

# **D. E. Shaw & Co. (London), LLP**

## **Pillar 3 Disclosure**

As at 30 September 2017

### **Introduction**

D. E. Shaw & Co. (London), LLP (the “Partnership”) is a member of the D. E. Shaw group, a global investment and technology development firm. The Partnership is authorised and regulated by the Financial Conduct Authority (the “FCA”) in the United Kingdom. The Partnership provides investment management services to affiliated U.S.-based investment advisers for the benefit of certain affiliated private investment funds and separately managed accounts. Please refer to the Partnership’s entry in the FCA register for more information about its permissions and activities.

D. E. Shaw & Co. (U.K.), Ltd. (the “Corporate Member”) is a member of the Partnership and, together with the Partnership, forms a consolidation group. The Partnership is fully consolidated with the Corporate Member for both accounting and prudential purposes.

The FCA’s rules set out in Chapter 11 of its Prudential Sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”) require the Partnership to make certain disclosures regarding its capital, risks, risk management process, and remuneration policy. This is the Partnership’s BIPRU 11 Disclosure (Pillar 3) document (the “Pillar 3 Disclosures”). The Pillar 3 Disclosures apply solely to the Partnership and the Corporate Member and not to any other member of the D. E. Shaw group or the investment funds managed by the D. E. Shaw group.

### **Regulatory background**

The 2004 Basel Accord (“Basel II”) replaced the original 1988 Basel Accord and established a risk-based approach for calculating capital. European member states implement the Basel II framework via the Capital Requirements Directive (“CRD”). The CRD framework consists of three “pillars”:

- Pillar 1 (minimum capital requirements) sets out the minimum capital that firms are required to hold for credit, market, and operational risk;
- Pillar 2 (supervisory review process) requires firms and the FCA to assess whether additional capital should be held against risks not adequately covered by Pillar 1 capital; and
- Pillar 3 (market disclosures) requires firms to publish details of their risks, capital, risk management processes, and remuneration policy.

In turn, the FCA implements the CRD via rules and guidance published in the FCA Handbook, including Chapter 11 of BIPRU.

The FCA has classified the Partnership as a BIPRU firm. The Partnership’s minimum Pillar 1 capital requirement is therefore €50,000 but its actual capital requirement under Pillar 1 is higher (see “Capital resources” below). As required under FCA rules, the Partnership assesses risks to its business on an annual basis through its Internal Capital Adequacy Assessment Process (“ICAAP”) to determine whether additional capital is required to address credit, market, or operational risks to which it is exposed (Pillar 2). The Pillar 3 Disclosures describe the Partnership’s risk management, capital, risk assessment processes, and remuneration policy in accordance with BIPRU 11 (Pillar 3).

## Frequency, location, and verification of disclosures

The Pillar 3 Disclosures are based on unaudited figures as at 30 September 2017. The Partnership expects to update the Pillar 3 Disclosures annually, unless it determines that a more frequent update is appropriate.

The Pillar 3 Disclosures can be found on the D. E. Shaw group's external website under the heading "Important Disclosure".

The Partnership's Management Committee and other members of senior management have reviewed the information in the Pillar 3 Disclosures. The Pillar 3 Disclosures were not audited or reviewed by the Partnership's external auditors.

## Risk governance

The Partnership is committed to maintaining a risk management framework appropriate to the size, nature, and complexity of its business and activities. The principal risks and uncertainties surrounding the Partnership's business arise primarily from its relationship with D. E. Shaw & Co., L.P. ("DESCO LP"), the Partnership's indirect parent company, primary client, and sole source of revenue. The Partnership's Management Committee is ultimately responsible for ensuring that the risks relevant to the Partnership are managed appropriately.

## Risk management objectives and policies

The Partnership benefits from and operates within the risk management framework that has been implemented globally across the D. E. Shaw group's operations. The D. E. Shaw group has established substantial infrastructure designed to manage the business and operational risks faced by a global investment management firm. This infrastructure includes employees with expertise in a range of disciplines, including operations, finance, tax, legal, and compliance, who are managed by highly experienced professionals and supported by external advisers that are experts in their respective fields. The D. E. Shaw group, including the Partnership, also utilizes sophisticated technological and systems infrastructure to support its activities and to facilitate the monitoring and management of a range of potential risks. The D. E. Shaw group, and the Partnership, seek to minimize business and operational risk to the greatest extent to which it is efficient to do so.

