

Sanderson Asset Management Limited

Pillar 3 Disclosure Statement

Introduction

Sanderson Asset Management Limited (“SAM”) is authorised by the Financial Services Authority (“FSA”) and has been classified as a BIPRU €50,000 limited license firm. The FSA is responsible, in the United Kingdom, for the implementation of the 2006 Capital Requirements Directive of the European Union, which set up a new regulatory capital framework for the financial services industry. The new framework consists of three pillars:

- Pillar 1 specifies the minimum capital that SAM is required to carry to cover business risks;
- Pillar 2 sets out the supervisory review process to be used by SAM and the FSA to determine whether additional capital should be maintained against any other risks not covered under Pillar 1;
- Pillar 3 specifies the disclosure requirements which SAM is required to make of its capital, risk exposures and risk assessment processes.

The FSA regulations for the disclosures required under Pillar 3 are contained in the Prudential Sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”). Further information on BIPRU can be found on the FSA website (www.fsa.gov.uk). These rules allow the business to exclude disclosures where the information is regarded as immaterial, proprietary or confidential. Disclosures have been made in this document in compliance with BIPRU 11 unless that disclosure has been regarded as immaterial, proprietary or confidential. Additional information is available from SAM’s Chief Compliance Officer (rcawdron@sandersonam.com).

Business structure

The disclosures contained in the document relate to SAM’s business. SAM is a privately held firm that is majority owned and controlled by employees that are active in its business.

SAM’s audited financial statements are prepared in accordance with UK GAAP. SAM has one wholly owned subsidiary – Sanderson Asset Management, Inc. (“SAM, Inc.”). SAM, Inc. is fully consolidated with SAM for audit and regulatory purposes. SAM has a minority investor in its business Silchester International Investors Limited (“SII”), who own 49.9% of the total share capital.

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

Risk Management

SAM’s Board of Directors is responsible for determining the risk strategy of the company, setting the company’s risk appetite and ensuring that risk is monitored and controlled effectively. The Board of Directors works closely with the Compliance Group. The company’s risk management framework has been designed and implemented and will be updated, as necessary, to take into account material changes in SAM’s business, capital obligations, or resource requirements. SAM’s risk appetite is regularly reviewed by considering various stress tests and sets out the amount and type of risk that it regards as appropriate for SAM to accept in order to execute its strategy. SAM has developed a risk matrix that is broken down by business function and each underlying process within the business function. Each risk is then assessed to determine (i) the type of risk exposure (ii) if it is material, (iii) whether it is covered by insurance, and (ii) what mitigating procedures can be put in place to control the risk of error. SAM’s culture ensures that each member of staff is focused on improving procedures and minimising risk to SAM’s business fostering an enterprise-wide risk management culture to establish a robust risk, capital and performance management setup.

SAM is exempt from the operational risk requirement at Pillar 1 and is not required to calculate an operational risk capital charge. As a BIPRU limited license firm SAM’s minimum capital requirement is the greatest of:

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

As market and credit risks are not considered material for SAM, the fixed overhead requirement is the greatest and, therefore, establishes the minimum capital requirement of £1.2 million. At 30th April 2010, SAM's capital reserves are as follows:

| | |
|--|--------------|
| Tier 1 Capital | £2.4 million |
| Deductions from Tier 1 Capital | £ 0 |
| Tier 2 Capital | £ 0 |
| Deductions from Tier 2 Capital | £ 0 |
| Tier 3 Capital | £ 0 |
| Deductions from Tier 3 Capital | £ 0 |
| Total capital resources, net of deductions | £2.4 million |
| Fixed Overhead Capital Requirement | £1.2 million |
| Surplus over ICAAP Capital | £1.2 million |

SAM's ICAAP analysis highlights that SAM had surplus liquid capital at 30th April 2010 compared to the capital resource requirements computed under applicable capital resource requirement rules known as **Pillar 1**.

