

ICAAP and Pillar 3

Dundas Partners LLP, March 2020

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

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

Executive Summary

- Dundas is authorised and regulated by the Financial Conduct Authority (FCA) registration number 587649 since 26 February 2013. Its permission 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. It 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. The impact of both would be felt through declining profitability without adjustment to our cost base.
- 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 (FOR) plus a further buffer of £50,000**. On a **look forward basis** the FOR is circa £274k during 2020/21. The firm's capital should be £324k.
 - The firm's risk management process has been reviewed by the Partnership Board and by Moore Stephen as part of their controls 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 predicted as a result of the Covid-19 global pandemic.
- 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 1 and the firm's Pillar 2 capital figures (as at 31.03.2020)

	Minimum capital	ICAAP
Credit risk	£51,000	
Market risk	£0	
Operational risk	£0	
Fixed Overhead Requirement	£274,000	£274,000
Buffer		£50,000
ICAAP capital		£324,000
Total capital		£1,542,243

- 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 2020. This will also reflect changes to ICAAP calculations, namely the addition of the k-factor consideration which will be in effect from June 2021, and the uplift from a BIPRU limited licence €50k firm to a BIPRU limited licence €75k firm.
- The ICAAP was prepared on behalf of the firm by the Partner responsible for Dundas’s finances in conjunction with the Managing Partner. It was then reviewed and challenged by at the Partners Board meeting.

Background

The Capital Requirements Directive (CRD) 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, 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.

Due to the nature of its regulatory permissions, Dundas is subject to the requirements of CRD III.

The CRD 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 a firm to regularly assess the amount of internal capital it considers adequate to cover the level and nature of the risks to which it is or might be exposed. This assessment should cover the major sources of risks to the firm’s ability to meet its liabilities as they fall due and should incorporate stress testing and scenario analysis. This has been implemented in the UK as the Internal Capital Adequacy Assessment Process (‘ICAAP’); and
- Pillar 3 requires public disclosure of specified information relating to its capital, risk exposures and policies for managing these risks.

Firm overview

Dundas Global Investors Ltd was set up in 2010 as a Limited Company by Alan McFarlane, Senior Partner, and Russell Hogan, Managing Partner. 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. Dundas Global Investors is the trading name of the partnership which it continues to market itself as.

In the last fiscal year 2019/20 the firm generated operating profits of c.£1.14m. 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 Dundas's partners at the discretion of the 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.

Dundas is an institutional manager working with large superannuation funds and their advisors in Australia, New Zealand, the USA and the UK. 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 2019/20 clients from Australia represented 42% of the firm's total assets under management while clients in the United States represented 48% of the total and those from the UK represented 10% of total AUM. Dundas's top five clients at the end of fiscal 2019/20 represented 84% of the firm's assets under management. Over the last twelve months growth in assets has come from the US and UK markets.

Business strategy

Dundas is a global equity manager for institutional clients. It runs one investment strategy: selecting stocks for a portfolio of 60-100 global businesses which will generate both capital and dividend growth. To date Dundas' 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 Dundas calls this portfolio its International Strategy.

The principal activities of Dundas are to act as a fee-based investment manager of separate accounts and of open-ended investment funds. Its business objective is to profitably grow assets under management from the 31st March 2020 level £1.07 million. Through 2020/2021 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 £447m. This agreement allows for continued expansion into the New Zealand market, where managed assets amount to £4.8m.
- grow the assets managed in the UK UCITS fund, The Heriot Global Fund, through its distribution relationship with LGBR Capital, and T. Bailey Fund Services as the ACD. At our financial year end, it held assets of £106m.
- continue to establish a presence and grow assets in the US. Dundas signed a distribution agreement in 2015 with South Avenue Investment Partners (SAIPUS) to distribute its strategy to a US client base. In addition, Dundas manages money for a pooled investment vehicle

through its 20 stock ADR and best picks funds. Dundas has been successful with several emerging managers programs facilitated by Xponance and Bivium Capital Partners, LLC. At the year-end DGI managed £518m for its US clients.

During the last financial year Dundas has maintained sufficient capital to meet its regulatory and business needs. The business model of Dundas is predicated on the need to keep costs down and pass this on to clients in the form of lower fees. For the year ahead non-staff operating costs are expected to be £881k before expenditure on travel and the non-cash cost of depreciation. Staff costs are expected to be in the region of £215k. This implies a Fixed Overhead Requirement of £274k. Net revenues for the year ahead are expected to be in the region of £2.2m (based upon our current client base).

There are no planned changes to the firm's strategy or objective. Today Dundas extends to a team of eleven members. As the firm grows its client base and its assets under management it expects to add additional members to its team. It is the firm's plan to increase the number of partners participating in the firm's growth and development.

