Muzinich & Co. Limited | Pillar 3 Disclosure 2016

The Capital Requirements Directive ("CRD") of the European Union establishes a common 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 has 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"), and the Interim Prudential Sourcebook for Investment Business ("IPRU (INV)").

The CRD consists of three 'Pillars':

- Pillar 1 – sets out the minimum capital requirements for the Firm;
- Pillar 2 – deals with the Internal Capital Adequacy Assessment Process ("ICAAP") undertaken by the Firm to assess the adequacy of capital held in relation to its material risks; and
- Pillar 3 – requires the Firm to publicly disclose its policies on risk management, capital resources and capital requirements.

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

This document has been prepared by Muzinich & Co. Limited ("Muzinich" or the "Firm") in accordance with the requirements of BIPRU 11 and is verified by the Muzinich Board of Directors. Unless otherwise stated, the information contained in this document is accurate as at the 31 December 2016 financial year-end. It has not been verified independently and does not constitute any form of financial statement.

Pillar 3 disclosures will be made on an annual basis and published on the Firm's website (www.muzinich.com) as soon as practical after the year end.

The Pillar 3 disclosure requirements as detailed in BIPRU 11.3.6R permit the Firm to omit required disclosures if it believes that the information is immaterial or could be regarded as proprietary or confidential.

Materiality is based on the criteria that the 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. Proprietary information is that which, if it were shared, would undermine the Firm's competitive position. Information is considered to be confidential where there are obligations binding the Firm to confidentiality with its customers, suppliers and counterparties.

Scope and application of the requirements

The Firm is authorised and regulated by the FCA and as such is subject to minimum regulatory capital requirements. The Firm is categorised as a BIPRU Firm by the FCA for capital purposes.

Company Profile

Muzinich & Co. Ltd. is authorised and regulated in the UK by the FCA and as such is subject to minimum regulatory capital requirements. The Firm's activities give it the categorisation of a BIPRU Investment Firm.

The Firm is regulated as a standalone entity in the UK and is not part of a UK consolidation group and this disclosure has been prepared in relation to the Firm only. The Firm was initially set up in October 1999 and now has offices in London, Manchester, Paris, Frankfurt, Zurich, Milan and Madrid. These offices are used primarily as marketing vehicles to raise awareness of the Firm and its investment strategies. Overall the Firm offers a range of corporate credit investment strategies that seek to meet the performance, risk control, liquidity and transparency requirements for Professional Clients and Eligible Counterparties (as defined in the FCA Handbook). All of the Firm's investment strategies are available as separate accounts or commingled vehicles.

Risk management

The Firm has established a risk management process designed to provide effective systems and controls in place to identify, monitor and manage risks arising in the Firm.

The risk management process is overseen by the Global Portfolio Risk Analytics Committee ("PRAC"), with Muzinich's senior management team taking overall responsibility for this process and the fundamental risk appetite of the Firm ("Senior Management").

The PRAC, whose members include the Compliance Officer, has responsibility for overseeing the implementation and enforcement of the Firm's risk management process.

Senior Management meet on a regular basis to discuss current projections for profitability, cash flow, regulatory capital management, business planning and risk management. Senior Management aim to mitigate the Firm's risks though a framework of policy and procedures having regard to the relevant laws, standards, principles and rules (including FCA principles and rules) with the aim to operate a defined and transparent risk management framework. These policies and procedures are updated as required.

Senior Management has identified business, operational, market and credit as the main areas of risk that could impact the Firm directly or indirectly Senior Management meet formally on an annual basis to review the Firm's risks, controls and other risk mitigation arrangements and assess their effectiveness.

A formal update on operational matters is provided to Senior Management on a regular basis. Management accounts demonstrate continued adequacy of the Firm's regulatory capital and are reviewed on a regular basis.

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 the Firm's mitigating controls.

Risks

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

Business risk

The Firm's revenue is reliant on the performance of its existing accounts under management and its ability to launch new funds and obtain new mandates. As such, the risk posed to the Firm relates to underperformance resulting in a decline in revenue and adverse market conditions hindering the launch of new funds and obtaining new mandates and ultimately the risk of redemptions from the funds managed by the Firm or the termination of investment management agreements with existing clients. This risk is mitigated by:

- the continued support of the Firm by its US parent, Muzinich & Co. Inc.; and
- significant levels of capital held by the Firm which will continue to cover all the expenses of the business, even in a weakening environment, for a number of years.

