IRISH LIFE INVESTMENT MANAGERS LIMITED (“ILIM”)

Capital Requirements Directives - Risk Management disclosures

2018

Background

The European Union (EU) Capital Requirements Directive ("CRD") implements the Basel capital adequacy framework (Basel II) and applies it to investment firms, authorised under MIFID. The CRD was formally adopted by the EU on 14 June 2006, and became effective in the Republic of Ireland on 1 January 2007.

The CRD is organised around three "pillars" which the Basel Committee considers to be complementary.

Pillar 1:

Minimum Capital Requirements

Pillar 1 involves calculating a minimum regulatory capital requirement using one of several standard methodologies dependent on activities carried on by the business.

Pillar 2:

Supervisory Review Process ("SRP") comprising:

The Internal Capital Adequacy Assessment Process ("ICAAP")

The ICAAP requires firms:

(i) to identify, measure and monitor its risks
(ii) to identify the internal/economic capital requirements in relation to the firm's risk profile

The Supervisory Review and Evaluation Process

This is the Central Bank of Ireland's process to review the firm's ICAAP and the adequacy of the Economic Capital identified.

Adherence to the SRP ensures material risks are identified and managed.

Pillar 3:

Enhanced Market Disclosure

Pillar 3 encourages market discipline whereby a firm develops disclosure requirements which allow market participants to assess key information on a firm's capital, risk exposures and risk assessment processes.

Capital Requirements Regulation ('CRR')

Capital Requirements Regulation ('CRR)' – Regulation (EU) No 575/2013 – as a regulation introduced in Europe is directly applicable in Ireland from 01 January 2014

On 31st March 2014, the Minister for Finance, Mr. Michael Noonan T.D., signed into Irish law two regulations. The European Union (Capital Requirements) Regulations 2014 give effect to the Capital Requirements Directive (Directive 2013/36/EU) (**CRD IV**) and the European Union (Capital Requirements) (No. 2) Regulations 2014, give effect to a number of technical requirements in order that the CRR can operate effectively in Irish law.

Investment firms authorised for dealing on own account and/or underwriting or placing on firm commitment basis are initially captured by CRR which does not apply to ILIM.

Certain MiFID firms previously captured under the previous CRD definition of 'investment firm' are no longer captured under the CRD IV definition.

CRD IV exempt firms' are those that are not authorised to hold client money, are not authorised for the MiFID ancillary service of safekeeping and administration, and are only authorised for a combination of MiFID investment services: reception and transmission of orders, execution of orders, portfolio management and investment advice.

The Central Bank of Ireland have exercised their discretion to set capital requirements for certain of those CRD IV exempt firms as those that were previously applicable under CRD III.

ILIM is not an "investment firm" as defined for CRD IV but is still subject to CRD III requirements.

In order to achieve this exempt status, ILIM's authorisation to hold client assets and to provide the ancillary service of safe keeping and administration of financial assets was revoked in 2014.

As ILIM is a CRD IV Exempt Firm it is not required to perform a Pillar 3 disclosure. However, ILIM has continues to disclose certain information to maintain transparency of its key information under the directives.

Principal Activities

The Company manages assets on behalf of a wide range of institutional clients, including Irish Life Assurance plc, pension schemes, large multinational corporations, charities and domestic companies.

At end September 2018, the Company managed €70.5bn worth of assets.

Risk Management Objectives and Policies

Risk Governance

The key components of ILIM's risk governance framework are as follows:

ILIM's Board is responsible for the governance of risk in the Company and for establishing mechanisms and structures to control and manage this risk.

The day to day management of the business is delegated to the ILIM Executive Management Team. The ILIM Executive Management Team ("EMT") has a formalised governance structure in place with monthly meetings, focusing on the operational agenda for the business and special meetings focussed on the strategic agenda for the business. In addition the Executive Management Team meets weekly to review the on-going developments in the business.

