

**Capital Requirements Directive  
Pillar III Disclosure Statement for  
Appleton Capital Management Limited**

**Important Information**

This Capital Requirements Directive (“CRD”) Pillar III Disclosure Statement has been prepared by Appleton Capital Management Limited (“Appleton”). It has not been audited or independently verified by a person external to Appleton.

The risk management objectives, policies, strategies, approaches and limits described in this document constitute Appleton’s judgement as of the date of this document and are subject to change without notice.

Unless otherwise stated, figures quoted in relation to capital or capital requirements in the CRD Pillar III Disclosure Statement have been taken from Appleton’s 30th June 2009 “COREP ISPS Individual” return to the Financial Regulator which draws upon the audited financial statements of Appleton for the year ending 30th June 2008.

Information in this document: (i) has been prepared solely for the purposes of complying with Regulation 37 of Statutory Instrument Number 660 of 2006 (European Communities (Capital Adequacy of Investment Firms) Regulations 2006) as amended; (ii) does not constitute any form of financial statement concerning the business of Appleton; and (iii) does not constitute investment, accounting, credit, taxation, regulatory or legal advice.

If you intend entering into an investment management agreement with Appleton you should consult suitably qualified and independent investment, taxation, accounting, legal and regulatory advisors to discuss your specific situation and investment objectives before proceeding. This document should not be viewed as identifying or suggesting all of the direct and indirect risks that may be associated with a decision to have part of an investor’s portfolio managed by Appleton. Before making any decisions in relation to investments managed by Appleton, readers of this document should as part of their due diligence process review, challenge and discuss its contents, assumptions and the nature of the models used to derive analyses herein with their advisors and not regard this document as a substitute for the exercise of reasoned judgement on their part or on the part of their advisors. The results, charts, graphs, figures and returns shown in this document are based on assumptions that may not be realised and should not be relied upon as predictions of the future events. Despite the objective of the CRD to provide a common basis for Pillar III disclosures across investment firms and credit institutions, these disclosures may not be directly comparable with those of other investment firms for a number of reasons including but not limited to;

- Different elections available under the CRD and allowed by the various EU competent authorities
- The nature of Appleton’s business compared with that of other investment firms
- Differences in the risk appetite of investment firms
- Different options open to investment firms under the CRD
- The absence of any requirement for investment firms to disclose publicly their Pillar II capital requirements as such requirements may be critical to a valid comparison between investment firms.

## **General Description of Appleton**

ACMP Limited, which trades as Appleton Capital Management (“Appleton”), is a Republic of Ireland Company incorporated in May 1991, registration number 174103. Until 24th November 2000, Appleton was registered and traded as Gaiacorp Ireland Limited and was 100% owned by the Gaia Trust, a Danish cooperative. A management buyout resulted in 30% of the equity being purchased by the management and 70% being purchased by The Appleton Group, a South African investment company. On April 17th 2003, the management purchased the remaining 70% of the ordinary share capital. The change of name was a result of the management buyout. Appleton has been engaged since inception in the business of providing trading advisory services to institutional and other investors through individual managed accounts, as well as to non-US funds. Appleton was registered as a Commodity Trading Advisor with the Commodity Futures Trading Commission (“CFTC”) effective August 8th 1996 and as a Commodity Pool Operator effective October 17th 1997.

Appleton is a member of the National Futures Association (“NFA”) in such capacities. The Irish Financial Services Authority (“IFSRA”) also regulates Appleton. Its offices located at The Dublin Exchange Facility, IFSC, Dublin 1, and Ireland. Telephone + 353 1 607 5100; Telefax + 353 1 607 5177..

### **Frequency of Disclosure**

The Pillar III Disclosure Statement is updated annually.

### **Location & Medium**

Appleton posts its Pillar III Disclosure Statement on its website, [www.appleton.com](http://www.appleton.com), under the link “CRD Pillar III Disclosures”.

## **Appleton Disclosures as at 30th June 2009**

### **Risks Faced by Appleton**

In conducting its business activities Appleton faces a number of risks the most significant of which are discussed below. For the purposes of the discussion, Appleton has used the definitions of the various risks set out in the Committee of European Banking Supervisors CPO3 Revised Paper dated 25th January 2006.

