

# First Principles Capital Management, LLC

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Firm Brochure/Part 2A of Form ADV

This brochure provides information about the qualifications and business practices of First Principles Capital Management, LLC. If you have any questions about the contents of this brochure, please contact us at 212 380-2280. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority. First Principles Capital Management, LLC is a Registered Investment Advisor. Registration does not imply a certain level of skill or training.

Additional information about First Principles Capital Management, LLC also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

## **Material Changes**

This is the annual 2016 update of FPCM's ADV II Brochure.

In September of 2015, FPCM was acquired by American International Group (AIG), and is now a fully-owned subsidiary of AIG Asset Management (U.S.) LLC, also a Registered Investment Advisor. FPCM maintained its separate investment advisor registration and current business address. Douglas Dachille became the Chief Investment Officer of AIG, the parent company, Richard Dolan replaced Doug as Chief Executive Officer of FPCM and Mark Alexandridis became the Chief Investment Officer of FPCM.

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## Advisory Business

First Principles Capital Management, LLC (“FPCM”) was established in 2004 to offer investment supervisory advice to financial institutions, endowments and foundations, industrial corporations, family offices, high net worth individuals, and private funds.

FPCM acts as the sponsor, administrator, and manager of private funds. As the manager of the funds, FPCM provides investment supervisory services to the funds with respect to investment assets of the funds. All fund strategies and investment policies are included in the Private Placement Memorandum for each fund.

FPCM also provides investment supervisory to banks and thrift organizations that would like advice on the strategies and trading of securities that may also be the same strategies provided to financial institutions, endowments and foundations, industrial corporations, family offices, high net worth individuals, and private funds. FPCM will provide both execution and investment supervisory services or only investment supervisory services to such clients if they so choose.

FPCM does not participate in wrap fee programs.

FPCM does tailor separate accounts to specific client objectives where FPCM will work with clients to establish specific investment guidelines, including permitted investment instruments, which are incorporated in the investment management agreement.

As of December 31, 2015, FPCM managed the following client assets:

	U.S. Dollar Amount
Discretionary	\$7,102,000,000
Non-Discretionary	\$ 603,000,000
Total	\$7,705,000,000

## Fees and Compensation

FPCM may receive the following fee types:

1. Percentage of Assets Under Management
2. Performance Fees
3. Fixed/Flat Fees.

### 1. Annual Percentage of Assets Under Management

FPCM may charge a percentage of assets under management fee for its advisory services. Such fee will be paid in arrears on a period subject to negotiation with the client (typically monthly or quarterly). This fee is negotiable, but will generally range from 0.20% to 2.50% annually. The fee to a particular client, along with the payment frequency, will be detailed in the operating agreement and/or contract for services with the client. Once fees are paid they are non-refundable.

### 2. Performance-Based Fees

FPCM will also charge performance-based fees in its relationships. These fees are not only charged to private investment fund clients, but also to other advisory clients. These charges will be subject to the contract of agreement struck with each client. The typical performance-based fee would be 15%-25% of the net profits from the assets under management, but the calculation for such fee and the actual amount will be subject to negotiation as part of each client agreement. Once fees are paid they are non-refundable.

The following are examples of the fees and methodology for some particular client fee structures:

In consideration for providing investment supervisory services to funds, FPCM will charge a monthly fee in arrears as stipulated in the client service agreement. The management fee will be paid by the clients, subject to the following example schedules:

#### Catena Capital, LLC

An amount equal to  $1/12^{\text{th}}$  of 2.50% per annum of the aggregate Funded Amounts of all Members (calculated as of the end of each month).

Once fees are paid they are non-refundable.

#### Performance Fee for Catena Capital, LLC

FPCM is entitled to receive an incentive allocation, if earned, subject to the covenants of the operating agreement, at the end of each fiscal quarter; 10% of the portion of the net profits, if any, credited to the capital account of each member during the fiscal quarter will be allocated to FPCM and charged against each member's respective capital account.

FPCM may also receive a deferred incentive allocation equaling 10% of the base amount for all accounting periods. This calculation method is included in the Private Placement Memorandum and the Operating Agreement for the fund. Once fees are paid they are non-refundable.

