Capital Resources for Regulatory Purpose

The European Capital Requirements Directive introduced consistent capital adequacy standards and an associated supervisory framework in the EU based on the Basel II rules. The Directive was introduced into the UK by the Financial Services Authority ("FSA"). The new framework consists of three **'pillars'.**

- **Pillar 1**

This specifies the minimum capital requirements.

- **Pillar 2**

This supervisory review process requires an assessment to be made of whether additional capital should be held against risks not covered by Pillar 1.

- **Pillar 3**

This introduces public disclosure of qualitative and quantitative information and is designed to promote market discipline by providing market participants with key information on a firm's risk exposures and risk management processes. It is the application of the Capital Requirements Directive and Basel II to the firm that requires it to make the Pillar 3 disclosures. The FSA regulations for the disclosures required under Pillar 3 are contained in the Prudential Sourcebook for Banks, Building Societies and Investment Firms ("BIPRU"). These rules allow a firm to exclude disclosures where the information is regarded as immaterial or proprietary/confidential. Disclosures have been made in this document in compliance with BIPRU11 unless that disclosure has been regarded as immaterial or proprietary/confidential.

MERCATER CAPITAL MANAGEMENT is authorised and regulated by the FSA and has permission to provide discretionary investment management and investment advisory services only and as such is subject to minimum capital requirements, based on the fact that it is a limited licence firm. The firm is not subject to consolidated reporting with other entities.

The directors and senior managers of the company determine the business strategy and risk appetite together with the design and implementation of a risk identification, monitoring and management framework. The Firm has an Audit & Risk Management Committee, comprising apportioned directors and the senior managers responsible for managing risk within the firm, to oversee the adequacy of and consider the risk identification monitoring and management arrangements. MERCATER CAPITAL MANAGEMENT principally manages its risks by maintaining appropriate documented procedures with the aim of operating a defined and transparent risk management framework. Additionally as new risks arise, these are dealt with appropriately at the time.

Risk appetite is the degree of risk that senior management are willing to accept without applying further resources and capital to mitigate the risk. Risks are assessed in terms of the probability and potential impact of risks after having taken into account any risk mitigation arrangements. Reasonable steps are taken by the firm to reduce the probability of any risk crystallising. Furthermore, additional capital resources would be maintained correlated to the potential impact, for risks where the probability is not fully mitigated and which the firm does not wish to bear.

The company is small with a simple operational infrastructure. It carries no market risk, no commodity position risk, and it is exposed to credit risk from management & performance fees receivable from the funds under its management. The firm follows the standardised approach for the assessment of both market risk and credit risk, using a simplified approach to calculate risk weights for credit risk exposures.

The firm is exempt from the operational risk requirement at Pillar 1 and is not required to calculate an operational risk capital charge. As above, MERCATER CAPITAL MANAGEMENT is a limited licence firm and as such its minimum capital requirement is the greatest of:

- The base capital requirement of €125,000; or
- The sum of its market and credit risk requirements; or
- The firm's fixed overhead requirement.

It is MERCATER`S experience that, as market and credit risks are not considered material for the company, the fixed overhead requirement is the greatest and therefore establishes the minimum capital requirement of £152,000.

The approach of the business to assessing the adequacy of its internal capital to support current and future activities is contained in the Internal Capital Adequacy Assessment Process. The fixed overhead requirement under Pillar 1 is deemed by the company to be sufficient capital to meet its current needs. All known risks, including operational risks, have been assessed and appropriate stress tests and scenario analyses have been undertaken to help determine any additional capital required under Pillar 2. No additional capital is currently required for Pillar 2.

The main features of **MERCATER CAPITAL MANAGEMENT`S** capital resources for regulatory purposes, at 31 December 2009 are as follows:

Capital item:	£000's
Tier 1 capital less innovative tier 1 capital	122
Total of tier 2, innovative tier 1 and tier 3 capital	420
Deductions from tier 1 and tier 2 capital	152
Total capital resources, net of deductions	268

Since the capital resources requirement of the firm is its fixed overhead requirement and not the total of the credit risk and market risk requirements, disclosures relating to credit, dilution and market risk are considered to be immaterial in assessing the risk exposures assessment processes of the business.

MERCATER CAPITAL MANAGEMENT does not have a trading book. The firm does not undertake securitisation. The firm does not hold any securities or equities as principal.