



# SANDERSON

## ASSET MANAGEMENT

### Pillar 3 Disclosure Statement

#### Introduction

Sanderson Asset Management LLP (“**Sanderson**”) manages international equities, ex US and Canada, with a predominantly value approach. Funds are managed principally on behalf of US institutional investors and high net worth clients. Sanderson’s audited financial statements are prepared in accordance with UK GAAP. Sanderson is authorised and regulated by the United Kingdom Financial Conduct Authority (“**FCA**”).

The EU *Capital Requirements Directive* (“**CRD**”) set up a risk-sensitive framework for the calculation of regulatory capital for the financial services industry across Europe. The FCA implemented the CRD in the UK via its *Handbook of Rules and Guidance* (“**FCA Handbook**”), which set out a framework for risk and capital assessment consisting of three ‘pillars’.

- **Pillar 1**: specifies the minimum capital that Sanderson is required to carry to cover business risks;
- **Pillar 2**: sets out the internal assessment and supervisory review process to be used by Sanderson and the FCA to assess whether additional capital should be maintained by Sanderson against any other risks not already covered under Pillar 1; and
- **Pillar 3**: specifies the public disclosures which Sanderson is required to make of its capital management, risk exposures, risk assessment processes and remuneration practices.

Sanderson is subject to this framework as it is laid down and further defined in the *Prudential Sourcebook for Banks, Building Societies and Investment Firms* (“**BIPRU**”) within the FCA Handbook. The specific disclosures which Sanderson is required to make under Pillar 3 are set out in BIPRU 11 and the disclosures in this statement are intended to satisfy compliance with these provisions.

Sanderson is also regulated as a full-scope Alternative Investment Fund Manager (“**AIFM**”), pursuant to the *Alternative Investment Fund Managers Directive* (“**AIFMD**”) and the UK’s adopting legislation. As such, Sanderson is also subject to the capital requirements set out in the *Interim Prudential Sourcebook for Investment Business* (“**IPRU(INV)**”).

#### Exclusion of Disclosure Information

The guidance in BIPRU 11 sets out that Sanderson may exclude a disclosure where such information is assessed as immaterial, proprietary or confidential. BIPRU 11 provides the technical criteria which should be used to guide any such assessment. Where Sanderson makes such a determination and disclosure information is excluded, this will be stated in the relevant section below. Reasons to support the determination will also be provided.

## Update of Disclosures

These disclosures are required to be made and updated on at least an annual basis, although Sanderson may carry out a more frequent update on the occurrence of a material change to its business or similar event. The disclosures contained herein are based on Sanderson's position as at 31 March 2017.

## Firm Structure

Sanderson is an independent private investment management firm and is structured as a limited liability partnership. Sanderson's members are Sanderson Partners Limited ("**Sanderson Ltd**") and working members in the firm. Sanderson Ltd's capital is controlled by its former employees and their connected parties. Silchester Partners Ltd ("**Silchester**"), holds a minority stake in Sanderson Ltd and owns 49.9% of the total share capital, with 19.9% of the voting rights. Silchester is a member of Silchester International Investors LLP, a provider of investment management services.

## Scope of Disclosure

Sanderson has one wholly owned subsidiary, Sanderson Asset Management, Inc. ("Sanderson, Inc."). Sanderson, Inc. is fully consolidated with Sanderson for audit and regulatory purposes and the disclosures made in this document are made in respect of both entities.

There is no current or foreseen material practical or legal impediment to transfers of intra-group capital between Sanderson and Sanderson, Inc. Because Silchester is only a minority shareholder in Sanderson Ltd, it is unable to require Sanderson to make any formal transfer of capital to Silchester. Likewise, Sanderson cannot compel Silchester to make any loan or capital injection.

## Risk Management Objectives and Policies

### *Governance Structure*

Sanderson's Supervisory Group is responsible for determining the risk strategy of the firm, setting the firm's risk appetite and ensuring that risk is monitored and controlled effectively. The Supervisory Group works closely with the Compliance Group to ensure that Sanderson's risk management framework is adequate and effective. The firm's risk management framework has been designed, implemented and, as necessary, will be updated to take into account material changes in Sanderson's business, capital obligations, or resource requirements.

Sanderson's risk appetite is regularly reviewed by Sanderson's management by considering various stress tests (as set out in Sanderson's *Internal Capital Adequacy Assessment Process* ("**ICAAP**")) and the amount and type of risk that it regards as appropriate for Sanderson to accept in order to execute its strategy.

### *Risk Management Systems and Techniques*

Sanderson's aims to ensure that each member of staff is focused on improving procedures, minimising risk to Sanderson's business and fostering an enterprise-wide risk management culture to establish a robust risk, capital and performance management setup.

