# Pillar 3 Disclosures: 31 March 2021

## Background

The capital adequacy framework implemented by the Financial Conduct Authority ("FCA") consists of three "pillars":

- Pillar 1 sets out the minimum capital requirements (base capital resources, credit risk and market risk requirements, and fixed overhead requirement ('FOR');
- Pillar 2 requires firms to assess through the Internal Capital Adequacy Assessment Process ("ICAAP") whether additional capital should be held against risks not adequately covered by Pillar 1; and
- Pillar 3 requires firms to publish certain details of their capital, risks and risk management processes.

## Scope of Application

The CQS consolidation group (the "Group") includes one entity that is regulated in the UK by the FCA, being CQS (UK) LLP ("UK LLP"). UK LLP is authorised by the FCA as a full-scope UK Alternative Investment Fund Manager and is categorised as a BIPRU firm for prudential regulatory purposes. UK LLP is subject to consolidated disclosure requirements by the FCA.

The Pillar 3 disclosures contained within this document apply to the Group on a consolidated basis. The Group is headed by CQS Management Limited and, in addition to the regulated entity listed above, fully consolidates the following entities:

| Name | Nature of business |
|---|---|
| CQS Aiguille du Chardonnet S.à.r.l. | Fund general partner |
| CQS Carry Partner, LP | In process of being wound-up |
| CQS DeepBlue Limited | In process of being wound-up |
| CQS DeepBlue HoldCo Limited | In process of being wound-up |
| CQS Directional Opportunities IA, LP | Holding company |
| CQS Global Relative Value IA, LP | In process of being wound-up |
| CQS (Hong Kong) Limited | Investment management and advisory, regulated by HK SFC |
| CQS IA General Partner | Holding company |
| CQS Investment Management (Australia) PTY LTD | Sales agent and marketing, regulated by ASIC in Australia |
| CQS RCR Carry Partner, LP | Holding company |
| CQS RCR Fund I GP Limited | Fund general partner |
| CQS US Feeder Fund (GP) LLC | Fund general partner |
| CQS (US), LLC | Investment management and advisory, regulated by US SEC |
| Rua Tierno Galvan (Investments Services) S.A. | Sales agent and marketing |

The Group's Pillar 3 disclosures are made annually as at the accounting reference date of 31 March each year.

## Governance Framework

The Group is overseen by the Board of Directors of CQS Management Limited.

Reporting to the Board are the following committees:

- The Board Executive Committee ("BEC"), whose primary focus is developing, articulating and executing the Group's strategy. BEC is supported by the Operating Committee ("OpCo"), which has responsibility for managing day-to-day operations in respect of the global investment management business and associated activities, and advising BEC as required.
- The Senior Partner Group, which supports the Board Executive Committee as an advisory forum and sounding board in respect of developing the Firm's business strategy and long-term vision.
- The Audit Committee, which provides oversight of corporate governance matters, including the Firm's enterprise risk framework, external and management reporting and external and internal audits.
- The Remuneration Committee, which provides review and approval of remuneration policies and the remuneration framework.

Sub-groups or committees:

- The Fund Risk Committee ("FRC"): Oversight of the risk management frameworks for investment mandates, including funds' market, liquidity, counterparty credit and operational risk.
- Valuation Committee ("ValCo"): Oversight of valuation policies and pricing of hard-to-value positions.
- Regulatory Oversight & Conflicts Committee ("ROCC"): Dual focus on the impact of regulatory developments upon CQS and the assessment of conflicts of interest affecting CQS or its funds.

Governance Structure:

# Risk Management Objectives and Policies

OpCo is responsible for oversight of the Group's risk management including the review and approval of the Risk Management Framework, Risk Appetite Statement and regulatory capital assessment; monitoring and assessment of risk; oversight of systems and controls; escalation of risks and matters of significance to BEC where required.

The objective of the Group's risk management structure is to manage known risks effectively and react to emerging risks.

## Business Risk

The Group has identified its key business risk as being the risk of a substantial decline in assets under management and, therefore, fee income. This is principally driven by the risk of poor investment performance, whether due to internal decision making, errors or external market conditions. The Group mitigates this risk through close monitoring of investment performance, implementing appropriate remuneration and incentive structures to hire and retain highly skilled professionals, and through maintaining robust procedures for identifying, measuring and managing portfolio risk.