### 3. Fixed Fees:

FPCM may charge a fixed fee for its advisory services. FPCM's fixed fee is negotiable based on the client's needs, payable over time. The services that may correspond to the designated fixed fee amount may vary. Advisory services that are anticipated to be more complex will generally warrant a higher fixed-fee amount. Less complex services may generally result in a lower fixed-fee amount. Fees typically range between \$200,000 and \$1,000,000, annually.

FPCM's fixed fee for providing advisory services is determined based on anticipated work to be done. Since FPCM cannot accurately determine the fee amount until learning about the client's financial circumstance, it is FPCM's practice to provide an initial, no obligation, no cost meeting in order to become familiar with the client's circumstances. FPCM will obtain information from the client verbally and on any current information gathering documents approved for use by FPCM. The information gathered during this session will assist FPCM in determining the fee amount for the client's advisory services.

As mentioned previously, FPCM does charge performance fees on some of its investment advisory accounts or funds and charges a fixed dollar or fixed basis point management fees on other investment advisory accounts. To the extent that a performance fee based account holds the same securities as a different pure management fee based account there could be conflicts favoring the performance based account. FPCM addresses those conflicts by implementing a trade allocation policy which ensures that portfolio managers allocate eligible securities on a pro-rata basis and rotate those allocations when a full pro-rata allocation is not practical.

## **Types of Clients**

FPCM provides investment supervisory advice to financial institutions, endowments and foundations, industrial corporations, family offices, high net worth individuals, private funds, and registered investment companies.

Generally, FPCM shall impose an engagement balance or an annual minimum fee for its investment advisory services. FPCM's minimum investment size varies by fund for investment supervisory services provided to the individual funds. All minimum investment amounts can be identified in the fund Private Placement Memorandum or marketing material for separate accounts.

FPCM shall also impose a minimum account size and fee for other clients. These minimums will be instituted on a case-by-case basis and subject to negotiation.

## Methods of Analysis, Investment Strategies, and Risk of Loss

FPCM's fixed income investment philosophy is to:

- Pursue a solutions-oriented investment process by first understanding client objectives and constraints, then designing portfolios that meet those objectives. Because we focus on customized and limited client-centric mandates, we tend to be intimately familiar with a client's circumstance and/or regulatory context.
- Align FPCM's interests with client interests in the form of our compensation, which is often directly linked to specific performance metrics or client objectives.
- Manage value-oriented portfolios by focusing on net realized risk adjusted cash flows to be earned over an investment horizon. This approach helps us avoid pro-cyclical market environments.
- Focus on investment goals, not the perpetuity of the investment business. Our experience allows us to participate actively across multiple fixed income markets, cash and derivatives, including US Treasuries & Agencies, MBS, Corporate Credit, ABS and Municipals. Our approach allows us to act with confidence when we decide to return capital to clients when their objectives have been met.

FPCM has a solutions-oriented approach which allows us to tailor the investment management process for each portfolio, taking into account the investment objectives and guidelines established for each client.

The choice of market sector and securities within that sector are driven by fundamental analysis of the risk-return characteristics of that sector relative to other sectors, and by performing detailed, fundamental cash-flow and structural analysis of each fixed income instrument with respect to credit, pre-payment, and structure (senior/subordinated). Cash flows and structure differentiate fixed income from equity and other markets. FPCM combines this fundamental analysis with an understanding, and a view, of the technical supply and demand drivers in each of these markets to make final portfolio construction decisions. Although FPCM is attuned to these technical drivers, we are not a momentum driven manager, and do not pretend to predict when the market will realize that an asset is undervalued.

Portfolio managers make buy and sell decisions and execute the trades in each portfolio sector as part of the Investment Process for a given portfolio.

Proprietary research is very important to the investment process at FPCM. Portfolio managers and analysts perform their own fundamental credit, interest rate/curve, prepayment, and other structural analysis. FPCM has never relied solely upon external dealer research, credit ratings from rating agencies, third party dealer MBS pre-payment or other derivative models to draw final conclusions on how to position a portfolio. In fact, by understanding the weaknesses of third party models and analysis through the benefit of our years of experience in these markets combined with our understanding how the providers of research operate, FPCM is better able to benefit from the combination of proprietary research and access to third party research.



