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INTERNATIONAL PRIVATE CAPITAL (IPC): FINANCING & INVESTING IN COMMODITIES

24 April 2013

Presentation by:

Ashley King-Christopher
Partner
Speechly Bircham LLP
London

IPC Commodity Financing - Commercial Drivers

BACKGROUND

- Increasing global indebtedness (intermediaries and government) with no ready means of repayment post-Global Financial Crises (GFC)
- Increasing tax, regulatory and transparency initiatives at both the OECD and governmental levels.
- Underlying insolvency fundamentals not being addressed through Fed/BoE/ECB/BOJ increasingly frequent and co-ordinated liquidity operations.

BANK (DOLLAR) FINANCE

- Deflationary and contractionary (demand) forces continue to prove resilient despite unprecedented Fed/BoE/ECB/BOJ liquidity and balance sheet expansion support
- Banks and Western sovereigns therefore continue to de-risk and shrink balance sheets/loan books.
- Critically dollar funding for banks is not as readily available as pre-GFC despite Fed swap line operations with the ECB.

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IPC Commodity Financing - Commercial Drivers (Cont'd)

INTERNATIONAL PRIVATE CAPITAL (IPC) LENDING/ FINANCING OPPORTUNITY

- Why?
- International High Net Worth Individuals and their Family Offices along with Sovereign Wealth Funds (often themselves owned by a family) are the few last remaining IPC pools of unleveraged readily available investment capital
- IPC pools now looking to become the Bank in niche commodity/special financing situations structures/deals
- IPC constituted as Family Offices are increasingly constituted as a multi-channel financial services investment and financing businesses capitalising on niche IPC opportunities

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Case Study I: IPC Commodity Financing – Principal Investment & Financing (PIF) Structure

IPC ONSHORE PIF FINANCING STRUCTURE

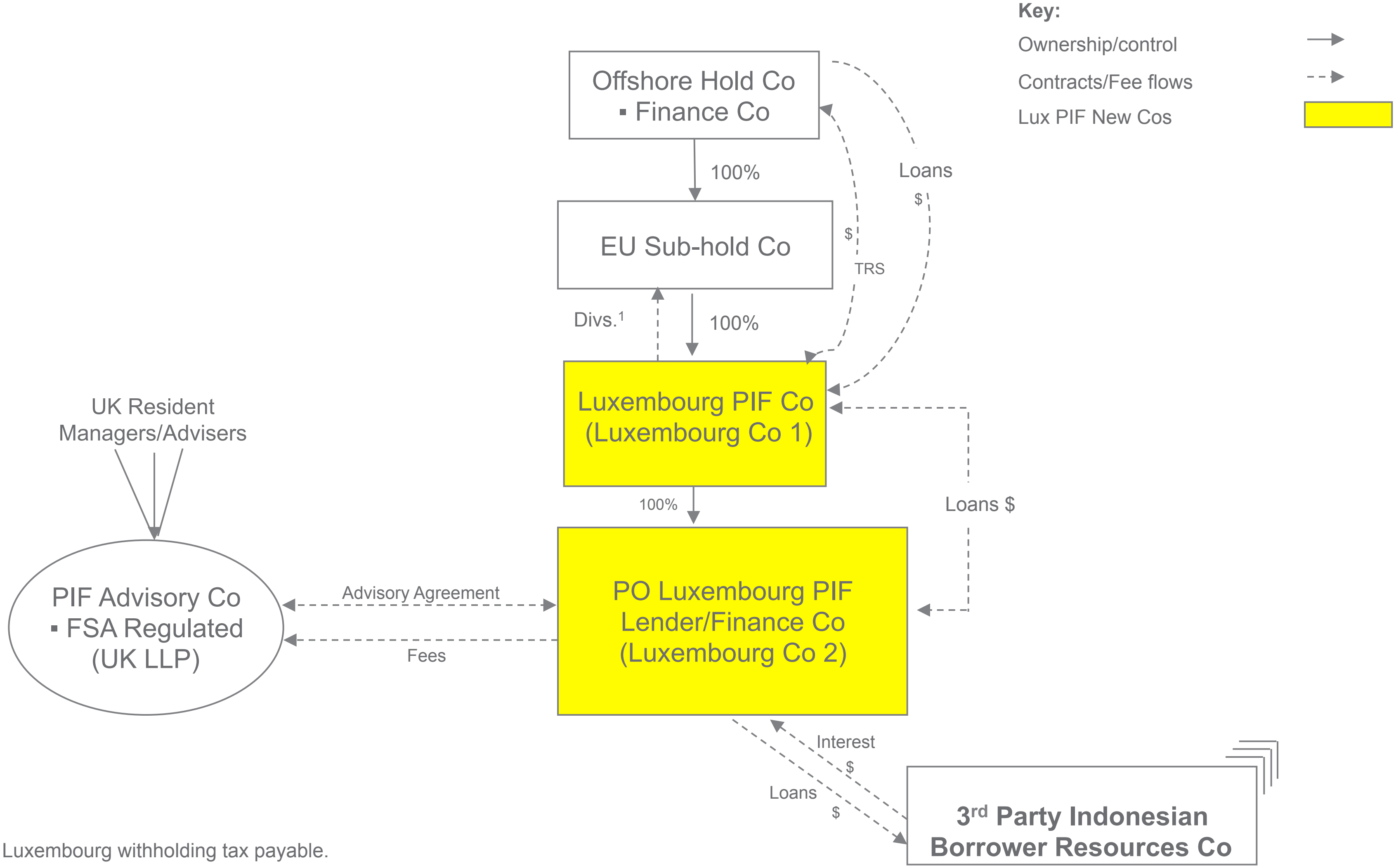
- In essence a commodity financing structure
- Satisfies quest for high yield (tied to the spot rate) in a low yield/rate world
- Often structured as Revolving Facility arrangement = regular staged repayments
- Yield with downside protection due to senior security collateral features

