Financial Services

SIEMENS

Authors	Current Version	December 2022
Vitalii Kozlov, SFS RC RCA FPI RAA		
Yelena Krasnozhen, SFS RC RCA FPI RAA		

Type of regulation
☒ Policy
☐ Guideline
☐ Manual

Regulation Publisher:
Siemens Financial Services

Regulation relevant for
☐ SFS ALL
☐ SFS PS EA
☒ SFS PS AM
☒ SFS COF

SFS Pricing Policy for Latin America (LATAM)

1. Table of Contents

2. Purpose and scope 3
3. Inputs as Inherited from SFS Pricing Guideline and Credit Risk Policy 4
3.1. Asset Recovery 4
3.2. Borrower Credit Risk Parameters 4
3.3. Guarantor Credit Risk Parameters 4
3.4. OPEX 4
3.5. Required Return on Risk Adjusted Capital (RORAC) 5
3.6. Pricing Set 5
4. Inputs and Methodology Specific to LATAM 6
4.1. Country Risk Adder and Political Risk Insurance 6
4.1.1. Country Risk Adder 6
4.1.2. Political Risk Insurance 6
4.2. Withholding Tax (WHT) 6
4.2.1. WHT Key Input Factors 7
4.2.2. Foreign Tax Credits 7
4.2.3. WHT Methodology 8
4.3. Funding for LATAM deals 10
5. Appendix 11
5.1. Example: Tax Cost Calculation 11

2. Purpose and scope

The purpose of this document is to provide guidance on how to accurately reflect the financial impacts and risks associated with a funding Latin American (LATAM) deal in an approved Pricing evaluation (Pricing).

While Pricing requirements are detailed in other SFS policies, specifically the SFS Pricing Guideline[1] and the Credit Policy for Service Company Financial Services (SFS)[2], where the requirements of this document are more specific, these will supersede other SFS policies. Where other SFS policies are more specific but not in conflict with the requirements of this document, such SFS policies will supersede this document.

This document is applicable to all Latin American (LATAM) deals; it details the pricing inputs, requirements, and methodologies as specific to Latin America.

Please note, for the purposes of this document:

“Deal” refers to a potential contract with a customer

“Pricing evaluation” or “Pricing” refers to the valuation of the profitability of a Deal as to be approved by the SFS Pricing team

“Transaction” refers to the internal funding activities associated with a Deal

---

[1] Link to SFS Pricing Guideline:

[2] Link to Credit Policy for Service Company Financial Services (SFS): https://soc.siemens.cloud/c/6ukllv

3. Inputs as Inherited from SFS Pricing Guideline and Credit Risk Policy

3.1. Asset Recovery

As specified in the SFS Pricing Guideline, all deals with asset recoveries must be assigned an asset recovery in alignment with the Credit Policy and the respective guidelines under Transaction Risk.

3.2. Borrower Credit Risk Parameters

Credit Risk of the Borrower must be factored in all Pricings as inputs, the following are standard as in other SFS Pricings and are in accordance with the SFS Pricing Guideline:

- Rating: All deals must be assigned a rating in compliance with the Credit Policy and the respective rating guidelines.
- Recovery Rate: All deals must be priced using the generic recovery rates as defined in the Credit Policy unless specific recovery rates have been approved for the transaction.
- G-factor: As with all SFS deals, market impact of the Borrower (denoted “Big” or “Small”) must be submitted as a pricing parameter[3]

3.3. Guarantor Credit Risk Parameters

- In the case that a deal is guaranteed for the Borrower, all above parameters must also be supplied for the Guarantor. In addition, percent of nominal covered by Guarantor (for partial Guarantees) must be entered as a pricing parameter:

3.4. OPEX

OPEX refers to operational expenses or administrative costs. Deals must be priced with budgeted OPEX spread of the BU.

[3] As directly taken from the SFS Pricing Guideline Appendix: “Big” is for Obligors with annual revenues > EUR 50 Mio. captured in CBASE and STAR with Rating Method LRM or external rating. Where a rating in CBASE is not available, the transaction risk manager is responsible to determine “Big”/ “Small”

3.5. Required Return on Risk Adjusted Capital (RORAC)

As specified in the SFS Pricing Guideline, required return on risk adjusted capital (RORAC) is defined in the “Country-specific costs of capital” published annually by SFS AC.

These are subject to change annually and must be reviewed in the Pricings. The RORAC must be that of the funding entity (i.e.: SOFOM or SFS, Inc.)

3.6. Pricing Set

The Pricing set reflects the funding conditions for the Entity (including the Country Risk Adder). For Latin American deals funding out of the SOFOM, the Pricing set input parameter in BTS (aka Business Unit input parameter in SuperTrump) is “MMF Latin America”.

