

**Kiltearn Partners LLP (“Kiltearn”)
(FRN 540470)
Pillar 3 Disclosure Statement
1 September 2017**

Introduction

Kiltearn Partners LLP (“**Kiltearn**”) is authorised and regulated by the Financial Conduct Authority (“**FCA**”) as an Alternative Investment Fund Manager (“**AIFM**”) and complies with applicable rules and capital requirements adopted by the EU and the FCA with respect to the Alternative Investment Fund Manager Directive (“**AIFMD**”). The FCA is responsible for the implementation of the EU Capital Requirements Directive, which has set up a regulatory capital framework for the financial services industry. The framework consists of three pillars:

- Pillar 1 specifies the minimum capital that Kiltearn is required to carry to cover business risks;
- Pillar 2 sets out the supervisory review process to be used when determining whether additional capital should be maintained against any other risks not covered under Pillar 1;
- Pillar 3 specifies the disclosure requirements which Kiltearn is required to make of its capital, risk exposures and risk assessment processes.

The FCA regulations for the disclosures required under Pillar 3 are contained in the Prudential Sourcebook for Banks, Building Societies and Investment Firms (“**BIPRU**”). Further information on BIPRU can be found on the FCA website (www.fca.gov.uk). These rules allow each firm to exclude disclosures where the information is regarded as immaterial, proprietary or confidential. Disclosures have been made in this document in compliance with BIPRU 11 unless that disclosure has been regarded by Kiltearn as being immaterial, proprietary or confidential. Additional information is available from Stuart Gunderson (sgunderson@kiltearnpartners.com), Kiltearn’s Chief Compliance Officer or the compliance team (compliancegroup@kiltearnpartners.com).

Business Structure

Kiltearn is a private limited liability partnership that is managed by its members. Kiltearn employees, contractors and members are collectively referred to as “**Staff**” in this statement. Kiltearn Limited (“**KP Ltd**”) is a member of Kiltearn and holds a significant proportion of Kiltearn’s capital. Kiltearn has one subsidiary, Kiltearn Partners, Inc. (“**KP Inc.**”). There are no current or foreseen material practical or legal impediment to transfers of intra-group capital between Kiltearn and KP Inc. Kiltearn’s LLP agreement permits, but does not obligate, KP Ltd to invest additional capital in Kiltearn where this is needed by Kiltearn

Risk Management

Kiltearn’s Supervisory Group is responsible for determining Kiltearn’s risk strategy, setting its risk appetite and ensuring that risk is monitored and controlled effectively. Kiltearn’s risk management framework is updated, as necessary, to take into account material changes in Kiltearn’s business, capital obligations, or resource requirements. Kiltearn’s risk appetite is regularly reviewed. Kiltearn sets out the amount and types of risk that are considered appropriate for Kiltearn to accept in order to execute its business strategy. Kiltearn has developed a risk matrix that is broken down by business function and each underlying process within the business function. Each risk is then assessed to determine, for example, the type of risk exposure, its materiality, whether it is covered by insurance, and what mitigating procedures can be put in place to control the risk of error. Kiltearn’s culture aims

to ensure that each Partner is focused on improving procedures, minimising risk and establishing a robust risk, capital and performance structure.

Kiltearn is exempt from the operational risk requirement at Pillar 1 and is not required to calculate an operational risk capital charge. Kiltearn's minimum capital requirement is the greater of (i) the base capital, (ii) the sum of its capital and risk requirements; and (iii) its fixed overhead requirement. From July 2014, Kiltearn also became subject to the capital requirements under AIFMD for which Kiltearn are required to calculate the sum of its core regulatory capital and its professional liability risks capital requirement. Kiltearn increased its permanent capital to £8 million during 2016.

Kiltearn's ICAAP analysis highlights that Kiltearn had surplus Tier 1 capital as of 31 March 2017 compared to the capital resource requirements computed under Pillar 1 and will, based on its projections, maintain surplus capital under AIFMD rules. This capital requirement will be recalculated in the event of material changes occur to Kiltearn's business.

