



## **Capital Requirements Directive: Pillar 3 Disclosure**

**The F&C Group 2009**

## Purpose

The Capital Requirements Directive (“CRD”) introduced a revised capital adequacy framework across Europe seeking to reduce the probability of consumer loss or market disruption as a result of prudential failure. It does so by seeking to ensure that the financial resources held by firms are commensurate with the risks associated with the business profile and the control environment within them.

## Background

The framework under the CRD consists of three 'pillars' of regulatory capital. Pillar 1 of the new standards sets out the minimum capital requirements firms are required to meet for credit, market and operational risk. Under Pillar 2, firms and their supervisors have to form an opinion on whether they should hold additional capital against risks not adequately covered in Pillar 1 and must take action accordingly. The aim of Pillar 3 is to then improve market discipline by requiring firms to publish certain details of their capital, risk exposures and management practices, and to have a formal disclosure policy in place which should assess the appropriateness, verification and frequency of the disclosure. This document is F&C's response to the Pillar 3 disclosure requirement and forms the F&C Group disclosure policy.

The general disclosure requirements require firms to disclose information on:

- the scope of application of directive requirements;
- their risk management objectives and policies;
- their capital resources;
- their compliance with applicable prudential rules and Pillar 2 requirements; and

- credit, market and operational risk.

## Scope and application of disclosure requirements

The disclosures in this document relate to the F&C Group (“F&C” or “the Group”), the parent of which, F&C Asset Management plc (“FCAM”), is an unregulated holding company, listed on the London Stock Exchange.

The Group obtained a waiver from the United Kingdom's Financial Services Authority (“FSA”) (the UK financial regulator) from meeting any minimum capital requirements under the consolidated supervision rules and consequently under the FSA rules, specifically BIPRU 11.2.1 R (3), disclosures must be made on an individual basis across all in-scope CRD firms. These firms are:

F&C Group Company	Abbreviation	Country of incorporation	Prudential Regulator
F&C Asset Managers Limited	F&CAM	England	FSA <sup>1</sup>
F&C Management Limited	FCM	England	FSA
ISIS Investment Manager plc	ISISIM	England	FSA
F&C Managers Limited	FCMGRS	England	FSA
F&C Partners LLP	FCPLLP	England	FSA
F&C REIT Property Asset Mgmt. plc	FCRPAM	England	FSA
F&C Investment Business Limited	FCIB	Scotland	FSA
F&C Ireland Limited	FCIRL	Ireland	FR <sup>2</sup>
F&C Netherlands B.V.	FCNL	Netherlands	DNB <sup>3</sup>
F&C Portugal S.A.	FCPGL	Portugal	BoP <sup>4</sup>

<sup>1</sup> Financial Services Authority

<sup>2</sup> Irish Financial Services Regulatory Authority

<sup>3</sup> De Nederlandsche Bank

<sup>4</sup> Banco de Portugal

All firms detailed are fully consolidated into the Group for accounting purposes and prudential purposes. There are no known current or foreseen practical or legal impediments to the prompt transfer of capital resources or repayments of liabilities between parent and subsidiary undertakings and there are no subsidiary undertakings where actual capital resources are less than the required minimum, i.e. each regulated company within the Group currently holds a surplus of regulatory capital.

### **Risk management objectives and policies**

The Group is an international asset management group with a client focus on the UK and Continental Europe. Clients of the Group comprise a wide range of insurance, institutional and retail investors, across multiple jurisdictions.

Our risks are typical to those of other investment managers and fall under the categories of: credit risk, market risk, operational risk, liquidity risk, concentration risk, business risk, interest rate risk and pension obligation risk, none of which are currently considered material. It is important to note that all risks are monitored, controlled and managed as part of our governance and risk management framework which is consistent across all firms within the Group. This uniformity arises as all Group firms are managed and operated to support the Group's objectives and strategies, and the Group Board and Executive Committee provides oversight of all operations.

The procedures that the Directors have established are designed to provide effective control within the Group and accord with the Internal Control Guidance for Directors on the Combined Code issued by the Institute of Chartered Accountants in England and Wales ("ICAEW"), "Internal Control: Guidance for Directors on the Combined Code", (the "Turnbull Guidance"). The ongoing process for identifying,

evaluating and managing significant risks is regularly reviewed by the Board to ensure that it complies with the Turnbull Guidance.

### **Control environment**

The Group is committed to the highest standards of business conduct and seeks to maintain these standards across all areas of its business and all geographies in which it operates. The Group has in place appropriate procedures for reporting and resolution of activities that do not meet the required standards of business conduct.

