

Muzinich & Co. Limited

Basel III Pillar 3 and Remuneration Code Disclosure

Year ended 31 December 2014

The Capital Requirements Directive ('CRD') 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 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 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 Muzinich & Co. Limited ('The Firm') in accordance with the requirements of BIPRU 11 and is verified by the Board. Unless otherwise stated, all figures are as at the 31 December 2014 financial year-end.

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

The Pillar 3 disclosure requirements as detailed in the CRR 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.

Muzinich & Co. Ltd. is authorised and regulated in the UK by the Financial Conduct Authority (“FCA”) and as such is subject to minimum regulatory capital requirements. Firm’s activities give it the BIPRU categorisation of a “Limited Licence” and a “BIPRU €50K” Investment Firm. It is an investment management firm and as such has no trading book exposures.

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 for the Firm alone. The Firm was set up in October 1999 and had, as at 31 December 2014, branch offices in Paris, Cologne, Milan, Madrid, and a subsidiary in Zurich. These offices are used primarily 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. All the Firm’s investment strategies are available as separate accounts or commingled vehicles.

Risk management

The Firm has established a risk management process in order to ensure that it has effective systems and controls in place to identify, monitor and manage risks arising in the business. The risk management process is overseen by the group’s global Portfolio Risk Analytics Committee (PRAC), with the Senior Management team taking overall responsibility for this process and the fundamental risk appetite of the firm. The PRAC, which includes the Compliance Officer, has responsibility for the implementation and enforcement of Muzinich & Co. Ltd.’s risk principles.

Senior Management meet on a regular basis and discuss current projections for profitability, cash flow, regulatory capital management, business planning and risk management. Senior Management engage in the Firm’s risks through 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.

The Senior Management team has identified that business, operational, market and credit are the main areas of risk to which the Firm is exposed. Annually the Senior Management team formally review their 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 the existing accounts under management and its ability to launch new funds/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/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;
- 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 that it has in place in order 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 a third party provider, key man risk, potential for serious regulatory breaches, market abuse, trade dealing errors and fraud/theft. Appropriate policies are in place to mitigate against these risks, which include but 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) banks where collected fees are deposited and the Firm's general deposits are held fail. Our credit risk appetite is low; therefore the Firm holds all cash balances with international banks assigned 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	28,587	1.6% - 8%	454
Inter-company	0	8%	0
Trade Debtor	9,900	8%	792
Prepayments and other debtors	368	8%	30
Fixed Assets	1,063	8%	85
Other Investments	27,489	8%	2,199
Total	67,407		3,560

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	EUR	CHF	Total
	£000	£000	£000	£000
Assets	50,131	9,303	143	59,577
Liabilities	0	0	0	0
Net Currency Position	50,131	9,303	143	59,577
Capital charge applied	8%	8%	8%	8%
Foreign Exchange Risk Capital Charge	4,010	744	12	4,766

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 by its Chief Financial Officer on a regular basis, and the Firm would be able to call on the parent 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:

	2014 £'000
Tier 1 capital*	56,388
Tier 2 capital	0
Deductions from Tiers 1 and 2	(79)
Total capital resources	56,309
*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 company. 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 discussed above the Firm is a limited licence firm and as such its capital requirements are:

- €50,000; and
- The sum of the market & credit risk requirements; or
- The FOR which is essentially 25% of the firm's operating expenses less certain variable costs.

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

Muzinich & Co. Ltd. ("the Firm") is authorised and regulated by the Financial Conduct Authority as a Limited. Licence Firm and, as such, is subject to FCA Rules on remuneration. These are contained in the FCA's Remuneration Code located in the SYSC Sourcebook of the FCA's Handbook. The Remuneration Code ("the RemCode") covers an individual's total remuneration, fixed and variable. The Firm incentivises staff through a combination of the two.

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

Our policy is designed to ensure that we comply with the RemCode and that our compensation 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 has relevant total assets <£50bn*] and so makes this disclosure in accordance with the second test (BIPRU 11.5.20R(2)).

* average total assets on the last three accounting dates.

Application of the requirements

We are required to disclose certain information on at least an annual basis regarding our remuneration policy and practices for those staff whose professional activities have a material impact on the risk profile of the firm. Our disclosure is made in accordance with our 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 the Senior Management in line with the RemCode principles laid down by the FCA.
 - Due to the size, nature and complexity of the firm, we are not required to appoint an independent remuneration committee.
 - The Firm's policy will be reviewed as part of an annual process, and following a significant change to the business requiring an update to its internal capital adequacy assessment.
 - The Firm's ability to pay bonus is based on the performance of Firm overall and 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.

We may omit required disclosures where we believe that the information could be regarded as prejudicial to the UK or other national transposition 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.

We have 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").