

**Pershing Holdings (UK) Limited**

**PILLAR 3 DISCLOSURE  
DECEMBER 31, 2015**



## Pillar 3 Disclosure Report

December 31, 2015

**Table of Contents**

<b>1</b>	<b>Overview .....</b>	<b>6</b>
1.1	Background.....	6
1.2	Disclosure Requirements .....	6
1.3	Disclosure Policy .....	6
1.4	Post Year-end Events .....	7
<b>2</b>	<b>Key Metrics.....</b>	<b>7</b>
<b>3</b>	<b>Scope of Application.....</b>	<b>7</b>
3.1	Company Description.....	7
3.2	Core Business Lines .....	8
<b>4</b>	<b>Own Funds .....</b>	<b>10</b>
<b>5</b>	<b>Capital Requirements .....</b>	<b>12</b>
5.1	Calculating capital requirements .....	12
<b>6</b>	<b>Risk Management Objectives and Policies .....</b>	<b>13</b>
6.1	Risk Governance.....	14
6.1.1	Board of Directors .....	14
6.1.2	Risk Committees.....	14
6.2	Risk Management Framework .....	15
6.3	Risk Appetite Statement.....	16
6.4	Stress Testing .....	17
<b>7</b>	<b>Credit Risk.....</b>	<b>17</b>
7.1	Definition and Identification.....	17
7.2	Management of Credit Risk .....	17
7.3	Governance.....	18
7.4	Analysis of past due and impaired exposures .....	18
7.5	Credit Risk Mitigation.....	18
7.5.1	ISDA Master Agreements and Netting .....	19
7.5.2	Collateral Valuation and Management .....	19
7.5.3	Wrong-Way Risk .....	19
7.5.4	Credit Risk Concentration .....	19
7.6	Analysis of Credit Risk .....	19
7.7	External Credit Rating Agencies.....	23
<b>8</b>	<b>Market Risk.....</b>	<b>27</b>
8.1	Interest Rate Risk – Non-Trade Book.....	27
<b>9</b>	<b>Operational Risk.....</b>	<b>27</b>
9.1	Operational Risk Management Framework .....	27
9.2	Operational Risk Capital Resource Requirement .....	29

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<b>10</b>	<b>Leverage Ratio</b> .....	<b>29</b>
<b>11</b>	<b>Remuneration Disclosure</b> .....	<b>30</b>
11.1	Governance .....	30
11.2	Aligning Pay with Performance .....	30
11.3	Fixed Remuneration .....	30
11.4	Variable Compensation Funding and Risk Adjustment .....	31
11.5	Ratio between Fixed and Variable Pay .....	31
11.6	Deferral Policy and Vesting Criteria .....	31
11.7	Variable Remuneration of Control Function Staff .....	31
11.8	Quantitative Disclosures .....	31

## List of Tables

Table 1: Reconciliation of Regulatory Own Funds.....	10
Table 2: Composition of regulatory Own Funds.....	11
Table 3: Transitional Own Funds disclosure.....	11
Table 4: Capital requirements overview.....	13
Table 5: Credit Risk Pre and Post Credit Risk Mitigation Techniques (CRM).....	20
Table 6: Credit Risk Pre CRM Techniques - Standardised Approach by Geographical Area.....	21
Table 7: Credit Risk Pre CRM Techniques - Standardised Approach by Counterparty Type.....	22
Table 8: Credit Risk Pre CRM Techniques - Standardised Approach by Residual Maturity.....	22
Table 9: Exposures covered by financial and other eligible collateral.....	23
Table 10: Mapping of ECAs credit assessments to credit quality steps.....	23
Table 11: Credit quality steps (CQS) and risk weights.....	24
Table 12: Credit quality step pre CRM by credit exposure class.....	24
Table 13: Credit quality step post CRM and CCF by credit exposure class.....	25
Table 14: Counterparty Credit Risk.....	26
Table 15: Credit valuation adjustment (CVA).....	26
Table 16: Market Risk – Standardised Approach.....	27
Table 17: Leverage Ratio.....	29
Table 18: Aggregate Remuneration Expenditure for MRTs in 2015 by Business (£000s).....	32
Table 19: Aggregate Remuneration Expenditure for MRTs by Remuneration Type.....	32
Table 20: Total Deferred Variable Remuneration for MRTs Outstanding from Previous Years .....	32
Table 21: Number and Value of New Sign-on and Severance Payments made during 2015.....	33
Table 22: Number of Individuals being Remunerated EUR 1 million or more .....	33

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## List of Appendices

<b>Appendix 1 Liquidity and Other Risks.....</b>	<b>34</b>
Regulatory and Compliance Risk .....	34
Reputation Risk .....	34
Legal Risk.....	34
Outsourcing Risk.....	35
Business Risk .....	35
Concentration Risk .....	35
Group Risk.....	35
Model Risk.....	36
Strategic Risk.....	36
Country Risk.....	36
<b>Appendix 2 Glossary of Terms.....</b>	<b>37</b>
<b>Appendix 3 Supplementary Tables.....</b>	<b>39</b>

# 1 Overview

## 1.1 Background

This document comprises the Pershing Holdings (UK) Limited and its subsidiary undertakings (together the “PHUK Group” or “Pershing”) Pillar 3 disclosures on capital and risk management at 31 December 2015. These Pillar 3 disclosures are published in accordance with the requirements of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) referred to together as CRD IV, which came into effect on 1 January 2014. CRD IV has the effect of implementing the international Basel III reforms of the Basel Committee on Banking Supervision within the European Union. The Pillar 3 disclosure requirements are contained in Part Eight of the CRR, in particular articles 431 to 455.

Pillar 3 disclosures are required for a consolidated group and for those parts of the group covered by CRD IV. As such, these disclosures have been prepared for the PHUK Group and information in this report has been prepared solely to meet the Pillar 3 disclosure requirements of the entities noted, and to provide certain specified information about capital and other risks and details about the management of those risks, and for no other purpose. These disclosures do not constitute any form of financial statement of the business nor do they constitute any form of contemporary or forward looking record or opinion of the business.

## 1.2 Disclosure Requirements

Pillar 3 requires the external publication of exposures and associated risk weighted assets and the approach to calculating capital requirements for the following risk and exposure types:

- Credit Risk
- Counterparty Credit Risk
- Market Risk
- Credit Valuation Adjustment
- Securitisations
- Operational Risk

Not all of the above risk and exposure types are relevant to PHUK Group. In accordance with CRD IV, the Board may omit one or more disclosures if the information provided is not regarded as material. Accordingly, these Pillar 3 disclosures only focus on those risk and exposure types relevant to PHUK Group. Furthermore, the Board may omit one or more disclosures if the information provided is regarded as proprietary or confidential. In such circumstance, the Board will state in its disclosures the fact that specific items of information are not disclosed and the reason for non-disclosure.

For completeness, other risks that the PHUK Group is exposed to, but are not covered above, are also discussed in Appendix 1.

## 1.3 Disclosure Policy

These disclosures were approved for publication by the PHUK Group’s Board of Directors (“the Board”) on 29 November 2016.

Disclosure will be made annually based on calendar year end and will be published following the preparation of the Annual Report and Financial Statements. PHUK will reassess the need to publish some or all of the disclosures more frequently than annually in light of any significant change to the relevant characteristics of its business including disclosure about capital resources and adequacy, and information about risk exposure and other items prone to rapid change.

Disclosures will be published on The Bank of New York Mellon group website ([www.bnymellon.com](http://www.bnymellon.com)), within the “Investor relations, financial reports, other regulatory filings” section of the Company’s website.

## 1.4 Post Year-end Events

In relation to the assessment and monitoring of economic, political and regulatory risks, the Company is continuing to evaluate the impact of the outcome of the recent referendum in relation to the UK’s membership of the EU on the company’s business strategy and business risks in the short, medium and long term. In the short term there is no significant impact expected on the Company’s business activities, there will be no immediate change in business strategy, and it does not affect the going concern position of the company. Over the course of the expected two year transition period following a notification of intention to leave the EU, the Company will continue to closely monitor developments and will make appropriate changes to the business strategy once the impact of the referendum result on the UK and European financial services industry is more certain.

## 2 Key Metrics

The following risk metric reflect PHUK Group’s risk profile.

Metrics	PHUK Group			
	2015		2014	
	£ '000s	Ratio	£ '000s	Ratio
Common equity tier 1 capital	173,596	92.2%	185,756	79.9%
Total tier 1 capital	173,596	92.2%	185,756	79.9%
Total capital	173,596	92.2%	185,756	79.9%
Risk weighted assets	188,303		232,525	

As can be seen, PHUK Group is extremely well capitalised with a CET1 capital ratio at the end 2015 of 92.2%.

## 3 Scope of Application

### 3.1 Company Description

Pershing Holdings (UK) Limited is a parent financial holding company incorporated in the UK and is a wholly owned and operationally independent subsidiary of Pershing Group LLC which is, in turn a subsidiary of the Bank of New York Mellon Corporation (“BNYMellon”).

Pershing Group LLC is engaged in broadly the same business activity as PHUK Group. As at 31 December 2015, Pershing Group LLC had total assets of \$32 billion.

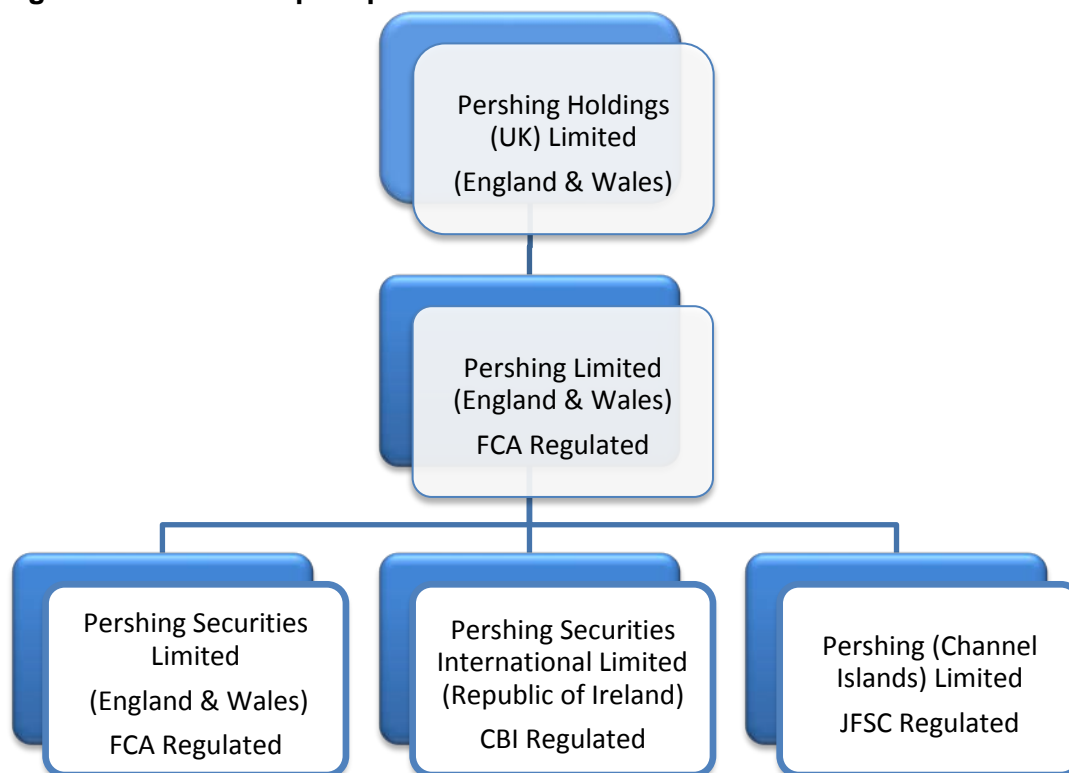
BNYMellon is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment lifecycle. Whether providing financial services for institutions, corporations or individual investors, BNYMellon delivers informed investment management and investment services in 35 countries and more than 100 markets. As at 31 December 2015, BNY Mellon had \$28.9 trillion in assets under custody and/or administration, and \$1.6 trillion in assets under management. BNY Mellon can act as a single point of contact for clients looking to create, trade, hold, manage, service, distribute or restructure investments.

