

Pillar 3 and remuneration disclosure

December 2011

1. Background

The European Capital Requirements Directive (CRD) created a revised regulatory capital framework based on the provisions of the Basel 2 Capital Accord.

This was implemented in the United Kingdom by the FSA through the creation of the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU').

The framework consists of three 'pillars' namely;

- Pillar 1 – which sets out the minimum capital requirements that firms are required to meet for credit, market and operational risk;
- Pillar 2 – which requires firms to take a view on whether additional capital should be held against capital risks not covered by Pillar 1; and
- Pillar 3 - which requires firms to publish certain details of its risks, capital and risk management process.

BIPRU 11.5 (technical criteria on disclosure: general requirements) and 11.6 (qualifying requirements for the use of particular instruments or methodologies) require that a firm subject to the provisions of the CRD must disclose, as appropriate, the relevant information required under Pillar 3. This must be done in accordance with a formal disclosure policy which sets out the firm's policies for assessing the appropriateness of its disclosures, including their verification and frequency.

The rules provide that the firm may omit one or more of the required disclosures if it believes that the information is immaterial. Materiality is based on the criteria that the omission or misstatement of material information would be likely to change or influence the assessment or decision of a user relying on that information for the purposes of making economic decisions. Where the firm considers a disclosure to be immaterial, it should state this in the relevant section.

The firm is also permitted to omit one or more of the required disclosures where it believes that the information is regarded as proprietary or confidential. Proprietary information is that which, if it were shared, would undermine the firm's competitive position. Information is considered to be confidential where there are obligations binding the firm to confidentiality with its clients and counterparties. Where the firm has omitted information for either of these two reasons it should state this in the relevant section and the reasons for this. Where appropriate, the firm has published more general information on the subject matter of the required disclosure.

In this document the firm discloses information in accordance with the following BIPRU 11.5 rules unless it has been determined as immaterial or of a proprietary or confidential nature:

- BIPRU 11.5.1R on our risk management objectives and policies;
- BIPRU 11.5.2R on the scope of application of directive requirements;
- BIPRU 11.5.3R on our capital resources;
- BIPRU 11.5.4R (subsections 1 and 2) on our compliance with the rules in BIPRU and on Pillar 2 requirements;
- BIPRU 11.5.16R on our interest rate risk

BIPRU 11.6 does not apply to UK Portfolio Management Ltd.

These Pillar 3 Disclosures have been subject to internal review procedures. The information has not been audited by the firm's external auditors.

2. Scope and application of Directive requirements

The disclosures in this document are made in respect of UK Portfolio Management Ltd which provides independent financial advice and / or discretionary investment management services.

The firm is a limited licence firm as defined by the FSA.

3. Risk management objectives and policies

Our risk management policy reflects the FSA requirement that we must manage a number of different categories of risk. These include: liquidity, credit, market, interest rate, business and operational risks.

i. Liquidity risk

The firm manages cash resources to maximise potential interest income whilst ensuring the firm has sufficient liquid resources to meet the continued operating needs of the business. Cash resources are held with Lloyds Banking Group (Bank of Scotland), a A-rated credit

institution (by Standard & Poor's as at 22nd December 2011). This is supported by a robust budgeting and forecasting process which has the full involvement of the senior management team.

ii. Credit risk

The main credit risk for the firm relates to advisory fees, being the risk that a client does not pay amounts due for services provided. This risk is mitigated by the high number of clients in respect of which amounts are due at any one time, and that income is collected via the client's cash account directly under the terms of the agreement. Clients are invoiced bi-annually in advance.

iii. Market Risk

The firm is indirectly subject to market risk as a significant element of income is dependent upon the value of client funds under management. This risk is mitigated by the asset allocation strategy adopted, which ensures that clients have highly diversified portfolios with limited exposure to any one asset class. Accordingly exposure to market risk is considered minimal.

The firm does not trade on its own account and is thus not exposed itself to market movements.

iv. Interest rate risk

The firm has no borrowings and no exposure to interest rate risk.

v. Business Risk

The firm's Pillar 2 business risk assessment principally takes the form of a fall in assets under management following a market downturn that leads to lower management fees, although other risks such as loss of Investment Managers and systems failures are also considered. To mitigate our business risk, we regularly analyse various different economic scenarios to model the impact of economic downturns on our financial position. This is undertaken annually as part of our ICAAP review (see section 4 below). In addition, investment portfolios are monitored against benchmarks, which provide increased transparency to clients and assists in client retention to mitigate business risk.

vi. Operational Risk

Operational risk is defined as the potential risk of financial loss or impairment to reputation resulting from inadequate or failed internal processes and systems, from the actions of people or from external events.

Major sources of operational risk include: outsourcing of operations, IT security, internal and external fraud, implementation of strategic change and regulatory non-compliance.

