arabesque

# Pillar 3, Stewardship Code and Remuneration Disclosure

February 2021

# Arabesque Asset Management Limited

# (“AAML”/the “Firm”)

The Capital Requirements Directive (“**CRD**”) of the European Union establishes a revised regulatory capital framework across Europe governing the amount and nature of capital credit institutions and investment firms must maintain.

In the United Kingdom, the CRD has been implemented by the Financial Conduct Authority (“**FCA**”) in its regulations through the General Prudential Sourcebook (“**GENPRU**”), the Prudential Sourcebook for Banks, Building Societies and Investment Firms (“**BIPRU**”), the Interim Prudential Sourcebook for Investment Business (“**IPRU (INV)**”).

The CRD consists of three ‘Pillars’:

- Pillar 1 sets out the minimum capital amount that meets the Firm’s credit, market and operational risk capital requirement;
- Pillar 2 requires the Firm to assess whether its capital reserves, processes, strategies and systems are adequate to meet pillar 1 requirements and further determine whether it should apply additional capital, processes, strategies or systems to cover any other risks that it may be exposed to; and
- Pillar 3 requires disclosure of specified information about the underlying risk management controls and capital position to encourage market discipline.

The rules in BIPRU 11 set out the provision for Pillar 3 disclosure. This document is designed to meet our Pillar 3 obligations.

The Pillar 3 disclosure document has been prepared by AAML in accordance with the requirements of BIPRU 11. Unless otherwise stated, all figures are as at the 31 December 2020 financial year-end.

Pillar 3 disclosures will be issued on an annual basis after the year end and published as soon as practical with the annual accounts.

AAML is permitted to omit required disclosures if it believes that the information is immaterial such that omission would be unlikely to change or influence the decision of a reader relying on that information for the purpose of making economic decisions about the Firm.

In addition, AAML may omit required disclosures where it believes that the information is regarded as proprietary or confidential. In its view, proprietary information is that which, if it were shared, would undermine its competitive position. Information is considered to be confidential where there are obligations binding the Firm to confidentiality with its customers, suppliers and counterparties.

AAML has made no omissions on the grounds that it is immaterial, proprietary or confidential.

## Scope and application of the requirements

AAML is authorised and regulated by the FCA and, as such, is subject to minimum regulatory capital requirements. The Firm is categorised as a BIPRU Firm by the FCA for capital purposes.

It is an agency investment management firm and, as such, has no trading book exposures.

Although part of a group, AAML is managed on a "stand-alone" basis for liquidity purposes and the Firm does not foresee any impediments to the prompt transfer of capital between group entities should the need arise. There are no differences in the basis of consolidation for accounting and prudential purposes.

## Risk management

AAML has established a risk management process in order to ensure that it has effective systems and controls in place to identify, monitor and manage risks arising in the business. The risk management process is overseen by the Risk Function, with the senior management team taking overall responsibility for this process and the fundamental risk appetite of the firm. The Risk Function has responsibility for the implementation and enforcement of the Firm's risk principles.

Senior management meets periodically and discusses current projections for profitability, cash flow, regulatory capital management, business planning and risk management. Senior management engages in AAML's risks though a framework of policy and procedures, having regard to the relevant laws, standards, principles and rules (including FCA principles and rules) with the aim of operating a defined and transparent risk management framework. These policies and procedures are updated as required.

The Risk Function has identified that business, operational, market and credit are the main areas of risk to which the Firm is, or may be, exposed. At least annually, the Risk Function reviews the Firm's risks, controls and other risk mitigation arrangements and assesses their effectiveness.

A formal update on operational matters is provided to the senior management team on a quarterly basis. Management accounts and cash flow forecasts demonstrating continued adequacy of AAML's regulatory capital are reviewed at least monthly.

Appropriate action is taken where risks are identified which fall outside of the Firm's tolerance levels or where the need for remedial action is required in respect of identified weaknesses in AAML's mitigating controls.

## Business Risks

Specific risks applicable to the Firm come under the headings of business, operational, credit and market risks.