Pershing Limited (“PL”) and Pershing Securities Limited (“PSL”) are significant subsidiaries of Pershing Holdings (UK) Limited. They are both full scope IFPRU investment firms and are both authorised and regulated by the FCA. PL and PSL capital resources and requirements are disclosed in Appendix 3.

Pershing (Channel Islands) Limited (“PCI”) is regulated by the Jersey Financial Securities Commission. Pershing Securities International Limited (“PSIL”) is regulated by the Central Bank of Ireland whose Pillar 3 disclosures are published separately.

The corporate structure of PHUK Group is illustrated in Figure 1.

**Figure 1: PHUK Group corporate structure**



### 3.2 Core Business Lines

Pershing provides a broad range of financial business solutions to investment banks, broker dealers, wealth managers, financial planners and advisers across EMEA from offices in London, Liverpool, Manchester, Channel Islands and Ireland. Our multi-asset class solution combines sophisticated frontend technology and flexible middle office capabilities with execution, settlement and custody services. These are supported by a robust regulatory and compliance framework with dedicated client asset experience and expertise.

Pershing does not engage in any proprietary trading, retail services or high risk or structured banking activities. Generally Pershing only uses its balance sheet to facilitate client activity by trading on a matched principal basis (i.e. simultaneous buy and sell transactions of the same security), or to provide fully collateralised financing to its clients in respect of such activity. The Pershing business model inherently carries less balance sheet risk than many traditional financial services firms.

PHUK Group’s business model is split into two main market segments:

#### **Institutional Broker Dealer Services (IBD)**

Pershing provides a broad range of financial business solutions to investment banks and broker-dealers across EMEA. Our multi-asset class solutions combine sophisticated front-end technology with flexible middle and back-office capabilities. Pershing can manage and help our clients with the full spectrum of post-trade services, from execution through to settlement and clearing, specialising in Fixed Income and Equities across 40+ markets.



Our clients recognise us as an industry leader in directing them to operate more efficiently by affording them the facility to outsource any, or all, of their trade life-cycle. Our clients leverage upon our technology, strength and global stability and as such we have become a trusted and independent partner to many financial institutions.

We retain our leadership by investing heavily in our technology, so that our customers can be confident in the knowledge that the functionality and capability of our systems and services will continually meet their industry needs, whilst simultaneously addressing the ever changing regulatory landscape, thereby enabling them to focus on their core business proposition and future proof their corporate positioning.

### **Wealth and Adviser Solutions (WAS)**

Pershing specialises in providing administration and custody services to wealth management professionals. Many of our clients prefer to outsource back and middle office functions to Pershing so they can focus on serving their existing clients and developing new business. Clients benefit from reduced operational costs, Pershing's expertise in meeting regulatory requirements and from holding their clients' assets with the world's largest global custodian.

Clients include banks, wealth managers, family offices, advisers and "consolidator" platforms that provide platform services for smaller advisory firms.

Many wealth management firms are large enough to self-clear their business and most will choose to do this. However, the increasing rate of technological change, transparency in pricing exerting a downward pressure on charges, and the increasing cost of regulatory demands can reduce profit margins and so there is a general industry trend for wealth management firms to consider other ways of working to reduce costs.

### **Contract bases**

Clients contract on a basis appropriate to their business needs, either Model A, B or GlobalClear, as outlined below.

#### **Model A**

Model A business provides the outsourcing of settlement and clearing functions by client firms. All settlement accounts are maintained in the name of the client and Pershing has no settlement obligation to any counterparty, except where it is providing a General Clearing Member ("GCM") service. Therefore, in all other cases, Pershing is not exposed to any credit and market risk relating to such activity. Pershing does however have credit exposure as a GCM, as it assumes an obligation to deliver cash and stock to the Central Counterparty ("CCP") and is reliant upon receiving cash or stock from the CCP or client firm.

#### **Model B**

The largest portion of Pershing's business is contracted on a Model B basis where we assume the settlement obligations of clients and it is Pershing's name not the clients in the market place. The main risk exposure from this activity relates to credit risk arising from clients failing to meet their corresponding obligations to PHUK Group. However the actual exposure is generally limited to any adverse mark to market movement in the underlying securities and is mitigated through various techniques and processes, including credit risk monitoring, rights over retained commissions and cash collateral deposits.

#### **GlobalClear**

The GlobalClear Model is designed as an intermediate model. The model utilises key Model A components where, for non-GCM trades, PHUK Group does not assume the settlement obligations of clients as we do under Model B. Clients support these trades on their own balance sheet and PHUK Group is under no obligation to clear such transactions. GlobalClear also utilises key Model B

components where the client uses PHUK Group's network for clearing of GCM trades and PHUK Group's settlement network for settlement of GCM and non-GCM transactions. Clients also use PHUK Group for associated cash and network management.

### Nexus Loans

Nexus loans provide a mechanism for investors (including corporate investors) to leverage fully-paid for securities held in custody with PLC for purpose borrowing. Whilst the loan account gives the investor access to loans, many investors use their assets to gain leverage as well as using cash to purchase additional securities.

## 4 Own Funds

This section provides an overview of the composition of PHUK Group's regulatory Own Funds. Please note;

1. PHUK Group holds no Additional Tier 1 capital or Tier 2 capital. Accordingly the analysis of those line items has not been shown
2. Similar tables for the significant subsidiaries PSL and PL are shown in Appendix 3

### Table 1: Reconciliation of Regulatory Own Funds

This table shows a reconciliation of PHUK Group's Own Funds prepared in accordance with IFRS and regulatory Own Funds prepared under prudential rules. The regulatory balance sheet forms the basis for the calculation of regulatory capital requirements.

31 December 2015 (PHUK Group – GBP'000s)	Published Audited Financial Statements	Adjustments due Consolidation Scope	Adjustments due Transitional Provisions	Regulatory Prudential Adjustments	Regulatory Own Funds
<b>Common Equity Tier 1 (CET1)</b>					
Capital Instruments	291,136	0	0	0	291,136
Retained Earnings	(47,174)	0	0	0	(47,174)
Other comprehensive income	4,494	0	0	0	4,494
Reserves	0	0	0	0	0
Minority Interest	0	0	0	0	0
Other adjustments and assets deducted	0	0	0	(74,859)	(74,859)
<b>Total CET1</b>	<b>248,455</b>	<b>0</b>	<b>0</b>	<b>(74,859)</b>	<b>173,596</b>
<b>Total Additional Tier 1 Capital (AT1)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total Tier 1 (CET1 + AT1)</b>	<b>248,455</b>	<b>0</b>	<b>0</b>	<b>(74,859)</b>	<b>173,596</b>
<b>Total Tier 2 Capital</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total Own Funds</b>	<b>248,455</b>	<b>0</b>	<b>0</b>	<b>(74,859)</b>	<b>173,596</b>

**Table 2: Composition of regulatory Own Funds**

This table shows the composition of PHUK Group's regulatory Own Funds, including all regulatory adjustments and a comparison to the prior year. Similar information for its significant subsidiaries, PSL and PL, is included in Appendix 3.

Own Funds	31-Dec-15	31-Dec-14
<b>PHUK Group</b>		
<b>Common Equity Tier 1 (CET1)</b>	GBP'000s	GBP'000s
Capital Instruments	291,136	291,136
Retained Earnings	(47,174)	(8,368)
Other comprehensive income	4,494	5,747
Reserves and others	0	0
CET1 adjustments	(74,859)	(102,759)
<b>Total CET1</b>	<b>173,596</b>	<b>185,756</b>
<b>Total Additional Tier 1 Capital (AT1)</b>	<b>0</b>	<b>0</b>
<b>Total Tier 1 (CET1 + AT1)</b>	<b>173,596</b>	<b>185,756</b>
<b>Total Tier 2 Capital</b>	<b>0</b>	<b>0</b>
<b>Total Own Funds</b>	<b>173,596</b>	<b>185,756</b>

**Table 3: Transitional Own Funds disclosure**

Equity Instruments, Reserves and Regulatory Adjustments PHUK Group - GBP '000s	Amount at disclosure date	Subject to pre-CRR treatment or prescribed residual amount of CRR
<b>Common Equity Tier 1 capital: Instruments and Reserves)</b>		
Capital instruments and the related share premium accounts	291,136	
of which: ordinary shares	291,136	
Retained earnings	(8,459)	
Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	4,494	
<b>Common Equity Tier 1 (CET1) capital before regulatory adjustments</b>	<b>287,170</b>	<b>0</b>
<b>Common Equity Tier 1 (CET1) capital: regulatory adjustments</b>		
Additional value adjustments	(74,859)	
Losses for the current financial year	(38,715)	
<b>Total regulatory adjustments to Common equity Tier 1 (CET1)</b>	<b>(113,574)</b>	
<b>Additional Tier 1 (AT1) capital: Instruments</b>		
Capital instruments and the related share premium accounts	0	
<b>Additional Tier 1 (AT1) capital before regulatory adjustments</b>	<b>0</b>	
<b>Additional Tier 1 (AT1) capital: regulatory adjustments</b>		

Total regulatory adjustments to Additional Tier 1 (AT1) capital	0
Additional Tier 1 (AT1) capital	0
Tier 1 capital (T1 = CET1 + AT1)	173,596
Tier 2 (T2) capital	0
Total capital (TC = T1 + T2)	173,596
Total risk weighted assets	188,303

#### Capital ratios and buffers

Common Equity Tier 1 (as a percentage of risk exposure amount)	92.2%
Tier 1 (as a percentage of risk exposure amount)	92.2%
Total capital (as a percentage of risk exposure amount)	92.2%

#### Common tier 1 and additional tier 1 instruments and tier 2 instruments

This table provides a description of the main features of regulatory instruments issued and included as common tier 1 capital in table 3.

		At 31 December 2015
1	Legal entity issuer	Pershing Holdings UK Limited
2	Governing law	England and Wales
3	Capital classification	Common Equity Tier 1
4	Level	Not applicable
5	Type	Ordinary Shares
6	Capital amount	291,136 shares of £1 each
7	Issue price	£1
8	Accountancy classification	Shareholder's Equity
9	Issue date	1 April, 2013
10	Dated or perpetual	No Maturity
11	Fixed or floating dividend	Fully discretionary
12	Other pertinent information	None

## 5 Capital Requirements

The PHUK Group has an Internal Capital Adequacy Assessment Process ("ICAAP") which defines the risks that the PHUK Group is exposed to, and sets out the associated capital plan which aims to ensure that the PHUK Group holds an appropriate amount of capital to support its business model, through the economic cycle and given a range of plausible but severe stress scenarios. The plan is reflective of PHUK Group's commitment to a low risk appetite, with no proprietary trading, coupled with a strong capital structure which gives the necessary confidence to our clients.

### 5.1 Calculating capital requirements

CRD IV allows for different approaches towards calculating capital requirements. PHUK Group has chosen to use the standardised approach where risk weights are based on the exposure class to which the exposure is assigned and its credit quality. These risk weights used to assess requirements against credit exposures are consistent across the industry. The Standardised

Approach is used for calculating the risk weights assigned to each risk component including Credit Risk, Counterparty Credit Risk, Market Risk and Operational Risk.

