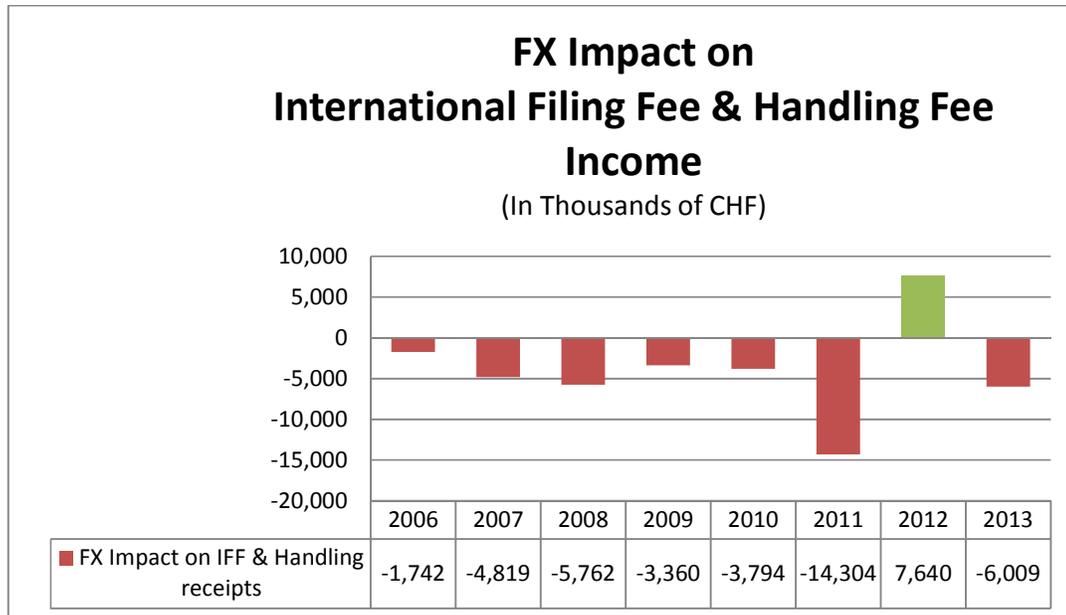
10. Gains or losses are further generated by the relatively slow process to establish new equivalent amounts. This process is triggered only when the exchange rate between the fixed currency and the local RO currency has changed by more than 5 per cent over a period covering four consecutive Fridays (see paragraph 5 of the Directives of the PCT Assembly Relating to the Establishment of Equivalent Amounts of Certain Fees, reproduced in Annex I to this Circular). After the process is triggered, it can take between three and five months for the new exchange rate to enter into force.

11. Thus, where the international filing fee and the search fee are paid in a freely convertible RO currency (which is the case in respect of the vast majority of international applications filed), all the financial risks associated with the transfer of those fees by the RO in the local RO currency and their subsequent conversion into the “fixed currencies” are solely born by the IB. While the current procedure (receipt of fees in one currency and subsequent conversion of those fees into another currency) can, of course, result in both gains and losses, it exposes the PCT fee income of the IB to a major risk of fluctuating currency exchange rates.

12. Given that PCT fee income constitutes WIPO’s largest source of revenue (in 2013, PCT fee income amounted to 257.5 million Swiss francs, which represented 73.2 per cent of total revenue), this exposure has a significant effect on overall income of WIPO. To illustrate this effect, see the graph, below: from 2006 to 2011, the IB incurred a loss in PCT fee income (international filing fees and handling fees (under Chapter II)) of more than 33 million Swiss francs, with a loss of more than 14 million Swiss francs in 2011 alone, due to the sharp appreciation of the Swiss franc against all major currencies. By contrast, in 2012, changes in exchange rates resulted in gains in PCT fee income (international filing fees and handling fees) for the IB of about 7.6 million Swiss francs, whereas in 2013, changes in exchange rates again resulted in a loss in PCT fee income of about 6 million Swiss francs. Overall, in the eight years between 2006 and 2013, the IB incurred a loss in PCT fee income of more than 31 million Swiss francs.

⁴ PCT Rules 15.3 and 16.1(f).

⁵ See PCT Rule 16*bis*.1.



NEED TO TAKE ACTION TO REDUCE THE INHERENT RISK OF EXPOSURE OF PCT FEE INCOME TO MOVEMENTS IN CURRENCY EXCHANGE RATES

13. In the view of the International Bureau, there is a need to take action to reduce the risk of exposure of PCT fee income to movements in currency exchange rates, so as to provide greater predictability to the budgetary process and thereby add to the financial stability of the Organization.

14. Such a need was also highlighted in reports by both WIPO's Internal Audit and Oversight Division as well as WIPO's External Auditors, the Office of the Comptroller and Auditor General of India, following a performance audit of the PCT carried out in October and November 2012.

15. In the fourth quarter of 2013, WIPO instigated a treasury review project, the key objective of which was to undertake an independent and objective assessment of WIPO's current treasury management functions, policies and procedures, including a review of WIPO's current treasury exposures. One of the objectives of the latter was to review the principal foreign exchange exposures at WIPO, notably with regard to PCT fee income, so as to obtain independent and objective advice on the possible need to introduce a new foreign exchange risk management strategy, including in relation to the management and accounting for any proposed hedging instruments.

16. Following a competitive tender process, WIPO selected an independent specialist treasury service provider, FTI Treasury (Ireland), to undertake the treasury review, which was carried out between December 2013 and March 2014. In March 2014, FTI Treasury presented its final report to WIPO. The full version of that report is available from WIPO on request. As far as the foreign exchange exposures with regard to PCT fee income is concerned, the study concluded that WIPO should:

- (a) consider implementing a hedging strategy based on net currency cash flows using forward contracts;

(b) consider fixing equivalent amounts of PCT fees only once a year and thus leave equivalent amounts unchanged for a period of 12 months, so as to provide more certainty of currency cash flows and significantly remove risks associated with hedging strategies; and

(c) consider introducing a “netting structure” for all PCT fee transactions between the ROs, the ISA and the IB.

17. The detailed recommendations by FTI Treasury set out in the report as to possible actions to be taken with regard to the foreign exchange exposures of PCT fee income are contained in Annex II to this Circular.