The Group's business model is also at risk from reputational factors, as reputational damage could result in a significant decrease in assets under management and impairment of future business development. To curb both the effect and occurrence of damage to reputation, the Group invests resources into portfolio management, the infrastructure platform and communications with relevant parties, including investors, independent directors, regulators, third party service providers and counterparties.

Regulatory factors also give rise to business risk; the Group operates within a highly regulated environment and laws and regulations may evolve in a manner that negatively impacts upon the Group's business model. The Group mitigates this risk through ongoing monitoring of current and proposed regulatory requirements along with engagement with industry bodies.

## Operational Risk

The Group is exposed to operational risks as a result of inadequate or failed internal processes, breaches of regulatory or ethical standards, errors and breaches in the Group's security. Operational risk is monitored primarily by OpCo (with legal and compliance risks additionally covered by ROCC) and is mitigated through the implementation of robust controls and processes, regular staff training and policies covering anti-money laundering, bribery, market abuse etc.

The Group has also established an internal audit function to provide independent, objective assurance and consulting services that help senior management to protect the assets, reputation and sustainability of the Group. Internal audit conducts ongoing audit testing and controls assurance reviews to cover areas assessed as higher risk or of being of particular interest or concern to senior management.

## Market Risk and Interest Rate Risk

The Group holds investments in Collateralised Loan Obligations ("CLOs") to satisfy risk retention requirements, along with investments in certain CQS funds (either through direct holdings or derivatives linked to CQS funds), both of which are exposed to possible impairment due to market performance. As part of the Group's capital planning process, specific capital and reserves are held in consideration of market risk to mitigate the impact of this exposure, which is reported to BEC on a monthly basis.

Market risk also arises through exposure to balances held in foreign currencies, primarily due to fees generated in currencies other than the Group's functional currency as well as foreign currency denominated investments. Foreign currency balances are monitored on an ongoing basis and hedging strategies executed to mitigate exposure.

The Group is exposed to interest rate risk from investments held in CLO notes, cash at bank and borrowings. Exposure to interest rate risk is monitored on an ongoing basis and managed using financial instruments where necessary.

## Credit Risk

The Group is exposed to the risk of loss should any of the Group's counterparties fail to fulfil their contractual obligations. This risk is managed through the establishment of short settlement terms with the Group's counterparties, primarily the funds managed by the Group and other CQS entities outside the Group, with billing for management and performance fees settled within three months. Oversight of the market, liquidity, credit and operational risk of the funds managed by the Group is provided by the Group's Fund Risk Committee.

## Liquidity Risk

The Group is required to maintain sufficient liquidity to ensure that there is no significant risk that liabilities cannot be met as they fall due. The Group maintains sufficient surplus cash and other liquid assets to meet its working capital requirements and other immediate requirements that can reasonably be foreseen through cash forecasting and review of net liquid assets on a regular basis.

# Capital Resources and Requirements

## Capital Resources

The Group's capital resources, on a consolidated basis, consisted of the following as at 31 March 2021:

| Capital Resources | | $ millions |
|---|---|---|
| Core Tier One Capital | Share capital, share premium and other reserves | 36.1 |
| Less: Deductions | | (2.1) |
| **Total Capital Resources** | | **34.0** |

## Capital Requirement

As a BIPRU 50k firm, the Group's minimum capital requirement under Pillar 1 is calculated as being the greater of:

- A base capital requirement of €50,000;
- The sum of its market and credit risk capital requirements; and
- The fixed overheads requirement.

As at 31 March 2021, the Group's Pillar 1 capital requirement was as follows:

| Capital Requirement | $ millions |
|---|---|
| Credit Risk | 9.4 |
| Market Risk | 1.4 |
| **Sum of Credit and Market Risk** | **10.7** |
| Fixed Overhead Requirement | 16.8 |
| **Total Pillar 1 Capital Requirement** | **16.8** |

As a result of the regulatory permissions held, the Group's Pillar 1 capital requirements do not include an operational risk capital component. As part of the Group's ICAAP, the Group assesses all known risks, including operational risks, to consider the adequacy of the level of capital held in view of the Group's current and future activities. The risks identified are stress-tested against various scenarios to determine the level of capital that needs to be held.

The adequacy of the capital held by the Group is assessed regularly, and at least annually, as part of the ICAAP framework and is subject to review by the Audit Committee and approval by OpCo and BEC. Following the most recent ICAAP review, it was concluded that the Group's total Pillar 2 capital requirement was $9.4 million.

