Pillar Three Disclosures 2013

Overview

Introduction

The purpose of pillar three disclosures is to implement articles 68(3), 72, 145-149 and annex 2 of the banking consolidation directive, and in addition articles 2, 23(3) and 39 of the capital adequacy directive.

Their objective is to ensure transparency in a firm's management of capital and risk under the BASEL II framework, which consists of the pillars 1 (minimal capital requirements), 2 (supervisory review) and 3 (market discipline).

The firm is also working closely on its BASEL III requirements as set out under the capital requirements directive (CRD) IV and will be fully compliant with this new regime by 1st Jan 2014.

The existing requirements are set out in BIPRU 11 and the relevant disclosures are made below.

Scope and Frequency of disclosure

Within the GAIN Capital Group (GCG) of companies the following entities are subject to their respective governance under the following regulators:

- GAIN Capital UK Ltd - Financial Conduct Authority (FCA)
- GAIN Capital Australia Pty Ltd - Australian Securities and Investments Commission (ASIC)
- GAIN Capital Singapore Pte Ltd - Monetary Authority of Singapore (MAS)

GCG is not subject to consolidated supervision by the FCA and as such all disclosures herein pertain to GAIN Capital UK Ltd 'GCL'. Under BIRPU 11.2.3, and as the only FCA-regulated entity within the group GCL discloses information specified under BIPRU 11.4.5 R on an individual basis.

As at 31st March GCL incurred a deduction on capital resources of £11.7m.

Capital Resources Summary

	31st March 2013, £000
Core tier one capital	63,685
Upper tier 2 capital	10,000
Tier 3 capital	(2,498)
Capital deductions	(20,106)
Total capital after deductions	51,081
Pillar 1 requirements:	
Credit and counterparty risk capital requirement	(4,655)
Operational capital risk	(8,878)
Market risk capital requirement	(12,132)
Total pillar 1 requirement	(25,665)
Excess Financial Resources	25,416

Tier 1 capital

Ordinary equity shares of the Company are identical, including economic rights and voting rights. The rights, preferences, and restrictions with respect to voting, the distribution of dividends, and the repayment of capital are contained in the Memorandum and Articles of Association. At the reporting date, there were no limitations on the distribution of retained earnings to shareholders other than dependent on the Company's loan covenant arrangements.

The redeemable preference shares carry a non-cumulative preferential cash dividend at the rate of 2% per annum above the average base rate of Barclays Bank PLC applicable in the six months' period up to the date of payment of the dividend. The redeemable preference shares carry no voting rights and are redeemable at any time at the option of the Company and with the prior consent of the Financial Conduct Authority. The preference shares rank in seniority to the ordinary shares for repayment in the event of the Company being wound up.

Upper Tier 2 Capital

As with the tier 1 redeemable preference shares, those held as tier 2 also carry a non-cumulative preferential cash dividend (2% per annum above the average base rate), carry no voting rights and are redeemable at any time at the option of the Company and with the prior consent of the Financial Conduct Authority. Similarly the preference shares rank in priority over ordinary shares and there is no obligation on the Company to redeem or declare dividends in respect of the preference shares