Under Pillar 2 of the Capital Requirements Directive, the firm is required to enact an Internal Capital Adequacy Assessment Process ("ICAAP"). The ICAAP document is prepared by the Compliance Group, under the supervision of SAM's Compliance Officer. However, the sufficiency of the ICAAP is ultimately the responsibility of SAM's Board of Directors. In its ICAAP analysis, SAM has prepared various scenario analyses. 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 SAM needs to maintain approximately £2 million of capital or a further £0.8 million over its Pillar 1 obligations. Despite this conservative (and extreme) example, SAM has surplus liquid capital compared to the capital resource requirements computed under **Pillar 2**.

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, SAM 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. SAM's Chief Compliance Officer, who is independent of SAM's investment function, acts as risk manager and monitors and manages the risk exposures of the business with input from SAM's various business groups. In assessing the risk appetite of the business, consideration has been given to identifying the material risks facing SAM.

These include risks at the client level, and on SAM in the form of loss of revenue, loss of assets or higher costs. These risks are detailed in SAM's Internal Capital Adequacy Assessment Document ("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 SAM's risk exposures are set out below:

- **Credit Risk.** As an asset management company, SAM is subject to credit risk. SAM receives investment management fees on a quarterly basis from its separate accounts and non-US commingled fund, and on a monthly basis from the US commingled funds. The fees from the commingled funds are calculated using the value of each underlying investor's holding in the commingled funds. US commingled fund investment management fees are paid within five business days after each month end. As all accounts managed by SAM are "long only" accounts

SAM'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 the SAM Board. The credit rating and financial strength of each bank is subject to review by the SAM Board. The Finance Manager also monitors credit ratings on a monthly basis. SAM does not utilise any risk mitigation techniques (i.e. credit default swaps) to minimise its financial exposure to bank deposits.

- **Market Risk.** As an asset management company, SAM's client portfolios are subject to market risk. SAM's fees are asset based fees and SAM's revenue increases as assets under management ("AUM") increase, and will fall if AUM fall. SAM 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, SAM keeps base salaries low and remunerates employees through discretionary bonuses. Surplus liquid capital is not at risk until a loss fully offsets SAM's profit before remuneration and taxes ("PBRT") less any committed salaries and staff benefits. SAM's core regulatory capital, surplus capital and free cash flow are ordinarily invested in cash deposits. Cash deposits are not subject to market risk.
- **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 SAM 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.

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

- **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. SAM attempts to mitigate the impact of operational risks by (i) maintaining substantial financial resources, (ii) aligning the interests of all staff and shareholders with the supervision of its operations through remuneration/ dividends, (iii) maintaining a risk matrix and key operating procedures ("KOPs") for all material business areas, (iv) reviewing the operations of all material business groups annually, and (v) keeping SAM'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 SAM's business. SAM 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. SAM'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 SAM or (iii) the US dollar sharply appreciates, negatively impacting relative returns. There is little SAM 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 SAM from carrying out its business plan and desired strategy. SAM is a small, closely held organisation, where senior management also own a significant stake in the business. All material structural changes to SAM's business are subject to discussion at the SAM Board level. The SAM Board 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 SAM collective investment scheme;
 - Making any material change in SAM's cost structure or base salaries;
 - Making a change in the timing of dividend or bonus payments; or
 - Making any share buyback.
- **Interest Rate Risk.** SAM does not engage in any principal trades or run any trading book exposures that could be subject to interest rate risk. From SAM's perspective (given its cash balances) and assuming no impact on investment performance, SAM would expect to benefit from increases in interest rates as its interest income would rise.
 - **Insurance Risk.** SAM maintains fiduciary liability (also known as professional indemnity), crime and ERISA insurance cover with AIG UK Ltd. The cover is set at a limit which SAM considers appropriate for its business and is subject to a deductible which SAM can reasonably afford to meet if called upon. SAM would be exposed to potential losses in the event that an error occurred and AIG UK Ltd. was unable to meet its obligations. SAM attempts to obtain insurance cover from well capitalised insurance companies to minimise such a risk occurring.

Capital Resources

SAM has calculated its capital needs in accordance with the relevant FSA regulations.

Other Disclosures

The approach of the business to assessing the adequacy of its internal capital to support current and future activities is contained in SAM's ICAAP document. This process includes an assessment of the specific risks to SAM'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. The required capital level has been assessed, in accordance with Pillar 2, to be less than the Pillar 1 requirement; this is the minimum level of capital which SAM is required to maintain and is the fixed overhead requirement.