#### Table 4: Capital requirements overview

This table shows the risk weighted assets using the standardised approach and their respective capital requirements. Significant subsidiaries, PSL and PL, are shown in Appendix 3.

Type of Risk (PHUK – GBP'000s)	Risk Exposure Amount		Capital Requirements	
	31-Dec-15	31-Dec-14	31-Dec-15	31-Dec-14
Credit Risk SA*	34,090	45,121	2,727	3,610
Counterparty Credit Risk SA*	1,754	3,467	140	277
Securitisation Risk in banking book SA*	0	0	0	0
Settlement Risk	11,953	10,776	956	862
Market Risk SA*	25,822	57,763	2,066	2,959
of which: Foreign Exchange Position Risk	25,822	57,763	2,066	2,959
Operational Risk	114,056	115,288	9,124	9,223
of which: Basic Indicator Approach	0	0	0	0
of which: Standardised Approach	114,056	115,288	9,124	9,223
of which: Additional Amount due to fixed overheads	0	0	0	0
Credit Valuation Adjustment - Standardised method	628	111	50	9
Related to Large Exposure in Trading Book	0	0	0	0
Other risk	0	0	0	0
<b>Total</b>	<b>188,303</b>	<b>232,525</b>	<b>15,064</b>	<b>18,602</b>
<b>Total Capital</b>			<b>173,596</b>	<b>185,756</b>
<b>Surplus Capital</b>			<b>158,532</b>	<b>167,154</b>

\* SA: Standardised Approach

PHUK Group significantly exceeds the minimum capital ratios required to ensure compliance with regulatory requirements at all times.

## 6 Risk Management Objectives and Policies

Clients and other market participants need to have confidence that PHUK Group and its subsidiaries will remain strong and continue to deliver operational excellence and maintain an uninterrupted service throughout market cycles and especially during periods of market turbulence. PHUK Group is committed to maintaining a strong balance sheet and this philosophy is also consistent with Pershing Group LLC and BNY Mellon Corporation as a whole.

Whilst PHUK Group assumes less balance sheet risk than most financial services companies due to its focus on transaction processing, its business model does give rise to some risk as described below. As a consequence, Pershing has developed a risk management program that is designed to ensure that:

- Risk tolerances (limits) are in place to govern its risk-taking activities across all businesses and risk types.
- Risk appetite principles are incorporated into its strategic decision making processes.
- An appropriate risk framework is in place to identify, manage, monitor and report on risk within the governance structure
- Monitoring and reporting of key risk metrics to senior management and the Board takes place.
- There is a capital planning process which incorporates both economic capital modelling and a stress testing programme.

## **6.1 Risk Governance**

### **6.1.1 Board of Directors**

The main duty and responsibility of the Board is to define the strategy of PHUK Group and to supervise the management of PHUK Group. Whilst acting autonomously and in accordance with its legal and regulatory requirements, the Board also aligns PHUK Group's strategy to that of its primary shareholder, Pershing Group LLC. The Board has overall responsibility for the establishment and maintenance of PHUK Group's risk appetite framework and for the approval of the risk appetite statement. The Board ensures that strategic business plans are consistent with the approved risk appetite.

The Board is also responsible for both the management and the oversight of risks, together with the quality and effectiveness of internal controls, but delegates risk management oversight to general management, supported by the risk management committees. It is also responsible for reviewing, challenging and approving all risk management processes including risk identification and assessment, stress testing and capital adequacy. The various control functions provide further support for the management of risk within the business.

### **6.1.2 Risk Committees**

#### **PHUK Group Risk Governance**

The PHUK Group Board is the senior strategic and decision making body. The Board delegates day to day responsibility for managing the business to the Executive Committee according to approved plans, policies and risk appetite.

The Executive Committee further delegates specific responsibilities to various committees to provide an appropriate oversight and direction to various risk and regulatory processes and activities, including:

#### **Pershing Risk Committee**

The Pershing Risk Committee (PRC) provides senior management oversight to the overall risk framework and all individual risk types that could potentially impact PHUK Group. The PRC reports to the Executive Committee and forms a central point for the oversight and management of risk and the escalation of significant risk issues and events to the Executive Committee and the Board. All other risk committees report to the PRC to ensure a consistent and holistic reporting of risks and these include the Operational Risk Committee, Credit and Market Risk Committee, Assets and Liability Committee, Client Asset Committee, the Business Acceptance Committee, and the Audit Oversight Committee.

#### **Operational Risk Committee**

The Operational Risk Committee (ORC) has oversight of the embedding of the operational risk framework within PHUK Group. The Operational Risk Management Department is responsible for providing all necessary support to the ORC to ensure that the framework meets regulatory requirements and industry best practice in identifying, measuring and reporting on the relevant operational risks inherent in PHUK Group's business (including events such as, but not limited to, technical system failures, disaster events, failed processes or fraud).

#### **Credit and Market Risk Committee**

The Credit and Market Risk Committee (C&MRC) oversees the review of all Credit and Market Risk issues associated with and impacting on business undertaken by PHUK Group.

The Committee's principal Credit Risk responsibility is to determine and maintain an acceptable credit exposure to PHUK Group's clients, as well as to market makers, custodians and banks, within the limits set by the Boards.

### **Asset and Liability Committee**

The Asset and Liability Committee (ALCO) is responsible for overseeing the asset and liability management activities of the balance sheets of PHUK Group and its subsidiaries, and for ensuring compliance with all liquidity related regulatory requirements.

### **Client Asset Committee**

The Client Asset Committee is responsible for the oversight and governance of PHUK Group's adherence to the FCA, CBI and JFSC custody and client money rules, and reviews the adequacy of systems and controls in place to identify, segregate, and hold client assets in accordance with regulatory rules.

### **Business Acceptance Committee**

The Business Acceptance Committee (BAC) is responsible for the review and approval of all new clients, products/services and material changes to existing processes before they can be executed or implemented.

### **Audit Oversight Committee**

The Audit Oversight Committee is responsible for providing assurance that key business risks are being managed and that internal controls are operating effectively, actively soliciting input from PHUK Group's risk and control functions, and embedding risk management and control awareness across the business. The Committee provides a forum to outline management's expectations for Internal Audit, as well as monitor and review the effectiveness of PHUK Group's Internal Audit function in relation to their role in providing an independent oversight of PHUK Group's systems and controls.

In addition, there are specific regional committees as follows:

### **Irish Compliance and Oversight Committee**

The Irish Compliance and Oversight Committee oversees the adherence of PSIL to applicable Irish laws, guidelines and notices effecting its operations and to fulfil the requirements of the Standards for Stockbrokers, as issued by the Central Bank of Ireland.

### **Jersey Compliance and Oversight Committee**

The Jersey Compliance and Oversight Committee oversees the adherence of Pershing Channel Islands Limited to applicable Jersey laws, guidelines and notices effecting its operations and to fulfil the requirements of the investment firms, as issued by the Jersey Financial Services Commission

## **6.2 Risk Management Framework**

PHUK Group's risk management framework is designed to:

- Ensure that risks are identified, managed, mitigated, monitored and reported.
- Define and communicate the types and amount of risks to take.
- Ensure that risk-taking activities are consistent with the risk appetite.
- Monitor emerging risks and ensure they are weighed against the risk appetite.
- Promote a strong risk management culture that considers risk-adjusted performance.

Suitable policies and procedures have been adopted by PHUK Group in order to ensure an appropriate level of risk management is directed at the relevant element of the business.

PHUK Group has adopted the 'Three Lines of Defence' (3LOD) model in deploying its risk management framework (figure 2 below). The first line of defence (1LOD) is the business or, in some cases, business partner level. The business takes and owns the risk associated with its

activities, and it manages the risks and the related control processes and procedures on an operational basis. The risk management and compliance functions are the second line of defence (2LOD) and own the risk management framework and provide independent oversight of the 1LOD, ensuring that policies are adhered to and challenged. The 2LOD also includes corporate security, business continuity, financial management and analysis within Finance. The third line of defence (3LOD) is Internal Audit, which independently provides the PHUK Group Board and senior management with the assurance that the governance structures, risk management and internal controls in place are effective.

**Figure 2: Managing Three Lines of Defence**



The risk management function monitors and identifies emerging risks with a forward-looking approach. It provides risk management information to the PHUK Group Board and governance committees, and contributes to a “no surprise” risk culture. It aligns closely with Compliance (2LOD) and Internal Audit (3LOD) plus Finance and Treasury (as 1LOD control functions). It independently educates staff, promotes risk awareness and continually makes improvements, whilst monitoring progress against defined success criteria for improving the effectiveness of the risk function.

**6.3 Risk Appetite Statement**

Pershing defines risk appetite as the maximum level of risk it is normally willing to accept while pursuing the interests of major stakeholders, including clients, shareholders, employees and regulators i.e. it considers the balance between risk and reward aligning the strategic goals and the overall risk. It is linked to the strategic direction set by senior management and is approved by the PHUK Group Board.

The statement applies to all subsidiaries and is reviewed at least annually or when the Company’s risk profile changes. The risk appetite ultimately determines the level of regulatory capital

PHUK Group uses a variety of metrics to measure and monitor its risk taking activities relative to its risk appetite. Articulating risk appetite through its metrics aids important decision-making by determining actions such as pursuing new products and enterprises, exiting businesses, and aligning resources to maximise potential gains given acceptable levels of risk. The metrics are actively monitored, managed and mitigated through PRC.

Thresholds are established to measure the performance of the business against its risk appetite. The metrics are actively monitored, managed and mitigated through the monthly PHUK Risk



Committee (PRC), to ensure that the performance of business activities remains within risk tolerance levels.

## 6.4 Stress Testing

Stress testing is undertaken at PHUK Group to monitor and quantify risk and ascertain that sufficient capital resources are held against risks on a forward-looking basis. The process reflects stressed scenarios that identify an appropriate range of adverse circumstances of varying nature, severity and duration relevant to PHUK Group's risk profile. PHUK Group's stress testing process conclusion is a statement of the future risk(s) that the business faces, control improvements to mitigate the impact should the risk arise and where appropriate, a recommendation for capital to be held against each risk type.

Scenarios are derived from current, emerging, and plausible future risks and strategy, and reviewed, discussed and agreed by PHUK Group's Risk Committee and Board.

## 7 Credit Risk

### 7.1 Definition and Identification

Credit Risk is the risk of loss arising from counterparties defaulting on their obligations to PHUK Group.

On balance sheet Credit Risk covers default risk for loans, commitments, securities, receivables and other assets where the realisation of the value of the asset is dependent on the counterparty's ability and willingness to repay its contractual obligations.

Due to the nature of PHUK Group's business as a provider of clearing and settlement services, Credit Risk mainly arises from the risk of loss in the event that a client, underlying investor or market counterparty fails to meet its contractual obligations to pay for a trade, or to deliver securities for sale. However, the legal structure of the clearing agreements provides PHUK Group with the right to set-off any indebtedness of underlying clients against any credit balance in the name of the same underlying client. PHUK Group also has recourse to securities and cash as collateral and indemnities from client firms in respect of any underlying clients. Consequently, the residual credit risk (i.e. post mitigation) will devolve to market risk, as the exposure in such cases is the movement in the underlying stock and foreign currency prices. In addition, Pershing also requires clients to place a security deposit with PHUK Group to cover this potential mark to market exposure.

Credit Risk also arises from the non-payment of other receivables, cash at bank, loans to third parties, investment securities and outstanding client invoices and loans to third parties.

