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The effect of the new Financial Transaction Tax on traders and trends in treasury

An event presented by PwC's Academy In collaboration with the Zug Commodity Association

Wednesday, 19 June 2013
Parkhotel Zug

pwc

Introduction

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Corporate Tax Reform III

Facts

- Holdings, domiciliary and mixed companies are currently privileged taxed for cantonal- and communal taxes.
- Privileged taxation has been challenged by the European Union (in particular the differentiated taxation of Swiss and foreign sourced income).

What is the current status in general?

- Finance Minister Widmer-Schlumpf has given an update on the status of the project on May 17:
  - The government is working on new solutions in different working groups
  - Those solutions should be presented to the public late 2013/early 2014
  - It is expected that there will be an IP box as well as a finance box regime
  - Solution for “traders” is still work in progress
  - Old regimes should “survive“ until around 2020

Corporate Tax Reform III (cont.)

Adjustments in the tax law of the canton of Zug

- Cantonal Government of Zug supports corporate tax reform III.
- Privileged taxed companies in Zug will have to take a moderate increase in their tax burden as from 2018 into account.
- Introduction of a license box, an interest box or a notional interest deduction will be reviewed.
- Ordinary income tax rate will be decreased to 12%* (incl. Federal tax) for all companies in Zug.

  * 2012 rates between 12.96% and 17.8%

The Financial Transaction Tax also affects commodity traders - are you prepared?

Martin Meyer, Senior Manager, PwC

What is the Financial Transaction Tax (FTT)?

What is FTT?

- indirect tax, levied on specific financial transactions **(including derivatives)**
- Unilaterally implemented by France and Italy
- Planned implementation of new FTT in 11 EU participating member states as per 1 January 2014

Target of the tax

- Ensure that the financial services sector makes a contribution towards the costs of the financial crisis

Participating member states of the new FTT

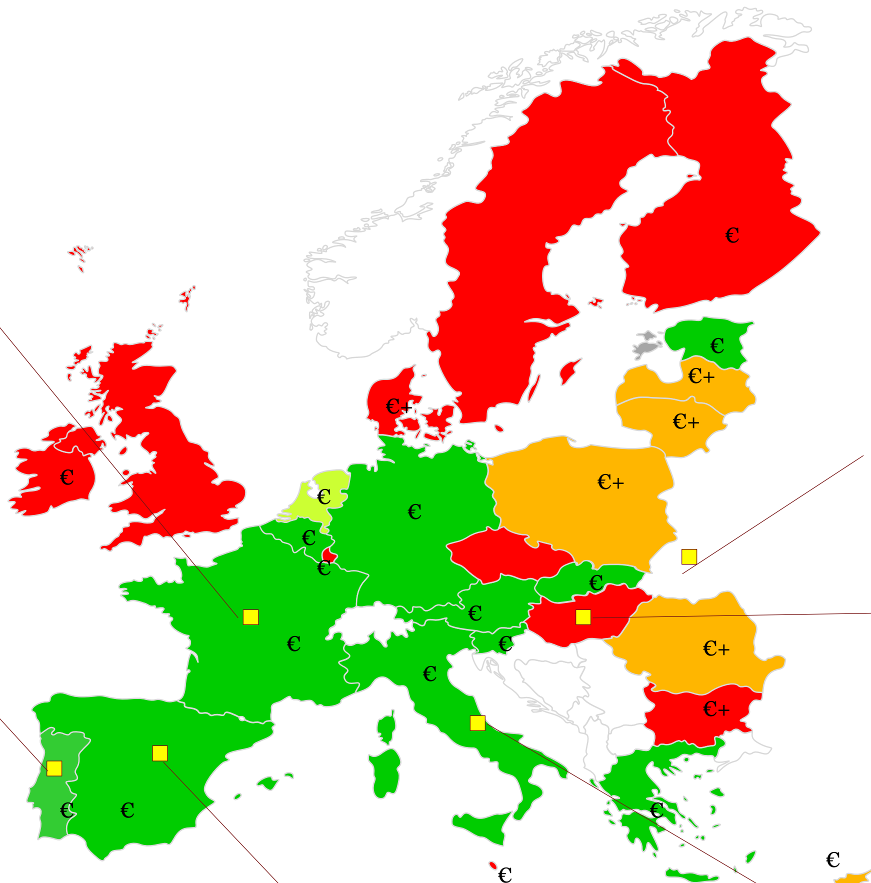
- Belgium
- Germany
- Estonia
- Greece
- Spain
- France
- Italy
- Austria
- Portugal
- Slovenia
- Slovakia

