



Pillar 3 disclosures – Capital Dynamics Limited

As of 31 December, 2010

Capital Dynamics Ltd. is authorized and regulated by the Financial Services Authority. Registered in England and Wales n° 2215798. Registered office: 9 Colmore Row, Birmingham B3 2BJ, United Kingdom

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Confidential

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1. Overview

1.1 Introduction

The Capital Requirements Directive (CRD) is the framework for implementing Basel II in the European Union. Basel II implements a risk sensitive framework for the calculation of regulatory capital.

The CRD consists of three 'pillars':- Pillar 1 sets out the minimum capital requirements that entities are required to meet for credit, market and operational risk. For Pillar 2, firms and supervisors take a view on whether a firm should hold additional capital against risks not covered in Pillar 1 and to take action accordingly within the Internal Capital Adequacy Assessment Process (ICAAP). Pillar 3 complements the minimum capital requirements (Pillar 1) and the supervisory review process (Pillar 2) with the aim of improving market discipline by requiring firms to publish certain details of their risks, capital and risk management.

In the United Kingdom, the Financial Services Authority (FSA) has introduced Pillar 3 by duplicating the CRD articles and annexes to create Chapter 11 – Disclosure (Pillar 3) of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU).

1.2 Basis of disclosures

In accordance with the requirements of Chapter 11 of BIPRU, the disclosures included in this document relate to the Capital Dynamics Limited. The disclosures cover both the qualitative and quantitative requirements.

1.3 Frequency of disclosures

The disclosures are required to be made on an annual basis at a minimum and if appropriate some disclosures will be made more frequently. Capital Dynamics Limited has an Accounting Reference Date of 31 December. These disclosures are made at this date.

1.4 Verification, media and location

These disclosures have been put together to explain the basis of preparation and disclosure of certain capital requirements and provide information about the management of certain risks and for no other purposes. These disclosures are not subject to audit; they do not constitute any form of audited financial statement and have been produced solely for the purposes of satisfying Pillar 3 requirements.

The Capital Dynamics Limited Board is responsible for the company's system of internal control and for reviewing its effectiveness. Such a system can provide only reasonable and not absolute assurance against material financial misstatement or loss and is designed to mitigate, not eliminate, risk.

These disclosures are published on the Capital Dynamics Group corporate website (www.capdyn.com).

2. Risk management framework

Capital Dynamics Ltd believes that active and effective risk management is a business imperative and it is regarded as a core competence by clients, consultants, regulators, counterparties and other interested parties.

2.1 Approach to risk management

Capital Dynamics' Ltd approach to risk management builds on the following structures:

Capital Dynamics Ltd Board

- Authority to manage the business, including corporate governance, internal controls and risk, is the responsibility of the Capital Dynamics Ltd Board
- The Board is responsible for ensuring that the internal control system remains effective.
- The Board delegates primary responsibility for the risk and controls framework and the independent monitoring and reporting of risk and controls to the Group Accountant and the accounts team, as well as the heads of Business Development, Investment Management and Portfolio Servicing and the head of Compliance (The 'Capital Dynamics Ltd senior management')
- The Board must ensure continued individual responsibility and accountability across the firm, supported by guidance and training as required.
- The Board is supported by the independent monitoring and advice provided by the Internal Audit and Compliance departments as well as the External Auditors.

Capital Dynamics Ltd senior management

The role of the senior management:

- to encourage highest standards in financial and regulatory reporting, risk management, internal controls and integrity
- the ongoing monitoring and review of Capital Dynamics Ltd processes to ensure adequacy

The Head of Compliance supports the Group Accountant with the monitoring and reporting of risks and controls. Significant risk and control issues are reported to the Board of Directors either by the relevant business head or by the Group Accountant.

2.2 Risk management systems and techniques

Risk Assessment and Identification

Change in every aspect of our business and the external environment is a key driver of risk.

Change may impact the potential occurrence or potential magnitude of events relating to existing risks or may result in new or emerging risks. Different approaches may be used for the assessment of risk depending on the type of risk faced and the evidence available to assess the risk. These approaches may be used in combination or isolation and include qualitative and quantitative assessments.

Risk Mitigation

Like any Investment Management Firm we are exposed to a range of risks. These risks if not managed properly, increase the possibility of the company not being able to meet its objectives.

