

Ashmore Group plc

Internal Capital Adequacy Assessment Process Report

Pillar III Disclosures

June 2012

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1. Overview

1.1 Introduction

Ashmore Group plc (the “Group”) as a UK registered group, listed on the London Stock Exchange, is subject to prudential oversight by the UK Financial Services Authority (FSA). As such, the Group is required to meet the requirements of the FSA’s capital adequacy framework, in addition to meeting the solo entity requirements of regulated subsidiaries. This framework consists of three pillars:

- Pillar I: Sets out the minimum capital requirements for credit, market and operational risks;
- Pillar II: Requires that regulated firms take a view on whether a firm should hold additional capital against risks not covered by Pillar I; and
- Pillar III: Complements Pillars I and II, and requires firms to publish details of their risks, risk management processes and capital position.

The regulated entities and relevant regulatory body are set out in section 1.4.

1.2 Basis of Disclosures

In accordance with the requirements of Chapter 11 of Building Societies and Investment Firms (BIPRU), the disclosures included in this document relate to the Group (a full list of all material subsidiaries is included within the Group’s Annual Report and Accounts). The disclosures cover both the qualitative and quantitative requirements.

1.3 Frequency of Disclosures

The Group has an accounting reference date of 30 June, and publishes its disclosures as soon as is practically possible after publication of the Annual Report and Accounts, and if appropriate, more frequently.

1.4 Scope of Regulation

The Group has the following regulated entities, all of which it controls, either as the sole or majority shareholder. The Group has been in compliance with solo entity capital requirements at all times during the year ended 30 June 2012.

ASHMORE REGULATED SUBSIDIARIES	% Ownership	Local Regulator
Ashmore Investment Management Limited	100%	FSA
Ashmore Management Company Turkey Ltd	95.20%	GFSC
Ashmore Portfooy YAS	95.16%	CMB
Ashmore Management Company Ltd	100%	GFSC
Ashmore Global Special Situations Fund 3 (GP) Ltd	100%	GFSC
Ashmore Global Special Situations Fund 4 (GP) Ltd	100%	GFSC
Ashmore Global Special Situations Fund 5 (GP) Ltd	100%	GFSC
Ashmore Global Special Situations Fund 6 (GP) Ltd	100%	GFSC
Ashmore Emerging Markets Special Situations Opportunities Fund (GP) Ltd	100%	GFSC
Ashmore Private Equity Turkey Fund 1 (GP)	95.2%	GFSC
AA Development Capital Investment Managers (Mauritius)	55%	FSCM
Ashmore Management Company Brasil Limited	91.3%	GFSC
Ashmore Brasil Gestora de Recursos Limitada	91.2%	CVM

AA Development Capital India (GP) Limited	55%	GFSC
Ashmore Japan Co Ltd	100%	JFSA
Ashmore Investment Management (US) (AIMUS)	100%	SEC
Ashmore EMM LLC	63.6%	SEC
Ashmore EMM (Ireland) Ltd	63.6%	CBI
Ashmore Investment Management (Singapore) Pte. Ltd.	100%	MAS

FSA = Financial Services Authority; GFSC = Guernsey Financial Services Commission; CMB = Capital Markets Board, Turkey; FSCM = Financial Services Commission Mauritius; CVM = Brazilian Securities Exchange Commission; JFSA = Financial Services Agency of Japan; SEC = Securities and Exchange Commission; CBI = Central Bank of Ireland; MAS = Monetary Authority of Singapore.

2. Risk

2.1 Risk Appetite and governance

The Group's risk appetite framework has been developed by engaging key stakeholders at the functional, business and executive levels of the organisation and accordingly, the Group's risk appetite (and its associated components) is regularly reviewed and updated in line with the evolving strategy, business model, financial capacity, business opportunities, regulatory constraints and other internal and external factors.

The Group employs a proportionate approach in assessing, quantifying or analysing the risks and related risk appetite of the firm. For example, while detailed analysis and review of the Group's risk appetite is undertaken it may not always be practical to apply quantitative techniques to estimate these. In these instances, the Group would engage in qualitative analysis and discussion to ensure those risks and related risk appetite have been appropriately considered. In addition, the Group has policies in which it defines and quantifies its risk appetite in relation to seed capital, liquidity, foreign exchange hedging and counterparty exposures.

