Pillar 3 Disclosure, Palomar Capital Mgmt LLP, FRN # 589092, May 2015, J. McDougall

Regulatory Context

The Capital Requirements Directive ('the Directive') of the EU establishes a revised regulatory capital framework across Europe governing the amount and nature of capital credit institutions and investment firms must maintain. In the United Kingdom, the Directive has been implemented by the Financial Conduct Authority ('FCA') in its regulations through the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU').

The FCA framework consists of three 'Pillars':

- Pillar 1: minimum capital amount that meets the firm's credit, market and operational risk;
- Pillar 2: firm must assess whether its Pillar 1 capital is adequate to meet its risks and is subject to annual review by the FCA; and
- Pillar 3: required disclosure of specified information about the underlying risk management controls and capital position.

The rules in BIPRU 11 set out the provision for Pillar 3 disclosure. This document is designed to meet our Pillar 3 obligations.

We are permitted to omit required disclosures if we believe that the information is immaterial such that omission would be likely to change or influence the decision of a reader relying on that information.

In addition, we may omit required disclosures where we believe that the information is regarded as proprietary or confidential. In our view, proprietary information is that which, if it were shared, would undermine our competitive position. Information is considered to be confidential where there are obligations binding us to confidentiality with our customers, suppliers and counterparties.

Scope and application of the requirements

Palomar is authorised and regulated by the Financial Conduct Authority and as such is subject to minimum regulatory capital requirements, and categorized as a limited licence firm by the FCA for capital purposes. It is an investment management firm and as such has no trading book exposures. The Firm is not a member of a group and so is not required to prepare consolidated reporting for prudential purposes.

Risk management

The Firm is governed by its partners who determine its business strategy and risk appetite. They are also responsible for establishing and maintaining the Firm's governance arrangements along with designing and implementing a risk management framework that recognizes the risks that the business faces. The Principals also determine how the risk our business faces may be mitigated and assess on an ongoing basis the arrangements to manage those risks. The Principals meet on a regular basis and discuss current projections for profitability, cash flow, regulatory capital management, and business planning and risk management. The Principals manage the Firm's risks though a framework of policies and procedures having regard to relevant laws, standards, principles and rules (including FCA principles and rules) with the aim to operate a defined and transparent risk management framework.

These policies and procedures are updated as required. Given the nature of our business, the Firm is mainly exposed to business risk and operational risk. Our approach is to have in place processes and controls that are commensurate with the scale of the business operation. Our assessment of business risk looks at a range of potential risks and we regularly assess the likelihood of these risks and any controls in place to mitigate our exposure. Our operational risk exposure is typical for a business of our size and nature and we have established controls in place to mitigate the risk exposure accordingly. The Principals have oversight of the operational risk of our business.

Regulatory capital

As of May 2015 the Firm's capital resource is more that 50% in excess of our requirements and consists entirely of Tier 1 capital and no deductions. Our Firm is small with a simple operational infrastructure. Its market risk is limited to foreign exchange risk on its accounts receivable in foreign currency, and credit risk from management and performance fees receivable from the funds under its management. The Firm follows the standardised approach to market risk and the simplified standard approach to credit risk. The Firm is subject to the Fixed Overhead Requirement and is not required to calculate an operational risk capital charge though it considers this as part of its process to identify the level of risk based capital required.

As discussed above the firm is a limited licence firm and as such its capital requirements are the greater of:

- Its base capital requirement of €50,000; or
- The sum of its market and credit risk requirements; or
- Its Fixed Overhead Requirement.

We have not identified credit risk exposure classes or the minimum capital requirements for market risk as we believe that they are immaterial.

The firm has calculated that the base capital requirement is greater than the fixed overhead requirement, and thus that €50,000 establishes its capital requirements and hence market and credit risks are considered not to be material.

UK Stewardship Code

Under Rule 2.2.3R of the FCA's Conduct of Business Sourcebook, the Firm is required to disclose the nature of its commitment to the UK Financial Reporting Council's Stewardship Code (the "Code") or, where it does not commit to the Code, its alternative investment strategy. Palomar pursues a systematic, quantitative investment strategy that does not result in it trading or investing in single equities. Consequently, while Palomar supports the objectives that underlie the Code, the provisions of the Code are not relevant to the type of trading currently undertaken by Palomar. If Palomar's investment strategy changes in such a manner that the provisions of the Code become relevant, Palomar will amend this disclosure accordingly.