The Group has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve its objectives. This structure is designed to provide clear responsibilities and a control framework for key areas of the Group's business.

Operational responsibility for the control environment rests with the Chief Executive and is devolved through a documented executive structure with clearly delegated and appropriate levels of authority. Members of Group management are, therefore, accountable for the operation of the systems of internal controls within the Group's business.

### **Monitoring and corrective action**

The Group has a formal compliance function, which forms part of the Audit, Risk & Compliance department ("ARC"). ARC conducts regular monitoring of various business areas and control procedures in line with a plan agreed annually with the Group Audit & Compliance Committee ("ACC"), a sub-committee of the FCAM Board. Any issues of significance are brought to the attention of the ACC by ARC

and through the regular reporting process. Planned corrective actions are independently monitored for timely completion and reviewed by the ACC.

The ACC reviews the effectiveness of the operation of the control framework at least twice each year.

A formal annual internal control report is produced for F&C's clients providing assurance on both the design and the operating effectiveness of F&C's control procedures. The report follows the Audit & Assurance Faculty (AAF<sup>2</sup>) guidelines established by the ICAEW.

#### **Approach to operational and business risk**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Business risk is the current or prospective risk to earnings and capital arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment.

The identification of major operational and business risks is carried out by the Board in conjunction with management, and procedures to manage these risks, where possible, are reviewed and agreed.

Quarterly reports are prepared by each of the business units, across all locations including the Group's overseas locations. The quarterly reports include issues of material business risk. These reports are discussed in detail by the Group's management, which includes the Executive Directors of FCAM. All significant items are identified and reported to the Board on a regular basis.

ARC facilitates the identification and documentation of operational risk in the business and helps the business identify mitigating actions. In addition, any business errors, including mandate breaches, are reported by the business to ARC where they are recorded, resolutions analysed and progress actively monitored.

#### **Approach to credit, market and interest rate risk**

The Group's risk management objectives and policies applicable to this disclosure and with specific regard to credit risk, market risk and interest rate risk are summarised below. The actual exposures relating to each of these are detailed in the annual financial statements which are also available on the Company website.

- Credit risk is the current or prospective risk to earnings and capital arising from a counterparty's failure to meet the terms of any contract or otherwise fail to perform as agreed.
- Market risk is the risk of losses from on and off balance sheet positions arising from movements in market prices, which for the Group, primarily relates to movements in foreign exchange rates.
- Interest rate risk is the current or prospective risk to earnings and capital arising from adverse movements in interest rates.

F&C adopts a low risk approach to treasury management and seeks to ensure that its capital is preserved and financial risks are managed appropriately.

The Group treasury operations are managed by the Finance function within parameters defined by the Board. The regulatory capital and treasury position of the Group are reported to the Board on a regular basis.

The Group is exposed to a number of financial risks in the normal course of its business. The risk management policies adopted are designed to manage risk and recognise that treasury management operations are specifically not treated as a profit centre. The key aspects of this policy and its implementation are detailed below:

- The Board Reserved List prohibits the establishment of borrowing facilities without the prior approval of the Board.
- Placing of funds on deposit is short term only (maximum term 90 days).
- Deposits may only be placed with counterparties approved by the F&C Credit Committee, and the Board sets the appropriate limit of exposure to any one counterparty.
- Foreign currency exposure is managed to reduce the risk and impact of movements in exchange rates by the repatriation of surplus foreign currency into Sterling and the hedging of non-sterling balances where deemed appropriate. Surplus currency balances are defined as being the level of cash which exceeds the regulatory and legal capital and working capital requirements of the relevant foreign operations.

The Directors give careful consideration to the appropriate funding structure for financing all acquisitions including the capacity to fund anticipated restructuring activity.

The Group is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial assets.

## Capital resources

The core tier 1 capital resources of each firm consist of share capital (or members capital for F&C Partners LLP), share premium and profit & loss and other reserves. Share capital relates to ordinary shares in each firm that is allotted, called up and fully paid. F&C Management Limited holds tier 2 capital of £10m relating to a

subordinated loan with a fellow subsidiary undertaking. F&C Partners LLP holds tier 2 capital of £104k which is the corporate members' working capital and tier 3 capital of £500k being the corporate members' equity preference capital.

