Liquidity Finance LLP Pillar 3 disclosure

June 2017

Disclosure Policy

The Pillar 3 rules in BIPRU 11 set out the need for firms to have a formal disclosure policy. In accordance with the rules of the Financial Conduct Authority ("FCA") Liquidity Finance LLP (the "Firm") will disclose the information set out in BIPRU 11 (the Pillar 3 rule) on at least an annual basis.

The Firm may omit information it deems as immaterial, in accordance with the rules. Materiality is based on the criterion that the omission or misstatement of any information would be likely to change or influence the decision of a reader relying on that information. Accordingly where the Firm has considered an item to be immaterial it has not been disclosed.

In addition, if the required information is deemed to be proprietary or confidential then the Firm may take the decision to exclude it from the disclosure. In the Firm's view, proprietary information is that which, if it were shared, would undermine its competitive position. Information is considered to be confidential where there are obligations binding the Firm to confidentiality with our customers, suppliers or counterparties. Where information is omitted for either of these reasons this is stated in the relevant section of the disclosure, along with the jurisdiction.

Introduction

The Firm is authorised and regulated by the FCA and as such is subject to minimum regulatory capital requirements. The Firm is categorised by the FCA, for capital purposes, as a BIPRU €50k Limited Licence firm. It is an investment management firm and has no trading book exposures. The Firm is not a member of a group and is not required to prepare consolidated reporting for prudential purposes.

The FCA's current prudential regime can be split into three "pillars":

- Pillar 1 – prescribes the minimum capital requirements that authorised firms need to hold. This is the higher of €50k; a quarter of the firm's annual adjusted expenditure (the Fixed Overheads Requirement); or the sum of the firm's prescribed Credit risk + Market risk.
- Pillar 2 – requires firms to analyse the risks to the business and then consider whether the risks are mitigated to an appropriate standard. If the firm feels that the risks are not adequately mitigated then they should allocate capital against those risks. Stress and scenario tests are conducted to ensure that the processes,

strategies and systems are comprehensive and robust and that the allocation of capital is sufficient.
- Pillar 3 - requires firms to develop a set of disclosures which will allow market participants to assess key information about the Firm's underlying risks, risk management controls and capital position.

The Firm is a Limited Liability Partnership and its capital arrangements are established in its Members Agreement. Its capital as at March 31, 2017 is summarised as follows:

	£000's
Members' capital	1,500
Revenue reserves	3,580

Members' capital and other reserves	5,080
	====

The main features of the Firm's Capital Resources Requirement are as follows:

Capital Item	£'000s
Tier 1 capital	1,500
Total tier 2 and tier 3 capital	-
Deductions from tier 1 and tier 2 capital	-
Total capital resources, net of deductions	1,500

Risk Management

The Firm operates as a matched principal broker in fixed income OTC securities. It does not use its own capital and its risk appetite is low. Due to the size, nature, scale and complexity of the Firm, there is no independent risk management function. The Management Committee determines the business strategy and risk appetite along with the risk management policies and procedures. Risks to the Firm are identified and considered and the Firm's resultant exposure is assessed after the application of both management and mitigation of these risks. Furthermore the Firm then conduct a series of stress tests and scenario analyses on these risks to determine the effect they would have on the firm.

If necessary the Firm would allocate extra capital to the relevant risk, as per the Pillar 2 requirement: this has not been deemed necessary. This process is conducted at Management Committee's meetings which are held on a regular basis and the relevant policies and procedures are updated where necessary.

The Management Committee has identified Market, Credit and Operational risk as the main areas of risk to which the firm is exposed.

The Firm’s Market risk is limited to foreign exchange risk on its cash held in foreign currency. To some extent, it is mitigated by accounts payable in foreign currency.

Credit risk arises mainly from cash holdings, accounts receivable, intercompany balances with the Firm’s affiliates and deposit held with the clearing agent.

The firm follows the standardised approach to Market risk and simplified approach to Credit Risk.

Operational risk is the risk of a financial loss or reputational damage arising from a failure or inadequate internal systems, operational processes or human error. It is managed by a number of means, including documenting the Firm’s key policies and procedures, Compliance Monitoring Programme, periodic staff training, regular dialogue with the clearing agent, frequent reconciliation exercises, as well as having in place multiple check points covering all stages of broker transactions, from order taking to trade booking and settlement.

The Firm is subject to the Fixed Overhead Requirement. It is the Firm’s experience that the Fixed Overhead Requirement tends to exceed the capital requirement for Credit risk + Market risk, hence the Fixed Overheads Requirement determines the Firm’s Capital Resources Requirement.

As at March 31, 2017 the Firm has calculated its Fixed Overhead Requirement to be £505k in accordance with GENPRU 2.1.53, resulting in a surplus over its capital requirement of £995k.

Pillar 1 and Pillar 2

The Firm has undertaken an Internal Capital Adequacy Assessment Process (ICAAP) to determine whether it needs any further regulatory capital due to the risks set out above.

The Firm has concluded that its Tier 1 capital is sufficient to cover its Pillar 1 and Pillar 2 requirements.