

# AJ Bell Group – Capital Requirement Regulation (CRR) Part Eight Disclosure

January 2018

## 1 Overview

### 1.1 Introduction

The European Union Capital Requirements Directive third Amendment (CRD IV) came into effect on 1 January 2014. It introduced consistent capital adequacy standards and an associated supervisory framework in the EU based on the Basel II rules agreed by the G-10.

Implementation of the Directive in the UK was by way of rules introduced by the Financial Conduct Authority (FCA), and through the Capital Requirements Regulations (CRR) from the European Banking Authority (EBA). Among them are disclosure requirements applicable to investment firms under rules known as Disclosure by Institutions (Articles 431 to 455 of the CRR), replacing the previously used 'Pillar 3'. These are designed to promote market discipline by providing market participants with key information on a firm's risk management processes, risk exposures and capital. The CRR disclosure also aims to complement the minimum capital requirements described under Pillar 1 of Basel II, as well as the supervisory review processes of Pillar 2.

This disclosure document has been prepared by the AJ Bell Group (the 'Group') in accordance with the requirements of Part Eight of the CRR, and is available in the 'Investor relations' section of the Group's website ([www.ajbell.co.uk](http://www.ajbell.co.uk)).

### 1.2 Scope

The CRR rules governing disclosures state that the Group may omit one or more of the disclosures, provided the disclosure omitted is not material (Article 432 (1)). The Group may also choose not to disclose information if it is proprietary or confidential, however, it must state if any such items have been omitted (Article 432 (2)), with the exception of Risk Management Objectives and Policy (Article 435 (2) (C)), Own Funds (Article 437) and Remuneration Policy (Article 450).

AJ Bell Holdings Limited (AJBHL) is a Parent Institution of a group regulated by the FCA. The Group, excluding AJ Bell Media, is supervised by the FCA on a consolidated basis. In addition, there are four subsidiaries directly regulated by the FCA:

AJ Bell Securities Limited (AJBSL) is classified as a limited licence IFPRU 125k Investment Firm and the required parameters are set out in the FCA handbook (IFPRU 2.2). AJBSL does not trade on its own account and operates on an execution-only basis with limited advisory permissions. It does not provide personal recommendations. AJBSL is a significant IFPRU firm and as a consequence, in addition to reviewing the adequacy of the individual Internal Capital Adequacy Assessment Process (ICAAP) at least annually, the firm is required to submit the results of its stress and scenario testing to the FCA within six months of its annual reporting date (30 September).

AJ Bell Management Limited (AJBML) is authorised by the FCA to establish, operate and wind-up personal pension schemes, and acts as the administrator to all the Group's Self-Invested Personal Pension schemes (SIPPs). It is subject to the requirements set out in the Interim Prudential sourcebook for Investment Businesses. With effect from 1 September 2016 a new capital framework for SIPP operators was implemented, as set out in FCA Policy Statement 14/12 and the Personal Pension Scheme Operators (Capital Requirements) Instrument 2014. As a minimum, AJBML will always hold the amount of capital required by the 2014 instrument, recalculated at the end of each calendar quarter.

AJ Bell Asset Management Limited (AJBAML) is an investment management company, authorised by the FCA to provide investment management services to professional and retail clients and provide investment advice to eligible counterparties and professional investors. It may control but not hold client money. It acts as investment manager to a number of FCA regulated funds. AJBAML is classified as a Limited Licence BIPRU 50k Firm and is subject to the provisions of the Capital Requirements Directive IV, comprising the CRD and the Capital Requirements Regulation (CRR), and the required parameters as set out in the FCA handbook (BIPRU).

AJ Bell Investments LLP (AJBI) is currently classified as a Limited License BIPRU 50k Firm. AJBI will relinquish its permissions during 2018 as all permissions and requirements have been adopted by AJBAML.

The accounting consolidation for the annual financial statements includes all entities controlled by AJBHL. A list of the principal Group subsidiaries can be found in Note 4 of the Notes to the Company financial statements in the 2017 Annual Report and Financial Statements of the company.

Apart from the requirements to hold regulatory capital in individual regulated entities and corporate law restrictions on the reduction, redemption and purchase of share capital, there are no practical or legal impediments to the prompt transfer of capital between AJBHL and its subsidiaries.

### **1.3 Basis and frequency of disclosures**

The Group's capital assessment will be informed by the Group's ICAAP, which is kept under review and subject to formal revision at least annually. Future disclosures will be issued on an annual basis and published as soon as practicable after the publication of the Group's annual report and accounts.

### **1.4 Verification of disclosure**

Disclosures will only be subject to external verification to the extent they are equivalent to those taken from the audited annual financial statements. These disclosures explain how the Board has calculated certain capital requirements and information about risk management. They do not constitute financial statements and should not be relied upon in making judgements about the Group.

## **2 Risk management objectives and policies (Article 435)**

### **2.1 Risk appetite**

#### **2.1.1 Objectives of risk appetite statement**

At a high level, the Group has defined its risk appetite as representing the amount and type of risk it is prepared to seek, accept or tolerate in the course of achieving its strategic objectives. As an example, given the nature of its business model and strategy as documented in the AJ Bell Way, the Group does not actively seek either credit risk or market risk as a lever for increasing revenues.

At a lower level, a balanced mix of qualitative and quantitative measures are employed together with more granular tolerances and thresholds, where appropriate, to assess individual risks against the Group's risk appetite.

