



Allocation of risks and corresponding profits – the special case on high-risk high return for investors

Speakers:

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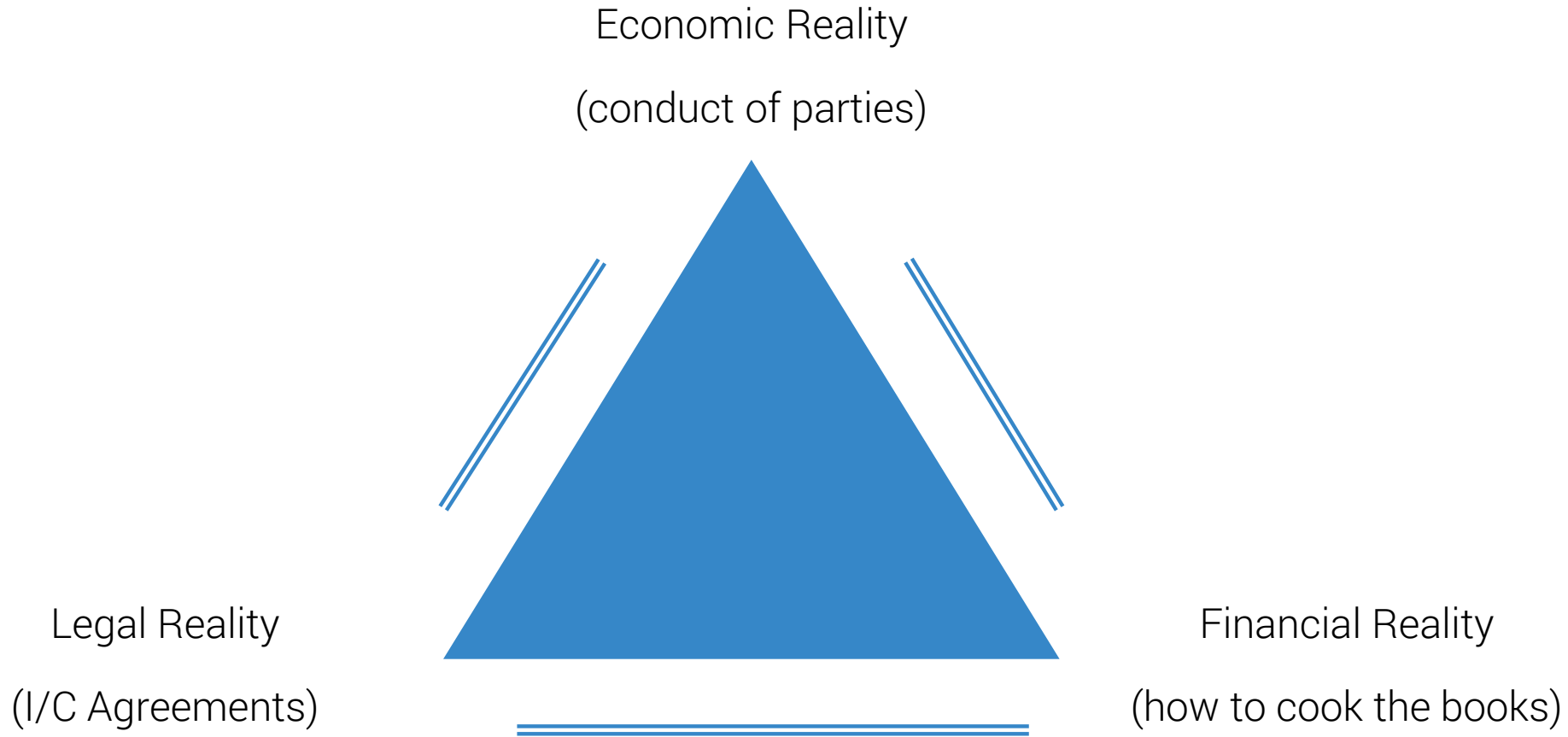
Panellists:

Steeff Huibregtse, Louan Verdoner, Abhijay Bhatia

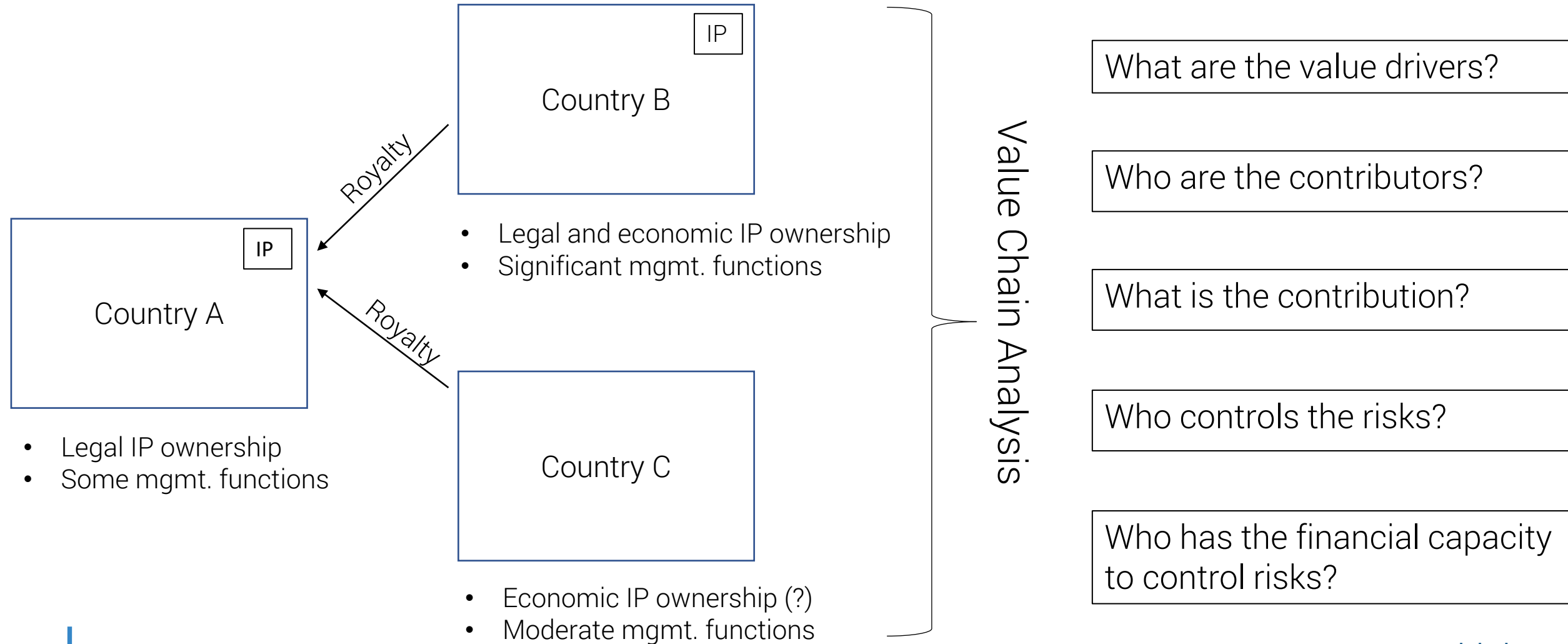
The OECD's "Control over Risk" framework

- BEPS Action 8-10 requires:
 - I. Having the capability to make, actually making decisions regarding whether to take on, lay-off or decline a risk,
 - II. Having the capability and actually making decisions on how to respond to risk, and
 - III. Actually taking actions to affect the outcome of the risk.
- The guidance requires I and ii above but not iii to be regarded as having "control over risk"
- The Risk Framework is implemented following these 6 steps:
 - I. Relevant significant risk are specially identified
 - II. Parties Contractually agree who assumes which risk
 - III. A Functional Analysis determines which Party actually bears the risk, which party controls the risk and has the financial capacity to assume the risk
 - IV. Determine whether actual conduct and contractual assumption of risk are aligned.
 - V. If conduct and contractual assumption of risk are aligned, it will be assigned to the party that has control over the risk and can financially assume the risk
 - VI. The pricing of the accurately delineated transaction is determined

A balancing act between three realities



Allocation of Risks and Profit – From.... To



Setting the Scene – Fund Manager Example

- Para 1.70 of the Guidelines claims that an Investor is exercising control over risk and thus entitled to the return through:
 - I. The decision on risk preference and diversification and initial allocation of capital for investing
 - II. The decision to hire (or fire) the relevant fund manager
 - III. The extent of authority and objectives given to the fund manager
 - IV. The decision on the amount of funds allocated to the fund manager.
- The Challenge
 - If the Fund manager does not do anything, there is no return nor loss,
 - If the Fund manager acts and starts to invest, it is the Fund manager deciding what to invest in, the level of actual risk type to enter, the ability to timely invest, which submanagers to use, etc,
- Questions for Discussion
 - Does the Investor have any actual idea, knowledge, insight in the actual risks created, managed, mitigated by the Fund Manager?
 - Can one still claim that the investor is i) using his capability to take, ii) to actually take decisions to take, or iii) to lay-off or decline a risk?
 - How does this translate in a situation of a MNE with Senior Management setting strategy and execution is at C-1, C-2, etc. Level?