Sanderson's Compliance Group has developed and maintains a risk matrix that is broken down by business function and each key underlying process within the business function. Each risk is then assessed to determine (i) the type of risk exposure (ii) its materiality, (iii) whether it is covered by insurance, and (ii) what mitigating procedures can be put in place to control the risk of error.

## *Compliance Group*

Sanderson's Compliance Group supports the business and the Supervisory Group in fulfilling their regulatory obligations. This support is provided primarily through the provision of advice and training, and carrying out Sanderson's internal risk-based monitoring programme. The monitoring programme is structured around Sanderson's detailed risk matrix and the outcomes and recommendations of the programme are reported directly to Sanderson's Supervisory Group. Sanderson's Compliance Group is independent of the firm's investment function.

## **Capital Resources**

### *Pillar 1 and AIFMD*

As a BIPRU limited licence firm Sanderson's minimum capital requirement is the largest of:

- The base capital requirement of €50,000;
- The sum of its credit and market risk requirements; or
- Sanderson's fixed overhead requirement.

Sanderson's current minimum capital requirement under this calculation is determined by its fixed overhead requirement, which is £1.7 million. Sanderson is also subject to the AIFMD capital requirements set out in IPRU(INV) and is required to maintain the largest of (i) the factors set out above, and (ii) the additional factors listed below:

- The AIFMD base capital of €125,000; or
- The AIFMD core regulatory capital requirement, including professional liability risk capital.

The latter of these requirements is the largest and sets the firm's minimum capital requirement. Based on audited figures for the year ended March 31, 2017, this calculation establishes a capital requirement for Sanderson of £2.4m. Note that, Sanderson's AIFMD capital requirements will be driven by the firm's assets under management, rather than expenditure requirements and financial commitments. As a result, Sanderson's AIFMD capital requirements will generally rise or fall in line with Sanderson's assets under management.

At March 31, 2017, Sanderson's capital and reserves, as assessed in its ICAAP, were as follows:

<u>Tier 1 Capital</u>	£	<u>3.6 mn</u>
Deductions from Tier 1 Capital	£	0
<u>Tier 2 Capital</u>	£	0
Deductions from Tier 2 Capital	£	0
<u>Tier 3 Capital</u>	£	0
Deductions from Tier 3 Capital	£	0
Total capital resources, net of deductions	£	<u>3.6 mn</u>
BIPRU Capital Requirement	£	1.7 mn
AIFMD Capital Requirement	£	2.4 mn
<b>Surplus over highest Capital Requirement</b>	<b>£</b>	<b>1.2 mn</b>

Sanderson's Tier 1 capital comprises of permanent partnership capital. Sanderson's ICAAP analysis highlights that Sanderson had surplus liquid capital at March 31, 2017 compared to the capital resource requirements computed under the applicable capital resource requirement rules of Pillar 1.

### Pillar 2

Sanderson makes its Pillar 2 assessment via its ICAAP, which is carried out at least annually. The ICAAP document is prepared by Sanderson's Compliance Group, under the supervision of the Chief Compliance Officer. However, the sufficiency of the ICAAP is ultimately the responsibility of Sanderson's Supervisory Group.

In its ICAAP analysis, Sanderson has prepared various scenario analyses to assist in determining how much capital it should hold. The most extreme scenario (that of a complete wind down of the firm over a six month period with no revenues received during this time), highlights the fact that Sanderson needs to maintain approximately £3.2 million of capital, or a further £0.8 million over its current minimum capital requirement. Despite this conservative (and extreme) example, Sanderson has surplus liquid capital compared to the capital resource requirements computed under Pillar 2.

### **Risk Categories and Analysis**

As a long-only asset manager that principally invests client assets in publicly traded companies located in any country other than the United States and Canada, Sanderson is mainly exposed to operational risk; however, there is additional exposure both to business risk and credit risk. All of these exposures are regarded as typical for a business engaged in the activity of asset management. Sanderson's Chief Compliance Officer, who is independent of Sanderson's investment function, acts as risk manager and monitors and manages the risk exposures of the business with input from Sanderson's various business groups. In assessing the risk appetite of the business, consideration has been given to identifying the material risks facing Sanderson.

These include risks at the client level, and to Sanderson in the form of loss of revenue, loss of assets or higher costs. These risks are detailed in Sanderson's ICAAP and are reviewed by the Compliance Group on a regular basis. Two specific factors have been considered in defining the risk appetite; firstly, the likelihood of occurrence of an event and secondly, the impact level of an event. Further information on Sanderson's risk exposures is set out below:

#### *Credit Risk*

As an asset management company, Sanderson is subject to credit risk. Sanderson receives investment management fees on a quarterly basis from its separate accounts, and on a monthly basis from its commingled funds. The fees from the commingled funds are calculated using the value of each underlying investor's holding in the commingled funds. Commingled fund investment management fees are paid within five business days after each month end. As all accounts managed by Sanderson are "long only" accounts that cannot use leverage, margin or derivative products, there is little, if any, credit risk associated with the fees.