The risk management framework embodies the policies, procedures and systems that the Group has implemented to identify, manage and mitigate its risks.

With the risk appetite in mind, the Group has designed an appropriate control environment incorporating senior management arrangements, organisational structures, combined assurance framework, senior management reporting and monitoring systems together with the necessary financial, operational, HR and IT/Projects policies, procedures and systems. The resulting framework is reviewed, at least annually, by the Risk & Compliance Committee (RCC), a sub-committee of the Board, and by the Executive Management Board (EMB), to ensure it is appropriate in the context of the Group's material risks and its stated risk appetite.

The Group adopts a 'top-down' and 'bottom-up' approach to the identification of risks. EMB and the Board have identified the high impact top risks that could impact the ability of the business to meet its strategic objectives, and these are reviewed against the Group's risk appetite statement on an ongoing basis by the RCC and Executive Management Assurance Committee (EMAC), a sub-committee of the EMB chaired by the Chief Risk Officer (CRO). The high impact top risks are also reviewed as part of the business planning process each year.

In addition to these high impact top risks, the Group maintains a register of 'bottom-up' risks, comprising the following:

#### **α) Departmental risk registers**

The Group Risk Register is maintained and managed using the RSM risk software 4Risk. It is maintained by the Risk Function, supported by the CRO and RMC. These risk registers are largely service-led and focused on the day-to-day departmental operations, procedures and any potential impact on consumer outcomes. Individual risks are owned by the senior manager for each functional area and the name of the risk owner is shown in the risk register. The purpose of the risk register is to consistently facilitate:

- a mechanism for recording and identifying individual risks at a granular level
- a methodology for considering individual impacts, probabilities, gross risks, control strengths and resulting net risks on a relative and qualitative basis
- a mechanism for identifying risks that are currently outside risk appetite and the agreement of an action plan to bring the risk back within appetite
- a review tool for RMC to assess the impact of risks which have crystallised in the month;
- a means for prioritising outstanding risk related actions (e.g. strengthening controls)
- a means for recording risk and control amendments, including the uploading and storing the evidence of closure of Corrective Action Plans
- a means for recording risks that have been "accepted" through the risk acceptance process where additional controls or mitigating actions are not possible or would not provide sufficient risk controls for the costs

- a means for linking bottom-up risks with the High Impact Top Risks and the Risk Appetite Categories
- a means for recording new risks emerging and assessing any implications on risk tolerance, risk appetite and capital allocation
- a means for horizon scanning for potential future risks
- a means for reviewing the Group's understanding of its previously identified risks (e.g. probability and impact of operating losses) and assessing the implications of any amendments to net risk scoring and consequential impacts on risk tolerance, risk appetite and capital allocation

The Group Risk Register is managed by the Risk Management Function, reporting into the RMC, and therefore provides a link between the bottom-up granular approach to risk management and the top-down setting of risk tolerance, risk appetite and capital allocation, if applicable.

### b) Product risk registers

The Group's product risk registers are maintained by the Product Management Teams, comprising individuals appointed by the Product Owner. These risk registers are largely focused on marketing and product design aspects of the individual product life cycles and identification of those product-specific risks that have the potential to deliver poor consumer outcomes. Any risks outside appetite, or other identified issues, are subject to escalation to the EMB by the Product Owner. Second line of defence oversight is achieved through Risk and Compliance representatives attending Product Management Team meetings and monthly reports to the RMC and quarterly reports to RCC.

### c) Project risk registers

For all significant projects, the Group maintains project risk registers. These are maintained by the Project Manager appointed by the Project Sponsor. In addition to project delivery risks, these risk registers are focused on the changes to the design of individual products and any potential impact on consumer outcomes. Any issues are subject to escalation to the Project Portfolio Meeting, which is a sub-committee of the EMB responsible for the approval and prioritisation of projects and business change. Second line of defence oversight is also achieved through Risk and Compliance team representation at project meetings.

### Methodology for assessing risk exposure

All of the risks identified are collated in the Group's risk registers and scored according to impact and probability to provide the gross risk exposure. The current controls and risk management/mitigation strategy are then considered and the controls assessed as highly effective, mostly effective, partly effective, or mostly ineffective to provide the net risk exposure. The assessment methodology is described below and set out in more detail in the Group Risk Management Policy.

Individual risk assessments are carried out by the managers responsible for each functional risk area. The RMC representative for that area is initially responsible for reviewing and challenging each such assessment, with the Risk Manager and RMC providing further challenge.

The metrics for the gross assessment of risks used throughout the Group are set out below:

Probability & impact matrix								
Probability	Timescales	Probability	Impact					Probability
	Imminent	90%	5	10	15	20	25	
Within 12 months	70%	4	8	12	16	20		
Between 1 and 3 years	50%	3	6	9	12	15		
Within 3 years	30%	2	4	6	8	10		
Within 5 years	10%	1	2	3	4	5		
% of risk appetite			Below 6.25% of risk budget	6.25% of risk budget	12.5% of risk budget	25% of risk budget	50% of risk budget	
<b>Impact</b>								

Probability and impact are considered independently on a Gross, or inherent, basis, then multiplied to arrive at the Gross Position within the Probability and Impact matrix.

The current controls and risk management/mitigation strategy are then considered and the controls assessed on their ability to reduce impact or likelihood (or probability).

