## CAPITAL REQUIREMENTS DIRECTIVE

### Pillar 3 Disclosures

### 1. Introduction

The Capital Requirements Directive ("CRD") is the framework for implementing Basel II in the European Union. Basel II implements a risk sensitive framework for the calculation of regulatory capital. In the UK, the Financial Conduct Authority ("FCA") implemented the CRD in its regulations through the Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU"), the General Prudential Sourcebook ("GENPRU") and the Senior Management Systems and Controls Sourcebook ("SYSC").

The CRD consists of three 'Pillars':

- Pillar 1: sets outs the minimum capital requirements for measuring the firm's credit, market and operational risk.
- Pillar 2: requires the firm to determine whether its Pillar 1 capital is adequate to cover these risks. This is achieved through the firm's Internal Capital Adequacy Assessment Process ("ICAAP") and is subject to annual review.
- Pillar 3: requires disclosure of certain requirements about the underlying risk management controls and capital position.

The provisions for Pillar 3 have been set out by the FCA in BIPRU Chapter 11. This document is designed to satisfy these disclosure requirements.

BIPRU 11 allows a firm to omit one or more of the required disclosures where it believes that the information is immaterial. For the purposes of this requirement, CLIM will regard information as material if its omission or misstatement would change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

The disclosures are required to be made on an annual basis at a minimum. The disclosures contained herein are based on the position as at 30th June 2017 (the firm's financial year end).

These disclosures have been produced solely for the purposes of Pillar 3. The disclosures do not form part of any audited financial statements. The disclosures have been reviewed by the Board.

These disclosures will be published on the City of London Investment Group PLC website: www.citlon.co.uk.

### 2. Background to the Firm

City of London Investment Management Company Limited ("CLIM") is a wholly owned subsidiary of City of London Investment Group PLC (CLIG) (which is listed on the LSE Main Market in London) and is a limited liability company. CLIM is authorised and regulated by the FCA as a full-scope alternative investment fund manager and is categorised by the FCA for prudential regulatory purposes both as a collective portfolio management investment firm ("CPMI Firm") and a BIPRU 50 firm as defined in the FCA's rulebook.

CLIM acts as manager/adviser to a number of commingled funds and segregated accounts and in all cases the client assets are held independently by custodians, appointed either by the account holder (for segregated accounts) or by the trustee (for the commingled funds) or in one case by the Board of the Open-Ended Investment Company (OEIC) (for the Irish domiciled World Markets Umbrella Fund plc). CLIM does not hold Clients' money or assets and does not have the relevant FCA permissions to do so.

CLIM manages USD5.1bn (as of 30th June 2018) via a range of comingled and segregated accounts with mandates to invest in closed ended funds and equities. Our investment approach is relative return, and is focused on the institutional market.

## 3. Risk Management Framework

### 3.1 Governance structure

The Board of CLIM is the governing body ultimately responsible for the risk management framework within the business. The Board of Directors is responsible for ensuring an appropriate governance regime is in place, including ensuring effective processes are in place to identify, monitor, report and manage the risks that the firm is, or may be, exposed to. The Risk & Compliance Committee, which meets 5-6 times each year, reports to the Board on any significant internal control failures and on the quality of the risk management framework in place, making suggestions for improvements where necessary.

### 3.2 Risk management systems and techniques

Risk management is viewed as the responsibility of all employees and directors within the firm. The Compliance department maintains the firm's risk register which is reviewed by the Board at each quarterly board meeting. In addition, each individual department maintains a risk assessment for their area, which is formally reviewed and amended (if necessary) every six months. Both the risk register and the departmental risk assessments will be updated outside the usual schedules should the need arise. The Compliance department will also provide advice and guidance to the business on the quality and effectiveness of the control structures in place, and will work with the business to ensure internal control failures are addressed as necessary.

### 3.3 Compliance

The Compliance department is primarily responsible for supporting the business and the Board in achieving its regulatory obligations. This is predominantly done via the provision of advice and guidance, training, and carrying out the firm's risk based monitoring programme. The monitoring programme has been tailored to test the firm's key controls in order to provide the Board with the necessary assurances as to their effectiveness. Compliance also carries out daily reviews of adherence to clients' investment guidelines.

