

PILLAR 3 Disclosures

1 Introduction

1.1 Background

The Capital Requirements Directive (“CRD”) established a regulatory framework consisting of three ‘Pillars’:

1. Pillar 1 sets out the minimum capital required to meet a firm’s credit, market and operational risk;
2. Pillar 2 requires a firm to establish an Internal Capital Adequacy Assessment Process (“ICAAP”) to establish whether its Pillar 1 capital requirement is sufficient to cover all the risks faced by the firm, and if not, to calculate the additional capital required. The ICAAP is then subject to review by the FSA through the Supervisory Review and Evaluation Process (“SREP”); and
3. Pillar 3 requires a firm to disclose specific information concerning its risk management policies and procedures, and its regulatory capital position.

The CRD has been implemented in the UK by the FSA Handbook, specifically the General Prudential Sourcebook (“GENPRU”) and the Prudential Sourcebook for Banks, Building Societies and Investment Groups (“BIPRU”). BIPRU 11 set out the provisions governing Pillar 3 disclosures, and the purpose of this document is to enable the UK incorporated, FSA regulated subsidiaries within the Tradition group to meet these requirements.

1.2 Disclosure Policy

In accordance with BIPRU 11.3.3 the Tradition London Group has adopted a formal disclosure policy to comply with the disclosure requirements set out in BIPRU 11, and has policies for assessing the appropriateness of the disclosures, including their verification and frequency.

Under BIPRU 11.3.5, a group may omit one or more of the required disclosures if the information is not material, that is that the information would not be likely to change or influence the decision of a user relying on that information for the purposes of making an economic decision.

Under BIPRU 11.3.6 a group may omit one or more of the required disclosures if they would require the disclosure of any information regarded as proprietary or confidential, that is information which would, respectively, undermine a competitive position or breach an obligation of confidence between a group and its customers.

In accordance with BIPRU 11.3.8 and BIPRU 11.3.10, the Tradition London Group will publish this disclosure at least annually on the Tradition London Group’s website.

2 Risk Management

2.1 Tradition London Group - Management and Control

The Tradition London Group is composed of the following UK FSA authorised and regulated incorporated entities:

- ◆ Tradition (UK) Ltd (TUK)
- ◆ Tradition Financial Services Ltd (TFS)
- ◆ TFS Derivatives Ltd (TFD)
- ◆ Tradition London Clearing (TLC)

The Tradition London Group entities are provided with administrative support services by a UK incorporated sister company, Tradition Management Services Ltd (TMS). Costs incurred by TMS are recharged to the appropriate Tradition London Group entity.

All the Tradition London Group entities are subsidiaries, via different intermediate holding companies of Compagnie Financiere Tradition ("CFT"), which is the holding company of all the "Tradition" businesses and is listed on the Swiss stock exchange. CFT itself is a subsidiary of Viel et Cie a company listed on Euronext Paris.

The Tradition London Group has created a governance and control framework that sets out the way in which the formal Board and Committee structure and approval systems operate. The framework covers: policy, risk appetite, business performance, limits setting, delegation of levels of authority, capital management and assurance mechanisms.

The governance and controls structure for the Tradition London Group's entities are based on the following three lines of defence:

- ◆ 1st line – Process owners and the management functions which have primary responsibility for the assessment and monitoring of their own risks;
- ◆ 2nd line – Support functions which provide the business with specialist support in analysing risks and monitoring controls; and
- ◆ 3rd line – Independent assurance, in particular oversight, review and validation by Internal Audit and External Audit.

The boards of the Tradition London Group provide the following governance and oversight:

- ◆ Setting appropriate risk strategy and risk appetite;
- ◆ Promoting internal risk culture and risk awareness;
- ◆ Monitoring the implementation of the risk strategy by the Risk Committee;
- ◆ Ensuring the independence of the control functions such as Compliance and Risk Management;
- ◆ Ensuring the independence of Internal Audit (Assurance activity); and
- ◆ Verifying that independent control functions operate correctly.

