

## **TRX Futures Limited (“TRXF” or “The Firm”)**

### **Pillar 3 Disclosure and Policy, 31<sup>st</sup> December 2010**

The Firm’s Pillar 3 disclosures as required by [BIPRU 11.3.3 R](#) are set out below

The following information is provided pursuant to the Pillar 3 disclosure rules as laid out by the Financial Services Authority (“FSA”) in section 11 of its Prudential sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”).

#### **Background**

The FSA has implemented a Prudential framework for investment firms through changes to the FSA Handbook of Rules and Guidance (specifically in BIPRU). The framework consists of three “pillars”:

- Pillar 1 sets out the minimum capital requirements;
- Pillar 2 is an assessment of whether additional capital is needed over and above that determined under Pillar 1; and
- Pillar 3 requires the Firm to publish its objectives and policies in relation to risk management, information on its risk exposures and capital resources as well as disclosures with respect to FSA’s “Remuneration Code”.

The rules provide that disclosures are only required where the information would be considered material to a user relying on that information to make economic decisions. TRFX is a “BIPRU €730,000 Full Scope Firm”, The Firm has permission to hold client money and although it has permission to deal with “Retail” clients, it does not do so.

The Firm is also authorised as an Exempt Foreign Firm by The National Futures Association (NFA), and is a clearing member of NYSE.Liffe and ICE Futures Europe. TRFX provides brokerage, trade facilitation and clearing services in commodities, financial and energy futures and options. The Firm’s client base includes trade, industry and professional individual traders.

As a consequence the main risks facing the Firm are operational, liquidity, market, credit and group as well as those relating to its business environment.

The disclosures below are the required Pillar 3 disclosures and apply solely to the Firm.

Although the Firm believes the risk management framework outlined herein is appropriate for the size and complexity of the Firm and that the Firm’s capital is adequate to meet the risks assessed, it can not guarantee that this will actually be the case in the event any particular risk arises. There will always be some unlikely risks with unusually high impact which may require additional capital should they arise.

#### **Risk management**

The Firm operates a risk management framework that sets out the responsibilities and escalation procedures for the identification, monitoring, and management of operational and business risks. Capital planning takes these identified risks into account.

Specific personnel are assigned responsibility for the risks across the Firm's offices and business units. The Firm's Chief Executive takes overall responsibility, with the assistance of the other two directors, the Compliance Officer and MLRO of the Firm as well as a skilled and experienced Finance and Operations Managers, for identifying material risks to the Firm and putting appropriate mitigating controls in place.

Risks and mitigating controls are periodically reassessed, taking into account the Firm's risk appetite. Where risks are identified which fall outside of the Firm's risk tolerance levels, or where the need for remedial action is identified in respect of identified weaknesses in the Firm's mitigating controls, then actions are taken to improve the control framework.

The Board meets periodically to review the quality of the control framework and to satisfy itself that appropriate controls are in place and that mitigating actions are moving forward.

The specific types of risks faced by the Firm are;

- Operational risk,
- Liquidity risk,
- Credit risk,
- Market risk, and
- Group risk

In addition to the above Business risk arises from external sources such as changes to the economic environment or one-off economic shocks, and also from internal sources such as poor decisions or suboptimal allocation of capital resulting in poor performance and damage to the Firm's reputation.

Various different scenarios are modelled in order to assess the impact of adverse economic conditions on our financial position. This enables the Firm to monitor its business risk and to assist in its capital planning.

### ***Operational risk***

This is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.

The Firm seeks to minimize operational risk through a controls framework, particularly when engaging in new business ventures or trading new products. The Firm considers risks which may impact the Firm directly or indirectly. As part of its risk assessment TRFX has amongst other risks considered the following with a view to establishing systems and controls and mitigation:

- Pre-trade limit setting
- Post-trade position monitoring
- Front-end trading system functionality
- Provision and maintaining of passwords
- Potential for rogue trading outside office hours
- Risks associated with give-up agreements
- Losses resulting from front and back office errors
- Risk of fraudulent use of systems by employees

In 2010, the firm suffered losses from fraudulent activity by an employee. Internal systems and controls have been independently reviewed and revised and management now considers the potential exposure to financial crime to be very low.

### ***Liquidity risk***

The risk that a firm, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost.

The firm's largest overnight exposure is on ICE coffee and NYSE.Liffe coffee. In the case of ICE, our clearer, Triland, does not issue intra-day margin calls. In the case of NYSE.Liffe, we may be subject to intra-day margin calls. We have immediate credit facilities with RBS and NG Group Treasury to cover these calls in UK banking hours and with Deutsche Bank and Commerzbank to cover New York hours. Total facilities amount to US\$ 14 million.

The firm undertakes daily analysis on liquidity of percentage price movement scenarios.

### ***Credit risk***

The risk of financial loss arising as a result of a client or counterparty defaulting on their obligations

TRXF offers credit facilities to commercial hedgers in its Commodity Division. No credit facilities are offered in the Financials or Energy Divisions. The Credit and Risk Committee sets credit limits for all clients before an account can be opened. These limits are viewed daily by the Directors and Risk Managers and are reviewed periodically by the Committee.