There are a variety of techniques that are used to mitigate risks, which may be used in isolation or in combination depending on the nature of the risk. These techniques include use of controls, outsourcing, contingency planning and insurance.

Risk Monitoring and Reporting

Risks are managed in a variety of different ways, depending on the nature of the risk and the areas potentially affected to ensure that wherever appropriate the consequences are mitigated.

Monitoring and communication is key to an effective risk management framework.

2.3 Key risks faced

The key risk types faced which are relevant to this Pillar 3 disclosure are as follows:

Operational risk

Operational risk is the risk resulting from inadequate or failed internal processes, people and systems or from external events, including legal, regulatory and compliance risk.

Capital Dynamics Ltd is aware that operational risk can never be eliminated, but seeks to minimise the probability and impact of operational events, through the governance structure described, with frameworks, policies and procedures to support it.

- Core responsibility for the management of this risk lies with senior management (heads of business and Group Accountant as described above).
- Risk oversight and challenge is provided to the Board via the Group Accountant and Head of Compliance.
- Independent review and testing of controls are provided by our ISO 9000 Internal Audit function.

Credit risk

Credit risk, is the risk of loss if counterparty fails to perform its financial obligations. Credit risk exposures are supported by prudent policies on all aspects of credit risk including treasury activities, limit setting and monitoring.

Oversight for credit risk is provided via the Group Accountant.

Market risk

Market risk is the risk that arises from fluctuations in values of, or income from, assets or from changes in the value of interest or exchange rates.

Market movements affect non Sterling cash balances and revenues. Market risk is actively monitored and managed.

Liquidity risk

Liquidity risk is the risk that the Company, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost.

The Group's liquidity policy is to maintain sufficient liquidity to cover any cash flow funding, meet all obligations as they fall due.

Business risk

Any risk arising from changes in the business, including the risk that the firm may not be able to carry out its business plan and its desired strategy.

This includes exposure to a wide range of macro-economic, geopolitical, industrial, regulatory and other external risks that might deflect the company from its strategy and business plan.

Internal Capital Adequacy Assessment Process (ICAAP)

On an annual basis, or more frequently if there is a fundamental change to our business or the environment in which we operate, the ICAAP is reviewed. This is an internal process where the firm must:

- carry out regular assessment of types and amounts of capital required to cover the risks to which it is exposed
- identify the sources of risk vs. its ability to meet its liabilities
- conduct stress and scenario tests
- ensure that processes, strategies and systems required are appropriate and proportionate to the nature, scale and complexity of the firms activities

Operational risk

The operational risk analysis focuses on modelling of key risk scenarios for the Company. The Company is subject to the Fixed Overhead Requirement for calculation of its Pillar 1 Capital Resource Requirements. For the year ended 31 December 2010 the amount required to be held by the Company to meet the Fixed Overhead Requirement was GBP 817,000. The Company considers this to be an acceptable alternative calculation for operational risk.

Credit risk

The Company is not considered to have a significant credit risk as most of the Company's income is received from its subsidiary Capital Dynamics General Partners Limited and from management fees for unauthorised unit trusts. The fees receivable are based on the terms of the Limited Partnership or Unit Trust Agreements. Draw downs from the Investors are made to meet the obligations of the Fund. All of the Funds Investors are large institutional investors.

Market risk

The Company is not considered to have a significant interest rate risk. It is the Company's policy only to hold sufficient cash in order to enable it to meet its minimum FSA liquid capital requirements and to fund short term requirements and therefore interest earnings are minimal. The Company holds cash balances denominated in currencies other than GBP, the base currency of the Company. Consequently the Company is exposed to currency risk due as the cash balances held in other currencies will fluctuate due to changes in exchange rates. The Company accepts this currency risk and consequently does not maintain any policy to enter into any currency hedging transactions.

Market risk, as determined under Pillar 1, was less than the level that was considered material as at 31 December 2010.

Liquidity risk

Capital Dynamics uses a range of liquidity risk assessments and stress tests to assess our ability to always meet our obligations as they fall due.

Business risk

Business risk is assessed through consideration of the threat to Capital Dynamics Limited capital base and strategic plans of a severe, sustained recession.

There are the individual assessments of capital required for specific risk types. In accordance with current best practice, there is also an assessment of the capital required to ensure an orderly wind-up of the Company if it is no longer viable.

