



THOMAS HUG

TRANSFER PRICING IN PRIVATE BANKING BUSINESS

UNIVERSITY OF LAUSANNE, 2 JULY 2021

WWW.THOMASHUG.COM

Julius Bär

EXECUTIVE PROGRAM IN TRANSFER PRICING: PRIVATE BANKING BUSINESS

Thomas Hug / Julius Baer Group
July 2021



ABOUT MYSELF



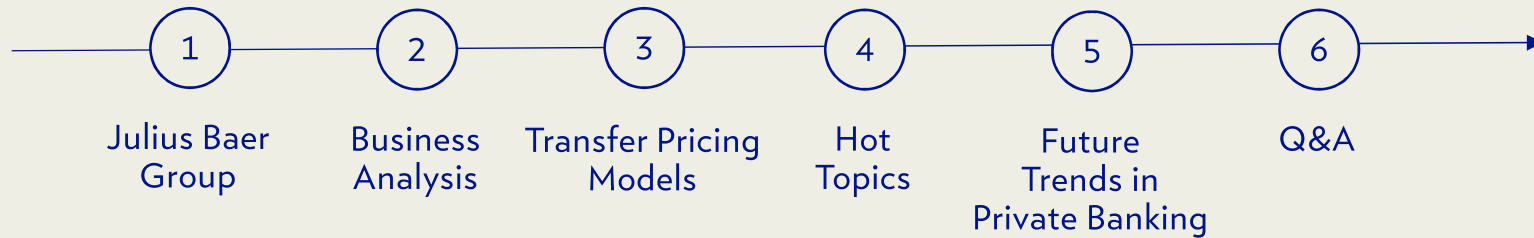
Thomas Hug

Certified Swiss Tax Expert, Certified Business Lawyer

- 2007 – 2014 Senior Manager, PwC Switzerland
- 2014 – today Deputy Head Group Tax, Julius Baer Group
- 2014 – today Examiner Swiss Tax Expert Exams
- 2019 – today Swiss Banking Association, technical working groups on PE and BEPS 2.0

Author of various technical papers on transfer pricing and co-author the first comprehensive book on Swiss transfer pricing law (to be published in Q1/2022)

A GUIDE TO ORIENTATION



1

JULIUS BAER GROUP

*“IF CONTACT BETWEEN PEOPLE
IS BASED ON TRUST AND ABSOLUTE INTEGRITY,
THEN IT IS OF BENEFIT FOR BOTH SIDES”*

JULIUS BAER (1844 – 1906)



JULIUS BAER GROUP

“The international reference in wealth management”

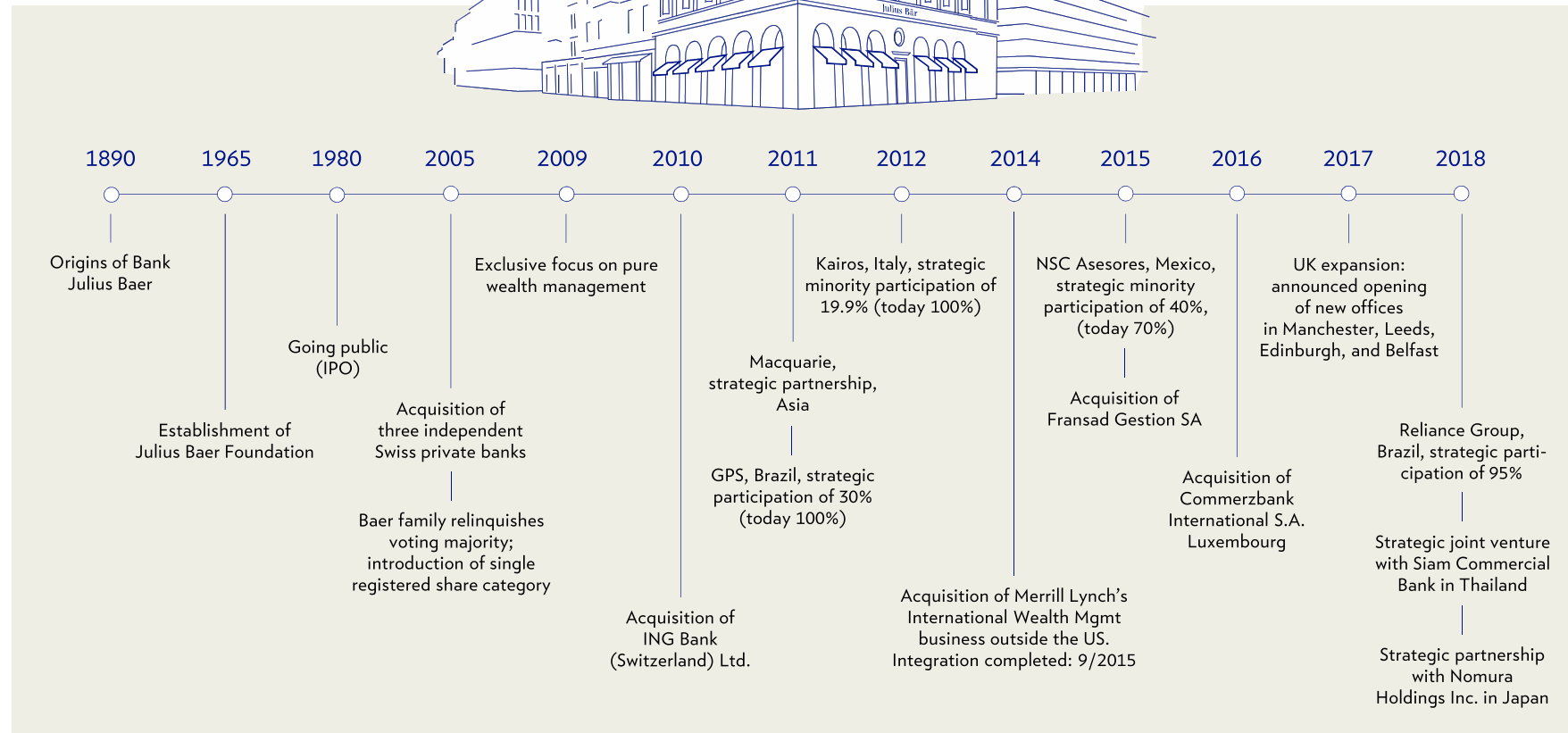


- Julius Baer Group is the leading Swiss wealth management group, focusing on providing personal advice to private clients around the world
- Founded in 1890 as a family business, meanwhile listed company with a market capitalization of CHF 13bn
- Exclusive focus on wealth management
- Present in over 20 countries with more than 50 locations
- Key performance indicators (31/12/2020)
 - Assets under management (AuM): 433.7bn
 - Employees (FTE): 6'606
 - Relationship managers (FTE): 1,376

OUR HISTORY

From a Swiss family company...

