***Introduction***

Capstone Investment Advisors (UK), LLP (“CIA UK” or the Firm) is required by the FCA to disclose information relating to the capital it holds and each material category of risk it faces in order to assist users of its accounts and to encourage market discipline.

***Regulatory Framework***

The Capital Requirements Directive (CRD) created a revised regulatory capital framework across Europe covering how much capital financial services firms must retain. In the United Kingdom, rules and guidance are provided in the General Prudential Sourcebook (GENPRU) for Banks, Building Societies and Investments Firms (BIPRU).

The FCA framework consists of three "Pillars":

* Pillar 1 sets out the minimum capital requirements that companies need to retain to meet their credit, market and operational risk;
* Pillar 2 requires companies to have an internal Capital Adequacy Assessment Process (ICAAP) and requires that regulatory supervisors evaluate each firm’s overall risk profile as well as its risk management and internal control processes;
* Pillar 3 requires companies to develop a set of disclosures which will allow market participants to assess key information about its underlying risks, risk management controls and capital position.

***Disclosure Policy***

BIPRU 11 provides that a firm is permitted to omit one or more required disclosures if the information is immaterial or could be regarded as confidential or proprietary in nature. CIA UK regards information as material in disclosure if its omission or misstatement could change or influence assessment or decision of a user relying on that information for the purpose of making economic decisions. If CIA UK deems certain disclosure to be immaterial, it may be omitted. CIA UK regards information as proprietary if sharing that information with the public would undermine its competitive position. Proprietary information may include information on products, investments held in those product strategies, client and investors systems which, if shared with competitors or publicly, could render CIA UK services less valuable. Further, CIA UK must regard information as confidential if there are obligations to customers or other counterparty relationships binding CIA UK to confidentiality. In the event that any such information is omitted, CIA shall disclose such and explain the grounds why it has not been disclosed.

Unless otherwise stated, all figures are based on the audited financial statements of CIA UK for the year ended 31st December 2019.

***Frequency of Publication, Verification and Publication***

This disclosure will be reviewed annually or more frequently if appropriate. The disclosure will be published as soon as practicable after the completion of CIA UK’s annual financial statements and Internal Capital Adequacy Assessment Process (ICAAP).

The information contained in this document has not been audited by CIA UK’s external auditors and does not constitute any form of financial statement and must not be relied upon in making any judgement on CIA UK.

This Pillar 3 disclosure is published on Capstone Investment Advisors website [www.capstoneco.com](http://www.capstoneco.com)

***Risk Management Objectives and Policies***

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 Firm's members.

As risks are identified within the business, appropriate controls are put in place to mitigate these and compliance with them is monitored on a regular basis. The frequency of monitoring in respect of each risk area is determined by the significance of the risk. The Firm does not intend to take any risks with its own capital and ensures that risk taken within the portfolios that it provides advice to is closely monitored. The results of the compliance monitoring performed are reported to the partners by the Compliance Officer. The Governing Body of CIA UK has the daily management and oversight responsibility.

The Governing Body is responsible for the entire process of risk management, as well as forming its own opinion on the effectiveness of the process. In addition, the Governing Body decides CIA UK’s risk appetite or tolerance for risk and ensures that CIA UK has implemented an effective, ongoing process to identify risks, to measure its potential impact and then to ensure that such risks are actively managed. Senior Management is accountable to the Governing Body for designing, implementing and monitoring the process of risk management and implementing it into the day-to-day business activities of CIA UK.

***Capital Resources and Requirements***

Capital adequacy is assessed formally on a regular basis. This involves comparing resources with the capital requirement and assessing whether there is a sufficient surplus of capital resources.

CIA UK’s capital is the higher of Pillar 1 plus Pillar 2 capital (as described below) or the wind down requirement. The wind down requirement is the forecasted cost of winding the business down in an orderly manner, which takes all contractual obligations into consideration. CIA UK’s regulatory capital is the Pillar 1 capital plus Pillar 2 capital.

***Capital Resources***

***Pillar 1***

CIA UK is incorporated in the UK and is authorised and regulated by the FCA as an Investment Management Firm. CIA UK’s activities give it a limited licence BIPRU categorization. This means that its minimum regulatory capital requirement (Pillar 1) is the highest of the following:

* Its base capital requirement of €50,000;
* The sum of its market and credit risk requirements; or
* Its fixed overhead requirement (FOR).

***Pillar 2***

The ICAAP provides an assessment of CIA UK’s risk, risk appetite and determines the level of capital required to deal with those risks. For each key risk, CIA UK has identified the probability and severity of the risk materializing and the mitigating factors adopted by CIA UK. Stress testing is also included as part of the process.

The ICAAP assessment is reviewed by the UK Governing Body on an annual basis or when material change to the business occurs.

