CAIRN CAPITAL LIMITED
PILLAR 3 DISCLOSURES
31 DECEMBER 2014

CAIRN
CAPITAL

Disclaimer
This publication has been prepared solely for the purpose of explaining the basis on which Cairn Capital Limited ("Cairn") has prepared and disclosed certain capital requirements and information about the management of risks relating to those requirements, and for no other purpose. It therefore does not constitute any form of financial statement on Cairn nor does it constitute any contemporary or forward looking record or opinion on any of Cairn's activities.

Unless stated otherwise, quantitative disclosures are based on data at 31 December 2014.

This publication has not been audited.

Although Pillar 3 disclosures are intended to provide transparent capital disclosures on a common basis, the information contained in this document may not be directly comparable with other investment firms.

Contents

1 1 Scope

1.1 Introduction

The Capital Requirements Directive (“CRD”) uses the concept of three ‘Pillars’. Pillar 1 sets out the minimum capital requirements that regulated entities are required to meet for credit, market and operational risk. Under Pillar 2, regulated entities have to assess whether additional capital is required to capture risks not covered in Pillar 1. Pillar 3 is a set of disclosure requirements which enable market participants to assess information on an entity’s risk and management objectives and policies. The Financial Conduct Authority (“FCA”) has introduced Pillar 3 by creating Chapter 11 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”).

1.2 Frequency of Publication

In line with the BIPRU 11 requirement Cairn will publish its Pillar 3 disclosures at least annually. The Directors will consider the need to publish some or all of the disclosures more frequently than annually should circumstances change or its processes and procedures be subject to material change. The Directors believe the website is the most appropriate medium for communicating Pillar 3 disclosures (www.cairncapital.com)

1.3 Basis of Consolidation

Cairn is regulated and authorised by the FCA and is a wholly owned subsidiary of Cairn Capital Group Limited (“Cairn Group” or “the Group”). Cairn Group is incorporated in England and Wales and is not regulated by the FCA. Cairn Group acts as an investment holding company. Cairn Group also wholly owns an operating company in the USA, Cairn Capital North America Inc. (“CCNA”). CCNA is an investment adviser registered with the SEC. All other subsidiary companies are currently dormant and there are no other significant entities within the Group.

Cairn reports on a single entity basis as well as on a consolidated basis showing the position of the Group. Similarly the Internal Capital Adequacy Assessment Process (“ICAAP”) is considered on both a Cairn standalone and a Cairn Group consolidated basis. Both companies are subject to common management and there is no current or foreseen material, practical or legal impediment to the prompt transfer of capital resources or repayment of liabilities between Cairn and Cairn Group.

The disclosures in this document relate to Cairn Group as well as to Cairn.

2 Risk Management

2.1 Overview and Statement of Risk Appetite

The Group's overall business risk strategy and appetite and the control environment are recommended by the Executive Management Committee ("EMC") to the Directors. The Directors in turn, review the proposal, amend where necessary and delegate to the EMC the implementation of the risk strategy.

Risk appetite can be defined as the amount of risk that an organisation is prepared to accept in order to achieve its business plan. In this context the Group has a relatively low risk appetite, seeking wherever possible to reduce its risk while remaining well placed to achieve its objectives. Risk appetite forms the basis for the firm's strategic direction and investing decisions, and is communicated by the EMC to the relevant business heads.

The Group has a dedicated risk department headed by the Chief Risk Officer who has responsibility for the oversight of risk processes associated with investment management. Other business groups contribute to the operational effectiveness of the Group and the maintenance of an effective control environment designed to mitigate exposure to identified risks.

Cairn's principal risks are considered to be business risk, operational risk, employee risk, credit risk and market risk. The risks are considered in more detail later in the document.

2.2 Board

The board of Cairn Group meets at regular intervals at least five times a year and the board of Cairn meets at regular intervals four to six times a year. Should urgent issues arise that require the input or approval of the boards then the boards will meet more frequently. The boards are also charged with approving the risk management policies of Cairn.

2.3 Executive Committee

Cairn's EMC meets weekly and is responsible for implementing the strategy of the business and determining investment guidelines and the appropriate apportionment of responsibility to each business area. The EMC recommends the overall risk strategy, risk appetite and control environment. Day to day market, position and business risk monitoring of Cairn's asset management business is delegated to the risk management team headed by the Chief Risk Officer.

2.4 Investment Process and Committees

Investment decisions are generally made by investment committees, the composition of which varies depending on the business line concerned, and are executed by portfolio managers.

