



## **IronFX Financial Services Limited**

**Pillar 3 disclosures for the year ended  
31 December 2010**

**May 2011**

## TABLE OF CONTENTS

1. Introduction	3
2. Risk Management Objectives and Policies	3
2.1 Risk Management Policy	3
2.2 Credit Risk Management	4
2.3 Operational Risk	5
2.4 Market Risk	6
2.5 Liquidity Risk	8
3. Own Funds	8
3.1 Original own funds	8
4. Minimum Required Own Funds for Credit, Market and Operational Risk	9
5. Counterparty Credit Risk	9
6. Exposure to Credit Risk and Impairment	9
7. Exposure in Equities not included in the Trading Book	10

## 1. Introduction

IronFX Financial Services Ltd (hereinafter called the “Company”) is an investment firm regulated by the Cyprus Securities and Exchange Commission (hereinafter the “CySEC) under the license number 125/10.

This report has been prepared pursuant to Chapter 7 (Sub-Chapter A, Paragraphs 34-38) of Part C and Annex XII of the CySEC on Directive DI1442007-05 – “Capital Requirements of Investment Firms”.

The Directive is based on three pillars:

- Pillar 1 has to do with the standards that set out the minimum regulatory capital requirements that are required for credit, market and operational risk.
- Pillar 2 covers the Supervisory Review Process which assesses the internal capital adequacy processes. Investment firms have to evaluate and assess whether a bank should hold additional capital against risks not covered in Pillar 1.
- Pillar 3 (Market discipline) covers transparency and the obligation of firm’s to disclose meaningful information to the market related to their risks, capital and generally risk management.

The Company’s Disclosures below have been prepared using 31 December 2010 data in accordance with the Directive.

## 2. Risk Management Objectives and Policies

Risk taking constitutes a major characteristic of the business of the Company, and the development of a robust risk management framework is considered of high importance. The identification and classification of risks begins from the definition of the vision and business objectives, which clearly provide guidance and direction, defining the approach that the Company adopts in order to successfully confront and respond to different risks inherent in its operations and functions.

### 2.1 Risk Management Policy

The Risk Management Policy aims to elucidate the approach taken by the Company towards the risk confronted by the Company and the principles guiding its approach. The analysis

refers to the risks confronted by the Company and the strategies employed for their mitigation or elimination. Importantly, the approach of the Company's management and the resulting policy adopted regarding the issue of risk is exemplified throughout.

This Policy is split into three main subcategories. Firstly, the main risks confronted by the Company and the mitigation strategies that should be implemented. Secondly, the risk management procedures that may be used by the Company for assessing exposures and trading limits when this will be applicable for the Company (e.g. dealing on own account). Thirdly, the most significant investment risks that most investors are exposed to by investing in the financial markets are discussed.

## **2.2 Credit Risk Management**

Credit Risk is defined as the risk that a counterparty will fail to discharge their obligation and cause the Company to incur a financial loss. Credit risk arises primarily on the Company's own funds deposited with bank institutions and amounts due on client positions.

### Credit Risk Monitoring and Mitigation

Credit risk is monitored by management and the risk committee on an ongoing basis.

The Company addresses credit risk in a number of ways as follows:

- (a) aiming to maintain a diversified client portfolio thus avoiding high concentration and exposure to a small number of clients
- (b) depositing the Company's own funds as well as client funds only in highly rated banking institutions
- (c) ensuring that clients cannot begin to trade unless money has been deposited into clients' account and
- (d) ensuring that the necessary margin is tied for any open positions.

Furthermore, the credit risk that arises from client positions is further reduced by the Company's policies and tools, which include manual and automatic stop loss limits in order to prevent any open positions exceeding the Company's pre-set margin.

### Credit Risk calculation

The Company follows the Standardised Approach for the calculation the capital requirements for credit risk.

## 2.3 Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external factors.

The operational risk is divided into the following sub-categories:

- Internal fraud; External fraud; Marketing & Advertising; Regulatory reporting; Internal procedures and controls; Client communication damage to physical assets business disruption & systems failures; Chinese walls; Employment practices and workplace safety; Conflicts of interest; Client & Business Practice; Legal risk and etc.

### Operational risk mitigation

The Company has established various techniques for the mitigation of operational risk. These techniques include the following:

- Maintain a four eye structure and implement board oversight. The Board of Directors should further review any decisions made by management and monitor their activities.
- The compliance officer must ensure the accuracy of any statements made during the marketing and advertising processes and ensure that the information addressed to the client is fair, clear and not misleading.
- Compliance officer should ensure that proper information/reports are sent on time to CySEC.
- Management should formally communicate duties and responsibilities to employees.
- Internal audit visits should be implemented to ensure that employees comply with the Company's internal procedures.
- Several policies and procedures have been established and followed in an attempt to identify and minimize any fraudulent activities.
- The Company should create a comprehensive and detailed business contingency plan with recovery procedures and actions to be followed in the case of damage to any vital of the Company's structure.
- The Company should have in place a summary conflicts of interest policy.
- The Company should obtain legal advice from its legal advisors for all its official documents and before entering into new markets.

## Operational Risk calculation

For the calculation of the capital requirements of operational risk, the Company uses the Basic Indicator Approach.

## **2.4 Market Risk**

The Company defines Market Risk as the risk of adverse movements in the level of interest rates, in the rate of exchange between currencies and the current prices of securities, commodities and other financial instruments. Accordingly, these movements may affect the Company's profitability.

