

JM Finn & Co

Pillar 3 Disclosures for J. M. Finn & Co. Ltd  
December 2009



## Introduction

The Capital Requirements Directive (“CRD”) created a revised regulatory capital framework across Europe, based on the provisions of the Basel II Capital Accord. The disclosures in this document complement the ongoing work undertaken by J. M. Finn & Co. Ltd (the “Firm”) in the assessment of its capital requirements under the Financial Services Authority’s (“FSA”) Internal Capital Adequacy Assessment Process (“ICAAP”).

This is the second Pillar 3 disclosure document for J. M. Finn & Co. Ltd and JMFinn Capital Markets Limited (together the “Group”) prepared in accordance with chapter 11 of the FSA’s Prudential sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”).

The Firm is the parent company of JMFinn Capital Markets Limited and is required to produce UK consolidated accounts to assess its regulatory capital resources and capital resources requirement. These are similar to the statutory financial statements produced for the consolidated annual report and accounts.

These disclosures will be made on an annual basis and the report will be published on the Firm’s website ([www.jmfinn.com](http://www.jmfinn.com)) and the website of JMFinn Capital Markets Limited ([www.finnncap.com](http://www.finnncap.com)). Copies of the report will also be available on request by writing to the Company Secretary of the Firm at 4 Coleman Street, London EC2R 5TA.

## 2. CORPORATE BACKGROUND

### J.M. Finn & Co. Ltd

J.M. Finn & Co. Ltd is one of the UK’s leading privately owned firms of investment managers and advisers. It was founded as a partnership in 1945 and incorporated as a private limited company in 2006.

The Firm has offices in London, Bristol, Leeds, Bury St Edmunds and Ipswich. Its largest office is in London where the majority of the Firm’s investment managers and advisers, as well as its middle office and back office departments, are located.

The Firm provides discretionary, advisory, and execution only services for private clients and professional advisers as well as trusts, charities and pension funds. It also manages two Investment Funds (CF J.M. Finn UK Portfolio Fund and CF J.M. Finn Global Opportunities Fund). The Firm has approximately 20,000 client accounts and over £3bn

funds under management (as at November 2009). The Firm expects to continue to grow its funds under management through attracting new clients as well as new investment managers and advisers.

As an independent firm, the Firm is able to offer a level of service, which is both flexible and objective. The Firm adapts its services to suit its clients and aims to hold fast to the traditional values on which the Firm was built. Further details about the Firm can be found at [www.jmfinn.com](http://www.jmfinn.com).

### JMFinn Capital Markets Limited

In August 2007, the Firm transferred its corporate finance, institutional research and institutional broking business into its subsidiary, JMFinn Capital Markets Limited, which trades as “FinnCap”. The Firm retains a majority stake in the company with the management team and employees of FinnCap owning the remaining shares. Its business comprises experienced teams in Corporate Finance, Corporate Broking, Institutional Sales, Sales Trading and Research. FinnCap is a Nominated Adviser (NOMAD) on AIM and a Corporate Adviser on Plus Markets. Further details about can be found at [www.finnncap.com](http://www.finnncap.com).

## 3. RISK MANAGEMENT

The Firm’s Board of Directors is responsible for setting the risk appetite of the Firm. The Firm has a low risk appetite. The Firm’s risk appetite is considered by the Board in conjunction with its reviews of the Firm’s strategy. The last such review was carried out during 2008.

The Firm’s Board of Directors has taken the view that the management of risk is best achieved by embedding the process within the Firm’s committees rather than having a separate Risk Department. The Directors and/or Heads of Department are represented on these committees. The committees report to the Board or to a member of the Firm’s Management Committee.

The Firm’s principal committees are:

- Management Committee, including Internal Audit and Risk Review
- Compliance Client Money & Assets Committee
- Treating Customers Fairly Committee

The Firm’s risk management measures also incorporate the activities of its Front Office Director and Manager, Compliance Department, Internal Auditor and Finance Department.

The Front Office Director and Manager and Compliance Department have a programme to monitor compliance by investment managers and advisers with the key Front Office controls. The Front Office Director and Compliance Director are members of the Management Committee and report to the Committee regularly.

The Internal Audit plan is derived from a risk based approach. The annual plan is compiled from known risk areas with particular focus on the Firm's Investment Administration operations and is reviewed by the Internal Audit and Risk Review Committee. The Internal Auditor reports to the Managing Director and his audit reports are circulated to and reviewed by the Management Committee and Board.