The investment process varies across business lines but central to Cairn's business model is the emphasis placed on a deep appreciation and fundamental understanding of credit. Cairn's research model is built upon a foundation of experienced credit analysts, each of whom have worked through credit cycles across geographies, industries and capital structures. Cairn's research analysts work in partnership with portfolio managers to analyse investment and trading opportunities on a dynamic basis.

Cairn's credit research capabilities include proprietary analytical screening, cash flow/relative value modelling, credit fundamentals monitoring tools and extensive in-house fundamental credit analyses facilitated by relationships with external credit/equity analysts, bankers, advisers and management teams built through transactional experience in real estate, CDS, distressed/high yield, credit/equity structuring and leveraged finance.

The portfolio management team includes experienced portfolio managers with strong fundamental credit backgrounds. Within certain defined parameters, an individual senior portfolio manager is permitted to make discretionary investment decisions, which are subject to review.

2.5 Chief Risk Officer and Risk Management

The Risk Management function, headed by the Chief Risk Officer, has responsibility for the oversight of risk processes associated with investment management. The Chief Risk Officer is responsible for risk monitoring and identification. Weekly risk meetings are held for each business line at which the product strategy, investment position and risk tolerance are reviewed.

Whilst the risk management team retains overall responsibility, individual responsibility for positions and risk management within agreed upon tolerances rests with the portfolio management team. Portfolio managers communicate regularly with the risk management, operations and research teams as well as with other portfolio managers in setting strategy and managing risk.

2.6 Compliance Officer

The Compliance Officer (who is also the Money Laundering Reporting Officer) is a member of the Executive Management Committee and has the requisite authority to carry out his responsibilities appropriately. The Compliance Officer is assisted by the Chief Legal Officer as required and has prime responsibility for ensuring that Cairn remains compliant with all relevant regulations. This is achieved through Cairn's compliance monitoring programme.

The Compliance Manual covers the compliance policies and procedures relevant to Cairn. The legal and compliance groups monitor activities to ensure as far as possible that business is conducted in compliance with regulatory requirements. This is referred to as the compliance monitoring programme. Actual or potential problems are reported and discussed at EMC meetings and Cairn board meetings.

2.7 Treasury Policy

The business area responsible for the support and processing of investment transactions is the Operations & Treasury department. Cairn's clients ordinarily appoint third party outsourced service providers who are responsible for trade settlement, custody and, where applicable, fund administration and accounting. The Operations & Treasury department performs a dealing support role to third party trustees, custodians, administrators and accountants as applicable, and in doing so seeks to ensure that Cairn's records are accurate and reconciled to those of such third parties. It undertakes reconciliation of investment holdings, valuations and cash accounts and is also responsible for ensuring that Cairn remains compliant with all relevant client investment restrictions and guidelines.

Cairn's finance department monitors Cairn's capital on a regular basis and ensures that it remains compliant with its capital requirements as defined by the FCA.

The finance team also monitors Cairn's exposure to foreign currency risk. Foreign currency risk arises as a consequence of some of Cairn's income being denominated in currencies other than sterling. The finance team produces regular cash flow projections taking account of contractual future revenue streams and expected items of expenditure. Foreign currency exposure is hedged using forward foreign exchange contracts. Occasional one-off income amounts in non-GBP denominated currencies are converted to sterling on receipt.

Credit risk associated with cash and cash equivalents is managed by placing deposits only with major UK financial institutions. No cash is placed in money market funds as this does not comply with Cairn's risk appetite.

Cairn will occasionally invest in funds to which it provides investment services. Such investments are typically motivated by wider commercial criteria than would otherwise be the case for investments. Investing in its own funds helps to encourage third-party investment by demonstrating an alignment of interest between the investor and the fund manager. Its investments are monitored by the finance team in the context of managing exposure to price risk and liquidity risk. Any significant changes identified are reported to the EMC.

3 Capital Resources

3.1 Pillar 1 Capital

Cairn Group's capital comprises Tier one capital and Tier two capital. Cairn Group does not hold tier three capital.

Tier one capital comprises permanent share capital, externally verified realised profits, and share premium. Investments in own shares, intangible assets and material holdings are required deductions from tier one capital.

Cairn has not elected to deduct illiquid assets from its capital. Cairn has no material holdings in financial institutions so no deduction is required.

A summary of Cairn Group's total capital on a consolidated basis as at 31 December 2014 is shown below:

	Cairn Capital Limited £'000s	**Cairn Capital Group Limited £'000s**
Tier One Capital		
Permanent share capital	1,200	3,000
Retained earnings	5,026	3,682
Less Deductions:		
Investments in own shares*	-	(1,431)
Other	-	(104)
Total Tier One Capital after deductions	**6,226**	**5,147**
Tier Two Capital		
Preference share capital	-	2,000
Subordinated loan	1,000	-
Total Capital after deductions	**7,226**	**7,147**

* Investment in own shares represents shares held by the Cairn Capital Employee Benefit Trust solely for the benefit of the employees of the Company.

