Pacific Current Group Limited

ACN 006 708 792

Risk Management Framework

Pacific Current Group Limited's[1] enterprise risk management framework is based upon PAC's core business as a passive investor with principally minority interests in its underlying boutique investment managers.

This risk framework recognises that PAC faces a broad array of risks, many of which are fully in our control to manage and many others of which are outside our control. PAC categorises risks into two types: internal and external. The internal risks tend to be more controllable, and thus easier to reduce or eliminate, while the external ones are often outside our control but can often be partially mitigated, primarily through certain practices such as diversification.

Material risks, each identified below, need to be assessed in terms of the likelihood of the risk event occurring and the potential consequences if the risk event were to occur.

Material i**nternal** risks include:

1. Corporate governance;
2. Financial statement preparation & reporting;
3. Tax Compliance and Planning;
4. Execution risks in acquiring and disposing of boutiques;
5. Key person;
6. Technology & Operations (principally cybersecurity); and
7. Legal/compliance relating to Company operations.

Material **external** risks include:

1. Investment strategy;
2. Investment performance;
3. Organisational risk (boutiques);
4. Operational risk (boutiques);
5. Macroeconomic;
6. Monetisation; and
7. Changes in regulatory environment.

In this document, PAC not only attempts to identify the major internal and external risks, but provide an overview on how the Company currently manages these risks, and how we attempt to monitor them on an ongoing basis. It is important to note that the description of how PAC manages and monitors risks is meant to describe current practices and not necessarily those practices we may employ in the future.

Internal Risks

1. Corporate Governance

Principal governance risks facing the Company includes: (1) potential conflicts of interest between the Company and management or its Board members and the Company; (2) Board competence; and (3) Board functioning.

[1] In this Risk Management Framework, a reference to 'Pacific Current Group', 'Group', 'the Group', 'PAC', 'the Company', 'we', 'us', 'our' is to Pacific Current Group Limited and its subsidiaries unless it clearly means just Pacific Current Group Limited.

Risk Management

The Board and Board committees have oversight of the executive team (**Management**). The majority of the Board and each committee is made up of non-executives. All material decisions not otherwise delegated to Management are brought to the Board for approval, including most notably, decisions to acquire and dispose of interests in the portfolio (**boutique**s). The Board has two subcommittees that oversee governance in 3 specific areas:

- *Audit and Risk Committee* - is responsible for oversight of financial controls and reporting, and of risk management; and
- *Remuneration, Nomination and Governance Committee* - is responsible for setting executive compensation and is also responsible for oversight of governance, including Board membership and Board functioning

Risk Monitoring

Monitoring corporate governance risk occurs at several levels:

- Board members are asked to declare, in advance, any interest they may have in matters slated to come before the Board so that a decision regarding participation and voting may be made;
- The Remuneration, Nomination and Governance Committee obtains benchmarking data for executive compensation as needed;
- The Audit and Risk Committee meets with the Company's external auditors to discuss the planning, conduct and results of the Company's annual audit and preparation of its unaudited half-yearly results. This includes review of exception reports and recommendations. The Audit and Risk Committee also meets separately with the external auditors, both periodically and as needed, to discuss the strengths and weaknesses of the Company's financial systems; and
- The Remuneration, Nomination and Governance Committee conducts annual self-assessment of the Board, Board committees and Board members, and reports the results to the full Board.

2. Financial Statement Preparation and Reporting

As an Australia Securities Exchange (**ASX**) listed Company, we are heavily regulated. These regulations place a great burden on us to perform accurate and timely accounting of our financial results. Failure to do this well can lead to: (1) damaged reputation; (2) potential litigation; (3) impairment of value due to trading at lower valuations; and/or (4) the inability to raise capital to implement our investment strategy.

Risk Management

Managing the financial statement risk primarily involves ensuring all necessary financial disclosures are made and are in compliance with relevant accounting standards. All of this must be done within the time constraints imposed on PAC as publicly listed entity. To help manage the risk around financial statement preparation, PAC seeks to provide:

- clearly delineated responsibilities for work product and Quality Assurance processes;
- KPIs directly tied to the preparation of timely and accurate financial statements;
- monthly boutique update meetings to keep finance team informed about developments that may impact financial results;
- Management prepares position papers and a detailed mapped timetable outlining all deliverables and responsibilities; and
- regular calls/meetings among finance team members.