Kiltearn's surplus capital will be impacted if (i) the FCA requires discretionary staff bonuses to be included in fixed overhead requirement computations, and (ii) the FCA requires monthly partner drawings to be included in fixed overhead requirement computations.

Under Pillar 2 and as required according to GENPRU 1.2, Kiltearn is required to adopt an internal capital adequacy assessment process ("**ICAAP**"). The ICAAP document is prepared by the Risk Management & Compliance groups, under the supervision of the Chief Compliance Officer. However, the sufficiency of the ICAAP is ultimately the responsibility of the Supervisory Group. In its ICAAP analysis, Kiltearn has stress tested various scenarios. The most extreme scenario highlights the fact that Kiltearn needs to maintain approximately £1.63 million of capital to fulfil its financial obligations. This is below Kiltearn's regulatory capital requirement. Kiltearn has surplus liquid capital compared to its requirements under **Pillar 2**.

As at 31 March 2017, Kiltearn's capital reserves are as follows:

	(GBP)
Tier 1 Capital	8,000,000
Tier 2 Capital	0
Deductions from Tier 2 Capital	0
Tier 3 Capital	0
Deductions from Tier 3 Capital	<u>0</u>
	8,000,000

As a long only asset manager that primarily invests client assets in publicly traded global equity securities, Kiltearn is mainly exposed to operational risk; however there is some small additional exposure both to business risk and credit risk. All of these exposures are regarded as typical for a business engaged in the activity of asset management. Kiltearn's Chief Compliance Officer, who is independent of Kiltearn's investment function, acts as the operational risk manager and monitors and manages the risk exposures of the business with input from Kiltearn's various business groups. In assessing the risk appetite of the business, consideration has been given to identifying the material risks facing Kiltearn's operations. These include risks at both the client level and at the firm level and take the form of loss of revenue, loss of assets or higher costs. Two (2) specific factors have been considered in defining the risk appetite; firstly, the likelihood of occurrence of an event and secondly, the impact level of an event. Further information is set out below:

- **Credit Risk.** As an asset management company, Kiltearn is subject to credit risk. Kiltearn receives investment management fees on a monthly basis. These fees are computed based on the value

of each underlying investor's holdings in the commingled funds. Investment management fees are paid within five (5) business days of each month. As the commingled funds are "long only" equity funds that cannot use leverage, margin or derivative products, there is little, if any, credit risk associated with the fees. Kiltearn's free cash flow is placed on deposit each month. Deposits are normally placed with a highly capitalised bank(s). The bank(s) are approved by the Supervisory Group. The credit rating and financial strength of each bank is subject to an annual re-appraisal by the Risk Management Group. The Dealing Group also monitors certain credit ratings a monthly basis. Kiltearn does not utilise any risk mitigation techniques (i.e., credit default swaps) to minimise our financial exposure to bank deposits.

