Pillar 3 Disclosures

As at 30th September 2017

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1 Introduction

Background

The following disclosures are provided pursuant to the Pillar 3 disclosure rules as laid out by the Financial Conduct Authority (FCA).

The disclosures below apply solely to Waverton Investment Management Limited (Waverton). Waverton is a limited licence (IFPRU – the Prudential Sourcebook for Investment Firms: €125k Limited Licence) investment management company.

The prudential framework for investment management firms consists of three "Pillars" under the Capital Requirements Directive:

- Pillar 1 sets out the minimum capital requirements that firms are required to meet for credit, market and operational risk;
- Pillar 2 requires firms, and the FCA, to take a view on operational risk whether a higher level of capital should be held against capital risks not covered by Pillar 1; and
- Pillar 3 requires firms to publish certain details of their capital, risks and risk management process.

2 Basis of Disclosure

Frequency of Disclosure

Disclosures will be issued on an annual basis at a minimum and will be published as soon as is practicable following the publication of the audited Financial Statements.

Verification

These disclosures have been prepared in order to comply with regulatory requirements and provide information about the management of certain risks. They do not constitute financial statements, may be based on unaudited financial positions, and should not be relied upon in making judgments about Waverton.

Location

The disclosures, in the form of this report, will be published on Waverton's website.

Materiality

In accordance with Pillar 3 rules, disclosures are only required where the information would be considered material to a user relying on that information to make economic decisions.

Proprietary and Confidential Information

In accordance with Pillar 3 rules, firms may omit information where the information is regarded as proprietary or confidential.

3 Scope and application of the Directive requirements

Waverton is authorised and regulated by the FCA to conduct investment business, with permission to hold and control client money. The firm is categorised as a Limited Licence firm by the FCA for capital purposes.

There are no current or foreseen material, practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities.

4 Risk Management Objectives and Policies

Risk Assessment Process

Waverton has a comprehensive risk matrix that defines the universe of inherent material operational risks, which arise due to business activities. The risk matrix forms the basis of operational risk assessment and reporting. It supports the operational risk quantification and capital calculations. Critically it provides a transparent link through to the health of the internal control environment. The Risk Committee oversee the risk assessment. The scope of each risk category is reviewed regularly in the light of new or changed business activities as well as external developments.

In order to monitor our risk profile against our risk appetite, we make use of scenario analysis to assess the impact of a severe stressed event at firm-wide level. This complementary framework captures exposures to material primary and consequential risk across all businesses.

Structure of Risk Management Function

(i) Three lines of Defence

Waverton's risk management and control principles are consistent with the three lines of defence model. In this model, business management as the first line of defence, own their risk exposures and are required to maintain effective processes and systems to manage their risks. This includes robust and comprehensive internal controls and documented procedures.

The Board is responsible for determining Waverton's risk principles and risk appetite, following proposal from business management. The Chief Executive Officer is responsible for the execution and implementation of strategy approved by the Board. Business management is also accountable for the results of their businesses. This includes actively managing their risk exposures. They have authority over decisions in respect to all business activities that may have a negative regulatory or reputational impact in their respective business areas.

Control functions such as Finance, Legal & Compliance, Risk Control act as second line of defence, providing independent oversight of primary and consequential risks. This includes setting risk limits and protecting against non-compliance with applicable laws and regulations.

External and internal auditors, which together form the third line of defence, evaluate the overall effectiveness of governance, risk management and the control environment. This includes consideration of how the first and second lines of defence meet their objectives.

(ii) Committee Governance

The Board has the ultimate responsibility in setting long-term strategy and the commercial agenda that will achieve an appropriate balance between risk and return. It has responsibility to approve major new initiatives and capital projects, revenue and expenditure budgets in order to be in line with the agreed long-term strategy. Additionally, it has the responsibility to align capital adequacy to Waverton's risk profile.

The Board meets quarterly and has delegated general oversight of Waverton's business to the Management Committee. The Management Committee meets on a monthly basis; and is empowered to propose business strategy for the Board's approval and monitor the progress of the business as a whole, through the Operations Executive Committee, both financially, strategically and from a legal and compliance perspective.

