

## **Drakewood Capital Management Limited - Pillar 3 Disclosure and Policy as at 31 December 2019**

### **Introduction**

#### **Regulatory Context**

The Pillar 3 disclosure of Drakewood Capital Management Limited (“Drakewood” or “the Firm”) is set out below as required by the introduction of the Capital Requirements Regulation (“CRR”) and the Capital Requirements Directive (“CRD”) which together comprise CRD IV. This came into force from 1 January 2014 with the CRR directly binding on all EU member states with the CRD incorporated into UK law. Under CRD IV, Drakewood became a Collective Portfolio Management (CPM) firm (as defined by the FCA) and will need to comply with the EU CRR and the FCA’s General Prudential Sourcebook (GENPRU) and Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU). CRD IV introduced a stricter definition of capital resources, increased capital requirements, increased reporting requirements, binding liquidity ratios and new requirements on remuneration. The changes arising from the implementation of CRD IV have been considered by the Firm in its latest ICAAP assessment, which shows the Firm to have sufficient excess capital resources over its minimum capital requirements under CRD IV.

#### **Frequency**

The Firm will be making Pillar 3 disclosures annually. In the event of any changes that impact the business the Pillar 3 disclosure will be more frequently than annually if the directors deem it necessary. The disclosures will be as at the Accounting Reference Date (“ARD”).

#### **Media and Location**

The disclosure will be published in the Firm’s annual audited financial statements.

#### **Verification**

The information contained in this document has not been audited by the Firm’s external auditors and does not constitute any form of financial statement and must not be relied upon in making any judgement on the Firm.

#### **Materiality**

The Firm regards information as material in disclosures if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions. If the Firm deems a certain disclosure to be immaterial, it may be omitted from this Statement.

#### **Confidentiality**

The Firm regards information as proprietary if sharing that information with the public would undermine its competitive position. Proprietary information may include information on products or systems which, if shared with competitors, would render the Firm’s investments therein less valuable. Further, the Firm must regard information as confidential if there are obligations to customers or other counterparty relationships binding the Firm to confidentiality. In the event that any such information is omitted, we shall disclose such and explain the grounds why it has not been disclosed.

## **Summary**

The CRD requirements have three pillars.

Pillar 1 deals with minimum capital requirements.

Pillar 2 deals with Internal Capital Adequacy Assessment Process (“ICAAP”) undertaken by a firm and the Supervisory Review and Evaluation Process through which the firm and regulator satisfy themselves on the adequacy of capital held by the Firm in relation to the risks it faces.

Pillar 3 which deals with public disclosure of risk management policies, capital resources and capital requirements. The regulatory aim of the disclosure is to improve market discipline.

The Firm is a €50k Full Scope AIFM. The Firm seeks to mitigate risk by implementing sound systems and controls and corporate governance arrangements.

The Firm has grouped the risk categories in the overall Pillar 2 rule (GENPRU 1.2.30R) into groups that it believes the firm is exposed to: Market, Credit, Operational, Liquidity, Interest Rate, and ‘Other’ risks. The greatest risks in financial terms are considered to be Liquidity Risk, IT Risk and Key Personnel Risk. An Assessment of all identified Risks faced by the firm has been undertaken in its Pillar 2 ICAAP assessment.

The Firm has identified several scenarios which may have a detrimental impact on the business and subjected them to analysis and a stress test. The results inform the Firm on its capital planning forecasts and proposed management actions to ensure that the Firm holds, at all times, adequate Regulatory Capital. The existing financial planning process has been integrated into the ICAAP to develop forward looking financial forecasts.

The Firm captures records and monitors its risks via a Risk Register software application that it has been developed internally. The Risk Register allows entered risks to be categorised into the appropriate Pillar 2 category and weighted accordingly depending upon the perceived likelihood of the risk occurring as well as the potential financial cost to the company which is calculated using a cost adjustment algorithm.

## **Background to the Firm**

The Firm is incorporated in the UK and is authorised and regulated by the Financial Conduct Authority. The Firm's activities give it the categorisation of a €50k Collective Portfolio Management (CPM) firm (IPRU INV 11 and GENPRU/BIPRU)

The Firm is a solo regulated entity and does not form part of a UK Consolidation Group.

## **Risk Management Objective**

The Firm has a risk management objective to develop systems and controls to mitigate risk to within its risk appetite.

## **Governance Framework**

The Board is the Governing Body of the Firm and has the daily management and oversight responsibility. The Risk Committee has oversight of the Firm's Risk portfolio and reports its findings to the Board. The Board meets periodically during the year and the Risk Committee meets weekly. Composition of these bodies is as follows:

### **Board of Directors**

David Lilley - Director

Alan Spangler - Director

### **Risk Committee**

Alan Spangler - Chair

Adam Esah

Charles Davis

Connie Hua

Daniel Jones

Jim Stevenot

Katie Shao

The Board of the Firm is ultimately responsible for the total process of risk management. The Board delegates certain Risk responsibilities to the Risk Committee.