➡ **Unilaterally implemented FTTs will be abolished with introduction of new FTT in 11 EU member states**

Where do we stand?

French FTT on certain French equities and certain activities in France from 1 August 2012 (ADRs within scope from 1 December 2012)

Portuguese FTT - currently y on hold



11 countries	**Opt-ins for the EU FTT via ECP**
1 country	**For an EU wide FTT via ECP subject to conditions**
10 countries	**Not intent on implementing an EU FTT via ECP**
5 countries	**Potential "swing states" in favour of an EU FTT**

Ukrainian FTT from 1 January 2013

Hungarian FTT from 1 January 2013

€ **Euro zone country**

€+ **Euro Plus Pact country**

Spanish FTT – currently on hold

Italian FTT on securities from 1 March 2013 and derivatives from 1 July 2013

Scope of the tax

Financial transactions carried out by **financial institutions**

Definition of Financial Transaction*:

- Purchase and sale of financial instruments
- Transfer between group companies of the right to dispose of a financial instrument
- Conclusion or modification of derivative contracts
- Exchange of financial instruments
- Repo, reverse repo and stock lending agreements

Included in the scope

- Over the counter transactions

Definition of Financial Instruments**:

- Transferable securities (including equity and debt securities)
- Money market instruments
- Fund units
- Options, futures, swaps, forwards and other derivatives over commodities, currencies, indices and various other assets/prices
- Credit default swaps
- Financial contracts for differences ("CFDs")
- Structured products

Not included in the scope

- **Physical commodity transactions**
- Primary market transactions

Definition of Financial Institutions*:

Undertakings, Institutions, bodies or persons **carrying out financial activities** with a significant annual value of financial transactions*

- Investment firms
- Organised markets
- Credit Institutions
- Insurance and reinsurance undertakings
- Collective investment undertakings
- Pension funds
- Holding companies
- Financial Leasing companies
- Special purpose entities
- etc.

threshold of 50% of average value of financial transactions compared to average net annual turnover of the entity

Territorial application

The directive is planned to apply under the following conditions:

1. Residence principle

At least **one party** to the transaction is **established** in the territory of a participating Member State.
If one of the parties to the transaction is established in a participating Member State, the financial institution **that is not established** in a participating Member State **will also be deemed** to be established in that participating Member State and the transaction becomes taxable there.

2. Issuance principle

When none of the parties to the transaction would have been “established” in a participating Member State, but where such parties are trading in financial instruments **issued in a Member State**, trading in the financial instrument is subject to taxation.

Payment of the tax

Responsibility to pay the tax

FTT shall be payable by **each** financial institution which fulfils any of the following conditions:

- it is party to the transaction, acting either for its own account or for the account of another person;
- it is acting in the name of a party to the transaction;
- the transaction has been carried out on its account.

Where a financial institution acts in the name or for the account of another financial institution only that other financial institution shall be liable to pay FTT.

Tax rates

Financial transactions other than derivatives contracts	min. 0.1% on the market price
Derivatives contracts:	min. 0.01% on the notional amount

➡ Exchange of financial instruments is considered as **two financial transactions**!

Potential consequences for Commodity Traders

- ***Qualification of a commodity trader as a financial institution?***

  The definition of a financial institution is very broad. If the annual value of financial transactions is >50% of the overall average net annual turnover, the commodity trader will qualify as a financial institution.