18. The purpose of the present Circular is to consult on possible measures that could be taken to reduce the risk of exposure of PCT fee income to movements in currency exchange rates. Two of those measures, namely, the proposal to start hedging and setting equivalent amounts for PCT fees for a fixed period, as set out in paragraphs 20 to 36, below, and the proposal to introduce a netting structure for the transfer of fees as set out in paragraphs 37 to 53, below, are based on the recommendations by FTI Treasury referred to in paragraph 16, above, and reproduced in Annex II. The other proposed measures, namely, the proposal to add a margin when setting equivalent amounts, as set out in paragraph 55, below, and the proposal to have applicants pay the international filing fee in Swiss francs and the search fee in the applicable ISA currency, as set out in paragraphs 56 to 61, below, are independent of the first two measures which are based on the recommendations by FTI Treasury and could be implemented either together with those measures or independently.

19. Any comments received in response to this Circular will be considered by the International Bureau in developing any proposals to modify the current legal and procedural framework relating to the establishment of equivalent amounts and the payment of PCT fees, for consideration by the PCT Working Group at its 2015 session.

POSSIBLE MEASURES

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

Hedging

20. As stated in the report by FTI Treasury, one possible way to reduce the risk of exposure of PCT fee income to movements in currency exchange rates would be to hedge the risk resulting from transactions in foreign currencies. Hedging refers to the undertaking of offsetting positions to minimize the impact of unfavorable interest or, as in WIPO’s case, exchange rate movements and is frequently achieved by purchasing financial products from commercial banks. These products are often referred to as financial instruments.

21. The financial instrument which has been proposed by FTI Treasury for use by WIPO is a foreign exchange forward contract (“forward”), which is one of the most straightforward financial instruments to implement and administer. A forward is a contractual agreement between two parties to exchange currency amounts at an agreed exchange rate at a fixed date in the future. The exchange rate contained within the agreement is known as the “forward rate”.

22. Using one currency inflow, the following example demonstrates how a forward could operate for the IB:

(a) PCT fee income in United States dollars is received on a monthly basis and these revenue inflows can be predicted with a high degree of accuracy. The amounts are converted into Swiss francs when they arrive, at the exchange rate prevailing in the market on the day of conversion. The IB has no control over the exchange rate to be used and so is unable to predict how many Swiss francs will be received.

(b) In October 2014, the IB predicts that 8 million United States dollars will be received in June 2015 and decides to cover the risk posed by a variable United States dollar/Swiss franc exchange rate by acquiring a forward for 8 million United States dollars. Details are as follows:

(i) United States dollar/Swiss franc spot rate at October 28, 2014 (date of acquiring the forward): 0.9457

(ii) United States dollar/Swiss franc forward rate for June 15, 2015: 0.9428

(c) On June 15, 2015, when the 8 million United States dollars are received, the forward will be activated and the United States dollars will be converted into Swiss francs at a rate of 0.9428 in accordance with the terms of the forward contract. The prevailing market rate may be higher (say, 0.9435), in which case the IB would be unable to benefit from this, as it would have to adhere to the contract terms and sell the 8 million United States dollars at the forward rate. The market rate could, however, be lower (say, 0.9421), in which case the IB would have ensured itself of a higher rate (the forward rate of 0.9428). In both cases (either a higher or a lower market rate), the IB would have achieved certainty with regard to its cash-flows.

Setting Equivalent Amounts for a Fixed Period

23. The example above demonstrates how important it is to ensure that the amount of currency contained within the contract (8 million United States dollars) equates to the amount of money actually received by the IB. If the currency amount received varies, the IB may find that it has over or under hedged.

24. For this reason, a process such as the current process to fix new equivalent amounts of PCT fees cannot operate easily alongside the implementation of a hedging strategy, as changes in the equivalent amounts would inevitably have an impact on the total amount of currency received. If, in the example above, the United States dollar were to strengthen against the Swiss franc ahead of June 2015 to such an extent that a new equivalent amount was introduced, fees in United States dollars would be less. As a result, a smaller amount of United States dollars would be received and the IB would have to purchase the difference between the amount received and the 8 million United States dollar amount specified within the contract in order to satisfy the terms of the contract. The difference would have to be purchased in the spot market at a rate which would be less favorable to the IB than the forward rate of the contract and the IB would therefore make a foreign currency loss on this purchase of United States dollars.

25. Hence the recommendation by FTI Treasury to modify the current equivalent amount process so that new equivalent amounts would be fixed only once per year, to remain unchanged for a period of 12 months, with a hedging strategy being put in place for the same 12 month period. In October of each year, the IB would acquire forward contracts covering the months from January to December of the following year. The currency amounts in each contract would differ according to the predicted cash-flows of the currencies and would be established as a percentage (say, 80 per cent) of predicted cash-flows in order to allow for the fact that actual cash-flows are unlikely to be of exactly the same amounts as those predicted. This is because, although the numbers of patent applications filed in a given year are reasonably predictable, it is more difficult to estimate the timing of the associated cash inflows, as ROs vary in the timeliness of their remittances to the IB. This hedging would be applied to the IB's principal currency inflows (United States dollar, Japanese yen and euro for international filing fees) and its principal exposures with regard to search fees. Currency inflows and outflows would first be netted to maximize 'internal hedging' before determining the amount to be covered by the forward contracts. For example, if, in June 2015, the IB expects to receive 8 million United States dollars (80 per cent of 10 million United States dollars) but also expects to pay out 1.5 million United States dollars, the forward contract would cover the net amount, namely, 6.5 million United States dollars (see paragraphs 37 to 53, below, with regard to the possible introduction of a netting solution).

26. Such a hedging strategy would bring to the IB a significant increase in the predictability of its revenues and search fee compensation payments under PCT Rule 16.1(e), which would thus improve the financial stability of the entire Organization. PCT income would be far less subject to the variances encountered within the foreign exchange market, as the exchange rates applied to its principal currency transactions would have been fixed within the forward contracts. Hedging would reduce the foreign exchange risks to which PCT income is currently subject and, as a consequence, act as protection to the budget and program delivery of the Organization.