### 1. Business risk

AAML's revenue is reliant on the performance of the existing funds under management and its ability to launch new funds/obtain new mandates. As such, the risk posed to the Firm relates to underperformance resulting in a decline in revenue and adverse market conditions hindering the launch of new funds and ultimately the risk of redemptions from the funds managed by AAML. This risk is mitigated by, for example:

- The use of lock up periods and redemption gates imposed by the funds;
- Significant levels of capital held by the Firm which will continue to cover all the expenses of the business;
- A diverse investor base and product offerings.

## 2. Operational risk

AAML places strong reliance on the operational procedures and controls that it has in place in order to mitigate risk and seeks to ensure that all members of staff are aware of their responsibilities in this respect.

The Firm has identified a number of key operational risks to manage. These relate to systems failure, failure of a third-party provider, key man, potential for serious regulatory breaches, and model risk. Appropriate polices are in place to mitigate against these risks, which includes taking out adequate professional indemnity insurance.

## 3. Credit risk

The Firm is exposed to credit risk in respect of its debtors and investment management fees billed and cash held on deposit.

The number of credit exposures relating to AAML's investment management clients is limited. Management fees are drawn monthly from the funds managed and performance fees are drawn annually where applicable. The Firm considers that there is little risk of default by its clients. All bank accounts are held with large international credit institutions.

Given the nature of the Firm's exposures, no specific policy for hedging and mitigating credit risk is in place. AAML uses the simplified standardised approach detailed in BIPRU 3.5.5G of the FCA Handbook when calculating risk weighted exposures of 1.6% (Cash in Bank) and 8% in respect of its other assets.

## 4. Credit risk summary

| Credit risk exposure | Risk weighting | Risk weighted exposure |
|---|---|---|
| Cash in the bank | 1.6% or 8% subject to institution and FCA rules | £15,890 |
| Inter-company | 8% | £33,946 |
| Trade Debtor | 8% | £368 |
| Prepayments and Accruals | 8% | £23,666 |

| | | |
|---|---|---|
| Other debtors (<1 year) | 8% | £38,869 |
| Other debtors (>1 year) | 8% | £Nil |
| Other assets | 8% | £44,049 |

## 5. Market risk

The Firm takes no market risk other than foreign exchange risk in respect of its accounts receivable and cash balances held in currencies other than GBP.

Since AAML takes no trading book positions on its balance sheet, it has only indirect market risk exposure. The Firm's foreign exchange risk therefore would only arise in respect of its accounts receivable and cash balances held in currencies other than GBP.

No specific strategies are adopted in order to mitigate the risk of currency fluctuations.

## 6. Market risk summary

| Market risk exposure | Risk weighting | Risk weighted exposure |
|---|---|---|
| Foreign currency assets and liabilities | 8% | £80,898 |

## 7. Liquidity risk

AAML is required to maintain sufficient liquidity to ensure that there is no significant risk that its liabilities cannot be met as they fall due or to ensure that it can secure additional financial resources in the event of a stress scenario.

The Firm retains an amount it considers suitable for providing sufficient liquidity to meet the working capital requirements under normal business conditions. AAML has always had sufficient liquidity within the business to meet its obligations and there are no perceived threats to this given the cash deposits its holds. Additionally, it has historically been the case that all management fee debtors are settled promptly, thus ensuring further liquidity resources are available to the Firm on a timely basis. The cash position of the Firm is monitored by the Finance Function on a monthly basis.

AAML maintains a Liquidity risk policy which formalises this approach.

## Regulatory capital

The Firm is a Limited Company and its capital arrangements are established in its Articles. Its capital is summarised as follows:

The main features of AAML's capital resources for regulatory purposes are as follows:

| | **31/12/2020**<br>**£000** |
|---|---|
| Tier 1 capital* | 960 |
| Tier 2 capital | - |
| Tier 3 capital** | - |
| Deductions from Tiers 1 and 2 | (524) |
| Total capital resources | 436 |
| *No hybrid tier one capital is held | |

The Firm is small with a simple operational infrastructure. Its market risk is limited to foreign exchange risk on its accounts receivable in foreign currency, and credit risk from management and performance fees receivable from the funds under its management. AAML follows the standardised approach to market risk and the simplified standard approach to credit risk.