The members of the EMT are the:

- Managing Director
- Chief Investment Officer
- Head of Compliance and Business Risk
- Director – Global Institutional Distribution
- Director – Wealth and Corporate Distribution
- Head of Funds Platform & Development
- Head of Quantitative Strategies
- Director - Strategy, Change and Finance
- Head of IS and Operations.
- Head of Human Resources

The risk management for the assets under management is overseen by the Fund Management Executive ("FME") which is responsible for monitoring the fund mandates, reviewing performance of funds versus benchmarks, reviewing the output from quantitative models and overseeing the fund management operations including the implementation of best execution policies and the implementation of mandate and house rules on the fund management systems. The monthly fund management report for the Executive Management Team includes updates from the Fund Management Executive.

The Operational Risk Steering Committee ("ORSC") exercises authority delegated to it by the ILIM Executive Management Team to provide governance to the management of operational risk within Irish Life Investment Managers ("ILIM"), and to monitor operational risk levels across ILIM are in line with ILIM's stated risk appetite.

As such ORSC is intended to ensure:

- ILIM has a culture that encourages open discussion of risk and emerging issues, and for fostering an awareness of operational risk management in the organisation
- ILIM management have an overall view of, and responsibility for the effective implementation of operational risk management
- Cross functional review and assessment of the implications of business and macro related change activities and incidents.
- A representative forum exists in ILIM to discuss all aspects of operational risk incidents which allows for open and forthright discussion of operational risk events.

The membership of the ORSC consists of senior management representatives from all the business areas and is supported the Business Risk function.

The ORSC's principal objectives are:

- To establish formal incident reporting policies and procedures, and to monitor errors, near misses and any resultant changes to procedures;
- To approve the design and monitor those key risk indicators (KRIs) which relate to ILIM's material operational risks and approve the quarterly indicators that are reported to the Group Operational Risk Committee (GORC);
- To review and approve the output, including calculated capital, from the first line assessment reported in the quarterly operational risk assessments (RCSA);
- To assess the reporting output, and commitments from first line in relation to the control testing performed by ILIM Business Risk;
- To sign-off Operational Risk Assessments (ORAs) for significant new product, platform or client introductions;
- To ensure sufficient permeation of the statement of ILIM's Risk Appetite to first line teams that it represents;
- To consider any implications of the output from audit activity and significant issues or themes arising;
- To consider the implications for ILIM that arise from changes in the macro environment;
- To provide a forum for the prioritisation and review of ILIM's existing and emerging material operational risks;
- To implement all relevant and appropriate Group Policies relating to Operational Risk, and report

relevant information relating to operational risk in ILIM to Group Operational Risk;

- To ensure that ILIM maintains a robust and accurate internal capital adequacy assessment process (ICAAP). Including the development, review and approval of operational risk stress tests.
- **To proactively monitor outsourcing risk in line with the Outsourcing Policy**
- **To consider any operational risk implications of the output from the business continuity programme and significant issues or themes arising**

In line with best practice the governance structure is based on the three lines of defence model of risk management. In this model the 1st line of defence resides in the business units, Risk Management and Compliance operates as part of the 2nd line of defence, and the Internal Audit function form the 3rd line.

Reporting lines of ILIM Compliance and Business Risk ensure independence from the business, provide improved reporting to the group and ensure consistency across the Irish Life group's second line monitoring functions. The maintenance of dotted line reporting into the divisional Managing Director by ILIM Compliance and Business Risk, and the continued location of this function in the business division itself is designed to maintain the business partnership role.

The Group Internal Audit function is the firm's 3rd line of defence and is separate and independent from the other functions and activities within ILIM and the group. Group Internal Audit reports directly to the ILGL Board of Directors through the ILGL Board Audit Committee for audit assurance purposes and to the Irish Life Group Chief Executive for administrative purposes.