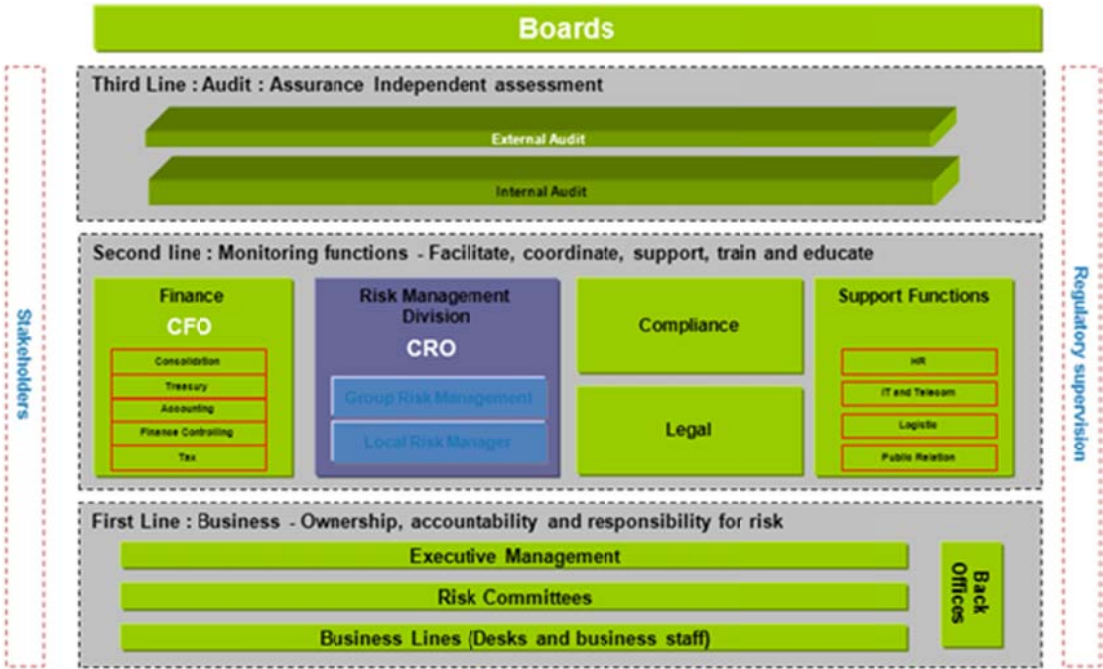
The TUK, TFD and TFS Boards have delegated their authority to an Executive Committee of the Tradition London Group which is chaired by the Chief Executive Officer (CEO). The Executive Committee is supported by other functional committees, including a New Product Committee and a Finance Committee.

TLC has its own Board and CEO and is a management structure which does not fall under the main Executive Committee although it relies on the support and control functions of the London office.

The Tradition London Group Boards are supported by two additional control committees –the Risk Committee and the Regulatory Committee. In addition, a local Audit Committee, chaired by the CFT CFO, reviews the effectiveness of the control functions and the control environment in order to provide assurance to the Tradition London Group Boards on the effectiveness of these.

Tradition London Group Governance and Control Framework

The governance framework is based upon the concept of 3 internal lines of defense against risk. This concept aims to ensure that accountability for the management of risk is pushed “towards the coal-face” to ensure that it is embedded in day-to-day management, but the boundaries between lines of defense should not be considered rigid.



First Line of Defence

The First Line of Defence is individuals who adhere to policy and standards and principles established by the Boards of Directors and are responsible for day to day business management.