- **Market Risk.** As an asset management company, Kiltearn's portfolios are subject to market risk. Kiltearn's fees are asset based fees and Kiltearn's revenue increases as AUM increase and will fall if AUM falls. Kiltearn has structured its business so that many costs are variable (i.e., custody costs) and will fall as its AUM fall. More importantly, Kiltearn keeps base salaries low and remunerates employees through discretionary bonuses. Members receive a limited proportion of the partnership share through a monthly drawing and periodic discretionary distributions. Any excess drawings above a member's final allocable partnership share must be repaid. Surplus liquid capital is not at risk until a loss fully offsets Kiltearn's profit before remuneration and taxes ("PBRT") less committed salaries, and benefits. Kiltearn's core regulatory capital is primarily invested in cash deposits and the Kiltearn Global Equity (Ireland) Fund, an Irish UCITS vehicle formed to accommodate non-US investors wishing to allocate moneys to Kiltearn's investment programme.
- **Liquidity Risk.** Liquidity risk consists of two primary items – funding liquidity risk and market liquidity risk. Funding liquidity risk is the risk that the counterparties who provide Kiltearn with short-term funding will withdraw or not roll over that funding. Market liquidity risk is the risk of a generalised disruption in asset markets that make normally-liquid assets illiquid. Kiltearn has no borrowing and is not dependent on external financing for any aspect of its business. As a result, Kiltearn is not exposed to funding liquidity risk. Kiltearn has some exposure to market liquidity risk. One of Kiltearn's banking counterparties could suffer severe financial distress and elect not to return some of Kiltearn's cash deposits.
- **Operational Risk.** Operational risk refers to the risk of a direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. Kiltearn attempts to mitigate these risks by (i) maintaining substantial financial resources, (ii) aligning the interests of all Staff with supervision of the operations of the business through its remuneration policies, (iii) maintaining a risk matrix and key operating procedures ("KOPs") for all material business areas, (iv) reviewing the operations of all material business groups annually, (v) providing training where required and (vi) keeping Kiltearn's business relatively simple.
- **Concentration Risk.** Concentration risk is the risk that exposures to specific sectors or asset concentration could result in losses to Kiltearn or its business. Kiltearn principally invests client assets in publicly traded global equity securities and earns its revenue primarily from a US client base. Kiltearn's business could suffer (i) from a decline in its investment performance relative to benchmark indices, (ii) if US institutional investors spoil on investing on a global basis and/or shift their asset allocations to private equity, hedge funds, commodities or other types of investments, or (iii) the US dollar sharply appreciates, negatively impacting relative returns. There is little Kiltearn can do to minimise this risk except focusing on keeping its business simple and aligned with clients, and minimising overheads.

- **Business Risk.** Business risk arises from changes in the business that prevents Kiltearn from carrying out its business plan and desired strategy. Kiltearn is a private limited partnership. All material structural changes to Kiltearn’s business are subject to discussion at the Supervisory Group level. The Supervisory Group consults the Compliance & Risk Management groups before (i) an investment, loan or capital subscription is made; (ii) before a significant investment is made in any unregulated collective investment scheme; (iii) before any material change in Kiltearn’s cost structure, base salaries or a material change in the level of member drawings; or (iv) before any repayment or distribution of member capital is permitted.
- **Interest Rate Risk.** Kiltearn does not engage in any principal trades or run any trading book exposures that could be subject to interest rate risk. From a business perspective (given its cash balances) and assuming no impact on investment performance, Kiltearn would expect to benefit from increases in interest rates as its interest income would rise.
- **Insurance Risk.** Kiltearn maintains fiduciary liability (also referred to as professional indemnity), crime (also referred to as errors and omissions) and ERISA insurance. Professional indemnity, crime and ERISA fidelity bond cover is set at a limit which Kiltearn considers appropriate for the business of Kiltearn and subject to a deductible which Kiltearn can reasonably afford to meet if called upon. Kiltearn would be exposed to potential losses in the event that an error occurred and XL Insurance Company SE, AXIS Speciality Europe SE & Travelers Insurance Company Ltd did not pay the anticipated insurance settlement proceeds. Kiltearn attempts to obtain insurance only from well capitalised insurance firms to minimise the risk of loss arising from insurance risk.

Summary - Capital Resources and Regulatory Obligations

Kiltearn has calculated its capital needs in accordance with relevant FCA regulations and has determined that it has surplus regulatory capital.

Remuneration Code Provisions

Kiltearn has completed this section of the Pillar 3 disclosure document on the basis that it is a full scope AIFM BIPRU firm that is subject to the remuneration rules set out in SYSC 19B and SYSC 19C and is eligible to apply principles of proportionality pursuant to BIPRU rules. Market regulators impose a variety of requirements on asset management firms with respect to remuneration. The general thrust of the FCA remuneration Code’s objective is to ensure that all regulated firms and their related parties have (i) robust governance arrangements in place, (ii) established remuneration controls for Partners whose professional activities could have a material impact on the risk profile of their firms, and (iii) prepared qualitative and quantitative disclosures of their remuneration policies. Kiltearn is authorised and regulated by the FCA. Kiltearn is subject to the Remuneration Code. Kiltearn Partners LLP and Kiltearn Partners, Inc. are referred to as “**Kiltearn**” in this discussion of the Remuneration Code.