To elaborate on the differences between Pricing Sets:

1. Pricing set “PS Americas”: prices deal with funding/refinancing spread consisting of corporate spread and basis/CCY swap
2. Pricing set “MMF Latin America”: prices deal with funding/refinancing spread consisting of corporate spread, basis/CCY swap, and country risk adder for Mexico

4. Inputs and Methodology Specific to LATAM

4.1. Country Risk Adder and Political Risk Insurance

Both Country Risk Adder and Political Risk Insurance (PRI) deal with the political risks associated with doing business in foreign countries. Pricing incorporates these into the profitability metrics to accurately reflect the financial impact of the deal.

4.1.1. Country Risk Adder

Country Risk Adder for a particular entity reflects the additional premium in the cost of funds for doing business in a country. It is an additional expense because of political risks. Pricing out of the SOFOM using the Country Risk Adder, one would use the Pricing set "MMF Latin America". Pricing out of SFS, inc. using the Country Risk Adder is the same as pricing any other SFS, inc. deal; one would use the Pricing set "PS Americas".

4.1.2. Political Risk Insurance

There is also the option to price deals with Political Risk Insurance (PRI). PRI is handled by a third party (PwC) and the cost of this may be added to a Pricing for a particular deal. There are tenor and size eligibility requirements which must be met for a deal to be eligible for PRI, these are managed by the SFS Pricing team in alignment with Central Treasury.

Political Risk Insurance must be requested from the SFS Funding Team (fundingam.sfs@internal.siemens.com) prior to booking transaction

4.2. Withholding Tax (WHT)

SFS may be involved in deals affected by cross-border withholding tax treatments, i.e.: any deals in Latin America where the Borrower and Lender, an SFS Entity, are cross-border. For example, this could be between the SOFOM entity and any non-Mexican Borrower (i.e.: Colombian), between SFS, Inc. entity and a Mexican Borrower, etc.

In the context of this Policy, a withholding tax is a tax paid to a Local Tax Authority by the borrower on behalf of the foreign lender. Even if the withholding tax amount is not paid to the lender, the lender (SFS or the SOFOM) must recognize the withholding tax amount as taxable income.

To eliminate the financial impact of paying income tax on income that has not been received, the lender must file for a "foreign tax credit" with its local Governing Tax Authority (for example, the U.S.). No credit can be applied for unless Siemens receives sufficient evidence in the form of a receipt from the local government to which the withholding tax has been paid. Additionally, under certain circumstances, Siemens USA may not be able to utilize the credit, for instance if Siemens USA is in a BEAT tax position (see further below). Thus, there is a risk that tax credit relief may not be obtained for the withholding tax amount.

The pricing must reflect this risk that the Siemens Entity will NOT claim the tax credit.

This section in the Policy explains how the full deduction of taxes withheld from income and the risk of failing to claim the tax credit should be adequately reflected as **post tax** events in the pricing evaluation of the deals.

4.2.1. WHT Key Input Factors

- Customer Rate/Margin: the applicable interest rate on the outstanding principal balance that will generate the taxable income. The customer rate/margin is exclusive of the gross-up clause. The Business is responsible for the accuracy of the customer rate/margin applied in the pricing runs submitted for approval.

- Gross Up Rate: the rate in addition to the Customer Rate/Margin applied to the outstanding principal balance up to which the borrower will gross up the payments to the Entity. The gross up rate will generate additional taxable income. On instances where the loan documentation includes a clause stating that the borrower will provide a gross-up for the taxes required to be withheld, the Business is responsible for confirming the existence of such a clause as well as the gross-up rate.

- Corporate Income Tax Rate: the tax rate that the lender is subject to by its Governing Tax Authorities (e.g., IRS in US). As of 2022, the current standard Siemens Corporate Tax Rate of 30% is applied to the regular cashflows is taken as reference for the calculations. Note: this rate may vary based upon the inclusion of the Base Erosion and Anti-Abuse Tax (BEAT) in the US in certain fiscal years. The tax rate can range from 25% to 32.5%.

- Withholding Tax Rate: the tax rate at which payments to the lender are subjected to by the Local Tax Authority. The Business is responsible for confirming the withholding tax rate based on the region/country/nature of the transaction. WHT rates may vary for a variety of reasons, including the specific purpose of the lending, so it is imperative that the withholding rate be validated, often by confirmation by the borrower’s tax counsel.

4.2.2. Foreign Tax Credits

There are certain requirements to successfully claim the withholding tax amount as tax credit from the Governing Tax Authority. They are:

- Borrower will need to produce the documentation as evidence WHT payments have occurred each time a withholding tax is paid.