Second Line of Defence

The Second Line of Defence is performed by the support functions and senior managers described below:

- ◆ Finance Function – The Chief Financial Officer (“CFO”) reports functionally to the CFT CFO and locally to the Tradition London Group CEOs and the Executive Committee. The CFO is responsible for financial management of the Tradition London Group with an objective to control and support the business activities undertaken by the Tradition London Group, taking into account the strategy of CFT and the local legal, regulatory and fiscal environments. Key responsibilities include the reporting on performance, monitoring capital adequacy, meeting regulatory, legal and fiscal reporting requirements and the management of liquidity, funding and credit control.
- ◆ Risk Management Function – The Risk Manager has a dual reporting line into the Tradition London Group Boards of Directors and the CFT’s Chief Risk Officer. The Risk Manager is responsible for the measurement, monitoring and management of risks within the Tradition London Group and for driving the development of the risk management capability in line with the CFT’s risk enterprise management framework. (See 2.2 below).
- ◆ Compliance Function – The London Head of Compliance has a dual reporting line to the Chief Executives of the Tradition London Group and to the CFT Head of Compliance. The objective of compliance is to monitor compliance with FSA and other regulatory rules and ensure all regulatory issues are effectively monitored and managed; and
- ◆ Legal Function – The Legal Function reports to the Chief Executives of the Tradition London Group. There are currently three Solicitors (with a further lawyer taking up the role of Strategy Director). Their responsibilities include managing the Tradition London Group’s contractual relationships with the business’s principal asset: its staff (the HR team reports to the Head of Legal.) as well as its relationships with suppliers and certain customers.

Third Line of Defence

As a Third Line of Defence, the Tradition London Group’s Internal Audit function provides assurance to the London Executive Committee, the Audit Committee and the Boards of Directors on the adequacy of the internal controls, risk management and governance processes, in particular when these are affected by material changes to CFT’s risk environment. Within London, there is an FSA approved Controlled Function (CF28) Head of Internal Audit who performs regular reviews of the London operations. On an annual basis, Internal Audit prepares an audit programme. The programme is developed working closely with the local and CFT control functions, and the external auditors. The programme is approved by the London and CFT Audit Committee. Internal Audit provides quarterly update reports to the Audit Committees focusing on key findings and their resolution.

2.2 Risk Management

The objective of risk management within the Tradition London Group is to provide the second line of defence (alongside other support functions) with the Local Risk Manager being responsible for:

- ◆ The assessment, mitigation and monitoring of risks within Tradition London Group;
- ◆ Ensuring risk exposures are contained within the Tradition London Group's risk appetite;
- ◆ Driving the development of the Tradition London Group's risk management capability through the implementation of improvement projects, control frameworks and risk measures; and
- ◆ Satisfying CFT's Risk Management and external stakeholders (e.g. the FSA) that Tradition London Group applies appropriate risk management systems and processes.

Jointly with the Risk Committee, the Risk Manager provides the overall executive leadership for risk management for all legal entities across the support functions and across all disciplines of risks.

2.3 Risk Categorisation and Profile

Risk categories of relevance for Tradition London Group include:

- ◆ Credit Risk (including default, settlement and concentration risk)

The Tradition London Group utilises a centralised credit team based in CFT Lausanne which has responsibility for assessing, challenging and setting credit ratings and trading limits for the matched principal/cleared broking trading businesses. Daily limit and breach reports are created for monitoring and enforcement purposes. The CFT Credit Function ensures that credit exposures are monitored and that appropriate management information is provided to both local and CFT management.

The Tradition London Group is exposed to settlement risk in its matched principal/cleared broking businesses. All transactions are managed on a Delivery versus Payment ("DVP") basis. A trade is deemed to be completed when both sides of a deal are settled, which is once payment is made and securities are delivered. The Tradition London Group is therefore exposed to settlement risk between trade date and settlement date when at least one side of a transaction remains unsettled beyond the agreed time frame (normally three days). Unsettled ("failed") trades are marked to market and monitored very closely at both local and CFT level. The relevant Tradition London Group settlement department will liaise with counterparties to ensure that unsettled trades are resolved as quickly as possible; monitoring will take into account counterparty rating, underlying liquidity class, mark to market and capital requirement; ultimately, where justified, buy-ins will be triggered e.g. in case of technical default or counterparty insolvency.

