2018

# Pillar 3 disclosures

Dundas Partners LLP, March 2018

*Dundas Partners LLP will be referred to as DPL in this document.*

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

## Executive Summary

- DPL is authorised and regulated by the FCA (registration number 587649 and registered since 26 February 2013) and is subject to minimum capital requirements based on its prudential categorisation as a BIPRU Limited Licence €50,000 firm unable to hold client money and with activity restriction.
- This report confirms that the firm has adequate capital for its size and business complexity.
- The firm has only one regulated entity that is covered by the assessment. The firm is not part of a group.
- The material risks identified by the firm are a prolonged period of negative global equity returns resulting in a decline in fees earned and loss of a major client at this early stage in the firm's development. The impact of both would be felt through declining profitability without adjustment to our cost base. Both these risks are within the firm's risk appetite.
- The findings of the ICAAP analysis are:
    - The firm considers it should hold capital equal to the capital resource requirement pillar 1 calculation, being **based on fixed overhead requirement plus a further buffer of £50,000**. On a **look forward basis** the FOR will is circa £189k during 2018/19. The firm's capital should be £239k.
    - The firm's risk management process has been reviewed by the partnership board and by Moore Stephen as part of their control audit and found to be satisfactory.
    - The firm has adequate resources over its planning horizon taking into account the potential impact of an economic downturn.
- The firm has examined credit, market and operational risks – the details of which are in the attached table. The firm has determined that given its business model these risks are modest and appropriately mitigated.
- The table below itemises the components of Pillar one and the firm's pillar two capital figures (as at 31.03.2018)

| | Minimum capital | ICAAP |
|---|---|---|
| Credit risk | £60,480 | |
| Market risk | £0 | |
| Operational risk | £0 | |
| Fixed overhead require. | £188,500 | £188,500 |
| Buffer | | £50,000 |
| ICAAP capital | | £239,500 |
| Total capital | | £1,424,228 |

- The firm considers no further analysis is required for now but given the expected growth in funds under management an interim review will be undertaken at the half year in the autumn of 2018.
- The ICAAP was prepared on behalf of the firm by the Partner responsible for DPL's finances in conjunction with the Head of Operations and the Managing Partner. It was then reviewed and challenged by the partners' board chaired by the Senior Partner. These will be reviewed, amended or clarified during the next partners' board meeting in June 2018.

## Background

The Capital Requirements Directive (the "Directive") of the European Union establishes a regulatory capital framework across Europe governing the amount and nature of capital that must be maintained by credit institutions and investment firms. In the United Kingdom, the Directive has been implemented by the Financial Conduct Authority (FCA), in its regulations through the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU'). Chapter 11 of BIPRU sets out the disclosure requirements in relation to Pillar 3.

In preparing this document, DPL is permitted to omit certain disclosures and, where disclosures are not required, they have been omitted. Albeit DPL has not omitted disclosures for reasons set out in BIPRU 11.3.5 and 11.3.6.

The FCA framework comprises three Pillars:

- Pillar 1 sets out the minimum requirement for regulatory capital that meets the firm's Credit, Market and Operational risks
- Pillar 2 requires the firm to assess whether Pillar 1 capital is adequate to meet its risks and is subject to annual review by the FCA. This has been implemented in the UK as the Internal Capital Adequacy Assessment Process ("ICAAP"); and
- Pillar 3 requires disclosure of specified information about the underlying risk management controls, capital position and remuneration.

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**Firm overview**

Dundas Global Investors Ltd was set up in 2010 as a Limited Company by the Senior Partner and Managing Partner of DPL. In February 2013 the business of Dundas Global Investors Ltd was transferred to Dundas Partners LLP, this was done to facilitate participation in the business by team members. DPL is the trading name of the partnership while the firm continues to market itself as Dundas Global Investors.

In the last fiscal year 2017/18 the firm generated operating profits of c.£900k. Tax generated on these operating profits are the liability of the individual partners in accordance with HMRC's laws on income.

Once all overheads have been settled and employees paid, the remaining profit is available for distribution to DPL's partners at the discretion of both the Senior and Managing Partners. Where necessary, funds are retained in response to the need for capital or if there is the need for a higher fixed overhead requirement and its associated level of capital.

DPL is an institutional manager working with large superannuation funds and their advisors in Australia, New Zealand and the USA. The firm provides separate accounts, sub-advisory portfolios and has Funds available in each marketplace it serves including in the UK. To the extent the firm has individual investors these are through the regulated Funds.

