

### **Pillar 3 Disclosures for Penson Financial Services Ltd (“the Company”)**

The 2006 Capital Requirements Directive ('the Directive') of the European Union establishes a revised regulatory capital framework across Europe based on the provisions of the Basel 2 Capital Accord governing the amount and nature of capital credit institutions and investment firms must maintain.

In the United Kingdom, the Directive has been implemented by the Financial Services Authority ('FSA') in its regulations through the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU').

Pillar 3 requires disclosure of specified information about the underlying risk management controls and capital position. The rules in BIPRU 11 set out the provision for Pillar 3 disclosure. This disclosure is designed to meet the Company's Pillar 3 obligations.

The Company is controlled by Penson Worldwide Inc ('PWI'), which owns a controlling interest.

PWI provides execution, clearing, settlement and technology services to a range of brokers, funds and other firms in the financial industry.

#### **Risk management objectives and policies**

The Company is governed by a board of directors who determine the business strategy and associated risks. They are responsible for designing and implementing risk controls that recognise the risks being taken so that they can be effectively managed and mitigated where possible.

The board meets regularly to consider market conditions, profitability, level of reserves and business planning. It delegates day-to-day running of the Company to an executive committee, led by the Chief Executive Officer. Risks are managed through policies and procedures, principles and rules (including FSA principles and rules), which are updated as required.

The board have identified that credit, market, operational and business risks are the main areas of risk to which the company is exposed. The board formally review risks and controls annually and this includes the level of capital deemed adequate to cover the risks identified.

#### **Credit risk**

Credit risk is the risk of financial loss to the Company if a correspondent or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from correspondents and investment securities.

The main source of risk is counterparty credit risk, and it is monitored on a daily basis. The Company is exposed to credit risk from our counterparties to security transactions during the period between trade date and actual settlement date.

The Company performs several tasks to ensure that counterparty risk with trading correspondents is monitored and credit losses to the Company are minimised. In particular, the Company seeks to mitigate the risks associated with clearing, settlement and custody services through active customer screenings, selection procedures and reviews, and by taking sufficient collateral deposits and setting appropriate dealing limits to minimise potential shortfalls.

The Company is also exposed to credit risk by its banking relationships. This is minimised through the Companies policies regarding credit quality of banks and through initial and on-going due diligence.

### **Market risk**

Market risk represents the risk of loss that may result from a change in value of a financial instrument due to fluctuations in its market price, and is inherent in financial instruments. The Company's exposure to market risk is directly related to its role as a financial intermediary in customer trading. Market risk normally only exists between trade date and actual settlement date, and is viewed as a subset of credit risk as all trades are executed on a matched basis. The Company monitors this risk on a daily basis to ensure that it remains small.

### **Operational risk**

Operational risk is the risk of loss arising from failed or inadequate internal processes or systems, human error or other factors. The risk is managed by the executives who have responsibility for putting in place appropriate controls for the business. The Company uses its Risk department to monitor and analyse such processes on a regular basis, is subjected to Internal Audit procedures by its parent company, and employs outside consultants if necessary to monitor the effectiveness of these controls.

### **Business Risk**

Business risk is the risk that the Company may not be able to carry out its business plan and could therefore suffer losses if its income fails. This is a risk that all businesses face. Although the Company made a loss in 2010, plans are in place for profits in future years, and the board and executives continuously monitor income and expenditure levels and adjust their plans accordingly.