Separately to the assessment of Group capital requirements, UK LLP is subject to a capital requirement under the AIFMD. This is UK LLP's own fixed overhead requirement ($14.8 million) plus a "professional negligence capital requirement" of 0.01% of AIF assets under management, gross of leverage. This gives a total capital requirement for the LLP of $20.3 million, which acts as an additional floor of regulatory capital that UK LLP (and Group) must hold.

## Exposure to Securitisation Positions

The Group's securitisation positions represent holdings in European CLOs to satisfy risk retention requirements arising under Article 405 of Regulation No 575/2013/EU (the "Retention Rules"). The Retention Rules require that the Group holds at least 5% of the nominal value of each tranche sold or transferred to investors of each CLO for which the Group acts as originator in its role as collateral manager. Consequently, the CLO notes held by the Group range from most senior to most subordinate.

# Remuneration

The following Pillar 3 disclosure on remuneration is made for the year ended 31 December 2020 (the "Performance Period").

## Proportionality

UK LLP has been identified as a proportionality level three firm, as described in the FCA's General Guidance on Proportionality dated January 2014, for the purposes of this remuneration disclosure. All staff involved in this business during the Performance Period are captured by this disclosure.

## Governing Body and Remuneration Committee

The responsibility for remuneration of the above staff lies with the board of directors of CQS Management Limited (the "Governing Body"), which is the corporate member of UK LLP.

The Governing Body sets the Remuneration Policy for CQS and oversees its governance framework to ensure that remuneration arrangements are consistent with, and promote, effective risk management. The setting of the Remuneration Policy and its operation takes account of the following:

- the primary business of CQS is the provision of investment management and advisory services to funds (each of which have their own independent governing bodies), generating fee-based income;
- the retention, recruitment and talent development requirements of the firm as well as the external market environment; and
- updates on regulatory developments and market wide remuneration issues.

The Governing Body has appointed a Remuneration Committee ("RemCo") to make recommendations to the Governing Body in respect of remuneration.

RemCo has met several times to consider evidence provided by senior management within CQS and the results of external benchmarking studies and advice from third party consultants with respect to the Performance Period.

The Group's Remuneration Committee is responsible for providing an independent review and approval of all remuneration policies and the remuneration framework of the firm.

## Information on Link Between Pay and Performance

The total remuneration for each individual comprises a base salary/draw, discretionary variable award (which may be deferred) and benefits. These components are considered and are balanced appropriately having regard to the role fulfilled by each particular individual.

In establishing the level of variable awards (if any) for the firm as whole and the individuals, the Governing Body takes into consideration:

- the operating profit of CQS, reflecting the revenue from management and performance fees (on a crystallisation basis) less its operating expenses;
- the performance of the relevant team, being the business line (e.g. the Convertibles portfolio management team) or support function (e.g. the Distribution or Legal function);
- the performance of the individual (both financial and non-financial performance); and
- market and benchmarking data for the industry and individual functions.

The assessment of each individual's performance encompasses both financial and non-financial performance with quantitative metrics and qualitative input utilised. CQS is committed to ensuring that individuals are not rewarded for running undue risk and are incentivised to operate within the risk tolerance set by the Governing Body in conjunction with the firm's Board Executive Committee. The Compliance and Human Resources teams provide input into the discretionary compensation process in relation to staff behaviour including any breaches of relevant policies.

CQS also uses deferral plans to incentivise and retain staff, to ensure individuals maintain sustainable performance and effective risk management over a multi-year timeframe and to align interests to investors in the funds managed by the firm. All individuals designated as Code Staff and certain other non-Code Staff receive part of their remuneration in the form of deferred compensation. Amounts deferred are invested in CQS managed funds. The vesting and payout of awards are made in accordance with the relevant deferral plan rules. In certain circumstances, where deferred amounts have not yet vested, they may be clawed back and forfeited by the individual.

## Quantitative Information on Remuneration

Code Staff have been identified as those falling into the following categories:

- Senior management, risk takers and control functions; and
- Staff receiving total remuneration that takes them into a defined remuneration bracket that is considered to be indicative of having a material impact on the risk profile of CQS.

CQS has identified 43 individuals as Code Staff during the course of the Performance Period. The aggregate remuneration of staff identified as Code Staff for the Performance Period was $68.2m. CQS considers that it has a single business area (investment management) which benefits from a range of support and ancillary functions.