



# **Capital Requirements Directive**

## **Pillar 3 Disclosures**

**June 2011**

## Background

The 2006 Capital Requirements Directive ('the Directive') of the European Union created a revised regulatory capital framework across Europe based on the provisions of the Basel 2 Capital Accord.

This was implemented in the United Kingdom through changes to the Financial Services Authority ('FSA') Handbook of Rules and Guidance, and specifically through the creation of the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU').

The new framework consists of three 'pillars':

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

BIPRU 11.5 (technical criteria on disclosure: general requirements) and 11.6<sup>1</sup> (qualifying requirements for the use of particular instruments or methodologies) require that a firm subject to the provisions of the Directive must disclose, as appropriate, the relevant information required under Pillar 3. This must be done in accordance with a formal disclosure policy which sets out our policies for assessing the appropriateness of our disclosures, including their verification and frequency.

The rules provide that we may omit one or more of the required disclosures if we believe that the information is immaterial. Materiality is based on the criteria that the omission or misstatement of material information would be likely to change or influence the assessment or decision of a user relying on that information for the purposes of making economic decisions. Where we have considered a disclosure to be immaterial, we have stated this in the relevant section.

We are also permitted to omit one or more of the required disclosures where we believe that the information is regarded as proprietary or confidential. Proprietary information is that which, if it were shared, would undermine our competitive position. Information is considered to be confidential where there are obligations binding us to confidentiality with our customers and counterparties. Where we have omitted information for either of these two reasons we have stated this in the relevant section and the reasons for this. Where appropriate, we have published more general information on the subject matter of the required disclosure.

<sup>1</sup> BIPRU 11.6 does not apply to Towry

In this document we disclose information in accordance with the following BIPRU 11.5 rules unless it is has been determined as immaterial or of a proprietary or confidential nature:

- BIPRU 11.5.1R on our risk management objectives and policies;
- BIPRU 11.5.2R on the scope of application of directive requirements;
- BIPRU 11.5.3R on our capital resources;
- BIPRU 11.5.4R (subsections 1 and 2) on our compliance with the rules in BIPRU and on Pillar 2 requirements;
- BIPRU 11.5.16R on our interest rate risk

These Pillar 3 Disclosures have been subject to internal review procedures. The information has not been audited by Towry's external auditors.

## Scope and application of Directive requirements

The disclosures in this document are made in respect of the Towry group, which provides independent financial advice and discretionary investment management services.

The Towry group as it now stands has resulted from a number of significant acquisitions. Following the integration of these acquisitions with the existing operations of the group, the core operating companies are:

<b>Company</b>	<b>Activities</b>
Towry Limited	The main financial advisory company in the group. All Towry advisors are registered with this company, and any new advisors acquired through acquisitions are transferred to this firm. FSA regulated.
Towry Investment Management Limited	Provides the Towry discretionary wealth management service. FSA regulated.
Towry Services Limited	Provides support services to the Towry group. Employment and supplier contracts are with this company, and all fixed assets used by the group are owned by this firm. Not regulated.
Towry Pension Trustees Limited	Provides trust services and is the trustee for the Towry SIPP. FSA regulated.
Towry EJ Limited	Formerly Edward Jones Limited, this company is authorised to provide financial advice. FSA regulated.

Towry Investment Management is the only BIPRU firm and is a limited licence firm as defined by the FSA.

Towry has an investment firm consolidation waiver in place, which means that it will remain subject to consolidated supervision and must report its consolidated financial position but is not required to meet a consolidated capital requirement. This waiver is required because the expansion of the group has been financed through the use of bank loans, which to a large extent funded the acquisition of intangible assets (i.e. relationships with clients), which are inadmissible for regulatory capital purposes.

## **Risk management objectives and policies**

Our risk management policy reflects the FSA requirement that we must manage a number of different categories of risk. These include: liquidity, group, credit, market, interest rate, business and operational risks. These risks are considered at a group level as this is the way in which risks are monitored and managed

### **Liquidity and group risk**

The group manages all cash and borrowing requirements centrally to maximise potential interest income whilst ensuring the group has sufficient liquid resources to meet the continued operating needs of the business. This is supported by a robust budgeting and forecasting process which includes stress testing and scenario analysis and has the full involvement of the Towry Executive Committee.

