



Liberum Capital Limited

Capital, Risk Management and Remuneration Disclosure (Pillar III)

May 2019

1. Overview

Regulatory capital framework

The CRD and CRR were approved by the EU Council of Ministers at the end of June 2013 and have been applicable from the beginning of 2014. The CRR introduced the first single set of prudential rules for banks across the EU, and applies directly to all banks in the EU member states. It helps to ensure that the Basel III international standards for bank capital adequacy are fully respected in all EU member states. EU Banks are supervised by EU member states' competent authorities, in collaboration with the EBA, whose supervisory powers have been expanded.

The Basel II accord has been implemented in the European Union (“**EU**”) through the Capital Requirements Directive IV (“**CRD IV**”). CRD IV details the standard regulatory capital framework for the financial services industry within the EU.

In the United Kingdom, CRD IV has been implemented by the Financial Conduct Authority (“**FCA**”) in its regulations through the General Prudential Sourcebook (“**GENPRU**”) and the Prudential Sourcebook for Investment Firms (“**IFPRU**”).

The regulatory capital framework consists of three ‘pillars’:

- Pillar I specifies the minimum capital requirement of firms to cover credit, market and operational risk
- Pillar II requires firms to assess the need to hold additional capital to cover risks not adequately covered under Pillar I
- Pillar III requires a set of disclosures to be made which enable market participants to assess information on the company’s capital, risk exposure and risk management procedures

Basis and frequency of disclosure

These disclosures are made on a consolidated basis for Liberum Capital (“**Liberum**” or the “**Group**”), in accordance with the minimum disclosure requirements of Pillar III set out under BIPRU 11 of the FCA Handbook.

The Pillar III disclosures are made annually and published as soon as practicable after completion of the annual financial statements, unless circumstances warrant update on a more frequent basis.

Company structure and business activities

Liberum is a UK based independent investment bank which is controlled by T&N Holdings (BVI) Limited, a company registered in the British Virgin Islands and owned by the family trust of Mr Shane Le Prevost.

Liberum’s main operating entity is Liberum Capital Limited (“**LCL**”) which is authorised and regulated by the FCA (Firm Reference Number: 465050) and is classified as a full scope €730k IFPRU investment firm. LCL was authorised on 5 June 2007 and commenced trading on 10 September 2007. Liberum is a “**non-ILAS BIPRU**” firm for the purposes of liquidity risk management.

LCL has two main operating subsidiaries, Liberum Capital Inc (“**LCI**”) and Liberum Wealth Limited (“**LWL**”). LCI, a wholly owned subsidiary based in New York, is a registered broker-dealer with the Securities and Exchange Commission (“**SEC**”) and a member of the Financial Industry Regulatory Authority (“**FINRA**”). LWL is an 85% owned subsidiary based in Guernsey and is licensed and regulated by the Guernsey Financial Services Commission (“**GFSC**”).

The principal activity of the Group is the provision of institutional and corporate stockbroking services, focused on cash equities and investment banking.

- Liberum provides research, execution, sales and trading in large and mid-cap UK and European equities, small cap UK equities and closed end investment funds. It also undertakes market making in UK small and mid-cap companies and closed end investment funds. In addition, Liberum provides sales, trading and execution services in convertible bonds. LCI provides access to the European markets for institutional investors based in North America
- Liberum provides corporate broking, corporate finance and advisory services to public and private companies and closed end investment funds
- LWL provides high quality execution, custody and associated administrative services to high net worth individuals and corporate entities

Location and verification

These Pillar III disclosures are published on the Group’s website www.liberum.com. The disclosures are reviewed on an annual basis and are not subject to audit.

2. Risk Management Objectives

Introduction

The monitoring and controlling of risk is a fundamental part of the management process. The board of directors of the Group (the “**Board**”) in conjunction with the risk and regulatory committee (the “**Risk & Regulatory Committee**”) review the key risks facing the Group and the controls that have been put in place to mitigate them. All risks are monitored in a timely manner through a sequence of financial reports using pre-defined and approved guidelines. The evaluation of these risks and the setting of policies in order to control them is the ultimate responsibility of the Board.

