Nikko Asset Management Europe Ltd

FCA Reference Number: 122084

Capital Requirements Directive Pillar 3 Disclosure 2014

Background

1. Overview

1.1 Background

The European Union Capital Requirements Directive introduced standards in the EU for capital adequacy based on the assessment of risk, together with an associated supervisory framework and disclosure requirements. The Capital Requirements Directive is implemented in the UK through rules and guidance enforced by the Financial Conduct Authority ("FCA").

The Capital Requirements Directive consists of three 'Pillars':

Pillar 1 establishes minimum capital requirements in respect of credit, market and operational risk exposures using standard criteria.

Pillar 2 requires firms to assess the risk exposures specific to their business and to calculate the amount of capital that should be held against those exposures. This has been implemented in the UK by the FCA as the Individual Capital Adequacy Assessment Process ("ICAAP"). FCA rules also establish a supervisory process for the FCA to challenge firms' own assessments of their risk exposures and corresponding capital requirements.

The amount of capital a firm is required to hold is the greater of the Pillar 1 and Pillar 2 values.

Pillar 3 requires firms to publicly disclose their policies for managing risk and their capital requirements. This is designed to promote market discipline by providing market participants with key information on a firm's risk exposures and risk management processes.

On 1 January 2014, a fourth iteration of the CRD came into effect ("CRDIV"). All disclosures in the document are based upon data as at and the rules extant at 31 December 2013. The next update of this document will provide data based upon the new CRDIV rules.

1.2. Scope and Application of Requirements

Nikko Asset Management Europe Ltd is part of a "UK consolidation group" (the "Group") for FCA reporting purposes and in accordance with the provisions of BIPRU 2.2.6G, the ICAAP review and report has been compiled on this basis.

Nikko AM Global Holdings Limited is the EEA parent financial holding company for the "UK consolidation group". The other sister companies in the "UK

consolidation group" are Nikko AM Global Cayman Limited and Nikko AM (Cayman) Ltd.

It should be noted that Nikko Asset Management (Mauritius) Limited is excluded from accounting consolidation in accordance with SIC 12 consolidation - special purpose entities due to the lack of principal benefits generated from its investment and is therefore not included within the corporate structure chart though remains part of the "UK consolidation group."

1.3. Basis of Disclosures

This document sets out the Pillar 3 disclosure for UK consolidation group". Unless otherwise stated all figures are as at 31 December 2014.

Nikko Asset Management Europe Ltd (FCA Firm No. 122084) (the "Company") was incorporated on 27 March 1984 and is an investment manager and advisor to third parties and other group companies within the Nikko Group and manages and advises on funds and segregated portfolios (collectively, "accounts")

This Pillar 3 disclosure is made in accordance with the FCA's Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU").

2. The Group' Risk Management Arrangements

2.1 Risk Management Objectives

Risk is an inherent part of the Group' business. Our objective is not to completely eliminate risk but to manage it to an acceptable level whilst balancing risk with reward. Effective risk management assists in the delivery of our strategic objectives; protecting the value of The Group by managing potential threats and adding value by enhancing our ability to take advantage of the available opportunities. It also forms a vital element of our capital planning, helping to ensure our business model is resilient and enabling The Group to retain the ability to meet its liabilities as they fall due.

2.2 Our Risk Governance Framework

The Group Risk Governance Framework ensures that risks are being appropriately identified and managed, and that the risks of significant loss or damage to our reputation are being minimised. The framework comprises:

- **Risk appetite** - Sets out the Group' attitude to risk and the ranges and limits of acceptable risk taking.

- **Risk policies** - Define our approach to monitoring and controlling risk, so as to ensure we are only exposed to risks that are within appetite.
- **Risk identification and assessment** - Tools that help managers identify and evaluate the risks to which we may be exposed.
- **Risk management information** - How we report and review ongoing and emerging risks, and assess actual risk positions relative to the risk targets and limits that we set.
- **Risk oversight** - Review and challenge of how we identify and manage risk by the Group.
- **Risk committees** - Management committees are the forums where we review key risks and develop risk management strategies. Group level committees oversee the management of risks and challenge how the risk framework is working.

2.3 Governance and Oversight Structure

Globally, Risk Management is sponsored by the Nikko AM Group Board and is a top priority for senior management. The Nikko AM Group Board is responsible for setting the tone of risk management and for developing an organization wide risk management strategy.

The Risk Oversight Committee (ROC) is appointed by the Board to represent and assist the Board in fulfilling its oversight responsibilities, acting as the highest decision-making body for risk governance matters in the Nikko AM group.