Risk is inherent in all businesses and is therefore present within the Group's activities. The Group accepts this, and seeks to effectively identify, monitor and manage each of its risks and actively promotes a risk awareness culture throughout the organisation. At least annually, the Board reviews the material risks and considers the results of the work of the various individuals, functions and committees in mitigating the risks and making the appropriate disclosures. Ashmore has both Professional Indemnity and Directors and Officers Liability insurance arrangements in place.

Effective risk management and control is one element of the Group's overall system of internal controls within its corporate governance framework - incorporating Finance, Compliance, Legal, Operations, Information Technology, Risk and Internal Audit functions. Annually, Ashmore publishes its ISAE3402 review, which is audited by KPMG. The outcome of the reviews conducted to date underline Ashmore's assertion that operational risks are adequately managed and mitigated. The latest published ISAE3402 was for the period ended 30 June 2012.

During the year, the Group's risk control framework was reviewed to take account of changing business and market conditions. There has been an ongoing focus on the development of the Group Risk Matrix, which seeks to identify the key risks of the Group, as well as current mitigants and forward-looking action plans. The matrix is used to identify and track key business, investment, credit, financial, legal, compliance and other operational risks including consideration of the likelihood of those risks crystallising and the resultant impact. The inherent risk within each activity has been identified, with the adequacy and mitigating effect of existing processes being assessed to determine a current residual risk level for each such activity. On the basis that

further mitigants may be employed over time, a target residual risk for each activity after approximately one or two years has been identified. Further details of the Group’s internal control environment have been included in the Corporate Governance report within the annual report and accounts.

2.2 Overview of Material Risks

The ultimate responsibility for risk management rests with the Board. However, from a practical perspective some of this activity is delegated. The key risks, their primary mitigants, and their delegated owners are set out below for each of the four risk categories that Ashmore considers most important: Strategic and business, investment, operational, and treasury - with reputational risk being a common characteristic across all four categories:-

Risk type/owner	Description of risk	Mitigation
<p>Strategic and business Risk</p> <p>The risk that the medium and long term profitability of the Group could be adversely impacted by the failure to identify and implement the correct strategy, and to react appropriately to changes in the business environment.</p> <p><i>Delegated to:</i> <i>Ashmore Group Plc Board</i></p>	<p>These include:</p> <ul style="list-style-type: none"> - A long-term downturn in the fundamental and technical dynamics of emerging markets; - Reputational damage to Ashmore impacting marketing and distribution capabilities; - Potential market capacity issues and increased competition. 	<p>These include:</p> <ul style="list-style-type: none"> - The Board’s long investment management experience; - A clearly defined Group strategy, understood throughout the organisation and actively monitored; - The diversification of investment capabilities to reduce single event/product exposure; - A committee-based top down investment methodology to create a scalable business model; - Experienced, centrally managed and globally located distribution team; - Product Committee with knowledge of the markets in place.
<p>Investment Risk</p> <p>The risk of non-performance or manager neglect, including the risk that long term investment outperformance is not delivered, thereby damaging prospects for winning and retaining clients, and putting average management fee margins under increased pressure.</p> <p><i>Delegated to:</i> <i>Ashmore Group Investment Committee</i></p>	<p>These include:</p> <ul style="list-style-type: none"> - That the investment manager does not adhere to policies; - A downturn in investment performance; - Expansion into unsuccessful themes; - Insufficient counterparties. 	<p>These include:</p> <ul style="list-style-type: none"> - Experienced Investment Committees meet weekly ensuring consistent core investment processes are applied; - Dedicated emerging markets research and investment focus, with frequent country visits as well as a physical presence in key Emerging Markets; - Strong Compliance and Risk Management oversight of policies, restrictions, limits and other related controls; - Formal counterparty policy with reviews held at least quarterly.