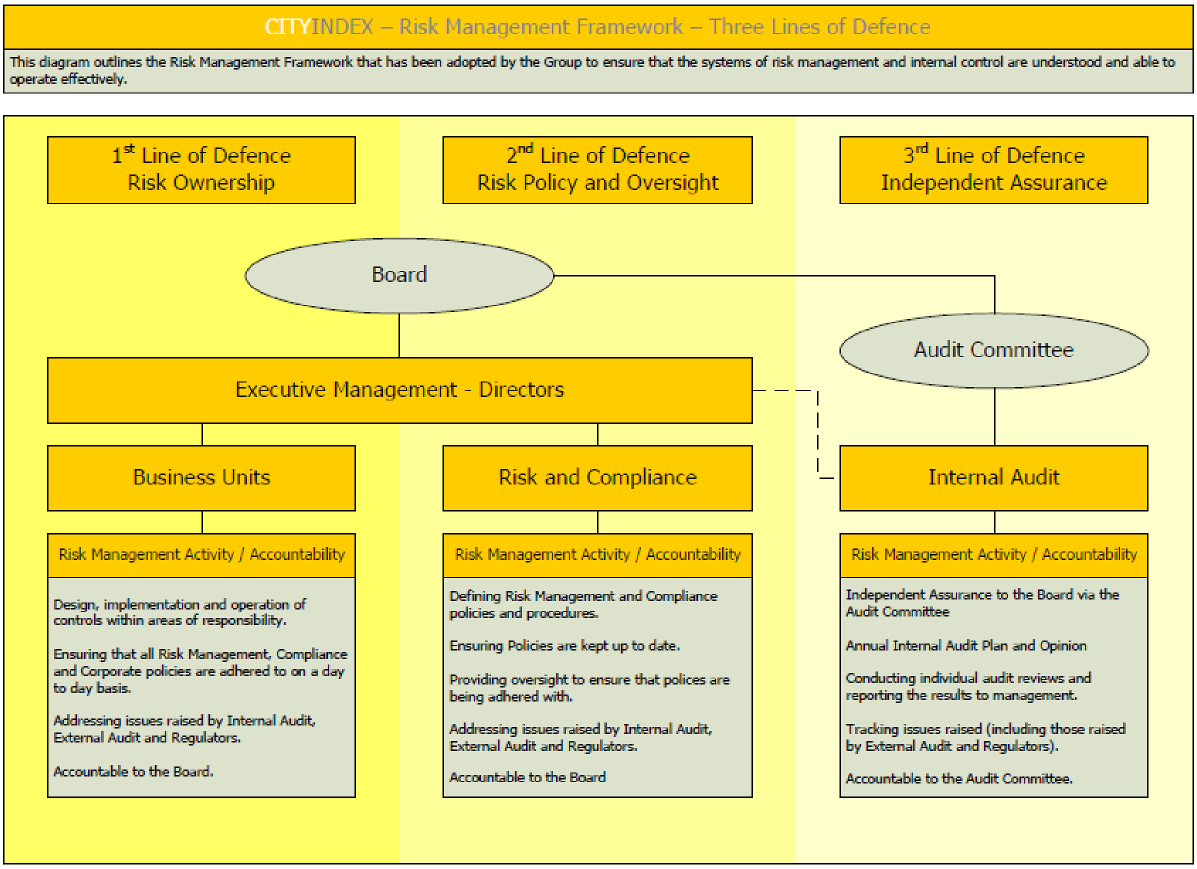
Internal Capital Adequacy Assessment Process (ICAAP)

The firm identifies capital requirements over and above those incurred under pillar 1- that is, its pillar 2 requirements- in the form of its ICAAP document which is embedded within corporate management structure of the firm.
The FCA also uses this document to assess the firm individual capital guidance which dictates the amount and quality of capital that should be held.

To safeguard the documents relevance to the business, the Regulatory Reporting Framework working group actively monitors regulatory change and the firm’s own capital needs in the context of the ICAAP.
This allows the firm to anticipate and pre-empt changes to the business environment and in turn ensure that it continues to manage its capital resources effectively.

Risk Management Objectives and Policies

GCL's risk management framework is outlined below:



It is the Board's job to approve risk management policies and mandates and ultimately it is the boards responsibility for oversight of risk management, however the Board of GCL devolves responsibility to the Risk Committee for the establishment and maintenance of policies and procedures related to risk management and in particular the maintenance of the Group Risk Policy (GRP).

The GRP document sets out the policies and procedures which seek to manage different types of risk applicable to the business and although focuses on the FCA regulated business conducted within GCL and its registered trading names, common systems and controls ensure that any relevant policies and procedures are also followed by the overseas offices of the group.

The Group Risk Committee meet each month and review all significant operational policies for the Group and recommend to the Group Executive Committee / Board any change to these polices

It is also their responsibility to ensure that effective systems and procedures are in place throughout the Group to ensure the effective implementation and execution of all relevant policies, and in addition ensure that appropriate management information is available to enable the effective management and oversight of operational risk.

The Group Audit Committee provides independent assurance that the operational risk management systems are operating effectively while ensuring that any related audit issues are adequately addressed by management.

Principal risks

The Board is responsible for determining and managing the principal risks of the business. This is subject to periodic review, at least annually and is performed in consultation with its shareholders. The Company seeks to mitigate its risks through the application of limits and controls, a monitoring process at both Company and operational level, and the use of hedging instruments and insurance policies. The Company's existing risk management tools continue to be enhanced by the on-going development of a real-time risk management system across all products.

The principal risks and uncertainties faced by the Company are primarily financial risks. The principal non-financial risk faced by the Company is operational risk. All of these risks are summarised further below.

Credit risk

Credit risk represents the loss that the Company would incur if a client or counterparty failed to perform its contractual obligations. A client credit exposure exists where a client's net contractual payable to the Company is greater than the margin or other collateral received by the Company ("margin deficiency") net of any credit value adjustments made against the margin deficiency.
GCL currently employs the simplified method of assigning capital to its credit risk but this will move to the standardised method under CRD IV.