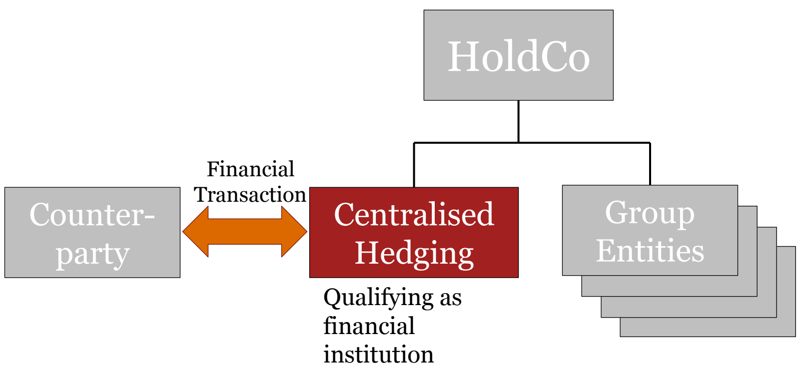
- ***FTT liability of a Swiss based commodity trader, if***

  1. One of the parties to the transaction is based in a participating member state *and*
     - the Swiss based commodity trader qualifies as financial institution *or*
     - a bank is acting on behalf of the Swiss based commodity trader (if a bank failes to levy FTT)
  2. The financial instrument was issued in a member state
     (derivatives: only applicable if traded on organised trade venues or platforms*)

➡ Impacts on the business model of Swiss based Commodity Traders have to be analysed

Centralised Hedging and FTT Recharge in practice

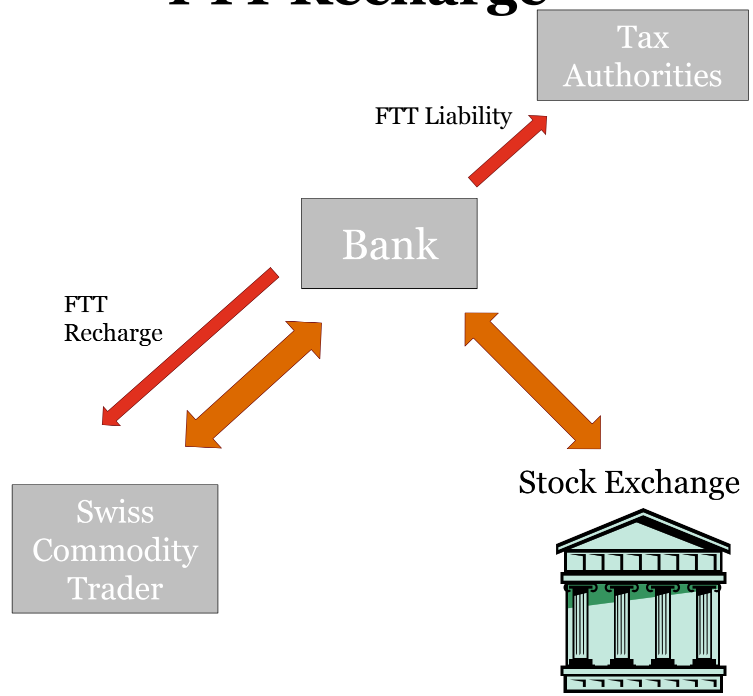
Centralised Hedging



- Due to high value of financial transactions*, the hedging entity within the group is likely to qualify as a financial institution

* in relation to net annual turnover of the entity

FTT Recharge



- FTT paid by the bank will be recharged to the Swiss Commodity Trader

What should you do?

Developing a strategic approach

FTT impact assessment

- **Current FTT rules**
- **Proposed FTT rules**
- **Current state**

French FTT — **Italian FTT** — **Proposed EU FTT**

French FTT
- Tax based on location of securities
- Few instruments in scope
- Few transactions in scope
- Exemptions, e.g. market maker relief
- Single charge

Final EU FTT?