IPC Commodity Financing Structure – PIF Structure

IPC ONSHORE PIF COMMODITY FINANCING STRUCTURE

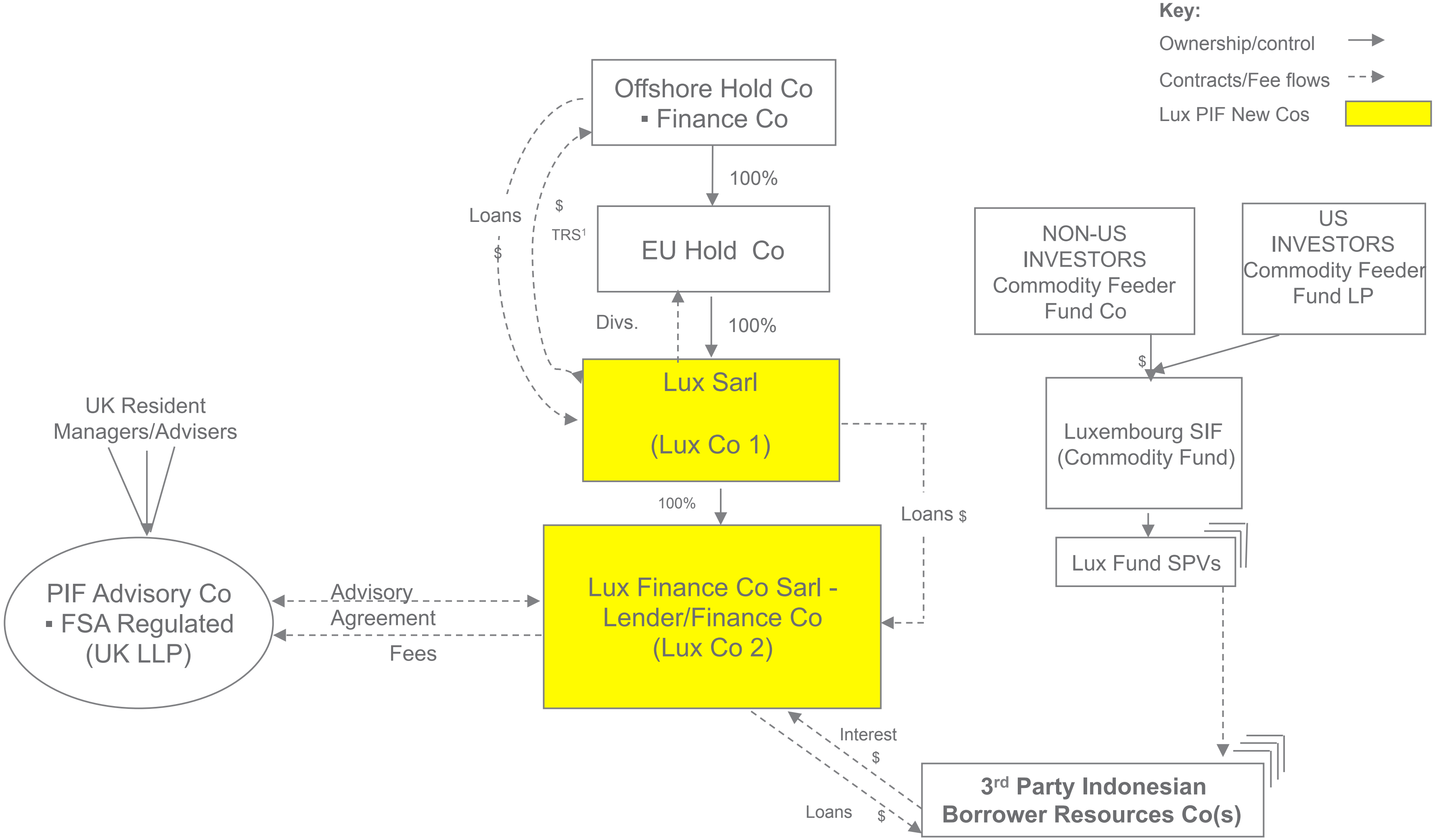
- Luxembourg a key international IPC PIF jurisdiction
- Wide comprehensive Tax Treaty network
- Tax efficient financing jurisdiction
- Lightly regulated with broad choice of asset classes
- Wide Participation (Tax) Exemption (commodity investment) regime
- Onshore EU with access to beneficial tax EU Directives
- Transparent

Example Structure (EU Onshore) - PIF Structure



[1] Nil Luxembourg withholding tax payable.

PIF & Regulated Lux Commodity Fund Co-investor



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Example - Luxembourg PIF Effective Tax Rate Table

EXAMPLE	LUXEMBOURG	
Entity	**Relevant Taxes**	**Estimated Tax Burden/year (€)**
Luxembourg Finance Co	CIT (effective liability on basis of €10m financing & leasing) WHT VAT Subscription Tax	€10,000.00 0.00 0.00 0.00
Luxembourg SPV Co	CIT WHT VAT Subscription Tax	0.00 0.00 0.00 0.00

Abbreviation:
CIT: Corporate Income Tax
WHT: Withholding Tax

Additional Information:
CIT rate in Luxembourg: 28.80%
WHT rate: 15% (on dividends and certain interest payments)
VAT rate: 15%
Subscription tax rate: 0.01% on NAV

Case study II: IPC Investing in Mexican Commodities

Background

- Transaction involves buying commodities that have been placed in warehouses at the dock in Mexico. The local mine operating group owner will own the commodity from the mine to the warehouse at the port.
- Once in the Mexican bonded warehouse it will be purchased by the non-resident (as Principal), who will then on sell it to a Chinese buyer; following which the commodity will be will be paid for and owned by the Chinese buyer (FOB).
- The Transaction can also be structured tax efficiently through Luxembourg by the use of a double-tier corporate structure.