To address market risk the Company employs a risk manager who is responsible for the monitoring of the Company's risk exposures; any deviations are reported to the risk management committee where appropriate action is taken. The risk management committee is an independent unit reporting directly to the Board of Directors and is not involved in any risk taking or execution activities.

Aggregate net exposures are monitored as they develop from the opening and/or closing of positions by clients. If the risk exceeds desired levels, appropriate actions are taken to hedge risk until intended levels are achieved.

## Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fluctuations of market interest affect the prices of securities.

The Company's management monitors the interest rate fluctuations on a continuous basis and acts accordingly.

Due to the fact that the Company commenced trading in December 2010, there were no significant open trading positions which would materially affect the Company's profitability or equity due to fluctuations in interest rates at 31 December 2010.

## Foreign exchange Risk

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates.

As the Company's principal activity is trading in foreign currencies, it is exposed to foreign currency risk as a result of the existence of open currency positions in the currencies in which it performs transactions with its customers. The Company maintains position limits for its open positions for each currency, in order to mitigate these risks. The open positions up to a limit are monitored on a continuous basis by the Company's traders.

## Price risk

Price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk and currency risk). The Company is exposed to price risk with regards to its investment portfolio in equity shares which have been classified as available for sale. The management of the Company and the Risk Committee continuously monitor market prices and act accordingly in order to maintain price risk at acceptable levels.

## Market risk mitigation

Below are procedures that have been identified by the Company and are used for market risk mitigations purposes:

- The Company employs a risk manager who is responsible for the monitoring of the Company's risk exposure; any deviation ought to be reported to the risk management committee where appropriate action must be taken.
- Risk management committee is an independent unit reporting directly to Board of Directors.
- The trading activity is recorded so as to allow the risk committee to review and monitor the Company's exposure.
- Aggregate net exposures are monitored as they develop from the opening and/or closing of positions by clients. If risk exceeds desired levels, appropriate actions should be taken to hedge risk until intended levels are achieved.

- The Company must maintain trading accounts with other regulated Companies for engaging in proprietary positions in financial instruments for its own account as a hedging measure and in order to minimize market risk.

## Market Risk calculation

The Company uses the Standardised Approach to calculate the capital requirements of market risk.

## **2.5 Liquidity Risk**

Liquidity risk is the risk that the Company will encounter difficulty in meeting payment obligations and potential payment obligations as and when they fall due without incurring unacceptable losses. Liquidity risk also arises from the inability to find buyers on the terms desired. Infrequently traded securities/assets bear higher liquidity risk. The imbalance between the number of buyers and sellers or because the securities/assets are not traded very often cause this liquidity risk. The liquidity risk is usually reflected in a wide bid-ask spread or large price movements.

The Company does not consider liquidity risk to be significant as it maintains bank balances which are adequate to cover its liquidity needs.

## **3. Own Funds**

The own funds of the Company as at 31/12/2010 were €1.032 thousand as shown below:

	<b>€000</b>
<b>Original Own Funds (Tier 1)</b>	
Share Capital	1.700
Reserves	(288)
Intangible Assets	(201)
Investment Revaluation Reserve	(179)
<b>Total Own Funds</b>	<b>1.032</b>

### **3.1 Original Own Funds**

#### Share Capital

As at 31/12/2010 the share capital of the Company comprises 1.700.000 shares with a nominal value of €1 each.

#### 4. Minimum Required Own Funds for Credit, Market and Operational risk

The different methods used to assess the adequacy of the capital for the different categories of risks are described above.

The table below represents the minimum capital requirements as at 31 December 2010. The capital requirements for market risk relate only to foreign exchange risk.

	<b>Capital Requirements 31/12/2010</b>
	<b>€000</b>
<b>Credit Risk</b>	
<i>Standardised approach</i>	<b>78</b>
<b>Market Risk</b>	
<i>Standardised approach</i>	<b>49</b>
<b>Operational Risk</b>	
<i>Basic Indicator Approach</i>	<b>113</b>
<b>Total</b>	<b>240</b>
<b>Capital Adequacy Ratio</b>	<b>34,53%</b>

#### 5. Counterparty Credit Risk

As at 31 December 2010, the Company did not have any outstanding securities or commodities lending or borrowing transactions, long settlement transactions, margin lending transactions or derivative instruments transactions.

#### 6. Exposure to Credit Risk and Impairment

##### Impairment of Available for Sale Equity Investments

Available for sale investments in equity securities are impaired when there has been a significant or prolonged decline in their fair value below cost. The determination of what is significant or prolonged requires judgment by management. The factors which are evaluated include the expected volatility in market prices. In addition, impairment may be appropriate when there is evidence that significant adverse changes have taken place in the technological, market, economic or legal environment in which the investee operates.

As at 31 December 2010 no impairment has been recognised in respect of the Available for Sale Equity Investments.

## **7. Exposure in Equities not included in the Trading Book**

Non-trading equity risk is defined as the potential variation in the Company's non-trading income and reserves arising from changes in equity prices. The risk may crystallise during the course of normal business activities or in stressed market conditions.

During 2010 and as at 31 December 2010 the Company held shares in which were listed in the Cyprus Stock Exchange. The fair value of investments quoted in an active market is based on quoted bid prices.