S&P Global
Market Intelligence

CASE STUDY

A Government Agency Sharpens Its Focus On Transfer Pricing Strategies

THE CLIENT:

Tax authority of a major world government

USERS:

Transfer pricing group

Transfer pricing strategies for tangibles, which involve charging one division of a company for goods or services provided by another, typically offer advantages from a taxation perspective. Rigorous analysis is done at the corporate level to assess the creditworthiness of the tested party and the appropriate interest rate to set for any intercompany loan. This is to validate that the controlled transaction in question satisfies the arm's-length principle - as if the transaction occurred between two comparable, unrelated parties. As overseers of tax issues, certain government agencies need to undertake similar analysis to evaluate potential profit shifting risks by determining if the interest charges, which are tax deductible, actually reflect market conditions. The transfer pricing group at this government agency wanted to utilize a range of data and analytical tools that were popular with many companies in order to replicate the analysis being done. The group reached out to S&P Global Market Intelligence ("Market Intelligence") to discuss the firm's capabilities in this area.

Pain Points

The transfer pricing group set out several important criteria to evaluate information providers. This included having:

- **A strong market reputation** for a comprehensive and reliable set of services used by many companies.
- **A well-developed and trusted methodology for assessing the creditworthiness** of a wide range of companies — both public and private and large and small.
- The ability to **assess multiple interest rate scenarios.**

Members of the group emphasized the important role they play in assessing and monitoring the activities of companies with respect to transfer pricing. Given this, they stressed the importance of having models and analytical approaches that were easy to understand, fully transparent, and defendable.

This government agency's transfer pricing group plays an important role in overseeing the activities of companies in its jurisdiction and needed access to trusted data and analytical tools to evaluate potential credit risks and proposed interest rates for transfer pricing arrangements.

The Solution

Market Intelligence discussed its Credit Analytics solution set that blends cutting-edge models with robust data to help users reliably assess the credit risk of companies across the globe. This includes Probability of Default Fundamental Model (PDFN), a fundamentals-driven credit risk model that measures the likelihood of default over a number of time horizons by utilizing financial statements, proprietary risk metrics, and one of the world's largest financial databases. It also includes CreditModel™, a powerful suite of over 100 statistical models that are trained on credit ratings from S&P Global Ratings[1] that can help users reliably evaluate and monitor the long-term creditworthiness of public and private, rated and unrated companies. Market Intelligence also explained its Corporate Yield Curve offering. Together these capabilities would enable the transfer pricing group to:

Assess the creditworthiness of smaller-sized companies

PDFN measures the likelihood of default over a number of time horizons. Users can evaluate the one- to five-year default risk of public and private banks, corporations, and REITS. PDs can be mapped to quantitatively-derived credit scores (i.e., 'bbb') for increased comparability. Workflows may be optimized by accessing a pre-scored database leveraging comprehensive, timely, and robust data on over 50 million[2] companies globally. Users may also determine the default risk of a single company or a portfolio of companies.

[1] S&P Global Ratings does not contribute to or participate in the creation of credit scores generated by S&P Global Market Intelligence. Lowercase nomenclature is used to differentiate S&P Global Market Intelligence PD credit model scores from the credit ratings issued by S&P Global Ratings.
[2] All coverage numbers as of March 2021

Assess the creditworthiness of mid- and large-cap companies

CreditModel's powerful suite of statistical models, trained on credit ratings from S&P Global Ratings, enables users to quickly evaluate the long-term creditworthiness of mid- and large-cap, public and private banks, insurance companies, and corporations globally. The models utilize financial statement and macroeconomic data to generate a quantitative credit score that statistically matches a credit rating from S&P Global Ratings. These scores can be mapped to observed default rates (i.e., 1.2%) to quantify default risk. Analysis can be streamlined by accessing a database of over 58,000 pre-scored entities, going back more than 15 years.

Evaluate interest rates being used by companies

Corporate Yield Curves offer broad and consistent coverage of credit term structures (one month to 30 years) across four currencies ($, €, £, A$) and every GICS sector, as well as a broader non-financial corporates sector and seven rating categories (AAA – CCC), or aggregates with investment grade and high-yield categories. Data is sourced directly from major buy-side firms, credit trading desks, and trade reporting venues. This provides robust and transparent data to drill down and view the underlying bond constituents and prices used in the construction of each curve.

Key Benefits

Members of the transfer pricing group saw many benefits to subscribing to the Market Intelligence offering, including the ability to rely on:

- **A well-recognized information provider** trusted by companies around the world.
- **A rigorous methodology for PDFN** that evaluates risk over a number of time horizons.
- **A rigorous methodology for CreditModel** that employs sophisticated statistical techniques to evaluate the relationship between financial data and credit ratings using Exponential Density theory to achieve a high level of reliability, granularity, and predictive power.
- **Annual backtesting reports** that provide comprehensive assessments of model performance using data from the most recent calendar year.
- **A transparent approach** to understand where the risk lies in a company's fundamentals, and where to focus attention for analysis, from both an absolute and relative perspective.
- **Similar transparency on the bond constituents, prices, and z-spreads** used in the construction of each yield curve, as well as minimum/maximum ranges, average and median yields/spreads, and inter-quartile ranges.
- **Flexible delivery** via the S&P Capital IQ platform or Market Intelligence's Excel® Plug-in.
- **Detailed user guides and technical documentation** for the models, plus access to a 24x7 support group.

Click here for more information on some of data and tools discussed in this Case Study.

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Contact Us

Asia-Pacific

+852-2533-3565

Europe, Middle East & Africa

+44-207-176-1234

The Americas

+1 877 863 1306