3. Basis of consolidation

3.1 Accounting consolidation

The consolidation of the financial statements is based upon the inclusion of all entities controlled by Capital Dynamics Limited prepared to 31 December each year. Control is achieved where Capital Dynamics Limited has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. The consolidated statutory financial statements include all subsidiary undertakings which, in the opinion of the Board of Directors, principally affect the consolidated profits or assets of the Capital Dynamics Ltd Group.

3.2 Regulatory consolidation

For regulatory purposes, this is not on the same basis as above. Entities excluded from the regulatory consolidation:

- Capital Dynamics General Partners Limited
- Capital Dynamics Investments Pty Limited

4. Capital resources

4.1 Tier 1 capital

Tier 1 capital is the highest ranking form of capital. Eligible Tier 1 capital consists of the total ordinary share capital. Also included in Tier 1 capital are retained profits and other reserves.

There are no deductions to retained earnings, as the company does not operate a defined benefit pension.

Tier 1 capital at 31 December 2010 totals GBP 1,879,000, comprising GBP 300,000 ordinary share capital and GBP 1,579,000 retained earnings.

4.2 Tier 2 capital

Tier 2 capital is a firm's supplementary capital and consists of revaluation reserves, general provisions and some classes of subordinated debt.

As at 31 December 2010, the Company had no revaluation reserves, subordinated debt or general provisions and therefore had no Tier 2 capital.

4.3 Tier 3 capital

Tier 3 brings together shorter term debt capital and less permanent reserves and may only be used to meet regulatory capital requirements arising from market risk in the trading book.

The Company did not hold any Tier 3 capital as at 31 December 2010.

Tier 1	GBP
Ordinary share capital	300,000
Retained earnings	1,579,000
Total	1,879,000
Deductions from Tier 1	0
Tier 1 after deductions	1,879,000
Deductions from Tier 2	0
Total capital resources	1,879,000

During the period Capital Dynamics Ltd complied at all times with the externally imposed regulatory capital requirements.

5. Capital adequacy

As part of the assessment of the adequacy of its capital, the Company considers its risk appetite, the key risks facing the Company and the management strategies in place for dealing with such risks. This is included within the Company's Internal Capital Adequacy Assessment Process which is reviewed by the Capital Dynamics Limited Board.

It is the Capital Dynamics Ltd policy to have sufficient capital to:

- meet regulatory requirements
- keep an appropriate credit standing with counterparties; and
- maintain sufficient liquid funds to meet working capital requirements
- Calculation of the Company's capital resources requirement

The capital resources requirement of the Capital Dynamics Limited for regulatory reporting purposes takes into consideration the credit risk, market risk and operational risk capital requirements.

Credit risk

Credit risk is not considered significant to the Company, as the vast of the revenues are received from other company's under common control of Capital Dynamics Limited ultimate parent.

The revenue is generated from the provision of advisory services to Capital Dynamics fund of fund investments, which is paid by the fund. Investors in the fund are large institutions, this mitigates the risk further.

Market risk

Market risk, as determined under Pillar 1, was less than the level that was considered material as at 31 December 2010.

Operational risk

For the year ended 31 December 2010 the amount required to be held by the Company to meet the Fixed Overhead Requirement was GBP 817,000. The Company considers this to be an acceptable alternative calculation for operational risk.

6. Credit risk & dilution risk**6.1 Past due and impaired**

A financial asset is past due when the counterparty has failed to make a payment when contractually due. An exposure is classified as impaired (the carrying value exceeds the amount to be recovered through use or sale) or non-performing (principal, interest or fees remain unpaid more than 90 days after the due date) when, following review, there are indications that the likelihood of full repayment is in doubt. These indications may include, but not be restricted to: non-payment of interest or a fall in credit worthiness.

6.2 Provisions against financial assets

Other debtors consist mainly of fee debtors, which arise principally within the Company's institutional business and amounts are monitored regularly by the Accounts team.

The Company's does not have any fee debtors that are past due (i.e. items that are past their contractually agreed settlement date) and none that are not considered to be impaired as at 31 December 2010.

Factors considered in determining whether impairment has taken place include how many days past the due date a receivable is, deterioration in the credit quality of a counterparty, and knowledge of specific events that could influence a debtor's ability to repay an amount due.

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