The Chairman of the Operations Executive Committee reports and escalates, where appropriate, to the Management Committee; whereas the Chairman of the Management Committee reports and escalates to the Board on matters within its duties and responsibilities.

The Board delegates the oversight of risk to the Audit Committee. The Audit Committee in turn delegates to the Executive Risk Committee, which monitors and oversees the firm's risk profile and the implementation of risk framework as approved by the Board. The Risk management manages the internal audit process with the Chairman of the Audit Committee.

The Portfolio Risk Review Committee in turn has oversight on our fundamental approach to stock selection and daily management of our client investment portfolios from an investment risk perspective. The Chairman reports and escalates, where appropriate, to the Management Committee and the Performance Review Committee.

Other investment related committees include the Asset Allocation Committee, the Performance Review Committee and Dispersion Review Committee. The respective Terms of Reference of the Committees set out the responsibilities and escalation route for risk reporting.

5 Internal Capital Adequacy Assessment Process (ICAAP)

Waverton's ICAAP serves to describe the overall methodology adopted in determining whether it is holding sufficient capital in accordance with the GENPRU (the General Prudential Sourcebook). The ICAAP is reviewed by the Board in order to ensure that its risk management processes and assumptions are challenged.

The ICAAP provides an on-going assessment of Waverton's key risks under Pillar 2 and the controls in place to identify, manage and mitigate these risks. The risks identified are stress tested against various scenarios to determine the level of capital that needs to be held.

In addition, the ICAAP also considers Waverton's long-term capital outlook as well as a wind down analysis, which looks at whether Waverton would be required to hold additional capital over the period that it would take to wind down the firm.

6 Capital resources

As an IFPRU (the Prudential Sourcebook for investment firms) firm, Waverton maintains sufficient capital to meet its regulatory capital requirements and takes a prudent approach to the management of its capital base.

Capital resources of the Firm, as at 30th September 2017, are set out in the table below:

	£000
Ordinary share capital	23
Share premium	313
Retained earnings	16,373
Core Tier 1 capital	16,709
Tier 2 capital	Nil
Own Funds	16,709
Total Risk Exposure Amount (TREA)	66,328
Core Tier 1 and total capital ratio	25%
Surplus capital over minimum requirement	9,902

There are minimum capital requirements, which relate to the Total Risk Exposure Amount.

Waverton is required to satisfy three tests of capital adequacy:

- Common Equity Tier 1 capital of 4.5% of TREA. Our minimum requirement is £2,985k and we currently have a Common Equity Tier 1 capital amount of £16,709k;
- Tier 1 capital of 6% of TREA. Our minimum requirement is £3,980k and we currently hold a Tier 1 capital amount of £16,709k;
- Own funds of 8% of TREA. Our minimum requirement is £5,306k and we currently hold own funds of £16,709k.

	Pillar 1
Market Risk	£19k
Credit Risk	-
Fixed Overhead Requirement (FOR)	£5,306k
Core Capital	£16,709k

As at 30 September 2017 Waverton had capital resources of £16,709k, which exceeded Waverton's Pillar 1 requirements. This is met from the existing capital resources and there is no significant risk that its liabilities cannot be met as they fall due.

The Board are therefore comfortable that Waverton is adequately capitalised for Pillar 1 purposes and has sufficient cover for market downturns and other risks that may materialise in the short to medium term.

7 Risk Categories

The following risks take into account the European Central Bank's minimum requirement in terms of risk identification to which Waverton's capital adequacy is potentially exposed. Explanation is provided where some of the risks are not applicable to Waverton.

Credit Risk

Credit Risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge the obligation.

Waverton does not undertake lending activities as part of its business. Its debtors typically consist of client balances, which arise incidentally to its business such as management fee income receivable. Waverton has a mandate to debit fees directly from the majority of its client portfolios. Waverton's assets are not held as collateral nor are they encumbered. The company regularly assesses the liquidity of its assets in order to comply with capital adequacy requirements.

Credit risk concentrations can arise if clients are engaged in similar activities, are located in the same geographical region or have comparable economic characteristics, for example if their ability to meet contractual obligations would be similarly affected by changes in economic, political and other conditions. Since Waverton does not take proprietary positions and has minimal levels of credit exposures, it is not exposed to potential sources of concentration risk such a sector, industry, country or group exposure.

