Pillar III Disclosures

31 December 2018

The Capital Requirements Directive (CRD) was implemented on 1 January 2007. It comprises three 'pillars':

i. Pillar I is the calculation of minimum regulatory capital requirements which firms are required to keep for credit, market and operational risk.

ii. Pillar II requires an Internal Capital Adequacy Assessment Process (ICAAP) by firms to assess whether additional regulatory capital should be held by the firm in addition to Pillar I based on the risks faced by the firm, the risk management processes and stress testing.

iii. Pillar III sets disclosure requirements which allow market participants to assess a firm's capital, risk exposures and risk management processes.

In accordance with the requirements of Pillar III, this document is intended to disclose information relating to Big Society Capital Limited's ('BSC') risk and control framework and capital position.

The Capital Requirements Directive ('the Directive') established a revised regulatory capital framework across Europe governing the amount and nature of capital that investment firms must maintain. In the United Kingdom, the Directive has been implemented by the Financial Conduct Authority ('FCA') in its regulations through the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU'). All disclosures are in line with BIPRU 11.

The Big Society Trust is the ultimate parent company in the Big Society Group. BSC is its subsidiary. BSC is authorised and regulated by the Financial Conduct Authority (FCA).

BSC's object is to act as a social investment wholesaler and generally to promote the development of the social investment marketplace in the UK. It also seeks to achieve and maintain financial sustainability over the longer term.

Risk management objectives and policies

The BSC Board is responsible for the overall risk strategy of the firm, which includes ensuring that there are adequate systems of risk management. The systems and processes aim to identify, measure and report risks. Risk is controlled through a system of procedures, checks, reports and responsibilities.

BSC Board

The composition of the BSC Board reflects its purpose and includes directors with financial and/or social sector expertise. The Board comprises non-executive directors (including one who is nominated by the shareholder banks) and the CEO of Big Society Capital.

The Principles for Appointments, to the BSC Board, agreed between BSC and the Big Society Trust specify that appointments of board members shall be made on merit and shall not be made on any basis of discrimination.

BSC commits to the Big Society Trust that appointments to the Board of BSC shall take account of specified principles detailed in the UK Corporate Governance Code published by the Financial Reporting Council (June 2010 edition). This includes adoption of a formal, rigorous and transparent procedure for appointment of new directors. The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender. Under the BSC Articles, one director is appointed by the shareholder banks.

There is specific reference in the Articles of BSC for the need to maintain "an even balance of board appointed directors with experience of the financial and social sectors of the economy".

After each Board appointment, the Nominations and Remuneration Committee sends a brief paper explaining the reason for their choice of candidate to the Chair of the Big Society Trust.

Details of BSC board members are available on its website (http://www.bigsocietycapital.com). The BSC board at 31 December 2018 had twelve members, six of whom were women.

Additional non-executive and executive director roles (including charity trusteeships and members of educational governing boards) held by the directors total 51. BSC maintains a Register of Interests of all current BSC Directors which is regularly updated.

Committee Structures

Big Society Capital has two Board Committees each comprising a majority of non-executive directors with external members providing specific expertise:

Audit, Risk and Compliance Committee

The Audit, Risk and Compliance Committee (ARCC) is responsible for overseeing management processes and other arrangements to ensure the appropriateness and effectiveness of systems and controls, including risk management.

Nominations and Remuneration Committee

The Nominations and Remuneration Committee is responsible for making recommendations concerning the appointment of directors, particularly for ensuring that there is an even balance on the Board between individuals with the appropriate depth of experience and expertise in the financial and social sectors. It also has responsibilities for setting levels of remuneration.

Big Society Capital has three other operational committees:

Executive Committee

BSC is run by an Executive Committee which meets on a weekly basis, and leads the six key areas of the business: investments; strategy and market development; financial sector engagement; social sector engagement; finance, legal and operations; and communications. It is chaired by the CEO of Big Society Capital. The Executive Committee has a quarterly Risk Management meeting to review BSC's risk framework and key risks. As part of this meeting, the Executive Committee also identifies its key risks for the next quarter. Risks, arising in the interim, are discussed during the weekly Executive Committee meetings and, where deemed necessary, escalated to the Board or the relevant Board Committee.