The Board sets the Firm's appetite or tolerance for risk – those risks it will accept and those it will not take in the pursuit of its goals and objectives. In addition the Board ensures that the Firm has implemented an ongoing process to identify risk and to measure its potential impact against a broad set of assumptions. The Risk Committee is accountable to the Board for designing, implementing and monitoring the process of risk management and incorporating it into the day-to-day business activities of the Firm.

## **Risk Framework**

Risk within the Firm is managed by use of the following:

- The Board of the Firm is responsible for the total process of risk management and the Board sets the risk strategy policies through the Risk Committee;
- The Firm has a conservative approach to risk;
- The Firm identifies its risks and records them in the Risk Register;

- The Risk Register is updated by risk owners on at least a weekly basis and all risks are managed and reviewed by the Head of Operations;
- The Firm undertakes stress tests on the most significant risks identified on a periodic basis. This informs the Firm how risks are likely to behave and what, if any, impact there is likely to be to its Balance Sheet;
- The Firm has in place an internal control framework to govern its processes and procedures and to mitigate any risks;
- The Risk Committee is accountable for designing, implementing and monitoring the process of risk management and implementing it into the day-to-day business activities of the Firm. The Board, through the Risk Committee, is also responsible for communicating the Firm's approach and commitment to establishing and maintaining an effective risk management framework and approach;
- The Board is responsible for ensuring that employees are adequately equipped with appropriate tools, support and knowledge. They have made a considerable investment in software to enable those employees involved in Risk Management functions, at all levels, to fulfil their obligations with regards to the risks faced by the company.

## **Principal Risks**

### **Credit Risk**

The Credit Risk faced by the Firm consists of counterparty credit risk arising from cash deposits held at banks. All cash deposits are held with highly rated clearing banks and counterparty exposures are monitored and kept under review with steps in place to reduce counterparty risk where market conditions require.

The possibility of concentration risk exists in the level of exposure to an individual counterparty. Credit policy is to monitor concentration risk across group companies, country exposure, credit rating and types of counterparty.

### **Credit Risk calculation**

For its Pillar 1 regulatory capital calculation of Credit Risk, under the credit risk capital component, the Firm has adopted the Standardised approach under Chapter 2 of the CRD and the Simplified method of calculating risk weights.

<b>Credit Risk</b>	<b>Actual (£'000s)</b>	<b>Weighting</b>	<b>Weighted (£'000s)</b>
Debtors < 90 days	660	100 %	660
Debtors > 90 days	1,192	150 %	1,778
Fixed assets	16	100 %	16
Investments	-	100 %	-
Cash at bank < 90 days	235	20 %	47
	<b>2,103</b>		<b>2,511</b>

**Credit Risk Capital Component:** 8% of risk weighted exposure - **£201k**.

### **Market Risk**

Market Risk is the vulnerability of the Firm to an adverse movement in its assets or an increase in its liabilities based on changes in market prices. Drakewood does not take any trading risk and does not hold any proprietary trading positions, so does not have Trading Book potential exposure.

The Firm does however have market risk as it is a GBP denominated company and faces risk over its USD currency exposures. Revenue streams are generally received in USD and the principal liabilities of the Firm need to be met in GBP (consultancy, personnel, rent and legal expenses). Foreign Exchange risk is monitored by the daily reconciliation of the Cash Sheets which detail balances across all currencies. All the balances have been stress tested to consider the effect that a large currency movement on a given day would have on Drakewood's currency positions.

### **Operational Risk**

The Firm, being a CPM firm, is not subject to the Pillar 1 Operational Risk Requirement under Title III of Part Three of the CRR and therefore it is not required to calculate its operational exposure amounts.

However, the Firm does take into account, as part of the Pillar 2 calculations, the Operational Risk of a loss resulting from inadequate or failed internal processes, people activities, systems or external events. The Operational Risks are tracked and monitored by a risk owner who reports on the status and effectiveness of each risk on the Risk Register. The risk register is updated on a weekly basis. The Head of Finance is in charge of the risk register.

Operational Risks identified within the Firm, documented and managed by the respective risk owners as at 31 December 2019 include:

- Human Resources - Operational dependency on key individuals.
- IT and Technology - Systems failures, breakdown in security or loss of data integrity and business continuation.
- External providers - Insurance cover risk, pension obligation and access to premises.
- Regulatory and Compliance - Breach of regulatory requirements, leading to fines and reputational damage.
- Finance – Outsourcing of certain aspects of its financial reporting to external accountants. Risks of lost data, misreporting and returns not being filed or being incorrect.

### **Fixed Overhead Requirement**

Given the classification of the Firm as a CPM firm, it is exempted from the condition to calculate an Operational Risk requirement. It is, however, required to calculate a Fixed Overhead Requirement ("FOR") in accordance with Article 97 of the CRR.