27. Similar considerations as those set out in paragraphs 23 to 26, above, would appear to apply with regard to changes during a given year in the amounts of the search fees as fixed by the ISA in the ISA currency, noting that changes in those amounts would equally have an impact on the total amounts of currency received and thus would reduce the element of stability that hedging is aiming to introduce. ISAs may therefore wish to consider voluntarily moving to introducing any changes in search fee amounts only once a year, with effect from January 1 of the following year given the importance of regular currency flows to make hedging "work". However, as the search fee is set by the relevant ISA concerned for carrying out the international search and other tasks entrusted to the ISA, the Circular does not propose that ISAs should only change search fee amounts on an annual basis.

28. An additional recommendation from FTI Treasury concerns the use of a blended hedge rate to set equivalent amounts. A blended rate would take into account the forward rate of each forward contract, with a weighting given to the amounts of currency in each contract, thus producing a weighted average forward rate (blended rate). The fees established to come into force each January would be calculated by reference to the blended rate, thus ensuring that the fee established reflected the conversion rates to be used during the year, rather than the market rate at 1 October of the previous year (the rate currently used to establish new equivalent amounts).

29. Example: The International Bureau expects three inflows of international application fees in United States dollars for application fees in 2015: 10 million United States dollars in March, 15 million United States dollars in June and 20 million United States dollars in September. On November, 24, 2014 (spot rate: United States dollar/Swiss franc = 0.9690), it hedges 80 per cent of these amounts and obtains forward contract rates as follows:

	Amount hedged	Rate	CHF to be received
March	8 million	0.9672	7,737,600
June	12 million	0.9656	11,587,200
September	16 million	0.9635	15,416,000
Totals	36 million		34,740,800

Weighted average forward rate is calculated as: $\frac{34,740,000}{36,000,000} = 0.96502$

The rate of 0.96502 would therefore be used as the basis for establishing the equivalent amount in January.

Impact on PCT Stakeholders

30. A change in the procedures which would result in equivalent amounts of PCT fees only to be fixed once a year and thus equivalent amounts to remain unchanged for a period of 12 months, from January 1 to December 31 of any given calendar year, would impact PCT stakeholders as set out in the following paragraphs.

Applicants

31. Applicants would gain certainty, for an entire calendar year, as to the equivalent amounts of the international filing fee and the search fee payable in any local RO currency, and would be protected against changes in the exchange rates between the Swiss franc and/or the ISA currency on the one hand and the local RO currency in which those fees are to be paid on the other.

32. Thus, if, during the calendar year, the local RO currency were to depreciate relative to the Swiss franc and/or the ISA currency, applicants would benefit from, in effect, paying a lower amount of the international filing fee and/or the search fee than they would have had to pay under the current procedures if the depreciation of the local RO currency relative to the Swiss franc and/or the ISA currency would have been such that it would have triggered—under the current procedures—the establishment of new, higher equivalent amounts of those fees in the local RO currency.

33. If, on the other hand, during the calendar year, the local RO currency were to appreciate relative to the Swiss franc and/or the ISA currency, applicants would only benefit from such appreciation as of January 1 the following calendar year, when new equivalent amounts in the local RO currency of the international filing fee, taking into account the appreciation of the local RO currency, would become effective. Under the current procedures, applicants would have benefited at an earlier point in time if the appreciation of the local RO currency relative to the Swiss franc and/or the ISA currency had been such that it would have triggered the establishment of new, lower equivalent amounts of those fees in the local RO currency already during the calendar year.

Receiving Offices

34. Receiving Offices would not be affected by such a change in procedures, other than generally benefitting from less frequent changes to the equivalent amounts of fees to be paid by applicants to ROs, as set out in paragraph 36, below.

International Authorities

35. Other than benefitting from less frequent changes to the equivalent amounts of the search fee as set out in paragraph 36, below, International Authorities would also not be impacted by a change in the procedures which would result in equivalent amounts of PCT fees only to be fixed once a year. As at present, any losses in search fee income incurred by an ISA due to changes in exchange rates between the date on which the equivalent amounts of the search fees have been established and the date on which these fees are transferred to the ISA would be reimbursed by the IB, whereas any additional amount received over the amount fixed in the ISA fixed currency would belong to the IB (see PCT Rule 16.1(e)). Note, however, the proposed possible introduction of a “netting structure” as set out in paragraphs 37 to 53, below, which would remove the need for ISAs having to rely on the PCT Rule 16.1(e) procedure to be compensated by the IB for any losses incurred as a result of such foreign currency transactions or, where applicable, to transfer any gains resulting from such transactions to the IB, as the ISA would always receive from the IB the full amount of the search fee, in the ISA currency and in the amount as fixed by it.

All Stakeholders

36. All stakeholders, receiving Offices, International Authorities, the International Bureau and applicants alike, would benefit from less frequent changes to the equivalent amounts of the international filing fee and of the search fee to be paid by applicants, resulting in less frequent changes to fee data, forms, IT systems, information material for applicants, etc.