The acceptance of new business is subject to a due diligence process and requires members of the Board’s approval prior to engagement. New institutional trading counterparts are subject to a legal, regulatory and anti-money laundering review prior to commencement of trading. Senior management review all new institutional accounts.

The comprehensive controls and governance structures established by the Board are considered appropriate to the size, nature and complexity of Liberum’s activities.

The Group has developed a suitable risk assessment methodology and process which continues to evolve alongside its risk management strategy, policy and appetite.

Risks

Liberum has mainly low risk activities and an uncomplicated operational structure. The Group has considered each of the risk categories identified in the CRR and IFPRU 2 and other risks identified by the Board.

The following risks have been considered as part of the internal capital adequacy assessment process (“ICAAP”), including risks highlighted internally and under IFPRU 2.

Credit and counterparty risk

The Group has exposure to credit risk, which is the risk that a counterparty will cause a financial loss for the Group by failing to discharge an obligation. Credit risk exposure primarily arises from the settlement risk on securities. This is the risk that a counterparty fails to settle a trade under its contractual obligations thereby forcing the Group to close out the trade at a possible loss based on the mark to market value. In the ordinary course of business, counterparty risk is relatively limited because securities’ trading is normally carried out on a matched principal basis with settlement on a delivery versus payment basis.

The Group is also exposed to credit risk on outstanding receivables; exposure to this risk is managed by taking into account financial position, past experience and other factors relating to counterparties. The Group is subject to credit risk with respect to its cash at bank, trade debtors and other receivables. The carrying amount of financial assets represents the maximum credit exposure to counterparties plus cash balances with its clearers and banks.

Credit risk – non-trading book exposures in equities

The Group holds strategic equity investments that are not held for trading. These financial assets are classified and measured as equity investments at fair value through other comprehensive income (“FVOCI”) under IFRS 9, which became effective from 1 January 2018. The Board continues to review the performance of financial assets in the Group’s portfolio and realises these investments when deemed appropriate. These exposures are held in the balance sheet at fair value and unrealised gains and losses are included in common equity tier 1 capital.

Information about equity investments at FVOCI is disclosed in note 13 of the Report of the Directors and Consolidated Financial Statements for the year ended 31 December 2018 (the “2018 Annual Report”).

Market risk

Market risk is defined as the potential adverse change in income or net worth arising from movements in interest rates, exchange rates, tax rates, inflation rate or other market prices / indices.

The Group’s activities are directly linked to the stock markets and therefore all market prices / indices that influence the stock markets form the market risk to which the Group is exposed. To mitigate and manage market risk, the Group has established a trading framework which does not permit overnight position holding except under exceptional circumstances. This framework sets out the nature of the market risks that may be taken along with aggregate risk limits, and stipulates the procedures, instruments and controls to be used in managing market risk. As per Group policy, all trading book investments are marked to market on a daily basis.

The Group's activities are primarily denominated in Sterling. The Group does not enter into forward exchange contracts for hedging anticipated transactions.

Market risk – equity position risk

The Group is exposed to equity market risk in respect of its trading assets and liabilities that result from market making.

Trading assets and liabilities are subject to Board approved book and position limits. These limits are monitored daily via an automated system and all breaches are monitored and resolved on a timely basis by senior management.

Market risk – foreign currency risk

Foreign currency exposure is measured daily by taking into consideration all non-sterling assets and liabilities. This exposure position, broken down by individual foreign currency and an overall summary position, is circulated to senior managers.

Operational risk

Operational risk is defined as the potential risk of financial loss or impairment to reputation resulting from inadequate or failed internal processes and systems, from the actions of people or from external events.

The Group recognises that operational risk can never be eliminated, but seeks to minimise the probability and impact of operational risk events.

The Board acknowledges that failure to adopt an appropriate business strategy or insufficient consideration of recessionary economic conditions may pose a critical risk to the Group. In order to ensure that the entity is able to trade during a severe recessionary environment the Group is well capitalised and holds capital resources significantly in excess of the minimum regulatory capital resource requirement.