FPCM utilizes third party research: Published Broker/Dealer strategy and fundamental credit and equity research, specific vendor research such as “ Capital IQ “, rating agency research, company filings, conference calls, monthly agency pre-payment data and RMBS remittance reports, models and data available through broker/dealer websites, Bloomberg, or other specific sources.

Internal Research: Fundamental analysis of corporate credit, mortgage prepayments, structure of MBS, asset-backed securities or municipal bonds. Internally generated models include options models, e.g., interest rate options, first-to-default structures on portfolios of names, etc.

Many of FPCM professionals have experience in the derivatives marketplace, and were among the founding members of various derivative businesses at J. P. Morgan.

FPCM makes extensive use of derivatives in mandates where applicable and prudent. FPCM utilizes all fixed income & credit OTC derivatives, including basis swaps, options, and first-to-default credit derivatives. Conversely, FPCM Portfolio managers also understand when not to use certain derivatives, such as highly customized, illiquid derivative contracts, which make it difficult and sometimes impossible, to rebalance the portfolio when desired.

Each Investment process starts with a “top down” view of relative value of all sectors or sub-sectors permitted in the investment guidelines.

The “bottom up” process evaluates risk inherent in each security prior to purchase. Understanding individual security risk (credit–spread & default, liquidity, interest rate, prepayment, and other call risks) is crucial in avoiding loss and creating value.

We believe that our investment process and our business model provide FPCM with a unique competitive advantage in the marketplace – ultimately benefiting our clients.

Positioning in fixed income securities can involve investment loss due to price fluctuation from changing interest rates, credit deterioration for non-government guaranteed bonds, unanticipated pre-payment for Mortgage Back and Asset-Backed securities, currency fluctuation for foreign denominated securities, liquidity risk for strategies that involve leverage or short sales, changes in market implied volatility parameters in options, and counterparty credit risk when implementing derivatives transactions and repurchase agreements if the counterparty defaults.

## **Disciplinary Information**

The firm and its employees have not been involved in any legal or disciplinary events.

## **Other Financial Industry Activities and Affiliations**

FPCM is affiliated with AIG Global Capital Markets Securities, LLC, a registered broker dealer. Several management persons are registered representatives of AIG Global Capital Markets Securities, LLC. Please see our brochure supplement for additional information.

FPCM is registered as a commodity pool operator.

FPCM does not have business relationships with other investment advisors that create material conflicts of interest.

## **Code of Ethics, Participation or Interest in Client Transactions, and Personal Trading**

At FPCM, we take great pride in our commitment to serving our clients' needs and the integrity with which we conduct our business. In our recent history, the financial services industry has come under significant scrutiny, especially in the area of the inherent responsibility of financial professionals to behave in the best interests of their clients.

Pursuant to Rule 204A-1 under the Investment Advisers Act of 1940, FPCM has developed a Code of Ethics ("Code") as a means of memorializing our vision of appropriate and professional conduct in carrying out the business of providing investment advisory services. Our Code addresses issues such as the following:

- Standards of conduct and compliance with applicable laws, rules, and regulations
- Protection of material non-public information
- The addressing of conflicts of interest
- Employee disclosure and reporting of personal securities holdings and transactions
- The firm's IPO and private placement policy
- The reporting of violations of the Code
- Educating employees about the Code
- Enforcement of the Code

Each of FPCM's representatives has been furnished with a copy of our Code and has signed their names to a written acknowledgement attesting to their understanding of the Code and acceptance of its terms. The Code is available to any current or prospective client upon request.

FPCM is the manager of private investment funds as well as separate account advisory clients, individuals or institutions. Both FPCM and its related persons may be investors in a fund that is a client of FPCM. Therefore FPCM or related persons of FPCM may purchase these private placement securities for themselves, as owners of their proportionate share of the funds, that FPCM is also recommending to clients, which may be financial institutions, endowments and foundations, industrial corporations, family offices, high net worth individuals, and private funds. In these situations, where FPCM related persons are co-investing with other outside investors in a fund, there is an alignment of interests between FPCM related person investors and outside investors.