Within Europe, the Nikko Asset Management Europe Board is responsible for Risk Management for the group. The Board has established a Risk Committee, to assist it in fulfilling its risk oversight and risk management responsibilities.

The purpose of the Risk Committee is to provide governance and oversight of the implementation and maintenance of global business Risk Management Framework (RMF).

Where deemed necessary by the Risk Committee, significant risk issues or changes to policy will be presented to the The Group Board or the NAM Risk Oversight Committee (ROC) for ratification.

The Risk Committee’s primary roles are to ensure the group business:-

- exhibits the appropriate risk culture within behaviors and actions,
- operates a risk management framework, including policies and processes, that complies with the group policies and standards on risk, legislative and regulatory matters,
- operates the appropriate processes in place to identify, assess, monitor and control all risks within the agreed risk appetite tolerances.

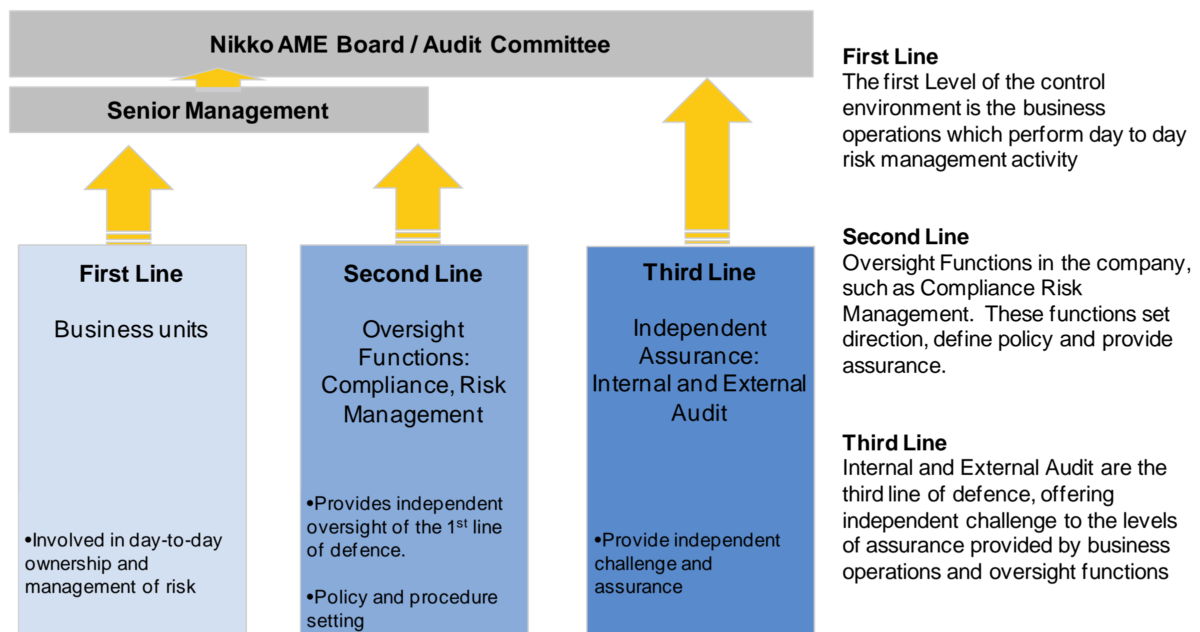
The Committee does not itself actively manage any specific risks. Rather, it has responsibility for ensuring there are appropriate management structures in place to manage the identified risks and issues.

The Risk Committee meets on a quarterly basis and is chaired by the Chief Executive Officer.

The group risk governance structure is based on the "three lines of defence" model detailed below.

This model assigns specific risk management responsibilities based on the principle that, to be effective, risk management capability must be embedded in the business lines, with independent oversight and assurance.

The Three Lines of defence model:



2.4 Risk Identification and Management

Business managers are responsible for identifying and assessing the risks in their business. An enterprise-wide risk management methodology been established to support the identification and assessment of risk. 2nd line risk teams facilitate the process of risk identification and assessment and provide objective review and challenge.

The review of risks is a continuous process, the method of which differs according to the category of risk:

- **Enterprise risks** - These risks relate to factors that may inherently affect the delivery of business strategy or transient and developing matters and issues that require active senior management involvement to ensure that they do not result in loss or reputational damage. The risks are identified through a 'bottom up (business management view) : top down (Board view)' review process. The risks are assessed in terms of their impact on the Group's profits, balance sheet, customers, reputation and strategic objectives.
- **Financial risks** – These risks relate to exposures such as market, insurance, credit and liquidity risks. They are inherent to the products or propositions that we provide. Exposures to these risks are identified and assessed using the Product Risk Matrix (PRM), which provides a framework to evaluate the circumstances under which the risks may arise and their relative impact.