Major sources of operational risk include outsourcing of operations and dependence on key suppliers. The risk here is minimal as all key suppliers are either supplier to most other similar businesses and to use them is normal market practice, or can be easily replaced by competitors at a nominal cost.

In addition, due consideration has been given to other potential operational risk, namely human resources, operations, internal control, IT security, internal and external fraud, implementation of strategic change, regulatory non-compliance and external threats.

Liberum manages operational risk through appropriate controls and loss mitigation actions, including (but not limited to) insurance. These actions include a range of policies, appropriate procedures and internal controls to ensure compliance with laws and regulations. In addition, specialist support functions provide expertise in operational risk areas such as information security, health and safety, compliance, fraud management, security and business continuity management.

A process is in place for the recognition, capture, analysis and reporting of risk events. This process is used to help identify where process and control requirements are needed to reduce the recurrence of risk events.

The operational risk policy that has been implemented incorporates three key processes:

- A risk and control assessment carried out by the Board through discussion with senior management and recommendations from the Risk & Regulatory Committee. The assessment scores risk events as to probability and impact as well as evaluating the design and performance of controls that have been put in place to mitigate the risk. The results of this assessment form the basis of the key risks database
- Monitoring of the key risks by the Board and the Risk & Regulatory Committee
- Establishment of an operational loss database to capture and analyse risk incidents and loss events

The Group also undertakes yearly appraisals for all employees as well as completing an independent employment screening of all new employees.

Liquidity risk

The Group's exposure to liquidity risk principally arises from equity trading activities and the settlement of trades within this business. The risk is short term in nature.

Liquidity risk management within the Group considers both the overall balance sheet structure and projected daily liquidity requirements, measuring the combined effect of asset and liability maturity mismatches and other contingent obligations. The Group manages its cash and borrowing requirements across its clearing and banking relationships in aggregate and enjoys a good level of liquidity within its balance sheet.

The Group has undertaken a thorough and proportionate exercise of identifying the key liquidity risks that it is exposed to. BIPRU 12.5 sets out the ten key liquidity risk drivers that companies must consider. Given the size, nature and complexity of Liberum's business there is relatively limited relevance and applicability of these to the Group. Importantly Liberum:

- Does not raise funding via wholesale markets in any way
- Does not take deposits or rely on other forms of retail funding
- Its securities trading activity is primarily on a matched trade basis with overnight position taking tightly controlled
- Does provide for long settlement for a proportion of trading and this is tightly controlled in accordance with internal limits
- The Group maintains a relatively modest market making book of a number of small and mid-cap listed companies

Capital risk management

The Group manages capital on the basis of its regulatory capital requirement calculated in accordance with CRD IV and CRR. The Group determines its own funds to be the main measure in its capital management monitoring and control.

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital.

Capital adequacy and the use of regulatory capital are monitored daily by the Group's senior management, employing techniques based on the rules implemented by the EBA under CRD IV / CRR.

The Group uses its internal capital adequacy assessment process to manage regulatory capital. The ICAAP takes into account the risk profile and future plans of the business. Under this process the Group is satisfied that there is either sufficient own funds to absorb potential losses or that there are mitigating controls in place to prevent the risks occurring.

The Board receives commentary on required and available own funds as part of a monthly risk report which is produced in conjunction with other management information.

Where significant business initiatives are planned, the effects on the risk profile of the Group and therefore its own funds requirement are considered as part of the business plan.

Based on the recommendation from the Risk & Regulatory Committee, the Board believes that the Group has more than sufficient capital for its size and complexity taking into account all material risks faced in carrying out the Group's activities.

3. Risk Management Approach

ICAAP methodology

In order to consider the capital implications of a number of risks occurring simultaneously, over a specific time horizon and with a defined confidence level, an appropriately simple additive approach has been applied, and the results of this approach have been used as the basis for the ICAAP.

