

Kancelaria Nowakowski i Wspólnicy

**Weather derivatives.
Selected aspects of Polish legal approach.**

Adam Krause

Berlin, November 6th, 2008



- Weather derivatives – Polish legal approach
 - derivative vs. insurance contracts
 - way of trading in derivatives
 - tax and accounting aspects



- Derivatives – Polish definition
 - no uniform definition in Polish regulations
 - CIT – underlying assets enumerated – weather not included
 - Act on trading in financial instruments dated September 23rd, 2005 (as result of implementation of MiFID) – more general definition of financial instruments allowing to assess the definition of derivatives

Derivatives / insurance contracts - similarities

- costs are made in advance (e.g. option premium/ insurance premium)
- relevant meteo data are needed
- insurance events
- valuation method – market value
- Taxes – CIT (+), VAT (-)

Derivatives/insurance contracts - differences

Derivatives	Insurance contracts
innominate contract – qualified as financial instrument	nominate contract – civil code, CIT, etc.
any party is capable to trade in derivatives	one party of insurance contract must be qualified

Commodity exchange in Poland

- WGT exchange in Warsaw
- in Poland weather derivatives could be traded at the commodity exchange provided that weather = commodity
- commodity exchange in Poland is defective:
 - the regulation of market of goods is too deep;
 - the underlying instruments are the certificates of origin issued by the URE (renewable energy sources, RES);
 - the profession of a stockbroker is regulated – statutory requirements (state examination);

Revenue

In the event of conducting business activity it is **any amount due** even if not yet received;

Example:

- amount due as a result of sale of a derivative
- amount due when exercising a derivative



Date of emergence of taxable revenue

The rule – the date is determined by:

- a moment, when the rights under derivatives are exercised (e.g. date of maturity of the settlement), or
- a moment, when the exercise of rights under derivatives is waived (statement on giving up the realisation of a right), or
- a moment of disposal of rights under derivatives (sale, exchange, etc.)

Deductible costs are

any expenses related to the revenue on the derivatives, in particular those incurred with purpose to purchase derivatives

- Expenses in connection with purchase of derivatives can be assessed:
 - at the moment the rights under derivatives are exercised, or
 - at the moment the exercise of rights under derivatives is waived, or
 - at the moment of disposal of rights under derivatives against payment

When are the costs incurred deductible?

It depends on the kind of costs

There are 2 categories of costs:

- direct costs (e.g. purchase price, exchange and administrative fees)
- indirect costs



The income is taxed at the rate of

19%



Derivatives and VAT

- classification of business activity on the basis of Polish Classification of Activities
- classification of goods and services performed on the basis of Polish Classification of Goods and Services
- services related to derivatives are classified as financial agency services and are EXEMPT FROM VAT – there is no rate indicated on the invoice
- above mentioned exemption does not concern: storage services of securities (or derivatives), financial consultancy or management of securities (or derivatives)

Following transactions are not subject to taxation with PCC (civil law transactions):

- any contracts relating to trading (sale) in property rights (including all kinds of derivatives) ONLY, if at least one party in respect to performance of such an act (related to derivatives) is taxed VAT, or is exempt from it

IAS 39 – financial instruments – recognition and measurement

- the recognition of expenses depends on the purpose of the conclusion of the futures contract (hedging, speculation, mixed);
- if the reason is hedging:
 - „the security instrument”;
 - IAS rules + securities based on derivatives = the accounting of the securities;
 - highly effective security – efficiency 80%;
 - no option net;



- Derivatives shall be deemed to reduce the risks associated with the assets or liabilities, if at least:
 - before the conclusion of a contract **the objective of the transaction** was established and the assets or liabilities (which shall be secured) were indicated
 - a financial instrument chosen to hedge and assets or liabilities secured by its means have **similar characteristics**, in particular the par value, the maturity date, the impact of changes in interest rate or exchange rate
 - **degree of confidence in expectations** about the anticipated cash flows as a result of this contract **is significant**

- Weather derivatives can be traded in at Polish market
- There are some foreign examples to follow
- There is a European regulation to be implemented



Thank you very much for your attention!



Adam Krause
Partner, Legal adviser



Kancelaria Nowakowski i Wspólnicy

Aleja Armii Ludowej 26

00-609 Warszawa

Tel. +48-22-5793450

Fax +48-22-5793459

a.krause@knw.pl

www.knw.pl



www.eurojuris.net



www.eurojuris.pl