

*Cenkos Securities Plc*  
*Pillar 3*

## Overview

The Basel II Accord, implemented in the European Union through the Capital Requirements Directive ('the Directive') establishes a revised regulatory capital framework across Europe governing the amount and nature of capital that must be maintained by credit institutions and investment firms.

In the United Kingdom, the Directive has been implemented by the Financial Services Authority ('FSA') in its regulations through the General Prudential Sourcebook ('GENPRU') and the Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU').

The CRD framework consists of three pillars:

- Pillar 1 specifies the minimum amount of capital that a financial services firm is required to maintain to support its business;
- Pillar 2 requires the firm to assess whether any additional capital should be maintained against any risks not adequately covered under Pillar 1, and the FSA then to review this process;
- Pillar 3 specifies the disclosures which the firm is required to make about its capital, its risk exposures and its risk assessment processes.

The FSA rules governing Pillar 3 disclosures provide that the firm may choose not to disclose information which is not material. The firm may also choose not to disclose information if it is proprietary or confidential, though it must state if any such items have been omitted (BIPRU 11.3.7).

## Frequency of Publication

The disclosure will be reviewed on an annual basis at a minimum and, if appropriate, more frequently.

## Report Location

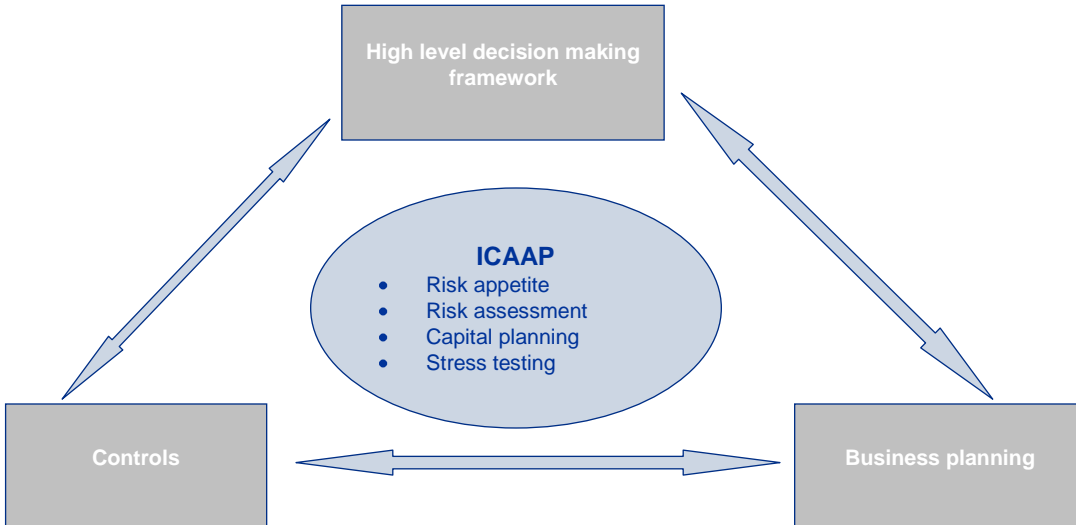
This report can be found under the Investor Relations section of our website.

## Corporate Governance Processes

Cenkos Securities plc Board ("the Board") oversees an ongoing capital assessment process in order to ensure the continuing capital adequacy of Cenkos, particularly in the light of changing business factors, both internal and external, to Cenkos Securities plc ("the Group"). The Board delegates the ongoing monitoring responsibility of this to the Chief Executive Officer, supported by senior management.

The overall governance of the firm is based upon the high level decision making and control framework, key controls and strategic and capital planning.

The firm's approach to assessing the adequacy of its internal capital to support its current and future activities is documented in its Internal Capital Adequacy Assessment Process ("ICAAP"), which includes an assessment of each of the risks faced by the firm and the internal controls in place to mitigate those risks.



## Internal control and risk management

As part of general corporate governance requirements, Cenkos has a risk framework covering all aspects of its risks. This enables it to identify, assess and manage its key risks. Cenkos' senior management review and evaluate the business processes and associated risks within each area of the firm's business, identifying and assessing the mitigating controls and procedures in place and the action plan to address any weaknesses in control. This framework includes a formal approach to risk event reporting, which involves the identification of an event, assessment of its materiality, analysis of the cause, the establishment of remedial action required and escalation to the Chief Executive Officer, the Group Risk and Compliance Committee and Audit Committee as required, within an overall framework and associated risk appetite that is set by the Board.

The system of internal control is designed to manage rather than eliminate the risk. As such it can provide only reasonable not absolute assurance against material misstatement or loss.

## Principal risks and controls

One of the principal risks to the Group is that Cenkos' income is dependent on the health of the financial markets and in particular the economic conditions of the UK.

In addition to this, the key risk areas that could impact the Group - and how they are managed - are categorised as follows:

- reputational risk;
- operational risk, including regulatory risk, people risk and litigation risk;
- credit risk; and
- market risk and liquidity risk.

### **Reputational risk**

The Group believes that one of the greatest risks it faces comes from the potential loss of its reputation. Whilst entrepreneurial employees are encouraged to develop new clients and streams of revenue, all new business is subject to a rigorous appraisal process from the New Business Committee to ensure that it

meets the Group's strict criteria. The Group also aims to demonstrate the highest level of integrity in all of its activities and the Executive Management Committee as well as Group Compliance instils awareness in all employees of the need to display the highest ethical standards and confidentiality in all the work that they undertake for the Group.