Examples of Investor Types

Types of financial investors:

- Angel Investor, Venture capitalists, Hedge funds, Private equity funds

Types of investments used:

- Shares
- Loans
- Combinations

The Instruments to control their investments:

- Right to appoint Board Members
- Right to appoint Executive Board Members,
- Specific Operational (financial) Ratio's/ KPI's
- Actual, Active and regular management involvement
- Other

Investor Reward – A Broader Definition?



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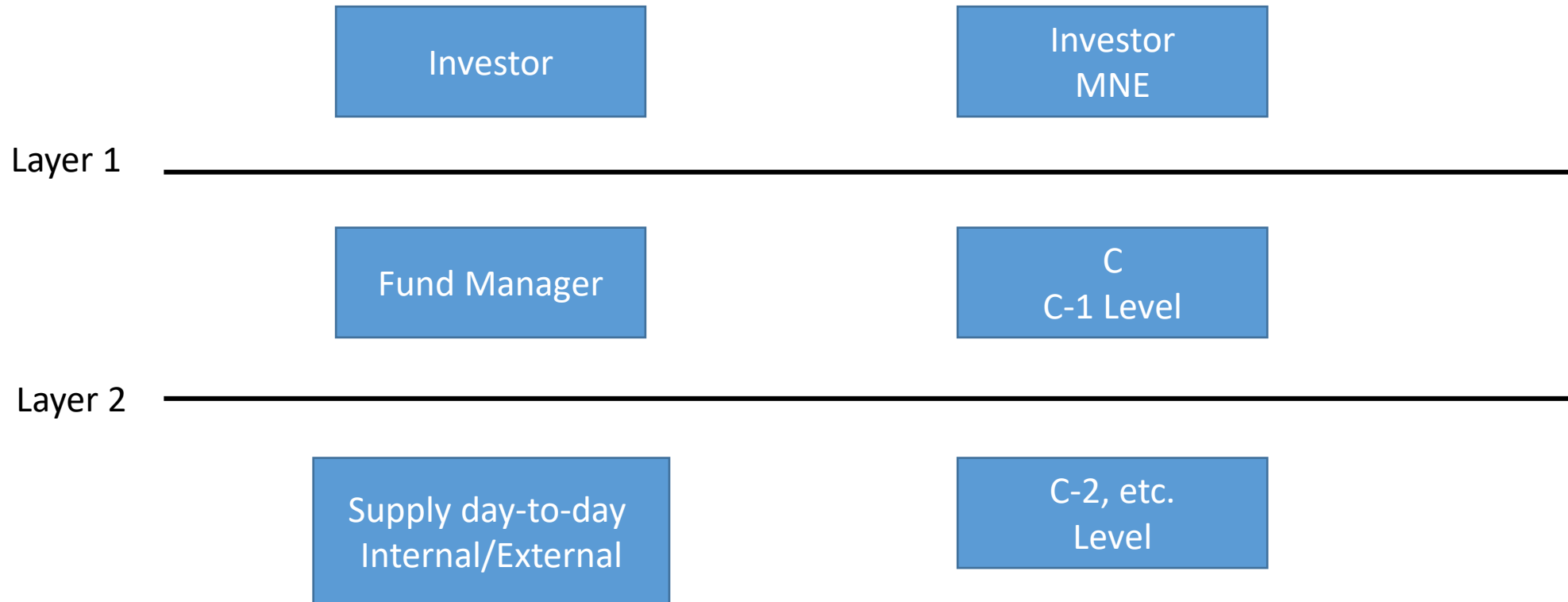
Consider the Authorize OECD Approach to Art 7 of the OECD Model

- The AOA strongly focusses on “the exercise of key risk-taking decisions”..
- Suggesting that the Fund Manager is the one that should share the profit as he seems to perform the “significant people function” for TP purposes?

Loan Funding by Investor

	Functions	Risks	Assets	L (fixed)	L (performance)
Type I	-	-	-	X (% RAROC) ²	-
Type II	-	-	-	-	X (% of OM) ³
Type III	X	-	-	-	X (% of OM)
Type IV	X	X	-	-	X (% of OM)
Type V	X	X	X	-	X (% of OM)

How to allocate Returns / Residual



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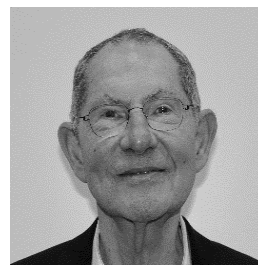


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