

At A Glance

Transfer Pricing for Investment Managers in a Complex Global Environment

Overview

Significant changes in market and regulatory conditions have placed investment returns, management charges, and the fund management industry itself under the microscope. Tax authorities across the world are likely to follow this trend and increase the already considerable level of scrutiny they apply to the industry's cross-border operations, including transfer pricing as a key item for review. While the most common transfer pricing issues encountered relate to the remuneration of core functions (such as fund management, investment research, commercial operations, and ancillary services), tax authorities have also examined compensation associated with the relocation of key activities.

Further developments in the industry will compound these trends. Among these are recent changes to the regulatory frameworks following the financial crisis in the US and Europe. The purpose of these changes is to improve investor protection through the enhancement of transparency and efficiency of the industry. In addition, as highlighted by some regulatory bodies, further enhancing competition is another factor to be considered when revising regulatory frameworks. Greater transparency within the industry will allow more detailed analysis of what constitutes arm's length pricing between related parties. However, increased cross-border competition will likely heighten tax authorities' concerns about both the compensation paid to key functions and intangible assets and the possible relocation of these functions and assets.

NERA's Capabilities

With specialist expertise and knowledge in transfer pricing for financial services companies, NERA is uniquely positioned to assist tax payers and authorities alike in transfer pricing, delivering value in this area. Our approach consists of:

- An in-depth understanding of the asset management industry and its transfer pricing challenges;
- The ability to determine how the value creation process impacts the remuneration that should be paid to different functions within the value chain;
- Strong expertise in financial economics and related advanced analytical techniques; and
- Access to a number of information sources that support robust analyses.

NERA's relevant expertise includes:

- Establishing an arm's length basis for transactions taking into account any provision of ancillary services and the contribution of intangibles to the value creation process;
- Providing economic and financial analyses of the net compensation paid to key functions within the value chain, as part of a series of cross-border transactions;
- Analyzing and providing economic advice on the overall cross border intra-group pricing system adopted;
- Designing transfer pricing policies in line with the dynamics of the business, the roles and responsibilities of the entities and teams, their functions, assets and



risks, and ultimately, their contribution to value creation;

- Performing the necessary equity and asset related valuations and pricing in cases of organizational restructuring;
- Assisting multinational enterprises to communicate their transfer pricing policies. This can include both the preparation of contemporaneous transfer pricing documentation for communication to tax authorities and the preparation of documents for a wider audience inside and outside of the group; and
- Providing experts specializing in financial economics and transfer pricing that can provide support whether during negotiations with tax authorities or in the context of disputes.

Client Experience

Portfolio Management Fee Pricing of a Global Asset Manager

NERA was retained by a global investment fund management group to establish the arm's length remuneration payable to a UK entity for providing investment management services. The first stage of the analysis was to derive an arm's length range of investment management fees for the UK entity ignoring any performance fees received by the group. NERA then combined market data from various sources and, using an econometric model, determined the proportion of the performance fee received by the group that should be allocated to the UK entity. Regression analyses were used to adjust for the scale of assets under management, and to accommodate for differences in fund objectives and geographical scope.

Equity Valuation of a Global Hedge Fund

A global hedge fund manager retained NERA to determine the fair market value of 100 percent of the company's equity as part of the overall value for a pari passu participation of new shareholders. NERA developed a simulation model that included basic assumptions about fund performance and volatility, the rate at which investors withdrew assets from a fund, management and performance fees, the risk-free interest rate, and the threshold at which the investment management company would liquidate the fund if the assets were to fall below a given level of the fund's high-water mark.

Investment Research and Management Services Pricing of a Bank

For the asset management arm of a leading European bank, NERA was retained to determine the remuneration of a Luxembourg-based fund manager with research and investment management subsidiaries in the UK and Switzerland. A comprehensive value chain analysis was first conducted, which highlighted the importance of intangible assets to the client's business. The approach relied on the use of market data in order to determine the remuneration of both the investment advisory and fund management activities. The remuneration was expressed as a function of the assets under management.

Private Bank Transfer Pricing Policy Assessment

NERA was retained by a leading private banking group to assess its transfer pricing policy applied to its three core business areas: discretionary accounts, insurance business, and investment management. This evaluation was performed for the purpose of redefining their transfer pricing policy and preparing a master file document. As part of this study NERA considered the full value chain including functions such as: Product Design, Distribution and Promotion, Portfolio Management, Research, Trade Execution, and Middle Office and Back Office Services. In addition, a careful analysis was performed on the group's intangibles, including the identification of the entities and functions that contributed to the development and maintenance of the intangibles.

About NERA

NERA Economic Consulting (www.nera.com) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

Contact

For more information or to contact our experts, please visit www.nera.com/tp-forinvestments.