Impact-reducing controls are assessed on their ability to reduce the impact of a risk should it occur, and could be detective or preventative in nature.

Likelihood-reducing controls are assessed on their ability to reduce the likelihood of a risk occurring, and could be detective or preventative in nature.

Controls are assessed as being Fully Effective, Highly Effective, Mostly Effective, Partially Effective, or Ineffective, which reduces the impact or probability score depending on the nature of the control.

Control Score	Risk reduction	Inherent Risk Score											Residual Risk Score
		25	20	15	12	10	9	8	6	4	3	2	
Fully effective	80%	5	4	3	2	2	2	2	1	1	1	0	0
Highly effective	60%	10	8	6	5	4	4	3	2	2	1	1	0
Mostly effective	40%	15	12	9	7	6	6	5	4	2	2	1	1
Partially effective	20%	20	16	12	10	8	8	6	5	3	2	2	1
Ineffective	0%	25	20	15	12	10	10	8	6	4	3	2	1

The risk reduction percentage is applied to the gross risk scores to arrive at a Net, or residual, risk score. Each risk is assessed individually, and the sum of Net Impact scores is compared to the stated risk appetite for each risk category.

Individual risk assessments are carried out by the managers responsible for each functional risk area.

The monthly Risk Forum, which is attended by a representative of the 2nd line Risk function, reviews changes to risk and control scores, and assesses them against recent related incidents or near misses.

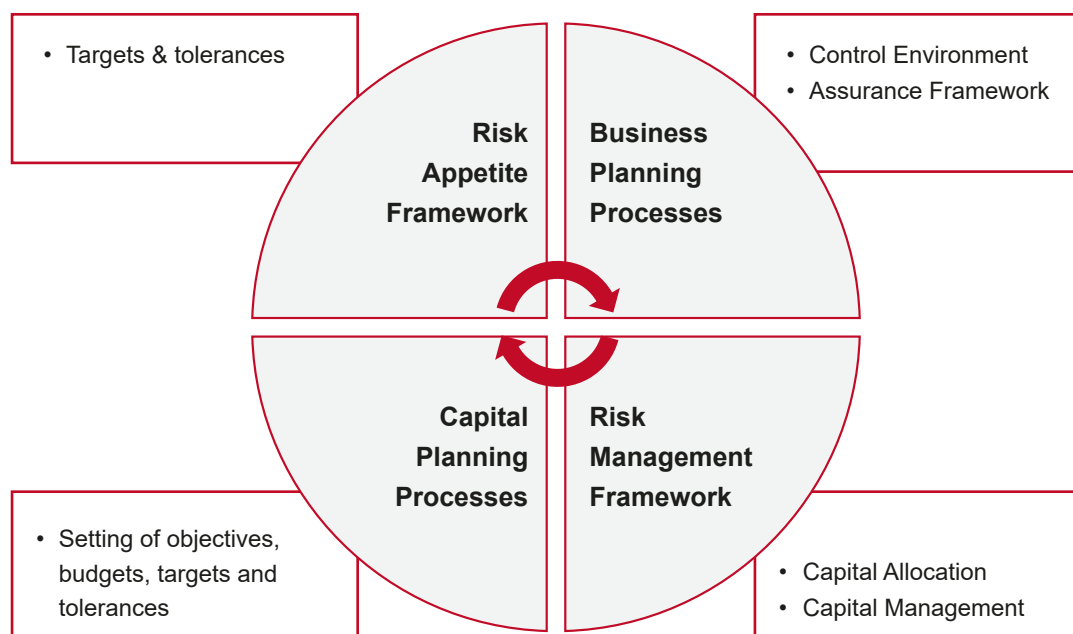
The quarterly RMC will also review the impact of significant risk events or incidents, including information on agreed actions to reduce the risk of the same or similar incidents occurring again.

Risk and Control Self Assessments (RCSAs) are completed on all risks with an inherent score of 9 or above on a six-monthly basis, where the design and implementation of controls is assessed and challenged by 1st and 2nd line.

In addition, the strength of the controls is considered by the Risk and Compliance and Internal Audit functions as part of reviews they carry out under their monitoring programmes, and any difference between their assessment and the manager's self –assessment will be documented in the reports to EMB members and CRO, together with any actions recommended to improve those controls to ensure the risk remains, or is brought back within, appetite. If it is established that a risk is outside the Group's risk appetite then senior management will either take action to strengthen controls in the appropriate area, or revisit the risk appetite for the risk via communication with the EMB and Board and by reference to achievement of the Group's strategic objectives.

### 2.1.2 Overview of the integration of risk appetite

Risk appetite is integrated into the business via the Group's business planning, capital planning and the risk management framework. These enable the EMB and the Group's Board to set the overarching parameters within which it wishes the business to operate and to monitor performance thereon. The process streams are illustrated below:



### 2.1.3 Communication of risk appetite

As part of the annual business planning process, the risk appetite statement is communicated by the EMB and Board to its senior management team and Risk Management Committee (RMC).

