N3 CAPITAL PARTNERS
Investment firm

Risk Management Policy

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Introduction

Risk management has always been an explicit or implicit fundamental management process in financial services. We strongly believe that a good risk management is a competitive advantage. Risk management is also an obligation to our stakeholders - diligent and intelligent risk taking represents an attitude towards stakeholders. Quantified risk is seductive, but can be misleading or provide a false sense of security and imperfections have to be acknowledged. Comprehensive, institution-wide strategy and tactics towards risk can be implemented with credible and relevant methodologies that identify, define, asses, reduce, transfer, avoid and manage risk.

First section of this Policy, “Internal controls”, explains internal control system put in place to ensure the integrity of financial and accounting information, meet operational and profitability targets and transmit management policies throughout the organization. Second section, “Risk management activities”, explains risk function procedures and is focused on risk assessment and reporting.

Internal controls

Internal controls are methods put in place to ensure integrity of information and transmit management policies throughout the organization. Each business unit has its own, unique and distinctive duties and responsibilities. The business is based on "four-eye principle" and no single person is permitted to handle all aspects of a transaction or sensitive data changes. Company's core activities are subject to internal controls.

Company's core office-by-office business activities and internal control procedures are defined in the following tables. They contain information about unit or employee performing internal control as well as regularity of the control process.

I. Front office

Activity	Internal control	Unit or employee performing internal control	Regularity
Trade order and settlement instruction	Pre-trade compliance checking of the order	Middle office	When it occurs
Pre-matching	Checking order execution	Operations	When it occurs

II. Operations

Activity	Internal control	Unit or employee performing internal control	Regularity
Settlement order	Checking settlement order	Head of Operations	When it occurs
Transaction list sending	Controlling the transaction list	Head of Operations	When it occurs
Portfolio reconciliation	Controlling the portfolio	Middle office and Head of Operations	Daily
Financial and tax reporting	Report checking	Management Board	Monthly, Quarterly, Annually
CFSSA reporting	Report checking	Management Board	Monthly, Quarterly, Annually
IT maintenance	Cross checking	Management Board	When it occurs

III. Support office

Activity	Internal control	Unit or employee performing internal control	Regularity
Investment recommendations and advisory	Recommendations controlling	Head of Support office	When it occurs

IV. Sales and marketing

Activity	Internal control	Unit or employee performing internal control	Regularity
Producing sales and marketing materials	Materials review	Head of sales and marketing	When it occurs
Web page content and update	Information and disclosures review	Middle office	When it occurs

Risk management

Every single business unit has its own important role in risk management process with Middle office being the most important of them all. Whenever there is a procedure, limit or policy breach in everyday activities, Middle and other offices have to comply with specific procedures defined in this Policy.

In this section, N3 Capital Partners outline most common risks in everyday business operations, frequency of risk assessment and actions needed to be taken in case of a breach. Due to nature of the business we operate in, additional risk not covered in this Policy could arise[1], It is responsibility of every employee, especially Management Board and Middle office to manage those risks accordingly.

I. Credit risk

Credit risk is defined as the potential that the borrower or counterparty will fail to meet its obligations in accordance with agreed terms resulting in loss. The risk of one party not fulfilling its obligations to another in a timely manner is a risk that all creditors face.

Monitoring issuer risk: Issuer risk is the probability of loss resulting from the default of the issuer of a security. Investment limits can be set to additionally monitor and manage issuer risk. Issuer risk is measured by the use of credit ratings, probability of default method, or any other method

[1] example of those risks could include the risks related to innovative financial products that willcome to the market in the future and are not managed by current risk management best practices

used by company's Support office. All outstanding breaches are immediately reported to the Management Board and discussed during Investment Committee.

Monitoring credit spread risk: Credit spread risk is the risk that arises from the possibility that changes in credit spreads will affect the value of financial instruments. Investment limits can be set to additionally monitor and manage credit spread risk. Middle office monitors credit spread risk of the portfolio. All outstanding breaches are immediately reported to the Management Board and discussed during Investment Committee.

Monitoring investment limits: All fixed income holdings must be within internal investment limits set by Investment Committee. Furthermore, investment limits can be set as a percentage of portfolio invested in fixed income instruments with same or similar credit risk. All outstanding breaches are immediately reported to the Management Board and discussed during Investment Committee.