### 7.2 Management of Credit Risk

PHUK Group manages credit risk exposure by a two-stage process:

- 1) Setting minimum thresholds for the type of client acceptable to PHUK Group in terms of net worth and business profile, including:
  - The type of business to be conducted through PHUK Group (e.g. retail vs. institutional; agency vs. matched principal);
  - Markets and financial instruments in which the client can trade; and
  - Any special conditions clients are subject to (e.g. cash on account).

Obtaining credit approval for a particular client is the primary responsibility of the business as the first line of defence alongside guidance and oversight from Credit Risk as the second line. Any new relationship requires approval from the Business acceptance Committee.

2) Monitoring all exposure (both pre- and post-settlement) on a daily basis against various limits for its clients, as follows:

- Trade Limit (set per client following analysis of the financial strength, management expertise, nature of business and expected – or historical – peak and average exposure levels);
- Gross Exposure Limit (calculated with reference to the security deposit and net worth of the client and utilised as the higher of total purchases or total sales);
- Negative mark to market exposure.

It should also be noted that the metrics supporting the management of credit risk are monitored on a daily basis and reported to senior management. Breaches are reported to senior management which may lead to management action such as requesting additional collateral, or requiring the client to inject additional capital into the business.

### **7.3 Governance**

Governance of credit risk oversight as a second line of defence function is described and controlled through credit risk policies and day-to-day procedures as follows:

- Credit policy describes the outsourcing of credit risk tasks, defines roles and responsibilities and requires reporting to be carried out to each business line and entity that the policy applies to. Any deviation from approved policy requires either senior business or senior legal entity approval depending on the type of event.
- Approvals for excesses are controlled by a series of credit risk authorities held within credit policy – each Credit Risk Officer has their own level granted ultimately by the Director, Credit and Market Risk and acts within those limits when making approvals. If an excess is beyond the Officer's approval limit, it is escalated to the Director of Credit Risk.
- Limit excesses are reported in the daily Risk Management Pack and reviewed at the weekly Credit Committee.

### **7.4 Analysis of past due and impaired exposures**

An aspect of credit risk management relates to problem debt management, which entails early problem identification through to litigation and recovery of cash where there is no realistic potential for rehabilitation.

As at 31 December 2015, PHUK Group had no material impaired assets for which a specific or general provision was required. There were no material assets past due greater than 90 days. PHUK Group did not incur any material write-offs of bad debts or make any recovery of amounts previously written off during the year to 31 December 2015.

### **7.5 Credit Risk Mitigation**

PHUK Group mitigates Credit Risk through a variety of strategies including obtaining collateral, and entering into ISDA Master Agreements with associated netting arrangements.

### 7.5.1 ISDA Master Agreements and Netting

The ISDA Master Agreement incorporates schedules that allow the contracting parties to customise the terms and conditions to their mutual satisfaction to cover termination events, netting arrangements, security and other matters.

Netting may take two different forms, close-out netting and settlement netting. Close-out netting refers to an agreement between PHUK Group and a counterparty that, in the event of a default, the non-defaulting party can require that:

- A single net payment be made as final settlement to whichever party holds the overall profit from the contracts; and
- Collateral be liquidated (if held).

Settlement netting requires that all foreign exchange obligations are payable on the same settlement date, be netted to produce a single payment obligation for each currency traded.

### 7.5.2 Collateral Valuation and Management

PHUK Group can receive collateral from a counterparty which can include guarantees, cash and both equity and debt securities and has the ability to call on this collateral in the event of a default by the counterparty.

Collateral amounts are adjusted on a daily basis to reflect market activity to ensure they continue to achieve an appropriate mitigation of risk value. Securities are marked-to-market daily and haircuts are applied to protect PHUK Group in the event of the value of the collateral suddenly reducing in value due to adverse market conditions. Customer agreements can include requirements for the provision of additional collateral should valuations decline.

### 7.5.3 Wrong-Way Risk

PHUK Group takes care to ensure that Wrong-way Risk between collateral and exposures do not exist. Wrong-way Risk results when the exposure to the counterparty increases when the counterparty's credit quality deteriorates.

### 7.5.4 Credit Risk Concentration

Credit risk mitigation taken by PHUK Group to reduce Credit Risk may result in Credit Risk Concentration. Credit Concentration Risk results from concentration of exposures to a single counterparty, borrower or group of connected counterparties or borrowers.

PHUK Group is exposed to Credit Concentration Risk through exchanges and central counterparties, correspondent banks and issuers of securities. These risks are managed and mitigated through the establishment of various limits, on-going monitoring of exposure, collateral and contractual obligations upon the client, including margin calls.

The number of counterparties PHUK Group is willing to place funds with is limited and hence, Concentration Risk can also arise from cash balances placed with a relatively small number of counterparties. To mitigate this, exposures are only placed on a very short-term basis, generally overnight (maximum of 180 days), ensuring ability to withdraw funds in a timely manner.

## 7.6 Analysis of Credit Risk

Credit risk exposure is computed under the standardised approach which uses external credit assessment institution ratings and supervisory risk weights supplied by external credit assessment agencies. The following credit risk exposure tables summarise the credit exposure for PHUK Group in accordance with the CRD IV requirements.

The following definitions are used in the tables:

**Exposure at Default (EAD)** is defined as the amount expected to be outstanding, after any Credit Risk Mitigation, if and when a counterparty defaults. Exposure reflects drawn balances as well as allowance for undrawn amounts of commitments and contingent exposures over a one-year time horizon. As such, exposure in this context may differ from statutory IFRS accounting balance sheet carrying values.

**Credit Risk Mitigation (CRM)** is defined as a technique to reduce the credit risk associated with an exposure by application of Credit Risk mitigants such as collateral, guarantees and credit protection.

**Geographic area** is based on the continental location for the counterparty.

**Residual maturity** is defined as the period outstanding from the reporting date to the maturity or end date of an exposure.

**Table 5: Credit Risk Pre and Post Credit Risk Mitigation Techniques (CRM) Standardised Approach by Exposure Class**

This table shows the standardised gross credit exposure by exposure class as at 31 December 2015 and the comparative amounts at 31 December 2014 (GBP'000s).

Credit Risk - EAD post CRM & CCF by Exposure Class	EAD pre CRM		Average EAD pre CRM	
	31-Dec-15	31-Dec-14	31-Dec-15	31-Dec-14
Central governments or central banks	133,634	134,370	132,478	99,518
Corporates	4,041	5,638	9,866	5,845
Equity	6,231	0	1,558	0
Institutions	139,317	276,906	182,872	281,129
Multilateral Development Banks	0	0	0	0
Other items	6,739	5,021	5,719	4,285
Public sector entities	218	348	613	412
Retail	6,516	10,918	19,011	10,575
<b>Total</b>	<b>296,696</b>	<b>433,201</b>	<b>352,117</b>	<b>401,763</b>

Credit Risk - EAD post CRM & CCF by Exposure Class	EAD post CRM & CCF		Risk Weight Amount		Capital Requirement	
	31-Dec-15	31-Dec-14	31-Dec-15	31-Dec-14	31-Dec-15	31-Dec-14
Central governments or central banks	133,634	134,370	0	0	0	0
Corporates	2,233	3,736	2,233	3,592	179	287
Equity	6,231	0	6,231	0	498	0
Institutions	70,122	119,318	17,645	36,433	1,412	2,915
Multilateral Development Banks	0	0	0	0	0	0
Other items	6,739	5,021	7,929	5,021	634	402
Public sector entities	218	348	44	70	3	6
Retail	11	7	8	6	1	0
<b>Total</b>	<b>219,189</b>	<b>262,800</b>	<b>34,090</b>	<b>45,121</b>	<b>2,727</b>	<b>3,610</b>

Notes: EAD (Exposure at Default), CRM (Credit Risk Mitigation), CCF (Credit Conversion Factors).  
The difference between EAD pre CRM and EAD post CRM is represented by credit risk mitigants.

**Table 6: Credit Risk Pre CRM Techniques - Standardised Approach by Geographical Area**

This table shows the EAD pre CRM by credit exposure class by geographic area of the counterparty (GBP'000s).

<b>SA Credit Risk by Exposure Class at 31 December 2015</b>	<b>Europe</b>	<b>Americas</b>	<b>MEA</b>	<b>APAC</b>	<b>Total</b>
Central governments or central banks	133,634	0	0	0	133,634
Corporates	3,993	11	2	35	4,041
Equity	6,231	0	0	0	6,231
Institutions	68,396	57,805	3,747	9,369	139,317
Multilateral Development Banks	0	0	0	0	0
Other items	6,739	0	0	0	6,739
Public sector entities	218	0	0	0	218
Retail	6,501	0	14	1	6,516
<b>Total</b>	<b>225,712</b>	<b>57,816</b>	<b>3,763</b>	<b>9,405</b>	<b>296,696</b>

Notes: MEA (Middle East and Africa); APAC (Asia - Pacific)

<b>SA Credit Risk by Exposure Class at 31 December 2014</b>	<b>Europe</b>	<b>Americas</b>	<b>MEA</b>	<b>APAC</b>	<b>Total</b>
Central governments or central banks	134,370	0	0	0	134,370
Corporates	5,536	90	11	1	5,638
Equity	0	0	0	0	0
Institutions	146,840	124,067	1,514	4,485	276,906
Multilateral Development Banks	0	0	0	0	0
Other items	5,021	0	0	0	5,021
Public sector entities	348	0	0	0	348
Retail	10,864	8	17	28	10,918
<b>Total</b>	<b>302,979</b>	<b>124,165</b>	<b>1,543</b>	<b>4,514</b>	<b>433,201</b>

**Table 7: Credit Risk Pre CRM Techniques - Standardised Approach by Counterparty Type**

This table shows the EAD pre CRM, classified by credit exposure class and by counterparty type (GBP'000s).

SA Credit Risk by Exposure Class at 31 December 2015	General governments	Credit institutions	Other financial corporations	Non-financial corporations	Retail	Various Balance Sheet Items	Total
Central governments or central banks	133,634	0	0	0	0	0	133,634
Corporates	0	0	4,041	0	0	0	4,041
Equity	0	0	0	6,231	0	0	6,231
Institutions	0	139,317	0	0	0	0	139,317
Multilateral Development Banks	0	0	0	0	0	0	0
Other items	0	0	0	0	0	6,739	6,739
Public sector entities	218	0	0	0	0	0	218
Retail	0	0	0	0	6,516	0	6,516
<b>Total</b>	<b>133,852</b>	<b>139,317</b>	<b>4,041</b>	<b>6,231</b>	<b>6,516</b>	<b>6,739</b>	<b>296,696</b>

**Table 8: Credit Risk Pre CRM Techniques - Standardised Approach by Residual Maturity**

This table shows the EAD pre credit risk mitigation, classified by credit exposure class and residual maturity (GBP'000s).

SA Credit Risk by Exposure Class at 31 December 2015	Less than 3 months	3 months to 1 year	Over 1 year	Total
Central governments or central banks	1,356	67,652	64,626	133,634
Corporates	4,041	0	0	4,041
Equity	6,231	0	0	6,231
Institutions	139,317	0	0	139,317
Multilateral Development Banks	0	0	0	0
Other items	0	0	6,739	6,739
Public sector entities	218	0	0	218
Retail	6,516	0	0	6,516
<b>Total</b>	<b>157,679</b>	<b>67,652</b>	<b>71,365</b>	<b>296,696</b>

SA Credit Risk by Exposure Class at 31 December 2015	Less than 3 months	3 months to 1 year	Over 1 year	Total
Central governments or central banks	0	0	134,370	134,370
Corporates	5,638	0	0	5,638
Equity	0	0	0	0
Institutions	276,906	0	0	276,906
Multilateral Development Banks	0	0	0	0
Other items	0	0	5,021	5,021
Public sector entities	348	0	0	348
Retail	10,918	0	0	10,918
<b>Total</b>	<b>293,810</b>	<b>0</b>	<b>139,391</b>	<b>433,201</b>

**Table 9: Exposures covered by financial and other eligible collateral**

This table shows by each exposure class the total exposure that is covered by financial and other eligible collateral (GBP'000s).