...to the international reference in wealth management



JULIUS BAER AROUND THE WORLD

We are where you are

EUROPE



SWITZERLAND



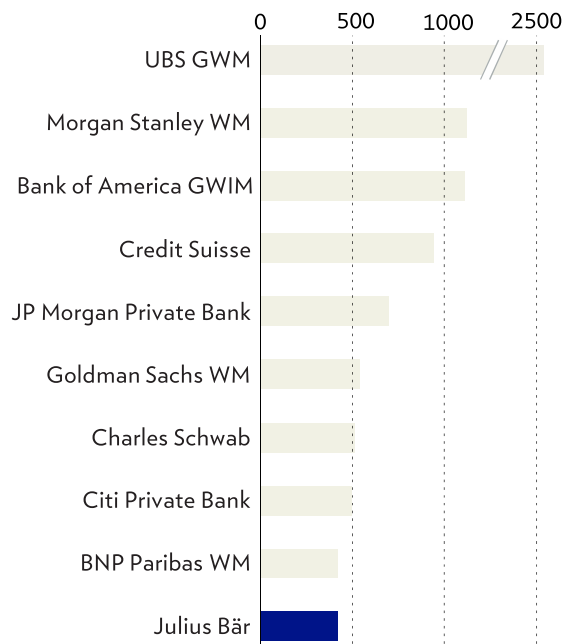
- Head Office
 - Location
 - Booking centre
 - Julius Baer Family Office Brasil (integrated operations of GPS and Reliance Group), a fully owned subsidiary
 - NSC Asesores, majority participation of 70% Julius Baer is present in Mexico City with a representative office
 - Strategic partnerships: in Bangkok, Thailand, with The Siam Commercial Bank, and in Tokyo, Japan, with Nomura Holdings Inc.
 - Kairos Partners SGR S.p.A., a fully consolidated subsidiary Julius Baer is present in Milan with Julius Baer Fiduciaria S.p.A.
- * Additional advisory locations in Bangalore, Chennai, Hyderabad, Kolkata, and New Delhi

OUR WEALTH MANAGEMENT EXPERTISE

Key financial and performance information

INTERNATIONAL REFERENCE IN WEALTH MANAGEMENT

Top 10 global wealth managers by Assets under Management (AuM) in USD billion (bn)



Source: ADV Ratings, June 2020

SOLID BUSINESS MODEL, STRONG FINANCIALS

Moody's rating	As of year end 2020
Julius Baer	Aa3
UBS AG	Aa2
BNP Paribas S.A.	Aa3
Credit Suisse	Aa3
Barclays Bank PLC	A1
HSBC Holdings plc	A2
Bank of America	A2
JPMorgan Chase	A2
Goldman Sachs	A2
Deutsche Bank	A3
Citigroup	A3
Julius Baer loan-to-deposit ratio	61%

Moody's long-term deposit rating: Bank Julius Baer & Co. Ltd., BNP Paribas Group, UBS AG, Barclays Bank PLC, Credit Suisse AG, Deutsche Bank AG; Moody's Senior Unsecured Debt ratings: HSBC Holdings plc, Bank of America Corporation, Goldman Sachs Group, JPMorgan Chase & Co., Citigroup Inc.

KEY FIGURES OF THE JULIUS BAER GROUP

	As of year end 2020
AuM (CHF bn)	433.7
Total assets (CHF bn)	109.1
BIS total capital ratio	21.0%
BIS CET1 capital ratio	14.9%
Number of employees (FTE)	6 606
of whom abroad	3 170
Number of relationship managers	1 376
Significant Shareholders	As of year end 2020
MFS Investment Management	9.98%
Wellington Management Group LLP	5.00%
BlackRock Inc.	4.80%
T. Rowe Price Associates Inc.	3.18%
Government of Singapore	3.09%
UBS Fund Management	3.09%

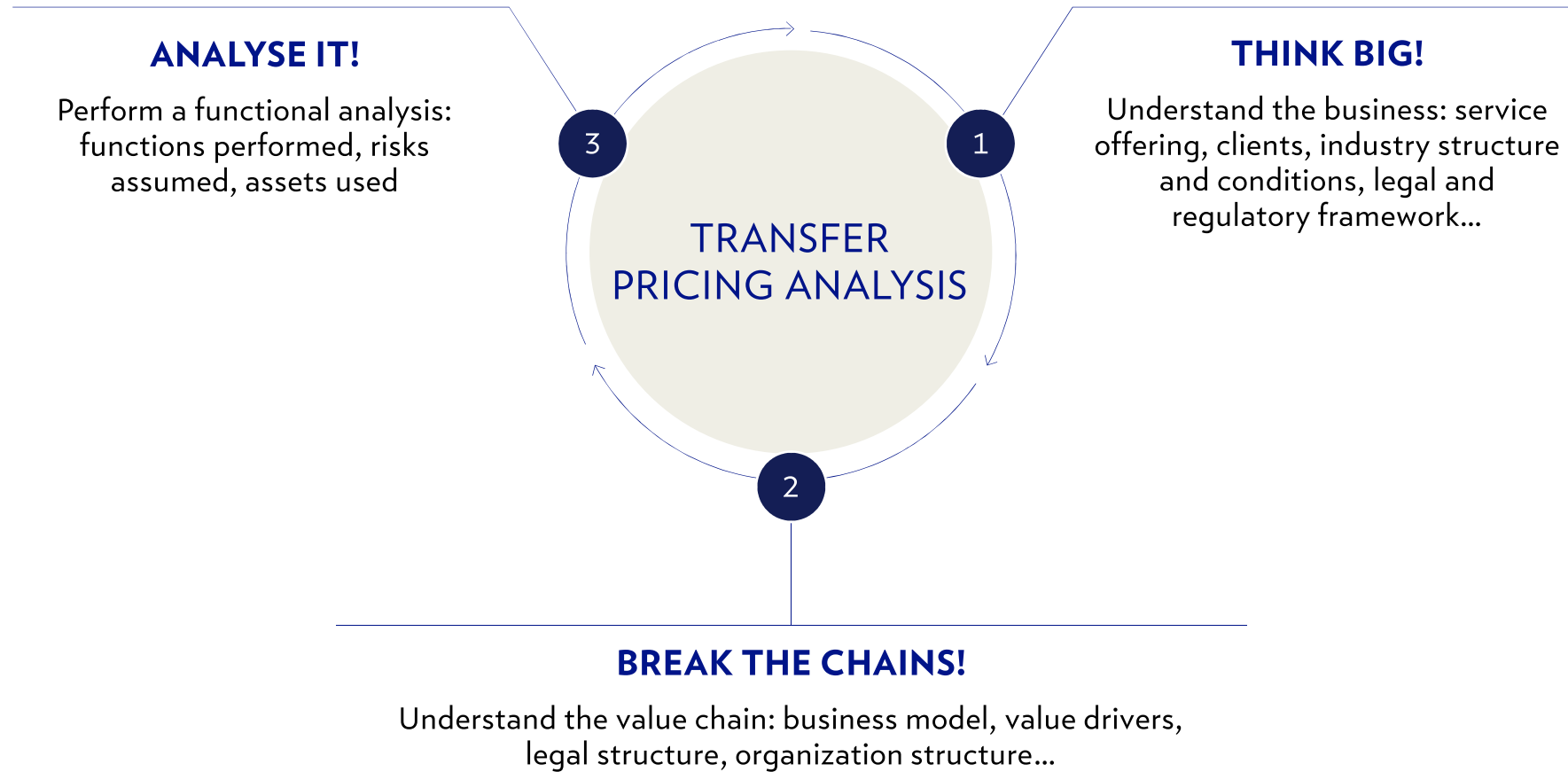
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BUSINESS ANALYSIS

“IN PARTICULAR, IT IS IMPORTANT TO UNDERSTAND HOW VALUE IS GENERATED BY THE GROUP AS A WHOLE, THE INTERDEPENDENCIES OF THE FUNCTIONS PERFORMED BY THE ASSOCIATED ENTERPRISES WITH THE REST OF THE GROUP, AND THE CONTRIBUTION THAT THE ASSOCIATED ENTERPRISES MAKE TO THAT VALUE CREATION”

OECD TP GUIDELINES

OVERVIEW



#1 – THINK BIG!



PRIVATE BANKING BUSINESS

- Private banking (or wealth management) is a sub-sector of the banking industry;
- Other sub-sectors: retail banking, commercial banking, investment banking, asset management

CLIENT SEGMENT

- High-net worth individuals (HNWI, >USD 1m), ultra high-net worth individuals (UHNWI, >USD 50m) and financial intermediaries («B2B»-clients such as independent asset managers, family offices), often with an international background (“global citizens”);
- Needs: quality relationship (high level of personal contact and discretion); robust, modern investment platform; comprehensive wealth management and preservation services

SERVICE OFFERING

- Investment related advice, discretionary asset management;
- “Traditional” banking services (e.g., deposits, custody, brokerage, payments, credit cards);
- Credit solutions (lombard loans, mortgages, special solutions);
- Financial planning, structured products etc.

#1 – THINK BIG!