2.5 Categorisation of Risk

The Group recognises that it is exposed to a wide range of risks and to ensure that employees and stakeholders can demonstrate a consistent view of what the key risks are and how their management is aligned to the Company's strategic objectives a common risk language is used. Central to this language is the categorisation of risk.

Risk categories relevant to this disclosure are detailed below:

Operational Risk

The risk of loss resulting from inadequate or failed internal processes, people or systems or from external events. The Group' definition of operational risk includes risks arising from outsourced and critical third party provider relationships, compliance and legal risks and strategic and business risks.

The Group is exposed to numerous types of operational risk which it has further categorised to facilitate meaningful assessment and reporting in accordance with its risk management framework processes.

The Group operates a system of controls which is designed to ensure operational risks are mitigated to therequired level. The operation and effectiveness of the controls are regularly assessed and confirmed through the work of the Group's assurance functions: Risk, Compliance and Internal Audit.

As part of regularly updating the Group's Internal Capital Adequacy Assessment Process ("ICAAP"), the Risk function facilitates a series of business wide workshops to gather expert opinion on the key operational risks and to provide an assessment of the future frequency and potential impact of each risk. Senior

management are selected by the Risk function on the basis of their expertise in their relevant business area, knowledge of business process and controls and the specific risk categories under review. The workshops consider a combination of internal and external historical data to determine the severity and frequency of each key risk on both an average and worst case basis. The workshops also consider the internal control environment around each risk and any mitigating actions that would be brought to bear in the event of the risk occurring.

The Group adopts a wide range of control and contingency measures to manage and mitigate its operational risks. Principle control measures in place include:

- Segregation of duties, enforced through IT security access privileges and operational process controls.
- Dealing and payment authorisation levels; dual or triple authorisation procedures and transaction checking controls.
- Recruitment and development of appropriately skilled individuals, with employee objectives set and measured on an ongoing basis.
- Pre-employment screening.
- Segregation and reconciliation across dealing, operations and finance. areas.
- Due diligence conducted prior to entering into strategic outsourcing and supplier relationships and on an ongoing basis through a programme of assessment against agreed service levels.
- IT system performance and capacity testing.
- Business continuity and disaster recovery plans which are regularly tested.

Business and strategic risks are also assessed through consideration of capital requirements using stress and scenario testing for relevant risks, including a severe, sustained fall in markets.

Credit risk

The risk of a transacting counterparty defaulting before the transaction's cash flow is ultimately settled. If a transaction with a counterparty has positive economic value at the time of default, economic loss will occur. The group is exposed to credit risk relating to default by its clients, custodians and brokers.

We do not consider that we are materially exposed to this risk as our sales debtors are managed funds and therefore management and performance fees receivable are governed by our agreements with these funds. To mitigate any residual risk of these assets failing to be delivered we ensure that the terms of these agreements in relation to payments of management and performance fees are adhered to by monitoring our aged debtor analysis against the agreed service level agreements. Further, with regard to bank deposits we only deposit money with approved counterparties on agreed terms and have recently

diversified our banking relationships to give us increased comfort in this area. Additionally we regularly monitor and review the credit status and ratings of our respective counterparties to ensure that we have adequate oversight over our exposures, and the exposures of our clients, to them.

Market risk

Market risk is the risk that market conditions lead to a decline in the value of Group available-for-sale financial assets. Further, in the event of market conditions adversely affecting clients' assets under management (AUM), fees earned from those AUM would reduce.

In defining market risk (or systemic risk) as that which is common to an entire class of assets or liabilities whereby their value can fluctuate simply because of economic changes or other events that impact large portions of the market, we consider we have no material exposure to market risk as the assets we manage are held by and for the benefit of those fund holders through separate legal entities.

Any foreign exchange risk on our fees receivable and payable. The Group mitigates this risk through the effect of natural hedges i.e. holding financial assets and liabilities of equal value in the same currency; by limiting the net exposure to an individual non-base currency; and by entering into hedging instruments such as foreign exchange contracts, which are primarily used to hedge available for-sale financial assets.

Liquidity Risk

The risk that the Company, although solvent, either does not have sufficient available resources to enable it to meet its obligations as they fall due, or can secure them only at excessive cost. The Group is exposed to liquidity risk in respect of payment obligations to its clients and product providers and the settlement timing of corresponding cash inflows and outflows.

The Group conducts stress testing against a range of potential liquidity risk events and scenarios on an ongoing basis as part of its liquidity risk management process.