### ***Operational risk***

Operational risk is the risk that the Group suffers a loss directly or indirectly from inadequate or failed internal processes, people, systems, or external events. Group Compliance and senior management closely ensure that the risk framework is working well and that any significant operational risks and their controls are continually reviewed, tested and assessed and, where applicable, corrective action plans are put in place. There is also an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, including fraud. Cenkos' low cost and responsive business model relies on consistent delivery from its key suppliers for its trading and settlement systems. Cenkos maintains regular dialogue and meetings with these vendors and the risk framework ensures there is the necessary oversight of these outsourcing risks.

Specific operational risks that are material to the Group's performance are regulatory risk, people risk and litigation risk. These are commented on in more detail below.

### ***Regulatory risk***

The Group's principal subsidiaries are regulated entities. The Board, Executive Management Committee and Group Compliance have established a strong culture of regulatory and legal compliance throughout the Group. Strong relations are maintained with the Group's regulators. There is strict adherence to applicable regulation, focusing particularly on our ongoing obligations and responsibilities as an AIM Nominated Advisor (Nomad) and a UK Listing Authority (UKLA) Sponsor. Cenkos continues to focus heavily on prudential risks to ensure the appropriate systems and controls, reporting, capital and liquidity requirements are in place to meet the ongoing obligations of an FSA regulated (BIPRU Investment) firm.

### ***People risk***

The Group's employees are its greatest asset and the future success of the Group depends on Cenkos' ability to attract and retain high quality employees. Failure to recruit or retain such employees could significantly affect the performance of the Group. Cenkos seeks to minimise this risk by creating the right culture and working environment and by rewarding employees through an overall remuneration package that is geared towards performance and share-based payments that align the interests of the employees and shareholders.

### ***Litigation risk***

There is always a risk that some form of litigious action may be taken against the Group. Before any decision to enter into litigation is made the Board, senior management and the Group's legal advisers will review all aspects of the case to assess and consider if it is in the best interests of the Group and ultimately the shareholders to either instigate proceedings or defend itself against litigation.

### ***Credit risk***

The Group faces limited credit risks in the normal course of business as its market making activities are carried out on a delivery versus payment basis. Hence any counterparty exposure here will manifest itself as either an operational risk (in the form of settlement risk), or a market risk in terms of an underlying exposure to equities.

### ***Market risk***

The Group is exposed to market risk arising from its short-term positions in predominantly market making stocks. To mitigate this risk the Group manages market risk by establishing individual stock limits and overall trading book limits. There are daily procedures in place to monitor the utilisation of these limits. These limits are reviewed on a continuous basis by the Chief Executive Officer and also by the Group Risk and Compliance Committee.

### ***Liquidity risk***

The Group is also exposed to liquidity risk being that it is unable to fund its commitments as and when they arise. To mitigate this risk, the Group has in place an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding and liquidity management requirements. The Board has oversight and approves the liquidity risk management framework and Individual Liquidity Adequacy Assessment report at least annually. The Group manages liquidity risk by maintaining adequate reserves and banking facilities, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. Given the nature of the Group's business, the Group does not run any significant liquidity mismatches, financial liabilities are on the whole short-term and the Group has sufficient cash retained to cover all these liabilities.

### **Satisfaction of capital requirements**

As noted earlier, Cenkos has a Board approved Internal Capital Adequacy Assessment Process (ICAAP), which documents senior management's assessment of the risk profile of the business and the resulting capital requirements. This ensures that the risk profile is assessed against mitigants and controls in place and that sufficient capital is maintained to withstand the resulting residual risk. This includes stress testing the results to ensure that there is adequate capital available under such conditions.

Cenkos calculates and reports its capital resources and requirements in accordance with the current FSA regulations as laid out in BIPRU. The following table summarises the capital resources available to Cenkos and the capital requirements under Pillar 1 and Pillar 2.

Our regulatory capital ratios continue to be strong, reflecting a sizable buffer over the FSA requirements.

		30/06/2011	31/12/2010	31/12/2010
		£ 000's	£ 000's	£ 000's
<b>Total capital held</b>				
<b>Tier 1 capital</b>				
Share capital		728	728	727
Share premium		-	-	22,700
Own shares		(2,147)	(2,147)	(2,037)
Revaluation Reserve		-	-	(48)
Retained earnings		28,135	27,134	6,626
Non-controlling interests		1,576	1,540	837
		28,292	27,255	28,805
Dividends declared		(3,848)	(3,822)	(4,279)
Deductions from Tier 1 capital		(4,366)	(4,073)	(4,961)
<b>Tier 2 and Tier 3 capital</b>		-	-	-
<b>Total capital</b>		<u>20,078</u>	<u>19,360</u>	<u>19,565</u>
<b>Pillar 1 Capital requirement</b>	<i>BIPRU calculation approach used</i>			
<b>Credit risk requirement</b>				
Non trading book	<i>Simplified approach</i>	1,098	1,118	926
Counterparty Risk	<i>Simplified approach</i>	8	57	19
<b>Market risk requirement</b>				
Position Risk	<i>Standardised approach</i>	1,407	1,012	1,042
Foreign Exchange Risk	<i>Standardised approach</i>	73	69	93
<b>Operational Risk requirement</b>	<i>Basic Indicator approach</i>	6,857	6,857	6,622
<b>Total Pillar 1 Capital requirement</b>		<u>9,443</u>	<u>9,113</u>	<u>8,702</u>
<b>Surplus over Pillar 1 requirement</b>		<u>10,635</u>	<u>10,247</u>	<u>10,863</u>
<b>Pillar 1 &amp; Pillar 2 Capital requirement</b>		12,087	11,664	12,444
<b>Surplus over Pillar 1 &amp; Pillar 2 requirement</b>		<u>7,991</u>	<u>7,696</u>	<u>7,121</u>