II. INTRODUCING A “NETTING” STRUCTURE FOR THE TRANSFER OF FEES

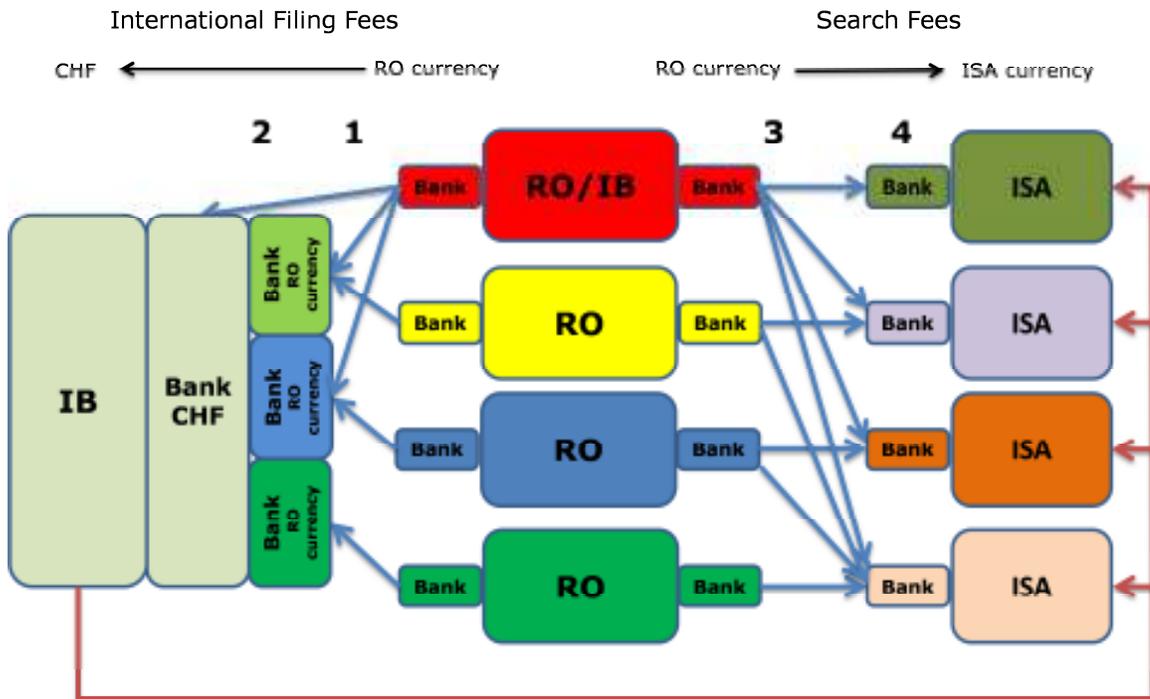
37. In addition to suggesting to fix equivalent amounts of PCT fees only once a year and to leave equivalent amounts unchanged for a period of 12 months so as to allow the IB to “hedge” international filing fees and search fees, FTI Treasury has further recommended the introduction of a “netting structure” for all PCT fee transactions between the ROs, the ISA and the IB.

38. While such a netting structure could be introduced independently of the proposal to fix equivalent amounts of PCT fees only once a year and to leave equivalent amounts unchanged for a period of 12 months, the biggest benefit would no doubt be achieved if both proposals were to be implemented at the same time.

39. The following paragraphs further explain the current flow of PCT fee transactions between the ROs, the ISAs and the IB, and explore the possible impact of a “netting structure” on those transactions.

Current Flow of PCT Fee Transactions

40. The current flow of PCT fee transactions (in currencies which are freely convertible) between the ROs, the ISAs and the IB can be described as follows:



Rule 16.1(e) procedure
(compensation for FX losses)

5

- (a) ROs (including RO/IB) transfer international filing fees in various currencies (in Swiss franc or equivalent amounts in various other freely convertible currencies) into bank accounts held by the IB, typically once a month (see (1) in the figure, above).
- (b) The IB holds bank accounts in various (but not all) RO currencies; if the RO currency in which the international filing fees are received is a currency in which the IB holds an account, the IB may use some of the currency for payments as required and then converts the remaining balance of any such fees into Swiss francs, typically once a month. If the IB does not hold an account in a particular RO currency, incoming international filing fees are received in the IB's Swiss franc account and automatically converted by the bank, upon receipt, into Swiss francs (see (2), in the figure, above). Where the amounts received are significant, the bank will first contact the IB in order to agree upon the exchange rate to be used for the conversion.
- (c) ROs (including RO/IB) transfer search fees in various currencies (ISA currency or equivalent amounts in various other freely convertible currencies) into the bank accounts held by "their" (often) multiple competent ISA, typically once a month (see (3) in the figure, above).

(d) Typically, each ISA holds a bank account only in “its” ISA currency and incoming search fees in any RO currency different from that ISA currency are received in that ISA currency account and automatically converted by the bank, upon receipt, into the ISA currency (see (4) in the figure, above).

(e) To balance any losses in search fee income as a result of exchange rate fluctuations (PCT Rule 16.1(e) procedure), the ISA, typically once a month, deducts the amount it is owed by the IB under PCT Rule 16.1(e) from the amount of the international filing fees which the same Office, in its capacity as a RO, transfers to the IB. Where, on the other hand, in accordance with PCT Rule 16.1(e), the ISA owes money to the IB, the ISA adds those amounts to the amount of the international filing fees which the same Office transfers to the IB in its capacity as a RO (see (5) in the figure, above).

41. The current flow of PCT fee transactions as set out in paragraph 40, above, has a number of disadvantages; most notably:

(a) ROs have to transfer PCT fees to different recipients, namely, to the IB (international filing fee) and to the ISA or, where several ISAs are competent to act in respect of international applications filed with a RO, to several ISAs (search fee), involving multiple banks, different applicable procedures, different fee reconciliation mechanisms, etc., resulting in a substantial workload for finance departments in ROs.

(b) All ISAs act as a competent Authority for several ROs (one Authority has been specified to act as a competent Authority by more than 60 ROs!) and thus are receiving fees from multiple different ROs, in various different currencies, involving different (remitting and receiving) banks, different applicable procedures, fee reconciliation mechanisms, etc., resulting in a substantial workload for finance departments in ISAs.

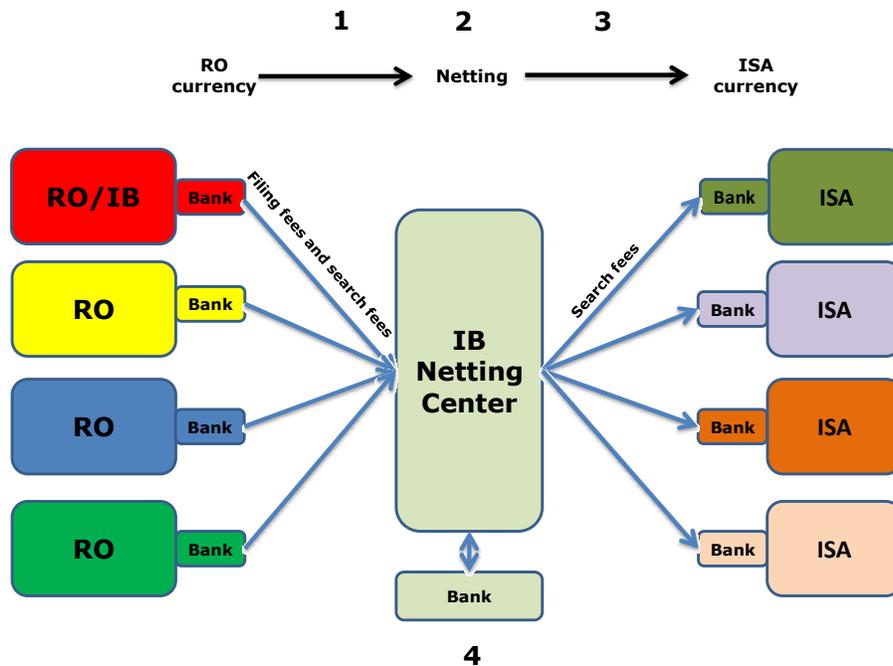
(c) The sheer number of PCT fee transactions from and to the various actors (IB, RO, ISA) results in high transaction costs (bank charges).