Approach

Operational, credit and market risks are quantified in aggregate according to rules set out in the CRR handbook. These are referred to in IFPRU 2 as Pillar I risks.

Risks which lie outside Pillar I scope (i.e. those other than operational, credit and market risks) must be individually quantified. These risks are known as Pillar II risks. The FCA considers Liberum's quantification of Pillar II risks under its Supervision, Review and Evaluation process ("SREP").

The impact of any Pillar II risk is quantified in financial terms. In order to do this, extreme, but plausible scenarios are considered. In addition a generic stress model, such as a one in 25 year economic downturn, is created. The Pillar II risks and thus more extreme stress have been fed through Liberum's three year financial projections to determine the impact on Liberum's own funds position.

Risk assessment

Liberum has supplemented the risk management process defined above to meet the needs of the ICAAP. A process has been built to identify which risks are relevant for the ICAAP, and protocols have been defined and developed to enable appropriate quantification of these risks.

Identification of material ICAAP risks

Liberum's embedded risk management framework identifies and reports material risks each quarter. These are captured in the risk register and associated Board report. This information provided the starting point for the identification of ICAAP risks.

Each of the risks chosen for inclusion in the ICAAP analysis was reviewed to determine which fall within the definition of Pillar I risks (market, credit or operational risk), and which should be defined as non-Pillar II risks.

The risk register has been reviewed to determine which risks should be included in the ICAAP calculation. The method used to determine which were included in the calculation is firstly to consider the materiality of the risk, secondly to consider whether they are provided for fully or partially by the Pillar II capital amount and thirdly to consider the appropriateness of capital as a strategy for the treatment of the risks.

Scenario risk analysis

Liberum considers a number of specific risk scenarios which would have a significant impact upon revenue. The scenarios are based on an adverse yet plausible real-world combination of events which would affect the key business areas such as revenue and economic capital.

Since Liberum has not suffered a significant adverse financial impact from an economic downturn in the past, the scenarios have been determined by analysing specific events which could give rise to extreme but plausible losses.

Liberum has predicted the impact on revenue and cost streams as well as capital resources under these scenarios in order to assess whether a material net loss arises which might result in a call on capital.

Risk descriptions

The following risks have been assessed as part of the ICAAP to determine if Liberum is required to hold additional own funds to cover Pillar II risks;

- Operational risks including reputational risk, retention of staff, major infrastructure incident and financial crime
- Regulatory risk
- Liquidity risk
- Leverage risk

The conclusion is that all of the risks mentioned above are deemed to be covered within the Pillar I requirement and no Pillar II risk is deemed to be appropriate.

Aggregation and diversification of risks

The overall level of own funds that is appropriate for Liberum's business is derived from its Pillar I calculations. The key elements considered in the risk assessments are based on Liberum's operational capacity under turbulent market conditions.

The Group's regulatory capital model is a subset of its internal capital model which demonstrates its ability to operate within the regulatory framework.

4. Own Funds and Capital Requirements

Liberum calculates its capital resources, capital requirements and capital ratios in accordance with the current FCA regulations as set out in IFPRU. Regulatory capital data is reported to the FCA via its online system and the COREP reporting regime (“COREP”).

The following tables summarise the calculation of own funds and capital requirements as at 31 December 2018. This data is based on the submitted COREP returns, which have been adjusted to include 2018 retained earnings following completion of the annual statutory audit.

Capital resources and own funds

The table below provides a full reconciliation between total equity per the audited financial statements and the Group’s total capital (own funds) for regulatory reporting purposes:

Capital resources as at 31 December 2018	£'000
Total capital held	
Called up share capital	794
Preference share capital	6,206
Retained earnings	17,689
Other reserves	3,711
Total equity per consolidated statement of financial position (audited)	28,400
Preference share capital	(6,206)
Common equity tier 1 capital	22,194
Deduction from common equity tier 1 capital:	
Intangible assets	(182)
Common equity tier 1 capital after deductions	22,012
Preference share capital	6,206
Tier 1 capital	28,218
Subordinated loan	-
Total capital – own funds	28,218

Common equity tier 1 capital is the core measure of Liberum’s financial strength and is the highest form of capital. It includes share capital, excluding preference share capital, and audited retained earnings, excluding non-controlling interests.