Capital Resources Dec. 2009	F&CAM £'000	FCM £'000	ISISIM £'000	FCMGRS £'000	FCPLLP £'000	FCRPAM £'000	FCIB £'000	FCIRL €000	FCNL €000	FCPGL €000
Core Tier 1:										
Share Capital	16,000	32,332	3,550	500	1,502	1,000	13,000	190	209	9,000
Share Premium	-	42,197	-	-	-	-	-	-	112,927	-
Profit & loss and other reserves <sup>5</sup>	494	20,210	(265)	21,395	(684)	2,916	136	3,816	(86,156)	26,669
Total Core Tier 1 Capital	16,494	94,739	3,285	21,895	818	3,916	13,136	4,006	26,980	35,669
Deductions from Tier 1:										
Intangible Assets	-	-	-	-	-	-	958	-	-	-
Material holdings in financial inst.	-	50	-	-	-	-	-	-	-	-
Pension fund calculation	-	-	-	-	-	-	-	-	-	682
Tier 1 capital after deductions	16,494	94,689	3,285	21,895	818	3,916	12,178	4,006	26,980	34,987
Tier 2 and Tier 3 capital	-	10,000	-	-	604	-	-	-	-	31
Deductions from total capital	-	69,624	2,621	6,349	12	287	318	89	1,620	3,935
<b>Total resources after deductions</b>	<b>16,494</b>	<b>35,065</b>	<b>664</b>	<b>15,546</b>	<b>1,410</b>	<b>3,629</b>	<b>11,860</b>	<b>3,917</b>	<b>25,360</b>	<b>31,083</b>

<sup>5</sup> Excludes 2009 profits (except F&C Portugal)

## Capital resource requirements

All firms captured by the CRD are “limited licence” as specified by Article 20(2) of the CRD, and this dictates that each firm’s Pillar 1 capital requirement must follow the higher of: (a) the sum of the credit risk capital requirement and the market risk capital requirement; and (b) the fixed overheads requirement. No operational risk

requirement is therefore calculated or included under Pillar 1. The exception to this is F&C Netherlands B.V. where the capital resource requirement is the credit risk capital requirement, per De Nederlandsche Bank prudential regulations.

Capital Resource Requirements	F&CAM £'000	FCM £'000	ISISIM £'000	FCMGRS £'000	FCPLLP £'000	FCRPAM £'000	FCIB £'000	FCIRL €000	FCNL €000	FCPGL €000
Credit risk capital requirement	433	3,073	59	656	47	263	833	136	947	821
Market risk capital requirement	-	1,454	-	-	5	44	32	-	178	-
Fixed overheads requirement	7,944	19,135	31	1,235	252	1,529	1,939	728	8,331	1,144
<b>Total variable capital requirement</b>	<b>7,944</b>	<b>19,135</b>	<b>59</b>	<b>1,235</b>	<b>252</b>	<b>1,529</b>	<b>1,939</b>	<b>728</b>	<b>947</b>	<b>1,144</b>

The Group calculates the pillar 1 credit risk capital requirement in accordance with the standardised approach. Further disclosures relating to the credit risk capital component have in most cases been considered immaterial under BIPRU 11.3.5R as the capital requirement for most firms is the fixed overhead requirement. The following table shows the credit risk exposure class for firms where the capital resource requirement is not the fixed overhead requirement. The market risk for those firms relates to foreign exchange.

<b>Credit risk exposure class</b>	<b>ISISIM</b> £'000	<b>FCNL</b> €000
Institutions	2	873
Other items	57	74
Total credit risk capital requirement	59	947

### **Compliance with rules in BIPRU and Pillar 2 rule requirements**

The adequacy of capital to support current and future activities is monitored in the F&C Internal Capital Adequacy Assessment Process ("ICAAP"). The level of capital required has been assessed through reviewing a number of scenarios and comparing them with the base case scenario of our budgeted business plan. This approach identifies the timescale and extent of possible capital deficiencies should an adverse scenario arise. The additional level of capital required to cover the Group against such a scenario can then be assessed and / or the mitigating actions identified which are required to ensure a continued capital surplus.

The latest base case scenario has been prepared to December 2009, with actual results, and forecasts to the end of 2011. This time span is deemed appropriate as it shows both a short-term view of any adverse scenarios and also an impact over the medium-term during which actions would be taken if continued deterioration were to occur.

### **Verification, Frequency and Ongoing review of the Disclosures**

The disclosures detailed in this document are updated in conjunction with the F&C Group ICAAP, and generally on an annual basis, unless there is a significant event which would detrimentally impact the capital and risk position of the Group.

The disclosures detailed in the ICAAP are reviewed and formally adopted by the Board of FCAM, further, the Board of each requisite firm.

The Pillar 3 disclosure document is reviewed and approved by the F&C Group Chief Financial Officer, who is also a member of the F&C Group Executive Committee, and the F&C Group Head of Audit Risk and Compliance. It is then issued to all applicable firm Boards for review and comment, after which time it is updated onto the F&C Group corporate website.