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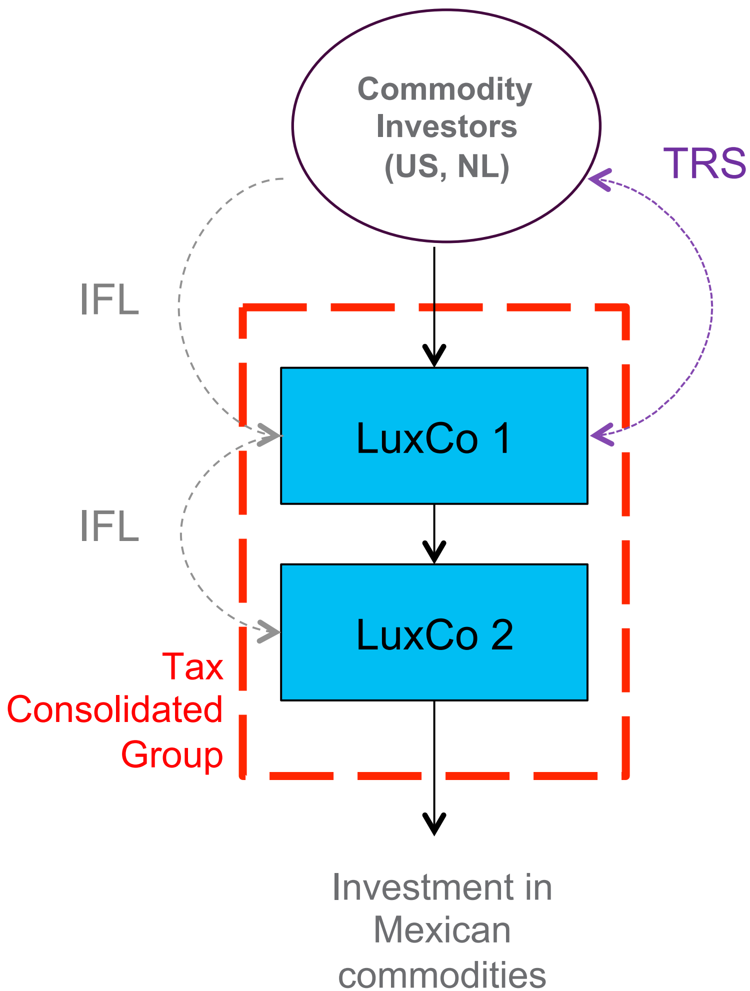
IPC Commodity Structure – Financing the Purchase of Mexican Commodities



Main steps:

- Investors set up LuxCo 1 with a blend of 1% equity and 99% interest free loan (**IFL**).
- LuxCo 1 sets up LuxCo 2 with the same blend of minimum equity and IFL.
- LuxCo 2 makes the Mexican Investment.
- Investors and LuxCo 1 enter into a total return swap (**TRS**) agreement.
- No local corporate income tax is due by LuxCo 2.
- No local withholding tax is due on distributions by LuxCo 2 to LuxCo 1.
- No local corporate income tax is due at the level of LuxCo 1, except on a limited amount of TRS fee.
- No withholding tax is due on TRS payments by LuxCo 1 to the Investors.