Group Internal Audit also report to the ILIM Board. Internal Audit is responsible for carrying out a risk-based independent assessment of the adequacy, effectiveness and sustainability of Irish Life Investment Manager's governance, risk management and control processes. Internal Audit meets with ILIM management to discuss audit plans and to ensure they capture emerging risks in the business.

The findings and resultant actions from internal audit reports are agreed with management before reports issued. Internal Audit reports are issued to senior management in ILIM as well as senior management in the wider group. A database of agreed actions is maintained by the business risk unit and actions are monitored against agreed implementation dates.

The business risk unit update the Central Bank on agreed audit actions. Internal Audit meet with the Executive Management Team on a quarterly basis to update management on audits undertaken, progress on findings and any trends identified across the group.

An operational incident event reporting policy is employed in ILIM to capture and record all operational incidents and ensure controls and processes are updated to mitigate any risk that is highlighted by an Operational Incident. These incidents are reviewed at the ORSC meetings.

ILIM has implemented a formal risk assessment process where all client and portfolio activity, new services/funds and platform initiatives pass through the "On-boarding" process. Formal risk assessments are completed on all new services/funds (which require new business processes or systems) with executive management team or ORSC sign-offs as required.

ILIM benefits from the additional oversight from the Irish Life Group with operational risk and key risk indicators reported to the Group Operational Risk Committee (GORC). The ILIM Managing Director and the Head of Compliance and Business Risk are members of the GORC.

Job profiles for all staff in ILIM include responsibility for mitigating risks.

Risk Assessment

ILIM in accordance with the Group Operational Risk Policy carries out a Risk and Control Self-Assessment on a quarterly basis. This process is used to identify strategic/business and operational risks.

Each of the business areas is involved in completing the Risk and Control Self-Assessment. These assessments are facilitated by Business Risk function.

Significant operational risks are identified based on detailed reviews of the business supplemented by reference to industry information and emerging market trends. Significant risks are reviewed by senior management and by the ORSC on a quarterly basis. The significant risks are approved by the ILIM ORSC each quarter. ILIM uses the OneSumX system to record the risks and their associated mitigating controls and actions.

The significant operational risks are quantitatively assessed by reference to likelihood of incidence and impact criteria and are recorded on OneSumX, including the direct and indirect financial impact and reputational impact.
OneSumX in turn takes the three scores into account to calculate the Planned Residual Risk (PRR) rating which can be low, medium, high or very high. The output from this evaluation is used to identify the potential costs of significant operational risks for the Company and feeds into the Pillar 2 capital assessment.

Control procedures (and action points if appropriate) are also identified for each risk. The Business Risk function carries out a testing programme to verify the design and effectiveness controls.

The significant operational risks identified for ILIM fall under the following categories:

- Implementing Client Mandates
- Fraud/Financial Asset Loss
- Legal & Regulatory
- Human Resources
- Business Processes
- Dependence on key providers
- Information Technology
- Pricing of Client Funds
- Business Continuity
- Model Risk
- Financial Reporting

In 2018 the risk assessments considered emerging risks to the business as result of developments in the business and other external factors.

In 2018 the business considered emerging risks under the following:

- Pension reform
- Mandatory Pensions in Ireland
- Market risks
- Geopolitical risks
- Brexit
- Resource constraints
- Pan-European funds
- New competition sources
- Impact of nascent technologies

The non-operational risks identified for the business fall under the following categories:

- **Market Risk**
- **Client Concentration**
- **Credit Risk**
- **Liquidity Risk**

Market Risk

The Company is not authorised and does not trade on its own account and therefore does not carry any market risk in respect of its own business.

Credit Risk

Credit Risk is defined as "*the risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the company or its failure to perform as agreed*". ILIM does not trade on its own account and has minimal credit risk. ILIM is exposed to counterparty credit risk where the firm's capital has been invested in liquid assets (cash deposits). The Company has assessed the exposure to credit risk as part of Pillar 2 capital assessment.