#### **Business Risks**

Business risks consist of at least the following risks: credit risk, market risk, interest rate risk, liquidity risk, operational risk, strategic risk, and reputation risk.

#### **Credit Risk**

Credit risk is the current or prospective risk to earnings and capital arising from a counterparty failure to meet the terms of any contract with Appleton or its failure to perform as agreed. This risk includes residual risk, the credit risk in securitisation and cross-border or transfer risk. Appleton does not trade for its own account and does not take on credit risk in return for an expected reward.

Residual risk is a subcategory of credit risk and as Appleton’s business does not involve assuming credit risk for reward, it is not particularly relevant for Appleton.

Concentration risk includes (i) large (connected) individual exposures and (ii) significant exposures to groups of counterparts whose likelihood of default is driven by common underlying factors, e.g. sector, economy, geographical location, instrument type. Concentration risk is also a part of credit risk. The firm has diversified its clients across legal

jurisdictions and by business type to mitigate as far as reasonably practical against concentration risk in relation to its short-term debtors.

Securitisation risk can be regarded as yet another dimension of credit risk. As Appleton is not involved in securitisation; securitisation risk is not relevant to the firm.

Settlement risk is made up of elements of credit risk and liquidity risk and is defined as the risk that a firm will deliver the sold asset or cash to the counterparty and will not receive the purchased asset or cash as expected. As Appleton does not trade for its own account or undertake transactions exposing the firm to settlement risk, settlement risk is not directly relevant to Appleton's operations.

The firm has the same exposure to credit risk as any other business which holds its share capital on deposit with credit institutions or which has short-term debtors. Appleton has diversified the cash on deposit, which represents its shareholders' capital and reserves across a number of different banks in the Irish market in order to reduce its exposure to any one bank. As at 30th June 2009, all of the banks used by Appleton for depositing its shareholders' capital and reserves were covered institution for which corporate deposits were guaranteed under the laws of Ireland by the Minister for Finance, for the period 30th September 2008 to 29 September 2010.

The firm chooses its clients carefully so that the probability of credit default in relation to management charges and performance fees is relatively low.

### **Market Risk**

Market risk is the current or prospective risk to earnings and capital arising from adverse movements in bond prices, security or commodity prices or foreign exchange rates in the trading book. This risk can arise from market making, dealing, and position taking in bonds, securities, currencies, commodities, or derivatives (on bonds, securities, currencies, or commodities).

Appleton is not authorised to trade for its own account; the firm has no trading book and does not engage in market making, dealing or position taking in bonds, securities, commodities or currencies or derivatives on bonds, securities, currencies or commodities for its own account.

Market risk includes foreign exchange risk, defined as the current or prospective risk to earnings and capital arising from adverse movements in currency exchange rates. From time to time, the firm holds some of its capital in foreign deposits, principally USD, for a short period of time pending translation to the Euro to match anticipated expenditure in USD. The firm's capital adequacy requirement is increased by a foreign currency requirement in line with the Capital Requirements Directive. Market risk indirectly affects the firm's earnings in that an absence of return generating opportunities in the futures markets in which the firm operates or a failure of the firm's models to capture return within acceptable risk parameters in the futures markets will lead to a decline in the management fees and performance fees that the firm earns. This risk is managed by having a relatively diversified set of return-generating components in the firm's trading system and by managing the risk of client's portfolios.

### **Interest Rate Risk**

Interest rate risk is the current or prospective risk to earnings and capital arising from adverse movements in interest rates.

The exposure that Appleton's prospective earnings and capital has to interest rate risk is derived from the rate of interest that the firm earns on the cash representing shareholders' capital and reserves that the firm holds on deposit. On 30th June 2009, the firm invested its surplus cash in short-term deposits for terms of up to three months. The term for which the firm invests deposits may change without notice. Interest rate risk is reviewed annually as part of the firm's review of its Internal Capital Adequacy Assessment Process ("ICAAP"). The vast bulk of Appleton's deposits are held in Euro. Interest on non-Euro denominated deposits is not material.