At the fiscal year end 2017/18 clients from Australia represented 32% of the firm's total assets under management while clients in the United States represented 55% of the total and those from the UK represented 13% of total AUM. DPL's top five clients at the end of fiscal 2017/18 represented 66% of the firm's assets under management. Over the last twelve months growth in assets under management has come from both the US and Australian markets.

**Business strategy**

DPL is a global equity manager for institutional clients. It runs one investment strategy: selecting stocks for a portfolio of 60-100 global businesses which it believes will generate both capital and dividend growth. To date DPL's Australian clients have requested global mandates excluding stocks in the Australian market. Clients in the US have made the same request: global mandates excluding those from the domestic market. Given the significance of the US stock market in global indices DPL calls this portfolio its international strategy.

The principal activities of DPL are to act as fee based investment manager of separate accounts and of open ended investment funds both in the UK and overseas. Its business objective is to profitably grow assets under management from the 31st March 2018 level £809 million. Through 2018/19 it plans to:

- expand the Australian fund and segregated mandates currently managed through a distribution agreement with Apostle Funds Management in Sydney, from its year end level of £259m. This agreement allows for continued expansion into the New Zealand market, where managed assets amount to £2.9m.
- grow the assets managed in the UK UCITS fund, launched on 20 March 2013 using T Bailey as the ACD. At our financial year end it held assets of £69m.
- continue establishing a presence and grow assets in the United States of America. DPL signed a distribution agreement in 2015 with South Avenue Investment Partners in the United States of America to distribute its strategy to a US client base. In addition to its managing money for

United Capital through its 20 stock ADR and best picks funds, the firm has been successful with several emerging managers programs facilitated by FIS Group and Bivium Capital Partners, LLC. At the year-end DPL managed £437m for its US clients.

During the past financial period DPL has maintained sufficient capital to meet all its regulatory and business needs. The business model of DPL is predicated on the need to keep costs down and to pass this on to clients in the form of lower than market fees. For the year ahead non-staff operating costs are expected to be £828k before expenditure on travel and the non-cash cost of depreciation. Staff costs are expected to be in the region of £108k. This implies a Fixed Overhead Requirement of £188,500. Net revenues for the year ahead are expected to be in the region of £2m.

There are no planned changes to the firm's strategy or objective. Today DPL extends to a team of nine members after some firm-initiated changes in the last financial year. As the firm grows its client base and its assets under management it expects to add additional members to its team. As suggested in the past it has been the firm's plan to increase the number of partners participating in the firm's growth and development – since the year-end two members of the team were invited to join the partnership.

New staff and larger capital projects will be considered throughout the year particularly following flow of additional assets under management. The business is therefore projected to be able to generate whatever additional regulatory and business capital may be required as a result of further growth internally.

Since the firm began the global investment environment has resulted in strong returns in the US market while the remaining markets have generated poorer returns. More recently, the biggest change is that markets outside the US have risen faster, resulting in DPL's six quarters of market outperformance for both the global and international strategies.

DPL does not plan to make any significant changes. Distribution channels in the US and Australian markets are well supported while it may look to spend more time building a client base in Canada. In addition the firm's US mutual fund has been approved by the SEC and is currently awaiting its first client. DPL may in future consider adding a mid or small cap strategy.

**Financial position**

DPL intends to grow from its year end 2018 assets under management of £809m. Over the next five years the firm aims to win new client mandates for its capital and dividend growth strategy. With only one office location and a team of nine members DPL's growth should provide sufficient capital for re-investment and to provide cash liquidity.

## Risk management framework

The Partners of DPL determine the business strategy and risk appetite together with the design and implementation of a risk management framework.

Risk appetite is the degree of risk that the Partners are willing to accept without applying further resources and capital to mitigate the risk. Risks are assessed in terms of the probability of the risk occurring and likely impact. Reasonable steps are taken by DPL to reduce the risk of any risk crystallising and any impact arising.

DPL is small and its business is not viewed as complex following the guidance of the FCA handbook (BIPRU 2.2). It carries no material Market or Credit risk since it is a BIPRU €50,000 firm with no trading book. As a Limited Licence firm, DPL's minimum capital requirement is the greater of:

- the base capital requirement of €50,000
- the sum of the Market and Credit risk requirements and,
- the Fixed Overhead Requirement (assessed to be £188,500)

It is DPL's experience that, as Market and Credit Risks are not considered material, the Fixed Overhead Requirement ("FOR") is the greatest and therefore establishes the Pillar 1 requirement looking forward of £188,500.