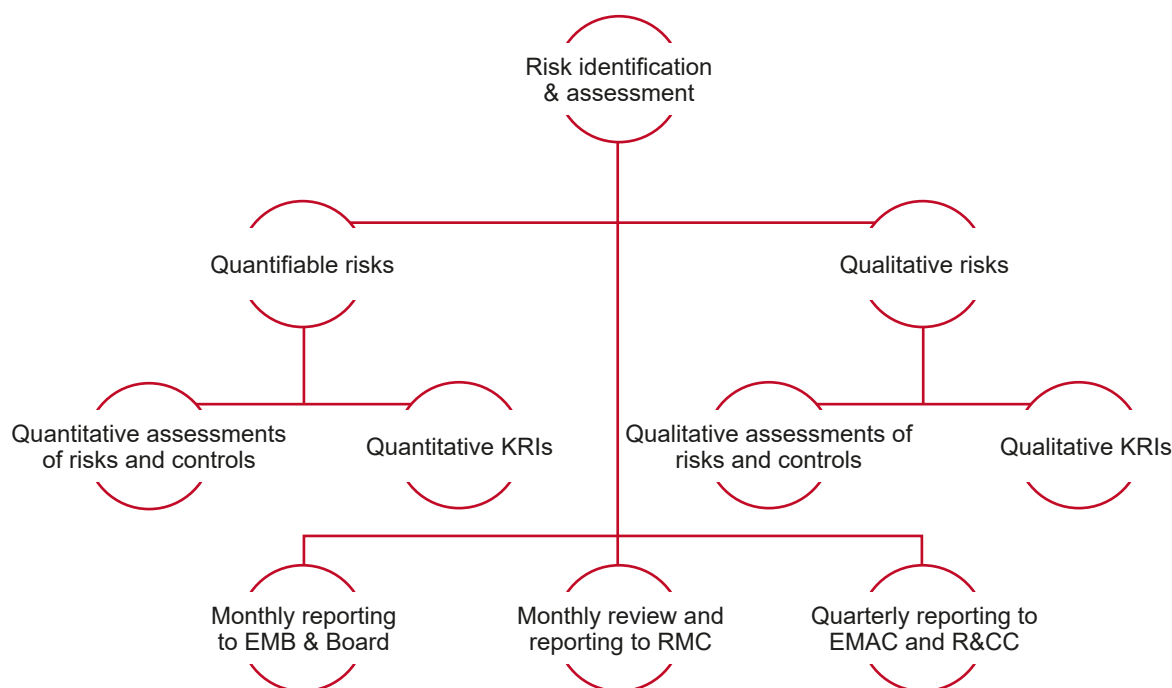
KRIs and KPIs are reported to senior management on all risk categories on a monthly basis.

Individual authorisation and reporting limits, where relevant, are set within the context of the Group's overall risk appetite and are defined according to the level of seniority within the organisation. Where relevant, these limits are documented and communicated to employees via the appropriate policies.

### 2.1.4 Top-down measurement and reporting of risk appetite

The Group adopts both quantitative and qualitative approaches to measuring risks against its risk appetite incorporating both absolute and relative measurements of risks within the categories of earnings, capital adequacy, reputation and regulatory compliance.

This process is summarised below:



The qualitative comparison to risk appetite is facilitated by the alignment of the risk register scoring system to the risk appetite grid derived from the Group's high level risk appetite statement.

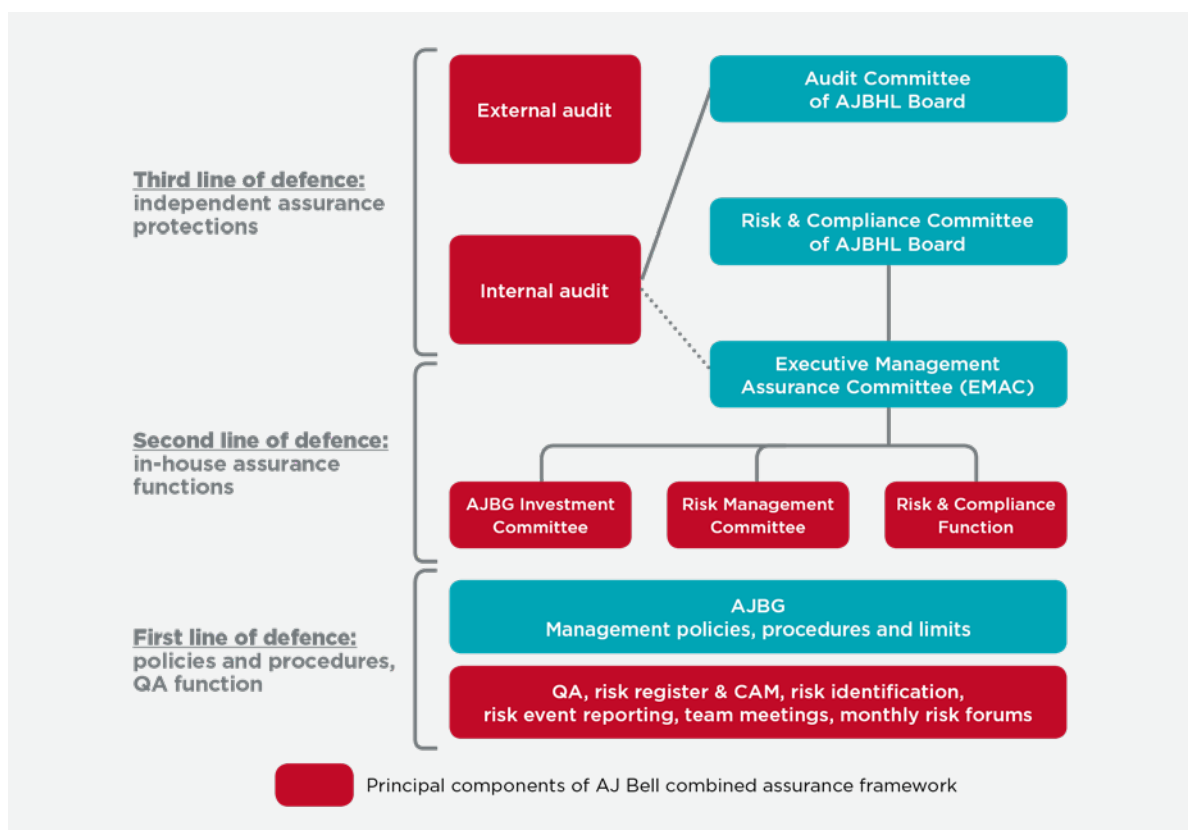
Where the Group has assessed that it faces a significant individual risk it seeks to set appropriate individual quantitative tolerance levels. In cases where such risks have crystallised materially in the past, the Group performs a review of the amount and distribution of past losses, or other techniques, and sets an appropriate tolerance level in the context of the overall risk appetite.