### **Liquidity Risk**

Liquidity risk is the current or prospective risk to earnings and capital arising from an institution's inability to meet its liabilities when they come due.

The vast bulk of Appleton's share capital is invested in short-term deposits with credit institutions which at 30th June were a covered institution for which corporate deposits were guaranteed under the laws of Ireland by the Minister for Finance, for the period 30th September 2008 to 29 September 2010 and in the event of default of a covered institution in relation to a covered liability, the Minister for Finance will pay to the relevant creditor, on demand, an amount equal to the unpaid covered liabilities. All such deposits can be accessed on terms that vary from one day's notice to three month's notice. The firm without notice may change the level of liquidity of Appleton's deposits.

Settlement risk is made up of elements of credit risk and liquidity risk and is defined as the risk that a firm will deliver the sold asset or cash to the counterparty and will not receive the purchased asset or cash as expected. As Appleton does not trade for its own account or undertake transactions exposing the firm to settlement risk, settlement risk is not directly relevant to Appleton's operations.

### **Operational Risk**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes IT, legal and compliance risk.

All clients conduct a due diligence exercise on Appleton prior to entering into an investment management agreement with Appleton. This ensures that the firm's operational procedures are subject to frequent and reasonably thorough review. The firm conducts and documents a review of certain major aspects of its business each year. Appleton's management of operational risk consists of hiring highly competent staff, training employees well, developing and operating robust procedures for the performance of all important tasks and having in place a robust and tested business continuity plan. Operational risks arising from sales and marketing activities are mitigated using appropriate procedures in this area of operation. The following sections of the firm's Compliance and Procedures Manual attempt to mitigate operational risk in the sales and marketing areas:

- Procedure for the Classification of Clients under S.I. No. 60 of 2007 (as amended)
- Account Opening Procedures
- Prevention of Money Laundering & Terrorist Financing
- Procedures in Relation to Appleton's Disclosure Document
- Procedures for Review & Approval of Promotional Material
- Procedures for the Supervision of Email
- Procedures for Supervision of Appleton's Web Site
- Complaints Procedure

Operational risks arising from portfolio management for clients are mitigated using appropriate procedures such as:

- Best Execution Policy
- Conflicts of Interest – Identification & Management
- Trading Procedures
- Procedures for Bunched Orders & Split or Partial Fills
- Market Abuse (Directive 2003/6/EC) Regulations 2005
- Employee Code of Conduct

Other operational risks arising in the firm are mitigated using procedures appropriate for the risk in question. The following sections of the firm's Compliance and Procedures Manual attempt to mitigate operational risk in other areas:

- Contents of Compliance Report to the Board of Appleton
- Controls Governing Cheque and Other Payment Instructions
- Risk Management for Appleton
- Staff Training
- Privacy Policy
- Ethics Training Policy

### **IT Risk**

IT risk is a subcategory of operational risk and is defined as the current or prospective risk to earnings and capital arising from inadequate information technology and processing in terms of manageability, exclusivity, integrity, controllability and continuity, or arising from an inadequate IT strategy and policy or from inadequate use of the institution's information technology. Appleton employs experienced IT staff with university degrees in IT, has reasonable security in place and tests IT programs and applications prior to implementing them within the business. Appleton's has a business recovery plan and an offsite recovery space to mitigate against IT risks involving damage to physical IT equipment and loss of essential services such as telephone or Internet.

### **Legal & Compliance Risks**

Legal and compliance risk is a subcategory of operational risk and is defined as the current or prospective risk to earnings and capital arising from violations or non-compliance with laws, rules, regulations, agreements, prescribed practices, or ethical standards.

The firm has a policy of reading the original legislation or compliance rule rather than depending on commentaries or books on such matters. Legal advice is sought where there are issues of interpretation. Compliance policies are designed from the original legislation using information technology systems and an understanding of the practicalities of implementation by human beings.

### **Strategic Risk**

Strategic risk is defined as the current or prospective 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. The main strategic risks that Appleton faces are: (i) an absence of return generating opportunities in the futures markets in which the firm operates; and (ii) failure of the firm's models to capture returns within acceptable risk parameters in the futures markets in which the firm operates.