A counterparty exposure exists where the Company's net contractual receivable is greater than the margin or other collateral deposited by the Company with the counterparty ("excess margin"). Clients do not normally have external credit ratings. Market counterparties generally have published credit ratings. In addition to the regular credit review of counterparties and country limits, other measures are undertaken to mitigate credit risk including holding margin or other collateral against client positions.

The Company has a formal credit policy which determines the financial and experience criteria which a client must satisfy before being given an account which exposes the Company to credit risk, as well as determining the account limits which are allocated to a client. The Company also has potential credit risk arising from its exposure to market counterparties with which it hedges and with banks. The Company sets limits for its maximum acceptable exposure to each market counterparty and bank to which it has credit exposure. These limits are approved by the Group Risk Committee and are reviewed at least every six months. The Group Risk Committee (GRC) also discusses the firm's approach to wrong way risk, although such risk has traditionally been negligible.

Total trade debtors at the end of the financial year were as follows:

Trade debtors	31st March 2013, £000
Brokers and dealers	24,917
Clients	988
Total	25,905

Trade debtors and provisions are broken down as follows:

Client Trade debtors	31st March 2013, £000
Gross Debtors	35,963
Bad Debt Provision	(34,975)
Total	988

Bad Debt Provision	31st March 2013, £000
Provision as at 1st April 2012	35,565
Bad Debts recovered	(270)
Decrease in Bad Debt Provision	(320)
Provision as at 31st March 2013	34,975

The majority of the provision brought forward relates to legacy / aged debtor balances outstanding from prior periods; the current year bad debt provisions have been successfully reduced and no material bad debts have been incurred in the current period.
Company policy is for a bad debt provision to be made against any client debt which falls due and remains outstanding after 30 days.

Credit Exposures

The following table provides a breakdown of GCL's credit exposure:

GCL credit risk exposure	31st March 2013, £000
Institutional exposure	64,145
Retail exposure	9,467
Other exposure (inc inter-company)	41,189
Total	114,801

N.B. GCL's credit exposure by geographical region at the financial year end was as follows:

GCL credit risk exposure	EMEA, £000	North America, £000	APAC, £000	31st March 2013, £000
Institutional exposure	63,279	866	-	64,145
Retail exposure	8,065	2	1,400	9,467
Other exposure (inc inter-company)	41,186	-	3	41,189
Total	112,530	868	1,403	114,801

Note that segregated client money held under trust does not form any part of the above credit exposure.

The following table provides a breakdown of GCL's institutional exposure by (Standard and Poor) credit rating as at 31/3/13:

GCL credit risk to institutions by rating	31st March 2013, £000
AA	-
AA-	577
A+	967
A	10,480
A-	38,917
BBB+	170
BBB	12,974
BBB-	6
Non-rated	54
Total credit risk exposure	64,145

The following table provides a breakdown of GCL's credit risk requirement as at 31/3/13:

GCL credit risk capital requirement	31st March 2013, £000
Institutional exposure capital requirement	1,554
Retail exposure capital requirement	742
Other exposure (inc inter-company) capital requirement	2,359
Total	4,655

Market risk

Market risk is the risk of loss arising from adverse movements in the level or volatility of market prices. Daily and intra-day margin calls are made on clients to reflect market movements affecting client positions. Clients of the Company agree terms of business in which, under certain circumstances, the Company unilaterally reserves the right to close out client positions. Exposure management is dependent on the liquidity of the relevant markets and hedging policy. These policies include limits, or a methodology for setting limits, for every single liquid financial market in which the Company trades, and for markets which the Directors consider to be correlated. The limits determine the maximum net exposure arising from client activity and associated hedging. During the year the Company significantly reduced its risk profile and increased hedging levels commensurate with market volatility.

The following table provides a breakdown of GCL's *trading book* market risk (using the standardised approach) as at 31/3/13:

GCL market risk capital requirement	31st March 2013, £000
Equity	7,914
Options	1,614
Commodities	999
Interest Rate	20
Foreign Currency	1,584

Total	12,131

Currency risk

The principal currencies in which the Company trades are British Pounds, Euros and United States Dollars. This gives rise to currency risk on the translation of its net current assets (mainly net funds held on behalf of clients) together with a currency risk on the conversion of its non-British Pounds income into British Pounds. The Company hedges both its trading and non-trading book FX risk on a daily basis.

Liquidity risk

In the event of a significant movement in markets, the Company could have a short-term funding requirement to meet its payment obligations to counterparties. Any failure by the Company to meet its payment obligations could result in market counterparties closing the Company's hedge positions, which would have materially adverse consequences for the Company's business. The level of liquidity required is influenced by the level of client activity and volatility in the markets.

