

First State Investments (UK Holdings) Ltd

Pillar 3 disclosures

For the year ended 30 June 2011

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1. INTRODUCTION

The provisions of the Basel 2 Capital Accord as encapsulated in the Capital Requirements Directive 2006 (“CRD”) issued by the European Union have created a changed regulatory capital regime for fund managers. The relevant rules have been enacted in the United Kingdom through the Financial Services Authority’s (“FSA”) Handbook and particularly within the General Prudential Sourcebook (“GENPRU”) and the Prudential Sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”).

As the First State Investments (UK Holdings) Limited (“FSI”) group of companies has three subsidiaries that are regulated by the FSA, it has to comply with this regulatory capital framework. This comprises three “pillars”:

- Pillar 1 --- the minimum capital requirement that FSI is required to meet to cover credit risk, market and operational risk
- Pillar 2 --- a more company-specific view that requires FSI to determine whether additional capital should be maintained against risks not covered by Pillar 1
- Pillar 3 --- gives requirements for disclosure of capital, risks and risk management procedures and specific remuneration disclosures

Under BIPRU11 FSI has adopted a disclosure policy which complies with the requirements taking into account that certain information of confidential, immaterial and proprietary nature may not be disclosed. In these instances FSI has outlined the reason for non-disclosure.

2. SCOPE OF APPLICATION

2.1 Group structure

As FSI is subject to consolidated supervision, the disclosures given under Pillar 3 are at a consolidated level for all the subsidiaries of First State Investments (UK) Holdings Ltd.

FSI is part of the international operation of Colonial First State Global Asset Management (CFS GAM), the asset management business of the Commonwealth Bank of Australia (CBA).

CFSGAM is a major division of the CBA's Wealth Management business unit. Within CBA, Wealth Management is responsible for the manufacture and administration of non-banking services, including business units such as CFSGAM Australia and First State Investments in the UK and Asia. Wealth Management also provides strategic and operational support for the investment and insurance products of group companies.

Being a separate and dedicated business allows FSI to focus on its key strengths in wholesale asset management while developing a performance culture to attract and retain the key investment talent to underpin future growth and success.

2.2 FSI Corporate Structure

The three FSI group subsidiaries that are individually registered with the FSA and are subject to individual Pillar 1 capital requirements are as follows:

- First State Investments (UK) Limited
- First State Investment Management (UK) Limited
- First State Investments International Limited

The Pillar 3 report will be made available on an annual basis based on the statutory accounts to 30 June each year.

3. RISK MANAGEMENT OBJECTIVES AND POLICIES

FSI has adopted the risk identification and assessment principles contained within the CBA Wealth Management Risk Management and Compliance, Business and Policy model. Both internal and external risks are recorded in a standardised risk register for the UK asset management business. Agreed risk weightings are ascribed to the specific risks that have been identified by the management team. The full Executive Committee reviews the UK risk register at least quarterly.

Findings of independent external reviews such as in ISAE 3402, internal and external audit reports, depositary reviews and FSA ARROW visit reports are considered when updating the risk register.

An agreed Capital Management Policy is in place that governs the level of capital held in excess of regulatory requirements.

FSI has an appropriately staffed Risk and Compliance department that is supported by the overall CFSGAM Risk Management and Compliance function. In addition, the Wealth Management business unit has a central Risk Management and Compliance team that provides support in a number of areas, including the consistent application of agreed standards that apply across the whole CBA group. The UK Compliance and Risk team provides regular reports to the CFS GAM Compliance and Risk Committee. The Committee meets monthly to oversee the internal controls and risk management processes, regulatory compliance and audit issues.

3.1 Credit risk

FSI is not subject to any material level of credit risk.

3.2 Market risk

The main risk that FSI is exposed to that is connected to market movements is that of global stockmarket devaluation. This is not a market risk to FSI but is considered to be a business risk.

True market risk only exists for any investments held by FSI. A limited manager's box is held of shares in the UK OEIC and certain FSI group companies could also hold seed capital positions in new funds at various points in time. At the levels currently held, this does not constitute a material level of risk.

3.3 Business risk

FSI considers a market downturn to be the single largest business risk as it could lead to a reduction in revenues. The Finance team has performed a number of key tests as part of the Internal Capital Adequacy Assessment Process ("ICAAP") (a key part of the Pillar 2 requirements) to enable management to understand the effect on the business.

FSI has taken a number of measures to mitigate other business risks such as:

- Poor relative performance in a falling market. FSI's investment style is structured such that it will tend to under perform in rising markets and outperform in falling markets.

- Key system or infrastructure failure. FSI has a fully tested Business Continuity Plan (BCP) in place to ensure that all critical processes can be carried out within maximum acceptable outage levels.
- Key fund manager retention and succession planning. Investment processes are a team matter and if one individual were to leave it is not felt that investment performance would unduly suffer.