Risk Monitoring

Having the appropriate feedback loops into the financial statement preparation is essential. Currently, PAC does the following:

- receives feedback from our auditors on their view of PAC's execution (timeliness, accuracy, control adequacy, etc.) after very reporting period; and
- receives reports from our auditors on specific errors /mistakes they have identified.

3. Tax Compliance and Planning

PAC has legal entities in Australia, UK, and the US and now has investments in four different countries. This results in a high level of complexity with regard to the tax implications for how PAC structures its investments, both to ensure compliance with the requirements in the local jurisdictions and reporting in PAC's consolidated financial statements, as well as to ensure optimal after-tax results for PAC shareholders.

Risk Management

Managing risks around compliance with relevant tax rules in each jurisdiction requires a high degree of knowledge in each jurisdiction and an understanding of PAC's global structure. To assist with this complexity, PAC has appointed a global tax adviser.

Risk Monitoring

PAC has relied on employees in both Australia and the U.S. to coordinate compliance with outside service providers.

4. Execution Risk

In acquiring and disposing of boutique interests, the principal execution risks include: (1) failure to structure acquisition transactions in a way that aligns the Company's interests with boutique managements' interests; (2) mispricing acquisitions and dispositions; and (3) failure to secure adequate protective rights in the event of future misalignment.

Risk Management

One definition of investing is "pricing risk." To do this, we must understand the risk we are pricing. We must also attempt to manage the risks around our ability to execute on investments we hope to secure. Execution based risk management involves the following:

- investment philosophy and process diligence;
- evaluation of business management and sales capabilities;
- extensive modeling of anticipated returns under different scenarios, including the use of Monte Carlo simulations when appropriate;
- due diligence conducted by experienced team, with assistance from outside counsel;
- use of expert outside counsel, and other advisers as needed;
- background checks of Targets' senior executives;
- team approach in review of documents, term sheet and final documentation;
- personal and professional reference checks of key people;
- acquisition and governance philosophy focused on maximising alignment with management, coupled with appropriate minority protection rights and covenants;
- information rights for financial reporting permit financial transparency;
- milestones to access additional capital when appropriate; and
- use of distribution and liquidation preferences to expedite returns of capital to PAC, provide downside protection, and disincentives for management to sell more of the business shortly after PAC invests.

Risk Monitoring

Execution risks are primarily managed through adherence to our own investment process. The primary way these risks are monitored is through requiring the completion of each step of our investment process. This is done through the use of a formal Investment Memo structure as well as informally at the Deal Execution Team level.

5. Key Person Risk

PAC is a small firm, with limited redundancy in most positions. As a result, the loss of a key team member can be particularly problematic.

Risk Management

Reducing key man risk through institutionalising PAC's knowledge capital is a long-term goal, though over the short term this risk is best managed via:

- availability of competitive compensation, including LTIs, for PAC executives and staff;
- employment agreements for key personnel, including incentives not to leave abruptly or compete with PAC; and
- benchmarking compensation by Management and the Remuneration, Nomination and Governance Committee.

Risk Monitoring

PAC is sufficiently small that this risk is best monitored through healthy communication between Board and Management and between Management and other key employees. Additionally, Management provides the Board with regular commentary on the risk of losing key people.

6. Technology / Operational Risk

PAC is not a company that is heavily reliant on technology or proprietary software. That said, the firm does conduct much of its business on computers, including communicating via email, transferring funds, and storing confidential information. Accordingly, cybersecurity risk is an important risk we must manage well.

Risk Management

The biggest risks PAC faces on the technology front don't relate to being precluded from pursuing our investment/business strategy over some short-term period. Rather, the risks involve matters of cyber security, particularly, as it relates to the movement of capital.