When considering the adequacy of Pillar 1, an assessment of risks identified has led the Partners of DPL to the decision that no further capital under Pillar 2 is required. However the Partners have deemed it prudent to hold a buffer of a further £50,000 on top of the variable capital requirement based on FOR. The total capital requirement is therefore £238,500.

DPL undertake an annual budgeting process which commences in January ahead of the 31 March year end. Projected revenues from existing clients are augmented by predicted new business wins/losses for the coming year. Resource needs are considered and a draft budget prepared for the Partners to consider. Between January and April the budget is refined and finally approved before becoming the basis for our management accounting monthly packs for the new financial year. All of our stated strategic objectives are regularly discussed at our partners meeting to ensure risks are being monitored.

## Capital Adequacy assessment

**Statement of Risk Appetite**

The Partners of DPL has assessed the impact of the risks taken in pursuit of its strategic objectives. Those strategic objectives are:

- Grow assets under management
- Safeguard reputation
- Grow profitability in a sustainable way
- Achieve appropriate investor returns
- Maintain regulatory standing
- Safeguard capital adequacy
- Financial crime

Each of these areas is subject to risk and the table below indicates the level of risk DPL is prepared to accept in each area:

| | Willingness to accept risk | | | | |
|---|---|---|---|---|---|
| | LOW | | MED | | HIGH |
| | 1 | 2 | 3 | 4 | 5 |
| Grow FUM | | | | | |
| Reputation | | | | | |
| Earnings | | | | | |
| Returns | | | | | |
| Regulatory | | | | | |
| Capital | | | | | |
| Financial Crime | | | | | |

*Grow assets under management*

This encompasses the activities required to grow the firm's client base or investment from existing clients. Outside the UK, DPL continues to work with established distributors and within the UK suitably experienced professionals will be hired to develop assets under management.

*Reputation*

This encompasses activities required to provide effective communication to stakeholders, provide strong, robust governance and demonstrate strong ethical standards.

*Grow profitably in a sustainable way*

Ensure that DPL continues to manage its cost base to expand less than assets under management through use of technology and maintaining one mainstream investment strategy.

*Investor returns*

The amount of risk the DPL investment team can take with investor monies to achieve appropriate returns on investment.

*Regulatory standing*

The indicator of how sensitive or how exposed DPL's products and services may be to changes or tightening of regulation. DPL's product offerings are and will remain fairly simple and unlikely to present regulatory risk in the short and medium term. DPL has appointed two outsourced compliance advisors to ensure regulatory compliance: these are GEM Compliance in the UK and Focus 1 in the United States.

*Capital adequacy*

The indicator of how prudent needs to be in provision of excess capital. The current model builds in large excess capital over and above the regulatory requirement. There are currently no plans to change this approach.

*Financial crime*

The indicator of how exposed DPL may be to financial crime. The current business model means the prevailing exposure to external crime is very low.

*Adoption and review*

This statement was adopted by the Partners. It will be reviewed annually in conjunction with development of annual capital management, strategic and operational plans.

**Material Risks**

The partners of DPL are responsible for determining the firm's risk strategy, setting its risk appetite and ensuring that risk is monitored and controlled effectively. DPL's risk appetite is reviewed every six months by considering various stress tests that set out the amount and type of risk that are considered appropriate for the firm to accept in order to execute its business strategy.

DPL has developed a risk matrix that is broken down by business function and each underlying process within the business function, this is reviewed every six months. Each risk is then assessed to determine the type of risk exposure, its materiality, whether it is covered by insurance and what mitigating procedures can be put in place to control the risk of error. DPL's culture aims to ensure that each Partner is focused on improving procedures and minimising risk while establishing a robust risk, capital and performance management structure.

DPL invests client assets in publicly traded global equity securities, it is mainly exposed to operational and reputational risk (BIPRU 2.2.61 to 2.2.65) however there is some small additional exposure to both business and credit risk. All of these exposures are regarded as typical for a business engaged in the activity of long only asset management. In assessing the risk appetite of the business consideration has been given to identifying the material risks facing DPL's operations. These risks include risks at both the client level and at the firm level and take the form of loss of revenue, loss of assets or higher costs.

