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# Pillar 3 Disclosure / December 2021

The Capital Requirements Directive ("CRD") and the Alternative Investment Fund Management Directive ("AIFMD") of the European Union establish a revised regulatory capital framework across Europe governing the amount and nature of capital credit institutions and investment firms must maintain.

In the United Kingdom, the CRD and AIFMD have been implemented by the Financial Conduct Authority ('FCA') in its regulations through the General Prudential Sourcebook ("GENPRU"), the Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU"), the Interim Prudential Sourcebook for Investment Business ("IPRU (INV)").

The CRD consists of three 'Pillars':

- Pillar 1 sets out the minimum capital amount that meets the Firm's credit, market and operational risk capital requirement;
- Pillar 2 requires the Firm to assess whether its capital reserves, processes, strategies and systems are adequate to meet pillar 1 requirements and further determine whether it should apply additional capital, processes, strategies or systems to cover any other risks that it may be exposed to; and
- Pillar 3 requires disclosure of specified information about the underlying risk management controls and capital position to encourage market discipline.

The AIFMD adds further capital requirements based on the Alternative Investment Fund ("AIF") assets under management and professional liability risks.

The rules in BIPRU 11 set out the provision for Pillar 3 disclosure. This document is designed to meet our Pillar 3 obligations.

The Pillar 3 disclosure document has been prepared by LGT PD UK in accordance with the requirements of BIPRU 11 and is verified by Risk Management Committee. Unless otherwise stated, all figures are as at the 31 December 2020 financial year-end.

Pillar 3 disclosures will be issued on an annual basis after the year end and published as soon as practical.

LGT PD UK is permitted to omit required disclosures if it believes that the information is immaterial such that omission would be unlikely to change or influence the decision of a reader relying on that information for the purpose of making economic decisions about the Firm.

In addition, LGT PD UK may omit required disclosures where it believes that the information is regarded as proprietary or confidential. In its view, proprietary information is that which, if it were shared, would undermine its competitive position. Information is considered to be confidential where there are obligations binding the Firm to confidentiality with its customers, suppliers and counterparties.

Where LGT PD UK has chosen to omit information because it is proprietary or confidential, it has explained the omission and provided its reason.

## Scope and application of the requirements

LGT PD UK is authorised and regulated by the FCA and as such is subject to minimum regulatory capital requirements. The Firm is categorised as a Collective Portfolio Management Investment Firm ('CPMI') Firm by the FCA for capital purposes.

LGT PD UK is a member of a group and so is required to prepare consolidated reporting for prudential purposes. Although part of a group, the Firm is managed on a "stand-alone" for liquidity purposes and the Firm does not foresee any impediments to the prompt transfer of capital between group entities should the need arise. There are no differences in the basis of consolidation for accounting and prudential purposes.

## Risk management

The Board of LGT PD UK is responsible for the total process of risk management, as well as forming its own opinion on the effectiveness of the process. The Board, in liaison with the executive directors and the Risk Management Committee, sets the risk strategy policies.

The Risk Management Committee is accountable to the Board for designing, implementing and monitoring the process of risk management and implementing it into the day-to-day business activities of the Firm. The Risk Management Committee is responsible for effectively communicating the Firm's approach and commitment to establishing and maintaining an effective risk management framework and approach. The Risk Management Committee is also responsible for ensuring that employees are adequately equipped with the right tools and knowledge to enable employees to fulfil their obligations to the risk management process.

The Risk Management Committee decides the Firm's appetite or tolerance to the impact of risk – those risks it will accept and those it will not take in the pursuit of its goals and objectives. In addition, the Risk Management Committee ensures that the Firm has implemented an effective, on-going process to identify risk, to measure its potential impact against a broad set of assumptions and then to ensure that such risks are actively managed.

The Risk Management Committee has designed, implemented and operates a Risk Management Framework that identifies the risks that the execution of the business' strategy entails, assesses those risks against the Firm's risk appetite, assesses the arrangements in place to mitigate and/or manage those risks on an ongoing basis, and – where appropriate – identifies, implements and operates enhanced procedures and/or controls to improve the Firm's ongoing mitigation and/or management of specific risks.