For significant, quantifiable risks, the Group reports monthly KPIs/KRIs. Absolute measurements of performance are shown against a pre-defined target. For each KPI/KRI a tolerance threshold is set in addition to a budget or target measure. Relative measurements are based on trend information to provide early warning indicators that the Group's risk appetite may be close to being breached for that measure.

In this manner the Group reports actual risks against trigger levels which are designed to alert senior management, EMB and the Group's Board that risk appetite or an individual tolerance level has been breached.

## 2.2 Risk management framework

### 2.2.1 AJ Bell risk management governance structure



### 2.2.2 Senior management arrangements and organisational structures

The CRO has principal, day-to-day responsibility for the effective operation of the Group's Risk Management Policy, with oversight provided by the EMAC and the RCC. The CRO reports directly to the Group's Chief Executive Officer (CEO), but also has direct access to the Chair of the RCC and the AJBHL Board.

The Board is made up of the following individuals:

Role	Board member
Chairman and Non-executive Director	Les Platts
Non-executive Director (and Chair of Audit Committee)	John Tomlins
Non-executive Director (and Chair of the RCC)	Simon Turner
Chief Executive Officer	Andy Bell
Chief Financial & Operational Officer (CFO)	Michael Summersgill

The Non-executive Directors are also the members of the RCC and the Audit Committee (AC), which are both sub-committees of the Board. RCC and AC meetings are held on a quarterly basis and are also attended, by invitation, by the CEO, Chief Financial & Operational Officer, CRO, the Head of Risk, the Head of Internal Audit (Deloitte) and the external auditors.

The EMB for the Group, responsible for the day-to-day management of the business, comprises the following individuals:

Chief Executive Officer	Andy Bell
Chief Financial & Operational Officer (CFOO)	Michael Summersgill
Managing Director, AJ Bell Investcentre	Fergus Lyons
Managing Director, AJ Bell Youinvest	Charles Galbraith
Group Finance Director	Roger Stott
Chief Risk Officer	Louis Petherick
Group Legal Services Director and Group Secretary	Bruce Robinson

The members of the EMB are also the directors of AJBML, AJBSL, AJBL, AJBI and AJBAM.

The Boards of AJBML, AJBSL, AJBL, AJBI and AJBAM have assigned day-to-day management responsibility to the EMB. The EMB is also the governing body of AJBML, AJBSL, AJBI and AJBAM.

The members of the EMB, with the exception of the CEO, comprise the EMAC which is a sub-committee of the EMB. The Chief Risk Officer chairs the EMAC.

Other sub-committees of the EMB include:

- The Treasury Committee, which operates sub-committees with delegated responsibility for the management of client money, pension trustee customer deposits and corporate monies. The Committee consists of all members of the EMB, except the AJ Bell Youinvest MD, with the CFOO acting as the chairman.
- The Strategic Portfolio Meeting, which has delegated responsibility for the approval and prioritisation of projects and business change. The Committee consists of the members of the EMB and the Technology Services Director, with the Technology Services Director acting as chairman.
- The Investment Committee, which is a sub-committee of EMB, is responsible for overseeing the activities of AJBI's investment team. In particular, the Committee monitors that AJBI's investment funds and services, including the AJ Bell Investcentre Managed Portfolio Service and AJ Bell Passive Funds, operate in accordance with their Investment Policy Statement (IPS), approved by the Committee, that risk volatility is within the agreed tolerances, performance is in line with expectations and that excessive risks are not being taken to achieve performance.

The Investment Committee comprises the following individuals:

Chair (external/independent)	Jim Sutcliffe
Chief Executive Officer	Andy Bell
Managing Director, AJBIC	Fergus Lyons
Chief Risk Officer	Louis Petherick
Managing Director, AJ Bell Youinvest	Charles Galbraith
Independent non-executive member	Paul Clements

Investment Committee meetings are also attended by the AJBAML Managing Director, AJBI Head of Active, AJBI Operations Manager and AJBI Head of Passive

## 2.2.3 Nomination Committee

The Group maintains a Nominations Committee. The committee is comprised of the Non-executive Directors of the Board.