Proposed EU FTT
- Tax based on location of parties & instruments
- Many instruments in scope
- Many transactions in scope
- Few exemptions
- Purchaser and seller liable

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Keeping up with growth: focus on treasury organisation and trading technology

Michiel Mannaerts, Director, PwC

Content

- Commodity trading market
- Typical trading organisation
- Key needs from ‘trading treasury’
- Solutions being implemented
- Increasing demands on the IT landscape
- Key trends in trading systems
- Implementation pitfalls
- Conclusion
- Want to know more?

Commodity Trading Market

Market in Switzerland

- Est. 400 trading companies in Switzerland
- Growth of the market

Trends

- Dramatic growth creates operational challenges
- Expansion in other commodities
- NOCs moving into trading space
- Moving into assets (refinery, storage, etc.)
- Commodity trading / procurement increasingly relevant for utilities and corporates

Issues

- Increased treasury needs
- Trading systems landscape needs
- Internal control lacking
- Accounting issues on more complex trading
- Regulatory developments

Geneva set to trump London in oil trading

FINANCIAL TIMES

By Javier Blas in London

Geneva will leave London behind and become the world's most important trading hub for physical energy commodities,

Typical trading organisation

Front Office	Operations Logistics	Back Office Accounting
Physical trading Paper trading Plants management Pre-deal analytics	Contract management Scheduling / Nomination Inventory management Shipping	Settlement (AP/AR), Financials Financial reporting

Mid Office Risk Management	Treasury Trade Finance
Risk reporting Risk limits (Market, Credit) Model management and validation	Funding Cash management Foreign exchange Interest rate risk (AP/AR) / (Credit)

Key needs from 'trading treasury'

- Increased cross-commodity trading impacts FX risk management
- Business is always cash constrained – need for visibility, access and funding
- Increased accuracy needed on cash flow forecasting, including margin call sensitivity
- Growth of the company completely dependent on the ability to obtain financing – different funding sources & types needed
- Communication with the banks important – also affects need for quality financial statements
- More interest rate sensitive business (Assets)
- Managing credit risk is core to the business, complexity increases with growth (consolidated view on trading and financial counterparties)
- Huge volumes in AP/AR. Late payments can delay delivery with significant resulting costs

FX Risk Management	**Bank Relationship Management**
Cash & Liquidity Management	**Interest Rate Risk Exposure Mgt**
Cash Flow Forecasting	**Credit Risk Management**
Trade Finance & Funding	**Accounts Payable / Accounts Receivable**

Solutions being implemented

Organisation & Process

- Developing of more professional treasury organisation and processes, integrated with the trading business as well as the more 'corporate' asset side

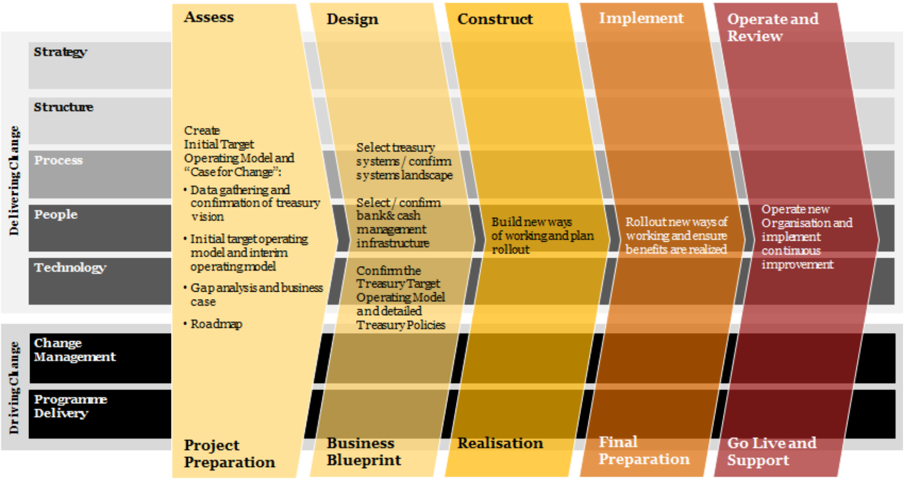
Technological support

- Select and implementing Treasury Management System, integrated with trading systems and/or ERP of the assets
- Enhanced bank connectivity (through Swift in combination with Service Bureau) allowing for visibility of cash & efficient payments
- Potentially moving to automated solutions in the area of Trade Finance (although not yet very mature)

Funding

- New types of non-transactional funding (bond issuances)

PwC has a global methodology that is used in Transformation projects. Our methodology is tailored for treasury projects.