### **Reputation Risk**

Reputation risk is defined as the current or prospective risk to earnings and capital arising from adverse perception of the image of the financial institution on the part of customers, counterparties, shareholders, investors or regulators. Appleton is in the business of providing fund management services to its customers. It is very important that the firm's reputation is based on integrity, compliance with laws and regulations, fair dealing and professionalism. Losses arising from the other risks faced by Appleton may be repaired by a variety of means including good investment performance, higher pricing. By contrast, a lost reputation is extremely difficult and often impossible to regain. The way that each employee acts and represents Appleton to the firm's stakeholders can be a critical success factor. The firm has identified a number of specific risk areas, which have the potential to damage the firm's reputation. These risks and the associated risk mitigation techniques designed to reduce the risks identified are deemed to be proprietary to Appleton.

Appleton has developed a Compliance and Procedures Manual to mitigate many of the risks that the firm faces and sufficient to ensure compliance of the firm and the persons who are the firm's managers and employees with the firm's obligations under the European Communities (Market in Financial Instruments) Regulations 2007 (as amended) and the European Communities (Capital Adequacy of Investment Firms) Regulations 2006. The board of Appleton is responsible for risk management at Appleton.

The board has delegated the day-to-day risk management functions through the firm's Compliance and Procedures Manual to the executive directors and the Compliance Officer. The board of Appleton determines the level of risk that is acceptable to the firm.

### **Internal Reports**

Internal reports, such as the compliance report, the sales and marketing report, the annual self examination check list, the review of execution policy & order execution arrangements, management accounts, the quarterly review of bunched orders and performance reports are used by staff to carry out their responsibilities in accordance with the Compliance & Procedures Manual. The board as part of its supervision and management function also uses certain internal reports.

### **External Audit**

Finlay Mulligan audits Appleton

The firm's accounting year-end is the last day of June in each calendar year; the firm's annual report and audited financial statements for each complete accounting period up to and including 30th June 2008 have not been qualified.

### **Internal Capital Adequacy Assessment Process ("ICAAP")**

The board of Appleton sets the scope, methodology and objectives of Appleton's ICAAP. The firm's ICAAP is prepared by the compliance officer and reviewed by the board. The board at its main meetings throughout the year reviews the key risks identified in the firm's ICAAP.

### **ICAAP Objectives**

The objectives of the ICAAP are;

1. To enhance the links within Appleton between the firm's risk profile, its risk management and risk mitigation systems and its capital requirements
2. To ensure that Appleton identifies, measures, aggregates and monitors its risks
3. To ensure that Appleton has sufficient capital to support the potentially significant risks to which its business is exposed
4. To ensure that Appleton uses sound risk management systems and continues to develop such systems
5. To ensure that Appleton complies with the 'own funds' requirements of the CRD.

### **ICAAP Scope**

The ICAAP covers the business operations of Appleton. The firm has no subsidiaries or affiliates. The document is designed to provide a template for the effective risk management of Appleton.

### **Methodology Underpinning ICAAP**

The methodology underpinning the firm's ICAAP is to identify the potentially significant risks faced by the firm. For each potentially significant risk identified, the firm seeks to estimate the likelihood of that risk occurring and the consequences of that risk occurring based on the current risk management infrastructure of the firm. The firm then seeks to find an appropriate means of mitigating each such risk and to document its plans for mitigating that risk within the contexts of its capital and management resources.

### **Process for Identifying Risks**

Staff identified the potentially significant types and sources of risks in the business. The firm examined the factors that would activate those risks, the consequences of those risks if they occurred and the likelihood of occurrence of those risks. An assessment was also made of the manner in which the risks are related.

The resulting risks, which were not fully mitigated by the existing risk management infrastructure of the firm, were listed in the risk register, which form part of the firm's ICAAP.

risk

### **Process for Measuring Risks**

Risks are measured by examining the likelihood of the risk occurring per unit of time and the potential consequence in terms of its impact on profits. A score can be calculated for each

combining the likelihood and consequence, using risk assessment tables.

### **Procedures Underpinning ICAAP**

Appleton's ICAAP is underpinned by the firm's Compliance & Procedures Manual, the firm's Business Recovery Plan.