The results of the ICAAP analysis are summarized below:

Pillar 1 total £1,998,535

Pillar 2 total £4,567,411

Wind-down requirement £1,854,015

**Total Capital Requirement £4,567,411**

Total regulatory capital £5,922,490

**Surplus Capital £1,355,079**

Based on the calculation above CIA UK considers that there is sufficient capital to ensure the Firm can continue to meet its requirements. No additional capital injections are considered necessary and the Firm expects to continue to be profitable.

***Operational Risk***

As a limited BIPRU firm we are not required to calculate an operational risk capital requirement under Pillar 1. However, operational activities are fundamental to the successful running of CIA UK. 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. These relate to disruption of the office facilities, system failures, trade failures and failure of third party service providers. Appropriate policies are in place to mitigate against risks, including appropriate insurance policies and business continuity plans.

***Credit Risk and Counterparty Risk***

The main credit risk to which the Firm is exposed is in respect to the failure of its debtors to meet their contractual obligations. The majority of the Firm's receivable is related to investment management activities. The Firm believes its credit risk exposure is limited since the Firm’s revenue is ultimately related to management fees received from funds. These management fees are drawn throughout the year from the funds managed. Other credit exposures include bank deposits.

The Firm undertakes periodic impairment reviews of its receivables. All amounts due to the Firm are current and none have been overdue during the year. As such, due to the low risk of non-payment from its counterparties, management is of the opinion that no provision is necessary. A financial asset is overdue when the counterparty has failed to make a payment when contractually due. Impairment is defined as a reduction in the recoverable amount of a fixed asset or goodwill below its carrying amount.

The Firm has adopted the standardised approach to credit risk, and therefore follows the provision within BIPRU 3 standardised credit risk of the FCA handbook. The Firm applies a credit risk capital component of 8% to its non-trading book risk weighted exposure. As the Firm does not make use of an external credit rating agency, it is obligated to use a risk weight of 100% to all non-trading book credit exposures, except cash and cash equivalents which are held by investment grade firms and currently attract a risk weighting of 20%. The credit and counterparty risk has been calculated as £1,987,118.

***Market Risk***

Since the Firm holds no trading book positions on its own account, and all advisory fee income is in GBP, the Firm’s exposure to foreign currency risk is not significant. Since the settlement of debtor balances take place without undue delay, the timing of the amount becoming payable and subsequently being paid is such that it is not considered to present a material risk to the Firm. The Firm has excluded Market risk on the basis that it is not a material risk to the Firm.

***Group Risk***

Group risk is the risk that the financial position of a firm may be adversely affected by its relationships (financial or non-financial) with other entities in the same group or by risks which may affect the financial position of the whole group, for example reputational contagion. CIA UK relies on its parent entity to cover its operational costs as well as accrues management fee over the course of the financial year. We have therefore decided to hold additional capital as part of our Pillar 2 group risk assessment.

***Other Risks***

Changes in interest rates do not materially affect CIA UK’s earnings which are primarily linked to performance of AUM and not interest income. CIA UK does not have any material debt which would be affected by a change in interest rates. Therefore we do not consider interest rate risk to be material.

CIA UK runs a defined contribution pension scheme and therefore there cannot be any deficit of payments and these are drawn in equal instalments throughout the year. We do not consider a risk.

CIA UK does not have any leverage exposure and therefore there is no leverage risk. During our ICAAP assessment we have also considered Business, Liquidity and Concentration risks but we have not deemed this as material

***Remuneration***

The Firm has adopted a remuneration policy and procedures that comply with the requirements of chapter 19C of the FCA's Senior Management Arrangements, Systems and Controls Sourcebook (SYSC), as interpreted in accordance with the FCA's guidance publication entitled "General Guidance on Proportionality: The Remuneration Code (SYSC 19C) & Pillar 3 Disclosures on Remuneration (BIPRU 11.5.20R)" and subsequent items of guidance issued by the FCA, including its document entitled "Frequently Asked Questions on the Remuneration Code".

As a BIPRU limited licence firm, the Firm falls within proportionality level 3. The Firm has concluded, on the basis of its size and the nature, scale and complexity of its legal structure and business that it does not need to appoint a remuneration committee. Instead, the Governing Body sets, and oversees compliance with, the Firm's remuneration policy including reviewing the terms of the policy at least annually. This includes ensuring that the Firm’s remuneration arrangements are consistent with and promote sound and effective risk management and do not encourage excessive risk taking.

As at 31 December 2019, the Firm currently sets the variable remuneration of its partners and staff in a manner which takes into account partner and firm performance, by reference to individual performance, performance of the Firm. As permitted for firms falling within proportionality level 3, the Firm takes into account the specific nature of its own activities (including the fee based nature of its revenues) in conducting any ex-ante risk adjustments to awards of variable remuneration and, given the nature of its business, has disapplied the requirement under the Remuneration Code to make ex-post risk adjustments.

The Firm only has one "business area", namely its investment management business. All of the Firm's Code Staff fall into the "senior management" category of Code Staff for the purposes of the Remuneration Code. The aggregate "remuneration" (as defined in the FCA Rules) awarded to the firm's Code Staff during the financial year ending on the accounting reference date was £20.9m.