Key challenges

FX Management

- FX exposure capture in Trading Systems
- Communication around FX exposures and hedges between trading desks and Treasury
- FX exposure netting

Cash Management

- Short term cash forecasting
- Free cash calculation (trade finance)
- Sensitivity to margin calls

Funding

- Line utilization calculation and capture of trade finance items
- Structured finance
- Capital consumption / Cash usage by desk

Integration

- Integration with accounting
- Bank connectivity (payments, cash visibility)
- Integration with trading system (FX, cash management, cash flow forecasting)

Increasing demands on IT landscape

CTRM solutions have become key to operational effectiveness, financial performance and risk control of commodity operations

Background

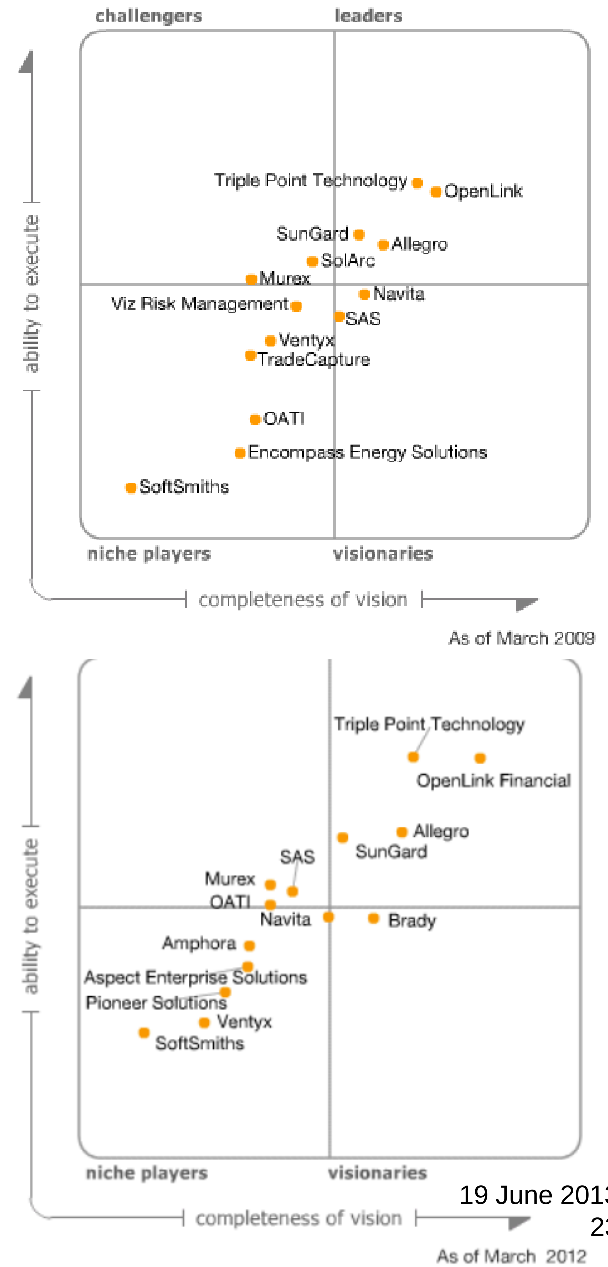
- **Increasing volume and complexity of commodities trades**
  - Growth of liquidity on European energy market place
  - Wide range of products traded from buy /sell transactions in near real time to structured multi commodities products
  - Various exchange standards with infrastructure operators for physical delivery management
- **Fragmentation of CTRM solutions market**
  - No CTRM solution can be considered as a standard
  - Solutions are mainly focused on local/regional issues, on technical functionalities (asset optimization, risk management, etc..) or specialized to one commodity
- **High expectations regarding CTRM solutions integration with other systems**
  - "Straight Through Process" Solution from initiation /execution through physical delivery to invoicing and settlement
  - Capability to link position management to risk and business control, as well as financial and cash forecast report