LEGAL & REGULATORY FRAMEWORK

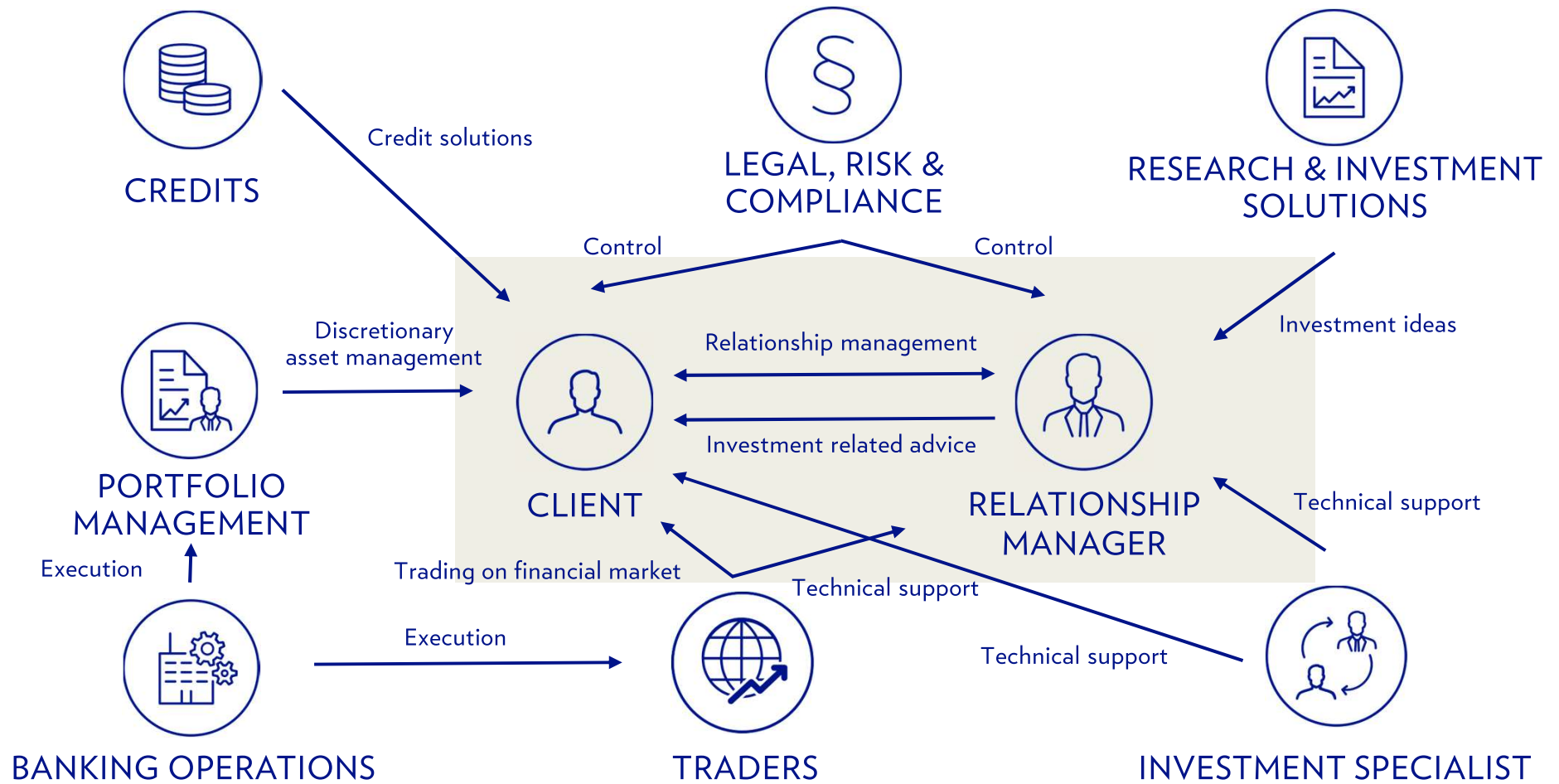
- Banking industry is one of the most strictly regulated industry in the world, with the aim of protecting bank clients and the security of the financial system;
- Increasing structural costs of doing business due to complex regulations, especially since the financial crises 2007/08

INDUSTRY STRUCTURE & CONDITIONS

- Strong focus on providing services in an international context with offshore and onshore banking;
- Revenues are strongly dependent on financial markets (transaction based fees, AuM based fees);
- Decentralized, co-entrepreneurial business model with a highly integrated value chain;
- Each client is assigned to a relationship manager («RM»);
- Highly competitive and fragmented industry with even the largest providers having a market share of only 5%