The Partnership addresses and takes steps to mitigate risks specific to its business on an on-going basis. These risk mitigation policies and procedures are assessed as part of the Partnership's annual risk review and summarized in the Partnership's ICAAP report.

The Partnership's risk management, business planning, and capital management processes are supervised by the Partnership's Management Committee with input from the Partnership's Legal and Compliance Officer and Money Laundering Reporting Officer, the D. E. Shaw group's Executive Committee, and members of DESCO LP's Compliance and Financial Operations groups, as well as others at the Partnership and DESCO LP. The Partnership maintains and is subject to documented policies designed to ensure regulatory compliance and manage areas of risk. Staff are trained on these policies and procedures during the on-boarding process and via periodic reminders, and staff receive additional compliance training at least annually.

## Capital resources

The Partnership monitors its capital base to ensure that it has adequate capital to meet its liabilities. As a BIPRU firm, the Partnership's minimum capital requirement under Pillar 1 is calculated as the higher of:

- A. Its base capital requirement of €50,000 (or approximately £44,100<sup>1</sup>);
- B. The sum of its credit and market risk requirements; and
- C. Its fixed overhead requirement ("FOR").

Using the standardised approach, the Partnership calculates its credit risk requirement as a percentage of the risk weighted exposure amounts as determined by the FCA. Market risk is calculated using the foreign currency position risks requirement ("PRR") method. The Partnership's market risk requirement was zero as at 30 September 2017 using the PRR method. The sum of the Partnership's credit and market risk requirements was greater than its base capital requirement but less than its FOR as at 30 September 2017.

The Partnership's FOR (as the highest of the three amounts described in A, B, and C above) represents its Pillar 1 regulatory capital requirement. The FOR is calculated as 13 weeks' fixed expenditure based on the most recent audited financial statements. The Partnership has calculated its FOR on a consolidated basis based on the audited financial statements of the Corporate Member for the year ended 31 March 2017. The Partnership's consolidated FOR was approximately £4,948,000 as at 30 September 2017. The actual capital held by the Partnership and the Corporate Member as at 30 September 2017 was approximately £11,132,000, a surplus of approximately £6,184,000.

The consolidation group's consolidated capital resources as at 30 September 2017 are shown in the following table:

Tier	Element	Amount <sup>2</sup>
Tier 1		
	Permanent Share Capital, including share premium account	0
	Profit and loss account and other reserves	11,132
	Interim net losses	0
	<b>Tier 1 Deductions</b>	<b>0</b>
	Investments in own shares	0
	<b>Total Tier 1 Capital</b>	<b>11,132</b>
Tier 2		
	Perpetual cumulative preference shares	0
	Provisions	0
	<b>Total Tier 2 Capital</b>	<b>0</b>
	<b>Total Tier 2 Deductions</b>	<b>0</b>
Tier 3		
	Short term subordinated debt	0
	<b>Deductions from total capital</b>	<b>0</b>
	Material holdings	0
	<b>Total capital after deductions</b>	<b>11,132</b>
	<b>Regulatory capital requirement</b>	<b>4,948</b>
	<b>Surplus</b>	<b>6,184</b>

<sup>1</sup> As at 30 September 2017, using an exchange rate of 1 EUR = 0.88194 GBP

<sup>2</sup> All figures in Pounds Sterling (GBP) and in thousands (000)

## The Internal Capital Adequacy Assessment Process

The Partnership conducts an annual ICAAP and risk assessment with the assistance of members of DESCO LP's Financial Operations groups. The resulting report is presented to the Partnership's Management Committee for consideration, challenge, and approval. Generally, the ICAAP report serves to keep the Management Committee apprised of the ongoing assessment of risks facing the Partnership, how the Partnership mitigates those risks, and the adequacy of the Partnership's capital should the material risks identified materialise. The Partnership's ICAAP report includes:

- A review of the Partnership's risk management framework and risk appetite;
- The identification of the major sources of risk to the Partnership's business and operations;
- A discussion of the capital planning and stress testing utilized by the Partnership;
- Confirmation that the Partnership's risk management processes and procedures are comprehensive and proportionate to the nature, scale, and complexity of the Partnership's business and activities; and
- Confirmation that the Partnership has adequate capital for the duration of its planning horizon given the nature and level of the risks to which it is or could foreseeably be exposed.