II. Counterparty risk

We engage with several types of counterparties which can be differentiated by type of services provided: investment related services or management related services.

Monitoring risk of management related counterparties: We engage with various management related services counterparties. Counterparty exposure must be managed efficiently. We can potentially have exposure to following counterparties:

- Alternative investment management investment firms (AIFM)
- Transfer agents
- Various risk analytics and portfolio accounting service providers
- Other

All counterparties must go through approval process, which is usually conducted by Middle office in order to prepare for final decision by Management Board. After decision has been made, Middle office will be in charge for further monitoring of counterparty risk. Management Board can define specifics of allowed counterparty exposure. All outstanding breaches are immediately reported and discussed with the Management Board.

Monitoring risk of investment related counterparties: Additionally we engage with various counterparties for investment related services. Counterparty exposure must be managed efficiently. We can potentially have exposure to following counterparties:

- Custodian
- Brokers
- OTC traders
- Other

All counterparties must go through approval process, which is usually conducted by Middle office in order to prepare for final decision by Management Board. After decision has been made, Middle office will be in charge for further monitoring of counterparty risk. Investment committee or Management Board can set limits to counterparty exposure. All outstanding breaches are immediately reported to the Management Board and discussed during Investment Committee.

Monitoring of failed trades: Middle and Front office check the list of failed trades. If there is a significant number of failed trades with a particular counterparty, an issue should be resolved by changing a service provider. If there is no adequate service provider on the approved list, Management Board has to be notified. Middle office also assesses the risk in its Annual risk report and discusses it during Investment Committee.

III. Market risk

Market risk is the risk of losses resulting from changes in the value of assets and liabilities due to fluctuations in risk factors such as interest rates, foreign exchange rates, stock prices etc.

Interest rate risk: The risk of loss resulting from changes in interest rates. As an investment firm our company profits and assets under management can be subject to interest rate change. Therefore, measuring interest rate risk is important risk management measure. If discretionary portfolio management client calculates its own risk measures, we will use this information as default but our Middle office can additionally calculate:

- Duration calculation available via Bloomberg terminal or done in-house.

In case of significant increase in risk measures or limit breaches, Front and Middle office have to report them to the Management Board and initiate discussion during Investment Committee.

Price changes risk: The risk of loss resulting from a decline in the value of assets due to changes in the prices of securities and financial instruments. All asset exposures must be within regulatory and internal investment limits set by Investment Committee. If discretionary portfolio management client calculates its own risk measures, we will use this information as default but our Middle office can additionally calculate:

- “Beta” calculation for equities. Bloomberg terminal is suitable source of information
- Value at Risk (VaR) measure. Both single and overall portfolio position will be calculated using 1-day, 99% VaR[2].
- “What-if analysis”[3] based on hypothetical deal or trade and the potential impact on the portfolio VaR results could also be used.

In case of significant increase in risk measures or limit breaches, Front and Middle office have to report them to the Management Board and initiate discussion during Investment Committee.

[2] VaR calculation is available via Bloomberg terminal (Multi Asset Risk System) or done in-house
[3] “What if analysis” is a Bloomberg tool that allows for different simulations of the portfolio and estimates various scenarios effects on portfolio return and risk.

Volatility risk: The risk of the size of changes in as security value. All asset exposures must be within internal investment limits set by Investment Committee. If discretionary portfolio management client calculates its own risk measures, we will use this information as default but our Middle office can additionally calculate:

- "Vega" calculation for options.
- "What-if analysis"[4] based on hypothetical deal or trade and the potential impact on the portfolio VaR results could also be used.

In case of significant increase in risk measures or limit breaches, Front and Middle office have to report them to the Management Board and initiate discussion during Investment Committee.

Stop-loss orders: Front and Middle office must discuss placing stop-loss orders and evaluate their efficiency in terms of reducing market risk.

Exit strategy of failed investments: Front and Middle office must discuss exit strategies for all investments.