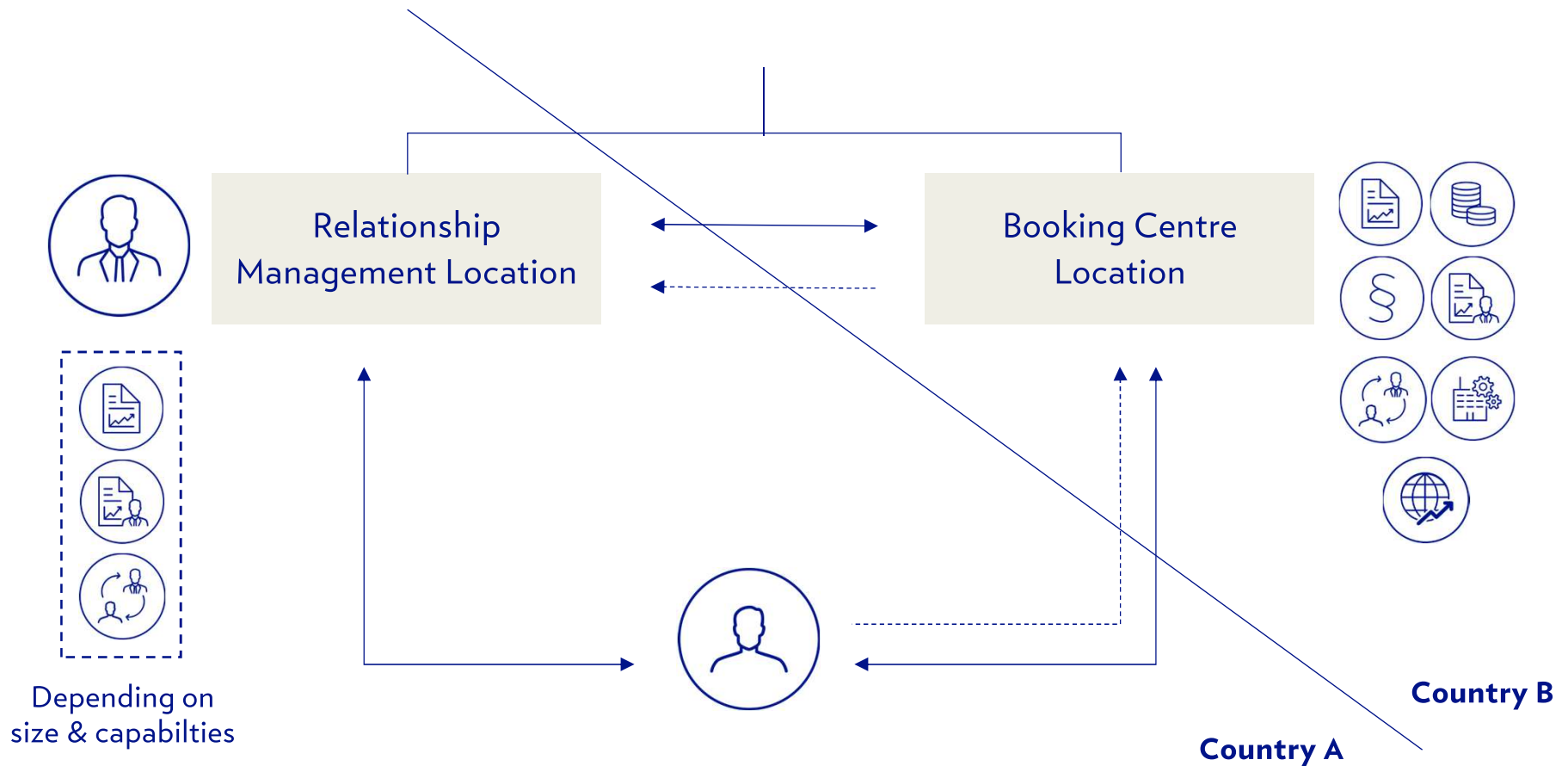
#2 – BREAK THE CHAINS

VALUE CHAIN IN AN OPERATIONAL CONTEXT



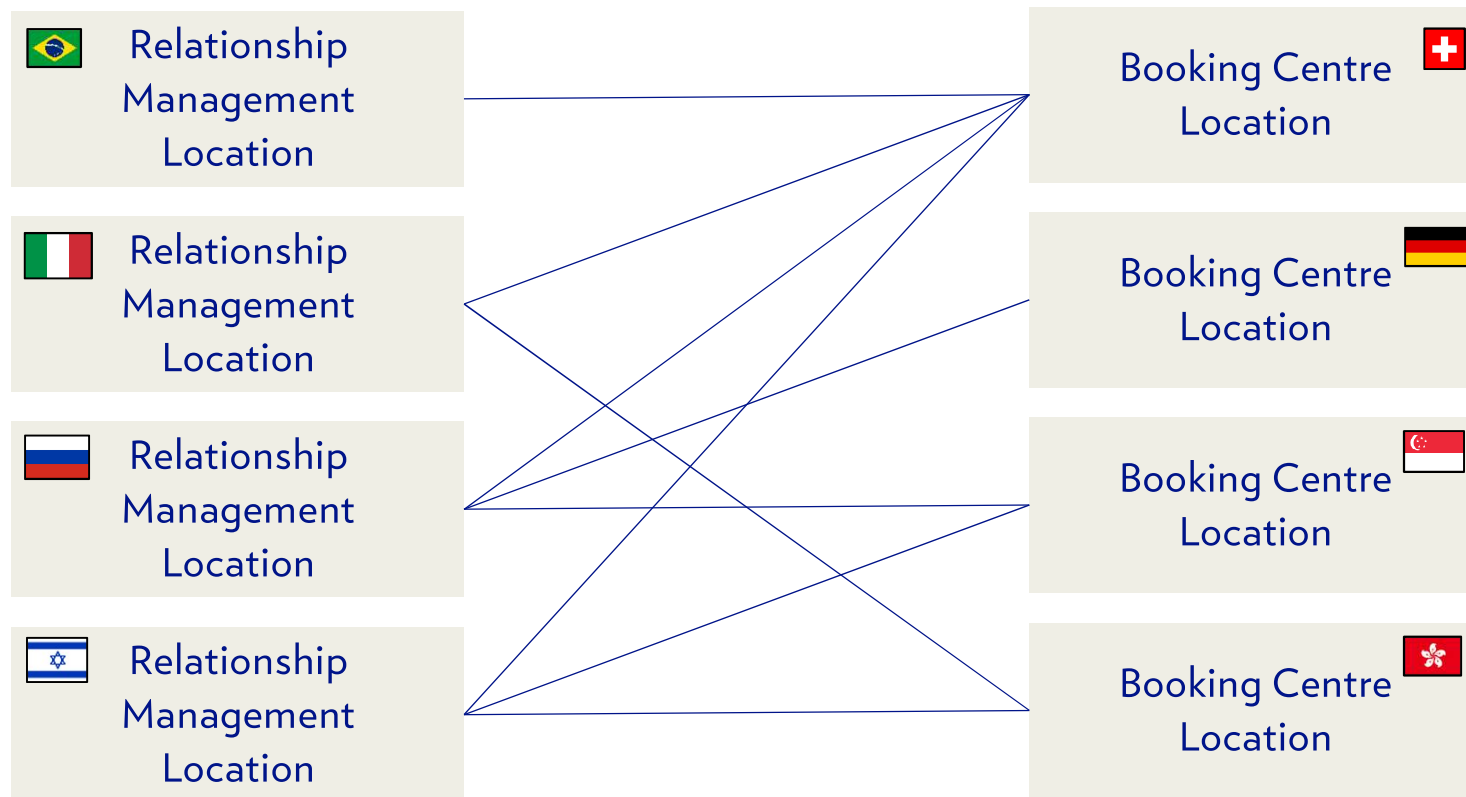
#2 – BREAK THE CHAINS

VALUE CHAIN IN A LEGAL CONTEXT («Dual-Entity-Approach»)



#2 – BREAK THE CHAINS

VALUE CHAIN IN A LEGAL CONTEXT («Dual-Entity-Approach»)



#2 – BREAK THE CHAINS

MAIN VALUE DRIVERS



RELATIONSHIP
MANAGER



INVESTMENT
EXPERTISE



REPUTATION

Julius Bär

BRAND

#3 – ANALYZE IT!

FUNCTIONAL ANALYSIS

	Relationship Mgt Location (advisory licence)	Booking Centre Location (banking licence)
Profile	<p>A radar chart with four axes: Functions (top), Value Drivers (right), Assets (bottom), and Risks (left). The chart features three concentric dashed circles and a red diamond shape. The red diamond is centered and its vertices touch the innermost dashed circle, indicating a balanced profile across all four dimensions.</p>	<p>A radar chart with four axes: Functions (top), Value Drivers (right), Assets (bottom), and Risks (left). The chart features three concentric dashed circles and a red diamond shape. The red diamond is centered and its vertices touch the innermost dashed circle, indicating a balanced profile across all four dimensions.</p>
Functions	<ul style="list-style-type: none"> - Introduction of new clients; - Client relationship; - Investment related advice 	<ul style="list-style-type: none"> - Investment and product expertise¹⁾; - Discretionary portfolio management¹⁾; - Custody, brokerage, deposits; - Credit solutions; - Banking operations
Risks	<ul style="list-style-type: none"> - Strategic risks; - Operational risks 	<ul style="list-style-type: none"> - Financial market and treasury risks; - Credit default risks; - Operational risks
Assets	<ul style="list-style-type: none"> - Client relationship; - Knowledge 	<ul style="list-style-type: none"> - Knowledge; - Client deposits; - Assets under management
Value Drivers	<ul style="list-style-type: none"> - Relationship Managers; - Investment expertise; - Reputation 	<ul style="list-style-type: none"> - Investment expertise; - Reputation

1) Depending on the size also performed by the Relationship Management Locations

SUMMARY

What is private banking all about?

- Decentralized, co-entrepreneurial business model with a highly integrated global value chain (“spider web”);
- Revenues are strongly dependent on financial markets (transaction based fees, AuM based fees);
- One of the most strictly regulated industry in the world with increasing structural costs of doing business due to complex regulations, especially since the financial crises 2007/08
- Value drivers: relationship managers, investment expertise, reputation, brand