Sanderson's free cash flow is placed on deposit each month. Deposits are normally placed with financial institutions depending on available interest rates. The eligible banks are each approved by Sanderson's Supervisory Group with advice from Sanderson's Chief Financial Officer. The credit rating and financial strength of a bank is subject to periodic review by Sanderson's Supervisory Group. Sanderson does not utilise any risk mitigation techniques (i.e. credit default swaps) to minimise its financial exposure to bank deposits. In accordance with BIPRU 11.5.4(2), further details of how Sanderson assesses the risk weighted exposure amounts for each of the relevant standardised credit risk exposure classes can be found in the table below.

<b>Exposure Class</b>	<b>Exposure (£)*</b>	<b>Risk Weighting</b>	<b>Risk Weighted Exposure (£)</b>
Banks	11,969,664	20%	2,393,933
Institutions/Corporates	5,833,156	100%	5,833,156
		<b>Total</b>	<b>8,227,089</b>
		<b>8% thereof</b>	<b>658,167</b>

*\*based on audited figures for the year ended 31 March 2017*

### *Market Risk*

As an asset management company, Sanderson's client portfolios are subject to market risk. Sanderson's fees are asset based fees and Sanderson's revenue increases as assets under management ("AUM") increase, and will fall if AUM fall. Sanderson has structured its business so that a significant part of its costs are variable (i.e. custody and fund administration) and will fall as its AUM fall. More importantly, Sanderson keeps base salaries low and remunerates employees through discretionary bonuses. Members' drawings are set by the Supervisory Group in its absolute discretion. Surplus liquid capital is not at risk until a loss fully offsets Sanderson's profit before remuneration and taxes ("PBRT") less any committed salaries and staff benefits. Sanderson's core regulatory capital, surplus capital and free cash flow are ordinarily invested in cash deposits. Core regulatory capital is invested in cash deposits and an Irish UCITS fund, to which Sanderson acts as investment manager.

In accordance with BIPRU 11.5.12(2), details of Sanderson's capital resources requirement in respect of foreign currency and commodity positional risk requirement ("PRR") can be found in the table below. Foreign Currency PRR refers to those sums which are retained or outstanding in USD.

<b>Exposure Class</b>	<b>Exposure (£)*</b>	<b>Risk Weighting</b>	<b>Risk Weighted Exposure (£)</b>
Foreign Currency PRR	10,733,329	8%	858,666
Commodity PRR	0	8%	0
<b>Total</b>	<b>0</b>	<b>Total</b>	<b>858,666</b>

*\*based on audited figures for the year ended 31 March 2017*

### *Interest Rate Risk*

Sanderson does not engage in any principal trades or run any trading book exposures that could be subject to interest rate risk. From Sanderson's perspective (given its cash balances) and assuming no impact on investment performance, Sanderson would expect to benefit from increases in interest rates as its interest income would rise.

### *Liquidity Risk*

Liquidity Risk consists of two primary items – funding liquidity risk and market liquidity risk. Funding liquidity risk is the risk that the counterparties who provide Sanderson with short-term funding will withdraw or not roll over that funding. Market liquidity risk is the risk of a generalised disruption in asset markets that make normally-liquid assets illiquid.

Sanderson has no borrowing and is not dependent on external financing for any aspects of its business. As a result, Sanderson is not exposed to funding liquidity risk. Sanderson has some limited exposure to market liquidity risk. For example, one of Sanderson’s banking counterparties could suffer severe financial distress and elect not to return some of Sanderson’s cash deposits or investments may become difficult to realise.

### *Operational Risk*

Operational risk refers to the risk of a direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. Sanderson attempts to mitigate the impact of operational risks by (i) maintaining substantial financial resources and ensuring that the business can meet its regulatory capital requirements on an ongoing basis, (ii) identifying and managing sources of risk, stress testing those risks and maintaining insurance or other capital to offset any financial losses created by those risks, (iii) aligning the interests of all staff and members with the supervision of the operations of the business through remuneration/ drawings, (iv) maintaining a risk matrix and key operating procedures (“**KOPs**”) for all material business areas, (v) reviewing the operations of all material business groups annually, and (vi) keeping Sanderson’s business, structure and operational requirements relatively simple.