In the light of the above, limits are not set in the conventional sense but the Finance department regularly monitor for any irregularities. This applies not only to the current outstanding balances, but also to any contingent commitments.

Market Risk

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Given the reliance on periodic asset based fees for revenue generation, the risks and uncertainties of Waverton's business are directly correlated with risks and uncertainties in financial markets.

So far this year the global stock market has continued the rise that began in early 2016. The FTSE World Index Total Return was up 15.52% over the year to 30th September 2017. The rise has been accompanied by remarkably low volatility.

These returns, and this lack of volatility, has come despite the nervousness that many investors feel about the geopolitical backdrop and the valuation of financial markets. Those geopolitical concerns include the March 2017 triggering of Article 50 of the Lisbon Treaty by the British Government and the subsequent negotiations with the European Union for 'Brexit'.

The Bank of England raised interest rates in November for the first time since 2007 but made it clear that it was not seeking to raise them significantly further. At 0.5% the base rate remains a long way below inflation, which is running at 3% (Consumer Price Index). Interest rates are likely to remain below the rate of inflation for the foreseeable future. This is also true in the United States where the Federal Reserve has raised interest rates to 1.25% and is likely to raise them further. It is also planning to reduce the size of its balance sheet, which had grown during its quantitative easing policy. In much of Europe and in Japan, short-term interest rates are negative in nominal terms although the European Central Bank has said it will slow its purchases of assets that are growing its balance sheet.

Monetary policy is therefore shifting to a tighter bias for the first time since the financial crisis of 2008-09 but the absolute level of rates remains very low. This has allowed investors to borrow money very cheaply by historic standards and has led to signs of speculation in some markets. Hence, the very high valuation of some parts of the stock market and the phenomenon of negative real interest rates on corporate bonds in Europe.

In summary, the market environment and outlook will determine the volume of Waverton is trading activity and the products in which its clients invest. Given a significant part of Waverton's turnover derives from the value of assets under management, market conditions directly affect Waverton's turnover.

In the light of the above, Waverton put in place a limit framework and risk measures for the funds and portfolios whereby appropriate limits have been set by the Portfolio Risk Review Committee.

We employ the following statistical risk management measures:

- Value at Risk (VaR)
  This is a downside risk measurement tool, which evaluates the minimum potential extreme loss over a given time horizon based on a defined confidence level. This is a regulatory requirement for certain funds managed by Waverton.

- Volatility
  This is a statistical measure using standard deviation to determine the variation around the mean return.

- Tracking Error
  Tracking error uses standard deviation to determine the divergence between the fund and the benchmark, measuring the variability from the mean relative return.

- Liquidity
  Liquidity monitoring is used to assess the liquidity characteristics of both the overall portfolio and underlying securities.

- Stress Tests
  Using the risk systems, Waverton is able to perform a wide variety of stress tests covering both historical events and scenarios across a range of factors. Waverton uses 12 historical events that are reviewed for relevance periodically. The average of these 12 events is used as a level to set a limit against.

- Concentration Risk
  Waverton has developed a measure to capture concentration risk by measuring the exposure weight to risk contribution for the top 10 risk contributors.

<u>Operational Risk</u>

Operational risk is the risk of loss to Waverton resulting from inadequate or failed internal processes, people and systems, or from external causes (deliberate, accidental or natural).

The Directors consider Waverton's arrangement for monitoring, recording and mitigating operational risk to be appropriate to the size, nature and complexity of the business. Management information is prepared on a monthly basis for the Management and Risk Committee respectively and there are clear lines of escalation within the Waverton governance structure.

Waverton employs experienced staff in the management of operations, together with clear segregation of duties and robust documented operational procedures.

There is an escalation process in place whereby breaches or error incidents exceeding our risk appetite of £25,000 total loss must be escalated to the CEO or higher as appropriate.

Stress tests are undertaken for the key risk areas to which Waverton's capital adequacy is potentially exposed. The tests are carried out in order to assess how Waverton's capital requirements would alter and what the reaction might be to a range of adverse scenarios (including operational and market events). The assessment of the impact of stress situations includes consideration of the impact of a severe economic downturn on Waverton's future earnings, own funds and own funds requirements, taking into account its business plans.