(d) Under PCT Rule 16.1(e), the financial risks associated with the transfer and conversion of search fees are solely borne by the IB. However, the IB is not involved in the transaction at all and thus has no influence on the management of the possible impact of exchange rate fluctuations. On the other hand, those actors which do, namely, the RO and the ISA, have no direct interest in better managing such possible impact. In particular, there is no incentive for the ISA to better manage the conversion of the search fee received in the RO-currency into the ISA-currency (for example, by delaying the conversion to a later date on which the exchange rate may be more favorable), noting that the PCT Rule 16.1(e) mechanism guarantees that the ISA will always (eventually) receive an amount of the search fee which is identical to the amount that it has fixed. In practice, the search fees which are being transferred to the ISA in the various RO-currencies are often simply converted, at the time of receipt by the bank at which the ISA holds its account, into the ISA-currency, without any attempt to manage that conversion process having due regard to the exchange rate between the two currencies applicable on the date of conversion.

Possible Netting Solution

42. “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 a single payment or receipt. A netting software system and process typically is used to perform the netting administration.

43. In the context of the flow of PCT fee transactions between the ROs, the ISAs and the IB, a possible netting solution could be described as follows:



(a) In general, the RO would continue to collect the international filing fee and the search fee from applicants. However, instead of being required to transfer the international filing fee to the IB and the search fee directly to the ISA, the RO would transfer both fees, the international filing fee and the search fee, in the (freely convertible) RO currency, to the IB.

(b) Once a month on a prescribed date, ROs would make a single payment to the netting center, covering all their international filing fee and search fee obligations vis-à-vis the IB and the ISAs, in the (freely convertible) local RO currency in which those fees have been collected by the RO (see **(1)** in the figure, above). Of course, in the case of an RO which also acts as an ISA, that single payment to the netting center would only consist of the balance between the international filing fees the RO “owes” to the IB and the search fees which the IB “owes” to that same Office in its capacity as an ISA.

(c) Foreign currency inflows (international filing fees and search fees in RO currencies) and outflows (search fees in ISA currencies) would be “netted” to give a net foreign currency amount (see **(2)** in the figure, above).

(d) The IB would, within five working days from the day on which the RO has made its payment to the netting center and sent the necessary payment information to the IB, covering all their international filing fee and search fee obligations vis-à-vis the IB and the ISAs, after the relevant reconciliation, transfer to the ISAs the relevant search fees due, in the ISA currency concerned and in the full amount as fixed by the ISA; thus, the PCT Rule 16.1(e) procedure would no longer have to be relied upon (see (3) in the figure, above).

(e) If a foreign currency hedging program were in place (as set out in paragraphs 20 to 22, above), forward contracts (based on forecasts as to the expected international filing fee and search fee amounts) would mature on the netting date to convert net foreign currency payments not covered by the income flow of currencies as described in paragraph (c), above (see (4) in the figure, above).

44. The following example illustrates the process:

(a) In the month of May, RO "A" receives international filing fees and search fees in respect of 100 international applications in the RO currency "United States dollar"; the currency of the competent ISA "B" is the "euro". In the same month, RO "C" receives international filing fees and search fees in respect of 200 international applications in the RO currency "euro"; the currency of the competent ISA "D" is "United States dollar".

(b) ROs "A" and "C" transfer all international filing fees and search fees collected by them in the respective RO currencies (USD and euro, respectively) to the netting center hosted by the IB. The IB transfers the search fees to the competent ISA "B" in the ISA currency "euro" and in the full amount as fixed by the ISA, using the euro amount received from RO "C". The IB transfers the search fees to competent ISA "D" in the ISA currency "United States dollar" and in the full amount as fixed by the ISA, using the United States dollar amount received from RO "A".

(c) If a foreign currency hedging program was in place (as set out in paragraphs 20 to 22, above), forward contracts (based on forecasts as to the expected international filing fee and search fee amounts) would mature on the netting date to convert net foreign currency payments not covered by the income flow of currencies as described in paragraph 43(c), above.

Benefits of Netting

45. A number of potential benefits for all stakeholders would arise from a netting solution.

Receiving Offices

46. For all PCT fee transactions, ROs would only have to deal with one other actor, namely, the IB, rather than, as at present, two or more (IB and all ISA competent to carry out international searches in respect of applications filed with the RO). A much lower volume of fee transactions would result in reduced transaction costs, noting that netting reduces the amount of money being transferred and can potentially reduce the entire settlement process to a single payment. A significant reduction in overall workload for finance departments in participating Offices could be achieved as a result of reduced operational time and effort; potential for automation of so far manual processes; and simplified reconciliation procedures for both international filing fees and search fees.

International Searching Authorities

47. For all PCT fee transactions relating to search fees, ISAs would only have to deal with one other actor, namely, the IB, rather than all ROs for which the ISA is competent to act. As in the case of ROs, netting would have the same general benefits for ISAs, as a much lower volume of fee transactions would result in much reduced transaction costs. A significant reduction in overall workload for finance departments as a result of reduced operational time and effort; potential for automation of so far manual processes; and simplified reconciliation procedures for search fees.

48. A netting solution, by way of which the ISA would receive all search fees from the IB, in the ISA currency and in the full amount fixed by it, would further remove the need for the ISA to execute foreign currency transactions with regard to its search fee income. It would also remove the need of having to rely on the PCT Rule 16.1(e) procedure to be compensated by the IB for any losses incurred as a result of such foreign currency transactions or, where applicable, to transfer any gains resulting from such transactions to the IB, as the ISA would always receive from the IB the full amount of the search fee, in the ISA currency and in the amount as fixed by it.