<p>Operational Risk</p> <p>Risks in this category are broad in nature and inherent in most businesses and processes. They include the risk that operational flaws result from a lack of resources or planning, error or fraud, the inability to capitalise on market opportunities, or weaknesses in systems and controls.</p> <p><i>Delegated to:</i> <i>Ashmore Group Risk & Compliance Committee</i></p>	<p>These include:</p> <ul style="list-style-type: none"> - The inability to fairly price assets; - The oversight of overseas subsidiaries; - Compliance with regulatory requirements as well as with respect to the monitoring of investment breaches; - Availability and retention of staff; - Execution and process management; - Business and systems disruption; - Fraud by an employee or third party service provider. 	<p>These include:</p> <ul style="list-style-type: none"> - The valuations of the most material assets are outsourced to independent third parties with the Pricing Methodology Valuation Committee (PMVC) providing additional oversight of the valuations used for hard-to-price assets; - An integrated control and management framework is in place to ensure day-to-day global operations are managed effectively; - Resources are regularly reviewed and also career development and succession planning is in place; - A Risk and Compliance Committee meets on a monthly basis to consider the Group’s Key Risk Indicators (“KRIs”); - A disaster recovery procedure exists, and is tested regularly; - Engagement letters or service level agreements are in place with all significant service providers; - A Product Committee approves new product launches.
<p>Treasury Risk</p> <p>These are the risks that the Management does not appropriately mitigate balance sheet risks or exposures which could ultimately impact the financial performance or position of the Group.</p> <p><i>Delegated to:</i> <i>Chief Executive Officer and Finance Director</i></p>	<p>These include:</p> <ul style="list-style-type: none"> - Group revenues are primarily US Dollar based, whereas results are denominated in Sterling; - The Group invests in its own funds from time-to-time, exposing it to price risk, credit risk and foreign exchange risk; - Liquidity management; - The Group is exposed to credit risk and interest rate risk in respect of its cash balances. 	<p>These include:</p> <ul style="list-style-type: none"> - Monthly reporting of all balance sheet exposures to the Executive; - A proportion of Group currency exposures are hedged as a matter of policy; - Significant corporate investments are approved by the Board, and all others by the CEO; - Cash flows are forecast and monitored on a regular basis and managed in line with approved policy; - The availability of GBP and USD S&P AAA rated liquidity funds managed by experienced cash managers; - Defined Risk Appetite in place.

The Group is strongly profitable, and considers that only treasury risks and operational risks may impact the financial strength of the Group in the short-term, although strategic and business risks, if not managed appropriately, could have such an impact over the medium to long term.

The extent to which risks other than treasury and operational could impact AuM to threaten the Group's profitability is embedded within the Group's scenario and stress testing analysis, which demonstrate the robust nature of the Group's current profitability.

The Group's assessment of the impact of the principal components of the risks identified and the Pillar II capital requirements in respect of these are set out below:

2.3 Treasury Risk

The Group considers Treasury risks to be those which primarily impact the performance of the Group. Typically these will be in relation to the Group's balance sheet exposures, and are set out below:

Market Risk

This is the risk that the value of an investment will decrease due to movements in market factors. The market risk factors considered by the Group are: Equity risk; interest rate risk; foreign exchange risk, credit spread risk; and commodity risk.

The potential loss amount due to market risk can be measured in a number of ways. For the purpose of estimating capital charges, one convention is to use Value at Risk (VaR). The capital charge for market risk, including foreign exchange exposure is based on an internal VaR model and uses the 99th percentile VaR over a 10-day holding period and a multiplier of three.

The modeling of the risk characteristics inherent in the positions involves a number of assumptions and approximations. While management believes that these assumptions and approximations are reasonable, there is no standard methodology for estimating VaR and different assumptions and approximations could produce materially different estimates.

We use historical data to estimate the VaR and given this dependency, an inherent limitation of VaR is that the distribution of past changes of market risk factors may not produce accurate predictions of future market risk. In addition, VaR calculated over a 10-day time horizon may not always fully capture the market risk of positions that cannot be liquidated within such a time period.

The market risk for liquid seed capital positions using the methodology outlined above, results in a capital charge of £20.6 million (June 2011, £14.1 million). The increase in the capital charge since last year reflects the increase in the amount of the Group's liquid seed capital positions at 30 June 2012 as a result of additional investments made during the year.