BIPRU - The Firm is subject to the Fixed Overhead Requirement and is not required to calculate an operational risk capital charge though it considers this as part of its process to identify the level of risk based capital required.

As discussed above, AAML is a BIPRU firm and, as such, its capital requirements are the higher of:

- €50,000; and
- The sum of the market & credit risk requirements; or
- The fixed overheads requirement ("**FOR**") which is essentially 25% of the Firm's operating expenses less certain variable costs.

The FOR is calculated, in accordance with FCA rules, based on the Firm's previous years audited expenditure. AAML has adopted the simplified standardised approach to credit and market risk and the above figures have been produced on that basis. The Firm is not subject to an operational risk requirement.

It is AAML's experience that the Fixed Overhead Requirement establishes its capital requirements.

## Capital requirement

AAML's Pillar 1 capital requirement has been determined by reference to the Firm's Fixed Overheads Requirement ("**FOR**") and calculated in accordance with Article 95. The requirement is based on the FOR since this exceeds the total of the credit and market risk capital requirements it faces and also exceeds its base capital requirement of €50,000.

The FOR is based on annual expenses net of variable costs deducted. The Firm monitors its expenditure on a monthly basis and takes into account any material fluctuations in order to determine whether the FOR remains appropriate to the size and nature of the business or whether any adjustment needs to be made intra-year.

This is monitored by the Finance Function and reported to senior management on a monthly basis.

## Remuneration disclosure

AAML is authorised and regulated by the Financial Conduct Authority as a BIPRU Firm and, so, it is subject to FCA Rules on remuneration. These are contained in the FCA's Remuneration Codes located in the SYSC Sourcebook of the FCA's Handbook.

The Remuneration Code ("**the RemCode**") covers an individual's total remuneration, fixed and variable. The Firm incentivises staff through a combination of the two.

The Firm's business is to provide portfolio management services to its clients.

AAML's policy is designed to ensure that it complies with the RemCode and its compensation arrangements:

1. Are consistent with and promotes sound and effective risk management;

2. Do not encourage excessive risk taking;

3. Include measures to avoid conflicts of interest; and

4. Are in line with the Firm's business strategy, objectives, values and long-term interests.

## Proportionality

Enshrined in the European remuneration provisions is the principle of proportionality. The FCA has sought to apply proportionality in the first instance by instituting two tests. Firstly, a firm that is significant in terms of its size must disclose quantitative information referred to in BIPRU 11.5.18R at the level of senior personnel. Secondly, a firm must make disclosure that is appropriate to the size, internal organisation and the nature, scope and complexity of their activities.

AAML is not 'significant' (that is to say has relevant total assets <£50bn*) and so makes this disclosure in accordance with the second test (BIPRU 11.5.20R(2)).

* average total assets on the last three accounting dates.

## Application of the requirements

The Firm is required to disclose certain information on at least an annual basis regarding its Remuneration Policy and practices for those staff whose professional activities have a material impact on the risk profile of the Firm. AAML's disclosure is made in accordance with its size, internal organisation and the nature, scope and complexity of its activities. The Firm's full Remuneration Policy is available at the request of investors.

## Quantitative disclosure

1. Aggregate quantitative information on remuneration broken down by significant business division (where such business divisions exist).

| Business Area | Aggregate compensation expense for prior fiscal year |
|---|---|
| Investment Management | £277,696.09 |
| Non-Investment Management | £564,401.61 |

2. Aggregate quantitative information on remuneration, for staff whose actions have a material impact on the risk profile of the Firm

| **Code Staff** | **Aggregate compensation expense in (Year Ending 31 December 2020)** |
|---|---|
| Senior Management: | n/a |
| Others (If applicable): | £277,696.09 |

The Firm may omit required disclosures where it believes that the information could be regarded as prejudicial to Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data.

The Firm has made no omissions on the grounds of data protection.