The Group's Nomination Committee is responsible for:

- reviewing the skills required to competently discharge the Board's duties
- considering the structure, size and composition of the Board, its committees and the Group's Executive Management Board
- succession planning for directors and other senior executives
- evaluating the balance of skills, knowledge and experience on the Board
- identifying and nominating for the approval of the Board, candidates to fill Board and EMB vacancies. In identifying suitable candidates the committee shall:
  - use open advertising or external advisers to facilitate the search
  - consider candidates from a wide range of backgrounds and take specific account of diversity factors
  - consider candidates on merit and against objective criteria, taking care that appointees have enough time available to devote to the position and meet any FCA requirements in relation to the number of existing directorships, as well as ensuring that the members of the Board and EMB do not hold more directorships than stipulated in Article 91(3) of the CRD
- reviewing the leadership needs of the organisation, both executive and non-executive
- reviewing:
  - the structure, size, composition and performance of the Board, its Committees and EMB, and, if applicable, make recommendations with regards to any changes, including for the establishment of a target for the representation of any underrepresented gender
  - the knowledge skills and experience of individual members of the Board, its Committees and the EMB and of those bodies collectively and reporting to the Board
  - the policy of the Board, its Committees and the EMB in relation to the selection and appointment of senior management and, if applicable, making recommendations with regards to any changes to the Board
- ensuring that on appointment to the Board, Non-executive Directors receive a formal letter of appointment setting out clearly what is expected of them in terms of time commitment, committee service and involvement outside Board meetings

## 3 Own funds – capital resources (Article 437)

### 3.1 Capital available

The Group has complied with the capital requirements set out by the FCA. The table below shows a breakdown of the total available capital for the CRD consolidation group and the total Group.

Tier 1 capital resources	CRD Group total as at 30 September		Total Group as at 30 September	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
<b>Core Tier 1 capital</b>				
Ordinary share capital	40	40	40	40
Share premium	2,806	2,229	2,806	2,229
Retained earnings	56,597	50,672	58,516	51,918
<b>Sub-total</b>	<b>59,443</b>	<b>52,941</b>	<b>61,362</b>	<b>54,187</b>
<b>Regulatory deductions</b>				
Intangible assets	(3,841)	(5,016)	(3,841)	(5,016)
Goodwill	(2,123)	(2,123)	(3,660)	(3,660)
<b>Total Tier 1 capital resources</b>	<b>53,479</b>	<b>45,802</b>	<b>53,861</b>	<b>45,511</b>
<b>Risk-weighted assets</b>	<b>142,377</b>	<b>121,413</b>	<b>142,377</b>	<b>121,413</b>
<b>Core Tier ratio</b>	<b>38%</b>	<b>38%</b>	<b>38%</b>	<b>37%</b>
Minimum CRD requirement	8%	8%	8%	8%
Coverage under CRD	472%	524%	469%	523%



For accounting purposes, software and development costs are capitalised as intangible fixed assets where they meet certain criteria. Intangibles do not qualify as capital for Tier 1 and so are deducted.

Throughout the year the Group complied with the capital requirements that were in force, as set out by the FCA. The Group's capital resources are based entirely on Tier 1 capital which is the most robust category of financial resources.

## 4 Capital requirement (Article 438)

### 4.1 Basic requirements

Under CRD IV the Group is required to perform a continual assessment of its risks in order to ensure that the higher of Pillar 1 and Pillar 2 requirements is met. This requirement is designed to ensure that all regulated entities have adequate capital to manage their risks. To satisfy this requirement, the Group performs an ICAAP, which is subject to formal review at least once a year.

All qualifying regulated entities within the Group are required to meet the general Own Funds requirement in accordance with Article 92 of the CRR, including the maintenance of a minimum total capital ratio of 8%.

The Group's minimum capital requirement under Pillar 1 is the higher of:

- i. the fixed overhead requirement and
- ii. the sum of the credit risk, market risk and settlement risk capital requirements in accordance with the sum of points a) to d) and f) of Article 92(3)

### 4.2 Total Pillar 1 minimum capital requirement

The Pillar 1 minimum requirements as at the two most recent financial year ends are set out below:

Own Funds Pillar 1 requirement	2017 As at 30 September		2016 As at 30 September	
	Minimum 8% own funds requirement £'000	Risk weighted assets £'000	Minimum 8% own funds requirement £'000	Risk weighted assets £'000
<b>Operational risk: risk exposure due to fixed overheads</b>	11,390	142,377	9,713	121,413
<b>Credit risk: risk weighted exposure</b>	3,758	46,974	3,012	37,654
<b>Market risk</b>	-	-	-	-
<b>Settlement risk: risk weighted exposure</b>	19	240	133	1,663
<b>Own Funds – Pillar 1 requirement</b>	<b>11,390</b>	<b>142,377</b>	<b>9,713</b>	<b>121,413</b>
<b>Capital resources</b>	<b>53,479</b>		<b>45,802</b>	
<b>Excess of capital resources over Pillar 1</b>	<b>42,089</b>		<b>36,089</b>	
Coverage under CRD	470%		472%	
<b>Additional information</b>				
SIPP Operator capital requirement (AJBML)	6,386		5,638	
Cover relative to Group capital resources	837%		812%	

### 4.3 Operational risk Pillar 1 minimum capital requirement

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. As a Limited Licence Group, the Group is not required to hold capital under the FCA's Pillar 1 standardised approach to operational risk (IFPRU 5.1.1). The Group had calculated the fixed overhead requirement as a proxy for Pillar 1 operational risk exposure as shown above.