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. Dundas' Global Strategy has now outperformed over one year, three years, and five years. Its International ADR Strategy has outperformed significantly since inception, and its International Strategy is approaching its four-year performance in May 2020.

Dundas signed a distribution agreement with LGBR Capital Partners to market the Heriot Global Fund in the UK in March 2019. 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 awaiting its first client. Dundas may in future consider adding a mid or small cap strategy.

Financial position

Dundas intends to grow from its year end 2020 assets under management of £1.07bn. 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 eleven members Dundas' growth should provide sufficient capital for re-investment and to provide cash liquidity.

Risk management framework

The firm's overall risk appetite is low, and its business strategy has focused on sustainable growth over the longer term while seeking operational efficiencies to control costs. The firm maintains capital cover over in excess of regulatory requirements.

Risk appetite is the degree of risk 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 Dundas to reduce the risk of any risk crystallising and any impact arising.

Dundas 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, Dundas’ minimum capital requirement is the greater of:

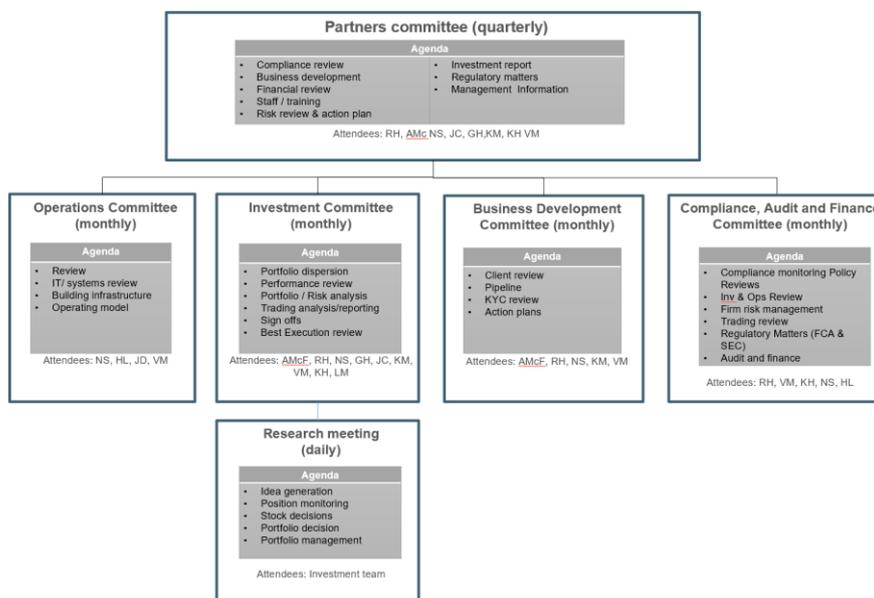
- the base capital requirement of €50,000
- the sum of the Market and Credit risk requirements and,
- the Fixed Overhead Requirement (assessed to be £274k)

It is Dundas’ 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 £274k.

When considering the adequacy of Pillar 1, an assessment of risks identified has led the Partners to agree 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 £324k.

Dundas undertake an annual budgeting process which starts 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. Our stated strategic objectives are regularly discussed at our Partners Board meeting to ensure risks are being monitored.

Dundas Partners - Governance meeting structure



Risk management is embedded into to the firm’s governance structure. Individual risks are considered at each of the monthly committee meetings and as a whole at the quarterly Partners meeting.

Capital Adequacy assessment

Statement of Risk Appetite

The Partners of Dundas have 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 DGI 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. DGI continues to work with established distributors 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 Dundas 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 Dundas investment team can take with investor monies to achieve appropriate returns on investment.

Regulatory standing

The indicator of how sensitive or how exposed Dundas products and services may be to changes or tightening of regulation. Dundas' product offerings are and will remain simple and unlikely to present regulatory risk in the short and medium term. Dundas has appointed two outsourced compliance advisors to ensure regulatory compliance: these are GEM Compliance in the UK and Focus1 in the United States.

Capital adequacy

The indicator of how prudent we need 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 Dundas 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 Board. It will be reviewed annually in conjunction with development of annual capital management, strategic and operational plans.

Material Risks

The Partners of Dundas are responsible for determining the firm's risk strategy. Dundas' risk appetite is reviewed regularly, the Partners consider 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.

Dundas has developed a risk matrix that is broken down by business function and each underlying process within the business function, this is reviewed periodically. 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 that risk. Senior Managers are accountable for risks in their business area and put in place mitigants to manage those risks. Dundas' 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.

Dundas 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. 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 Dundas' operations. These include risks at both the client and firm level and take the form of loss of revenue, loss of assets or higher costs.

