

CAPITAL REQUIREMENTS DIRECTIVE

Pillar 3 Disclosures

1. Introduction

The Capital Requirements Directive (“CRD”) is the framework for implementing Basel II in the European Union. Basel II implements a risk sensitive framework for the calculation of regulatory capital. In the UK, the FSA implemented the CRD in its regulations through its Prudential Sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”).

The CRD consists of three ‘Pillars’:

- Pillar 1: sets out the minimum capital requirements for measuring the firm’s credit, market and operational risk.
- Pillar 2: requires the firm to determine whether its Pillar 1 capital is adequate to cover these risks. This is achieved through the firm’s Internal Capital Adequacy Assessment Process (“ICAAP”) and is subject to annual review.
- Pillar 3: requires disclosure of certain requirements about the underlying risk management controls and capital position.

The provisions for Pillar 3 have been set out by the FSA in BIPRU Chapter 11. This document is designed to satisfy these disclosure requirements.

BIPRU 11 allows a firm to omit one or more of the required disclosures where it believes that the information is immaterial. For the purposes of this requirement, CoLIM will regard information as material if its omission or misstatement would change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.

The disclosures are required to be made on an annual basis at a minimum. The disclosures contained herein are based on the position as at 30th June 2011.

These disclosures have been produced solely for the purposes of Pillar 3. The disclosures do not form part of any audited financial statements. The disclosures have been reviewed by the board.

These disclosures will be published on the City of London Investment Group PLC website: www.citlon.co.uk.

2. Background to the Firm

City of London Investment Management Company Ltd (“CoLIM”) is a wholly owned subsidiary of City of London Investment Group PLC (CoLIG) (which is listed on the LSE Main Market in London) and is a limited liability company. CoLIM is authorised and regulated by the Financial Services Authority (FSA) and is a BIPRU 50 firm as defined in the FSA’s rulebook.

CoLIM acts as manager/adviser to a number of commingled funds and segregated accounts and in all cases the client assets are held independently by custodians, appointed either by the account holder (for segregated accounts) or by the trustee (for the commingled funds) or in one case by the Board of the Open-Ended Investment Company (OIEC) (for the Irish domiciled World Markets Umbrella Fund). CoLIM does not hold Clients’ money or assets and does not have the relevant FSA permitted business to do so.

CoLIM manages GBP3.6bn (as of 30th June 2011) via a range of comingled and segregated accounts with mandates to invest in closed ended funds and equities. Our investment approach is relative return, and is focused on the institutional market.

3. Risk Management Framework

3.1 Governance structure

The Board of CoLIM is the governing body ultimately responsible for the risk management framework within the business. The Board of Directors is responsible for ensuring an appropriate governance regime is in place, including ensuring effective processes are in place to identify, monitor, report and manage the risks that the firm is, or may be, exposed to. The Compliance Committee, which meets on a monthly basis, reports to the Board on any significant internal control failures and on the quality of the risk management framework in place, making suggestions for improvements where necessary.

3.2 Risk management systems and techniques

Risk management is viewed as the responsibility of all employees and directors within the firm. The Compliance department maintains a risk register and monitors key risks and controls on an ongoing basis. The Compliance department will also provide advice and guidance to the business on the quality and effectiveness of the control structures in place, and will work with the business to ensure internal control failures are addressed as

3.3 Compliance

The Compliance department is primarily responsible supporting the business and the Board in achieving its regulatory obligations. This is predominantly done via the provision of advice and guidance, training, and carrying out the firm's risk based monitoring programme. The monitoring programme has been tailored to test the firm's key controls in order to provide the Board with the necessary assurances as to their effectiveness. Compliance also carries out daily reviews of adherence to clients' investment guidelines.

4. Capital Resources

CoLIM's capital resources comprise the following:

	£'000
Pillar 1:	
Credit risk	665
Market risk	0
<i>Total</i>	665
Fixed overhead requirement (FOR)	1,294
<i>Pillar 1 requirement</i>	1,294
Pillar 2 Additional requirement	0
Total Capital Requirement	1,294
Current total capital	3,990
Surplus/(deficit)	2,696
Solvency Ratio %	308.35

Taken from the most recent semi-annual filing with the FSA, which was for May 2011

5. Capital Adequacy and risk categories

CoLIM's Pillar 1 requirement as at 30th June 2011 is £1,294 mn. This is derived by using the higher of either the FOR or the sum of credit and market risk.