**Credit risk**: DPL receives investment management fees on a monthly basis. These fees are computed based on the value of assets managed whether in a commingled fund or separate account. For global mandates fees are normally paid within 30 business days of each month end. For international strategies the payment window is longer and so far can take up to three months to settle. There is little credit risk associated with these fees.

**Market risk**: DPL's portfolios are subject to market risk and the fees are asset based fees: revenues will increase as assets under management increase and vice versa. DPL has structured its business so that many costs are variable and can be reduced should assets under management fall. More importantly DPL seeks to keep base costs low and the partnership model avoids high committed salaries and bonuses.

**Liquidity risk**: liquidity risk consists of two primary items – funding liquidity risk and market liquidity risk. DPL has no borrowing and is not dependent on external financing for any aspect of its business. As a result DPL is not exposed to funding liquidity risk. DPL has some exposure to market liquidity risk in that one of our banking counterparties could suffer severe financial distress and elect not to return some of DPL's cash deposits - for this reason DPL have a limit on deposits which is regularly reviewed.

**Operational risk**: operational risk refers to the risk of a direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. This would include administration and/or dealing errors or breaches or investment mandate breach. The Funds offered in the US, UK and Australia are priced and administered by third parties regulated for this activity.

DPL seeks to mitigate those risks by (i) maintaining substantial financial resources, (ii) aligning the interests of staff and working members with supervision of the operations of the business (iii) maintaining a risk matrix and key operating procedures for all material business areas (iv) reviewing the operations of all material business areas every six months and (v) keeping the business, structure and operational requirements relatively simple.

**Concentration risk**: this is the risk that exposures to specific sectors or assets could result in losses to DPL or its clients. DPL invests client assets in publicly traded global equity securities and earns its revenue from an Australian, US and UK client base. The major risk is that the business could suffer from a decline in its investment performance relative to benchmark indices. DPL seeks to minimise this risk through focusing on its own investment research, keeping its business simple and aligned with its clients while minimising overheads.

**Business risk**: business risk arises when changes in the business prevent DPL from carrying out its business plan and desired strategy. As an LLP all material structural changes to the firm are subject to discussion at regular partnership meetings. DPL seeks to mitigate the risk of losing key team members through making them partners in the Firm – participating in the Firm's growth.

**Interest rate risk**: DPL does not engage in any principal trades or run any trading book exposures that could be subject to interest rate risk.

**Insurance risk**: DPL maintains professional indemnity, crime and cyber cover. All are set at a limit which DPL consider appropriate for the business and subject to an excess which DPL can reasonably afford to meet if called upon. Through working with its insurance broker DPL obtains insurance only from well capitalised companies to minimise the risk of loss arising from insurance risk. The level of professional indemnity cover is reviewed on a regular basis.

**Reputational risk**: DPL are at risk from poor investment performance affecting its ability to generate profits; from the loss of one or more key staff; the loss of a large customer or through poor client service. DPL has sought to keep mandates simple as a mitigant of these risks. The firm understands that there could be a claim or legal action from a client.

DPL had reviewed the disclosure requirements in BIPRU 11.5.4 to 11.5.18 and concluded that no disclosures in respect of these specific regulations are required.

**Business continuity**: DPL continually reviews its business continuity and disaster recovery procedures every year. A full off-site disaster recovery and business continuity test was successfully completed in December 2017.

## Capital Planning and Stress and scenario tests

The effective date of this ICAAP calculation was April 2018, following the end of fiscal year 2017/18.

Over the coming year the firm's revenue is expected to be £2m and thereafter to over £2.25m. Core overhead costs will be tightly managed and on an overall basis lower than the previous year. Success with new mandates will see overheads rise while maintaining profit margins.

As part of the budgeting and capital planning process the firm believes the most relevant stress test is to look at the fall in FUM which would link to revenues meeting core overhead costs. This has been modelled and for comparative purposes FUM at year end March 2018 was £809m while the average on a look forward basis is £820m. The breakeven FUM would be £443m at the same blended fee rate representing a fall of 45% from the current levels. DPL considers a range of scenarios as part of its budgeting for the year: the impact of asset gathering, considering market declines and the impact of changes in foreign exchange rates on profitability, given that 70% of its revenue base is generated outside the UK.