Operational risk

The Firm places strong reliance on the operational procedures and controls it has in place to mitigate risk and seeks to ensure that all personnel are aware of their responsibilities in this respect.

The Firm has identified a number of key operational risks to manage. These relate to systems failure, breach of IT security, failure of third party providers, key man risk, potential for serious regulatory breaches, market abuse, trade dealing errors and fraud/theft. Appropriate polices are in place to mitigate against these risks, which include but are not limited to, taking out adequate group insurance, use of well-known and experienced third party providers, whistle blowing procedures, regular compliance training, and succession planning.

Credit risk

The Firm's exposure to credit risk is the risk that (i) investment management fees cannot be collected from clients; and (ii) the banks where collected fees are deposited and the Firm's general deposits are held fail. The Firm's credit risk appetite is low and therefore, the Firm holds all cash balances with international banks assigned with high credit ratings. The Firm does have an investment in its own UCITS managed funds where an 8% credit risk is applied for its market risk exposure. This investment is classed as a liquid asset and the fund strategies are diversified across the global corporate bond universe and allocated to investment grade, short duration and high yield sectors.

The amount of credit exposure relating to the Firm's investment management clients is limited. Management fees are drawn monthly from the Firm's proprietary funds, and monthly or quarterly from other accounts. Performance fees are drawn quarterly or annually where applicable. The Firm considers that there is little risk of default by its clients.

Given the nature of the Firm's exposures, no specific policy for hedging and mitigating credit risk is in place. The Firm uses the simplified standardised approach when calculating risk weighted exposures for (cash in bank) and its other assets.

Credit risk summary

Credit risk exposure	Total Exposure £'000	Risk weighting	Risk weighted exposure £'000
Cash in the bank	30,049	1.6%	481
Inter-company	1,134	8%	91
Trade Debtor	19,264	8%	1,541
Prepayments and other debtors	1,908	8%	153
Fixed Assets	1,688	8%	135
Other Investments	42,648	8%	3,412
Total	96,691		5,813

Market risk

The Firm's market risk is foreign exchange risk in respect of its accounts receivable, other investments and cash balances held in currencies other than GBP.

Since the Firm takes no trading book positions on its balance sheet, it has only indirect market risk

exposure via the wider Group and in so far as risk events in those markets can affect assets under management of its clients. The Firm's foreign exchange risk therefore would only arise in respect of its accounts receivable investments and cash balances held in currencies other than GBP.

No specific strategies are adopted in order to mitigate the risk of currency fluctuations.

The Firm calculates its foreign exchange risk by applying an 8% risk factor to its foreign exchange exposure.

Market risk summary

Market Risk Exposure	USD £000	EUR £000	Other (CHF, JPY etc) £000	Total £000
Assets	59,098	22,454	2,010	83,562
Liabilities	0	0	0	0
Net Currency Position	59,098	22,454	2,010	83,562
Capital charge applied	8%	8%	8%	8%
Foreign Exchange Risk Capital Charge	4,728	1,936	161	6,685

Liquidity risk

The Firm is required to maintain sufficient liquidity to ensure that there is no significant risk that its liabilities cannot be met as they fall due or to ensure that it can secure additional financial resources in the event of a stress scenario.

The Firm retains an amount it considers suitable for providing sufficient liquidity to meet the working capital requirements under normal business conditions. The Firm has always had sufficient liquidity within the business to meet its obligations and there are no perceived threats to this given the cash deposits it holds and support it receives from the parent company.

Additionally, it has historically been the case that all management fee debts are settled promptly, thus ensuring further liquidity resources are available to the Firm on a timely basis.

The cash position of the Firm is monitored on a regular basis by its Chief Financial Officer, and the Firm would be able to call on Muzinich & Co. Inc. for further capital as required.