3

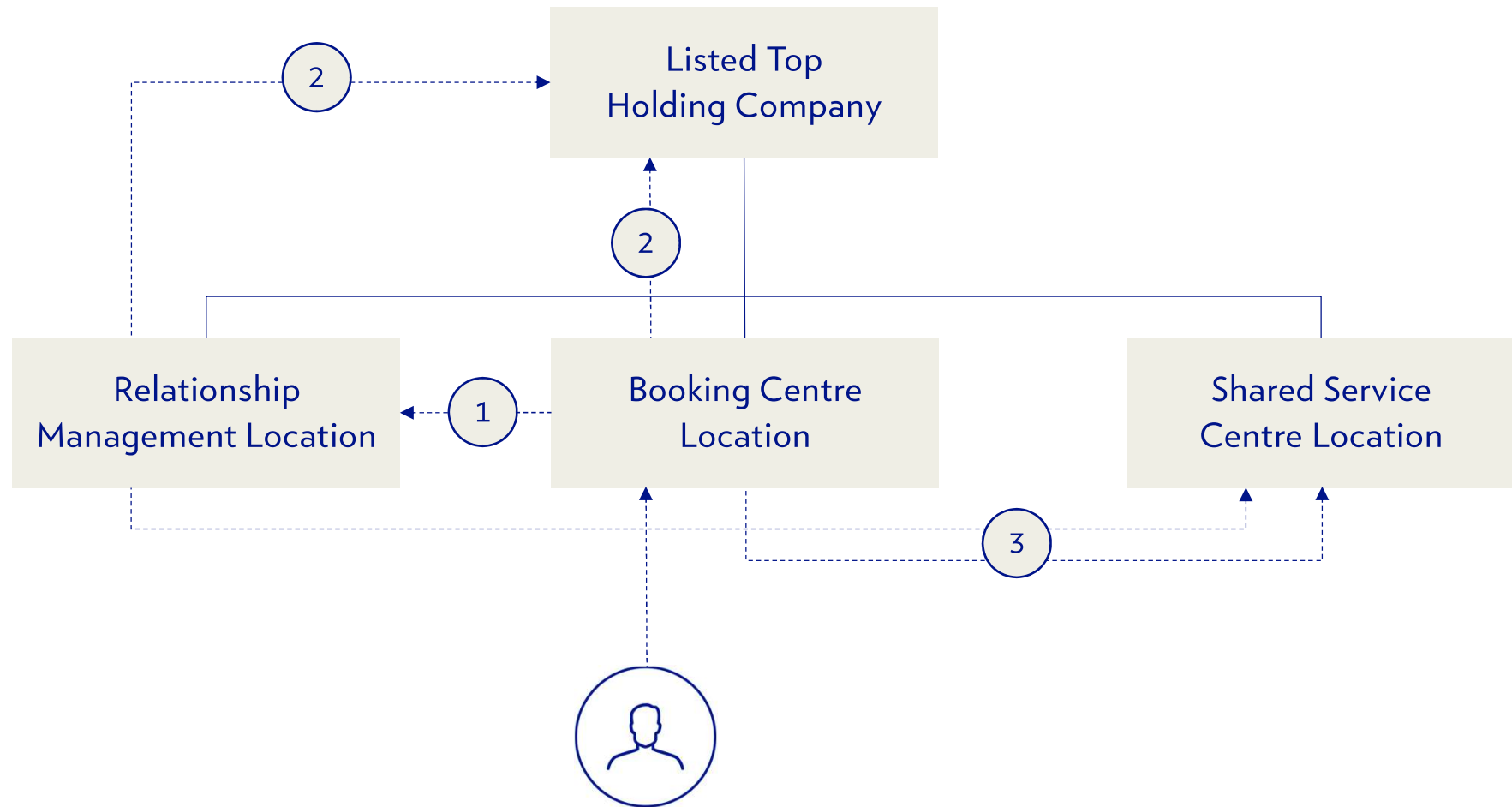
TRANSFER PRICING MODELS

*“TRANSFER PRICING IS NOT AN EXACT SCIENCE
BUT DOES REQUIRE THE EXERCISE OF
JUDGEMENT ON THE PART OF BOTH THE TAX
ADMINISTRATION AND TAXPAYER”*

OECD TP GUIDELINES

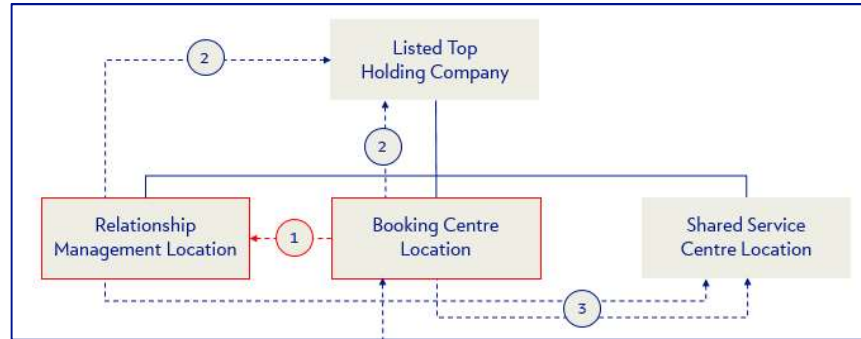
CORE MODELS

- ① Revenue Sharing Model
- ② Brand Royalty
- ③ Corporate Centre & IT Service Fee



REVENUE SHARING MODEL

“align transfer pricing with value creation”



OVERVIEW

- Gross revenue sharing model CURS (=cross unit revenue sharing);
- Basis: Total revenues (fees, commissions) collected by the Booking Centre Locations from clients under a specific cross unit relationship;
- Split: depending on capabilities of Relationship Management Location (four key functions identified in the value chain), between 60% and 90%

TRANSFER PRICING MODEL

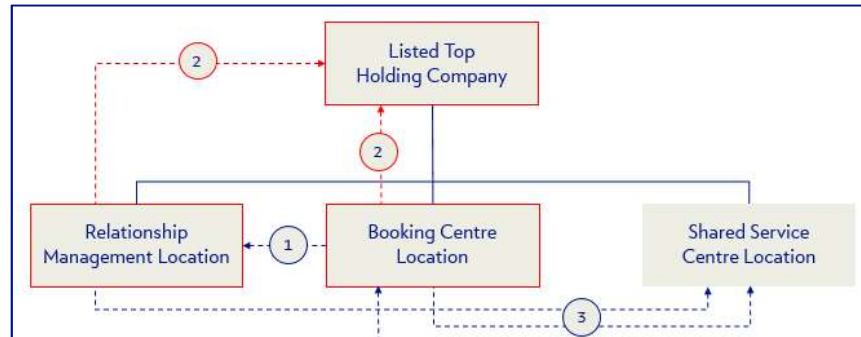
- Splits (Relationship Management Location perspective): basic capabilities (60%), discretionary portfolio management (8%), research & investment solutions (11%), investment specialists (11%);
- Reflecting co-entrepreneurial character of Relationship Management and Booking Centre Location, highly dependent on financial market conditions, requires certain size of business to be profitable (increasing structural costs of doing business)

BENCHMARKING

- OECD method: transactional profit split method;
- Basic capabilities: internal comparables (independent asset managers);
- Additional capabilities: external comparables, transformed into %-splits (Lipper database)

BRAND ROYALTY

“products are made in a factory but brands are created in the mind”



OVERVIEW

- Royalty for «Julius Baer»-brand legally and functionally owned by the listed top holding company;
- Percentage of total revenues (low single digits)