DPL's capital position as at the end of the financial period 31 March 2018 (unaudited figures) is summarised as follows:

| | |
|---|---|
| Unaudited profit and loss account | £903,591 |
| Capital introduced by members | £1,147,326 |
| Drawings & tax reserve | £(626,689) |
| **Total tier 1 capital** | **£1,424,228** |
| Deductions | £0 |
| **Total tier 1 capital after deductions** | **£1,424,228** |

DPL has no tier 2 capital deductions and as such DPL's total capital resources after deductions as at 31 March 2018 were £1,424,228.

DPL therefore maintains an adequate level of total capital resources to satisfy the regulatory capital requirements.

Regulatory capital is monitored and reviewed by the Partners on a quarterly basis.

## Wind-down analysis

DPL has assessed the firm's ability to wind-down using a combination of its FOR and also its liquid cash resources. The firm maintains cash balances across its sterling-denominated current and deposit accounts as well as in its AUD and USD current accounts to ensure sufficient cash reserves to settle bills in a timely fashion while at the same time building cash liquidity and reserves. Current liabilities are settled promptly, clients are regularly engaged with over any outstanding accounts receivable and partner's distributions are made only when there is sufficient cash liquidity to do so.

Should the necessity for an orderly wind-down be required the partners, in particular the Senior and Managing Partner would be the key decision makers, while relying on the whole team for execution. The Senior and Managing Partner would also take responsibility for stakeholder communications.

Over the year DPL's active involvement in growing its business in the US market has both resulted in growth and diversification, helping to mitigate the firm's biggest risk: the loss of a significant client.

## Challenge and adoption of the ICAAP

The ICAAP was prepared as part of the budgeting and business planning process begun in January 2018 for the new financial year 2018/19. It built upon the work done for in the last four fiscal years. The main business assumptions driving the budget process have been subject to review at a Partners meetings April 2018. Those assumptions then became the main drivers of the budgeting and resource planning which in turn impacted the FOR modelling for the coming year.

The FOR calculations have been driven directly from the challenge and testing of those key business assumptions. The calculations themselves have been subject to scrutiny by all the partners in the firm.

## Disclosure policy

DPL will issue its Pillar 3 disclosures along with its financial statements in June of each year. The Pillar 3 disclosures are as at the accounting reference date.

## Remuneration

DPL is considered to be a Tier 4 firm by the FCA for Remuneration Code purposes. As such DPL is required to identify those members of staff who are covered by the remuneration code. Because of its small size and the responsibilities assumed by individuals DPL consider all those who are on the FCA register to be code staff.

The FCA expects DPL to apply the Remuneration Code in a proportionate manner based on size, nature and complexity of its business. DPL is required to assess its own characteristics and to develop and implement policies and practices that appropriately align DPL with the risks faced by its business. The FCA is not expecting all firms to adhere to the remuneration requirements in the same way and to the same extent. The more burdensome provisions of Principle 12 of the Remuneration Code do not apply.

The principal objective of our remuneration policy is to encourage everyone at DPL to put clients' interests first. Our long term compensation flows from our ability to produce long term success in managing clients' portfolios.

The best way to achieve this is by operating as a partnership and this was the corporate structure adopted on 1 March 2013. At that time all the firm's senior members became partners in DPL. As members of a partnership their earnings are a function of the investment returns generated for existing clients, careful cost and risk control, and (lastly) winning new business. Partner drawings and profit share are determined by the two Managing Partners in accordance with the partnership agreement.

We have a simple approach to business development – win the confidence and trust of today's clients and new ones shall follow.

For other colleagues, DPL pays competitive base salaries and can offer discretionary bonuses which are dependent on the overall performance of the firm measured by profitability against budget rather than investment returns. Decisions on these salary and bonus levels are made by the Managing Partners.

DPL intends to remain private so the opportunity to capitalise the profit stream via a trade sale is not available. Partnership interests will pass between colleagues, not outside the firm.

By focusing on a single investment strategy, keeping costs under control and providing the opportunity for partnership, DPL seeks to avoid the high and complex cost structures which bedevil many larger investment managers.

For the year to 31 March 2019 aggregate remuneration for paid staff – salaries, national insurance contributions, pension costs and other benefits, namely health cover – is forecast to be in the region of £108k. Future profits are distributed to code staff at the discretion of the Managing Partners. These code staff carry a number of responsibilities but can be considered to be largely involved in investment research and portfolio management. Headcount started this year at nine full time.

Signed:

Alan McFarlane

Senior Partner and
Chief Compliance Officer

Russell Hogan

Managing Partner