Issues

- **How to deal with "Front/Middle/Back-Office and management requirements and to support activities development ?**
  - Need for a better understanding of activities and business
  - Capability to define priorities among changing and growing activities
  - Design of solutions able to manage multi commodities, various regional /local markets and different time horizons
- **Which IT solutions to industrialize activities and to improve control ?**
  - Costs /benefits analysis of internal development vs. Software implementation
  - Need for support on decision to replace existing tool or to purchase a new solution
- **Which IT solution to ensure real time financial position management, physical delivery and reporting?**
  - Design appropriate solution based on tools / software suite to cover all functionalities required

Key trends in trading systems

- The market for CTRM solutions is more fragmented compared with markets for established administrative solutions
- The reasons for this fragmentation, include regional and regulatory market variations, the range of end-user requirements, and the extent and rapidity of market change.
- Trend is towards off-the-shelf CTRM with increasingly powerful systems available.
- Companies with in-house CTRM consider this a long term strategic choice (often developed over decades).
- Credit Risk and Treasury often managed in separate systems.
- There is a risk that off-the-shelf systems effectively become in-house over a longer term.
- Market view on CTRM systems – Gartner Magic Quadrant 2009 versus 2012 show rapid evolution



CTRM Area specific implementation pitfalls

	Common Issues	Common Causes	Recommended Actions
Trade Capture	Accurately capturing daily transactions is key to reporting quality data.	Many trade capture issues stem from limited involvement of key front office stakeholders	An CTRM implementation is a great time to address deal capture issues and controls.
Book Structure	Defining, configuring and maintaining an appropriate book structure is a challenging issue that can easily derail an implementation.	Most book structure issues stem from (1) poor initial planning and (2) lack of change controls after go live.	When migrating to a new system or consolidating systems, there is an opportunity to reorganize and design a book structure able to accomplish front, mid, and back office objectives.
Risk and Position Reporting	Risk and position reporting are basic requirements for any CTRM implementation and in many cases the ultimate deliverable. However, many implementations struggle with this core issue and do not budget adequate time and dollars.	Most risk and position reporting structure issues stem from inadequate requirements.	Many of these reporting issues can be prevented by the use of a standard project methodology and a disciplined project manager.
Interface Management	Interfaces with legacy support systems have derailed many CTRM projects (particularly two way scheduling system interfaces).	Oversimplified interface requirements and design documents often don't reflect the embedded complications of an interface and create undetected project risk.	Disciplined project management is required to manage the dynamic challenges associated with interfaces.
Master Data Management	In a complex system environment with numerous internal and external interfaces, there will be instances of shared master data across many applications.	Issues arise when this shared master data is not managed consistently and becomes out of sync.	Develop a data strategy and data plan for master data that outlines the guiding principles by which data will be managed.
Project Management and Change Control	Every large scale IT project is subject to various issues and risks that can effect budget, costs and functionality. Some of the CTRM related project issues are listed in appendix.	In many cases, missing project methodology and controls cause several issues.	Many of these issues can be prevented by the definition and implementation of a standard project methodology and a disciplined project manager.

Conclusion

For these companies to sustain growth they need:

- A clearly defined treasury organisation and supporting Treasury Management System infrastructure
- A clearly defined trading organisation and supporting Trading System, integrated with Treasury, Credit and Accounting
- Strong internal controls and accounting (including quality financials)…

There is a Gap:

- Many trading companies are not there, given their significant growth!

Want to know more?

For questions please contact:

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Discussion round

Apéro

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