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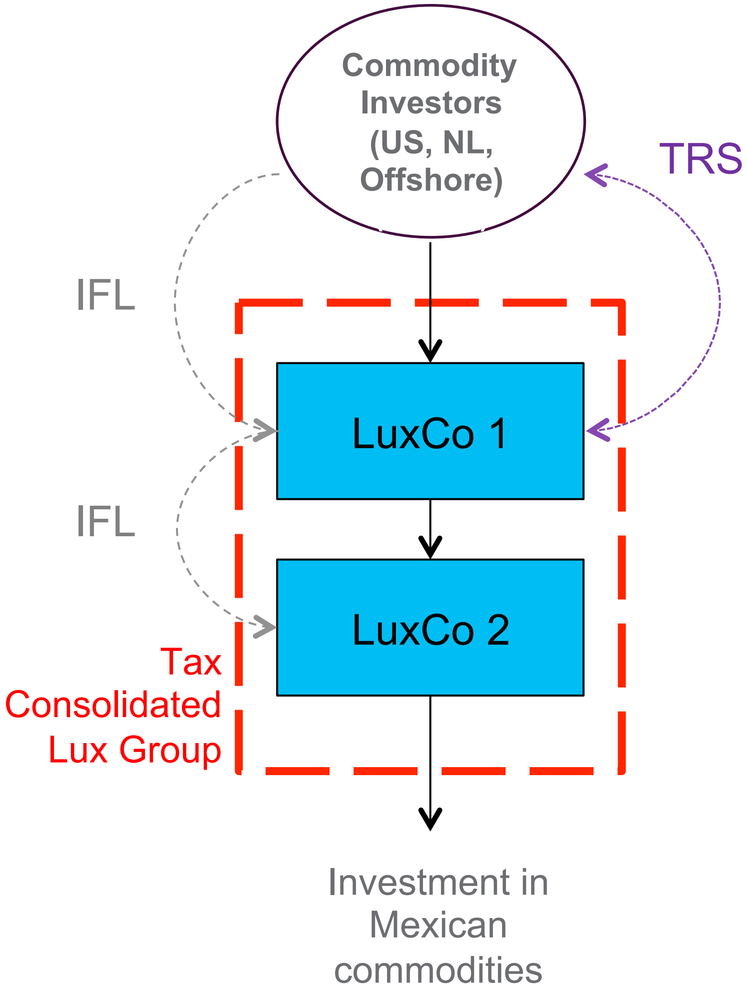
Luxembourg IPC (Double-tier) Commodity Investment Structure



- LuxCo 1 and LuxCo 2 can be incorporated as standard Luxembourg limited liability companies (S.à r.l.).
- The IFLs should be plain-vanilla non-interest bearing limited recourse loans.
- The TRS agreement would be an ISDA-based agreement whereby:
    - LuxCo commits to pay to the Investors an amount per annum equal to any income realised by LuxCo 2 in a given period/year on the Investment, net of LuxCo 2's op expenses..
    - The Investors, in return, commits to compensate LuxCo 1 for:
        - Any loss realised by LuxCo 2 in a given period on the Investment; **plus**
        - An arm's length TRS fee (which should be nominal).

CONCLUSION

- commodity intermediaries, banks and traditional sources of international commodity finance are retreating from commodity financing due to their regulatory driven shrinking balance sheets along with the reduction of their prop trading activities.

- IPC liquidity, in particular as provided by active Family Offices and Ultra High Net Worth Individuals are increasingly filling the traditional institutional commodity finance and investment 'vacuum‘ due to the de-risking of bank balance sheets.

- Increasing trend for Family Offices and Ultra High Net Worth Individuals to provide finance together with other 'like minded' long term IPC commodity investors.

- Banks and private equity firms and other similar financial intermediaries being increasingly excluded from so called IPC commodity ‘Club’ investment/financing deals.

- Back to the late 19th Century (1890’s) with international private capital pools again financing trade/ investment globally.

- Transparency for co-investors and financial counterparties is increasingly desired, along with on-shore tax efficiency.

- Luxembourg and the UK are key to the ‘choice of jurisdiction’ global matrix commodity finance solution, in particular in relation to covering reputational, tax and regulatory considerations.

QUESTIONS?

FURTHER INFORMATION

For more information on our services regarding the above please contact:

Partner name	**Ashley King-Christopher - Partner**
Telephone number	DD: 020 7427 6630
Email	ashley.king-christopher@speechlys.com