Investment Committee

The Investment Committee, meets on a weekly basis, and comprises Board and Executive Committee members responsible for making investments, the performance of Big Society Capital's portfolio of investments, and reporting its activities to the Board. It is chaired by the CEO of Big Society Capital or delegated to an alternative member of the Committee.

Each investment made by the firm is reviewed and approved by the Investment Committee. Before investments are reviewed by the Investment Committee significant due diligence is completed by the Investment Team including an assessment of the risk of the investment, financial sustainability, social impact and market development impact. In addition, legal and regulatory due diligence is completed. All investments over £10 million also require approval by the Board.

Valuation Committee

The Valuation Committee, meets on a quarterly basis, and is responsible for determining valuations and assessing investment performance, including social impact. This includes identifying key risks and issues within Big Society Capital's investment portfolio. As the basis for discussion, the Investment Team complete an analysis of valuation for each investment utilising data provided by the investees. It is chaired by the CFO of Big Society Capital (who is not a member of the Investment Committee). Members of ARCC and company auditors are invited to observe meetings of the Valuation Committee.

Internal Control

The Board is responsible for overall corporate governance, which includes ensuring that there are adequate systems of risk management. The systems and processes aim to identify, measure and

report risks. Risk is controlled through a system of procedures, checks, reports and responsibilities. The Audit, Risk and Compliance Committee examines management processes and other arrangements to ensure the appropriateness and effectiveness of systems and controls, including risk management.

The Board is responsible for the internal controls system and for reviewing its effectiveness. The following reporting is used in this assessment**:**

- The Finance Team prepare monthly management reporting which includes: a section on FCA Capital monitoring, showing the surplus of Capital Resources over the firm's Pillar II capital requirement; as well as KPIs, financial performance, balance sheet and investment portfolio and treasury data.

  These management accounts are provided to the Audit, Risk and Compliance Committee and the Board on a quarterly basis.

- Following the quarterly risk meeting of the Executive Committee, the Chief Financial Officer prepares a report summarising 'Key Risks' and presents this for review by the Audit, Risk and Compliance Committee. The Key Risks Summary is presented to the Board on a six monthly basis.

- A quarterly Activity Review is presented to the Board by members of the Executive Committee. This details:
  - investment performance and activity, including product development; pipeline; approvals, signings and drawdowns; co-investment; use of capital; and returns.
  - Progress towards the execution of the firm's strategy including major projects and social and financial sector engagement work

- The Head of Compliance presents a quarterly report to the Audit, Risk and Compliance Committee, in which any regulatory or operational compliance issues are raised.

- The Money Laundering Reporting Officer presents an annual report to the Audit, Risk and Compliance Committee on the anti-money laundering and fraud prevention (financial crime) measures in place within the firm.

- The Finance Team complete an annual budgeting / 5 year forecasting process, which is presented to the Board.

- An ICAAP report providing an assessment of the capital required to support the business is presented to the Board annually. This includes a series of stress tests designed to address the potential impact of the material risks facing the firm.

BSC have engaged an external regulatory advisor to provide on-going support and expertise to the firm and to perform reviews of the internal compliance monitoring processes.

Key risks faced by BSC

BSC Risk Framework

In order to achieve its mission BSC is required to take risks from a strategic, financial return and social impact perspective. BSC assesses risk under 4 Principal Risk headings as set out below. Within this overall risk framework, actual risk is monitored by the Board on a semi-annual basis, and by the Executive Committee and the Audit, Risk and Compliance Committee on a quarterly basis. The Board is responsible for determining the appropriate tolerance approach to risks faced by BSC.

The 4 Principal Risk areas are:

- **Strategic:** This assesses the risk that BSC is unable to meet its strategic objectives together with risk that BSC's reputation is damaged and therefore its ability to fulfill its mission is reduced.

- **Performance:** This assesses the risk that the social investment portfolio as a whole does not perform within its intended social impact or financial parameters.

- **External:** This assesses the risk that macroeconomic factors and policy changes outside BSC's control impact BSC's ability to fulfil its mission.

- **Operational and Preventable:** This assesses the risks that BSC does not operate within its financial control and regulatory parameters together with risks associated with the staffing and operational infrastructure of the organisation.