Financial instruments liquidity: The risk stemming from the lack of marketability of an investment that cannot be bought or sold quickly enough to prevent or minimize loss. Liquidity risk is typically reflected in unusually wide bid-ask spreads or large price movements. The rule of thumb is that the smaller the size of the security or its issuer, the larger the liquidity risk. Depending on limits, Front office and Middle office monitor the level of instrument liquidity risk. Middle office can assess financial instruments liquidity risk using:

- bid-ask analysis
- overall turnover analysis
- adding internal liquidity rating to each instrument

In case of significant increase in risk measures or limit breaches, Front and Middle office have to report them to the Management Board and initiate discussion during Investment Committee.

IV. Operational risk

Operational risk: Operational risk is the risk of adverse impact to business as a consequence of conducting it in an improper or inadequate manner and may result from external factors. Middle office assesses overall operational risk in the Annual risk report.

In the Annual risk report, Middle office has to list all risk events that happened throughout reporting period and categorize them in the "Event type Categories" as specified in table below.

[4] "What if analysis" is a Bloomberg tool that allows for different simulations of the portfolio and estimates various scenarios effects on portfolio return and risk.

Event type Categories	Probability	Potential impact	Level of risk
Internal fraud	Low	Serious	Moderate risk
External fraud	Low	Critical	High risk
Operating practices	Medium	Significant	Moderate risk
Damage to assets	Low	Significant	Minimal risk
Business disruption and System failures	Low	Minor	Minimal risk
Execution, Delivery and Asset management	Medium	Minor	Minimal risk

In its assessment of “Level of risk” for particular event, Middle office uses the following matrix, identifying impact of the risk activity versus the probability of risk activity.

Impact vs. probability table		Probability			
		Low	Medium	High	Imminent
Impact	Critical	High risk	High risk	Very high risk	Very high risk
	Serious	Moderate risk	High risk	High risk	High risk
	Significant	Minimal risk	Moderate risk	Moderate risk	High risk
	Minor	Minimal risk	Minimal risk	Minimal risk	Moderate risk

The report must also include one or more of the following proposals and measures for:

- Assessing of corporate insurance and its adequacy
- Reducing avoidable losses
- Protecting and enhancing reputation
- Improving risk and control culture
- Improving awareness, objectivity, transparency and accountability of risk
- Improving the efficiency and effectiveness of internal controls
- Identifying opportunities on how to reduce operating risk

Outsourced services risk assessment: Due to nature of investment business, some services are outsourced to third parties. Quality review and performance evaluation of outsourced services is responsibility of Middle office and Management Board. Regular risk assessment includes:

- List of operational failures and recommendations for quality improvement

- Review of annual compliance report
- Timely response to our inquiries
- Cooperation with external auditors and government agencies
- Regular reporting

Information and data security, privacy and records retentions: Middle office can regularly check "Data protection policy" and "Disaster recovery plan" as well as any other policy or procedure designed to secure, record or document our client or business information and check for mistakes and irregularities.

V. Currency risk

Currency risk: The risk of an investment's value changing due to changes in currency exchange rates and the risk that an investor will have to close out long or short position in a foreign currency at a loss due to an adverse movement in exchange rates**.** Depending on limits, Front and Middle office monitor the level of currency risk. If discretionary portfolio management client calculates its own risk measures, we will use this information as default but our Middle office can additionally calculate:

- Percentage of total portfolio exposure to foreign currencies
- Value at Risk (VaR) measure. Both single and overall portfolio position will be calculated using 1-day, 99% VaR[5].
- "What-if analysis"[6] based on hypothetical deal or trade and the potential impact on the portfolio VaR results could also be used.

In case of significant increase in risk measures or limit breaches, Front and Middle office have to report them to the Management Board and initiate discussion during Investment Committee.

VI. Political and Sovereign risk

Monitoring sovereign rating: Rating agencies issue sovereign rating that indicate political and economic outlook of a country. If we hold sovereign debt of a particular country when the country is downgraded and there is a significant increase in risk or limits have been breached, Middle office issues an alert to Front office, Management Board and Investment Committee.