The Risk Management Committee has identified that operational, business, market and concentration risks are the principal types of risk to which the Firm is exposed. Where the Risk Management Committee identifies that specific risks are material to the Firm, the financial impact of those risks is considered as part of business planning (as above) and also capital management (in determining whether the level of regulatory capital held by the Firm is adequate).

Regular reporting assists the Board in keeping sight of the effectiveness of these frameworks and enables informed decision-making with the considerations of risk management at front of mind. Financial analysis is also an ongoing process, with the impact on both Pillar 1 and Pillar 2 requirements of ad hoc events (internal and external to the Firm) and YTD results reassessed continuously.

Appropriate action is taken where risks are identified which fall outside of the Firm's tolerance levels or where the need for remedial action is required in respect of identified weaknesses in LGT PD UK's mitigating controls.

Specific risks applicable to the Firm come under the headings of business, operational, credit and market risks.

## Business risk

Business risk is the possibility that LGT PD UK will have lower than anticipated revenues resulting from loss of clients or make investments on behalf of clients, which do not deliver the anticipated returns. BR is influenced by numerous factors, including reputational damage, key man events, competition, the overall economic climate and government regulations.

In the course of the risk identification and assessment process, LGT PD UK has identified key business risks and considers reputational damage and the overall economic climate as principal sources of potential loss of revenues in the future.

The most recent development on a macroeconomic scale to affect global markets and firms is the coronavirus (COVID-19) pandemic. Globally, during 2020, market values of varying instruments widespread sectors had fallen, and only saw signs of recovery in the latter part of 2020 and into the first half of 2021. Impacting negatively on fund AUMs and in turn causing pressure on fee income for many firms. Further, in the UK, government lockdown protocols throughout 2020 (and to date) have meant firms have needed to adapt to new ways of working and overcome operational challenges associated with the workforce working remotely. Whilst LGT PD UK's funds have been adversely affected to some degree the Risk Management Committee if confident that the downside is temporary, and values will soon return to normality through the end of 2021 and into 2022 – which is supported by the observable trend since the height of the pandemic. Operationally, LGT PD UK is well-established to work remotely and, as such, the business continuity plan is assessed to have operated very effectively, minimising disruption as employees adapted to the new way of working. Consequently, the Risk Management Committee is confident that no further analysis is required, and capital resources are requirements do not need to be changed to mitigate this risk.

## Operational risk

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

In the course of the risk identification and assessment process, the Firm has identified breaches of investment procedures, access to inside information, outsourcing arrangements, failure of money laundering controls and cyber security as being the most pertinent OpR. Individually these risks are well controlled as detailed in the "LGT Risk Register".

The Board has implemented systems and controls to enable it to effectively manage its business activities and the policies to comply with the requirements of AIFMD. These are contained within LGT PD UK's compliance manual together with a compendium of policies, which detail how LGT PD UK will operate in order to meet its obligations under the AIFMD. LGT PD UK will ensure that its systems and controls arrangements are to be reviewed periodically and tested on a regular basis through regular compliance monitoring. The outcome of the monitoring will be presented to the Risk Management Committee in the form of a report assessment of the areas monitored together with suggested recommendations (action plan) based on any improvements identified such that management information enables LGT PD UK to take corrective measures if required and also to ensure that its systems and controls and governance and culture remain consistent with both sound commercial business management and the regulatory requirements imposed on an AIFM.

## Credit risk

Credit risk is the risk that arises from macroeconomic events and which may impact LGT PD UK's income (indirectly via the ability of the borrowers of the underlying fund investment portfolios of the respective AIFs to service their debt obligations).

AIFs portfolio credit risk may be considered higher in specific sectors and early indicators come through in the results of reported metrics, such as 'Minimum liquidity covenant tests'. Such counterparty borrowers would be closely monitored for any further indicators of further payment default risk. Systematic review of each portfolio company within the funds are performed to pre-empt such issues and create capacity to manage and mitigate any foreseeable periods of concern.

## Market risk

Market risk is the risk that arises from macroeconomic events and which may impact LGT PD UK's income.

LGT PD UK is subject to market risk in relation to a long-term macro-economic downturn at a global, national or regional level. The potential difficulty in raising new funds would directly affect LGT PD UK's expected income. As the management fees are linked to assets under management at any given quarter, the future aggregate AUM will be closely monitored and managed, paying particular attention to the status of the respective fund life cycles: eg.