Additional tier 1 capital includes paid up cumulative, non-redeemable preference shares. The terms and conditions relating to share capital are disclosed in note 21 of the 2018 Annual Report.

The Group calculates its total risk exposure and Pillar I capital requirements in accordance with the CRR handbook. Following completion of the annual statutory audit, the Group’s total capital (own funds) increased to £28,218,000 and the operational risk requirement has been adjusted resulting in a total Pillar I capital requirement of £10,825,000 and a total capital ratio of 20.9%.

Pillar 1 capital requirement

The table below provides an analysis of the Pillar 1 capital requirements for each risk classification:

Pillar 1 capital requirements as at 31 December 2018	£'000
Credit risk requirement	
Counterparty credit risk	1,306
Settlement risk	2
Market risk requirement	
Position risk	931
Foreign exchange risk	147
Operational risk requirement	
Operational risk	8,439
Total Pillar 1 capital requirement	10,825

Credit risk requirement

Counterparty credit risk is calculated using the standardised approach. The table below provides a breakdown of the credit risk requirement for each exposure class as at 31 December 2018:

Counterparty credit risk as at 31 December 2018	Balance sheet exposure £'000	Risk weighting %	Risk weighted exposure £'000	Risk factor %	Credit risk requirement £'000
Institutions	30,222	20% / 100%	6,044	8%	483
Corporates	810	100%	810	8%	65
Equities	3,384	100% / 150%	3,626	8%	290
Other	7,315	0% / 100%	5,852	8%	468
	41,731		16,332		1,306

Balance sheet exposure to institutions principally relates to cash deposits held at banks. An ECAI rating (Moody's) has been used to risk weight these exposures.

Equities exposures relate to positions not held in the trading book that are classified as equity investments at FVOCI. Holdings of equity investments at FVOCI are classified as credit risk under the standardised approach and assigned a risk weight of at least 100%.

Settlement risk exposure arises when a transaction is unsettled after its due delivery date. The capital requirement for settlement risk is calculated by applying a factor to the price difference between the agreed settlement price and its current market value.

Market risk requirement

Liberum's market risk exposure generally arises from cash equity positions in UK listed securities held in the trading book. The Pillar I capital required for the position risk requirement ("PRR") is calculated using the standardised approach. The total PRR weighting for equity positions is 16%, calculated as the sum of market risk (net exposure per country, weighted at 8%) and specific risk (aggregate of absolute gross exposure values, weighted at 8%).

Liberum holds positions in collective investment undertakings ("CIUs") which are subject to a risk weighting of 32%. This higher weighting is applied to the aggregate of long and short positions in CIUs and comprises specific risk and general risk.

Foreign exchange risk is calculated using the standardised approach and is based on the sum of the sterling equivalent overall net foreign exchange position multiplied by 8%.

Operational risk requirement

Liberum uses the Basic Indicator Approach to calculate the Pillar I capital requirement for operational risk, which is equal to 15% of the average audited relevant income over the last 3 years.

Capital conservation buffer

Liberum is required to maintain an additional capital conservation buffer to provide for losses in the event of stress. This is a standard buffer to be met with CET1 capital and is calculated as a percentage of risk-weighted assets (“RWA”). The buffer is being phased in; as at 31 December 2018 it was calculated as 1.875% of RWA (£2,537,000), and increases to 2.5% of RWA from 1 January 2019.