Applicability of the Remuneration Code

The principles of the Remuneration Code are codified in the systems and controls handbook (“**SYSC**”). Under SYSC 19A.3.7 and 19B.1.2R, Kiltearn must “*establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote effective risk management. The policies, procedures and practices must not encourage excessive risk-taking*”. The FCA expects Kiltearn to apply the Remuneration Code in a proportionate manner based on the size, nature and complexity of its business. Kiltearn is required to assess its own members and staff characteristics and to develop and implement policies and practices that appropriately align Kiltearn with the risks faced by its business and investors. Kiltearn must also ensure that adequate and effective incentives are given to all members of Staff. The FCA is not expecting all firms to adhere to the remuneration

requirements in the same way and to the same extent, i.e. there is no 'one-size fits all' approach. Kiltearn has taken into account its structure (i.e., that of a legal partnership) and the size, nature and complexity of its business.

Identification of Code Staff

Kiltearn is required to identify those members of Staff who are covered by the remuneration code (referred to as "**Code Staff**"). Because of its small size and the responsibilities assumed by various individuals, Kiltearn considers all but the most recent joiners to be Code Staff. This would include any individuals who are approved persons on the FCA register, working members, or senior management of the firm, individuals engaged in control functions (such as dealing), individuals that receive total remuneration in an amount similar to that as other members of senior management, risk takers and individuals whose professional activities (including members of the marketing and client service, operations or administration groups) could have a material impact on Kiltearn's risk profile or day to day business operations. As of 31 March 2017, Kiltearn had five (5) staff that are legally considered to be working members and fourteen (14) staff that are employees. As a result, Kiltearn has nineteen (19) Code Staff. Code Staff are provided with a copy of this remuneration code summary when Kiltearn's Pillar 3 disclosure document is updated. A copy of this summary is also included in Kiltearn's compliance manual. The more burdensome provisions of Principle 12 of the Remuneration Code (i.e., the requirement to restrict the ratio of discretionary payments to base salary/drawings, to defer remuneration and/or drawings over a period of time or to pay a portion of remuneration and drawings in shares) do not apply.

Investment Approach; Risk Tolerance

Kiltearn invests client assets in publicly traded global equity securities. Kiltearn primarily invests in developed markets, although a proportion of client portfolios may also be invested in the more developed "emerging" markets such as Taiwan, Thailand, Mexico, Malaysia and South Korea. Kiltearn does not short stocks, utilise derivatives or margin, underwrite securities, issue or write options, futures, warrants or over-the-counter ("**OTC**") instruments, or allow its clients to participate in securities lending programmes. Kiltearn does not invest in fixed income instruments, physical real estate, commodities or contracts for difference. Assets included in client portfolios are priced by each client's fund administrator using closing market prices and exchange rates. Kiltearn does not invest in "hard to value" assets. Kiltearn does not speculate in stock markets or charge performance fees. It is therefore reasonable to state that Kiltearn does not trade in unusual or high risk products and has designed its systems and controls with this in mind.

Kiltearn looks to add investments to client portfolios when they will help to maximise the earnings, assets and dividends of its investment programme. Such investments may be funded from the cash flow of the existing portfolio or by the sale of investments which have come to offer less value. This approach is generally evolutionary rather than revolutionary. Kiltearn usually maintain client cash balances at minimal levels. Typically, about 50 - 90 investments will be owned in client portfolios with a reasonable diversification by country, industry and sector. Kiltearn analyse currency fundamentals and can periodically undertake forward currency hedging transactions, although such activity is limited to 20% of the portfolio's value when the hedges are established and is not intended as a major part of the overall investment management programme. Kiltearn have no bias in terms of market capitalisation and seek opportunities in small, mid and large cap companies. In assessing risk, Kiltearn does not refer to stock market volatility. Rather, Kiltearn sees risk as the possibility of paying a price above the intrinsic value of a business, thereby suffering a permanent loss of capital.