The Finance Department produces extensive management information including profit and loss accounts for branch offices and departments, balance sheets and budget variance reports. The Group produces detailed expense and revenue budgets for the next financial year and 3 to 5 year forecasts. This information assists the Group in capital management (including regulatory capital) and cash flow planning. The Finance Department is responsible for the financial regulatory returns of the Group and reports on a monthly basis to the Managing Director.

FinnCap's risk management structure is similar to that of the Firm. FinnCap's Board of Directors undertakes reviews of the company's strategy and its risk appetite. The Board also delegates aspects of risk management to its:

- Management Committee
- Approvals Committee for new business.

## 4. APPROACH TO ASSESSING CAPITAL ADEQUACY

The FSA's ICAAP is a key element of the Group's implementation of the CRD. The ICAAP is a process that brings together the risk management framework that the Group has implemented to identify, manage and mitigate its risks within the financial discipline of budgeting and business planning.

The intention is that the ICAAP will be reviewed and updated regularly, unless there are any changes in the control environment or other events that warrant a more immediate update. When reviewing and challenging each update the Board will review its stated risk appetite and compare it against actual

performance. It will also consider the appropriateness of the stress tests performed as part of the ICAAP and if they are not considered appropriate will devise alternative stress tests.

The Board monitors performance against the ICAAP both directly and through Directors' representation on the Firm's principal committees.

Not all material risks can be mitigated by capital but where capital is appropriate the Board has adopted a "Pillar 1 plus" approach to determine the level of capital that needs to be held. This method takes the FSA's Pillar 1 capital resource requirement calculations as a starting point and then considers whether this delivers an adequate capital sum to cover the Firm's actual risks. Where the Board considers that the Pillar 1 calculation does not adequately reflect the risk, additional capital has been allocated as part of the ICAAP.

## 5. REVIEW OF MATERIAL RISKS

The Group has assessed its risks under the following headings (as set out in chapter 1 of the FSA's General Prudential sourcebook):

### (a) Credit risk

The Firm deals predominantly with the following counterparties:

**Clients** – The Firm has historically had very few bad debts. This is particularly the case because the vast majority of our clients hold cash with the Firm and/or hold investments in the Firm's nominee account. The Firm has a right of security over a client's cash and/or investments and can enforce this security in the event of a potential default.

**Market counterparties** – The Firm has controls in place to ensure that all new counterparties are approved based on regulatory and financial suitability. Although no fixed limits are applied, the Head of Dealing and the Dealing Director (with reference to the Managing Director) keep the ongoing suitability of counterparties under review.

**Banks/custodians** – When investing its own cash funds, and when placing the cash part of its clients' investment portfolios, the Group deals with banks based on a number of factors, including their ratings and security as perceived in the market. The investment of these funds reflects the Firm's low risk appetite. The Firm uses the following established market custodians: HSBC plc, Euroclear and Co-funds.

The Firm uses the FSA's "CCR mark to market method" when calculating its counterparty credit risk. In accordance with the FSA's rules, the risk requirement is calculated by applying a specified multiple to the notional principal amounts. For the Group the relevant multiple is 6% (for contracts concerning equities with residual maturity of less than one year).

## (b) Market risk

The Group is not exposed directly to market risk, as it does not hold principal positions (except in limited circumstances on a matched principal basis) and has very limited exposure to currency risk. The impact of market cycles on the capital position of the Group is considered under Business Risk.

## (c) Liquidity risk

The Group currently has no material liquidity risk as it has: a relatively high level of cash by comparison with its capital resources; no bank borrowings (as at December 2008); and an agreed overdraft facility in place.

## (d) Operational risk

The Firm and FinnCap maintain separate Risk Assessments in which the operational risks faced by each company are considered in detail. The Firm currently undertakes back office and support services for FinnCap and the risks in these areas are therefore common to the Group.

The Firm considers that it has all reasonable controls in place, particularly in the segregation of duties in relation to cash and stock transfers (which are overseen by an Authorisation Committee), to protect it from the operational risks identified in its risk assessment. During 2009 the Firm's controls, in relation to its custodial activities, were reviewed by its auditors in accordance with Technical Release 01/06 of the Audit and Assurance Faculty of the Institute of Chartered Accountants.