SA Credit Risk by Exposure Class at 31 December 2015	Over 1 year	Total
Central governments or central banks	0	0
Corporates	1,808	1,902
Equity	0	0
Institutions	69,194	157,588
Multilateral Development Banks	0	0
Other items	0	0
Public sector entities	0	0
Retail	6,505	10,910
<b>Total</b>	<b>77,507</b>	<b>170,400</b>

Financial and other eligible collateral can include cash, debt securities, equities, and their values are taken into account for the purposes of calculating the risk weighted exposure amount of the underlying exposure.

## 7.7 External Credit Rating Agencies

The standardised approach requires PHUK Group to use risk assessments prepared by External Credit Assessment Institutions (ECAIs) to determine the risk weightings applied to rated counterparties. PHUK Group uses Standard and Poor's, Moody's and Fitch as its chosen ECAIs. There has been no change to these ECAIs during the year.

**Table 10: Mapping of ECAIs credit assessments to credit quality steps**

PHUK Group uses Credit Quality Steps (CQS) to calculate the Risk Weighted Assets (RWAs) associated with credit risk exposures. Each CQS maps to the ECAIs' credit assessments.

This table shows the mapping of PHUK Group's nominated ECAIs' credit assessments to the credit quality steps.

Credit quality steps	Standard and Poor's assessments	Moody's assessments	Fitch's assessments
1	AAA to AA-	Aaa to Aa3	AAA to AA-
2	A+ to A-	A1 to A3	A+ to A-
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-
5	B+ to B-	B1 to B3	B+ to B-
6	CCC+ and below	Caa1 and below	CCC+ and below

**Table 11: Credit quality steps (CQS) and risk weights**

ECAI risk assessments are used for each exposure class except eligible retail exposures which are assigned a risk weight of 75%. In accordance with the regulations, institutions with a residual maturity of three months or less denominated and funded in the national currency of the borrower shall be assigned a risk weight different to institutions with a risk weight of more than three months. This distinction is shown in the table below.

Each CQS is associated with a particular risk-weighting.

This table shows the prescribed risk weights associated with the credit quality steps by exposure class.

Exposure classes	CQS 1	CQS 2	CQS 3	CQS 4	CQS 5	CQS 6
Central governments or central banks	0%	20%	50%	100%	100%	150%
Public sector entities	20%	50%	100%	100%	100%	150%
Institutions	20%	50%	50%	100%	100%	150%
Institutions up to 3 months residual risk	20%	20%	20%	50%	50%	150%
Unrated institutions	20%	50%	100%	100%	100%	150%
Corporates	20%	50%	100%	100%	150%	150%
Securitisation	20%	50%	100%	350%	1250%	1250%
Institutions and corporates with short-term credit assessment	20%	50%	100%	150%	150%	150%
Collective investment undertakings ('CIUs')	20%	50%	100%	100%	150%	150%
Covered bonds	10%	20%	20%	50%	50%	100%

The risk systems maintain the CQS mappings to customers in their database. When calculating the risk weighted value of an exposure using the ECAI risk assessments, the system will identify the customer, the maturity of the transaction and the relevant credit quality step to determine the risk weight percentage.

**Table 12: Credit quality step pre CRM by credit exposure class**

This table shows the EAD pre credit risk mitigation by CQS and credit exposure class using the standardised approach. The non CQS is where a rating is not available and a separate risk weight is assigned (GBP'000s).



SA Credit Risk by Exposure Class at 31 December 2015	Credit Quality Steps							
	1	2	3	4	5	6	Non CQS	Total
Central governments or central banks	133,634	0	0	0	0	0	0	133,634
Corporates	0	0	2,314	0	1,727	0	0	4,041
Equity	0	0	0	0	0	0	6,231	6,231
Institutions	88,126	9,755	0	41,312	0	125	0	139,317
Multilateral Development Banks	0	0	0	0	0	0	0	0
Other items	0	0	0	0	0	0	6,739	6,739
Public sector entities	218	0	0	0	0	0	0	218
Retail	0	0	0	0	0	0	6,516	6,516
<b>Total</b>	<b>221,978</b>	<b>9,755</b>	<b>2,314</b>	<b>41,312</b>	<b>1,727</b>	<b>125</b>	<b>19,487</b>	<b>296,696</b>

SA Credit Risk by Exposure Class at 31 December 2014	Credit Quality Steps							
	1	2	3	4	5	6	Non CQS	Total
Central governments or central banks	134,370	0	0	0	0	0	0	134,370
Corporates	180	0	4,948	0	511	0	0	5,638
Equity	0	0	0	0	0	0	0	0
Institutions	119,316	247	0	157,344	0	0	0	276,906
Multilateral Development Banks	0	0	0	0	0	0	0	0
Other items	0	0	0	0	0	0	5,021	5,021
Public sector entities	348	0	0	0	0	0	0	348
Retail	0	0	0	0	0	0	10,918	10,918
<b>Total</b>	<b>254,214</b>	<b>247</b>	<b>4,948</b>	<b>157,344</b>	<b>511</b>	<b>0</b>	<b>15,938</b>	<b>433,201</b>

**Table 13: Credit quality step post CRM and CCF by credit exposure class**

This table shows the EAD post credit risk mitigation by credit quality step and credit exposure class using the standardised approach. The non CQS is where a rating is not available and a separate risk weight is assigned (GBP'000s).

SA Credit Risk by Exposure Class at 31 December 2015	Credit Quality Steps							
	1	2	3	4	5	6	Non CQS	Total
Central governments or central banks	133,634	0	0	0	0	0	0	133,634
Corporates	0	0	2,233	0	0	0	0	2,233
Equity	0	0	0	0	0	0	6,231	6,231
Institutions	59,578	9,754	0	665	0	125	0	70,122
Multilateral Development Banks	0	0	0	0	0	0	0	0
Other items	0	0	0	0	0	0	6,739	6,739
Public sector entities	218	0	0	0	0	0	0	218
Retail	0	0	0	0	0	0	11	11
<b>Total</b>	<b>193,430</b>	<b>9,754</b>	<b>2,233</b>	<b>665</b>	<b>0</b>	<b>125</b>	<b>12,981</b>	<b>219,189</b>

SA Credit Risk by Exposure Class at 31 December 2014	Credit Quality Steps							
	1	2	3	4	5	6	Non CQS	Total
Central governments or central banks	134,370	0	0	0	0	0	0	134,370
Corporates	180	0	3,556	0	0	0	0	3,736
Equity	0	0	0	0	0	0	0	0
Institutions	103,452	247	0	15,619	0	0	0	119,318
Multilateral Development Banks	0	0	0	0	0	0	0	0
Other items	0	0	0	0	0	0	5,021	5,021
Public sector entities	348	0	0	0	0	0	0	348
Retail	0	0	0	0	0	0	7	7
<b>Total</b>	<b>238,350</b>	<b>247</b>	<b>3,556</b>	<b>15,619</b>	<b>0</b>	<b>0</b>	<b>5,028</b>	<b>262,800</b>

**Table 14: Counterparty Credit Risk**

This table shows the risk mitigating impact of netting and collateralisation on Counterparty Credit Risk relating solely to foreign currency derivative contracts under the mark-to-market method (GBP'000s).

Counterparty Credit Risk	31-Dec-15	31-Dec-14
<b>Long Settlement Transactions - Mark to Market Method</b>		
Net Current Credit Exposure	14,160	28,063
Collateral Held Notional Value	5,412	11,360
Exposure and Collateral Adjustments	0	0
Net Derivatives Credit Exposure	8,748	16,704
<b>SFT - under Financial collateral comprehensive method</b>		
Net Current Credit Exposure	0	0
Collateral Held Notional Value	0	0
Exposure and Collateral Adjustments	0	0
Net SFT Credit Exposure	0	0
<b>Counterparty Credit Risk Exposure</b>	<b>8,748</b>	<b>16,704</b>

## 7.8 Credit Valuation Adjustment

The credit valuation adjustment is the capital charge for potential mark-to-market losses due to the credit quality deterioration of a counterparty. The standardised approach uses the external credit rating of each counterparty and includes the effective maturity and exposure at default. **Table 15: Credit valuation adjustment (CVA)**

This table shows the credit valuation adjustment using the standardised approach (GBP'000s).

Counterparty Credit Risk	31-Dec-15	31-Dec-14
<b>CVA according to standardised method</b>		
Exposure Value	1,374	0
Risk Exposure Amount	628	111
Capital Requirements	50	9

## 8 Market Risk

Market Risk is defined as the risk of adverse change to the economic condition of PHUK Group due to variations in prices, rates, implied volatilities, or correlations of Market Risk factors. Market Risk factors include but are not limited to interest rates, foreign exchange rates, market liquidity and equity prices.

By simply executing orders on behalf of its clients, the PHUK Group business model does not result in any proprietary trading or high risk investments. However it does act as a riskless principal between its clients and the market which results from time to time in a small position, including in foreign exchange, and which is traded out on an expedited basis. The PHUK Group Credit and Market Risk Committee set small overall limits for foreign exchange positions resulting from client-generated exposure. PHUK Group's exposure to Market Risk mainly arises from Foreign Exchange (FX) Risk arising from its Euro investment in PSIL, and non-traded Interest Rate Risk, arising from its investment in Government securities held to satisfy FCA requirements in respect of the Liquid Asset Buffer (LAB).

**Table 16: Market Risk – Standardised Approach**

This table shows the components of the capital requirements and risk weighted assets for market risk using the standardised approach (GBP'000s).

Positions subject to Market Risk	Risk Exposure Amount		Capital Requirements	
	31-Dec-15	31-Dec-14	31-Dec-15	31-Dec-14
Central governments or central banks	25,822	36,989	2,066	2,959
Corporates	0	20,777	0	1,662
<b>Total</b>	<b>25,822</b>	<b>57,767</b>	<b>2,066</b>	<b>4,621</b>

### 8.1 Interest Rate Risk – Non-Trade Book

Interest Rate Risk (IRR) is the risk associated with changes in interest rates that affect net interest income (NII) from interest-earning assets and interest-paying liabilities. IRR exposure in the non-trading book arises from on and off-balance sheet assets and liabilities and changes with movements in domestic and foreign interest rates.

PHUK Group does not have any material exposure to Interest Rate Risk in its non-trading book.

## 9 Operational Risk

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events (including Legal Risk but excluding Strategic and Reputation Risk). It may arise from errors in transaction processing, breaches of internal control systems and compliance requirements, internal or external fraud, damage to physical assets, and business disruption due to systems failures, execution or delivery incidents and process management or other events. Operational Risk can also arise from potential legal or regulatory actions because of non-compliance with regulatory requirements, prudent ethical standards or contractual obligations, these being sub classified as Compliance Risk.

### 9.1 Operational Risk Management Framework

The Operational Risk Management Framework (ORMF) provides the processes and tools necessary to fulfil a strategy of managing risk through a culture of risk awareness, a clear governance structure, well defined policies and procedure, and suitable tools for reporting and

monitoring to effectively identify, manage, mitigate, monitor and report the risks in an organised way to the appropriate governance bodies. PHUK Group has set a risk appetite statement which recognises the inherent nature of Operational Risk and the reliance on the ORMF to mitigate it.