Material financial risks on the Social Investment and Treasury portfolios

Credit Risk

Credit risk is the risk of financial loss from a counterparty's failure to settle financial obligations as they fall due. The firm is exposed to credit risk principally from investments in unlisted funds, debt securities held, loans and receivables and cash deposits.

Investments in unlisted funds and loans included in fixed asset investments are all social investments. Debt securities, showing as current asset investments, are held within the treasury portfolio. Cash deposits are either held for operational purposes or as part of the treasury portfolio.

Cash deposits that can be withdrawn at any time without notice and without penalty or that have a maturity or period of notice of not more than 24 hours or one working day are shown as cash at bank and in hand. All other deposits with a maturity of up to 1 year are shown as investments held as current assets.

Within the treasury portfolio the firm has set a maximum exposure limit for each counterparty. The treasury policy seeks to minimise the exposure to counterparties with perceived higher risk of default by specifying an average credit rating for the portfolio. The treasury portfolio is managed

externally and counterparty exposure limits and average credit rating are monitored by the external managers. The firm receives monthly treasury reports.

The firm's maximum exposure subject to credit risk at the balance sheet date is represented by the respective carrying amounts of the relevant financial assets in the balance sheet. As detailed in the firm's audited Financial Statements credit risk exposure at 31 December 2018 was:

BSC Limited's Credit Risk Exposure as at 31 December 2018

	£000's
Fixed asset investments - Social Investment Portfolio	220,196
Other debtors and accrued income	91
Investments held as current assets -Social Bond/ Equity/ Multi Asset Funds	30,297
Investments held as current assets - Cash deposits	32,715
Investments held as current assets - Listed debt securities	256,305
Cash deposits - Cash at bank and in hand	17,251
Maximum exposure to credit risk at the balance sheet date	556,855

Liquidity Risk

Liquidity risk is the risk that cash may not be available to pay obligations. The firm's policy is to ensure it has sufficient funds to fulfil liabilities as they fall due, including investment commitments approved by the Investment Committee. BSC's liquidity risk is managed within the firm's Liquidity Risk Management Framework.

The firm's financial assets include loans, unlisted equity investments, investments in unlisted funds and investments in social impact bonds, which are generally illiquid.

The firm's investments in listed debt securities are considered to be readily realisable as they are actively traded. All cash deposits held as current assets have a maturity of less than 12 months.

The firm's overall liquidity is monitored on a daily basis and sufficient cash retained within the firm's operational bank account and the treasury portfolio.

Regulatory Risk

The firm is authorised and regulated by the FCA. In addition to meeting a range of regulatory obligations BSC is required to regularly assess the amount of regulatory capital needed to be in compliance with prudential rules and operational requirements. The Firm is committed to hold regulatory and liquid capital in excess of requirements.

The firm has, at all times during the period under regulatory supervision, held sufficient capital to meet its regulatory capital requirements.

Own Funds

BSC's own funds are set out below and reflect 2018 audited results.

BSC Limited Capital Position as at 31 December 2018	
	£000's
Tier 1 Share capital	581,345
Previous years' losses	(16,970)
Current year losses	(6,458)
Total deductions	(19,569)
Total own funds net of deductions	538,348

Deductions consist of holdings of common equity tier 1, deducted in accordance with the relevant regulations.

Capital requirements

Pillar I

The firm has adopted the standardised approach to credit risk. The firm has limited exposure to market risk (foreign exchange risk), from it's holdings in non-GBP denominated treasury assets which are hedged with currency forward contracts in accordance with the firm's investment management mandate (see Pillar II description below) and a small non-GBP denominated holding in its social investment portfolio.

The figures below reflect 2018 audited results. The capital requirement figures reflect 8% of the calculated risk weighted exposure amounts.

BSC Limited Capital Pillar I Capital Position as at 31 December 2018	
	£000's
(a) Capital requirement amounts for credit risk	45,425
(b) Capital requirement amounts for market risk	26
(c) Sum of (a) and (b)	45,451
(d) Fixed overhead requirement	1,305
Own funds requirement (higher of (c) or (d))	45,451
Surplus - Own funds less Pillar I requirement	492,897

Pillar II

The firm's overall approach to assessing the adequacy of our internal capital is set out in its Internal Capital Adequacy Assessment Process (ICAAP).

