

# Southey Capital

Distressed and Illiquid specialists

**ICARA Disclosure**

January 2023

FCA Firm Reference number 711717

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## Introduction

Document date: 19<sup>th</sup> December 2022

Period of Review: 1<sup>st</sup> of December 2021 to 31<sup>st</sup> December 2021

In accordance with The FCA MIFIDPRU 7.8.7(3) rules Southey Capital (“Southey” or the “Firm”) has considered the following aspects in our ICARA document.

- A clear description of the firm's business model and strategy and how it aligns with the firm's risk appetite (MIFIFPRU 7.8.7(3)(a));
- An explanation of the activities carried on by the firm, with a focus on the most material activities (MIFIFPRU 7.8.7(3)(b));
- An analysis of the effectiveness of the firm's risk management processes during the period covered by the review (MIFIFPRU 7.8.7(3) (f));
- A summary of the material harms identified by the firm and any steps taken to mitigate them (MIFIFPRU 7.8.7(3)(g));
- A clear explanation of how the firm is complying with the OFAR, including a clear breakdown of each component as at the review date (MIFIFPRU 7.8.7(3)(i));
- A summary of any stress testing and reverse stress testing carried out by the firm (MIFIFPRU 7.8.7(3)(j));
- The levels of own funds and liquid assets that, if reached, the firm has identified may indicate that there is a credible risk that the firm will breach its threshold requirements (MIFIFPRU 7.8.7(3)(k));
- The potential recovery actions that the firm has identified (MIFIFPRU 7.8.7(3)(l)); and
- An overview of the firm's wind-down planning (MIFIFPRU 7.8.7(3)(m)).

The Firm has taken in to account all aspects of the MIFIPRU 7.8.7(3) requirements and given the stable nature of the business model, conservative nature of the business risk and good mitigation of the possible risks covered, Southey considers the document fit for purposes.

This document has been reviewed and approved by the management board (Directors) of Southey Capital Ltd.



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Dated 2<sup>nd</sup> of January 2022

### Business model assessment

- Southey Capital is an active participant in the global markets for securities, providing a matched principal brokerage service to institutions and professional counterparties.

The majority of our business is conducted on a riskless matched principal brokerage basis, where Southey Capital sits between buyer and seller, buying and selling the same security or risk and earning a commission between the bid and offer prices. **Risk** is mitigated by having identical documentation with buyer and seller (no on-going risk stays with Southey) and careful selection and regard to trading counterparties to ensure that payment is made.

- We aim to find sellers and buyers for securities that are generally illiquid and have little market transparency, in this niche our research driven business is able to create value by being a broker counterparty to match a sellers desire for liquidity and a buyers appetite to invest in a niche sector of the life cycle of securities.
- The firms risk appetite is generally low, we aim to match buyers and sellers' orders with a spread between. In this way the firm should make a profit, and our downside should be limited to the risk of default by either trading counterparty, leaving a trade hanging.

### Risk Management focus

- Counterparty due diligence and risk assessment is our priority, we try to ensure that we trade with only well capitalised and regarded institutions, frequently regulated themselves. We look at their capital resources and make sure that trading risk/settlement risk is well within the means of the counterparty.
- We aim to offset counterparty default risk wherever possible on each party (buyer and seller) by documenting trades where possible with cancellation language so that should a counterparty to a trade fail, the trade can be cancelled without on-going liabilities.

### Forecasting and stress testing

#### Effectiveness of the Firms risk Management

- All key risk management activities are overseen by Robert Southey, the sole shareholder and director of Southey Capital.
- The board has come to the opinion that there has been no material change in the Firms business or operating model.
- With regard to our main risks (counterparty failure), during the Period of Review, Southey Capital on-boarded (reviewed the KYC of new trading counterparties) twenty-six counterparts and traded with forty-six, in total, total counterparts throughout the year. We recorded no failed trades and no counterparty failures.
- Southey traded a total nominal debt of c. GBP 300m, though two particularly large trades of €230m and €30m made up a large portion of this, the total cash traded value of the brokered trades for the Reporting Period amounted to c. £15m.

- As per (MIFIFPRU 7.8.7(3)(g)) the Firm identified no material harms and did not perceive any new additional ones in the forecasting period. As such, the firm has not taken any additional steps to mitigate such risks.
- As a matched principal broker, the main risk we face is to a large fixed overhead and a reduction in business quantity / lack of profitable opportunities to broker trades in.
- Therefore, we focus our stress testing on the Firms resilience to a prolonged lack of opportunities.
- In our stress tests we have modelled a) no trades for three months and b) 25% percent reduction in revenues for the whole year.

### Summary of stress testing and reverse stress testing

As per the requirements of carried out by the firm (MIFIFPRU 7.8.7(3)(j)). During 2021 Southey Capital achieved c. £600k of brokerage revenue, an average of c. £50k per month, whilst fixed overheads amounted to on average £12k and 37k in total costs per month including variable costs.

- a)
  - With no trades for three months, as per the FOR calculation, the firm would have net outgoings of £33k. The sum is easily covered by the paid in share capital and retained earnings.
- b)
  - In the circumstances of c. 25% reduction in business through the year, the Firm would see £450k of brokerage revenue and total costs including variable of £372k, thus with a pre-tax profit of £77k the firm would not suffer in a meaningful way.

The Firms **own funds threshold requirement** and own funds to address risk of **ongoing activities** ( MIFIFPRU 7.8.7(3)(k) )

- The Firm considers the FOR as the main threshold requirement, so we are confident to report a threshold of £35k. This will be reviewed periodically and on an ad hoc basis if the fixed overheads increase.

### Recovery planning

- In accordance with (MIFIFPRU 7.8.7(3)(l)), recovery planning of the own funds and liquid assets requirement, the firm manages its liquidity very carefully and aims to hold ample reserves.
- A key part of the firms recovery planning lies with its experienced Locum arrangement, our reliable out sourced IT infrastructure, strong risk management and ample liquidity.
- The Firm has tested remote working arrangements frequently and was able to operate as normal.
- The Firm has in place two separate corporate banking facilities and multiple security custodians, so that operationally the firm is resilient to at least one bank collapse.
- In addition to the careful management of trading exposure the firm intends to implement a standby credit facility to provide an additional £50k of liquidity, that can be drawn upon in the event of a short-fall.

- This credit facility will be made available by the principal shareholder.

### **Wind-down planning**

- An overview of the firm's wind-down planning (MIFIFPRU 7.8.7(3)(m)).

Own funds necessary for orderly wind-down

- The Firm estimates that around £35k, or a sum equivalent to the FOR should be enough for an orderly winddown, provided that legal and other professional services are kept to a minimum. The firm maintains few ongoing arrangements with clients to safeguard assets and hence operationally once all outstanding trades are settled, there should just be a cash balance to distribute.
- The Firm has in place a Locum arrangement should the Firm's sole director be incapacitated. The Locum provides for an experienced C-Level financial services executive to come in to the firm and run operations or wind them down.
  - The winddown procedures include:
    - Settling all outstanding trades
    - Selling off remaining assets in the firm
    - Closing custody accounts and bank accounts
    - Paying any remaining commissions and fees
    - Distributing any reserves
- Owing to the small size of the Firm, we believe that a winddown of the Firm would not present (to our estimation) any major issue to any clients of the Firm or to trading counterparties.