Related to technology risk is the need to have a robust Business Continuity Management Program for its US and Australian operations. These programs are designed to better enable Pacific Current Group to manage its risk should some event interrupt our business. These programs are required by different regulators that oversee PAC's business.

Risk Monitoring

In North America, PAC uses an outsourced IT provider (True North) to oversee its systems, including elements of cyber security. In Australia, we outsource IT management to Greenlight Technology. Additionally, PAC has a host of protocols and processes in place to protect it from some of the risks that arise when capital is moving. Management will report to the Board, known attempts to garner access to our systems or accounts as well as attempts to surreptitiously direct/redirect capital to unknown accounts.

7. Legal/Compliance Risk Company Operations

PAC is subject to a number of legal and regulatory regimes that affect its operations. Those risks relate to, among other things, corporate compliance for all PAC controlled affiliates regardless of domicile, ASX listing rules, Australian Securities and Investment Commission (**ASIC**) and Australia Prudential Regulation Authority (**APRA**) rules relating to PAC operations and Australian wholesale activities, Securities and Exchange Commission (**SE**C) rules and regulations relating to US operations as a registered investment adviser and as a broker dealer, and Financial Industry Regulatory Authority (**FINRA**) rules and regulations relating to US broker dealer operations. Of particular importance is adherence to the continuous disclosure obligations imposed by the ASX listing rules.

Risk Management

Managing legal/compliance risk requires a multi-prong approach including the following:

- for PAC corporate and ASX compliance and Treasury Group Investment Services Pty Ltd (**TIS**) Australian Financial Services Licence (**AFS**L) compliance, the Company has retained an outsourced company secretarial service and an outsourced AFSL compliance service, with the outsourced company secretary working directly with the General Counsel, the Board chair and the committee chairs.
- For US corporate compliance, the Company uses in-house legal and compliance resources under the General Counsel.

- For US regulatory obligations, the legal and compliance team:
  - maintains a regulatory compliance calendar;
  - maintains a current code of ethics and written supervisory procedures;
  - conducts new employee compliance training;
  - manages quarterly employee compliance attestations;
  - holds quarterly compliance committee meetings with the CEO and head of sales;
  - project manages US regulatory filings; and
  - project manages US regulatory examinations.
- Additionally, certain sales-related compliance functions, including sales material review, are outsourced to a compliance vendor.
- For Australian ASIC and APRA regulatory compliance, the Company relies upon the aforementioned outsourced compliance services to perform similar services.
- PAC employs a conservative approach to its continuous disclosure obligations by disclosing more than is required of us.

Risk Monitoring

- For US Code of Ethics compliance, PAC's internal legal and compliance team collects and reviews employees' quarterly attestations for reporting of outside business activities and other requirements;
- Retention of an industry-recognised independent regulatory auditor to annually review and assess its US legal and compliance program; and
- Monitoring of regulatory developments in Australia, the US and other jurisdictions is dealt with under External Risks, below.

External Risks

As it relates to investing in a new boutique, PAC's principal risk control opportunities occur at the time of acquisition. Consequently, much of the risk control process is reliant upon pre-acquisition diligence, alignment of interests through structuring, and securing appropriate minority protective rights and protections.

1. Investment Strategy

To employ PAC's investment strategy successfully, PAC needs an adequate pipeline of new investments, the ability to analyse and secure attractive investments, effectively negotiate and execute on new transactions. Importantly, PAC also needs access to capital to fund new investments.

Risk Management

PAC cannot control the competitive landscape, but it does have the ability to take actions to increase the number of opportunities it identifies and reviews. PAC also must maintain appropriate staffing levels to ensure it can identify, execute, and manage new investments, which means it is essential to attract and retain talented professionals.

Access to capital can be a material constraint. If PAC is willing to maintain a minimum amount of "dry powder" it can reduce the risk of PAC missing out on investments due to lack of capital. Having adequate capital on hand also allows us to stay relevant in discussions with targets and reduces the risk that we will need to raise capital during inhospitable periods. Maintaining a strong relationship with underwriters, such as Ord Minnett, is important to maintain the ability to raise capital on short notice.