The firm holds cash balances with the clearing houses: LCH.Clearnet Ltd, ICE Clear Europe, the clearing firms: Triland USA, Marex Financial Ltd and the banks: RBS, Deutsche Bank and Commerzbank. The Accounts Department performs due diligence on all counterparties including terms of business, netting agreements, segregation acknowledgement letters, FSA/NFA status and Dun & Bradstreet reports.

The Firm also generates execution brokerage (orders executed by TRXF brokers on behalf of the other counterparties' clients). Outstanding amounts for execution brokerage are followed up rigorously by Back Office/Operations staff for timely settlement. The Credit & Risk Committee periodically reviews lists of outstanding amounts.

Consequently the Firm has a number of credit exposures in respect of which it uses the simplified standardised approaches to calculating the various components of credit risk. As at 31 December 2010, the Firm's calculations of the components was as follows:

- Counterparty Risk Component           £1,514K
- Concentration Risk Component       £1,758K
- Credit Risk Component                 £ 122K

### ***Market risk***

The risk that the Firm's revenue, and/or operations might be damaged by adverse market movements or conditions.

TRXF uses real-time software to monitor positions and exposure. Alerts Direct, an ION Trading programme, is linked to our back office system and to a Reuters price feed. This has

the functionality to send email and SMS alerts. The risk managers can instruct the I.T. department to change pre-trade limits throughout the day. This is done on the front-end systems: Trading Technologies (TT), Easyscreen, WebIce and ORC. The Firm also conducts daily stress tests on house accounts.

The Firm calculates its Foreign Exchange risk by reference to the provisions in BIPRU 7.5 and on Commodity derivatives by reference to the provisions in BIPRU 7.4. The exposure to market risk calculated as at 31 December 2010 was £29K on foreign exchange positions. The

### ***Group risk***

The risk that financial problems at its parent, NG GmbH will prevent TRXF fulfilling its obligations to its other clients or to wind down its business in an orderly fashion.

TRXF's largest overnight exposure is from group companies. As commercial hedgers in coffee, the group always carries a large short position on the ICE and NYSE.Liffe coffee markets. Therefore, scenarios in which the group may encounter liquidity problems are when the price of coffee rallies sharply. There are facilities in place to swap futures positions to banks by "Exchange for Swap" EFS, which are sometimes used by NKG companies. TRXF's Non-Executive Director is the Finance Director of NG and has oversight across entities.

### **Capital adequacy**

As at 31 December 2010, the Firm's regulatory capital resources of £4,502K are made up as follows:

<b>Tier 1</b>	<b>£, 000</b>
Share capital	4,700
Audited reserves	3,706
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<b>Total Tier 1 capital before deductions</b>	<b>8,406</b>
Less deduction for intangible assets	(4)
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<b>Total Regulatory Capital</b>	<b>8,402</b>
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The Firm's Pillar 1 capital requirement is calculated in accordance with the General Prudential Sourcebook ("GENPRU") as the higher of the Operational Risk Requirement ("ORCR"), plus the sum of market and credit risk requirements, and the base capital requirement of €730,000. The ORCR is calculated in accordance with BIPRU 6.3 and equates to 15% of the average of three years audited net operational and non-operational revenue. The Firm's credit risk components (Credit Risk, Counterparty Risk and Concentration Risk) are calculated as per the "Standardised Approaches in BIPRU 3.4, BIPRU 14 and BIPRU 10 respectively, and market risk in line with BIPRU 7. As at 31 December 2010 the Firm's Pillar 1 requirement was £3,963K.

Under Pillar 2 of the FSA's capital requirements, the Firm has undertaken an assessment of the adequacy of capital based upon all the risks to which the business is exposed ("ICAAP"). As at 31 December 2010, this analysis concluded that the Firm required £1,865K capital against the identified key risks and added to the Pillar 1 requirements meant the Firm had to have an internal regulatory capital of £5,828K. It has therefore been concluded that the Firm's

resources are sufficient to support its operations over the next year, and no additional capital injections are necessary.

### **Remuneration Code**

Remuneration is determined and reviewed annually by the Board of Directors and approved by Neumann Gruppe's Human Resources Department. TRX is classified by the FSA as a Tier 3 firm which means, as of 1<sup>st</sup> December 2011, it will be subject to FSA regulations on remuneration code. No other firm in Neumann Kaffee Gruppe is subject to these regulations.

The firm operates four types of variable remuneration:

- Profit sharing of company profits. This is a fixed percentage after a deduction for interest on capital. It is based on audited accounts. Payouts are made annually.
- Commission sharing. This is a fixed percentage of commission and interest earned on client accounts. Payments are made either quarterly or half yearly and relate to the previous quarter or half year respectively.
- Profit sharing of proprietary accounts. Payments are made according to the account balance and subject to a buffer. Previous payments may be clawed back to cover losses.
- Discretionary bonus payments.

All these arrangements are linked to performance. The firm does not make any guaranteed bonus commitments.

Staff outside senior management will be classified as code staff if their variable remuneration becomes greater than their fixed remuneration. A clause to this effect will be added to contracts of employment in 2011.

In 2010, five employees were classified as code staff: the two Directors, the Compliance Officer and two proprietary traders. Their aggregate remuneration in 2010 amounted to £1,497,222.

The Board is confident that variable remuneration is linked to the interests of the firm and does not encourage excessive risk taking.