- IRS agrees that such documentation is acceptable

- The Entity is not in a tax position that prevents claiming the credit, such as Siemens being in a BEAT position (Base Erosion and Anti-Abuse Tax) in the US. Note that being in BEAT can vary every year and is subject to the specific tax circumstances of Siemens US each year. If the entity is in BEAT, it is NOT possible to receive a Foreign Tax Credit

It is important to note that for Siemens Corp Tax to obtain the tax benefit of the WHT gross-up via the Foreign Tax Credit ("FTC") and therefore being able to recapture the tax on the "additional income", the borrower must make the WHT payment and Siemens must receive a copy of the receipt for such payment. Otherwise, a tax obligation may arise in the respective tax jurisdiction and the foreign tax credit will be rejected.

Because, in practice, meeting these requirements to receive FTC is unlikely, the Pricing will NOT factor in the recovery of FTC.

4.2.3. WHT Methodology

1. Determine the <u>Gross</u> Total Taxable Income as the income generated by the deal's original customer rate/margin, adjusted by the gross-up rate stated in the applicable gross-up clause. Note: any fee, together with other applicable income, will also be subject to such adjustment. Note that withholding and the gross up increases the Gross Total Taxable Income and is calculated only on the <u>gross income</u> and not the net income (after deducting interest expense).

$$Total\ Taxable\ Income = Interest\ Income^{*} + \ Fees^{**}$$

- *Interest Income is based on the Customer Rate

- **Fees include Amortizing, Non-Amortizing and Commitment Fees

$$Gross\ Total\ Taxable\ Income = \frac{Total\ Taxable\ Income}{1 - Gross\ Up\ Rate}$$

2. Determine the total amount of taxes withheld.

$$Withholding\ Tax = \ -Gross\ Total\ Taxable\ Income * WHT\ Rate$$

3. Determine the Corporate Taxes on Withholding

$$Corporate\ Taxes\ on\ Withholding\ = \ Witholding\ Tax\ *\ Corporate\ Tax\ Rate$$

4. Determine the post-tax CF adjustment that will be sent to PrApp as cashflow type “TX”

This pertains SOLELY to the tax effect of the withholding. Essentially this is the corporate Taxes on the Withholding.

$$Post\ Tax\ Flow\ Adjustment\ = -Corporate\ Taxes\ on\ Withholding$$

See Appendix for Example.

4.3. Funding for LATAM deals

Funding availability is the same as for standard deals. Please see the list of fundable currencies as made available and maintained by Treasury (TRE)[4].

For non-fundable currencies, there are additional processes and costs to hedge risks arising from the difference in transaction and funding currencies. Hedging can be done using non-deliverable forwards (NDF) or Cross-Currency Swaps (CCS). Due to capital market constraints funding with NDF or CCS is permitted for transactions with tenors up to 2 years (as of December 2022). Please note this limit on tenor is subject to review and revision and depends on the capital markets conditions as clarified by TRE.

Pricing these deals requires contacting SFS Funding Team (fundingam.sfs@internal.siemens.com) for an indicative rate that includes hedging cost (NDF or CCS).

[4] Link to Fundable Currency policy as of April 2022: https://siemens.sharepoint.com/teams/10002412/Archiv/Fundable%20Currencies%2004.22.pdf

5. Appendix

5.1. Example: Tax Cost Calculation

Deal Amount	$ 500,000.00
Customer Rate	2.0000%
Gross Up Rate	10.0000%
WHT	10.0000%
Fees (Example: Doc)	0.1000%
Corporate Tax Rate	30.0000%
Start Date	12/20/2022

Date	Redemption	Outstanding	Interest Income	Fees	Gross Taxable Income	WHT	Corporate Taxes on Withholding	After-Tax Cost of Withholding
12/20/2022		$500,000.00		$500.00	$555.56	$55.56	$16.67	-$16.67
1/20/2023	$100,000.00	$400,000.00	$849.32		$943.68	$94.37	$28.31	-$28.31
2/20/2023	$100,000.00	$300,000.00	$679.45		$754.95	$75.49	$22.65	-$22.65
3/20/2023	$100,000.00	$200,000.00	$460.27		$511.42	$51.14	$15.34	-$15.34
4/20/2023	$100,000.00	$100,000.00	$339.73		$377.47	$37.75	$11.32	-$11.32
5/20/2023	$100,000.00	$0.00	$164.38		$182.65	$18.26	$5.48	-$5.48

Post Tax Adjustment Cashflow on 12/20/2022:
Gross Taxable Income = (" Interest Income" + "Fees") / (1 - "Gross Up Rate"):
500 / (1 - 10%) = 555.56
Withholding = "Gross Taxable Income" * "WHT Rate":
555.56 * 10% = 55.56
Corporate Taxes on Withholding = WHT * "Corporate Tax Rate":
55.56 * 30% = 16.67

After-Tax Cost of Withholding: -16.67