The Towry group is managed as a single entity therefore group intra risk is not considered material.

### **Credit risk**

The main credit risk for Towry relates to advisory fees, being the risk that a client does not pay amounts due for services provided. This risk is mitigated by the high number of clients in respect of which amounts are due at any one time; the risk of non payment is also reduced due to the nature of the clients as they are typically wealthy individuals.

Towry revenues also include annual management charges received from clients based on a percentage of client assets under management. These charges are made directly to the clients' asset portfolios, and therefore the credit risk relating to this income is low.

The risk relating to amounts due from product manufacturers as a result of legacy renewal commission streams is considered to be low. This is because these amounts are due from institutions that are authorised and regulated by the FSA.

### **Market Risk**

The Group is indirectly subject to market risk as a significant element of income is dependent upon the value of client funds under management. This risk is mitigated by the asset allocation strategy adopted, which ensures that clients have highly diversified portfolios with limited exposure to any one asset class.

### **Interest rate risk**

Towry is exposed to interest rate risk through the funding it has received by way of bank loans. The interest payable on these loans is charged at a rate of LIBOR plus fixed margins.

The risk associated with this interest rate exposure has been mitigated by entering into an interest rate 'collar' with the lender covering just over one half of the loans held.

## **Business Risk**

Our Pillar 2 business risk assessment principally takes the form of a fall in assets under management following a market downturn that leads to lower management fees, although other risks such as loss of advisers and systems failures are also considered. To mitigate our business risk, our Finance team regularly analyses various different economic scenarios to model the impact of economic downturns on our financial position.

## **Operational Risk**

Operational risk is defined as the potential risk of financial loss or impairment to reputation resulting from inadequate or failed internal processes and systems, from the actions of people or from external events.

Major sources of operation risk include: outsourcing of operations; IT security; internal and external fraud; implementation of strategic change and regulatory non-compliance.

Towry operates a robust risk management process which is regularly reviewed and updated with details being provided to all staff via the intranet.

The Head of Risk & Compliance is responsible for co-ordinating the periodic review of the Towry risk policy and recommending operational changes to the Executive Committee (EXCO) and the Board via the Audit Risk and Compliance Committee (ARCC).

The Towry risk appetite depends on a range of factors including:

- Board philosophy and positioning in the market;
- Market perception of Intermediaries and Wealth Managers;
- Degree of inherent risks in the business;
- The risk and return trade off of significant business initiatives;
- The cost of rectifying previous errors arising

The current appetite for risk is defined as being **low**. This means that Towry will operate with:

- An active and visible profile in the management of risk;
- Disciplined and structured reporting of risks and management actions;
- Regular senior management review of the risk environment and our actions to address it;
- The application of a customer fair value test for all services and products selected for inclusion in service offerings and solution matrices.

The ARCC's main responsibility is to assist Towry in discharging its corporate governance responsibilities in relation to:

- the relationship with the external auditors;
- the reliability and appropriateness of disclosures in the financial statements and external financial communications; and
- the maintenance of an effective framework of business risk management including compliance, internal controls and the assurance provided by the internal audit function.

All Business Unit Heads and Functional Area Heads bear responsibility for internal controls and the management of business risk as part of their accountability for achieving Towry's strategic and operational objectives.

In the context of their line responsibilities, individuals are responsible for identifying the risks surrounding their work, implementing controls over those risks and reporting areas of concern through normal management channels.

Every quarter, the EXCO members will submit to the Head of Risk & Compliance a risk and control certificate covering significant items. This provides positive assurance throughout the quarter that appropriate management controls and procedures have been implemented including for any significant issues arising. Any significant deficiencies or lapses should be reported together with the actions proposed to rectify or otherwise deal with them.