Reputational Risk

The risk of direct or indirect loss arising from damage to the Company's reputation. The Group considers that reputational risks exist as the potential outcome of risks occurring within other risk categories (such as operational or liquidity risks) and do not exist in isolation. The identification and mitigation of reputational risks is therefore managed through The Group' risk management framework processes for managing those other risk types.

3. Capital Resources and Requirements

3.1 ICAAP

The Group's Individual Capital Adequacy Assessment Process (ICAAP) methodology is designed to capture the key risks faced by the business under Pillar 2. Taking the FCA's BIPRU Rules and Guidance as a starting point, the key risk types defined therein have been assessed for relevance and appropriateness to the Group business model. The Group's policy is to review its ICAAP methodology at least annually. Reports are prepared on an annual basis for the Board, giving an assessment of the amounts, types and distribution of capital resources that the Group considers appropriate for the nature and level of risks to which it is or might be exposed.

Each other risk exposure identified that would cause potential future capital losses is considered and measured accordingly using a mixture of relevant Internal and external data. For those risks that would cause either reputational damage or reduce future revenue, rather than causing an immediate capital loss to the Group, assessment has been made through downside stress and scenario testing of the impact on Group financial forecasts.

The ICAAP also considers the Group's long term capital outlook, along with a downside scenario, a process which is incorporated into the Group's annual budgeting process and reviewed by the Board. In addition, it considers a wind-down analysis which looks at whether the Group would be required to hold additional capital over the period that it would take to wind up the Group.

3.2 Capital Resources

Current Distribution of Capital	
	(£) 000's
Permanent Share Capital	8,724
Profit and Loss account and other reserves	29,440
Total Tier 1 Capital	**38,164**
Tier 2 and 3 capital	338
Consolidated Capital Resource Requirement	**2,876**
Surplus	**35,626**

The value of share capital, share premium and audited reserves is £34,693k as at 31 March 2014 on a solo basis. Our capital resources comprise core Tier 1 capital only and therefore there are no other items or deductions.

On a group basis our capital resources comprise share capital and audited reserves of £38,109k and additionally Tier 3 capital of £337k which represents a subordinated loan from the immediate parent company to Nikko AM Global Holdings Limited. Therefore, our total capital resources on a group basis are £38,446k.

3.3 Capital Requirement

Nikko UK Consolidated Group	
	(£)
Credit Risk	1,398
Market Risk	507
Sum of Credit and Market Risk **(A)**	**1,905**
Fixed Overhead Requirement **(B)**	**2,876**
Pillar 1 Requirement (higher of A or B)	**2,876**

The group' Pillar 2 capital requirements is calculated in accordance with the Company's ICAAP. This includes an assessment of the adequacy of capital resources to support current and future activities and to cover the key risks faced by the business, including relevant stress scenarios, on a going concern basis and also the costs and capital requirements that would be required in the event that an orderly wind down of the Company was necessary. The ICAAP is reviewed and approved at least annually by the group Board.

4 . Remuneration Policy and Practices

The FCA's Remuneration Code (the "Code") was implemented with effect from 1 January 2011.The Code requires the firm to identify individuals whose professional activities have a material impact on its risk profile (known as "Code Staff") and the Code requirements and underlying disclosures, subject to any applicable proportionality requirements as a Tier 3 firm, apply to those individuals.

Code Staff are defined with reference to managerial responsibility to influence the firm's overall risk profile. At the discretion of the Board, other employees may be included as Code Staff if they consider that their role has a material impact on the firm's risk profile. An annual review of the firm's risk profile is conducted by the

CEO with advice from Compliance and agreed by the board of directors. to determine the Code Staff population and a record is maintained by HR.

Due to the size of the Company, we do not consider it appropriate to have a separate remuneration committee. Instead this function is undertaken by the Executive Directors and is subject to supervision and review and approval of the senior management of Nikko Asset Management Co., Ltd. ("NAM Tokyo"), the intermediate parent controlling 100% of the shares in the Company.

Aggregate Quantitative information on remuneration

8 employees are designated as Code Staff. The roles included are principally executive directors for the Company, who exert significant influence as senior managers in the running of the company and determine the firm's risk profile, risk takers and those employees receiving total remuneration which takes them into the same remuneration bracket as senior managers and/or risk takers.

The aggregate annual remuneration of Code Staff is £2,835,900 (2013 £2,763,200) for the period ending 31 March 2014. This is made up of fixed pay £1,621,000 (2013: £1,586,000) and variable pay £1,214,000 (2013: £1,177,900).