### **Adequacy of Risk Mitigation**

The risk mitigation techniques outlined in the ICAAP are designed to be practical, within the skill set of management and in most cases have a high likelihood of being achievable at reasonable cost. There is however no guarantee that risk mitigation techniques will be effective.

### **Assumptions Underpinning ICAAP**

Capital is not a long-run substitute with which to remedy a weakness in systems and controls; the underlying weakness must be addressed via risk management or risk mitigation techniques.

## **Assessment of Risk**

### **Risk Mitigation**

Appleton believes that there are four main ways in which downside risk can be managed.

Risks can be;

1. Reduced or eliminated
2. Transferred (e.g. to an insurance company)
3. Avoided
4. Absorbed or pooled.

### **Reducing or Eliminating Risks**

The firm seeks to reduce the probability of occurrence of an event and the adverse consequences if the event occurs. Reducing the probability of occurrence or the adverse consequences if the event occurs has mitigated much of Appleton's operational risk. For example, Appleton has trained its staff in the operating procedures for all of the main functions of the firm thus reducing the probability of occurrence of certain kinds of operational risk. The disaster recovery plan is a way of reducing the adverse consequences of some event that is not controllable.

### **Transferring Risks**

As a general principle of effective risk management, risks should be borne by the parties that are able to manage and mitigate those risks. For example, Appleton has transferred the risk of loss of business assets due to fire or theft and loss of profits due to business interruption to an insurance company as such an entity is best able to manage such risks through pooling them across many different types of businesses.

### **Avoiding Risks**

The most obvious way to avoid a risk is not to engage in the activity in a way that involves that risk. Appleton has avoided some counterparty credit and some market risk by not engaging in trading for its own account.

### **Absorbing and Pooling Risks**

Historically Appleton was dependent on one trading model trading in one asset class for revenue generation, which represented a significant risk to revenue.

The most effective way to reduce the risk to revenues a single trading strategy is to trade in more than one asset class with a diversified set of trading models. Hence research efforts have been focused on other asset classes and other more diverse trading models.

Currently Appleton's systematic futures trading model has several trading models operating in across multiple asset classes, which reduce the risks to revenue of underperformance, compared with operating just one trading model in one asset class.

### **Reducing Uncertainty**

The discussion of the mitigation options has so far assumed that all risks are known and can be quantified reasonably accurately. In practice, however, this is often far from being the case. Usually there is a degree of uncertainty about which risks might occur that could significantly affect the firm. Appleton has had considerable internal discussions to identify as many of the risks facing the business as possible.

### **No Guarantee that All Risks have been Identified**

Despite all the firm's efforts at risk management there may still be risks, which the firm faces but which it has not identified and which, might have a significant impact on the firm's earnings and capital.

### **Summary information on the terms & conditions of the main features of all own funds items & components thereof as at 30th June 2008.**

Paid up capital	Ordinary share capital	\$ 148,380
Share premium	Share premium on issue of ordinary shares	\$ Nil
Reserves	Audited revenue reserves	\$ 1,396,684

Source: Appleton annual report & audited financial statements for the years ending 30 June 2008  
There are no goodwill or intangible asset items.

The amount of original own funds, with separate disclosure of all positive items and deductions as at 30<sup>th</sup> June 2008

Paid up capital: \$148,386  
Share premium: \$ Nil  
Reserves: \$ 1,545,070

ORIGINAL OWN FUNDS AS AT 30TH JUNE 2008: \$ 148,386

### **Calculation of 'ICAAP Number'**

For each potentially significant risk identified by Appleton, the firm has in place a note of the factors that activate the risk, the consequences of the risk being activated, the risk management actions, the persons responsible for the management of that potentially significant risk, the current status of the risk and both the current and target risk scores. The ICAAP number is derived by mapping the frequency and consequences to probability and financial amounts respectively and aggregating across all such risks ignoring any reductions in risk due to lack of correlation between the risks.

### **Standardised approach exposure classes excluding securitisation positions**

Risk-weighted exposure amounts as at 30th June 2009

Institutions: EUR 80,000