The Tradition London Group's businesses have an inherent concentration risk profile. The exposure to concentration risk is managed through monitoring and action on large credit exposures via the Credit Control Committee.

The Finance Function assesses and manages the cash held with banks and the commission receivables from customers in order to assess and monitor overdue receivables. Where recovery, of all or part of amounts due, is in doubt, Finance is responsible for establishing provisions so that balance-sheet values fairly reflect current credit losses. Tradition London Group's Finance function has an agreed methodology that is used and is aligned with applicable accounting and regulatory requirements. Oversight of the provision process is undertaken through the Credit Control Committee.

The Tradition London Group has not experienced any significant credit losses. The universe of core clients of the Tradition London Group is primarily comprised of credit worthy banks and financial institutions. The experience of the market turmoil during the Credit Crisis and the collapse of Lehman Brothers had a limited impact on the Tradition London Group, as 85% of the original receivables due from Lehman Brothers at the time of its collapse were subsequently recovered.

◆ Market Risk

The Tradition London Group is mainly exposed to foreign currency risk that arises through its revenue generation. In addition to GBP, revenue is principally earned in EUR and USD and to a lesser degree other currencies. Foreign currency risk is analysed and managed locally by the Tradition London Group, taking into account economic trends and the magnitude of the currency exposures. The Tradition London Group policy is to monitor foreign currency bank balances daily and to convert currency balances regularly and ideally at times when exchange rates are favourable against the monthly benchmark. The timing of conversion cannot be guaranteed as the need for GBP may come at a time when the exchange rates may be adverse for the Tradition London Group. The risk is considered material and as such is mitigated by appropriate use of forward contracts for economic hedging of between 75% - 100% of the foreign currency exposure.

Market risk also arises when transactions arranged by the Tradition London Group between two clients are not completed at the original quoted price, leading to a difference or error, or in the Tradition London Group being left with a naked long or short position. As these are error related they are deemed to fall under Operational Risk and are budgeted for as a natural course of business. To manage this risk, it is company policy to close any positions as quickly as possible at the next available price.

◆ Operational Risk

Tradition London Group follows the Basel Committee definition for operational risk - the risk of loss caused by human error, ineffective or inadequately designed processes, system failure or improper conduct (including criminal activity).

The key operational risks facing the Tradition London Group are summarised as follows:

- Broker errors / differences risk;
- Errors in post trade instructions;
- HR or key staff risk: the loss of a key members from a broking desk;
- Significant and extended failure of IT systems and applications: IT systems failures, breakdown of information security, failure or loss of data integrity;
- Project risk in relation to critical IT developments;
- External events including failure of external settlement/clearing systems;
- Failure or withdrawal of settlement and clearing systems, errors in instructions;
- Internal / external fraud;
- Introduction of new products and markets and the related tax, legal, accounting, regulatory, settlement and technology issues;
- Tax risk: higher taxation than expected, ineffective management or realisation of taxation regulations and conditions;
- Legal risk: incomplete contract documentation, confirmation of deals, agreements etc. litigation with clients, litigation with staff, litigation with competitors;
- Compliance risk: failure to comply with regulatory requirements, failure to comply with internal regulations and the corporate governance structure; and
- Business continuity events: including loss of physical assets and / or operating site damage.

The Tradition London Group quantifies its exposures to the operational risk events by taking into consideration actual and historical loss experience across the legal entities. The Tradition London Group most frequently experiences operational risk losses in its day to day business from penalties, differences and errors in broking activities which are considered normal in an IDB business and as such are included in budgets and forecast as expected losses.

Operational risks relate to the Tradition London Group's undertaking its core business activities and the Tradition London Group seeks to minimise these risks by putting in place robust internal risk management and business controls. Tradition London Group uses its independent internal audit, compliance function and compliance monitoring plan to reinforce and oversee the operation of these controls. The Tradition London Group also aims to minimise operational risk at all times through a control and operational infrastructure aligned with CFT's operational risk management framework.