The ORMF defines roles and responsibilities for managing risk, using the three lines of defence model as a foundation. Thus, responsibility for the management of Operational Risk sits first and foremost with the business and support functions as the first line of defence, where ownership and accountability for the identification, assessment and management of risks that arise through the course of its business and service provision reside.

The second line of defence, being the independent Operational Risk Management function, is responsible for reviewing and challenging the risks identified, assessed and managed by the first line of defence. The Operational Risk function is also responsible for building and maintaining the ORMF framework and partnering the first line of defence to enable them to embed it within their normal business processes.

The third line is Internal Audit, which is organizationally independent from both the first and second line of defence. A key responsibility of the third line as it pertains to the ORMF is to opine on the adequacy of the framework and governance process.

The mechanisms for identifying and managing operational risk include but are not limited to:

- Operational Risk Events (OREs) – A standard for the capture, notification and reporting of OREs. The collection of internal loss data provides information for assessing the company's exposure to Operational Risk. Analysis of loss events provides insight into the root cause and information on whether a control weakness is isolated or potentially more systemic.
- Risk & Control Self-Assessments – A comprehensive process for business groups and select business partners to identify risks associated with key business processes, identifying and assessing the quality of controls in place to mitigate risk and assigning accountability for the effective operation of those controls in place to mitigate that risk.
- Key Risk Indicators (KRIs) – The use of key metrics designed to monitor risks which could cause financial loss, adverse consequences or reputation damage to the Company. Periodic and consistent monitoring of KRIs ensures that deviations from predetermined standards can be identified, managed and mitigated.
- Operational Risk Scenario Analysis - Operational risk scenario analysis is used to forecast the significant forward looking operational risks by combining operational risk data with expert management judgement.

These risk management processes are mandated through individual Operational Risk Policies. PHUK Group also uses the BNYMellon group system of record, the Risk Management Platform (RMP), to facilitate many of these processes.

PHUK Group also maintains a risk register which captures the most material risks associated with the business undertaken and the risk mitigations currently in place. The risk register is updated on a monthly basis.

Current issues, emerging and top risks, adverse KRIs and OREs (>\$10,000) are reported to the PHUK Group Risk Committee

Risk managers are assigned to oversee the risk management activities undertaken in the business of PHUK Group. Besides the operational risk function, other internal functions also ensure that processes are in place to support the sound operational risk management of the business e.g. Information Risk Management and Business Continuity Planning.

## 9.2 Operational Risk Capital Resource Requirement

PHUK Group calculates the Pillar 1 operational risk capital resource requirement under the Standardised Approach. Pershing has 3 applicable business lines as below with their beta factor.

Category	Beta
Trading and Sales	18%
Agency Services	15%
Retail Brokerage	12%

## 10 Leverage Ratio

**Table 17: Leverage Ratio**

(In GBP'000s)

Regulatory leverage ratio exposures	31-Dec-15
<b>On-balance sheet exposures (excluding derivatives and SFTs)</b>	
On-balance sheet items (excluding derivatives and SFTs, but including collateral)	302,796
Asset amounts deducted in determining Tier 1 capital	(74,859)
<b>Total on-balance sheet exposures (excluding derivatives and SFTs)</b>	<b>227,936</b>
<b>Derivative exposures</b>	
Replacement cost associated with derivatives transactions	0
Add-on amounts for PFE associated with derivatives transactions	0
Exposure determined under Original Exposure Method	0
<b>Total derivative exposures</b>	<b>0</b>
<b>Securities financing transaction exposures</b>	
SFT exposure according to Article 220 of CRR	0
SFT exposure according to Article 222 of CRR	0
<b>Total securities financing transaction exposures</b>	<b>0</b>
<b>Off-balance sheet exposures</b>	
Off-balance sheet exposures at gross notional amount	0
Adjustments for conversion to credit equivalent amounts	0
<b>Total off-balance sheet exposures</b>	<b>0</b>
<b>Capital and Total Exposures</b>	
Tier 1 capital	175,046
Exposures of financial sector entities according to Article 429(4) 2nd of CRR	0
<b>Leverage Ratios</b>	
<b>Total Exposures</b>	<b>227,936</b>
<b>End of quarter leverage ratio</b>	<b>76.80%</b>
<b>Choice on transitional arrangements and amount of derecognised fiduciary items</b>	
Choice on transitional arrangements for the definition of the capital measure	173,751
Amount of derecognised fiduciary items in accordance with Article 429(11) of CRR	0

Note: CRR (Regulation (EU) NO. 575/2013)

## 11 Remuneration Disclosure

### 11.1 Governance

The Human Resources and Compensation Committee (HRCC) of The Bank of New York Mellon Corporation (BNY Mellon) oversees Pershing's enterprise-wide employee compensation, benefit policies and programmes. It reviews and is responsible for other compensation plans, policies and programmes in which the executive officers participate and the incentive, retirement, welfare and equity plans in which all employees participate.

Members of the HRCC are non-executive board members, delegated by Pershing's Board of Directors to act on behalf of the Board on remuneration matters.

The company's compensation plans are also monitored by a management-level Compensation Oversight Committee (COC). The members are Pershing's senior management include the Chief Human Resources Officer, the Chief Risk Officer, the Chief Financial Officer and the Risk Management and Compliance Chief Administrative Officer. An important responsibility of the COC is to advise the HRCC on any remuneration risk-related issues.

To ensure alignment with local regulations in BNY Mellon's EMEA (Europe, Middle-East and Africa) region, the EMEA Remuneration Governance Committee (ERGC) was set up as a regional governance committee that reviews and ensures compliance with local regulations affecting BNY Mellon's EMEA businesses.

### 11.2 Aligning Pay with Performance

Pershing's compensation philosophy is to offer a total compensation scheme that supports its values, client focus, integrity, teamwork and excellence. It pays for performance, both at the individual and corporate level. It values individual and team contributions and rewards based on how both contribute to business results. In support of this philosophy, variable compensation is regularly used as a means of recognising performance.

Through its compensation philosophy and principles, it aligns the interests of its employees and shareholders by encouraging actions that contribute to superior financial performance and long-term shareholder value. Our compensation structure is comprised of an appropriate mix of fixed and variable compensation that is paid over time. Pershing aims to ensure that both fixed and variable compensation are consistent with business and market practice, fixed compensation is sufficient to provide for a fully flexible variable compensation program, and variable compensation is in the form of annual and/or long-term incentives, where appropriate.

### 11.3 Fixed Remuneration

Fixed remuneration is composed of (i) salary, (ii) any additional non-performance related amounts paid as a result of contractual obligations or applicable law, or as a result of market practice, including role based allowances, and (iii) any benefits in kind which are awarded as a result of the job rather than the performance within the job.

The fixed remuneration of an employee is determined by the job performed, its level of complexity and responsibility, and the remuneration paid in the market for that type of job. It is set, for all staff, at a rate to be at all times sufficient to provide for full flexibility in the variable remuneration, including a zero variable remuneration.

Employees who have been asked and been accepted to be a director of another of BNY Mellon's legal entities are not remunerated in their capacity as a director. Independent directors of Pershing only receive fixed remuneration, as disclosed in the annual Proxy Statement to shareholders.

## 11.4 Variable Compensation Funding and Risk Adjustment

The PHUK Group's staff are eligible to be awarded variable compensation. Variable compensation consists of both cash and deferred components and is determined by the functional hierarchy of the business or business partner service to which the individual staff member belongs, and in accordance with the terms and conditions of the incentive compensation plan that is applicable for the business or business partner service. The incentive pool funding is based upon the risk-adjusted performance of the business line, legal entity or company as appropriate.

The deferred component is intended to align a portion of the variable compensation award with the management of longer-term business risk. The deferred compensation component is generally awarded in the form of BNYMellon restricted stock units.

Furthermore, Pershing requires employees who receive awards to agree to clawback and/or forfeiture provisions on such awards in the event of fraud, misconduct or actions contributing to financial restatement or other irregularities. Where required by regulations, awards to Material Risk Takers are subject to more stringent risk adjustment, potentially including forfeiture and / or clawback in the case of misbehaviour, material error, material downturn in business unit performance or a material failure of risk management.

## 11.5 Ratio between Fixed and Variable Pay

The HRCC approved an increase in the maximum ratio of variable to fixed pay ("Bonus Cap") from 100% to 200% on 27 Jan 2014 on the basis that the increased cap would not affect the firm's ability to maintain a sound capital base, and allows for the appropriate incentivisation and reward in accordance with the Pay for Performance philosophy.

## 11.6 Deferral Policy and Vesting Criteria

For more senior-level employees, a portion of variable compensation will be deferred, under ordinary circumstances for a period of at least three years (albeit such compensation may be deferred on a prorata basis for alternative periods), and will be subject to the performance of either (or both) the company or the respective business. The deferred component of the variable compensation award is usually delivered as restricted stock units whose value is linked to BNY Mellon's share price. The percentage of the variable compensation award to be deferred depends on the level of the position, regulatory requirements and the amount of the award. For regulated staff, the variable compensation portion of an award comprises four different parts: upfront cash, upfront equity, deferred cash and deferred equity, in order to comply with local regulations. All such deferred awards are subject to terms and conditions that provide for forfeiture or clawback in certain circumstances.

## 11.7 Variable Remuneration of Control Function Staff

The variable compensation awarded to control function staff (for example: audit, legal and risk) is dependent on performance that is assessed according to the achievement of objectives specific to their functional role that is independent of the activities they oversee. Remuneration is benchmarked against the market level and funded independently of individual business line results and adjusted based on Pershing's overall annual financial performance.

## 11.8 Quantitative Disclosures

The tables below provide details of the aggregate remuneration of senior management and Material Risk Takers (MRT) for PHUK Group for the year ended 31 December 2015.

For completeness, this group of staff is limited to those considered to be primarily regulated due to their activities under PHUK Group. The remuneration amounts are presented on a gross basis,

regardless of the time spent by Pershing staff in respect of PHUK Group to reflect the full reporting period.

**Table 18: Aggregate Remuneration Expenditure for MRTs in 2015 by Business**

This table shows the aggregate remuneration expenditure for MRTs by business.

Aggregate remuneration expenditure for MRTs by business (£000's)	PHUK Group (GBP'000s)		
	Investment services	Other <sup>2</sup>	Total
Total remuneration <sup>1</sup>	4,887	0	4,887

<sup>1</sup> Includes base salary and other cash allowances, plus any cash incentive and the total of any deferred awards made in Pershing shares valued at the date of grant or deferred cash.

<sup>2</sup> Includes all support functions and general management positions.

**Table 19: Aggregate Remuneration Expenditure for MRTs by Remuneration Type**

This table shows the aggregate remuneration expenditure for MRTs by remuneration type.

Aggregate remuneration expenditure for MRTs by remuneration type	PHUK Group		
	Senior man <sup>1</sup>	Other MRTs	Total
Number of beneficiaries	10	22	32
Fixed remuneration <sup>2</sup>	1,725	2,064	3,789
Total variable remuneration (000's)	606	492	1,098
Variable cash (000's)	310	388	698
Variable shares (000's)	296	104	400

<sup>1</sup> Senior management is comprised of MRTs identified under Article 3.3 of the EBA RTS for identifying MRTs, consisting of Directors other Significant Influencing Functions and those holding the corporate title of Executive Vice President.

<sup>2</sup> Fixed remuneration includes base salary and any cash allowances.

**Table 20: Total Deferred Variable Remuneration for MRTs Outstanding from Previous Years**

This table shows the total deferred remuneration for MRTs outstanding from previous years.