Kiltearn's Remuneration Policy

Kiltearn does not charge performance fees and receives asset based fees from its client accounts on a periodic (normally monthly) basis. Costs are monitored closely. In order to ensure alignment between

members and Staff, the limited liability partnership agreement (the “**Partnership Deed**”) that governs Kiltearn business specifies the ratio of profits less direct costs (internally referred to as profits before remuneration and tax or “**PBRT**”) is shared. The ratios are:

<u>Accounting Year</u>	<u>PBRT Allocated to Working Members and Employees</u>	<u>PBRT Allocated to Kiltearn Ltd</u>
2016/2017 onwards	60%	40%

The PBRT sharing model has governed Kiltearn’s business since its establishment. Under the terms of Kiltearn’s Partnership Deed, the members of the LLP may vary the above ratios by a supermajority so long as a majority of KP Ltd shareholders also agree to the amendment. Establishing these ratios in the Partnership Deed ensures that both employees and members are focused on growing Kiltearn’s business in a profitable and efficient manner. While PBRT is distributed to employees as remuneration and to working members as drawings, the split is determined by the Remuneration Group. Kiltearn has a 31 March accounting year end and allocations of PBRT run from 1 April to 31 March.

The current members of the Remuneration Group are Murdoch Murchison, Stuart Gunderson and Ed Clarke. Kiltearn does not believe that the appointment of external staff to the Remuneration Group would benefit the firm or its clients. The Remuneration Group obtains feedback from the members of the firm on the performance and contribution of each individual. Remuneration and partnership distributions are not based on the profitability of any specific investment recommendation, the implementation of a given trade(s) or the growth/retention of client assets. In determining the levels of remuneration and/or discretionary drawings paid, the Remuneration Group considers the following:

Contribution and Ownership of Responsibility. Kiltearn looks at contribution to the success of the firm over a multi-year period and will consider its ownership of various responsibilities, whether related to investment, marketing and client service, investment administration, operations, or firm management. Each area is important to Kiltearn’s on-going viability.

Market Levels. Kiltearn believes that base salaries and monthly drawings should be competitive. It is reasonable to offer remuneration above general market levels when Kiltearn believes that the value justifies such a course. Kiltearn also recognises that it must be competitive to attract and retain good colleagues in their various areas of activity.

Reliability. This may be viewed as part of contribution, but it is a great benefit to a lean organisation when Kiltearn can rely on someone over a period of years to get a task done. Good work which has needed a great deal of supervision is less valuable, although, of course, totally normal in the early stages of responsibility.

Success of Kiltearn. If Kiltearn is successful there should be a benefit to all. It must of course be recognised that a system of this sort cannot deliver when the business is not doing well. In other words, if PBRT drops, remuneration and discretionary distributions must fall.

Split Between Fixed and Discretionary Components. Fixed aspects of remuneration should be more oriented to those with a reliable proven record of adding value and discharging responsibility. Where such a record has not been established the flexibility of discretionary payments is more appropriate. Fixed aspects of expenditure should be kept low as this provides the greatest level of flexibility and allows Kiltearn to withstand various stresses – performance volatility, loss of client assets, exchange rate volatility and changes in interest rates – without needing to terminate the employee or ask members to leave the partnership.

Members are notified of their share of income profits on an annual basis. Adjustments can be made at any time by the Remuneration Group. Profits are only allocated and paid after Kiltearn ensures that FCA capital and liquidity requirements are satisfied. Employees receive a base salary and are entitled to participate in Kiltearn's discretionary bonus pool.