The firm operates a robust risk management process which is regularly reviewed and updated with details being provided to all staff. The firm's Compliance Oversight is responsible for oversight of the periodic reviews, although 'ownership' of risks is generally held within the business operation, and these are discussed at least bi-annually by the Board.

All senior management will bear responsibility for internal controls and the management of business risk as part of their accountability to the board.

Individuals are responsible for identifying the risks surrounding their work, implementing controls over those risks and reporting areas of concern to their line manager.

Risk management is also overseen by the Audit, Risk & Compliance Committee, which is held quarterly, and whose membership comprises the non-executive Chairman (Chair), Chief Finance Officer, Finance Director, Governance Director and CEO of the group.

4. Capital resources

Pillar 1 requirement

In accordance with GENPRU 2.1.45R (calculation of variable capital requirement for a BIPRU firm), our capital requirement has been determined as being our fixed overhead requirement because it is the higher or the sum of our credit risk capital requirement and our market risk capital requirement.

The Pillar 1 capital requirement (fixed overhead requirement) for UK Portfolio Management Ltd was £142,000 as at 30th September 2011.

Pillar 2

Our overall approach to assessing the adequacy of our internal capital is set out in our Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP process involves separate consideration of risks to our capital combined with stress testing using scenario analysis. The level of capital required to cover risks is a function of impact and probability. We assess impact by modelling the changes in our income and expenses caused by various potential risks over a 1-year time horizon. Probability is assessed subjectively.

In addition, we have reviewed the outputs of our risk reviews to quantify any risks identified. This has identified a number of key business risks which we have classified against the risk categories contained in GENPRU 1.2.30R and reviewed the guidance in BIPRU 2.2.61-65.

Our Pillar 2 capital requirement, which is our own assessment of the minimum amount of capital that we believe is adequate against the risks identified, has been assessed as greater than our Pillar 1 requirement. There is a considerable surplus of reserves above the capital resource requirement deemed necessary to cover the risks identified. We have assessed in our latest ICAAP that there is an additional sum of £40,000 required in addition to the Pillar 1 requirement, and therefore our total requirement is £182,000.

Other risks

The firm operates a simple business model. Accordingly, many of the specific risks identified by the FSA do not apply.

Regulatory capital

The main features of UK Portfolio Management Ltd's capital resources for regulatory purposes, as at 30th September 2011 are as follows:

Capital item:	£000s
Tier 1 capital (called up share capital, share premium account, profit and loss account, externally verified interim net profits)	£2,203
Total of tier 2 and tier 3 capital (broadly long and short term subordinated loans)	£0
Deductions from tier 1 and tier 2 capital	£1,667
Total capital resources, net of deductions	£536

The firm holds regulatory capital in accordance with the Capital Requirements Directive. All such capital is classified as Tier 1 capital and is therefore of the highest quality.

5. Remuneration Disclosure

The FSA expects firms to make disclosures regarding its remuneration policy and practices for those categories of staff whose professional activities have a material impact on its risk profile, as follows:

- a) The process for determining remuneration policy.
- b) The link between pay and performance (including the main performance metrics and the forms of remuneration).
- c) Aggregate quantitative remuneration data by business area (although smaller firms may well consider they only have one business area).

d) Aggregate quantitative remuneration data broken down by reference to senior management and other staff whose actions have a material impact on the risk profile of the firm.

This is set out within the Remuneration Code. There are 4 tiers of firms within the Remuneration Code; UK Portfolio Management Ltd is classified as tier 4, the lowest tier, due to size, nature and scale of its activities.

UK Portfolio Management Ltd has considered, in determining which staff are caught within the intention of the Remuneration Code, the extent to which the individuals can determine the level of risk to be taken by the business, and the nature of the role in setting business strategy. Staff included in UK Portfolio Management Ltd's Remuneration Policy is therefore Investment Managers, members of the Board and other individuals responsible for setting the strategy for the firm.

There are 2 remuneration schemes operating relevant to the Remuneration Policy:

- Investment Managers – based on a contract of employment with a base salary and additional bonus, which contains financial and service quality performance measures to maintain compliant, ethical behaviour for the outcome of fair treatment of clients.
- Senior Managers – based on a contract of employment with a base salary and additional bonus funded from a bonus pool that is dependent on the performance of the Group overall.

The remuneration disclosures are as follows:

Aggregate remuneration of staff in respect of whom disclosure is required by business area (BIPRU 11.5.18(6))	
	Total Remuneration
Investment Management	£216,000
Senior Management	£525,000

Aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the firm (BIPRU 11.5.18(7))			
	Senior management	Other members of staff whose actions have a material impact on the risk profile of the firm	Totals
£	£525,000	£216,000	£741,000
Number of staff	8	3	11