FPCM related persons are required to notify the Chief Compliance Officer when purchasing a security which is on the firm's Restricted List, to ensure that there is no violation associated with the use of material, non-public information related to those companies. FPCM provides investment advisory services to clients primarily on fixed income instruments. FPCM may agree to offer advisory services on a very small, immaterial in the context of overall assets under management, amount of individual equity

assets, and FPCM will not participate in IPO's or "hot issues" when making recommendations or exercising discretion in investment advisory activities related to these equity assets.

FPCM related persons may hold/transact in equity or fixed income securities which are also held in client accounts with the stipulation that the client account has priority, whether there is a purchase or a sale. All FPCM related persons' securities transactions are reviewed at least quarterly to ensure compliance with this rule. All of FPCM's client-related transactions are conducted at arm's-length with a registered broker-dealer.

## Brokerage Practices

From time to time, FPCM may suggest that clients use specific brokers, dealers, or banks for the purposes of the effecting of securities transactions. For details as to what factors FPCM may consider in selecting such institutions, see below.

FPCM is not a broker-dealer, but as of September 2015 is affiliated with AIG Global Capital Markets Securities, LLC, a registered broker-dealer.

FPCM will use either AIG Global Capital Markets Securities, LLC, or other unaffiliated firms to solicit investors for the purpose of distributing private placement securities managed by FPCM. Such firms shall generally be broker-dealers or banks that may also maintain registrations that allow such firms to engage in other types of businesses outside of their broker-dealer or banking activities.

In seeking best execution, the determinative factor is not always the lowest possible cost, but whether the transaction represents the best qualitative execution, taking into consideration the full range of broker-dealer or bank services, including factors such as execution capability, commission rates, and responsiveness. Accordingly, although FPCM will seek competitive rates, it may not necessarily obtain the lowest possible commission rates for the client's transactions.

FPCM's general policies relative to the execution of the client's securities and brokerage transactions are as follows:

Transactions for the client's account generally will be effected independently, unless FPCM can purchase or sell the same securities for several clients at approximately the same time. FPCM may (but is not obligated to) combine or "batch" such orders to obtain best execution, to negotiate more favorable transaction rates. To the extent that FPCM elects to aggregate client orders for the purchase or sale of securities, including securities in which FPCM's principal(s) and/or associated person(s) may invest, FPCM shall generally do so in accordance with the parameters set forth in SEC No-Action Letter, SMC Capital, Inc. FPCM shall not receive any additional compensation or remuneration as a result of the aggregation.

The client may direct FPCM to use a particular broker, dealer, or bank (subject to FPCM's right to decline and/or terminate the engagement) to execute some or all transactions for the client's account. In such an event, the client will negotiate terms and arrangements for the account with that broker-dealer, and FPCM will not seek better execution services or prices from other broker-dealers or be able to "batch" the client's transactions for execution through other brokers, dealers, or banks with orders for other accounts managed by FPCM. As a result, the client may pay higher commissions or other transaction costs or greater spreads, or receive less favorable net prices, on transactions for the account than would otherwise be the case.

Consistent with obtaining best execution, transactions for a client's account may be effected through other brokers, dealers, or banks in return for execution, research products and/or services, which assist the Firm in its investment decision-making process. Such research generally will be used to service all of the Firm's clients, but brokerage commissions paid by client may be used to pay for research that is not used in managing the client's account. The account may pay to a broker-dealer or bank a commission greater than another qualified broker-dealer or bank might charge to effect the same transaction where the Firm

determines in good faith that the commission is reasonable in relation to the value of the brokerage and research services received.

All transactions for clients where such soft dollar transactions will be effected shall be in compliance with Section 28(e) of the Securities Exchange Act of 1934.

Certain investment adviser representatives of FPCM, when acting as registered representatives of a broker-dealer, may receive selling compensation from such broker-dealer as a result of the facilitation of certain securities transactions on a client's behalf through such broker-dealer.

The above-mentioned arrangements may cause a conflict of interest.