3.4 Concentration risk

Concentration risk is concerned with the possible lack of diversification of asset strategies, clients or distributors leading to the amplification of various other risk effects.

FSI has a wide client base across its products ranging from private investors investing directly, through those investing through fund supermarkets and other intermediaries, to large institutional clients. The client base is located across a wide geographic area as well. FSI does not therefore feel there is any concentration risk associated with location or type of client.

FSI also has relationships with a large number of intermediaries and asset consultants; so again, there is no concentration risk here.

3.5 Operational risk

Operational risk essentially covers the failure to carry out internal administration procedures properly or failure to carry out a client's instructions. It is considered that appropriate controls are currently in place to prevent an extreme operational control failure.

3.6 Other risk

FSI takes into account the following additional risks as part of the ICAAP process - pension obligation risk, insurance risk, interest rate risk, liquidity risk, residual risk and securitisation risk.

4. CAPITAL RESOURCES

FSI's total share capital and reserves as at 30th June 2011 amounted to £69.5m. Deducting goodwill of £11.3m gives the Tier 1 capital of £58.2m.

As credit and market risks are not material for FSI, the Pillar 1 capital requirement is based on a Fixed Overhead Requirement. This essentially represents one quarter of annual fixed expenses and will be £19.5m for the financial year to 30th June 2012.

FSI will thus have a surplus capital at the Pillar 1 level of around £38.7m for the year to 30th June 2012.

The Pillar 2 capital requirement is assessed as part of the ICAAP review. This involves detailed assessment of all relevant risks, modelling thereof and suitable sensitivity analysis and stress testing. We discussed our ICAAP findings with the FSA and subsequently agreed that our Pillar 2 capital requirement would be set at 122% of our Pillar 1 capital. This gives a surplus capital over the requirement at the Pillar 2 level of £34.5m.

The ICAAP review process adopted by FSI is a dynamic one as the specific risks impacting the group and the capital resources available change over time. The ICAAP is included in the FSA's future supervisory review process as part of the ARROW review. The ICAAP is an integral part of a company's risk management process. FSI has thus endeavoured to carry out the ICAAP process in such a way that it is fully integrated with other embedded processes such as reviews of risk registers and budgetary cycles.

All modelling has been undertaken using the most likely outcome based on past history and current experience of the business. However, for the most important risks, worst case scenario analysis has also been undertaken. Given the moderately risk averse attitude of FSI, substantial capital buffers are held in excess of the most likely modelling scenarios.

The stress testing that was undertaken as part of the ICAAP considered various levels of market correction looking out for 3 years from the date of preparation. This meant that we knew that the business would still be operating at a profitable level even after the recent market falls.

5. REMUNERATION DISCLOSURES

5.1 Decision-making process for remuneration policy

First State Investments EMEA ("FSI EMEA") which includes the regulated entities First State Investments (UK) Limited, First State Investment Management (UK) Limited and First State Investments International Limited, operates a Remuneration Assurance Committee ("Committee") that has been established by a resolution of the First State Investments UK Board of Directors ("FSI UK Board"). The Committee reports to the FSI UK Board. It has a mandate to;

- make recommendations to the CBA People and Remuneration Committee in relation to FSI EMEA relevant personnel;

- monitor adherence by FSI EMEA with the UK Financial Services Authority's Remuneration Code as amended or replaced from time to time and the Group Remuneration Policy
- ensure that the Head of Risk & Compliance for EMEA has appropriate input into remuneration policy, and to consider any concerns raised by the risk & compliance function about the behaviours of code staff or risks in any business undertaken
- review performance management frameworks and processes; and
- ensure that the bonus pool totals do not limit the company's ability to build its capital base.

The Committee is comprised of the following roles:

- Regional Managing Director EMEA, who is the Chair of the Committee;
- Head of Human Resources FSI EMEA; and
- Executive General Manager (EGM) Group Performance and Reward, as the delegate of the CBA People & Remuneration Committee

The Committee was first established during May 2011. There was 1 meeting of the Remuneration Committee in respect of the 2010 – 2011 financial year. Following each meeting the Committee reports to the Board on its activities.

5.2 External consultants

The Committee received independent advice on executive remuneration issues from PricewaterhouseCoopers. PwC also provided other consulting services to various parts of the Company. Other consultants are used from time to time to advise on specific issues.

5.3 Role of the relevant stakeholders

The Committee takes full account of the company's strategic objectives in setting remuneration policy and is mindful of its duties to shareholders and other stakeholders. The Committee seeks to preserve shareholder value by ensuring the successful retention, recruitment and motivation of employees.

No individual is involved in decisions relating to his or her own remuneration.