4 Capital Adequacy

4.1 Capital Oversight

Cairn manages its internal capital for both current and future activities through a combination of the committees and policies referred to in section 2. The EMC assesses whether capital is required as a result of any change in operating activities or unforeseen circumstances. Capital resource and requirement calculations are included in the financial pack which is reviewed at board meetings.

4.2 Internal Capital Adequacy Assessment Process ("ICAAP")

In line with the annual review process, Cairn's Internal Capital Adequacy Assessment Process ("ICAAP") required by the FCA under the Capital Requirements Directive ("CRD"), was updated and subsequently approved by the EMC. Pillar 2 requires regulated entities to assess whether additional capital is required to cover risks not covered in Pillar 1. The principal risks identified relate to operational and business risk. The adequacy of the Credit Risk and Market Risk requirement under the minimum capital requirement is considered in conjunction with the EMC's assessment of the risks specific to Cairn.

4.3 Minimum Capital Requirement

Cairn is a BIPRU limited licence firm and, accordingly, its minimum capital resource requirement under Pillar 1 is calculated as the higher of its:

- Base capital requirement of €50k; and

The higher of:
- Credit risk plus market risk; and
- Fixed overhead requirement

The following table shows Cairn Group's overall minimum capital requirement and the capital adequacy position under Pillar 1 at 31 December 2014:

	Cairn Capital Limited £'000s	Cairn Capital Group Limited £'000s
Capital resources	**7,226**	**7,147**
<u>Capital requirement – the higher of:</u>		
Credit risk + Market risk	1,035	2,411
and		
Fixed overhead requirement	3,595	4,122
Pillar 1 capital requirement	**3,595**	**4,122**
Excess capital resources under Pillar 1	3,631	3,025

5 Principal Risks

Cairn's risks are considered to be operational risk, employee risk and business risk. Cairn is also exposed to credit and market risk arising from the assets and liabilities held on its balance sheet.

5.1 Operational Risks

Operational risk is the potential for economic loss and/or reputational damage resulting from inadequate or failed processes, people or systems.

Cairn's procedures and processes are subject to periodic and rigorous reviews by a committee consisting of the Chief Investment Officer, the Chief Risk Officer, the Chief Operating Officer and the Chief Technology Officer. Control weaknesses are identified and deficiencies are remedied by introduction of new and/or improved processes. Control procedures and processes to mitigate risks are identified and documented in an ISAE3402 report. The ISAE3402 report is subject to annual audit to determine whether the controls are sufficient and appropriate to the business and the risks that the business faces. The audit also tests on a sample basis whether the controls have been operating as documented in the ISAE3402 report. Occasional ad-hoc reviews of Cairn's processes are carried out by third-party professionals to ensure that Cairn continues to operate within industry standard best-practice. Keen oversight of staff and operational activities by the EMC and the departmental heads ensures that staff are aware of procedures and remain compliant with the processes.

As a BIPRU limited licence firm Cairn's capital is the higher of: the base capital requirement; credit risk plus market risk; and the fixed overhead requirement. Consequently, Cairn does not have an operational risk capital requirement under Pillar 1.

The EMC and the board of Cairn have reviewed the control procedures and consider that they are sufficient and robust enough to reduce risk to an acceptably low level. As such the EMC and the Cairn board do not believe that any additional capital is required.

5.2 Employee Risk

Cairn's employees are essential to the growth and success of its business. Its ability to recruit, develop and retain talented and motivated individuals is essential for delivering shareholder value and for managing the principal risks.

Cairn offers a competitive remuneration package to employees including participation in a discretionary bonus scheme. Incentive compensation is intended to ensure alignment of employee and stakeholder interests by encouraging staff retention. Staff retention is encouraged by fostering a collegiate style and actively encouraging employee involvement and participation.

Cairn recognises its recruitment processes to be key to ensuring that the company meets its staffing objectives. As such Cairn has a rigorous and thorough recruitment process to ensure only the best candidates are employed. A number of interviews are held and all staff are interviewed by at least one member of the EMC, and invariably more. Candidates are measured against core competencies specific to the role as well as broader considerations to ensure that the employee will be a good fit within the team structure. In certain instances (such as IT recruitment) candidates are required to complete a short test to ensure that they are sufficiently technically competent to perform the proposed role.

All staff are subject to performance reviews at least annually. Performance reviews are designed to identify shortcomings in the employees' relevant skill-sets and to highlight areas for improvement as well as any training and development needs. Cairn recognises that such reviews play an important role in staff development and management take their responsibility very seriously in this regard.