The key risk areas are mainly regulatory and compliance, operational, business continuity and systems. These risks have been assessed taking into account the inherent risks posed and the effectiveness of controls in place to mitigate these risks.

- Regulatory and compliance - the key controls being monitoring of regulatory adherence through our Compliance Monitoring Programme and the management of regulatory development or a change that materially impacts Waverton such as MiFID II through project resource and governance.

- Operational – this risk in broad terms covers fraud, transaction risk, asset risk, outsourcing management risk, data protection risk, employment practices risk etc. The key controls lie with the line management as the first line of defence to assess its own risk exposures after taking into account their risk appetite, to implement robust internal controls and documented procedures, to have supervisory controls and review processes in place.

- Business continuity – Changes in customer behaviour, threats posed by low-cost competitors, disruption caused by key service provider / system availability are the examples of risk. Management discuss growth initiatives as part of their annual budget process. Another key control being the annual testing of our comprehensive business continuity plan in order to minimise disruption that could possibly be caused to critical business functions due to unavailability of servers / systems for instance.

- Systems – The main risk being fault in key systems such as DSA or Apsys that might possibly cause major damaging effect that threatens the deadline of time critical business processes. The key controls being regular network monitoring, access controls, enterprise level anti-malware & back up process.

- Cyber – Cyber-attacks cause sensitive and personal data stored within Waverton's IT systems to be leaked. The key controls being firewall as a monitoring device for immediate notification of any suspicious activity to IT Operations team and enterprise level anti-malware.

- People – The key man risk being the sudden departure of a key Portfolio Manager and Waverton faces the loss of substantial portfolios managed by a key Portfolio Manager. In terms of managing client relationship, there is a second Portfolio Manager assigned to each private client portfolios in order to reduce reliance on a single Portfolio Manager. In addition, it is built in Portfolio Managers' employment contract terms that they are prohibited from soliciting Waverton clients during their gardening leave following resignation.

Waverton also mitigates its operational risk by means of a comprehensive Professional Indemnity insurance policy.

Liquidity Risk

Waverton's liquidity and funding may be impacted by reduced revenues due to a fall in market values or in the event that access to capital resources is reduced.

Waverton aims to maintain excess cover of its capital adequacy requirement and sufficient reserves to cover the Professional Indemnity Insurance excess of £50,000 as well as to absorb losses or meet increased capital requirements in the event that adverse circumstances materialise.

At all times, Waverton aims to maintain liquid resources sufficient to cover six months of audited expenditure based upon costs which are fixed in the short term.

Waverton does not take proprietary positions therefore has minimal levels of liquidity and funding exposures. Finance regularly monitor for any significant exposures in order to assess its ability to comply with capital adequacy requirements.

Insurance Risk

Waverton does not undertake life or non-life insurance business and therefore does not have insurance liabilities.

For Waverton, insurance is a means of protection from financial loss. Waverton use this form of risk management primarily to hedge against the risk of a contingent, uncertain loss.

There are limits of liability and insurance retention in place for each category of insurance, which are deemed appropriate to the size, nature and complexity of the business.

Concentration Risk

Concentration risk is the risk arising from a lack of diversification in the business. Since Waverton does not take proprietary positions and has minimal levels of credit exposure it is not exposed to potential source of concentration risk such as sector industry, country or group exposure.

Concentration risk within individual client portfolios is managed by investment managers and monitored by the Performance & Risk team and the Portfolio Review Committee.

There is a certain extent of concentration risk in terms of revenue, on a small number of private client portfolios which accounts for relatively large percentage of Waverton's total revenue. This is mitigated by assigning a second Portfolio Manager to the portfolios in order to reduce reliance key man risk should a Portfolio Manager decided to leave suddenly.

Residual Risk

Residual risk is the risk that remains after Waverton has managed risks following choices made to avoid, reduce, transfer or accept each individual risk. It is difficult to completely eliminate risk and normally there is a residual risk that remains after each risk has been managed.

