

## BLUE OAR PLC PILLAR 3 DISCLOSURES DECEMBER 2008

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### Background:

The Basel II Accord has been implemented in the European Union through the Capital Requirements Directive ("CRD"). The CRD details the standard regulatory capital framework for the financial services industry within the EU and consists of three pillars:

- **Pillar 1** specifies the minimum capital requirements of firms to cover credit, market and operational risk;
- **Pillar 2** requires firms to assess the need to hold additional capital to cover risks not covered under Pillar 1; and
- **Pillar 3** requires a set of disclosures to be made which enable market participants to assess information on firms' capital, risk exposures and risk management procedures.

The Financial Services Authority (FSA) holds responsibility for implementing the CRD within the UK and has set out its minimum disclosure requirements in its handbook under BIPRU 11. The information set out below represents the Blue Oar plc Pillar 3 disclosures.

### Blue Oar Group Structure:

Blue Oar Plc ("BOP") is an investment banking and private client stockbroking and asset management business serving the investment needs of investors in the UK, Europe and the Asia Pacific region, offering the full range of institutional equity and a range of corporate finance services and private client stockbroking and wealth management services. The majority of the Group's underlying clients, by number, are retail investors but there is also a strong base of institutional and corporate clients.

The Group includes four entities within the scope of the CRD, Blue Oar Securities plc ("BOSP"), Rowan Dartington & Co Ltd ("RD"), Blue Oar Asset Management LLP ("BOAM") and Astaire. BOSP and RD are categorised as BIPRU €730k full scope firms, whilst BOAM and Astaire are BIPRU €125k limited licence firms.

- **Blue Oar Securities Plc**, is a niche institutional investment banking business with historically an emphasis on small and mid cap companies. BOSP offers a range of services across corporate finance, research and institutional sales.
- **Rowan Dartington & Co Limited**, is a private client stock broker and wealth manager offering bespoke private client stock broking and asset management services to private clients, trusts, charities and small businesses.
- **Blue Oar Asset Management**, is a fund management business currently managing two funds with a range of retail and professional clients.
- **Astaire**, is a stock broking partnership which offers a comprehensive range of traditional stock broking services to a broad range of clients both within the EU and around the world.

As BOAM and Astaire are not full scope BIPRU investment firms, neither is required to calculate an operational risk capital requirement under BIPRU 6, but instead they are both required to calculate a fixed overhead requirement in accordance with GENPRU 2.1.53 R. The Pillar 3 disclosures below relate to the two BIPRU firms only, being BOSP and RD.

For accounting purposes, the consolidated group of Blue Oar plc prepares accounts on a fully consolidated basis under International Financial Reporting Standards (“IRFS”).

## **Risk Management:**

Blue Oar Plc has adopted and refined a risk management methodology and process which continues to embed within the group. Coupled with the Group’s governance arrangements, the enhanced risk management procedures are considered appropriate to the size, nature and complexity of Blue Oar. Blue Oar’s governance arrangements are consistent across the group and are characterised by defined reporting lines and committee structures.

In conjunction with preparing the first version of the ICAAP statement, Blue Oar developed its enhanced risk assessment methodology and process. This has continued to evolve alongside the Group risk management strategy, policy, appetite, and monitoring framework. Each has been implemented at Group level and has filtered across all the business functions of the Group. Central to the ongoing process of managing risks within the group lies with apportionment of the key risks to senior management and the regular assessment of these through self certification. The ongoing monitoring of the risks is carried out through the Risk Monitoring Programme and both the findings of this testing and the returns from senior management are reported to the Risk Committee for consideration and action.

As part of embedding the new risk management framework, the Risk Committee continues to review the most appropriate process for management information that will support a robust risk and loss reporting process, which informs functional senior management on the risk management performance of the organisation. The Blue Oar Board receives and review information regarding the management of risk on at least a quarterly basis.

The Board sets the Group’s risk appetite. It is reviewed at least annually or as and when the ICAAP is updated or amended. This is presented to, and approved by the Board.