VII. Reputational risk

A threat or danger to the good name or standing of a business or entity. Reputational risk can occur through a number of ways: directly as the result of the actions of the company itself,

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[5] VaR calculation is available via Bloomberg terminal (Multi Asset Risk System) or done in-house

[6] "What if analysis" is a Bloomberg tool that allows for different simulations of the portfolio and estimates various scenarios effects on portfolio return and risk.

indirectly due to the actions of an employee or employees or tangentially through other peripheral parties.

Information Dissemination and One Voice: All the reports which are sent outside of N3 Capital Partners are reviewed by Management Board or other responsible units. Reports must have proper disclaimers. No one is permitted to talk to external news organization and press without proper clearance from the Management Board.

Proactive cooperation with all audit bodies: Ensure that all risk requests for information and all audit recommendations are dealt with in a timely manner.

Personal transactions and conflicts of interest: All employees are subject to financial disclosure and personal trading restrictions. See: “Conflicts of interest policy”, ”Personal Transaction Policy”, “Chinese Wall Policy”, “Market abuse and insider information policy” and “Compliance Manual”.

VIII. Business risk

Business risk: Like any business, we are exposed to risk resulting from general business and economic conditions, which could lead to a reduction in assets under management and decrease in management fees. Middle office assesses the business risk focusing on:

- Competition, management fees and overall economic climate
- Challenges in the economic environment
- Company’s financial strength

IX. Stress testing of the portfolio

Stress testing is a simulation technique used on assets under management to determine possible reaction to different financial situations and economic environments. Stress test is based on five-step approach:

1. Segmentation analysis
2. Trend analysis and data transformation
3. Selecting macro and single economic variables
4. Modeling
5. Scenario selection for stress test

Stress testing is conducted on Bloomberg terminal through “Multi-asset risk system”. Management Board and Investment Committee determine the inputs of the stress tests on annually basis. Stress test inputs are based on European Banking Authority guidelines from stress-testing of the banks by using simplified market risk stress test approach:

- Under the baseline scenario, the 1 times the standard deviation with respect to the previous three years represents the overall baseline loss and is assumed to be the stress impact on the P&L for the time horizon of the stress test.

- Under the adverse scenario, 2 times the standard deviation with respect to the previous five years represents the overall adverse loss and is assumed to be the overall stress impact on the P&L for the time horizon of the stress test

Additionally, Management Board and Investment Committee can request different scenarios analysis. Custom scenario analysis are conducted on Bloomberg "Multi Asset Risk System".

Stress test results are reported to Management Board and discussed during Investment Committee. Additionally, Middle office reports the results of the stress-testing in the "Annual risk report".

X. Back testing

Back testing is a technique used to compare the predicted model results with actual results. Middle office uses back testing techniques to test the Value at Risk (VaR) model predictability. This identifies instances where VaR has been underestimated, meaning portfolio has experienced greater loss than the original VaR estimate. Back testing is calculated using Bloomberg "Portfolio Risk and Analytics" and "Multi Asset Risk System".

The following standards apply:

- Data sets should be updated at least once every 3 months
- VaR is calculated on a monthly basis
- 99th percentile, one-tailed confidence interval is to be used
- A 10 day movement in prices should be used as the instant price shock
- 1 year is classified as a minimum period for "historical" observations
- Value at Risk (VaR) measure. Middle office will usually use 1-day, 99% VaR, but could be adjusted if appropriate. VaR calculation is available via Bloomberg terminal or done in-house.

Back testing is conducted on Bloomberg "Portfolio Risk and Analytics" and "Multi Asset Risk System" tools.

The following standards apply:

- Data sets should be updated at least once every 3 months
- VaR is calculated on a monthly basis
- 99th percentile, one-tailed confidence interval is to be used
- A 10 day movement in prices should be used as the instant price shock
- 1 year is classified as a minimum period for "historical" observations

Back testing results are reported to Management Board and Investment Committee. Additionally, Middle office reports the results of the back testing in the Annual risk report.

Risk reports

As an Investment firm incorporated in Croatia, Middle office is obligated to prepare two different types of risk reports:

- Annual operating risk report
- Control function work report.

All risk assessments mentioned in the previous sections of this Policy are integral parts of the risk reports.

Zagreb, July 4, 2014

N3 Capital Partners d.o.o.
Damir Čukman, President of the Management Board
Maja Bešević Vlajo, Member of the Management Board