TRANSFER PRICING MODEL

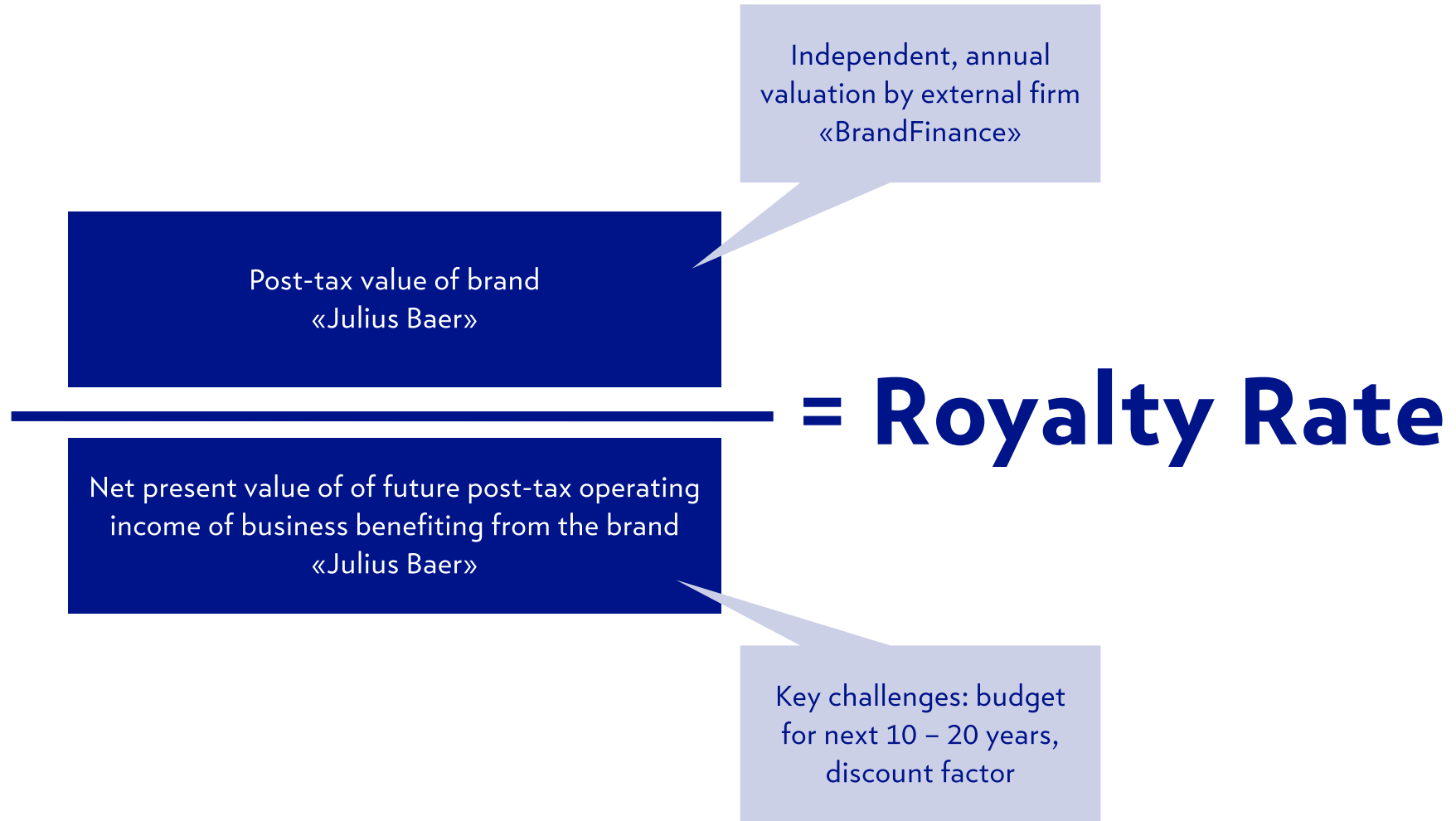
- Reflecting the brand as a key value driver in the private banking business;
- Listed top holding company identified as the legal (brand registration) and the functional owner (DEMPE-analysis) of the brand «Julius Baer»

BENCHMARKING

- OECD method: other method;
- Highly challenging to apply the CUP method as no robust comparable transactions are available in commonly used commercial databases (e.g. RoyaltyStat, RoyaltySource);
- Implied royalty rate analysis (see next page)

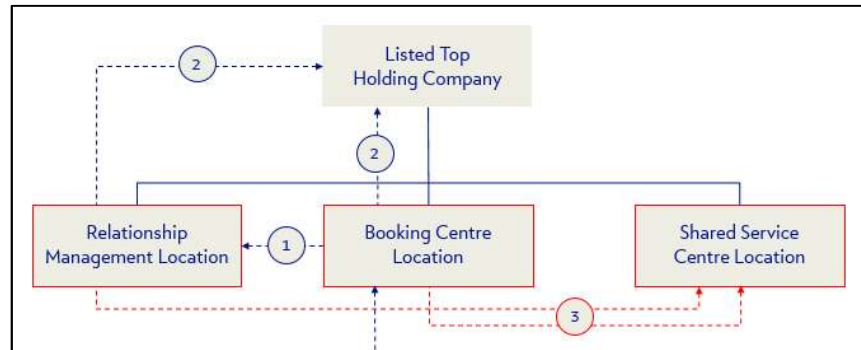
BRAND ROYALTY

Implied Royalty Rate Analysis



CORPORATE CENTRE & IT SERVICE FEE

“the glue that holds the corporate structure together”



OVERVIEW

- Service fee for corporate centre (HR, financial accounting etc.) and IT services provided by selected shared service centres;
- Full-costs with a mark-up of 5%; cost allocation mostly via indirect method (key based)

TRANSFER PRICING MODEL

- Reflecting the low value-adding character of the services provided

BENCHMARKING

- OECD method: transactional net margin method (TNMM);
- Although many countries apply the “low value-adding services”-approach, there are still some countries that require a benchmark study;
- External comparables in commercial database TPCatalyst (pan-European comparables)

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HOT TOPICS

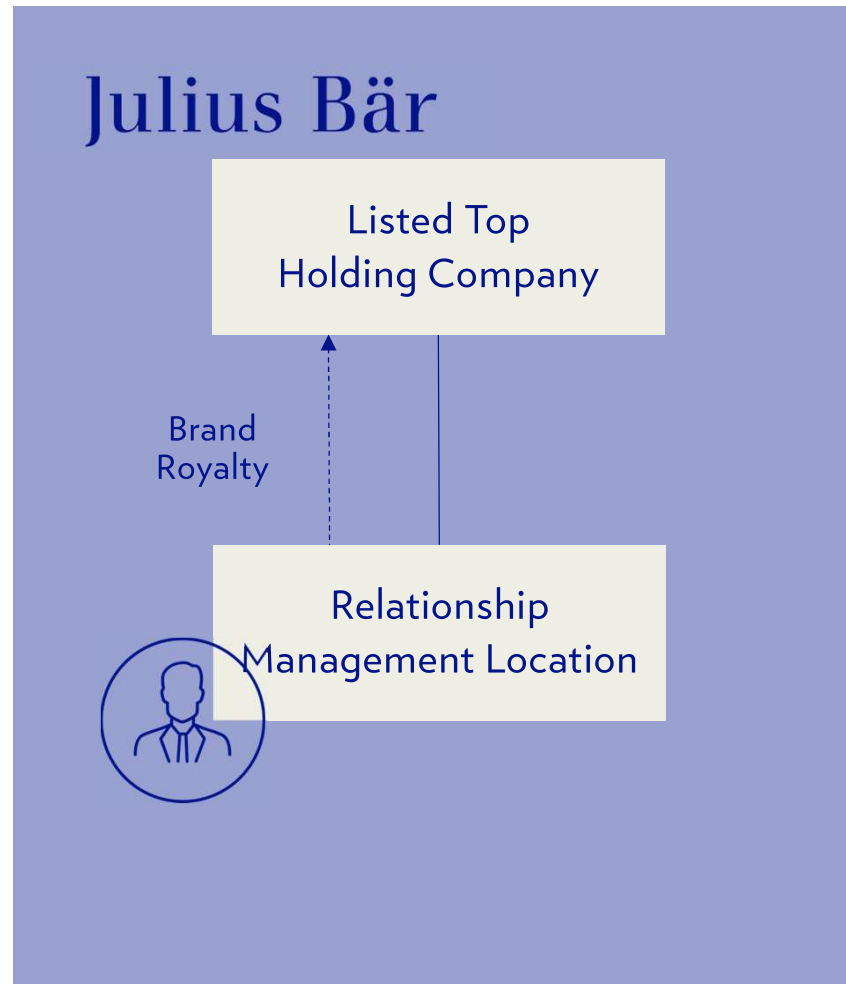
*“THE OPERA REMINDS ME OF MY TAX AUDIT.
IT WAS IN A LANGUAGE I DIDN’T UNDERSTAND.
AND IT ENDED IT A TRAGEDY”*

JEFF MACNELLY (1947 – 2000)



BRAND ROYALTY

What about DEMPE?