5.4 Code Staff criteria

The following groups of employees have been identified as meeting the FSA's criteria for Code Staff:

When determining whether an individual meets the criteria for Code Staff, the following information is considered:

- the role the individual performs;
- the reporting lines for the role;
- the number of staff reporting to the role;
- specific authority to carry out decisions under the role, any limits on authority and required sign-off;
- whether the employee/role is registered with the FSA as a Significant Influence Function;

- whether the individual heads a business line that is accountable for a material portion of the total annual revenue of First State Investments **and** they have a material impact on risk;
- whether the individual is in a Controlled Function; and
- whether the individual is a Risk Taker for Code Staff purposes, including where the employee's business activities are able to create material levels of risk for the Company.

The determinants above result in all members of the Executive Committee and the Joint Managing partner roles in the Asia Pacific/ Emerging Markets being designated as Code Staff.

5.5 The link between pay and performance for Code Staff

Remuneration is made up of fixed pay (i.e. salary and benefits) and performance-related pay (annual and long-term incentives).

Annual incentives are designed to reward performance in line with the business strategy, objectives, values and long term interests of the Company.

The annual incentive earned by an individual is dependent on the achievement of financial and non-financial objectives, including adherence to effective risk management.

The Company provides long-term incentives which are designed to link reward with the long-term success of the Company and recognise the responsibility participants have in driving its future success and delivering value for shareholders. Long-term incentive awards are conditional on the satisfaction of corporate performance measures.

The structure of remuneration packages is such that the fixed element is sufficiently large to enable the Company to operate a truly flexible bonus policy.

5.6 Design and structure of remuneration for Code Staff

5.6.1 Salary and fees

All Code Staff receive a base salary to reflect their market value, responsibility and contribution to the Company.

5.6.2 Annual Incentives

Employees receive an appropriate mix of fixed and incentive based remuneration. Remuneration arrangements for these employees are designed to:

- support the sustainable growth of revenue relative to costs;
- contribute to aligning rewards to the interests of shareholders and our customers;
- reflect the role remuneration can play in the overall risk management framework;
- be market competitive, with reference to internal relativities;
- be cost responsible and consider each component of remuneration as part of the totality of the arrangements, including non financial rewards;
- align the proportion of fixed versus at risk remuneration to the job family, impact and accountability of the role;
- be simple to understand and administer;

- be approved by an appropriate level within a framework of delegations by the Board; and
- ensure employees do not receive excessive benefits on termination.

Employees are eligible for a short term incentive based on their individual performance, and depending on their role, the performance of their business unit and/or the Group. These incentives are managed within a strict risk framework, and the Board retains ultimate discretion to reduce short term incentive outcomes where appropriate.

Executives receiving material short term incentives are required to defer a portion of their award for up to three years. Payment of this portion is subject to service conditions.

5.6.3 Long Term Incentives

Long Term Incentives are awarded to key individuals within the business. These awards are deferred for three years and are subject to service conditions. The awards are aligned with either the business performance or the performance of the publicly available investment funds being managed by the relevant team.

5.6.4 Risk Adjustment

We actively manage risks associated with delivering and measuring short term performance. All our activities are carefully managed within our risk appetite, and individual incentive outcomes are reviewed and may be reduced in light of any associated risk management issues.

Risk management is also built into our remuneration framework:

- Risk is managed through the mandatory deferral of a substantial and meaningful portion of the short and long term incentives of the employees with significant performance based remuneration. Rules for employees in Europe are set out in the UK Remuneration Policy.

This deferral serves as an important retention mechanism which helps us manage the risk of losing key executive talent. It also provides a mechanism for the Board to reduce or cancel the deferred component of a short term incentive.

The Committee reviews risk and compliance issues in relation to the vesting of deferred awards for all employees. Compliance is monitored throughout the vesting period by the Head of Risk and Compliance and their department, who reports the information to the Committee for assessment.

Any risk or performance issues that may impact the vesting of deferred awards are then highlighted to the Committee, along with any recommendations for the reduction or cancellation of any deferred awards (as appropriate). The Committee may consider reducing the deferred award.

5.7 Aggregate remuneration cost for Code Staff by business area

There were 13 Code Staff categorised as Senior Management. Aggregate remuneration expenditure in respect of Code Staff was as follows.

First State Investments

£15,049,344

5.8 Fixed/Variable remuneration

Fixed remuneration consists of base salaries for executives and benefits such as pension contributions. Variable remuneration consists of annual bonus and deferred bonuses payable based on the performance of certain funds or the financial performance of the CFSGAM business unit.

	Senior Management	Other Code Staff
Number of Code Staff	13	0
Fixed remuneration	£2,885,119	£0
Variable remuneration	£12,164,225	£0