The Partnership considers the estimated costs of an orderly wind-down as part of its ICAAP. The Partnership believes that it maintains sufficient capital to meet its liabilities for the duration of an orderly wind-down process. As part of the Partnership's analysis, it also considers the arrangements in place with DESCO LP under existing investment advisory and services agreements.

## Remuneration

The Partnership maintains a written remuneration policy designed to comply with the rules and guidance relating to the FCA's Remuneration Code as it applies to BIPRU firms (the "Remuneration Rules"). The Partnership's remuneration policy applies to its members and employees whose professional activities have a material impact on the Partnership's risk profile ("Remuneration Code Staff"). The Partnership's Management Committee oversees the Partnership's remuneration of Remuneration Code Staff.

The total compensation of Remuneration Code Staff is generally structured as a base salary and a year-end bonus. Remuneration Code Staff who are also Managing Directors of the Partnership may receive year-end bonuses typically calculated with reference to the overall financial performance of the D. E. Shaw group and the performance of the particular investment strategy or strategies that the Managing Director supervises (if applicable). The payment of any such year-end bonus is subject to various conditions and the amount may be zero under certain circumstances. In the case of other Remuneration Code Staff, the amount of any year-end bonus is entirely discretionary and is based on a number of considerations, including, among other things, the employee's experience and performance in the role, the overall performance of the investment strategy that the employee supports (if applicable), the profitability of the D. E. Shaw group, and competitive pay practices and industry benchmarks. The relative weight accorded to each of these factors is also entirely discretionary.

A portion of any year-end bonus awarded to Remuneration Code Staff is subject to mandatory deferral. Deferred amounts are generally invested in one or more of the private investment funds managed by the D. E. Shaw group. Remuneration Code Staff who voluntarily elect to leave the Partnership (other than in connection with retirement) will typically forfeit all or significant portions of their unvested deferred compensation and thus have an economic incentive to remain with the Partnership.

The Partnership takes into account the specific nature of its own activities (including the nature of its revenues) in conducting any ex-ante risk adjustments to year-end bonuses. The Partnership has elected not to make ex-post risk adjustments to year-end bonuses, as permitted under the Remuneration Rules. The Partnership may, however, reduce prior year deferred compensation awards under certain circumstances.

All Remuneration Code Staff support the Partnership's investment management activities (the Partnership's only "business area" for purposes of the Remuneration Rules) and either are "senior managers" of the Partnership or perform a significant influence function. The aggregate remuneration awarded to Remuneration Code Staff for purposes of BIPRU 11.5.18R(6) and BIPRU 11.5.18R(7) for the performance year ending 31 December 2016, including year-end bonus awards subject to the deferral policy described above, was approximately £36.0 million.

### Items omitted from the Pillar 3 Disclosures

The Partnership's minimum capital requirement under Pillar 1 is driven by its FOR and not the sum of its credit risk and market risk requirements. The Partnership has, accordingly, concluded that the detailed disclosure requirements in relation to credit risk and market risk set out in BIPRU 11.5.4R(2)-(4), BIPRU 11.5.5-11.5.13R, and BIPRU 11.5.15R-11.5.16R may be excluded from the Pillar 3 Disclosures on the grounds that they are immaterial (in accordance with BIPRU 11.3.5R).

The Partnership does not engage in securitization activity and the securitization disclosures in BIPRU 11.5.17R are not applicable. The Partnership has therefore concluded that it is permitted to exclude such disclosures from the Pillar 3 Disclosures on the grounds that they are immaterial (in accordance with BIPRU 11.3.5R).