Capital ratios

The table below provides an analysis of the capital ratios for each measure of capital expressed as a percentage of the total risk exposure amount:

Capital ratios as at 31 December 2018	%
Common Equity Tier 1 (CET1) capital ratio	16.3%
Tier 1 capital ratio	20.9%
Total capital ratio	20.9%

5. Leverage Ratio

The leverage ratio is calculated as the Group’s Tier 1 capital divided by the sum of the exposure values of all assets and off-balance sheet items not deducted when determining Tier 1 capital:

Leverage ratio as at 31 December 2018	£'000
Exposure measure	
Total assets per consolidated statement of financial position	67,550
Intangible assets deducted in determining Tier 1 capital	(182)
Off-balance sheet items	-
Leverage ratio total exposure measure	67,368
Tier 1 capital	28,218
Leverage ratio	41.9%

6. Return on Assets

The table below shows Liberum’s return on assets, calculated as consolidated profit for the year divided by total assets in the consolidated statement of financial position as at 31 December 2018:

Return on assets as at 31 December 2018	£'000
Consolidated profit for the year	9,300
Total assets per consolidated statement of financial position	67,550
Return on total assets	13.8%

7. Remuneration

Scope

Liberum is subject to the provisions of the FCA's Remuneration Code for IFPRU investment firms, as set out in SYSC 19A of the FCA Handbook (the "**Remuneration Code**" or "**Code**"). Liberum is required to establish and apply policies to comply with the Code in a way and to the extent that it is appropriate to its size, internal organisation and the nature, scope and the complexity of its activities. In accordance with the Code and the guidance on proportionality published by the FCA, Liberum is classified as a Tier 3 firm.

Decision making process

Liberum has put in place policies, procedures and practices relating to remuneration which, to the extent required, apply the principles of the Remuneration Code.

Liberum has identified two key participants in monitoring and implementing its risk and regulatory framework and its governance of risk: the Board and the Risk & Regulatory Committee. The Board is collectively responsible for the long term success of the Group. The Board sets the Group's strategic aims, within a framework of risk management and internal controls, ensuring that the necessary financial and human resources are in place to enable the Group to meet its objectives.

The Risk & Regulatory Committee is responsible for the oversight of risk and resulting risk management activity and is responsible for facilitating the risk management process and ensuring that appropriate risk management activities take place.

Although the Group may dis-apply the requirement to establish a remuneration committee, the Board has introduced such a committee to which it has delegated authority to approve the remuneration packages of individual members of the Board (the "**Remuneration Committee**"), which also extends to other Code Staff (as defined in the Code), this ensures that no individual within the Group will approve his/her own remuneration package.

Remuneration and performance

Sound and effective risk management contributes to the overall success of the Group. All individuals are rewarded from the combined bonus pool for the Group based on their contribution to the profitability of the Group in the widest sense and not for excessive risk taking. No individual or team are rewarded on a formulaic basis or any alternative methodology.

Summary of strategy and application of Code principles

The Group's strategy is to employ a critical mass of high quality individuals across all areas of the business. The discretionary and non-contractual nature of bonus payments allows the Board the flexibility to incentivise and reward those individuals who have contributed fully to the success of the Group in the short term. The long term nature of the Group Share Schemes (including the Growth Share Plan) promotes an incentive in the long term success of the Group. The communication of the business planning process and periodic performance assessment and reviews provide an opportunity for individuals to be set realistic targets and objectives for the short and long term horizons which are in line with the overall business strategy and objectives set by the Board.

As identified in the risk register, senior management in conjunction with the Risk & Regulatory Committee monitor Liberum's activities to ensure that all potential and actual conflicts of interest are managed and enforce the provisions contained within the Group published Conflicts of Interest policy in order to prevent conflicts of interest arising between any "relevant person" and a client. Relevant persons include but are not limited to all staff including Code Staff.

When proposing and approving the bonus pool the Board will collectively perform a risk adjusted performance assessment which will consider both financial and non-financial performance measurements, current and future risks and the ICAAP.

Quantitative disclosures

Remuneration for the year ended 31 December 2018	£'000
Fixed and variable remuneration: All Staff	31,992
Remuneration: Code Staff	
Fixed remuneration	1,000
Variable remuneration	1,205
Non-cash variable remuneration awarded in shares	5
Total remuneration for Code Staff	2,210

There were 6 Code Staff during the year made up of directors and senior management whose actions have a material impact on the risk profile of the Group. One Code Staff member individually received remuneration exceeding EUR 1 million.