Operational Risk

Operation Risk is defined as "*the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events*". The Company has extended this definition to include damage to reputation as a result of operational risk failures (i.e. the current or prospective risk to earnings and capital arising from adverse perception of the image of the Company on the part of customers, counterparties, shareholders, investors or regulators). Material operational risks are identified by risk assessment process detailed above.

Pillar 1 considers the Credit Risk, Market Risk and Operational Risk of an institution. Since ILIM is not authorised to trade on its own account, or underwrite at entity level, there is no requirement for ILIM to set aside additional regulatory capital for operational risk under Pillar 1 of the CRD. Capital requirements for operational risk are identified under the ICAAP (Pillar 2) assessment.

Other Risks

As an asset management company, the Company also has exposure to business/strategic risk.

Business risk is defined as "*the risk to earnings and capital in the short run (< 1 year) due to unforeseen changes in the competitive environment or failure to manage positive earnings performance*".

Strategic risk is defined as "*the risk to earnings and capital arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment. This is regarded as commencing more than one year in the future*."

If the economic environment is such that asset values fall, this would translate into reduced management fees for the Company. A reduction in regular investment inflows or an increase in outflows of investments would also impact management fees adversely.

The ICAAP has stress tested adverse scenarios and has determined that there is no requirement to provide for additional economic capital for ILIM business risk.

Capital Resources and Capital Adequacy

The Company's regulatory own funds as at 31 December 2017 is made up of the Ordinary Share Capital, the Profit and Loss reserve account, a Capital Contribution reserve account and a Capital Conversion reserve fund. Where applicable, current year losses are taken into account. At 31 December 2017 and during the previous 12 months, the Company complied with all externally imposed capital requirements and held a buffer over and above the minimum regulatory capital requirements.

ILIM's core capital objective is to meet or exceed all relevant regulatory capital requirements and to hold sufficient economic capital to withstand a plausible worst case loss in economic value due to risks arising from business activities. It is the Company's policy to maintain a strong capital base commensurate with its risk appetite and to hold a buffer over and above the minimum capital requirement. ILIM is regulated by the Central Bank of Ireland which sets and monitors regulatory capital requirements in respect to the Company's operations.

ILIM's Pillar 1 capital requirements are set in accordance with the Capital Requirements Directive (CRD 2006/49/EC). The capital requirement of the Company is currently calculated using the "Expenditure Requirement" methodology. This is the requirement under Regulation 19 of S.I 660 of 2006 for investment firms to hold own funds equivalent to 25% of their preceding year's fixed overheads less depreciation. Capital levels calculated using the Expenditure Requirement currently exceeds Economic Capital levels assessed under the ICAAP.

The Company's capital requirement in 2018 is €10.8m, the eligible own funds for solvency purposes reported to Central Bank of Ireland in September 2018 was €33.7m.

Formal procedures are in place to monitor and manage capital resources on an active and timely basis. Responsibility for ongoing monitoring of capital adequacy rests with the Finance Team, and Quarterly reports are signed off by Senior Management. Periodic reports are prepared and distributed to the ILIM Board.

As of the assessment date, Senior Management of the Company was of the opinion that there are adequate resources and contingency in place to support current and foreseeable activity.

Internal Capital Adequacy Assessment Process ("ICAAP")

Under Pillar II of the CRD, the Company is required to undertake an ICAAP, which is an internal assessment of capital requirements. This is undertaken annually or more frequently if required.

In implementing the ICAAP, an Internal Capital Assessment (ICA) has been prepared by ILIM. This ICA documents the ICAAP within the Company.

The ICA is presented to the board of the Company for formal review and approval. The data and assumptions used in the assessment of risk and capital adequacy are continually assessed and updated. Should new risks materialise or be identified by the Company, then these risks will be reviewed in the overall process. The most-recent formal ILIM Board review of the ICA was in November 2018.

Further Information

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