

## TARCHON CAPITAL MANAGEMENT LLP PILLAR 3 DISCLOSURE - December 2009

Following the 2006 introduction of the Capital Requirements Directive ("CRD"), representing the European Union's application of the Basel Capital Accord, the Financial Services Authority ("FSA") implemented this in the UK through the creation of the General Prudential Sourcebook ("GENPRU") and Prudential Sourcebooks for Banks, Building Societies and Investment Firms ("BIPRU").

The CRD requirements have three pillars:

1. Pillar 1 sets out minimum capital requirements
2. Pillar 2 requires us and the FSA to express a view on whether additional capital needs to be held for risks not covered by Pillar 1
3. Pillar 3 requires disclosure of specified of risk management processes, capital resources and capital requirements.

This formal disclosure document is designed to meet the rules in BIPRU 11 set out in the provisions for Pillar 3, Future disclosures will be made on an annual basis as soon as practicable after the publication of the Annual Financial Statements and published on our website.

Tarchon Capital Management LLP ("the Firm") is authorised and regulated by the Financial Services Authority and as such is subject to minimum regulatory capital requirements. The Firm is categorised as a limited licence firm by the FSA for capital purposes. It acts solely as an investment manager and does not hold client money.

The Partners of the Firm determine its business strategy and risk appetite along with designing and implementing a risk management framework that recognises the risks that the business faces. They also determine how those risks may be mitigated and assess on an ongoing basis the arrangements to manage those risks. The Partners meet on a regular basis and discuss current projections for profitability and regulatory capital management, business planning and risk management. The Partners manage the Firm's risks business through a framework of policy and procedures having regard to relevant laws, standards, principles and rules (including FSA principles and rules) with the aim to operate a defined and transparent risk management framework. These policies and procedures are updated as required.

The Partners have identified that the main areas of risk to which the Firm is exposed are:

- Business risk is the risk from general business and economic conditions which could lead to a reduction in assets under management and decrease in management fees. The partners consider the business risks factors in planning and decision-making and model various economic scenarios such as poor performance, economic downturn and employee turnover.
- Operational risk defined by the FSA as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. We have identified relevant risks and have dedicated human and systematic resources to monitor, understand and mitigate operational risks to the extent feasible in order to maintain a low risk profile in this area.
- Market risk is prevalent at the Firm in its exposure to foreign exchange fluctuations due to management and performance fees being denominated in currencies other than sterling. This is mitigated through regular monitoring
- Credit risk exists on receivables from third parties relating to management and performance fees and exposure to banks where the firm maintains deposits. These risks are mitigated through contractual arrangements in relation to the payment of management fees and monitoring payments against agreed payment arrangements whilst deposits are monitored weekly and reported to the management to ensure risk is diversified across several counterparties.

Annually the Partners formally review their risks, controls and other risk mitigation arrangements and assess their effectiveness. Where the Partners identify material risks they model the financial impact of these risks as part of our business planning and capital management and conclude whether the amount of regulatory capital is adequate.

The Firm is small with a simple operational infrastructure. It carries no market risk, other than foreign exchange risk on its accounts receivable and cash balances, and credit risk from management, advisory and performance fees receivable from its clients. The Firm follows a standardised approach to market risk and the simplified standard approach to credit risk. The Firm is subject to the Fixed Overhead Requirement and is not required to calculate an operational risk capital charge.

The Firm is Limited Liability Partnership and its capital arrangements are established in its Partnerships deed. Its capital is summarised as follows:

EQUITY	31 March 2009 £	31 March 2008 £
Members' capital	846,000	846,000
Other reserves	<u>951,463</u>	<u>1,794,803</u>
	<u>1,797,463</u>	<u>2,640,803</u>

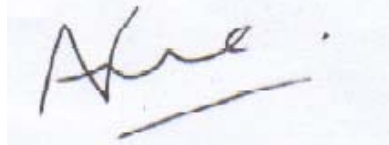
The main features of the Firm's capital resources for regulatory purposes are as follows:

Capital Item	£'000
Tier 1 capital less innovative tier 1 capital	1,797
Total tier 2, innovative tier 1 and tier 3 capital	
Deductions from tier 1 and tier 2 capital	
Total capital resources, net of deductions	1,797

As discussed above the firm is a limited licence firm and as such its capital requirements are the greater of:

- Its base capital requirement of €50,000; or
- The sum of its market and credit risk requirements; or
- Its Fixed Overhead Requirement

It is the Firm's experience that the Fixed Overhead Requirement establishes its capital requirements and hence market and credit risks are considered not to be material.



Abhay Varma  
Partner, Tarchon Capital Management  
11/12/09