Risk Monitoring

PAC tracks all the investments it identifies and engages with. It then documents the reasons for rejecting/losing out on opportunities. PAC also endeavors to perform a post mortem after each investment to discuss effectiveness of deal execution.

2. Investment Performance

Most, but not all, investment firms are highly dependent on producing competitive investment performance to retain existing clients and attract new ones. Clearly, the definition of “competitive” performance varies by strategy. Performance might be evaluated from a relative-return perspective; other times, performance is evaluated more on an absolute basis. Sustained poor performance can lead to revenue loss and even business failure.

Risk Management

PAC’s ability to improve a boutique’s investment performance is limited for several reasons:

- underperformance often stems from environmental or stylistic preferences that have nothing to do with a manager’s investment skills;
- while PAC can and does engage with boutique management to help understand the reasons for underperformance, we generally do not have the contractual ability to compel corrective action. Moreover, in our experience, we are highly skeptical of the ability of individuals outside of an established investment process to prescribe corrective actions that: (1) are appropriate; and (2) would be accepted by management and/or the firm’s clients; and
- most managers endure periods of underperformance. The primary risk control PAC can employ to minimise Investment Performance risk is: (1) successfully identify talented investors; (2) diversify our own portfolio to minimise the risk that certain factors, unrelated to investment skill, adversely impact multiple PAC boutiques at the same time; and (3) structure features, particularly in early stage investments, that make some portion of our investment conditional upon certain performance milestones being met.

Risk Monitoring

Performance is one of the simplest risks to monitor and yet one of the most difficult to do anything about. That said PAC does perform the following:

- reviews quarterly performance for every manager in its portfolio. If performance seems meaningfully different from expectations, PAC will reach out to discuss in greater detail, perhaps requesting additional analysis from the manager;
- updates performance risk quarterly on our internal *Portfolio Company Risk Scorecard*; and
- quantify the return (excess and absolute) correlations between managers.

3. Organisational Risk (boutiques)

Investment firms are highly dependent on a host of factors/attributes, many of which are very subjective in nature, that impact the ultimate success of an investment firm. Common risks include, but are not limited to the following:

- *Key man* - this is a common risk among boutique investment managers and widespread across our portfolio.
- *Company culture and partnership dynamics* - the quality of investment management decision making is often highly dependent on the interpersonal dynamics and general investment culture at a firm. The culture also plays an enormous role in terms of employee retention.
- *Operational capabilities* - the operational risk varies considerably across our managers depending on the nature of their investment strategies.
- *Compliance issues* - all of the investment managers in which we invest will be regulated by different regulatory bodies.
- *Leadership transitions* - investment managers, particularly for firms highly dependent on specific individuals, face significant challenges transitioning investment leadership from one person to another.

Risk Management

No two firms are exactly alike. Some of these organisational risks are apparent before PAC invests, while others will surface over time.

- PAC performs up-front analysis to maximise the probability that we have identified the most relevant risks. These risks are specifically identified and assessed on PAC’s *Manager Evaluation Template*.

- Our team structures appropriate governance and protections into each of our investments, particularly if a manageable risk is identified prior to the inception of our partnership.
- PAC actively manages boutique relationships so that we can identify risks early and be in a position where our insights or suggestions are welcomed and considered.
- PAC negotiates a variety of information rights to ensure it has access to organisation, financial, and investment information it deems important.

Risk Monitoring

The primary and most effective way these organisational risks are identified is through the maintenance of strong relationships and frequent interaction with the management of our boutiques. That said, PAC typically is represented on the boutique Board, and thus can require access to management and specific information. PAC will also provide a quarterly update on various organisational risks on our *Portfolio Company Risk Scorecard.*

4. Operational Risk (boutiques)

The operational risk varies across our boutiques. This risk is highest when a firm is new, as it often takes new managers an extended period of time to refine their back office, client reporting, compliance monitoring, etc.

Risk Management

Our approach to operational risk management starts with understanding the complexity of the firm's operations and speaking with the firm's management about the operational challenges they face. If operations are truly challenging - such as with a long-only manager - we will undertake detailed operational diligence, typically by contracting a consultant with relevant expertise. We will also perform legal and financial diligence to shed more light on the general operations of the business.