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 the Firm's capital resources for regulatory purposes are as follows:

	As at 31.12.2016 £'000
Tier 1 capital*	74,696
Tier 2 capital	0
Deductions from Tiers 1 and 2	(165)
Total capital resources	74,530

*No hybrid tier one capital is held

The Firm has a simple operational infrastructure. Its market risk is limited to foreign exchange risk on its accounts receivable, cash and other investments in foreign currency, and credit risk from management and performance fees receivable from the accounts under its management, as well as other assets of the Firm.

The Firm follows the standardised approach to market risk and the simplified standard approach to credit risk.

The Firm is subject to the Fixed Overhead Requirement ("FOR") 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 a BIPRU firm the Firm's capital requirements are:

- €50,000; and

- the sum of the market & credit risk requirements; or
- the FOR which is =25% of the firm's operating expenses less certain variable costs (i.e. fixed overhead).

The FOR is calculated based on the Firm's previous year's audited expenditure. The Firm has adopted the standardised approach to market risk and the above figures have been produced on that basis. The Firm is not subject to an operational risk requirement.

Capital requirement

The Firm's Pillar 1 capital requirement has been determined by reference to the Firm's credit and market risk exposure. The requirement is based on the credit and market risk capital since this exceeds the total of the FOR 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 allowable commission and 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 Chief Financial Officer and reported to Senior Management on a regular basis.

Remuneration code disclosure

The Firm is subject to the FCA's Remuneration Code set out in the SYSC Sourcebook of the FCA's Handbook. The Remuneration Code (the "RemCode") covers an individual's total remuneration including both fixed and variable. The Firm incentivises its staff through a combination of both.

The Firm's business is to provide investment management services to professional and institutional clients, including funds (the "Accounts").

The Firm's remuneration policy is designed to ensure that it complys with the RemCode and that our remuneration arrangements:

- are consistent with and promote sound and effective risk management;
- do not encourage excessive risk taking;
- include measures to avoid conflicts of interest; and
- are in line with the Firm's business strategy, objectives, values and long-term interests.

Proportionality

Enshrined in the European remuneration provisions is the principle of proportionality. The FCA has sought to apply proportionality in the first instance by instituting two tests. Firstly, a firm that is significant in terms of its size must disclose quantitative information referred to in BIPRU 11.5.18R at the level of senior personnel. Secondly, that a firm must make disclosure that is appropriate to the size, internal organisation and the nature, scope and complexity of their activities.

The Firm is not 'significant' (that is to say it has relevant total assets of <£50bn*) and consequently makes this disclosure in accordance with the second test (BIPRU 11.5.20 R(2)).

Application of the requirements

The Firm is required to disclose certain information on at least an annual basis regarding its remuneration policy and practices for those staff whose professional activities have a material impact on the risk profile of the Firm. This disclosure is made in accordance with the Firm's size, internal organisation and the nature, scope and complexity of our activities.

1. Summary of information on the decision-making process used for determining the

Firm's remuneration policy including use of external benchmarking consultants where relevant.

- The Firm's policy has been agreed by Senior Management in line with the RemCode principles laid down by the FCA.
- Due to the size, nature and complexity of the Firm, it is not required to appoint an independent remuneration committee.
- The Firm's policy will be reviewed annually and following any significant changes to the business which require an update to its internal capital adequacy assessment.
- The Firm's ability to pay bonuses is based on the performance of the Firm's overall performance and is derived after the Accounts' investment returns have been calculated, typically by client-appointed third party administrators.
- There is limited involvement of the Firm in setting valuation of assets in the Accounts.

2. Summary of how the Firm links pay and performance.

Individuals are rewarded based on their contribution to the overall strategy of the Firm.

Other factors such as performance, reliability, effectiveness of controls, business development and contribution to the Firm are taken into account when assessing the performance of the senior staff responsible for the infrastructure of the Firm.

The Firm may omit required disclosures where it believes that the information could be regarded as prejudicial to the UK or other national transpositions of Directive 95/46/EC of the European Parliament, and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data.

The Firm has made no omissions on the grounds of data protection but due to confidentiality have omitted to provide a breakdown of remuneration and aggregate compensation expense given the limited number of staff subject to the RemCode ("Code Staff").

* average total assets on the last three accounting dates.