### 4.4 Credit risk Pillar 1 minimum capital requirement

The Group has adopted the standardised approach applying an 8% factor to the risk weighting for each asset class as appropriate. The table below sets out the Group's minimum capital requirement for credit risk and risk-weighted assets:

Exposure classes (all domestic exposures)	CRD Group as at 30 September 2017	
	Minimum 8% own funds requirement £'000	Risk weighted assets £'000
Banking institutions	1,665	20,814
Corporates	-	-
Retail	-	-
Other debtors	1,730	21,629
Fixed assets	320	3,994
Deferred tax	43	538
<b>Total credit risk minimum capital requirement</b>	<b>3,758</b>	<b>46,974</b>

### 4.5 Market risk Pillar 1 minimum capital requirement

The Group does not trade as principal and does not expose itself to foreign exchange risk. Settlement risk is discussed below. Therefore, there is no Pillar 1 market risk capital requirement for the Group.

### 4.6 Settlement risk Pillar 1 minimum capital requirement

The risk exposure for settlement and delivery risk is calculated as the price difference between the agreed settlement price of the security and its current market value where this could result in a loss for the Group. This is known as the Counterparty Risk Requirement and is calculated in accordance with Articles 378 and 379.

## 5 Discussion of approach to risk exposures (Article 439 - 449)

### 5.1 Operational risk overview

As noted above, the Group has calculated the Fixed Overhead Requirement under Pillar 1 which assesses the risk as being equivalent to one quarter of the Group's relevant annual expenditure. For Pillar 2 purposes, the Group's approach is to assess the actual level of operational risk not covered under Pillar 1 to determine whether any additional capital is required. In assessing operational risk under Pillar 2, consideration has been given to a range of operational risks, including technology, back office failure, conduct and regulatory risks, and their potential impact on the Group's reputational risk stemming from a loss in confidence by customers and advisers.

Given the Group's business model, a high proportion of its material risks are classified under the heading of 'operational risks' within the Group's ICAAP.

The Group seeks to mitigate operational risk in accordance with its risk management processes as noted above, including the employment of appropriately qualified staff in all areas of the business, supported by appropriate training and HR policies.

## 5.2 Credit risk overview

### 5.2.1 Credit risk and dilution risk

The Group holds all cash with UK banks with high credit ratings. A financial asset is past due when a counterparty has failed to make a payment when contractually due. Impairment is defined as a reduction in the recoverable amount of a fixed asset. The risk of past due or impaired exposures is minimal.

### 5.2.2 Client and market counterparty settlement risk

There is a risk that unexpected losses may arise as a result of client and market counterparties used by the Group failing to meet their financial obligations. The Group carries out initial and ongoing due diligence on the market counterparties that it uses and regularly monitors the level of exposure. The Group does not have a trading book and executes trades for its clients on an agency basis.

Within the Group's stockbroking activities, the Group has limited exposure to the potential failure of securities transactions during the period between trade and settlement date, generally a period of two days. The AJ Bell Investcentre and AJ Bell Youinvest Terms and conditions make it clear that risk of a settlement failure is borne by the customer and that AJ Bell is not responsible for any delay in settlement as a result of circumstances beyond its control or for the failure of any other person.

The Group has credit exposure extending beyond the settlement period if the counterparty fails to either make a payment on a sell trade (although the Group holds and controls the relevant client securities pending such payment) or deliver securities on a buy trade (although the Group holds and controls the clients' cash pending such delivery). This settlement risk is substantially minimised as a result of the delivery versus payment mechanism. Therefore, the economic substance of a sales transaction is that securities act as collateral in the case of delivery versus payment debtors on the Group's balance sheet and so exposure is extremely limited. Similarly, in the case of a buy trade, client side settlement risk does not represent a significant real world exposure to the Group.

In addition, the deal sizes undertaken by the Group as agent of its retail clients are relatively small and therefore exposure to large deals is limited in number and can be monitored accordingly.

The FCA has stated that it does not require Pillar 1 capital to include a credit risk capital requirement in respect of the execution of client orders on an agency basis.

### 5.2.3 Other credit risk disclosures

Disclosure on retail or equity exposures is not required as the Group has not adopted the Internal Ratings Based (IRB) approach to credit risk. Disclosures on value added adjustments and provisions are not required as the Group does not make value adjustments and provisions for impaired exposures.

Disclosure on non-trading book exposures to equities is not required as the Group does not have such exposure. Similarly, the Group does not securitise its assets.

## 5.3 Market risk overview

### 5.3.1 General

Market risk is the risk of any impact on the Group's future cash flows due to market movements caused by market variables such as interest rates, asset prices etc. As noted above, the Group does not deal on its own account and so there is no Pillar 1 requirement for this risk. The Group is exposed to business risk arising from a downturn in stock markets and the resulting fall in revenues from assets under administration. The Group has assessed the impact of future market movements under its Pillar 2b capital buffer assessment.

### 5.3.2 Interest rate risk in the non-trading book

The Group is exposed to interest rate risk in relation to loss of revenues from adverse movements in its interest-bearing assets. There is an exposure to interest rates earned on banking deposits which is mitigated by negotiating terms with banking counterparties. The Group has no external borrowings and so is not exposed to significant interest rate risk on debt positions.