## 4. Capital Adequacy and risk categories

As a CPMI Firm, CLIM is required to hold liquid capital in excess of the following:

a) The higher of:

   i. the funds under management requirement (of its AIFs), i.e., €125,000 plus 0.02% of the amount by which CLIM's funds under management exceeds €250,000,000, (subject to a maximum of €10,000,000); and

   ii. the fixed overheads requirement ("FOR"), i.e., one quarter of CLIMs annual fixed overheads

b) Plus, to cover professional liability risks, either:

   i. additional own funds equal to 0.01% of the value of the AIFs managed by CLIM; or

ii. professional indemnity insurance cover meeting certain criteria (and for which the agreed excess is in addition to the own funds requirement).

CLIM has decided to cover professional liability risks by holding appropriate professional indemnity insurance cover.

As a BIPRU firm, CLIM is required to hold regulatory capital which will be the higher of:

a) The fixed overheads requirement; and

b) The sum of the credit risk and market risk capital requirement.

| **Calculations for a CPMI firm** | |
|---|---|
| | £'000 |
| i. Funds under management requirement | 487 |
| ii. Fixed overheads requirement | 1,574 |
| | |
| a) *Higher of i. or ii.* | 1,574 |
| | |
| b) Agreed excess under Professional indemnity insurance | 151 |
| | |
| **Total Capital Requirement** *(a + b)* | 1,725 |

| **Calculations for a BIPRU firm** | |
|---|---|
| | £'000 |
| **Pillar 1:** | |
| Credit risk | 742 |
| Market risk | 0 |
| *Total* | 742 |
| Fixed overhead requirement (FOR) | 1,574 |
| *Pillar 1 requirement* | 1,574 |
| | |
| Pillar 2 Additional requirement | 151 |
| | |
| **Total Capital Requirement** | 1,725 |
| Total capital @ 30th June 2018 | 3,626 |
| | |
| **Surplus/(deficit)** | 1,901 |
| **Solvency Ratio %** | 210.20 |

Credit Risk

Credit risk is the risk of financial loss arising from a client or other counterparty failing to meet its obligations to repay outstanding amounts as they fall due. Credit risk for CLIM is minimal. As at 30th June 2018, the company had no impaired assets for which a specific or general provision had been raised. Further breakdown is not disclosed due to immateriality.

Market Risk

Market risk arises from adverse changes to the values of positions or portfolios arising from changes in market prices, interest rates or exchange rates.

Market risk for CLIM is minimal as the firm does not undertake any principal trading for its own account. Revenues, however, will be impacted by falls in the value of assets under management.

Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people or systems or from external events.

As mentioned previously, CLIM undertakes risk assessments of all key areas of its business to identify the key risks it faces, along with the quality of related controls. These risks are monitored on an ongoing basis to ensure the business understands how they are evolving over time. CLIM also monitors all losses and potential losses with view to ensuring that policies, procedures and controls are appropriate, and enhanced where necessary in order to minimise future repetitions.

The simplicity of the business model (as briefly described above) means that CLIM is not exposed to many of the risks that many financial services firms might face. CLIM's risk management objective is to be as simple and risk averse as is practical. This is achieved by focusing on one line of business (the management of client money for a fee), avoiding as many potential conflicts of interest as possible, and by not holding any client assets.

However, CLIM performs a review of all risks associated with its business within the scope of the Risk Register, for which updates are provided to the Board on a quarterly basis.

Business interruption risks are managed proactively by an extensive backup network and offsite continuity services.

**5. Pillar 3 Remuneration Disclosures**

CLIM is subject to the FCA rules on remuneration, which are contained in the FCA's Remuneration Code located in the SYSC Sourcebook of the FCA's Handbook. CLIM makes the following disclosures with regards to its remuneration policies.