Blue Oar has considered each of the risk categories identified within GENPRU 1.2.30 and other risks identified by the group. Operational and Business risks have been assessed as the core risks to Blue Oar's business

**CREDIT RISK** is the current or prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the institution or its failure to perform as agreed.

Blue Oar has limited exposure to this risk category as the Group's credit risk exposure mainly relates to:

- Short term deposits held with highly rated banks.
- Fees accrued or invoiced, but not received.

Blue Oar is exposed to credit risk which may arise from short term deposits held with UK clearing banks, however this risk is mitigated through the use of only highly rated UK based banks. Although default has become more common in current times, the recent measures taken by the UK Government has provided a level of comfort.

**MARKET RISK** is the current or prospective risk to earnings or value arising from adverse movements in equity and commodity prices, interest and/or foreign exchange rates. This risk can arise from open positions in bonds, securities, currencies, commodities, or derivatives. This risk includes foreign exchange risk, defined as the current or prospective risk to earnings and capital arising from adverse movements in currency exchange rates.

Blue Oar is currently a 'Full Scope' group by virtue of its permissions; however it does not generally deal for its own account and only on rare occasions takes a principal position. Therefore the group does not have market risk of any significance. It manages assets for client portfolios. The impact of market movements on managed assets is considered comprehensively under business risk.

**OPERATIONAL RISK** can be defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. For operational risk measurement purposes, this definition includes legal/compliance risk/ financial crime risks, which is the risk of loss resulting from a failure to comply with laws, contractual obligations and prudent ethical standards. The definition also includes the exposure to litigation from all aspects of the firm's activities.

Reputational risk will be treated as a consequential risk arising from the crystallisation of other risks, rather than be treated as an independent risk. As such, reputational risk is also covered under operational risk.

Blue Oar seeks to mitigate operational risk to acceptable residual levels, in accordance with its risk appetite policy, by maintaining a strong control environment, which is managed through the group's Risk Management framework.

In assessing operational risk under Pillar 2, consideration was given to each of the areas where risk arises, which comprise loss of key staff, failure in the trading cycle, sanction from the regulator resulting from the failure to meet obligations, failure in the IT infrastructure, inadequate business continuity planning and likelihood of failure or weakness in the systems and controls procedures for the prevention of Market Abuse.

The likelihood and quantification of any risk crystallising was assessed, taking into account Blue Oar's past experience. A potential loss value was then calculated, which is considered to represent an adequate amount to be held as Pillar 2 capital.

**BUSINESS RISKS** arise from changes to a firm's internal and external environment and includes the risk that the firm may not be able to carry out its business plan and desired strategy.

Blue Oar has assessed that the key business risks relate to the failure to adopt an appropriate business strategy or failure to deliver it. By its nature this represents the single largest risk to the business. Additionally, the failure to adapt strategy to take account of economic conditions and in particular recessionary conditions will pose a potentially critical risk.

Blue Oar has stress tested its financial forecasts, take account of the key business risks and the findings show that the Group has the financial resources to continue to trade during a severe recession scenario with capital resources remaining in excess of its regulatory capital resource requirement. Additionally Blue Oar has an experienced Board which is well placed to take the necessary management action to protect the Group's trading position during a prolonged and deep recession.

However it is accepted that in such uncertain times, it may be necessary to hold additional capital with which to provide short term cover whilst a cost cutting strategy can be fully implemented. As a result Blue Oar has allocated additional capital of £76,000 to cover under the ICAAP to cover this.

**INTEREST RATE RISK** is the potential impact of adverse movements in interest rates in non-trading book and the impact these have on planned future cash flows.

Blue Oar has no outstanding loans or debt and a strong cash flow therefore it is not subject to interest rate risk in terms of additional charges that may arise from increasing rates. Interest income does not form a significant part of the group's revenue and as such any significant drop in interest rates would not represent a material risk to the Group's revenues.

**INSURANCE RISK** is the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities.

Blue Oar is not in the business of writing insurance policies and does not underwrite insurance. The inherent impact value therefore represents the policy excess under our own existing insurance arrangements.