Market risk is also calculated for undrawn illiquid seed capital positions arising on closed ended funds with a lock-in period greater than five years. Drawn-down commitments to such funds result in a 100% deduction from capital, whereas undrawn commitments result in a market risk charge. Instead of using VAR, the market risk charge is 100% to reflect the illiquid nature of these assets. The increase in drawn commitments results in an increase in the 100% market risk charge to capital but has no net effect on bottom line capital surplus given the corresponding reduction in undrawn commitments (which are deducted from capital at 100%).

The capital charge on undrawn illiquid seed capital positions is £12.2 million (June 2011, £14.9 million). The year on year decrease resulted from draw-downs made during the year, reducing the Group's undrawn commitment liability but having no net effect on the capital surplus.

Foreign Exchange Risk

The risk that changes in the value of non-sterling denominated income and expenses, seed capital positions, and other assets and liabilities, will adversely impact the capital position of the Group:

- In respect of the Group's exposure to non-sterling denominated income and expenses, the Group has a policy to hedge a proportion of its expected net management fee revenues. Residual currency exposure has been incorporated into the Group's scenario and stress testing analysis. Accordingly, the Group considers that no additional capital is required to cover this risk.
- In respect of the Group's balance sheet risk relating to seed capital investments, the associated foreign exchange risk has been incorporated within the market risk quota set out above, to facilitate an aggregated view.
- Other assets and liabilities, comprising bank balances, management fees receivable and rebates payable, have been analysed by currency, with a capital charge being computed according to the VaR methodology outlined above; this results in a capital charge of £12.1m million (June 2011, £10.2 million).

The increase in the capital charge reflects the increase in the amount of the Group's foreign currency denominated balance sheet positions at 30 June 2012. The impact of the increased exposure is partially offset by a reduction of the weighting applied under the VAR model to 11.5% (previously 17.6% at 30 June 2011).

Counterparty/Credit Risk

The risk of loss due to an obligor's non-payment of an outstanding debt, loan or other line of credit (either the principal or interest (coupon) or both).

- The Group had cash and cash equivalents as at 30 June 2012 of £346.6 million. These are all placed with institutions or within liquidity funds rated single A or above, and Group funds are included within the Risk Management and Control (RM&C) department's quarterly counterparty review.
- Under the standardised methodology under Pillar I, the capital required to cover credit risk in respect of cash and cash equivalents is £5.5 million (June 2011, £6.7 million). Given the vanilla nature of our credit risk, we have assumed the Pillar II charge to be calculated on the same basis.
- No credit risk requirement has been assessed as necessary for the Group's fee debtors and accrued income, as the Group manages client assets, and would be able to make a claim against any sizeable outstanding amount prior to transferring them to another manager. As at 30 June 2012 there were no debtors over 30 days old (June 2011, £0.1 million).
- The Group had fixed assets and deferred tax asset balances of £15.5 million as at 30 June 2012 (June 2011, £21.1m) and commitments to fund liquid seed positions of £12.2 million (June 2011, £16.6 million). The Pillar I capital requirement in respect of these balances of £0.6 million (June 2011, £1.1m) has also been adopted as the Pillar II charge.

Liquidity Risk

This is the risk that the Group either does not have available sufficient resources to enable it to meet its obligations as they fall due or can only secure such resources at excessive cost.

In the context of the Group, it is primarily the risk that investments in illiquid instruments prevent efficient investment exit strategies being adopted, especially in a downturn situation, for the Group's cash and cash equivalents, seed capital, and other assets.

- The group's liquidity risk management framework is set out in a policy document that was authorised by the Board in December 2010.
- The Group prepares regular cash-flow forecasts, and matches the maturity profile of the Group's cash, cash equivalents and other assets and liabilities on a conservative basis.
- In respect of seed investments, the Group only invests in Ashmore products. Liquidity management is a fundamental part of the firm's investment process across all its themes. There is a significant depth of expertise developed over the last 20 years across the asset classes – and liquidity metrics are monitored on a regular basis by the Investment Committee.
- In the case where seed investments are made in closed ended funds with lock-in periods of greater than 5 years, a capital charge/deduction of 100% of the drawn/undrawn commitment has been recognised. The drawn commitments are deducted from available capital and the undrawn commitments are included within the market risk charge above.
- The Group's illiquid fixed assets, goodwill and intangibles are deducted in calculating capital resources or captured within the counterparty risk charge.