New capital fundraising up to final close (increase to AUM); within the re-investment period that allows recycling of principal (steady state AUM); funds operating post investment period and in harvest mode (realising assets and decreasing AUM).

LGT PD UK is also subject to foreign exchange risk given that almost all income receivable is denominated in EUR and approximately half of the expense base is in GBP. The extent to which EUR moves against GBP could influence the profitability of LGT PD UK. LGT PD UK is developing a hedging strategy to manage the net EUR exposure. FX hedging is monitored as part of the quarterly Risk management review process.

## Liquidity risk

Liquidity risk is financial risk due to uncertain liquidity, within the overall heading of OpR, as liquidity crises occur as a result of inadequate or failed internal processes and/or systems in relation to monitoring and managing asset/liability profiles and related cash flows, and the Risk Management Committee considers that Liquidity Risk is of such importance to the stability of any business to warrant detailed consideration. Liquidity risk is managed by the following specific controls.

Preparation of budgets covering the short and medium term (monthly for the current year and annually for the next 3 years), Monitoring of current cash levels and of short-term cash requirements.

LGT PD UK's liquidity risk is reduced by the following factors:

- Its business model is profitable and predictable,
- Fee income for a large part of the business is receivable in advance and there is a clean record in terms of promptness of payment, and
- Bonuses are made at the discretion of the Firm's management team and are not contractual. Such payments can therefore be delayed if there are any liquidity concerns.

## Regulatory capital

The Firm is a Limited Liability Company and its capital arrangements are established in its Articles. Its capital is summarised as follows:

The main features of LGT PD UK's capital resources for regulatory purposes are as follows:

| | December 2020 €000 |
|---|---:|
| Tier 1 capital* | 6,818 |
| Tier 2 capital | - |
| Tier 3 capital | - |
| Deductions from Tiers 1 and 2 | 3,141 |
| **Total capital resources** | **3,677** |
| *No hybrid tier one capital is held | |

The Firm is small with a simple operational infrastructure. Its market risk is limited to foreign exchange risk on its accounts receivable in foreign currency, and credit risk from management and performance fees receivable from the funds under its management. LGT PD UK follows the standardised approach to market risk and the simplified standard approach to credit risk.

BIPRU - The Firm is subject to the Fixed Overhead Requirement and is not required to calculate an operational risk capital charge though it considers this as part of its process to identify the level of risk based capital required.

As discussed above, LGT PD UK is a CPMI firm and as such, its capital requirements are the higher of:

- €125,000 + 0.02% of AIF AUM > €250m; and
- The sum of the market & credit risk requirements; or
- The fixed overheads requirement ("FOR") which is essentially 25% of the Firm's operating expenses less certain variable costs.

0.02% is taken on the absolute value of all assets of all funds managed by LGT PD UK (for which it is the appointed AIFM) in excess of €250m, including assets acquired through the use of leverage, whereby derivative instruments shall be valued at their market value, including funds where the Firm has delegated the management function but excluding funds that it is managing as a delegate. The FOR is calculated, in accordance with FCA rules, based on the Firm's previous years audited expenditure. LGT PD UK has adopted the standardised approach to credit and market risk and the above figures have been produced on that basis. The Firm is not subject to an operational risk requirement.

It is LGT PD UK's experience that the Fixed Overhead Requirement establishes its capital requirements.

### Capital requirement

LGT PD UK's Pillar 1 capital requirement has been determined by reference to the Firm's Fixed Overheads Requirement ("FOR") and calculated in accordance with Article 95. The requirement is based on the FOR since this exceeds the total of the credit and market risk capital requirements it faces and also exceeds its base capital requirement of €50,000.

The FOR is based on annual expenses net of variable costs deducted, which include discretionary bonuses paid to staff and placement agent fees. The Firm monitors its expenditure on a monthly basis and takes into account any material fluctuations in order to determine whether the FOR remains appropriate to the size and nature of the business or whether any adjustment needs to be made intra-year.

This is monitored by the Finance team and reported to the Risk Management Committee on a regular basis.