In being a limited license firm, CLIM is classified as a 'Proportionality Level 3' firm. Proportionality Level 3 firms are considered to be the lowest category from a risk perspective and as such can disapply a number of the FCA's remuneration code requirements. Prior to doing so, however, firms must consider their individual circumstances and be satisfied that risks related to remuneration must not be unduly increased.

CLIM believes that its systems and processes relating to remuneration do not pose a risk to itself, the industry or the regulator's objectives. In line with FCA guidance, and following CLIM's own assessment, the firm has opted to disapply rules under the remuneration principles proportionality rule relating to deferral, payment in shares or other instruments and ratio between fixed and variable remuneration.

Under the FCA's Remuneration Code, CLIM is required to identify staff who are subject to the Code ("Code Staff"). Remuneration Code Staff comprises categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm's risk profile.

As at 30th June 2018, 21 individuals were classified as being Code Staff.

The structure of CLIM's remuneration programme is designed to reward individual and team performance, to align employees' interests with those of the firm, and to reward staff loyalty.

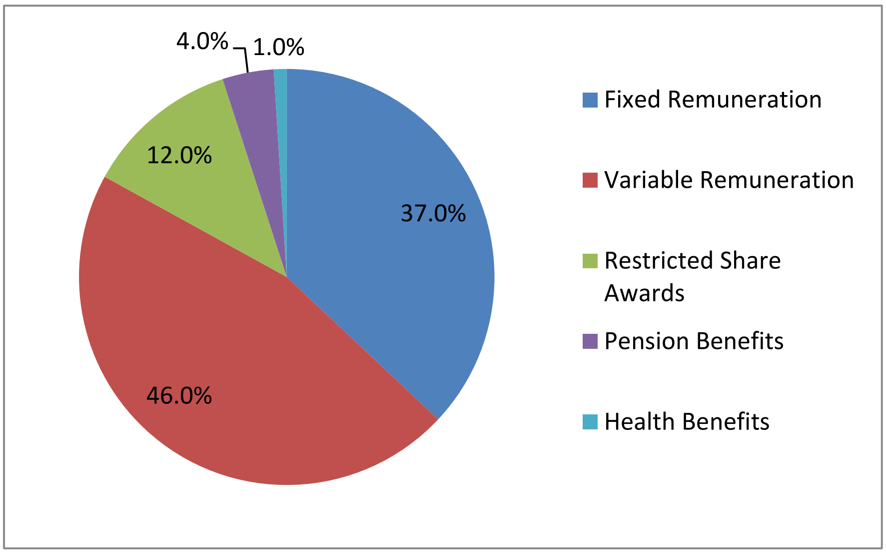
Eligible CLIM employees participate in a profit share scheme, whereby a maximum of 30% of pre-bonus, pre-tax, operating profit is distributed to staff on a quarterly basis. Individual awards are allocated taking into account individual performance (as measured during the performance appraisal process).

The Firm operates an Employee Incentive Plan (EIP) which is open to all those who participate in the discretionary profit share scheme.

Those eligible are offered the chance to waive up to 20% (or up to 30% if there is headroom) of their annual cash bonus in return for Restricted Share Awards (RSAs) of two times the amount waived. The ordinary shares awarded under the EIP are purchased in the open market. The RSAs are granted at the end of October and will vest over the following three years in equal proportions. A dividend equivalent accrues and is payable when the RSA vests.

Following shareholder approval in October 2016, the cost of matching the employee contribution is capped at 5% of pre-bonus, pre-tax, operating profit for the first four years. Thereafter, the EIP will fall within the 30% limit of the existing profit share pool.

For the 2017/2018 financial year, the total aggregate remuneration awarded to Code Staff was £7.5mn. The breakdown of this figure into the various remuneration constituents is represented in the chart below:




The firm has a Remuneration Committee comprising of, and chaired by, non-executive directors, and which oversees the remuneration process. The Remuneration Committee operates to an agreed terms of reference.

The Compliance & HR departments within CLIM are responsible for maintaining a list of the firm's Code employees, and ensuring that they, and the firm, remain in adherence with the obligations and the spirit of the FCA's Remuneration Code.

**September 2018**