Credit Risk

Credit risk is the risk of financial loss arising from a client or other counterparty failing to meet its obligations to repay outstanding amounts as they fall due. Credit risk for CoLIM is minimal. As at 30th June 2011, the company had no impaired assets for which a specific or general provision had been raised. Further breakdown is not disclosed due to immateriality.

Market Risk

Market risk arises from adverse changes to the values of positions or portfolios arising from changes in market prices, interest rates or exchange rates.

Market risk for CoLIM is minimal as the firm does not undertake any principal trading for its own account. Revenues, however, will be impacted by falls in the value of asset under management.

Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people or systems or from external events.

CoLIM undertakes risk assessments of all key areas of its business to identify the key risks it faces, along with the quality of related controls. These risks are monitored on an ongoing basis to ensure the business understands how they are evolving over time. CoLIM also monitors all losses and potential losses with view to ensuring that policies, procedures and controls are appropriate, and enhanced where necessary in order to minimize future repetitions.

The simplicity of the business model (as briefly described above) means that CoLIM is not exposed to many of the risks that many financial services firms might face. CoLIM's risk management objective is to be as simple and risk averse as is practical. This is achieved by focusing on one line of business (the management of client money for a fee), avoiding as many potential conflicts of interest as possible, and by not holding any client assets. However, CoLIM performs a review of all risks associated with its business within the scope of the Risk Register appended to its ICAAP which is also updated on an annual basis.

Business interruption risks are managed proactively by an extensive backup network and offsite continuity services.

6. Pillar 3 Remuneration Disclosures

In adherence with the FSA's implementation of the Capital Adequacy Directive into its Handbook, CoLIM makes the following disclosures with regards to its remuneration policies.

In being a limited license firm, CoLIM is classified as a 'proportionality Tier 4' firm. Proportionality tier four firms are considered to be the lowest category from a risk perspective and as such can disapply a number of the FSA's remuneration code requirements. Prior to doing so, however, firms must consider their individual circumstances and be satisfied that risks related to remuneration must not be unduly increased.

CoLIM believes that its systems and processes relating to remuneration do not pose a risk to either it, the industry or the regulator's objectives. In line with FSA guidance, and following CoLIM's own assessment, the firm has opted to disapply rules under the remuneration

principles proportionality rule relating to deferral, payment in shares or other instruments and ratio between fixed and variable remuneration.

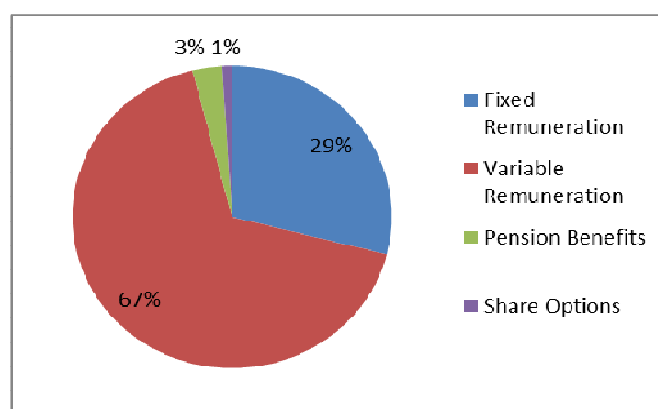
Under the FSA's Remuneration Code, CoLIM is required to identify staff who are subject to the Code ("Code Staff"). Remuneration Code staff comprises categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm's risk profile.

As at 31st May 2011 (the end of the firm's financial year), ten individuals were classified as being Code Staff.

The structure of CoLIM's remuneration programme is designed to reward individual and team performance, to align employees' interests with those of the firm, and to reward staff loyalty,

Eligible CoLIM employees participate in a profit share scheme, whereby a percentage of the firm's profits are distributed to staff on a quarterly basis. Individual awards are allocated taking into account individual performance (as measured during the performance appraisal process) and length of service.

For the 2010/2011 financial year, the total aggregate remuneration awarded to Code Staff was £3.1m. The breakdown of this figure into the various remuneration constituents is represented in the chart below.



The firm has a Remuneration Committee comprising of, and chaired by, non-executive directors, and which oversees the remuneration process. The Remuneration Committee operates to an agreed terms of reference.

The Compliance department within CoLIM is responsible for maintaining a list of the firm's Code employees, and ensuring that they, and the firm, remain in adherence with the obligations and the spirit of the FSA's Remuneration Code.

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