DEMPE ANALYSIS

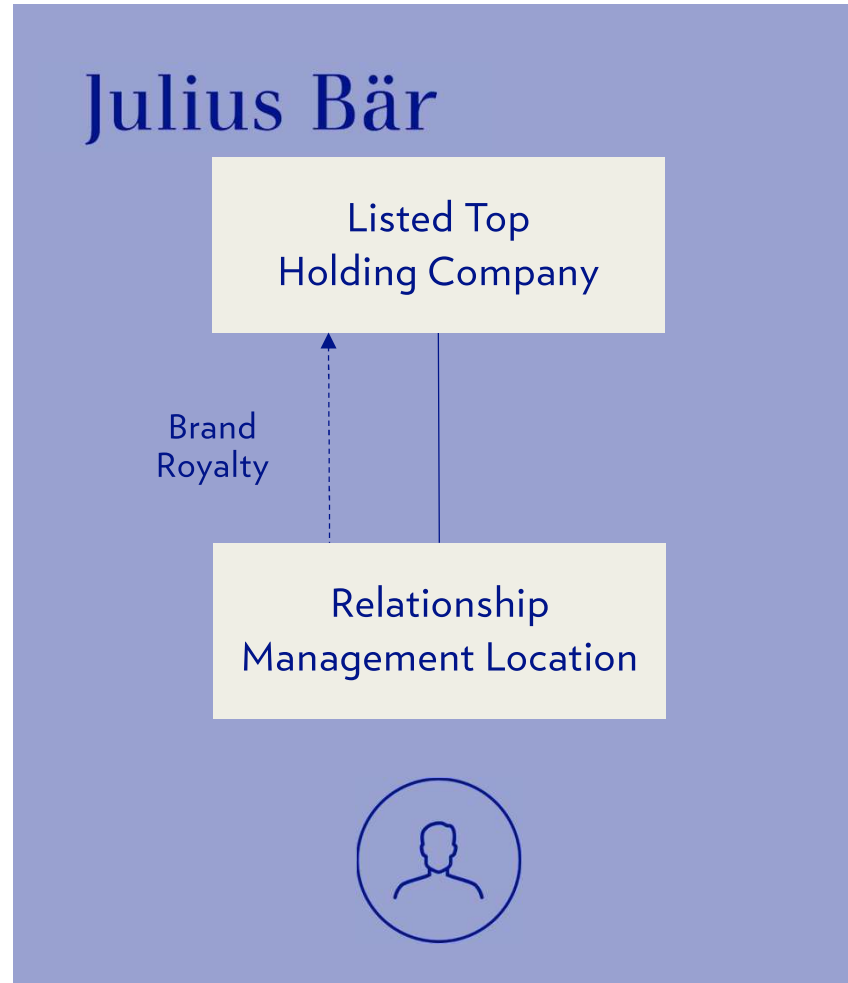
The OECD requires MNE to identify the parties performing functions, using assets, and managing risks related to developing, enhancing, maintaining, protecting and exploiting (DEMPE) the intangibles by means of functional analysis, and in particular which parties control any outsourced functions, and control specific, economically significant risks.

HOT TOPICS

- Mainly in European countries (e.g. Germany, UK)
- What are the DEMPE-functions related to a private banking brand?
- Which party assumes the risks related to the brand? Which party controls the risks?
- Do the relationship managers also perform DEMPE-functions?

BRAND ROYALTY

What about the benefits?



BENEFIT ANALYSIS

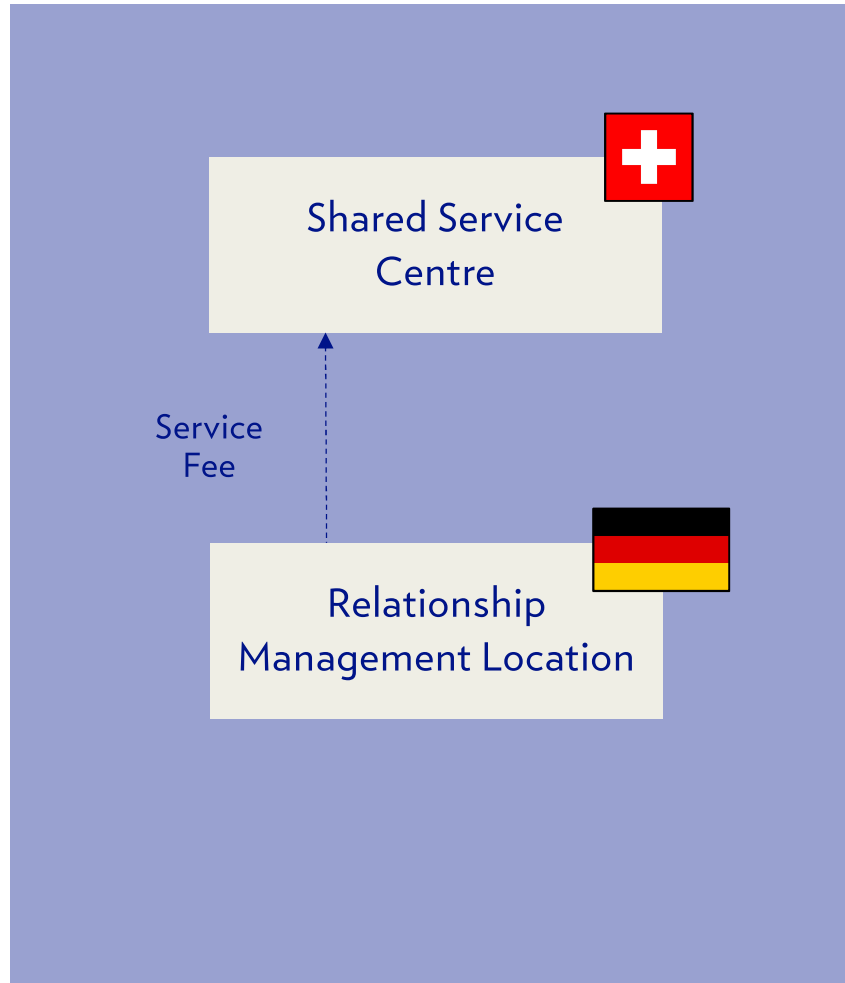
The OECD inherently requires MNEs to perform a benefit analysis related to licensed IP.

HOT TOPICS

- Mainly in Europe and Latin America
- What are the benefits of a brand in the private banking business?
- How to proof these benefits in a tax audit?

IT SERVICE FEE

What about the cost base?



TNMM

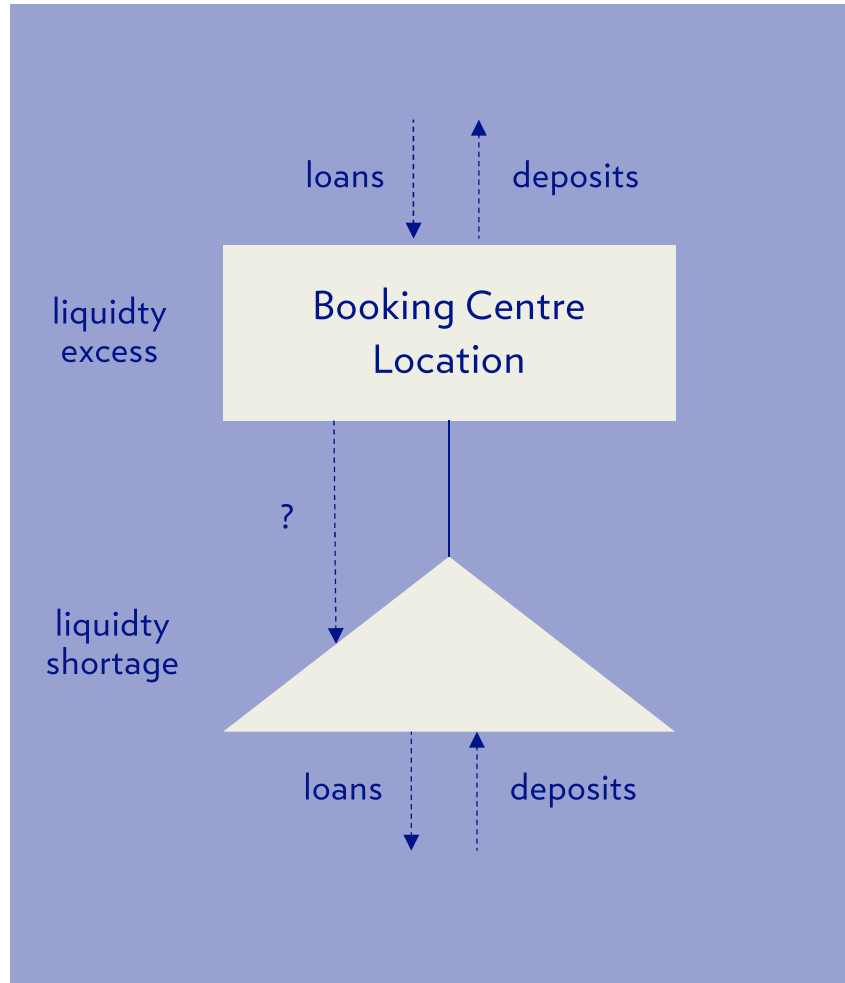
The TNMM method with a full-cost mark-up of 5% is commonly applied for IT services within the private banking industry.