The Company's policy is to hold both its own and its clients' cash reserves with a diversified range of counterparties, each of which is a major clearing bank or financial institution. Client money is held and recorded in accordance with the FCA client money rules. The Company's own money is held almost entirely on demand, as it needs to be readily available to meet short-term funding requirements. Segregated client cash is held primarily on demand but deposits of longer duration may be placed on deposit which can increase returns within an agreed maturity risk profile.

Regulatory capital and regulatory risk

The Company's activities are regulated in a number of jurisdictions and are therefore subject to various regulation and legislation relating to conduct of business, technology, the provision of internet services and additionally in the United Kingdom in relation to regulatory capital. This imposes extensive reporting requirements and continuing self-assessment and appraisal.

The Company has both a Compliance Department and a Regulatory Capital Department which are responsible for ensuring that it meets the rules of the regulators in each jurisdiction. The Company maintains close working relationships with its regulators and seeks continually to improve its operating efficiencies and standards. The Compliance officers are in regular contact with the Directors and Senior Executive Management. The regulatory environment is constantly evolving and imposes significant demands on the resources of the Company. The Company continues to provide considerable resources to meet the regulatory requirements.

The Company is subject to the capital adequacy supervision requirements of the FCA and has maintained adequate levels of capital within the Company during the year. The regulatory capital structure of the Company largely comprises share capital, preference shares and reserves (net of deductions). Capital requirements are calculated from market risk, counterparty risk, credit risk and operational risk assessments. The Company has an Internal Capital Adequacy Assessment Process ("ICAAP") as required by the FCA for establishing the appropriate amount of regulatory capital to be held. The ICAAP gives consideration to both current and projected financial and capital positions, and includes stress testing for adverse economic conditions. The ICAAP is updated, at least annually, to reflect changes to the Company's structure and the business environment. Capital adequacy is monitored on an on-going basis by Management. The Company uses the standardised approach to market risk, the simplified approach to credit risk and the basic indicator approach to operational risk. The Company applies the UK Intergroup regime exemption under BIPRU 10.8.
IPGL, the Company's ultimate parent company, is located in the European Economic Area and therefore the FCA applies consolidated capital adequacy supervision requirements at this level. Further details are contained in the financial statements of IPGL and Note 2 to the Financial Statements.

The liquidity regime covers adequacy of liquidity resources, controls, stress testing and the Individual Liquidity Adequacy Assessment ("ILAA") process. The ILAA informs the Board and FCA of the assessment and quantifications of the company's liquidity risk and their mitigation, and how much current and future liquidity is required.

Operational risk

Operational risk, inherent in all businesses, is the potential for financial and reputational loss arising from failures in internal controls, operational processes or the systems that support them. It includes errors, omissions, disasters and deliberate acts such as fraud. The Company has policies and procedures to mitigate operational risk and is currently in the process of implementing a more comprehensive operational risk management framework in conjunction with the GCL Group Internal Audit Department.

The GCG Group Internal Audit Department monitors the control environment of both the GCG Group and the Company. The Department is overseen by the GCG Group Audit Committee, which comprises representatives of the GCG Group's two major shareholders and two Directors of GCG (2012: two major shareholders and two Directors).

GCL adopts the basic indicator approach for operational risk; as at 31st March 2103 the firm incurred a capital requirement charge of £8.878m.

Non-trading book risk

There is negligible interest rate and equity exposure in the non-trading book.

Remuneration

Directors and employees information

The Group maintains a compensation policy for its employees to facilitate pay-for-performance and to retain key employees. The benefits accruing under the policy are based upon employee achievement and the financial performance of the Group. This includes a profit related discretionary bonus scheme and share option schemes for certain executives and employees of the Company.

The Group operates a remuneration committee which sets all executive and senior management remuneration and benefits. The Committee is comprised of a majority of non-executive directors and shareholder representatives, one of which is appointed as Chairman of the Committee.

Breakdown of Remuneration

	Year ended 31st March 2013, £000
Executive Directors and Senior Individuals:	
Wages and Salaries (Fixed)	1,271
Bonuses & Commissions (Variable)	685
Pension and other benefits	145
Sub-total	2,101
Other Employees:	
Wages and Salaries (Fixed)	14,533
Bonuses & Commissions (Variable)	4,274
Pension and other benefits	583
Sub-total	19,390
Total:	
Wages and Salaries (Fixed)	15,804
Bonuses & Commissions (Variable)	4,959
Pension and other benefits	728
Total	21,491