The liquidity risk of seed capital investments has been fully captured within the market and counterparty risk charges at 30 June 2012.

Interest Rate Risk (in non-trading book)

This is the risk that a movement in interest rates will impact the Group's profitability.

The Group's balance sheet is not levered and cash balances are held on overnight or short term deposit. Given this, and the historically low level of interest rates at present, the Group has assessed that no capital charge is required.

Securitisation Risk

The risk that the capital resources held by a firm in respect of assets which it has securitised are inadequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved.

This is not applicable to the Group as at 30 June 2012. Accordingly the Group has assessed that no capital is necessary.

Pensions Obligation Risk

The risk to the firm caused by its contractual or other liabilities to or with respect to a pension scheme.

The Group does not have a defined benefit pension scheme. Contributions to the defined contribution employee pension scheme are made as the Group's liability arises. Accordingly the Group has assessed that no capital is necessary.

2.4 Operational Risk

The Top Risk Matrix is one of the tools used to highlight and track over time the key risks of the Group. The matrix is typically reviewed as part of a quarterly assessment of the Top Risks and includes discussion and review of key risk indicators with the various departments including Legal, Compliance, Finance, Operations, Technology and Risk. Consideration of actual operational losses is factored into this process.

The findings are summarised and presented to the Risk and Compliance Committee. Periodic updates are also provided to the Group's Board at least annually. The Group recognises the importance of having a robust control framework to mitigate operational risks but recognises that operational errors may still occur from time to time.

An error report is produced for all operational errors. All error reports are reviewed at the Group's Risk and Compliance Committee and include an assessment of the error, the financial impact of the error and any additional controls required to minimise the likelihood of such errors in the future.

The Group has estimated the Pillar II Operational Risk requirement as at 30 June 2012 to be £14.6m. The quantification of the Operational Risk is based on combined event scenario analysis undertaken by the Group. The approach taken was as follows:

Senior Management reviewed the regular assessment of material risks to identify those that were considered to have a severe and direct impact on the Group based on the current and projected business operating model.

For each material risk, subject matter experts identified and completed a number of scenario assessments. The severity of each material risk was assessed with consideration to internal and external data loss, the business control environment, relevant business data and insurance mitigants. The scenarios were challenged by Senior Management for appropriateness and impact. Ten material risks were identified for the Operational Risk Capital assessment by Senior Management based on judgement, experience, risk profile, business and control environments.

The assessments were statistically modelled using the log normal distribution based on 1 in 5 years and 1 in 20 years data points which were assessed by Senior Management and subject matter experts for relevance and applicability to the Group's current and projected business operating model. The statistical estimate was challenged and approved by Senior Management to ensure applicability, consistent ranking of the risks and that the total capital for each combined scenario was reasonable.

The insurance cover applicable to each scenario was considered. In the case where full cover was available, a full deduction for available insurance cover up to a cap of £50m was taken into account. To be conservative, management limited the insurance deduction to an amount of 50% where partial cover was available. This approach is consistent with the current market practice of limited license investment firms. The excess of £250,000 was added back to reach the net operational risk capital amount when insurance was available.

The largest combined operational risk event scenario was put forward as the Pillar II operational risk capital requirement in the Group ICAAP. The final estimate was approved by the Group Board. Other operational risks such as insurance risks are not material to the group at this time.

3. Financial Resources

	30 June 2012 £m
Tier 1	
Permanent share capital	-
Profit and loss account and other reserves	521.6
Share premium account	15.7
Minority interests	20.8
Total	558.1
Deductions from Tier 1	
Intangible Assets/goodwill	(102.8)
Investments in associate and non-current investments	(7.9)
Tier 1 after deductions	447.4
Total Capital resources¹	447.4

4 Capital Adequacy

It is the Group's policy that all entities within the Group have sufficient capital to meet regulatory and working capital requirements, and to keep an appropriate credit standing with counterparties. With this mind, the Group conducts regular reviews of its capital requirements relative to its capital resources, and has maintained significant surpluses at all times during the period.