### *Concentration Risk*

Concentration risk is the risk that exposures to specific sectors or asset concentration could result in losses to Sanderson’s business. Sanderson principally invests client assets in publicly traded companies located in any country other than the United States and Canada and earns its revenue principally from a US client base. Sanderson’s business could suffer (i) from a decline in its investment performance relative to benchmark indices, (ii) if US institutional investors sell their overseas investments managed by Sanderson or (iii) the US dollar sharply appreciates, negatively impacting relative returns. There is little Sanderson can do to minimise this risk except by focusing on keeping its business simple and aligned with clients, and minimising its overheads.

### *Business Risk*

Business risk arises from changes in the core structure of the business that would prevent Sanderson from carrying out its business plan and desired strategy. Sanderson is a small, independent organisation, where senior management also hold a significant stake in the business via their capital contributions as members. All material structural changes to Sanderson’s business are subject to discussion at the Sanderson Supervisory Group level. The Sanderson Supervisory Group would consult the Compliance Group before agreeing to any of the following material transactions:

- Making an investment, loan or capital subscription;
- Making an investment in any Sanderson collective investment scheme;
- Making any material change in Sanderson’s cost structure or base salaries;
- Making a change in the timing of bonus payments; or
- Certain changes to capital contributions and capital accounts in the partnership.

## *Insurance Risk*

Sanderson maintains fiduciary liability (also known as professional indemnity), crime and ERISA insurance cover in a tri-party agreement with XL Insurance Company plc, Travellers Company Ltd, and AXIS Specialty Europe SE. The cover is set at a limit which Sanderson considers appropriate for its business and is subject to a deductible which Sanderson can reasonably afford to meet if called upon. Sanderson would be exposed to potential losses in the event that an error occurred and its insurers were unable to meet their obligations. Sanderson attempts to obtain insurance cover from well capitalised insurance companies to minimise such a risk occurring.

## **ICAAP**

The approach of the business to assessing the adequacy of its internal capital to support current and future activities is contained in Sanderson's ICAAP document. This process includes an assessment of the specific risks to Sanderson's business and the internal controls in place to mitigate those risks. These are tested under different scenarios in order to provide a robust picture of exposures for the business. Finally, an assessment is made of the probability of occurrence and the potential impact, in order to arrive at a level of required capital. Sanderson updates its ICAAP at least annually, although Sanderson may carry out a more frequent update on the occurrence of a material change to its business or similar event. Sanderson's most recent ICAAP was carried out in May 2017 to reflect Sanderson's position as of March 2017 and the audited figures available at that time.

## **Remuneration Disclosures**

### *Introduction*

In accordance with BIPRU, Sanderson is required to make certain formal disclosures on its remuneration policies and practices. Sanderson has a formal Remuneration Policy in place and further remuneration details can also be found in Sanderson's audited financial statements.

Under the terms of the FCA's updated *General Guidance on Proportionality: The Remuneration Code (SYSC 19a) & Pillar 3 Disclosures on Remuneration (BIPRU 11)* Sanderson is classified as a Tier 3 firm and is required to make the following disclosures.

### *Remuneration Policy Disclosures*

All Sanderson employees receive a basic salary and bonus compensation. Fixed remuneration comprises mainly of salaries, but also includes appropriate employee benefits. The current basic salary levels are competitive within the industry. Sanderson's members receive drawings which are at a level set by Sanderson's Supervisory Group.

The variable remuneration of Sanderson employees and the drawings of its members are tied to the overall profitability of the firm, with 60% of revenues after expenses distributed to staff. No set performance criteria or algorithms are used to determine individual staff remuneration, but rather they are determined based on an overall assessment of work quality, commitment and contribution.

Individual compensation levels are reviewed and set annually, with the split between each staff member being determined by Sanderson's Management Committee.

### *Identifying Code Staff*

In accordance with the provisions of the FCA's Remuneration Code, Sanderson is required to identify those of its staff which it considers to be Code Staff. In general terms, Code Staff are those staff in senior management positions and any other staff whose actions have a material impact on the risk profile of the firm.

Although not all members of the firm are “risk takers” or actively involved with research and portfolio implementation, Sanderson currently classifies all staff with more than two years’ experience at the firm as Code Staff from an administrative perspective, although it may elect to declassify certain employees as Code Staff based on the Guidance adopted by the FCA.

#### *Quantitative Remuneration Disclosures*

As of March 31, 2017, Sanderson had 22 staff members, 19 of whom were considered to be Code Staff and 5 of which held senior management positions. Aggregate remuneration for Code Staff and their connected parties, including distributions allocated to working members, was £31.1mn.

#### **Contact Information**

Additional information is available from Sanderson’s Chief Compliance Officer, James Longbottom ([jlongbottom@sandersonam.com](mailto:jlongbottom@sandersonam.com)). Further copies of this statement may be obtained from Sanderson’s website at [www.sandersonam.com](http://www.sandersonam.com).