Total deferred remuneration for MRTs outstanding from previous years	PHUK Group		
	Senior man <sup>1</sup>	Other MRTs	Total
Number of beneficiaries	10	22	32
Total deferred variable remuneration outstanding from previous years (000's)	719	207	926
Total vested (000's)	0	0	0
Total unvested (000's)	719	207	926

<sup>1</sup> Senior management is comprised of MRTs identified under Article 3.3 of the EBA RTS for identifying MRTs, consisting of Directors other Significant Influencing Functions and those holding the corporate title of Executive Vice President.



**Table 21: Number and Value of New Sign-on and Severance Payments made during 2015**

This table shows the number and value of new sign-on and severance payments made during 2015.

New sign-on and severance payments	PHUK Group		
	Senior man <sup>1</sup>	Other MRTs	Total
Number of sign-on payments awarded during 2015	0	0	0
Value of sign-on payments awarded during 2015 (000's)	0	0	0
Number of severance payments awarded during 2015	0	0	0
Value of severance payments awarded during 2015 (000's)	0	0	0
Highest individual severance payment awarded during 2015 (000's)	0	0	0

<sup>1</sup> Senior management is comprised of MRTs identified under Article 3.3 of the EBA RTS for identifying MRTs, consisting of Directors other than Significant Influencing Functions and those holding the corporate title of Executive Vice President

**Table 22: Number of Individuals being Remunerated EUR 1 million or more**

This table shows the number of individuals being remunerated €1m or more.

Number of individuals being remunerated ≥ €1m	PHUK Group Total Number of Individuals
EUR 1m – EUR 1.5m	0
EUR 1.5m – EUR 2m	0

## Appendix 1 Liquidity and Other Risks

### Liquidity Risk

Liquidity Risk is the risk that PHUK Group cannot meet its cash and collateral obligations without significantly affecting daily operations or financial conditions. Liquidity risks can arise from funding mismatches, market constraints from an inability to convert assets to cash, inability to raise cash in the markets, deposit run-off, or contingent liquidity events. Changes in economic conditions or exposure to credit, market, operational, legal, and reputational risks also can affect Pershing's liquidity risk profile and are considered in the liquidity risk management framework.

PHUK Group does not engage in proprietary trading activities or hold assets for resale on its balance sheet, (excluding Gilts comprising the liquid assets buffer (LAB)) and so does not have significant asset liquidity risk. PHUK Group's business model is of a transaction processing nature and PHUK Group maintains a prudent funding profile in order to support its clients trading activities. The availability of sufficient and appropriate credit lines is of paramount importance.

A liquidity risk management framework has been established which is maintained on a day to day basis by the Treasury department. The ALCO provides oversight and ultimately the PRC and the Board. PSL complies with FCA liquidity requirements at all times including the maintenance of a LAB.

### Regulatory and Compliance Risk

Regulatory and Compliance Risk is defined as sustaining loss arising from non-compliance with laws, directives, regulations, reporting standards and lack of adequately documented and understood processes.

Monitoring and Reporting Risk is the risk of loss arising from a failure to comply with financial reporting standards, agreements or regulatory requirements. This includes risks resulting from action taken by existing and new stockholders, regulators and investors who may have sustained losses due to incomplete, inaccurate or untimely reporting of financial performance.

Existing and new directives and regulations are monitored and reviewed by Compliance and Finance for finance regulatory reporting management and findings are reported to senior management and the Board. Strategies and changes to comply with new regulations are put in place when necessary.

### Reputation Risk

Reputation Risk is the risk to the Pershing's brand and relationships which does not arise out of any one specific error. It can arise from all aspects of business activities, including but not limited to operational failures in business practices, legal or regulatory sanctions, joint ventures with outside firms, engagements with third party vendors, or off-balance sheet activities.

Pershing relies heavily on its reputation and standing in the market place to retain and attract clients.

### Legal Risk

Legal Risk is the risk of loss arising from claims, lawsuits (including costs of defence and/or adverse judgments), and inability to enforce contracts.

Pershing's legal risks fall into the following categories:

- Corporate
- Client

- Employee
- Suppliers

These can occur as a result of non-payment / non-performance. They are mitigated using the legal documents that specify the responsibilities of both parties and the procedures for resolving disputes.

### **Outsourcing Risk**

Outsourcing Risk is the risk that failure in respect of the provision of services by third party provider(s) could potentially damage PHUK Group's operations, or if contracts with any of the third party providers are terminated, that PHUK Group may not be able to find alternative providers on a timely basis or on equivalent terms.

PHUK Group relies on internal and external outsourcing entities within and outside of the BNY Mellon group to perform its core business activities. To date, PHUK Group has only outsourced critical tasks to Pershing group entities that hold the required permissions in their jurisdiction to carry out the respective delegated tasks. Currently there are no critical tasks outsourced to third parties outside Pershing entities.

PHUK Group's outsourcing policy describes minimum standards that should be adopted when considering or dealing with a service and/or activity that is outsourced to another legal entity, either within the Pershing group or to an external provider and establishes a framework for evaluating and analysing outsourcing projects.

### **Business Risk**

Business Risk is the risk of loss that the business environment poses to PHUK Group's profitability. It normally consists of items such as changes in the external macro environment or client behaviour, inappropriate management actions and performance of competitors. The list is not exhaustive.

The principal business risk for PHUK Group is within the asset servicing and alternative investment services businesses as this is mainly driven by the fact that fees are significantly based on the client's net asset value. As business risk is difficult to assess, it has been defined as the residual risks that confronts PHUK Group after taking all known and quantifiable risks into consideration.

### **Concentration Risk**

Concentration Risk is the risk of loss arising from significant interrelated asset or liability exposures, which in cases of distress associated with markets, sectors, countries, or areas of activity, may threaten the soundness of the institution.

Traditionally analysed in relation to credit activities, concentration risk arises from exposures that may arise within or across different risk types, including intra-risk concentration where exposure concentration exists within a single risk type, and inter-risk concentrations arising from interactions between different risk exposures across different risk categories connected by a common risk factor (e.g. counterparties, vendor, economic sector, geographic region, and/or financial instrument/product type).

### **Group Risk**

Group Risk is the risk that the financial position of PHUK Group may be adversely affected by its relationships (financial and non-financial) with other entities within Pershing or by risks which may affect the financial position of the whole Group, for example reputational contagion or Group default.

PHUK Group has a number of dependencies on the larger Pershing group. These range from business leadership, dependency on certain IT systems and support services provided by central functions.

PHUK Group management has considered several possible scenarios where these services may be affected, these include IT services outage and other business continuity issues. These stress scenarios are included as part of the operational risk assessment, and in the liquidity stress testing.

### **Model Risk**

Model Risk refers to the possibility of unintended business outcomes arising from the design, implementation or use of models. Model risk includes the potential risk that management makes incorrect decisions based either upon incorrect model results, or incorrect understanding and use of model results.

PHUK Group uses models in its risk management framework. All models have been assessed in line with the relevant corporate policies and model risk management framework wherein the individual model is categorised into one of three tiers based on materiality, complexity, and level of reliance.

Models that impact the capital assessment process are categorised as Tier 1 models and the execution of the validation of Tier 1 models is done by a designated Independent model validation function. Tier 1 models are required to be validated or reviewed, as per the validation standards, on at least an annual basis.

Pershing internal audit provides independent reviews of compliance with the corporate model validation policy.

### **Strategic Risk**

Strategic Risk is defined as the risk of direct or indirect loss arising from the adverse effects or the improper implementation of business decisions. It is a function of the compatibility of an organisation's strategic goals, the business strategies developed, the resources deployed to achieve those goals and the quality of implementation. It can result from either a misalignment between strategic decisions taken at the asset servicing and alternative investment services business level which impact PHUK Group, or failure to deliver business value through new strategic initiatives.

### **Country Risk**

Country Risk is the risk of unfavourable evolution of operating profits and/or value of assets due to changes in the business environment resulting from political or macroeconomic factors.

## Appendix 2 Glossary of Terms

The following terms are used in this document:

- **ALCO:** Asset and Liability Committee
- **Basel III:** The capital reforms and introduction of a global liquidity standard proposed by the Basel Committee on Banking Supervision in 2010
- **CRD IV:** On 27 June 2013, the European Commission published, through the Official Journal of the European Union, its legislation for a Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR), which together form the CRD IV package. Amendments published on 30 November 2013 were made to the Regulation. The package implements the Basel III reforms in addition to the inclusion of new proposals on sanctions for non-compliance with prudential rules, corporate governance and remuneration. CRD IV rules apply from 1 January 2014 onwards, with certain requirements set to be phased in
- **Capital Requirements Directive (CRD):** A capital adequacy legislative package issued by the European Commission and adopted by EU member states
- **Capital Requirements Regulation (CRR):** Regulation that is directly applicable to anyone in the European Union and is not transposed into national law.
- **Central Bank of Ireland (CBI):** Responsible for the regulation of all financial services firms in Ireland
- **Common Equity Tier 1 capital:** The highest quality form of regulatory capital under Basel III comprising common shares issued and related share premium, retained earnings and other reserves excluding the cash flow hedging reserve, less specified regulatory adjustments.
- **Core Tier 1 capital:** Called-up share capital and eligible reserves plus equity non-controlling interests, less intangible assets and other regulatory deductions
- **Credit risk mitigation (CRM):** A technique to reduce the credit risk associated with an exposure by application of credit risk mitigants such as collateral, guarantees and credit protection.
- **Derivatives:** A derivative is a financial instrument that derives its value from one or more underlying assets, for example bonds or currencies.
- **EMEA:** Europe, Middle-East and Africa region
- **Exposure:** A claim, contingent claim or position which carries a risk of financial loss.
- **Exposure at default (EAD):** The amount expected to be outstanding, after any credit risk mitigation, if and when counterparty defaults. EAD reflects drawn balances as well as allowance for undrawn amounts of commitments and contingent exposures over a one-year time horizon.
- **Financial Conduct Authority (FCA):** The Financial Conduct Authority regulates the conduct of financial firms and, for certain firms, prudential standards in the UK. It has a strategic objective to ensure that the relevant markets function well
- **High Level Assessment (HLA):** An assessment of the quality of controls in place to mitigate risk and residual risk. Residual risk is assessed as high, moderate to high, moderate, moderate to low and low with direction anticipated.
- **Institutions:** Under the Standardised approach, Institutions are classified as credit institutions or investment firms.
- **Internal Capital Adequacy Assessment Process (ICAAP):** The group's own assessment of the levels of capital that it needs to hold through an examination of its risk profile from regulatory and economic capital viewpoints.
- **ISDA Master Agreement:** A document that outlines the terms applied to a derivatives transaction between two parties. Once the two parties have agreed to the standard terms, they do not have to renegotiate each time a new transaction is entered into.