HOT TOPICS

- Mainly in Europe and emerging markets
- Why not apply CUP method?
- Challenging the cost base due to high salary level in Switzerland

CAPITAL ATTRIBUTION

How to determine the “right” amount of capital to a branch?



CAPITAL ATTRIBUTION

The AOA requires MNE to attribute an “arm’s length” amount of capital to permanent establishments

HOT TOPICS

- Mainly in Asia (Hong Kong SAR, Singapore)
- How to determine the amount of capital to be attributed to foreign banking branches?

CAPITAL ATTRIBUTION

How to determine the “right” amount of capital to a branch?

1

CUP APPROACH

Determination of arm’s length capital of a branch following the separate legal entity approach (e.g. bank with comparable risk profile, regulatory minimum capital)

2

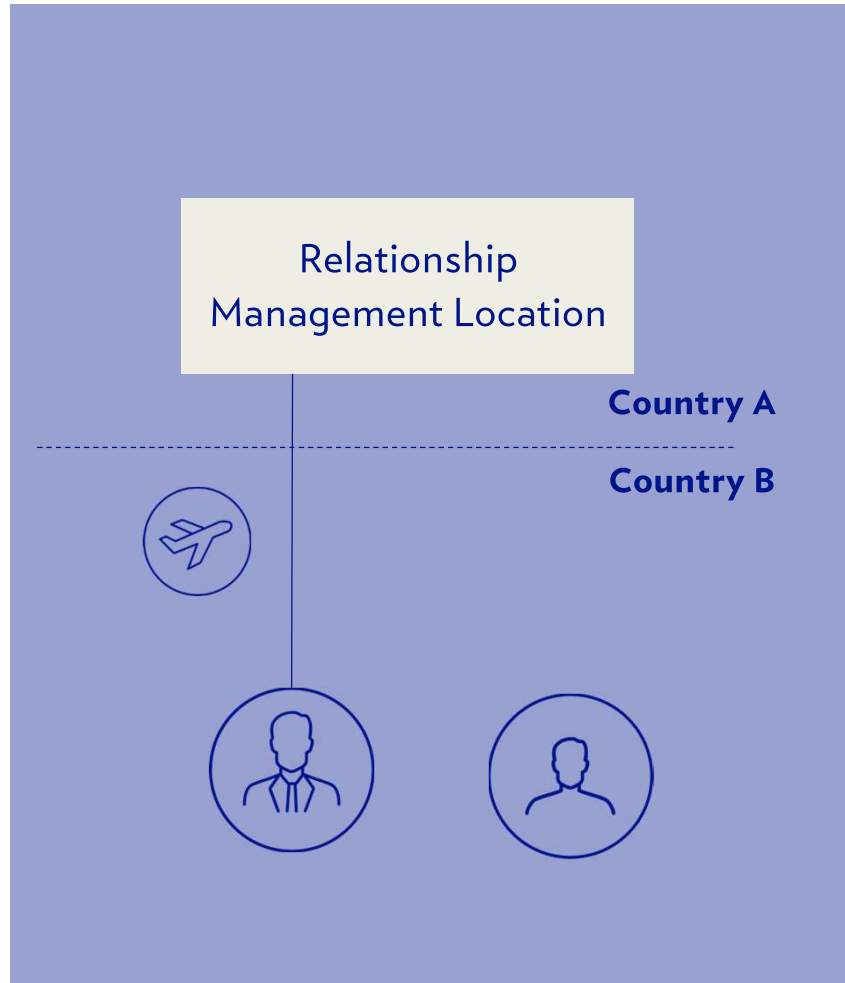
BASEL III APPROACH (BIS APPROACH)

Allocation of total capital to headquarters and foreign branches in line with the risk-weighted assets (RWA) under Basel III

RWA: bank’s assets or off-balance-sheet exposures, weighted according to risk

PERMANENT ESTABLISHMENT

What about the travellers?



PERMANENT ESTABLISHMENT

According to most DTT, dependent agents qualify as a permanent establishment of a foreign company

HOT TOPICS

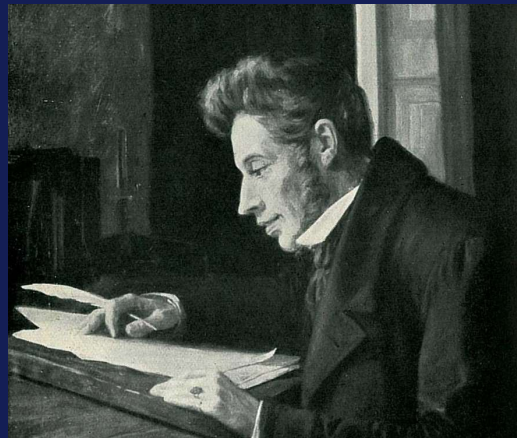
- How to apply the “dependent agent PE”-approach to private banking business?
- Does the BEPS-approach “playing the principle role in the conclusion of a contract” also apply to relationship managers?

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FUTURE TRENDS IN PRIVATE BANKING

*“LIFE CAN ONLY BE UNDERSTOOD BACKWARDS;
BUT IT MUST BE LIVED FORWARDS”*

SØREN KIERKEGAARD (1813 – 1855)



FUTURE TRENDS

It's all about digitalization!

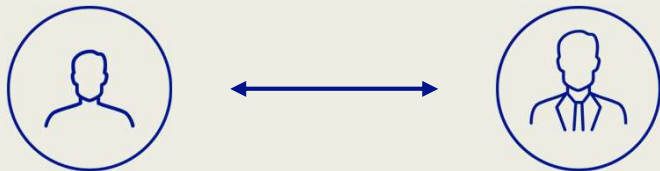
ROBO ADVISORS



FUTURE TRENDS

It's all about digitalization!

TODAY

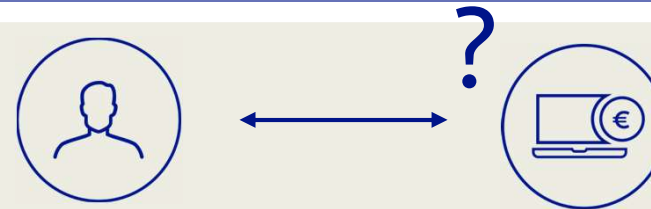


Strong focus on personal interaction with a relationship manager who is supported by economist, investment specialist and portfolio managers

Technology is viewed as a necessity for running the bank (i. e. providing the required infrastructure to effectively deliver banking services and stay abreast of the market), rather than as a competitive advantage that will build the bank

IT/technology as low value-adding services remunerated with TNMM, full-cost mark-up 5%

FUTURE



“Robo-Advisor Approach”: Digitalization of the entire value chain without any personal interaction

“Robo-Assistant Approach”: Still strong focus on personal interaction with a relationship manager, but supported by algorithm and robo-tools

IT/technology as value driver? Potential models: IT provider as co-entrepreneur? License model?

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Q&A

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