The business operations of the Group (particularly at its London office) are at risk of disruption from one-off events, such as terrorism, flooding or fire. To counter this risk, the Firm has a Disaster Recovery Plan. The Firm also maintains off-site facilities and back-up computer systems for the Group with a third party provider, which are tested each year, and at its offices outside London. The Firm's insurance covers office loss and business continuity.

The Firm and FinnCap are BIPRU limited licence firms and consequently the FSA's rules on operational risk capital requirement do not apply.

## (e) Insurance risk

The Firm maintains Professional Indemnity ("PI"), Directors & Officers Liability ("D&O"), and Commercial/Office Insurance for the benefit of the Group. The policies, which are in market standard terms, cover the most likely sources of loss to the Group to a level that is proportionate to the scale of the Group's business. The policies are underwritten by insurers with consistently high credit ratings.

In the event that any of these policies do not pay out as soon as anticipated, the Group's existing regulatory capital resource requirement (which is based on its fixed overhead costs) and its access to bank borrowing mean that the Group is in a position to continue to operate. In the event that a particular loss falls outside the terms of its insurance, the Group's management will, where appropriate, make provision in the ordinary course of business for such potential losses as soon as is prudent.

Based on the policy excesses, additional capital of £125,000 has been allocated under the ICAAP to cover an exposure the Group may face outside the fixed overhead costs taken into account in its regulatory capital resource requirement.

## (f) Concentration risk

The Group has no material concentration of credit risk. The Firm has over 20,000 client accounts drawn predominantly from the UK private client sector. This is a large sector worth over £300 billion of which the Firm has over £3 billion funds under management (as at November 2009). FinnCap continues to reduce its concentration risk by increasing its retained clientbase.

## (g) Residual risk

The Group does not lend money; the vast majority of its debtors are trade debtors and it has very limited exposure to credit risk.

## (h) Securitisation risk

This risk is not relevant to the Group.

## (i) Business risk and stress testing

The Firm considers that the risk that it may not be able to carry out its current business plan and desired strategy derives principally from a drop in revenue due to:

- a fall in the equity markets;
- commercial pressure from competitors; or

- damage to the Firm's reputation, either through damage to the investment management market or to the Group individually.

As required as part of the Group's ICAAP, the Firm has conducted stress testing on its financial forecasts for both income and capital. The stress tests are based on a combination of adverse events including significant falls in the equity markets.

The testing shows that the Firm has the financial resources to continue to trade during such scenarios with capital resources in excess of its regulatory capital resource requirement. The Firm's management, which also represents its key shareholders, is well placed to take the necessary management action to protect the Firm's trading position.

However, there are a number of uncertainties as to the amount and timing of the cost cutting measures that the Firm's management could take in the stress test scenarios. The most material of these uncertainties is considered to be in relation to reducing staff costs. Based on the Firm's stress test models, the Firm has allocated additional capital of £350,000 under the ICAAP to cover a delay in, or the phasing of, the redundancies that would be necessary in the stress tested scenarios.

In addition, the Group has demonstrated by its strong performance in the 12-18 months to November 2009 that it is able to withstand the recent, significant falls in the equity markets.

#### (j) Interest rate risk

This risk is not relevant to the Group.

#### (k) Pension obligation risk

This risk is not relevant to the Group. The Firm wound-up its Defined Benefit Scheme in 2001 and has no residual liabilities to this scheme.

### Other disclosures

The Group does not use the VaR model for calculating its market risk capital requirement.

## 6. REGULATORY CAPITAL RESOURCES

### Group Regulatory Capital Resources

(As reported at 31 October 2009)

|  | (£'000)      |
|--|--------------|
| <b>Tier one capital</b>                              |              |
| Permanent Share Capital                              | 5,739        |
| Share Premium  | 814          |
| Staff Option Reserve                                 | 199          |
| Profit and Loss Account                              | 2,438        |
| Innovative Tier one instruments – minority interests | 653          |
| <b>Total Tier one capital</b>                        | <b>9,843</b> |
| <b>Deductions from Tier one capital</b>              |              |
| Investments in own shares                            | (19)         |
| <b>Tier one capital after deductions</b>             | <b>9,824</b> |
| Tier two capital                                     | 0            |
| Tier three capital                                   | 0            |
| <b>Group regulatory capital resources</b>            | <b>9,824</b> |
|  | <b>12.09</b> |



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