There will be instances where human errors occur despite internal controls (risk reduction) that are in place. In that sense, Waverton manages residual risk through the breaches and error incidents reporting process. Assessment of breaches / non-compliance and control weaknesses / failure is carried out by Compliance and Operational Risk respectively. Remedial action plans will be developed as part of the assessment and monitored via the Risk Committee. Any exception is escalated to the Audit Committee / the Board.

Additionally, Waverton manages residual risk through insurance arrangement (risk transfer) where residual risk includes the insurance deductible amount.

The nature of Waverton's business meant that there is also an element of risk acceptance whereby the entire risk becomes a residual risk. For example, Portfolio Managers may accept the risk that a stock will go down because the potential rewards of the investment outweigh the risks.

Business Risk

In general, the main types of business risk to consider are strategic, compliance, financial and operational. Compliance, financial and operational risks are covered under the heading of Operational Risk.

As for strategic risk, the Management Committee discuss, as part of the annual budget review cycle, capital expenditure budget, growth initiatives amongst other things in order to remain competitive.

Another key business risk is a reduction in funds under management, following a market downturn or loss of clients, resulting in lower management fees. Management carries out stress testing in order to assess the impact on profit and loss from various scenarios where assets under management might fall.

Interest Rate Risk

Waverton does not deal on its own account or hold investments for either trading or investment purposes and accordingly has negligible sensitivity to changes in interest rate other than interest rate risk based on the variable interest earned / charged on the bank balances.

Pension Obligation Risk

Waverton does not operate a Defined Benefit Pension Scheme for its employees but maintains an appropriate occupational Defined Contribution Pension Scheme and exceeds the requirements of auto-enrolment regulations.

Participation Risk

Waverton does not have any off-balance-sheet transactions in which it sells its exposure to a contingent obligation.

Sovereign Risk

Waverton does not deal as principal on foreign exchange contracts therefore it is not exposed to foreign central bank altering its foreign exchange regulations, which may have the impact of significantly reducing or completely nullifying the value of its foreign exchange contracts. Waverton is exposed to exchange rate risk of its currency relative to other foreign currencies in that it may change in a manner that has an adverse effect on the value of that portion of Waverton's assets or liabilities denominated in currencies other than GBP.

Stress Testing

Stress tests are undertaken for the relevant risks to which Waverton's capital adequacy is potentially exposed. The tests are carried out in order to assess how Waverton's capital requirements would alter and what the reaction might be to a range of adverse scenarios (including operational and market events). The assessment of the impact of stress situations includes consideration of the impact of a severe economic downturn on Waverton's future earnings, own funds and own funds requirements, taking into account its business plans.

8 Remuneration

In accordance with CRD, Waverton is required to disclose certain information about its remuneration policies.

8.1 The Remuneration Committee

Waverton has adopted a remuneration policy that is in line with FCA Remuneration Code, which was established to adhere to the requirements of the Capital Requirements Directive CRD IV. Waverton's Remuneration Policy has been drawn up with reference to a level three firm and consequently considers that Waverton may, as permitted by the Code, dis-apply certain remuneration principles under the Code (SYSC 19A).

The Remuneration Committee is responsible for the approval of remuneration and incentive schemes. The Committee will review annually, or at such times as they deem appropriate, employees' remuneration. Team heads will make recommendations to the Committee based on their own analysis of individual performance, which will be taken into consideration by the Committee.

The Committee comprises two non-executive directors, one managing director and the Chief Executive Officer of Waverton.

8.2 Link between Pay and Performance

Waverton's remuneration packages reward employees and executives based on a set of over-arching Waverton principles. When considering variable remuneration, the Remuneration Committee takes account of overall business profit, the achievement of both financial and non-financial objectives, including adherence to compliance and regulatory rules, and individual performance. All variable pay awards are discretionary.

8.3 Remuneration Disclosure

The aggregate remuneration awarded to Waverton's Code Staff (11) during the financial year ended 30 September 2017 was £3.66m, of which £1.06m was variable pay.

For the purpose of Pillar 3 disclosure, Waverton considers itself as one business unit. The total aggregate payroll costs for Waverton were £16.11m and £15.57m respectively for the year ended 30th September 2017 and 2016.

Waverton did not have any individuals over the higher earners' threshold of £1 million.