In brief, the operational risk management framework determines that there are key steps in the management of operational risk. These steps include:

- Measuring risk and assessment of the risk mitigation frameworks: achieved through the application of a regular risk self-assessment using a list of control tools to assess Tradition London Group's business processes strengths and weaknesses;

- Reducing and controlling risks: achieved through use of the e-front tool to track losses, control effectiveness and action plans to improve mitigation of existing risks; and
- Ongoing management and monitoring of operational risks: achieved through management information reporting, review and Board reporting.

Another key component of the framework is the implementation of an appropriate governance framework within the Tradition London Group. This includes a central Risk Function that manages operational risk and reports into the relevant risk management committees at CFT and London levels. In particular, the Tradition London Group has dedicated local resources in the UK to oversee Transactional Risk, New Product Risk and Business Continuity as part of its operational risk framework.

The Tradition London Group has a dedicated New Product Committee that reviews and assesses the risks associated with the introduction of new products arising from strategic development or client-led service demand.

Historical losses associated with Operational Risk events are well within the Tradition London Group's minimum regulatory capital requirement for Operational Risk.

◆ Regulatory Risk

The Compliance Function in London has responsibility for ensuring that an appropriate regulatory risk framework is in place and that regulatory risk is identified, assessed and managed across all Tradition London Group entities. The scope for regulatory risk covers the risk of material loss, reputational damage or liability arising from a failure to comply with the requirements of the Financial Services Authority (FSA), the Tradition London Group's lead regulator, the FSA's related codes of best practice that oversee regulated financial services businesses and other applicable regulatory requirements..

The Tradition London Group is subject to legal and regulatory obligations designed to restrict the ability of criminals to launder the proceeds of crime through the financial system. The Compliance Function also has responsibility for ensuring that appropriate organisational arrangements are in place to undertake and monitor Anti Money Laundering activities.

The risk that changes to law or regulation could have a direct or indirect negative impact on the Tradition London Group's ability to conduct its business is deemed to be a Strategic/Business Risk.

◆ Strategic/Business Risk

Tradition London Group is exposed to risk arising from changes in its business environment, including the risk that it may not be able to carry out its business plans and its desired strategy. These risks are material, as failed entry to new markets and products, failed acquisitions or late adoption of technology can be costly.

The CFT Executive Board comprising CFT's most senior regional and functional managers is responsible for establishing the CFT's strategy and monitoring its implementation. It monitors the latest competitor, technological, market and regulatory developments and how these may affect CFT, including the Tradition London Group. Issues discussed may include increasing the breadth of products offered and assessing the need for new electronic brokering platforms or other IT initiatives. Proposed strategic responses, both proactive and reactive, are evaluated at a local and regional level and then discussed and endorsed at the CFT Executive Board before implementation.

◆ Liquidity Risk

Liquidity Risk is the current or prospective risk arising from an organisation's inability to meet its liabilities/obligations as they come due without incurring unacceptable losses. Tradition London Group has identified the following liquidity risk exposures:

- Balance Sheet liquidity: the need to finance working capital requirements; and
- Transactional Liquidity: the liquidity and financing risk that directly arises from front office operations, and consists of the financing of collateral for clearing and settlement.

Working capital is managed and monitored by the Finance Function. The Tradition London Group has never experienced any significant liquidity issues. Notwithstanding this the aim is to improve the cash management process continually. Monthly cash flow forecasting assists in mitigating any issues. Working capital requirements are predictable, relatively consistent and do not generate significant liquidity risk exposures.

Transactional liquidity is seen as a more significant risk; it is difficult to predict and not fully under the Tradition London Group's control as it depends upon a counterparty's ability to perform its settlement responsibilities.