International Bureau

49. One of the main benefits for the IB resulting from the introduction of a netting structure would be that it would facilitate the operation by the IB of a foreign exchange hedging program, as explained in paragraphs 20 to 22, above.

50. In particular with regard to search fee payments, setting up a netting structure would result in a much higher visibility to the IB of PCT Rule 16.1(e) foreign exchange exposures and would facilitate the management of that exposure.

51. Considerable savings on foreign exchange conversions could be achieved by the IB. The study by FTI Treasury referred to in paragraph 16, above, states that annual savings on foreign exchange conversions could conservatively be estimated to be 1 per cent of the gross cash flow and could be as high as 3 per cent, depending on the conversion processes used by the ISAs at present. Noting that the current gross value of the two main ISA currencies in which the IB is particularly exposed to currency fluctuations under the current Rule 16.1(e) procedure (the ISA currency "euro" vis-à-vis the RO currencies "United States dollar" and "pound sterling"; and the ISA currency "Korean won" vis-à-vis the RO currency "United States dollar") is more than 70 million Swiss francs, a 1% saving on this amount would result in a saving of 700,000 Swiss francs per annum.

52. Netting would further offer the opportunity for process automation, easier booking and reconciliation procedures, efficiency and control opportunities in relation to income data entry, would enhance cash collection and would facilitate liquidity management by the IB.

53. According to FTI Treasury, a netting solution would cost approximately 12,000 Swiss francs to implement (whether outsourced or in-house). If outsourced, there would also be an annual administration fee of approximately 50,000 Swiss francs. FTI Treasury has advised WIPO that carrying out the work in-house would be unlikely to reduce the annual fee as a large part of this relates to the technology required. This technology is heavily discounted for outsourced suppliers. An in-house netting solution would also require some staff time but this would not be significant.

54. Finally, it is recalled that the IB is currently running a pilot “eSearch-Copy” project, under which the IB prepares and transmits search copies electronically to the ISA on behalf of the RO where both RO and ISA so agree, allowing for faster and more efficient transfer of search copies to the ISAs. While a netting solution could be introduced independently from the implementation of the eSearch-Copy project, ideally, both netting and the eSearch-Copy project should go “hand-in-hand” and be implemented together, allowing participating ROs to rely on only one actor, namely, the IB, for its main transactions vis-à-vis ISAs (the transmittal of search copies and the transfer of search fees) rather than, as at present, two or more (IB and all ISA competent to carry out international searches in respect of applications filed with the RO).

III. OTHER PROPOSALS

Adding a Margin When Setting Equivalent Amounts

55. One possible further way to reduce the risk for the IB’s (and thus the Organization’s) PCT fee income due to exchange rate fluctuations between freely convertible RO currencies and the Swiss franc and ISA currencies would be to add a small, low percentage margin to the equivalent amounts of the international filing fee and of the search fees, for the benefit of the IB and, if no netting structure were to be introduced, the ISA, respectively. For example: say, the current equivalent amount of the international filing fee in currency “XYZ” is 1000 “XYZ”; adding a margin of 1 or 2 per cent to that equivalent amount in XYZ of the international filing fee would raise that amount from 1000 to 1010 or 1020 “XYZ”. That additional margin of 10 or 20 “XYZ” per international filing fee would serve to soften the possible impact of exchange rate fluctuations on fee income of the IB. Similarly, if no netting structure were to be introduced, such an additional margin per search fee would serve to soften the possible impact of exchange rate fluctuations on fee income of the ISA, resulting in fewer cases where that Authority would request reimbursement by the IB under Rule 16.1(e) of losses incurred.

Payment of the International Filing Fee in Swiss Francs and of the Search Fee in the Applicable ISA Currency

56. While all proposals set out above aim at reducing the risk of exposure of PCT fee income to fluctuating exchange rates, one possible way of eliminating that risk altogether would be to enable or indeed require applicants to pay the international filing fee in Swiss francs and the search fee in the applicable ISA currency, either to the RO or directly to the IB and the ISA, respectively.

Payment to the Receiving Office

57. Already at present, several ROs allow for or even require payment of the international filing fee in Swiss francs and of the search fee in the applicable ISA currency. In such a case, the RO simply transfers those fees in the currencies in which they have been paid to the IB and the ISA, respectively, and the issue of exchange rate fluctuations and subsequent loss of PCT fee income for the IB does not arise.

58. While it is not proposed to make it mandatory for an RO to allow for or require the payment of the international filing fee in Swiss francs and payment of the search fee in the applicable ISA currency, noting the various different financial circumstances in which ROs operate, the IB would like to strongly encourage all ROs which presently require payment of the international filing fee and of the search fee in a *freely convertible* local RO currency to review their current approach and consider collecting those fees in Swiss francs and the applicable ISA currency, respectively.

In the view of the IB, today's electronic e-commerce payment systems should make such an approach much more feasible than it would have been when the PCT fee payment system was first designed.

59. Similarly, the IB would like to strongly encourage those ROs which presently require payment of the international filing fee and of the search fee not in their local (often not-freely convertible) RO currency but rather in a freely convertible currency different from the Swiss franc and the applicable ISA currency (notably, United States dollar) to equally review their current approach and consider collecting those fees in Swiss francs and the applicable ISA currency, respectively.

60. Furthermore, the IB would like to strongly encourage those ROs which presently require payment of the international filing fee and of the search fee in a *not freely convertible* local RO currency and subsequently convert those fees into a freely convertible currency different from the Swiss franc and the applicable ISA currency (notably, United States dollar or Euro) to review their current approach and consider converting those fees into Swiss francs and the applicable ISA currency, respectively.

ePCT Payment of Fees Directly to the International Bureau and to the International Searching Authority

61. Within the context of the ePCT system, solutions are currently being explored that would allow applicants, at the time of filing using the ePCT-Filing system, and regardless of the RO with which the international application has been filed, to pay the international filing fee in Swiss francs to the IB and to pay the search fee in the applicable ISA currency to the ISA, for example, either by way of an online credit card transaction or by furnishing details of a current (deposit) account with WIPO or the ISA, as applicable, or possibly a bank transfer transaction.