Risk Monitoring

The best way to monitor operational performance is through an ongoing dialogue with boutique management. PAC also requires reporting on operational performance to the portfolio Company Boards. When PAC doesn't have Board participation, we contractually mandate that portfolio Company management provides periodic operational reviews.

5. Macroeconomic

Most of our investments will employ strategies where the investment results will be impacted, to varying degrees, by the macroeconomic environment. When manifested, these risks can adversely impact our boutiques either through their performance and/or the general fundraising environment for their strategies. Among the most important macroeconomic factors are:

- Equity market returns;
- Interest rates & inflation;
- Yield spreads & default rates;
- Currency; and
- Economic and political shocks.

Risk Management

The primary way we can manage and reduce our macroeconomic risk is by diversifying our portfolio across not only across a broad number of managers, but also across different asset classes, revenue models, firm sizes, and client types. Furthermore, strong initial diligence can help us understand the macro risk we are taking, which can help us factor those risks into our valuation and deal structures. Lastly, we can achieve further risk reduction through the structural elements we insert into our investments, such as preferred return and/or top-line vs. bottom-line participation.

Risk Monitoring

While we can update our view of macroeconomic risk on our quarterly *Portfolio Company Risk Scorecard,* that is not the same as managing the risk. Though understanding the implicit macro risks in our portfolio should inform the types of investments we would like to have in our portfolio.

6. Monetisation

One risk that PAC is exposed to is the risk that our portfolio companies will decide to sell most or all of their business after we invest in them. While often a windfall for PAC, it: (1) crystallises tax liabilities; (2) reduces our earnings; (3) often comes at a multiple below where our stock trades; and (4) puts pressure on us to replace the earnings at attractive prices.

Risk Management

There are multiple ways to reduce the risk of being forced to sell a boutique:

- the best is to invest in firms where management is relatively young - perhaps near 40. These younger managers tend to have enough experience to have already proven themselves, but they still have plenty of years in the business ahead of them;
- we can structure a variety of features into our investments, such as liquidation preferences, right of first refusals, or blocks on dispositions, until certain time or return thresholds are met; and
- lastly, candid discussions with boutique management before entering a transaction are an important, though imperfect, way to understand the boutique management's long-term plans.

Risk Monitoring

The only things we can do to monitor the risk that boutique management will decide to monetise their businesses is to: (1) stay in close contact with management to stay abreast of their thinking; and (2) remain cognisant of market appetite for acquisitions and hence current valuations.

7. Regulatory

Financial services are a heavily regulated industry. All our boutiques are exposed to different degrees of regulatory risk. Much of this risk relates to the need for managers to comply with a host of regulations; however, proposed regulations in different geographies can often have a material impact on the performance or appeal of the investment strategies our boutiques offer.

Risk Management

PAC analyses regulatory risks in the course of performing diligence the organisation and preparing the investment thesis. Our team performs legal diligence in advance of a transaction, highlighting key potential issues. We also perform background checks on key professionals to ensure they haven't had run-ins or been sanctioned by relevant governing bodies, regulators, etc.

Risk Monitoring

While the ability to mitigate regulatory risk post-investment is limited, PAC does do the following to heighten its awareness of any such risks:

- PAC reviews each manager's Form ADV (which is the uniform **form** used by investment advisers to register with both the SEC and US state securities authorities) on an annual basis;
- At the boutique Board level, PAC attempts to require disclosure of regulatory issues or concerns relevant to their business; and
- Regulatory risk will be updated quarterly on our *Portfolio Company Risk Scorecard.*

The table on the following page provides a tabular way to rank each manager across a variety of risks. Clearly, the number of risk factors can be expanded or decreased. The risks have ben subjectively quantified, but ultimately this framework should provide a helpful way to think about risk at the portfolio Company and track how the risk changes over time.

Approved and Adopted

This Risk Management Framework was approved and adopted by the Board on 30 August 2019.