- **Key Risk Indicator (KRI):** Key Risk Indicators are used by business lines to evaluate control effectiveness and residual risk within a business process.
- **Master Netting Agreement:** An agreement between two counterparties that have multiple contracts with each other that provides for the net settlement of all contracts through a single payment in the event of default or termination of any one contract.
- **Pillar 3:** The part of Basel III that sets out information banks must disclose about their risks, the amount of capital required to absorb them and their approach to risk management. The aim is to encourage market discipline and improve the information made available to the market.
- **Prudential Regulation Authority (PRA):** the statutory body responsible for the prudential supervision of banks, building societies, credit unions insurers and major investment firms in the UK. The PRA is a subsidiary of the Bank of England.
- **Residual maturity:** The period outstanding from the reporting date to the maturity or end date of an exposure.
- **Risk appetite:** A definition of the types and quantum of risks to which the firm wishes to be exposed.
- **Risk and Control Self-Assessment (RCSA):** Risk and Control Self-Assessment is used by business lines to identify risks associated with their key business processes and to complete a detailed assessment of the risk and associated controls.
- **Risk Governance Framework:** PHUK Group's risk governance framework has been developed in conjunction with Pershing requirements. Key elements of the framework are:
  - Formal governance committees, with mandates and attendees defined
  - Clearly defined escalation processes, both informally (management lines) and formally (governance committees, board, etc.)
  - A clear business as usual process for identification, management and control of risks
  - Regular reporting of risk issues
- **Risk Weighted Assets (RWAs):** Assets that are adjusted for their associated risks using weightings established in accordance with CRD IV requirements
- **Standardised approach:** Method used to calculate credit risk capital requirements using the Basel III, CRD IV, CRR model supplied by the BCBS. All financial institutions must opt to either use the Standard Approach (SA) specified by the regulator, or develop and use their own Internal Ratings Model (IRM). The SA model uses external credit assessment institution ratings and supervisory risk weights supplied by external credit assessment agencies
- **Tier 2 capital:** A component of regulatory capital under Basel III, mainly comprising qualifying subordinated loan capital, related non-controlling interests and eligible collective impairment allowances

### Appendix 3 Supplementary Tables

#### Reconciliation of Regulatory Own Funds for the significant subsidiary PSL

Reconciliation of Regulatory Own Funds 31 December 2015 (PSL – GBP'000s)	Published Audited Financial Statements	Adjustments due Consolidation Scope	Adjustments due Transitional Provisions	Regulatory Prudential Adjustments	Regulatory Own Funds
<b>Common Equity Tier 1</b>					
Capital Instruments	113,390	0	0	0	113,390
Retained Earnings	6,234	0	0	0	6,234
Other compressive income	4,492	0	0	0	4,492
Reserves	0	0	0	0	0
Minority Interest	0	0	0	0	0
Other adjustments and assets deducted	0	0	0	0	0
<b>Total CET1</b>	<b>124,116</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>124,116</b>
<b>Additional Tier 1 Capital</b>					
Capital Instruments	0	0	0	0	0
Instruments issued by subsidiaries	0	0	0	0	0
Other assets deducted	0	0	0	0	0
Other prudential deductions	0	0	0	0	0
Other adjustments and assets deducted	0	0	0	0	0
<b>Total AT1</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total Tier 1 (CET1 + AT1)</b>	<b>124,116</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>124,116</b>
<b>Tier 2 Capital</b>					
Capital Instruments	0	0	0	0	0
Subordinated loans	0	0	0	0	0
Instruments issued by subsidiaries	0	0	0	0	0
SA - Credit Risk Adjustments	0	0	0	0	0
Other asset deducted	0	0	0	0	0
Other adjustments and assets deducted	0	0	0	0	0
<b>Total Tier 2 Capital</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total Own Funds</b>	<b>124,116</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>124,116</b>

**Reconciliation of Regulatory Own Funds for the significant subsidiary PL**

Reconciliation of Regulatory Own Funds 31 December 2015 (PL – GBP'000s)	Published Audited Financial Statements	Adjustments due Consolidation Scope	Adjustments due Transitional Provisions	Regulatory Prudential Adjustments	Regulatory Own Funds
<b>Common Equity Tier 1</b>					
Capital Instruments	151,335	0	0	0	151,335
Retained Earnings	4,416	0	0	0	4,416
Other compressive income	0	0	0	0	0
Reserves	0	0	0	0	0
Minority Interest	0	0	0	0	0
Other adjustments and assets deducted	0	0	0	(122,600)	(122,600)
<b>Total CET1</b>	<b>155,751</b>	<b>0</b>	<b>0</b>	<b>(122,600)</b>	<b>33,151</b>
<b>Additional Tier 1 Capital</b>					
Capital Instruments	0	0	0	0	0
Instruments issued by subsidiaries	0	0	0	0	0
Other assets deducted	0	0	0	0	0
Other prudential deductions	0	0	0	0	0
Other adjustments and assets deducted	0	0	0	0	0
<b>Total AT1</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total Tier 1 (CET1 + AT1)</b>	<b>155,751</b>	<b>0</b>	<b>0</b>	<b>(122,600)</b>	<b>33,151</b>
<b>Tier 2 Capital</b>					
Capital Instruments	0	0	0	0	0
Subordinated loans	0	0	0	0	0
Instruments issued by subsidiaries	0	0	0	0	0
SA - Credit Risk Adjustments	0	0	0	0	0
Other asset deducted	0	0	0	0	0
Other adjustments and assets deducted	0	0	0	0	0
<b>Total Tier 2 Capital</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total Own Funds</b>	<b>155,751</b>	<b>0</b>	<b>0</b>	<b>(122,600)</b>	<b>33,151</b>



### Transitional Own Funds disclosure for the significant subsidiary PSL

Equity Instruments, Reserves and Regulatory Adjustments GBP '000s	Amount at disclosure date	Subject to pre-CRR treatment or prescribed residual amount of CRR
<b>Common Equity Tier 1 capital: Instruments and Reserves)</b>		
Capital instruments and the related share premium accounts	113,390	
of which: ordinary shares	113,390	
Retained earnings	6,234	
Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	4,492	
<b>Common Equity Tier 1 (CET1) capital before regulatory adjustments</b>	<b>124,116</b>	<b>0</b>
<b>Common Equity Tier 1 (CET1) capital: regulatory adjustments</b>		
Additional value adjustments	0	
Intangible assets (net of related tax liability)	0	
Regulatory adjustments applied to Common Equity Tier 1 in respect of amounts subject to pre-CRR treatment	0	0
Year-end non eligible earning adjustments		
<b>Total regulatory adjustments to Common equity Tier 1 (CET1)</b>	<b>0</b>	
<b>Common Equity Tier 1 (CET1) capital</b>	<b>124,116</b>	
<b>Additional Tier 1 (AT1) capital: Instruments</b>		
Capital instruments and the related share premium accounts	0	
<b>Additional Tier 1 (AT1) capital before regulatory adjustments</b>	<b>0</b>	
<b>Additional Tier 1 (AT1) capital: regulatory adjustments</b>		
<b>Total regulatory adjustments to Additional Tier 1 (AT1) capital</b>	<b>0</b>	
<b>Additional Tier 1 (AT1) capital</b>	<b>0</b>	
<b>Tier 1 capital (T1 = CET1 + AT1)</b>	<b>124,116</b>	
<b>Tier 2 (T2) capital</b>	<b>0</b>	
<b>Total capital (TC = T1 + T2)</b>	<b>124,116</b>	
<b>Total risk weighted assets</b>	<b>134,486</b>	
<b>Capital ratios and buffers</b>		
Common Equity Tier 1 (as a percentage of risk exposure amount)	92.3%	
Tier 1 (as a percentage of risk exposure amount)	92.3%	
Total capital (as a percentage of risk exposure amount)	92.3%	

## Transitional Own Funds disclosure for the significant subsidiary PL

Equity Instruments, Reserves and Regulatory Adjustments GBP '000s	Amount at disclosure date	Subject to pre-CRR treatment or prescribed residual amount of CRR
<b>Common Equity Tier 1 capital: Instruments and Reserves)</b>		
Capital instruments and the related share premium accounts	151,335	
of which: ordinary shares	151,335	
Retained earnings	4,739	
<b>Common Equity Tier 1 (CET1) capital before regulatory adjustments</b>	<b>156,074</b>	<b>0</b>
<b>Common Equity Tier 1 (CET1) capital: regulatory adjustments</b>		
Additional value adjustments	(9,497)	
Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions)	(112,429)	
Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in 38 (3) are met)	(674)	
Losses for the current financial year	(323)	
<b>Total regulatory adjustments to Common equity Tier 1 (CET1)</b>	<b>(122,923)</b>	
<b>Common Equity Tier 1 (CET1) capital</b>	<b>33,151</b>	
<b>Additional Tier 1 (AT1) capital: Instruments</b>		
Capital instruments and the related share premium accounts	0	
<b>Additional Tier 1 (AT1) capital before regulatory adjustments</b>	<b>0</b>	
<b>Additional Tier 1 (ATI) capital: regulatory adjustments</b>		
<b>Total regulatory adjustments to Additional Tier 1 (AT1) capital</b>	<b>0</b>	
<b>Additional Tier 1 (AT1) capital</b>	<b>0</b>	
<b>Tier 1 capital (T1 = CET1 + AT1)</b>	<b>33,151</b>	
<b>Tier 2 (T2) capital</b>	<b>0</b>	
<b>Total capital (TC = T1 + T2)</b>	<b>33,151</b>	
<b>Total risk weighted assets</b>	<b>47,566</b>	
<b>Capital ratios and buffers</b>		
Common Equity Tier 1 (as a percentage of risk exposure amount)	69.7%	
Tier 1 (as a percentage of risk exposure amount)	69.7%	
Total capital (as a percentage of risk exposure amount)	69.7%	

**Capital Requirements for the significant subsidiary PSL**

Type of Risk (PSL – GBP'000s)	Risk Exposure Amount		Capital Requirements	
	31-Dec-15	31-Dec-14	31-Dec-15	31-Dec-14
Credit Risk SA*	20,117	30,150	1,609	2,412
Counterparty Credit Risk SA*	0	0	0	0
Securitisation Risk in banking book SA*	0	0	0	0
Settlement Risk	11,898	10,763	952	861
Market Risk SA*	5,969	23,713	478	1,897
of which: Foreign Exchange Position Risk	5,969	2,935	478	235
Operational Risk	95,874	97,025	7,670	7,762
of which: Basic Indicator Approach	0	0	0	0
of which: Standardised Approach	95,874	97,025	7,670	7,762
of which: Additional Amount due to fixed overheads	0	0	0	0
Credit Valuation Adjustment - Standardised method	628	113	50	9
Related to Large Exposure in Trading Book	0	0	0	0
Other risk	0	0	0	0
<b>Total</b>	<b>134,486</b>	<b>161,763</b>	<b>10,759</b>	<b>12,941</b>
<b>Total Capital</b>			<b>124,116</b>	<b>134,707</b>
<b>Surplus Capital</b>			<b>113,357</b>	<b>121,766</b>

\* SA = Standardised Approach

**Capital Requirements for the significant subsidiary PL**

Type of Risk (PL – GBP'000s)	Risk Exposure Amount		Capital Requirements	
	31-Dec-15	31-Dec-14	31-Dec-15	31-Dec-14
Credit Risk SA*	22,800	12,850	1,824	1,028
Counterparty Credit Risk SA*	0	0	0	0
Securitisation Risk in banking book SA*	0	0	0	0
Settlement Risk	4	1	0	0
Market Risk SA*	18,131	15,963	1,451	1,277
of which: Foreign Exchange Position Risk	18,131	15,963	1,451	1,277
Operational Risk	6,630	7,225	530	578
of which: Basic Indicator Approach	0	0	0	0
of which: Standardised Approach	6,630	7,225	530	578
of which: Additional Amount due to fixed overheads	0	0	0	0
Credit Valuation Adjustment - Standardised method	0	0	0	0
Related to Large Exposure in Trading Book	0	0	0	0
Other risk	0	0	0	0
<b>Total</b>	<b>47,566</b>	<b>36,039</b>	<b>3,805</b>	<b>2,883</b>
<b>Total Capital</b>			<b>33,151</b>	<b>31,292</b>
<b>Surplus Capital</b>			<b>29,346</b>	<b>28,409</b>

**Contacts**

Name: Kevin Cracknell, Chief Financial Officer

Department: Finance

Phone: +44 20 7163 3605

Email: [regulatory@pershing.co.uk](mailto:regulatory@pershing.co.uk)



**BNY MELLON**

**Pershing Holdings (UK) Limited**

One Canada Square

London E14 5AL