RESPONSES TO THIS CIRCULAR

./ 62. A Questionnaire covering the issues explored in this Circular is attached in Annex III. Responses are invited to this Circular by completing the Questionnaire and returning it to the IB to Mr. Claus Matthes, Director, PCT Business Development Division (e-mail: pctbdd@wipo.int; fax: +41-22-338 7150) by March 13, 2015. Responses to this Questionnaire may be submitted in any of the six official languages of the United Nations (Arabic, Chinese, English, French, Russian and Spanish).

63. The IB will take any comments received by this date into account in developing any proposals to modify the current legal framework governing the payment of PCT fees and the establishment of equivalent amounts for consideration by the PCT Working Group in 2015.

64. Any responses received to the Questionnaire will be presented in an anonymous fashion; individual responses will not be attributed without the specific prior permission of the relevant Office or organization.

Yours sincerely,



Francis Gurry
Director General

- Enclosures:
- Annex I Directives of the PCT Assembly Relating to the Establishment of Equivalent Amounts of Certain Fees
 - Annex II Excerpt from the Report of FTI Treasury: Recommendations with Regard to Foreign Exchange Exposures of PCT Fee Income
 - Annex III Questionnaire

DIRECTIVES OF THE ASSEMBLY RELATING TO THE ESTABLISHMENT OF
EQUIVALENT AMOUNTS OF CERTAIN FEES

(reproduced from Annex IV to document PCT/A/40/7)

The Assembly establishes in the following terms the directives relating to the establishment of equivalent amounts of the international filing fee, the handling fee, the search fee and the supplementary search fee (see Rules 15.2(d)(i), 16.1(d)(i), 45bis.3(b) and 57.2(d)(i)), it being understood that, in the light of experience, the Assembly may at any time modify these directives:

Establishment of Equivalent Amounts

(1) The equivalent amounts of the international filing fee and the handling fee in any currency other than Swiss franc, and of the search fee and the supplementary search fee in any currency other than the fixed currency, shall be established by the Director General, in the case of:

- (i) the international filing fee, after consultation with each RO which prescribes payment of that fee in such currency;
- (ii) the search fee, after consultation with each RO which prescribes payment of that fee in such currency;
- (iii) the handling fee, after consultation with each IPEA which prescribes payment of that fee in such currency.

In the case of the international filing fee, the search fee and the handling fee, the equivalent amounts shall be established according to the exchange rates prevailing on the day preceding the day on which the consultations are initiated by the Director General. In the case of the supplementary search fee, the equivalent amounts shall be established according to the exchange rates prevailing on the day on which the Director General receives the notification of the amount of the supplementary search fee or prevailing on the day two months prior to the entry into force of the supplementary search fee, whichever is the later.

(2) The amounts so established shall be the equivalent, in round figures,

- (i) of the amount of the international filing fee and of the handling fee, respectively, in Swiss franc set out in the Schedule of Fees;
- (ii) of the amount of the search fee and the supplementary search fee (if applicable) established by the ISA in the fixed currency.

They shall be notified by the IB to each RO, ISA and IPEA, as applicable, prescribing payment or establishing fees in the currency concerned and shall be published in the *Gazette*.

Establishment of New Equivalent Amounts Consequential on Changes in the Amount of the Fee Concerned

(3) Paragraphs (1) and (2) shall apply *mutatis mutandis* where the amount of the international filing fee, the handling fee, the search fee or the supplementary search fee is changed. The new equivalent amounts in the prescribed currencies shall be applied from the same date as the changed amount of the international filing fee or of the handling fee set out in the amended Schedule of Fees, or from the same date as the changed amount of the search fee or the supplementary search fee in the fixed currency.

Establishment of New Equivalent Amounts Consequential on Changes in Exchange Rates

(4) In the month of October of each year, the Director General shall, where applicable, after consultations with the Offices or Authorities referred to in paragraph (1), establish new equivalent amounts of the international filing fee, the handling fee, the search fee and the supplementary search fee according to the exchange rates prevailing on the first Monday in the month of October. Unless otherwise decided by the Director General, any adjustment under this paragraph shall enter into force on the first day of the subsequent calendar year.

(5) Where, for more than four consecutive Fridays (midday, Geneva time), the exchange rate between Swiss franc (in the case of the international filing fee and the handling fee) or the fixed currency (in the case of the search fee and the supplementary search fee) and any applicable prescribed currency is by at least 5% higher, or by at least 5% lower, than the last exchange rate applied, the Director General shall, where applicable, after consultations with the Offices or Authorities referred to in paragraph (1), establish new equivalent amounts of the international filing fee, the search fee, the supplementary search fee and/or the handling fee, as applicable, according to the exchange rate prevailing on the first Monday following the expiration of the period referred to in the first sentence of this paragraph. The newly established amount shall become applicable two months after the date of its publication in the *Gazette*, provided that the ROs or the International Preliminary Examining Authorities concerned, as applicable, and the Director General may agree on a date falling during the said two-month period, in which case the said amount shall become applicable from that date.

[Annex II follows]

EXCERPT FROM THE REPORT OF FTI TREASURY:
RECOMMENDATIONS WITH REGARD TO
FOREIGN EXCHANGE EXPOSURES OF PCT FEE INCOME

“Foreign Exchange Exposure and Risk Management

“PCT income constitutes WIPO’s largest source of revenue (73.7% in 2012 or CHF 248.2 million) and gives rise to the significant foreign exchange risks arising in the organization. No significant treasury issues are identified with Madrid and Hague systems. The USD flows associated with Arbitration and Mediation are small in the overall WIPO context and consequently no significant treasury issues are identified with this service. The main findings in the study in respect of foreign exchange exposure and risk management are:

- “WIPO is exposed to significant risk as a result of foreign currency exposures. The New Equivalent Amount process protects WIPO from long term structural changes in exchange rates, but WIPO is still exposed to short term volatilities. This can have a significant impact on revenues with CHF 13 million FX loss being recorded in 2011. Based on the current budgeted figures, a negative move of just 0.5% in foreign exchange rates would eliminate the budgeted surplus operating result.
- “Value at risk relating to the PCT application fees based on forecast application volumes for the 2014/15 biennium and to a 95% confidence level is estimated at CHF 38,232,712. Value at risk relating to the ISA non base currency fees based on 2012 volumes and to a 95% confidence level is estimated at CHF 8,915,917.
- “The key currency exposures in terms of PCT application fees are USD, EUR and JPY. The key currency exposures in terms of ISA non-base currency fees are /EUR/USD, EUR/GBP and USD/KRW.
- “The current accounting process means that hedging exposures on a net basis will not eliminate the FX gain/loss recorded in the P&L⁶. Whilst the biennium budget may still be met, any offsetting gain/loss on the PCT income line would be reflected in either increased or decreased expenditure levels in CHF terms.
- “There are a wide range of hedging strategies available to WIPO. However, the new equivalent amount process reduces the ability to accurately define FX exposures and in the case of some hedging strategies may result in an increased exposure to WIPO given certain market conditions and volatilities. WIPO could look to implement a hedging strategy based purely on financial derivatives or could look to optimize a hedging strategy by altering some internal and external pricing processes.
- “*This report recommends that WIPO consider eliminating the New Equivalent Amount process and setting equivalent amounts for both PCT Application Fees and ISA non-base currency fees annually for a period of 12 months. This would provide more certainty of currency cash flows and significantly remove risks associated with hedging strategies.*

⁶ “P&L” is the acronym commonly used to represent the ‘Profit and Loss Account’, which is a financial statement showing the financial results (income less expenditure) generated during a period. The equivalent statement, at WIPO, is the “Statement of Financial Performance”.

- “This report recommends that WIPO consider implementing a hedging strategy based on net currency cash flows using Forward Contracts (subject to previous recommendation being adopted). We believe that this strategy would be the most suitable for implementation at WIPO for the following reasons:
- “Using forward contracts will allow WIPO to lock into FX rates which are close to the equivalent amount rate without the upfront expense of purchasing options.
- “The use of Forward Contract strategies are at the lower end of complexity for implementation. The results are clear, transparent and easily understandable.
- “Hedging the net currency flows will help WIPO meet the biennium budget financial goals.
- “*This report recommends that WIPO consider using the blended hedge rate to set equivalent amounts.* If WIPO uses the blended average weighted forward rate to set the equivalent amount rate then the premium/discount would be reflected in the equivalent amounts. Therefore consideration should be given to using the average blended forward rate for setting equivalent amounts.
- “*This report recommends that WIPO seek auditor’s opinion on application of hedge accounting to ISA non-base currency flows.* If WIPO chooses to hedge the risk associated with the foreign currency exposures on ISA non-base currency fees, we would recommend that a clear audit opinion is sought from WIPO’s external auditors confirming that hedge accounting would be permissible under IPSAS. It would be essential to receive this opinion in advance of embarking on any hedging strategy implementation.”

“It is noted that the accuracy of the PCT filing volume forecast and the ability to forecast on a jurisdiction (and therefore currency) basis are key driving data variables for the implementation of any proposed foreign exchange hedging strategies. Therefore the historical accuracy of these forecasts provides a strong confidence factor for any potential hedging strategies.”

“Added Value Services — Netting

“WIPO has a Strategic Goal (II) to provide a premier global IP Service and is committed to supporting the efficient administration of the Systems under its remit and seeks to add value to the process by introducing ways to enhance operations. An example of this is the recent implementation of the Memorandum of Understanding between the European Patent Office (EPO), The United States Patent and Trademark Office (USPTO) and WIPO with regard to the improved management of PCT search fee transfers. This pilot project is in the form of a ‘netting’ type solution. However it should be recognized that this is a one way cash flow direction rather than a reciprocal arrangement which reduces the potential benefit to WIPO.

“*This study recommends the introduction of netting structure for PCT cash flows covering all transactions between WIPO, ROs and ISAs that would be beneficial to all participants.* While a netting technology/administration solution has an annual cost of around CHF 50,000, estimated minimum annual cost savings of CHF 730,000 (for which WIPO is liable for) makes the financial business case for this technology. Apart from financial benefits, other significant benefits arise from efficiency savings, the functionality available, management and operational enhancements.”

[Annex III follows]

QUESTIONNAIRE

PCT FEE INCOME: POSSIBLE MEASURES TO REDUCE EXPOSURE TO
MOVEMENTS IN CURRENCY EXCHANGE RATES

RESPONSE FROM:

Name of responsible official:

On behalf of [Office]:

I. SETTING EQUIVALENT AMOUNTS FOR PCT FEES FOR A FIXED PERIOD

Please provide your comments on the option of reducing the risk of exposure of PCT fee income to fluctuating exchange rates by changing the procedures related to the fixing of equivalent amounts of fees which would result in equivalent amounts of PCT fees only to be fixed once a year and thus equivalent amounts to remain unchanged for a period of 12 months, from January 1 to December 31 of any given calendar year, as discussed in paragraphs 20 to 36 of the main body of this Circular.

II. INTRODUCING A “NETTING” STRUCTURE FOR THE TRANSFER OF FEES

Please provide your comments on the option of reducing the risk of exposure of PCT fee income to fluctuating exchange rates by introducing a “netting structure” for all PCT fee transactions between the ROs, the ISA and the IB, as discussed in paragraphs 37 to 53 in the main body of this Circular.

III. ADDING A MARGIN WHEN SETTING EQUIVALENT AMOUNTS OF THE INTERNATIONAL FILING FEE AND SEARCH FEE

Please provide your comments on the proposal to add a small, low percentage margin when establishing equivalent amounts of the international filing fee and search fee, as discussed in paragraph 55 of this Circular.

IV. PAYMENT OF THE INTERNATIONAL FILING FEE IN SWISS FRANCS AND OF THE SEARCH FEE IN THE APPLICABLE ISA CURRENCY

Please provide your comments on the option of paying the international filing fee in Swiss francs and the search fee in the applicable ISA currency, either to the RO or directly to the IB and the ISA, respectively, as discussed in paragraphs 56 to 61 in the main body of this Circular.

In particular, please address the following issues:

- Payment to the RO, as discussed in paragraphs 57 to 60 in the main body of this Circular.
- ePCT-Filing payment of fees directly to the IB and to the ISA, as discussed in paragraph 61 in the main body of this Circular.

V. OTHER ISSUES

Please provide any other comments you may have on the potential measures outlined in the Circular, or any other actions that could be taken to reduce the exposure of the IB and Offices acting in their various capacities under the PCT to movements in currency exchange rates.

[End of Annex III and of Circular]