The Remuneration Group and the Compliance Group review Kiltearn's liquidity and capital requirements before making any discretionary payments or setting fixed levels of remuneration (i.e., base salaries or monthly drawings). They will also ensure that the payments do not adversely impact Kiltearn ability to meet the obligations that it may owe from a client, legal, regulatory (e.g. FCA regulatory capital and FCA liquidity requirements) or other financial perspective.

As of 31 March 2017, Kiltearn, its staff, partners, SP Ltd and their related parties have significant moneys invested in its investment programme. These investments are made on substantially the same terms and liquidity rights and are subject to substantially the same fees as those paid by third party investors.

Kiltearn's Policy on Alignment and Co-Investment

In accordance with the spirit of SYSC 19B, from September 2014, all employees and working members must hold a minimum percentage (employees 30% and working members 50%) of their total remuneration in Kiltearn by end December 2016 or three (3) years after joining the firm, although the remuneration group may alter the percentage of aligned investment required for individuals based upon underlying facts at its sole discretion. Alignment can be achieved in a number of ways, including the following:

- Shareholdings in KP Ltd – Although not the investment management business, it accrues all the capital value of the investment management business through its interest in Kiltearn. Further, the limited company will receive 40% of PBRT in profit share as a member of Kiltearn Partners LLP. The shareholders of the limited company require the continued success of the investment management business for the value of their holdings to be maintained.
- Partner Capital - All partners of Kiltearn are committed to invest material capital into the partnership, which is immediately at risk should the business fail.
- Pensions and ISA's – Staff can invest their SIPP/ISA's into the commingled funds. This can also be done for spouses or dependents. The value of these investments directly links staff to the performance of the investment programme.
- Direct Investments – Staff can invest into the commingled funds. This can also be done for spouses or dependents. The value of these investments directly links staff to the performance of the investment programme.

How the Specific Principles of the Remuneration Code Apply to Kiltearn

Kiltearn believes that its remuneration policy is consistent with and promotes effective risk management. Kiltearn's PBRT model helps to ensure that all Staff are focused on growing Kiltearn's business in a profitable and efficient manner. The fact that remuneration and partnership distributions are not based on the profitability of any specific investment recommendation, the implementation of a given trade(s) or the growth/retention of client assets further removes short term incentives. Performance fees are not charged to clients preserving a longer term perspective. Fixed elements of remuneration and drawings are kept relatively low so the firm can withstand various market pressures while still meeting its on-going obligations.

Kiltearn documents its business strategy, objectives, values and long term objectives in its compliance manual and personnel handbook. Its investment philosophy, investment guidelines, and a summary

of risks inherent in its investment approach are set out in the Offering Memorandum of its various commingled funds. The Supervisory Group has reviewed and adopted this policy in conjunction with the Compliance Group. The Supervisory Group has a significant amount of experience in the industry and is involved in the day to day business; are responsible for ensuring that the operational and compliance controls are adequately resourced and operating effectively. The Chief Compliance Officer reports directly to the Supervisory Group. All material issues identified in risk management monitoring reviews that cannot be resolved in a timely and appropriate manner are raised with the Supervisory Group. The Remuneration Group directly oversees the remuneration and drawings payable to members of the risk management and compliance groups. Given Kiltearn's size, nature and complexity, Kiltearn believes that these controls are adequate. In its ICAAP, Kiltearn assesses its capital requirements and the material and non-material risks that may trigger additional capital requirements.

Disapplication of Remuneration Code Provisions

Given the limited size, scope and nature of Kiltearn's activities and consistent with the explicit guidance given by the FCA, Kiltearn has disapplied provisions or proportionately applied provisions related to (i) leverage for fixed and variable components of remuneration, (ii) retained shares and other financial instruments, (iii) deferral and (iv) performance adjustments. Kiltearn has considered the impact of remuneration policies on its capital requirements, ICAAP and monitoring programme.