In addition to the minimum level of Pillar I requirements, the firm must also hold sufficient capital, and maintain sufficient liquidity, that senior management deem necessary based on the risks faced by the business.

Credit and Counterparty Risk:

The firm has considered the credit risk requirement under Pillar II and has come up with its own internal calculation. For its social investment portfolio, the firm has assigned a risk exposure weighting based on asset type, draw down status and the firm's current write down ratio, which it then applies to the existing investment portfolio to come up with its own internal capital requirement. For its treasury portfolio the firm applies an average risk weighting across all treasury and cash assets, being an approximation of the credit risk requirement calculated under Pillar I.

Operational Risk:

The firm has considered the impact of operational risk as part of its own internal Pillar II calculation. There is no history of operational losses on which the firm can base its assessment. It has therefore considered situations that could result in losses and applied risk weighting against the size of its largest investment commitment in order to allocate internal capital for organisational risk. Should losses be incurred in the future the firm will use these as a basis for calculating any future capital allocation.

Foreign Exchange Risk:

The firm does not face significant foreign exchange risk on its treasury investments. The largest portion of the treasury portfolio is managed by a third party investment manager with an investment management mandate that permits up to 25% of the investment portfolio to be invested in securities denominated in US Dollars and/or Euro's.

The mandate requires that any such non-GBP investments must be hedged back to GBP with a requirement for the investment manager to maintain the hedge ratio between the band of 98% to 102% of the net asset value of the total investment portfolio.

The permitted derivatives that the investment manager may utilise are over the counter currency contracts for the purposes of hedging any non-base currency exposures in the investment portfolio back to GBP and bond futures to hedge non-GBP interest rate risk.

The firm has calculated, for the purpose of its Pillar II requirement, an exposure risk based on 2% of the net asset value of the treasury investment portfolio, being the tolerance detailed above.

The firm has also invested in a foreign currency denominated fund in its social investment portfolio – currently the size of this investment is too low for a hedging process to be cost effective and in addition the fund also holds GBP denominated assets which partially mitigate the exposure.

Risk Approach

The firm has considered its exposure to credit, market and liquidity risks. In most cases it has been determined that these risks are captured in the regulatory capital calculations and that there are adequate and appropriate mitigating controls as well as substantial equity capital in place. Where this has not been considered sufficient, the credit risk calculation described above, has been applied to ensure that adequate internal capital is allocated against this.

The firm is exposed to operational and reputational risks as a result of its business model and potential stakeholder interest. These risks are considered in detail in the firm's Key Risk Summary and Risk Register. The firm has allocated internal capital for operational risk, as detailed above.

If for any reason the firm were to become unviable at any point, due to the materialisation of significant unexpected issues, the Board would take actions appropriate to the circumstances to reduce costs. An assessment of the requirement to wind down the business is set out in the firm's financial projections.

Overall Capital Required

BSC Limited Capital Pillar II Capital Position as at 31 December 2018

	£000's
(a) Capital requirement amounts for credit risk	55,951
(b) Capital requirement amounts for operational risk	6,820
(c) Capital requirement amounts for market risk	202
(d) Sum of (a) and (b) and (c)	62,973
Own funds requirement	62,973
Surplus - Own funds less Pillar II requirement	475,375

Under the approach described above the Pillar II requirement, at the time of preparing the firm's ICAAP was £63.0m, compared to the 31 December 2018 Pillar I requirement of £48.0m. Both the Pillar I and the Pillar II requirements were higher than the business risk (wind down) requirement.

The firm's Board ensures that its own funds exceed the Pillar II requirement. Internally, own funds are monitored against the Pillar II requirement on a monthly basis. This monitoring is presented to the board on a quarterly basis.

Annual Report Disclosure

BSC's 2018 Report and Financial Statements are available from the firm's website, (http://www.bigsocietycapital.com).

a) Remuneration Policy

Details of BSC's remuneration policy are provided in the Remuneration Report on page 4 of BSC's 2018 Report and Financial Statements.