The capital resources requirements of the Group are detailed below. As the Group's Pillar II requirement is higher than its Pillar I requirement, this has been used to calculate the Group's surplus financial resources. The Pillar II requirement is higher than the Pillar I requirement primarily as a result of the higher market risk charges derived from the VaR methodology compared with the standardised rate used under Pillar I. The derivation of the £381.8 million consolidated Group surplus is set out in section 4.2.

4.1 Aggregated Capital Resource Assessment (Pillar I)

	30 June 2012 £m
Consolidated requirement	
Market risk	-
FX risk	23.0
Credit risk	21.9
Operational risk	-
Other entities	0.4
Total Group Consolidated Resources Requirement	45.3
Group Financial Resources (section 3)	447.4
Surplus capital	402.1

The Pillar I capital requirements are calculated in accordance with the guidance set out in the BIPRU handbook.

¹ The Group does not have Tier 2 or Tier 3 capital and any related deductions.

4.2 Consolidated Capital Resource Assessment (Pillar II)

	30 June 2012
	£m
Consolidated requirement	
Market risk	32.8
FX risk	12.1
Credit risk	6.1
Operational risk	14.6
Total Group Consolidated Resources Requirement	65.6
Group Financial Resources (section 3)	447.4
Surplus capital	381.8

5 Challenge and Adoption of the ICAAP

The production of the ICAAP report involved the input of a number of discipline heads across the Group's different departments including Finance, Compliance, and Risk. A full review was undertaken by the Group Finance Director and Chief Executive. Subsequently the document was reviewed and approved by the Ashmore Group Board.

Each discipline brought to bear their expertise with the aim of identifying and quantifying the risks that the Group faces. These risks are not isolated to specific areas within the business, and as a result we consider the potential impacts on a consolidated basis.

Underpinning the analysis was Ashmore's "Risk Matrix" and base case financial forecast model. All key business disciplines were involved in challenging and analysing the impact on the business of the different risks which the business faces. The Risk Matrix includes specific risk management activities and related control mechanisms. The Group's Board last reviewed this Risk Matrix in June 2012 as part of the annual review of the effectiveness of internal controls exercise.

The financial forecast model is derived from the detailed annual budget that the Group prepares and presents to the Board. The ICAAP tested and analysed various scenarios. While the Group's approach was to make prudent assumptions, it was also to ensure that the scenarios tested were realistic and reflected the inherent nature of the risks that the business faces. This process included not only a historical analysis of the Group's AuM development but also involved an examination of the changing environment that the Group operates in and the continually evolving nature of the Group's operations.

In the meantime, Ashmore understands the importance of prudent capital management and recognises that the ICAAP framework offers the Group the opportunity to assess its capital position within the context of its future strategic goals and objectives. As such, the ICAAP is recognised to be very much a live document and on this basis it will be reviewed regularly and formally considered by the Board as part of its annual risk and controls review. Finance has performed stress testing of its forecasts outside of the requirement to do so as part of this process.

6 Other disclosures

Code Staff Aggregate Remuneration

The Ashmore Group plc Remuneration Report for the year ending 30 June 2012 includes information required to be disclosed in accordance with the FSA's prudential sourcebook for banks, building societies and investment firms (BIPRU) 11.5.18(1) and (2).

The information in the tables below is provided in accordance with BIPRU 11.5.18(6) and (7). A total of 9 individuals were Code Staff during the year ending 30 June 2012. Code Staff are the Group's employees whose professional activities could have a material impact on the Group's risk profile.

Table 1: Aggregate remuneration of Code Staff by Business Area for financial year ending 30 June 2012 (11.5.18(6))

Breakdown of remuneration of staff in respect of whom disclosure is required by business area BIPRU 11.5.18 (6)		
Business Area	Number of Staff	Total Remuneration for Year Ending 30 June 2012 (GBP mn)
Ashmore Group PLC	10	5.4

Table 2: Aggregate remuneration of Code Staff by staff category for financial year ending 30 June 2012 (11.5.18(7))

Aggregate quantitative information, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the firm BIPRU 11.5.18 (7)			
	Staff Category		Total Remuneration for Year Ending 30 June 2012 (GBP mn)
	Senior Management	Other Members of Staff	
Remuneration (GBP mn)	5.4	0	5.4
Number of Staff	10	0	