In addition, the Head of Risk & Compliance will provide the ARCC with a quarterly summary report on all significant risk issues – these risks are classified as red (unacceptable), amber (watch list) and green (acceptable). For each risk a mitigation plan is developed and ownership of the risk is assigned to the appropriate EXCO member

In addition to the quarterly compliance certificate, it is the responsibility of all Business Unit Heads and Functional Area Heads to inform the Head of Risk & Compliance of any proposed changes to departmental policies and procedures or any exceptions that have arisen following an incident or error.

## Capital resources

Our capital resources comprise of core tier 1 capital only and therefore there are no other items or deductions.

In December 2009 a new parent company, TL UK Finance Limited, was established. We have been granted a consolidation waiver for TL UK Finance Limited which has £34.5m capital resources at 31 December 2010.

### Pillar 1 requirement

In accordance with GENPRU 2.1.45R (calculation of variable capital requirement for a BIPRU firm), our capital requirement has been determined as being our fixed overhead requirement and not the sum of our credit risk capital requirement and our market risk capital requirement. Towry Investment Management Limited complied with the capital requirements set out by the FSA throughout the years ended 31 December 2009 and 2010, and has maintained compliance to date.

Pillar 1 is defined as the higher of the sum of credit and market risks and the fixed overhead requirement. The Pillar 1 capital requirement for Towry Investment Management Limited as at 31 December 2010 and 2009 using audited figures is summarised below:

	<b>At 31-12-10</b>	<b>At 31-12-09</b>
	<b>£'000</b>	<b>£'000</b>
Core tier 1 capital	8,567	5,026
Deductions from tier 1 capital	-	-
<b>Total tier 1 capital after deductions</b>	<b>8,567</b>	<b>5,026</b>
Upper tier 2 capital	-	-
Lower tier 2 capital	100	100
Deductions from tier 2 capital	-	-
Deductions from total of tiers 1 and 2 capital	-	-
<b>Total tier 1 capital plus tier 2 capital after deductions</b>	<b>8,667</b>	<b>5,126</b>
Total tier 3 capital	-	-
<b>Total capital before deductions</b>	<b>8,667</b>	<b>5,126</b>
Deductions from total capital	(242)	(108)
<b>Total capital after deductions</b>	<b>8,425</b>	<b>5,018</b>
<b>Pillar 1 capital requirement</b>	<b>6,139</b>	<b>4,293</b>
<b>Excess of own funds over capital requirement</b>	<b>2,286</b>	<b>725</b>

Core tier 1 capital comprises of permanent share capital and profit and loss account reserves. The lower tier 2 capital of £100,000 relates to a subordinated loan. The deductions from total capital consist of investments in subsidiaries together with deferred tax assets.

## **Compliance with rules in BIPRU and Pillar 2 rule requirements**

Our overall approach to assessing the adequacy of our internal capital is set out in our Internal Capital Adequacy Assessment Process (ICAAP).

The ICAAP process involves separate consideration of risks to our capital combined with stress testing using scenario analysis. The level of capital required to cover risks is a function of impact and probability. We assess impact by modelling the changes in our income and expenses caused by various potential risks over a 1-year time horizon. Probability is assessed subjectively.

In addition, we have reviewed the output of our Executive Risk Reviews which includes a quantification of the risks identified by our Audit Risk & Compliance Committee. This has identified a number of key business risks which we have classified against the risk categories contained in GENPRU 1.2.30R and reviewed the guidance in BIPRU 2.2.61-65.

Our Pillar 2 capital requirement is our own assessment of the minimum amount of capital in addition to Pillar 1 that we believe is adequate against the risks identified. This has been assessed during 2010 and adjusted to be an additional 30% of the Pillar 1 capital requirement for Towry Investment Management Limited. Since this assessment was performed capital resources have been maintained in excess of the new total of Pillar 1 and Pillar 2 requirements.

## **Credit and Market risk**

Disclosures in relation to these have been considered immaterial under BIPRU 11.3.5R (Exemption from disclosure: Materiality). The sum of the credit and market risk requirements is immaterial compared to our fixed overhead requirement and therefore it is the latter that forms our Pillar 1 requirement.