Credit risk: Dundas 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 paid within 30 business days of each month end. For international

strategies the payment window is longer and so can take up to three months to settle. There is little credit risk associated with these fees.

Market risk: Dundas' portfolios are subject to market risk and the fees are asset based: revenues will increase as assets under management increase and vice versa. Dundas has structured its business so that many costs are variable and can be reduced should assets under management fall. More importantly Dundas 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. Dundas has no borrowing and is not dependent on external financing for any aspect of its business. As a result, Dundas is not exposed to funding liquidity risk. Dundas 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 Dundas' cash deposits - for this reason Dundas have a limit on deposits which is regularly reviewed. Our Liquidity Risk Policy is reviewed annually.

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.

Dundas 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 periodically 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 Dundas or its clients. Dundas 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. Dundas 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 Dundas from carrying out its business plan and desired strategy. As a Limited Liability Partnership all material structural changes to the firm are subject to discussion at quarterly Partnership meetings. Dundas seeks to mitigate the risk of losing key team members through making them Partners in the firm – participating in Dundas' growth.

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

Insurance risk: Dundas maintains professional indemnity, crime and cyber cover. All are set at a limit which Dundas consider appropriate for the business and subject to an excess which Dundas can reasonably afford to meet if called upon. Through working with its insurance broker Dundas obtains insurance 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: Dundas 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. Dundas 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.

Dundas 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: Dundas reviews its business continuity and disaster recovery procedures annually. A full off-site disaster recovery and business continuity test was successfully completed on 12 December 2019.

Capital Planning and Stress and Scenario Tests

The effective date of this ICAAP calculation was April 2020, following the end of fiscal year 2019/20.

Over the coming year the firm's net revenue is expected to be £2.2m and then continue to grow to over £2.75m. Core overhead costs will be tightly managed but will increase to support continued growth of the firm and to ensure the firm's capabilities as an institutional global equity manager. 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 AUM which would link to revenues meeting core overhead costs. This has been modelled and for comparative purposes AUM at year end March 2020 was £1.07bn while the average on a look forward basis is £1.25bn. The breakeven FUM would be £600m at the same blended fee rate representing a fall of 40% from the current levels. Dundas 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 more than 90% of its revenue base is generated outside the UK.

Dundas' capital position as at the end of the financial period 31 March 2020 (unaudited figures) is summarised as follows:

Unaudited profit and loss account	£1,138,581
Capital introduced by members	£1,175,656
Drawings & tax reserve	<u>£ (771,994)</u>
Total tier 1 capital	£1,542,243
Deductions	<u>£0</u>
Total tier 1 capital after deductions	<u>£1,542,243</u>

Dundas has no tier 2 capital deductions and as such Dundas' total capital resources after deductions as at 31 March 2020 were £1,542,243

Dundas 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

Dundas has assessed the firm's ability to wind-down using a combination of its FOR and 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. It is estimated that the wind-down of Dundas could take up to 6 months but likely much sooner. We have taken into account notice periods for client mandates, distribution partners, suppliers and staff. FCA guidelines issued in 2016 have been considered and would be the basis of our wind-down planning. The Senior and Managing Partner would also take responsibility for stakeholder communications.

Over the year Dundas' active involvement in growing its business in the US and UK markets has 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 which began in January 2020 for the new financial year 2020/21. It is built upon the work completed in the last five fiscal years. The main business assumptions driving the budget process have been subject to review at a Partners meeting in April 2020. 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

Dundas 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

Dundas is subject to the BIPRU Remuneration Code (SYSC 19C). It is not subject to CRD IV, as the firm does not have permission to hold client money. Within the FCA's categorisation of firms, Dundas is a Tier 3 firm for Remuneration Code purposes. As such Dundas 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 Dundas considers all those who are on the FCA register to be code staff.

In line with the FCA's guidance on proportionality for BIPRU Remuneration Code firms, Dundas has taken a proportionate approach when implementing the remuneration framework based on size, nature and complexity of its business. Dundas is required to assess its own characteristics and to develop and implement policies and practices that appropriately align Dundas with the risks faced by

its business. As such, Dundas is not expected to implement all of the FCA's guidelines on remuneration 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 Dundas 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 Dundas. 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, Dundas 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.

Dundas 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, Dundas seeks to avoid the high and complex cost structures which bedevil many larger investment managers.

For the year to 31 March 2021 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 £215k. Two new team members joined the firm in April and August 2019. Future profits are distributed to partners at the discretion of the Managing Partners. These code staff carry several responsibilities but can be considered to be largely involved in investment research and portfolio management. Headcount started this year at eleven full time.

Signed:



Alan McFarlane
Senior Partner



Russell Hogan
Managing Partner