As with most growing businesses, the Directors have considered ‘key man’ dependency. The directors regularly monitor key man risk and ensure that there is appropriate and experienced cover for each role within the business. When entering into agreements Cairn’s policy is that no one person should be identified as a ‘key man’ and as such its exposure to ‘key man’ risk is reduced.

Whilst recognising employees are integral to the business, the board remains satisfied that the risk remains low and that no additional capital is required to be held against it.

5.3 Business Risk

Cairn generates its revenues by managing investors’ assets and by providing advice to a range of clients. The aim of its asset management business is to generate returns in accordance with pre-determined targets whilst managing the risks of the investment portfolios. Business risk is the risk that sustained poor performance and conditions in the global market negatively affect investment sentiment and ultimately Cairn’s income streams.

General business risks are the most significant of those risks identified in terms of the likelihood of materialisation and the likely impact of such a materialisation. The following risks are considered key:

- The risk that Cairn makes poor asset management decisions and gives inappropriate advice;
- The risk of fraud and error; and
- The risk of a major downturn in the economic environment

Cairn believes that its processes that are followed for its management of investment risk in its asset management business, as set out in section 2, are sufficient to reduce its risk from its investment management operations to an acceptably low level. The board believes that effective internal controls and processes are an effective risk mitigant and as such no additional capital requirement has been assessed.

The board recognises that fraud and error is an inherent risk. Notwithstanding the risk, the board believes that the processes and procedures to prevent and detect material instances of fraud and error are sufficient so as not to warrant an additional capital requirement under Pillar 2.

The risk posed by a major downturn in the economic environment is noted by management. The board is of the view that Cairn is able to withstand downturns in the economic environment and this is reflected in the broad business plan and diverse product offerings. Cairn, historically, has been able to adapt to changing economic landscapes by amending its business plan and its focus to suit changing circumstances. Using the recent credit crisis of 2007-2008 as an example, Cairn was able to develop its advisory and restructuring services to compensate for a decline in its asset management services. In addition, Cairn’s variety of income sources lessens its exposure to a downturn in the economy or the poor performance of one of its funds. As such the board does not consider an additional capital requirement to arise as a consequence of this risk.

5.4 Credit Risk

Credit risk is the risk of financial loss to Cairn if a counterparty fails to meet its contractual obligations. Credit risk arises from fees due from clients, investments in Cairn managed transactions and cash held in financial institutions. Cairn uses the standardised approach to credit risk and in calculating its credit risk requirement under Pillar 1 sets aside 8% of the risk weighted assets. Cairn considers the Pillar 1 requirement to be adequate to cover its losses arising from credit risk.

Debtor balances arising from Cairn's asset management business are typically paid within 30 days and are not subject to credit risk. Fees from advisory mandates are paid according to Cairn's normal terms of business and are regularly monitored and reviewed for ageing. Old debtor balances are reviewed for ageing to identify any bad or doubtful debts. Provisions are made against debts considered to be doubtful. Periodic payments may be required in advance to mitigate credit risk and withdrawal of services in the event of non-payment is considered a last resort.

Cash is deposited at major UK financial institutions only. Cash is not held in money-market deposits as this does not match Cairn's risk profile. In light of the government response to the recent credit crisis, Cairn considers its credit risk arising from major UK financial institutions to be acceptably low and that the standardised credit risk as part of Pillar 1 covers this risk adequately.

Cairn's credit risk arising from its investment in its CLOs is regularly monitored by the board. Impairment reviews are carried out annually or more frequently when indications suggest that the asset might be impaired. This ensures that the carrying value of an investment is not stated at an amount in excess of its recoverable amount. On this basis the board has concluded that the credit risk arising is adequately covered by the credit risk requirement under Pillar 1.

5.5 Market Risk

Market risk is the risk that changes in market prices, such as interest rates and foreign exchange, affect Cairn's income and/or the value of certain assets. As Cairn does not maintain a trading book, market risk is limited to its assets and liabilities denominated in foreign currencies. Foreign currency position risk requirement under Pillar 1 is 8% of foreign currency denominated assets.

Cairn receives fee income in non-sterling denominated currencies and so has exposure to foreign currencies in the form of its debtor and cash balances. Cairn manages its foreign currency exposures by projecting its cash balances arising from expected foreign currency income and entering into forward foreign exchange contracts to hedge its foreign exchange risk. The board is of the view that these procedures operate effectively to reduce Cairn's risk arising from its foreign currency denominated income streams. As such the board believes that its exposure to market risk is adequately covered by its foreign currency position risk requirement under Pillar 1.