## **Review of Accounts**

FPCM will review the client's account(s) at least quarterly. A Designated Principal or his/her designee shall review the client accounts for best execution, suitability, and service.

Review with portfolio managers for best execution for all clients, both funds and individuals, will be conducted by a Designated Principal on a quarterly basis.

Reviews for suitability and service will be conducted in regularly scheduled meetings, at least once a quarter, with oversight by a Designated Principal.

Transaction suitability with respect to investment guidelines and client objectives will be reviewed.

For fund clients, a Designated Principal will review investment activity and compare executed transactions to the relevant fund document, such as Offering Memorandum.

For non-fund clients, the client's investment objectives will be used to review for suitability.

As part of the Quarterly review, transactions that may not fit a particular client's stated investment objectives or FPCM's understanding of the client's objectives will be flagged and reviewed in more detail.

Number of Reviewers: 5

Name and Title of Designated Principals:

Michael Baek, Managing Director

Richard Dolan, Chief Executive Officer

Robert Lewis, Managing Director

Stephen Miller, Chief Risk Officer

Mark Lieberman, Managing Director



## **Client Referrals and Other Compensation**

FPCM may enter into agreements with various independent solicitors or limited partners (collectively “solicitors”) that refer investors for investment advisory services or to private investment funds for which FPCM provides investment supervisory services. FPCM may charge such investors introduced by solicitors fees or costs greater than the fees or costs such funds charge its other investors who were not introduced by the solicitors. Any such agreements must be handled in accordance with the provisions of Rule 206(4)-3 under the Investment Advisers Act of 1940.

## **Custody**

For all investment advisory accounts, clients receive either a regular monthly/quarterly statement from a qualified custodian or a monthly/quarterly report from an independent fund administrator. In the case where clients are receiving fund administrator statements, there is annual audit of the fund which is furnished to fund investors upon request. FPCM provides supplemental regular reporting, recognizing that clients should view custodian and fund administrator statements as their primary source of information.

## Investment Discretion

FPCM may exercise discretion over the following areas/items:

- The specific securities to be bought or sold on the client's behalf
- The amount of securities to be bought or sold on the client's behalf
- The particular broker or dealer to be used for arranging client securities transactions

FPCM will have general authority to exercise its full discretion on the above named factors without restriction. FPCM shall observe any specific limitations that may be imposed by the client in relation to this discretionary authority. The limits on the discretionary authority on securities and amounts to be bought or sold will be identified in the Investment Management Agreement and the operating policy statement and the investment objectives of the fund. The limits on the types of securities are to those available under the Investment Management Agreement and the operating agreement specific to each fund, which is a client. There are no limits on the amounts of such securities purchases.

FPCM will review brokers, dealers, and banks for their financial wherewithal and ongoing operational strength as part of making a decision on the purchase of investments from such firms. FPCM may operate in its full discretion to select such broker or dealers because there are only select firms in which value of products, research, and services to be given to FPCM are a factor in that FPCM looks to purchase the investment products that best serve the needs of the funds and FPCM's other clients. FPCM does receive research and services from such brokers, dealers, or banks; however, such factors are negligible in the overall discretionary decision to use such broker, dealer, or bank. Research is generally used; however, and each client typically is restricted to certain investment products, therefore, certain specific research or services received may only be applicable to a singular client.

## **Voting Client Securities**

FPCM primarily provides investment advice on fixed income securities. Depending upon the client agreement, and if permitted by the client, FPCM may vote proxies on client securities. FPCM does have procedures and policies for voting proxies, a copy of which is available upon request.

## **Financial Information**

For investment advisory services, FPCM does not require or solicit prepayment of more than \$1,200 in fees per client six months or more in advance of providing service.

FPCM does not have any financial conditions that are likely to impair our ability to meet any contractual commitments to clients.

FPCM has not been the subject of a bankruptcy petition at any time.

## **Requirements for State-Registered Advisers**

Please see the Brochure Supplement for information on our principal executive officers and management persons.

FPCM has been established to offer investment supervisory advice to financial institutions, endowments and foundations, industrial corporations, family offices, high net worth individuals, and private funds. Less than 5% of the firm's time will be devoted to other business activities.