**RESIDUAL RISK** is the risk that recognised risk measurement and mitigation techniques used by the credit institution prove less effective than expected.

Blue Oar does not accept any form of collateral in the normal course of its business.

**SECURITISATION RISK** is the risk that the capital resources held by a firm in respect of assets which it has securitised are inadequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved.

Blue Oar does not have securitised assets and does not intend to securitise any assets for the foreseeable future.

**PENSION OBLIGATION RISK** is the risk to a Group caused by its contractual or other liabilities to or with respect to a pension scheme. It also means the risk that the Group will make payments or other contribution to or with respect to a pension scheme because of a moral obligation or because the Group considers that it needs to do so for some other reason.

Blue Oar does not have a defined benefit pension scheme and as such is not exposed to the risks associated with the valuation of future pension liabilities. Therefore this is not a relevant risk.

## Capital Adequacy

Capital is held within the Group to provide cover to the residual risks which remain following the risk mitigation process.

To ensure the Group's capital adequacy is sufficiently robust to withstand adverse macro economic conditions management have analysed the impact of different scenarios. By taking into consideration global events and experience, we have assessed the Group's ability to sustain losses resulting from the occurrence of extreme events outside the control of the Group. Management have identified three extreme risk scenarios and evaluated the Group's capital adequacy under each of these. The assessment has been undertaken to ensure that under such severely distressed conditions, the Group and its underlying businesses would still be able to adequately meet their capital requirements.

The key elements of our work comprised:

- Consideration of the Group's strategy, financial position and plans for the future.
- Analysis of risks.
- Assessment of mitigating controls and management actions to control and limit the impact of risks.
- Scenario analysis to review adequacy of capital in adverse scenarios.
- Assessment of Pillar 2 capital requirement.

## Capital Resources

As at 31 December 2008,

Capital Forecast 2009 (£ 000s)	Blue Oar Plc Consolidation Group	Blue Oar Securities Plc	Rowan Dartington & Co. Ltd	Astaire & Partners Ltd	Blue Oar Asset Management LLP	Inteq
Regulatory Capital available	14,905	4,453	4,746	913	348	806
Pillar 1 Capital requirement	4,244	1,788	1,373	444	120	403
Pillar 2 "add on" - based on ICG	637	268	206	67	18	60
Total Capital Requirement	4,881	2,056	1,579	511	138	463
Surplus Regulatory capital	10,024	2,397	3,167	402	210	343
Capital adequacy ratio	305%	217%	301%	179%	252%	174%

## **ICAAP and Future Disclosures**

The Blue Oar Plc approach to assessing the adequacy of its internal capital to support its current and future activities is documented in its Internal Capital Adequacy Assessment Process ("ICAAP"), which includes an assessment of the key risks to which the Group is exposed and details the internal controls which exist to mitigate those risks. This is then stress-tested against various scenarios.

As part of its ICAAP process the Group has reviewed its current and proposed business model and determined that its current categorisation as driven by its current permissions and standard limitations remains appropriate for its business model and its capital requirements.

The conclusion reached following the establishment of the Group's ICAAP was that there would be an additional capital requirement over and above the level specified under Pillar 1. The Pillar 2 capital add-on calculated related mainly to business risk and there was a small figure in respect of liquidity risk and insurance risk. Whilst the Group continues to consider operational risks to be a key area of risks, these are considered to be adequately covered by the operational risk calculations at Pillar 1. It should be noted that following the FSA's review of the initial ICAAP in January 2008 and subsequent ARROW visit in March 2008, an ICG (Individual Capital Guidance) add on was imposed to replace the Pillar 2 add on referred to above. The ICG provides for a 15% add on to Pillar 1.

Blue Oar Plc will review their ICAAP at least annually and will be amended where appropriate to take account for changes. Additionally a review will be conducted if there are any significant changes to the business profile and strategy of Blue Oar or its subsidiaries. Any changes to the ICAAP will be presented to the Board for approval and any subsequent Pillar III Disclosures will be made.

Pillar III Disclosures will be published on the Blue Oar Plc website, [www.blueoar.co.uk](http://www.blueoar.co.uk)