### 5.3.3 Foreign exchange risk

The Group is not exposed to any material foreign exchange risk.

### 5.3.4 Approach to ICAAP

The Group uses a structured approach to determine its internal capital adequacy requirement. Initially, the internal capital requirement has been set at a starting point of zero and then capital due to all Pillar 1 and Pillar 2 risks and external factors has been assessed as described in this document.

The material risks to achievement of the Group's Strategic Objectives, set out in each year's Business Planning Report, are reviewed and agreed annually as part of the business planning process. All material risks including credit, market and operational risks as discussed above have been agreed by the EMB and Board and are continuously assessed and taken into account in assessing the Group's internal capital adequacy requirement. The methodology in relation to risk appetite, tolerance and capital allocation is discussed in section 2 of this document.

In assessing the Group's material risks a range of stress and scenario tests have been undertaken. These are designed to demonstrate that the Group could survive a range of severe but plausible future events in line with the Group's stated risk appetite.

The Board and EMB oversee the ICAAP process, including agreeing the material risks, reviewing and challenging the assumptions used and the stress tests and scenario modelling carried out, and the final approval of the ICAAP document.

## 6 Remuneration Code disclosure (Article 450)

The Group maintains a Remuneration Committee which meets three times a year. The committee is comprised of the Non-executive Directors of the Board.

The Remuneration Committee is responsible for maintaining policies and practice in accordance with the applicable principles of the Remuneration Code. Material decisions in relation to the remuneration of staff whose actions have a material impact on the risk profile of the firm and in relation to individuals in control functions are overseen by the Remuneration Committee. The Group's remuneration policies provide for variable remuneration to be linked to performance.

### 6.1 Remuneration policy principles

The Group's remuneration policies are based on the following key principles:

Employees are rewarded on the basis of their own performance assessed against individual objectives, which are driven by the Group strategic objectives and guiding principles and on the performance of the Group against its financial objectives. Individual employee and group goals and objectives are set having due regard to the Group's risk management framework, risk appetite statements and risk tolerance levels.

In setting fixed remuneration and the structures of bonus schemes for variable remuneration, the Group has regard to risk management and ensuring that our remuneration structures are consistent with the group risk management framework and its effectiveness.

The Group maintains a conflicts of interest policy and the remuneration management structure includes measures to avoid conflicts of interest between employees and clients, in particular, and actively monitors situations where conflicts may arise.

### 6.2 Basis of remuneration

The basis of remuneration is that of fair reward, ensuring we are not significantly out of line with the market, based upon a combination of the role itself, the individual performing the role, and performance against defined objectives and behaviours.

Variable pay in the form of bonus is used to reward exceptional performance aligned to the AJ Bell Way, ensuring that our strategic business objectives are a key focus and that behaviours are in line with our guiding principles.

An individual employee's remuneration package will consist of the following elements:

**Fixed remuneration** Basic salary and other benefits e.g. pension contributions and life assurance cover, which do not vary directly as a result of individual or AJ Bell group performance against objectives.

**Variable remuneration** Bonus payments dependent on achievement of personal objectives and/or the achievement by AJ Bell of its strategic goals and financial objectives.

The proportions of an employee's remuneration that are fixed and variable will be determined by reference to the role of the employee and the bonus scheme to which they belong. The rules of each bonus scheme set out how the employee's variable remuneration will be determined based on their performance against their own, individual objectives and AJ Bell's performance in meeting its strategic goals and financial objectives.

### **6.3 Equity-based remuneration**

The Group's remuneration policies and strategy include the potential for employees to participate in equity ownership, through direct share holdings and share option schemes. This gives us the ability to include within an employee's overall remuneration, an element of remuneration which is based upon the longer-term performance of the individual employee and is intrinsically linked to the Group's longer-term performance against its strategic objectives.

All members of the Executive Bonus Scheme (EBS), Management Bonus Scheme (MBS) and Sales and Business Development Bonus Scheme (SBDBS) are members of the AJ Bell Option to Buy Shares (OTB) Scheme and are eligible to acquire additional shares through the scheme based on their performance, as per the scheme rules.

### **6.4 Code staff**

Only employees deemed Code Staff by reference to the FCA's definition are formally subject to the principles of the FCA's Remuneration Code. However, it is our policy to structure remuneration for all employees to meet the key principles of the Code, taking into account the scale, activities and risk profile of AJ Bell's business.

Employees meeting the definition of Code Staff include any employees who have a material impact on our risk profile. For AJ Bell, this includes all those individuals who perform a significant influence controlled function, senior managers who have been given delegated responsibility for management and supervision by the governing body of a regulated company within the Group, or the Chief Executive, and employees whose remuneration is in the same bracket as senior management. We review and record individuals who are deemed Code Staff on an annual basis.

### **6.5 Control function staff**

For employees who are engaged in work which represents a control function, such as risk management and compliance, variable remuneration is based on achievement of objectives linked to the function and the group PBT against financial objectives. However, a significant proportion is dependent upon achievement of the objectives set for individuals in meeting the objectives for that function.

In the case of AJ Bell, control functions such as Risk and Compliance are carried out at a Group level. Decisions as to the award of variable remuneration are made centrally and overseen by the Remuneration Committee to ensure no other business area has undue influence over the remuneration of employees within a control function.

In accordance with Article 450(1)(i) no individuals received remuneration of Euro 1 million in the last financial year.