Transactional liquidity risk is restricted to two business models within the Tradition London Group: exchange give-up listed derivatives business in TFD, and matched principal activities in TFD (Cash equity) and TLC (Securities). Transactional liquidity stress analyses are carried out to determine the level of cash reserves the London Group should maintain to protect itself from the liquidity demands which could arise in extremis.

3 Scope and Application of the CRD Requirements

3.1 Business Overview

The Tradition London Group is comprised of three firms acting as Inter Dealer Brokers and another as CFT's matched principal trade facilitator via a cleared broking model. The entities operate as intermediaries in the financial markets facilitating the trading activity of customers, in particular commercial and investment banks. The businesses cover the following major product groups: Treasury Products, Interest Rate Derivatives, Fixed Income, Equities and Energy. Supporting its voice broking activity, the Tradition London Group also provides customers with access to electronic broking platforms on an increasing range of products.

In addition to its brokerage services, the Tradition London Group offers a variety of market information services through its market data division which provides real-time price information to clients and data providers such as Reuters, Bloomberg and other third parties.

The Tradition London Group's operating subsidiaries provide brokerage services on either a Name Passing, Matched Principal/Cleared Broking or exchange traded 'give-up' basis (the latter referring to derivatives trades executed on recognised investment exchanges under an International Uniform Brokerage Execution Agreement).

3.2 Supervision and Consolidation Groups

The Tradition London Group has four constituent firms in the UK that are authorised and regulated by the FSA:

- ◆ Tradition (UK) Ltd (TUK)
- ◆ Tradition Financial Services Ltd (TFS)
- ◆ TFS Derivatives Ltd (TFD)
- ◆ Tradition London Clearing (TLC)

All of these firms are classified as either Limited Activity or Limited License as defined under BIPRU 1.1.11 and 1.1.12. These UK incorporated entities form UK regulatory sub-consolidation groups as follows:

- a. Tradition (UK) Ltd with its South African subsidiary, Tradition Government Bond Brokers and Derivatives Dealers Ltd; and
- b. Tradition Financial Services Ltd with TFS Derivatives Ltd and TFS's South African subsidiary TFS Securities (Pty) Ltd.

Tradition London Clearing Ltd is not part of a UK regulatory sub-consolidated group.

All of the UK incorporated entities in the Tradition London Group are also included in the regulatory consolidation for the Viel Group, which is the ultimate controller of the Tradition group of international companies; this regulatory consolidation group is headed by Viel et Cie Finance. Viel et Cie Finance is subject to consolidated supervision by the Commission Bancaire in France.

4 Capital Resources and Requirements

Outlined in the following sections are the capital resources and capital requirements for the sub-consolidation groups identified in section 3.2 above.

4.1 Capital Resources

Capital Resources as at 30 June 2011

	Tradition (UK) Limited consolidated	Tradition Financial Serviced Limited consolidated	Tradition London Clearing Limited
	£000	£000	£000
Permanent share capital	21,050	250	2,250
Profit & loss account & other reserves	3,698	19,914	(1,258)
Less: Intangible assets	(3)	-	(27)
Total tier one capital after deductions	24,745	20,164	965
Subordinated loan	3,100	2,000	-
Total tier two capital after deductions	3,100	2,000	-
Total Capital Resources	27,845	22,164	965

4.2 Capital Requirements

Capital Adequacy as at 30 June 2011

	Tradition (UK) Limited consolidated	Tradition Financial Serviced Limited consolidated	Tradition London Clearing Limited
	£000	£000	£000
Credit Risk Capital Requirement	-	2,259	141
Market Risk Capital Requirement	-	505	30
Concentration Risk Capital Requirement	-	-	-
Counterparty Risk Capital Requirement	-	146	311
Fixed overhead requirement	21,965	10,212	327
Total Pillar 1 Requirement	21,965	13,122	809
Additional Pillar 2 Requirement	-	-	-
Total Capital Resource Requirement	21,965	13,122	809
Capital Resources	27,845	22,164	965
Excess Capital Resources	5,880	9,042	156