The Firm is required to hold eligible capital of at least one quarter of the 2019 fixed overheads. The Fixed Overhead Requirement as at 31 December 2019 was £625k.

In accordance with Article 95(2) of the CRR, the combined risk exposure of Credit Risk and Market Risk (£216k) is less than the FOR (£625k) therefore the FOR forms the Firm's Pillar 1 capital requirement.

### **Other Risks**

The nature and scope of the Firm's operations mean that it is exposed to a number of other financial risks.

### **Interest Rate Risk**

A rise in UK interest rates would lead to an expected increase in the value of GBP against USD by way of the interest rate parity theory. Revenues of Drakewood are earned in USD and consequently make non-trading costs more expensive.

### **Liquidity Risk**

Drakewood is not a BIPRU ILAS firm or a significant IFPRU firm so is exempt from the obligations in Part 6 of the EU CRR, namely COREP templates Category 4 Liquidity ratio. However, Drakewood aims to ensure that it has constant access to an appropriate level of cash to enable it to finance its ongoing operations and reasonable unexpected events. The day to day liquidity management is performed by the Finance Department who calculate each day's opening multicurrency cash balances and the management of its liquid assets is designed to ensure liquidity even in highly stressed scenarios.

### **Non-applicable Risks**

Other than mentioned above, Drakewood does not have any exposure to the following risks so these have not been considered:

- Non-trading book exposures in equities,
- Securitisation Risk,
- Residual Risk

### **Cyclical and Systemic Capital Buffers**

Drakewood is not required to hold any Capital Buffers in addition to its Pillar 1 and Pillar 2 Capital requirements.

### **Overall Pillar 2 Rule**

The Firm has adopted the Pillar 1 + approach to the calculation of its ICAAP Capital Resources Requirement as outlined in the Committee of European Banking Supervisors Paper, 25 January 2006.

Overall the Pillar 1 requirement represents the Fixed Overhead Requirement of £625k, which is greater than the combined Credit Risk and Market Risk of £216k.

The ICAAP assessment is presented to the Board on an annual basis. The ICAAP report is amended by the Firm when a material change to the business occurs and the Board is notified accordingly. The Board reviews and endorses the ICAAP document. The Firm is subject to the disclosures under the Banking Consolidation Directive however, it is not a member of a UK Consolidation Group and consequently, does not report on a consolidated basis for accounting and prudential purposes.

### **Remuneration**

The Firm is a Remuneration Code Proportionality Tier 3 Firm and has applied the rules appropriate to its Proportionality Tier.

In relation to the remuneration policy, the Company's underlying objective is to ensure that individuals are appropriately rewarded relative to their responsibility, experience and value to the Company. This objective is to be applied as consistently and fairly as possible to all Company personnel over a prolonged period of time.

The Firm has chosen to make a copy of its Remuneration Policy available in the legal section of its website: [www.drakewood.co.uk](http://www.drakewood.co.uk)

### **FCA Remuneration Code**

FCA Handbook SYSC19 sets out the application and purpose of the FCA Remuneration Code. The purpose of the Remuneration Code is to ensure that firms have risk-focused remuneration policies that do not expose them to excessive risk.

### **Remuneration Code Staff**

FCA define Remuneration Code Staff as the following: Senior Manager; Risk Taker; Senior Manager Function. The remuneration of material risk takers and employees in senior market functions is subject to specific conditions laid down in FCA rule SYSC 19A.3.6.

In accordance with applicable guidelines once a year, subject to an annual assessment process the Board of Directors identifies employees in senior management functions and employees who are material risk takers.

Remuneration levels are also set by the board of directors on an annual basis and are made up of fixed pay (i.e. salary and ancillary benefits) and discretionary performance-related pay. Performance-related pay is designed to reflect success or failure against a range of objectives.

The Firm provides incentives which are designed to link reward with the long-term success of the Firm and recognise the responsibility participants have in driving its future success and delivering value for stakeholders.

The structure of the remuneration package is such that the fixed element is sufficiently large to enable the Firm to operate a fully flexible variable remuneration policy.

### **Capital Resources**

The table below sets out the Capital Resources of Drakewood as at 31 December 2019, reflecting the regulatory capital return submitted at this date.

<b>Capital Resources</b>	<b>(£'000s)</b>
<b>Common Tier One Capital (CRR Article 28)</b>	
Ordinary Share Capital	2,220
Non-cumulative Preference Share Capital	421
Share Premium Account	
Reserves excluding Revaluation Reserve	
Audited Retained Earnings	(1,978)
	<b>(£'000s)</b>
Externally verified interim net profits or current account	
<b>Total Tier One Capital</b>	<b>663</b>

Deductions (CRR Article 36)	-
<b>Total Tier One Capital after Deductions</b>	<b>663</b>
Pillar 1 Requirement	<b>625</b>
Surplus over Pillar 1 Requirement	<b>38</b>