CITADEL | Securities

Citadel Securities (Europe) Limited

Pillar 3 Disclosures

31 December 2015

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1. Introduction

Company overview

Citadel Securities (Europe) Limited ('CSEL' or 'the Company') is a €730,000 full scope IFPRU investment firm regulated by the Financial Conduct Authority ('FCA'). The principal activities of the Company during 2015 are liquidity provision and proprietary trading in equities and financial derivatives across various European exchanges and liquidity provision in cleared swaps.

CSEL is a wholly-owned subsidiary of CLP Holdings IV LLC, a Delaware limited liability company. The Company is part of Citadel Securities, a liquidity provider across a range of asset classes including equities, options, futures, US treasuries, FX and interest-rate swaps. Citadel Securities is a division of the Citadel Group, a global financial services business founded in 1991 and headquartered in the United States. CSEL operates from a single location in London.

Disclosure overview

The prudential framework consists of three 'Pillars':

- Pillar 1 sets out the minimum capital requirements for the Company;
- Pillar 2 deals with the Internal Capital Adequacy Assessment Process ('ICAAP') and the Supervisory Review and Evaluation Process through which the Company and the regulator satisfy themselves regarding the adequacy of capital; and
- Pillar 3 aims to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on a firm's capital resources, risk exposures and risk assessment process.

Information in this report are prepared in accordance with the Pillar 3 disclosure rules as required by the EU's Capital Requirements Regulation ('CRR'), supplemented by the Financial Conduct Authority ('FCA') Prudential sourcebook for Investment Firms ('IFPRU').

The Pillar 3 disclosures have been prepared solely to comply with regulatory requirements to provide public information on: the Company's risk management objectives and policies; its capital position; its capital resources requirements under Pillar 1; and its approach to assessing the adequacy of capital. The data presented in this report refers to the CSEL regulatory position as at 31 December 2015 and should be read in conjunction with the Company's annual report and financial statements.

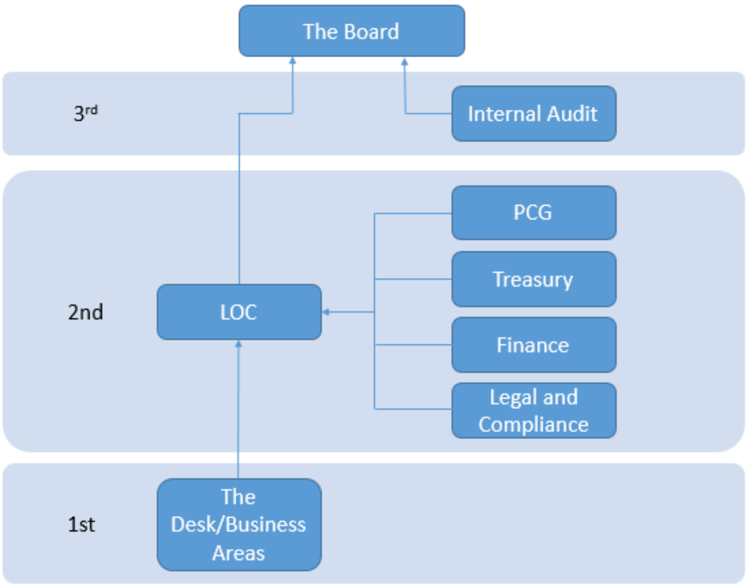
In accordance with CRR, the disclosures are issued as a minimum on an annual basis and published on the Citadel Group website www.citadel.com. The disclosures are reviewed and approved by the Company's senior management and Board of Directors. CSEL is not part of a Group for the purposes of CRR disclosure requirements and is regulated by the FCA on a 'solo' basis.

2. Risk management framework

CSEL's Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The framework includes:

- the process of identifying the principal risks faced by the Company in achieving its strategic objectives;
- establishing appropriate tolerances, limits and controls to manage those risks; and
- ensuring that appropriate monitoring and reporting systems are in place such that controls remain robust and evolve with the changing risk profile of the Company.

The organisational structure is designed to facilitate risk management through three lines of defence, as illustrated below:



Risk is monitored first by the trading desk. Each businesses area is responsible for managing this risk, in real time and in accordance with the firm's overall risk appetite.

Secondly, risk is monitored by the Portfolio Construction Group ("PCG"), the global independent risk control function for the Citadel Group. The support functions including Treasury, Finance, Legal and Compliance help to assess and monitor significant categories of the firm's risk to ensure risk is managed holistically on a day-to-day basis. The organisation framework for risk management is designed to facilitate reporting and escalation of risks to the London Operating Committee ('LOC') and the Board of Directors depending on their severity.

The third line of defence is the firm's internal audit function. The internal audit function provides an objective and independent assessment of the adequacy and effectiveness of the internal controls across the business and reports to the Company's Board of Directors and Internal Audit Committee.

3. Risk exposure overview

CSEL conducts a comprehensive risk identification exercise by risk category across the business to ensure that all significant risks have been identified, assessed and are effectively managed. All significant risks are assessed and documented along with any risk mitigants and associated controls. The resulting risk exposure level is estimated using a matrix of parameters. These risks are then monitored real-time, daily or monthly as appropriate via key risk indicators. Any breaches against agreed risk tolerances are escalated through the governance process.

A high level risk assessment for CSEL is provided below.

Market risk

Market risk is the potential for changes in the value of investment positions due to changes in market conditions. Market risk is directly impacted by the volatility and liquidity in the markets in which the related underlying financial instruments are traded. Categories of market risk include equity position risk, foreign exchange risk and interest rate risk.

Equity position risk is the risk of loss due to changes in prices and volatilities of individual equities, baskets of equities and equity indices. Risk tolerances are set for both intra-day and end of day positions and are monitored by the independent risk control function.

Foreign exchange risk is the risk of loss due to the fluctuation of exchange rates. The valuation of the portfolio is subject to foreign exchange risk arising from non-US dollar positions. This risk is managed by the Treasury team through monitoring and hedging foreign exchange exposures on a daily basis.

Interest rate risk is the risk of loss due to changes in the level, slope and curvature of yield curves. The Company is primarily exposed to interest rate risk through its interest rate swap market making activity. The business only trades cleared interest rate swaps and seeks to maintain a relatively flat risk ladder with automated hedging of the duration risk. The Company does not carry any material interest rate risk in its non-trading book.

Credit risk

Credit risk is the risk of financial loss due to the failure of a counterparty to meet its obligations as they fall due. CSEL adopts the standardised approach to credit risk and further information is presented in section 5 of this report. The Finance team monitors the credit risk exposure by counterparty on a daily basis.

Counterparty credit risk is the risk of loss as a result of a party to a transaction defaulting before the final settlement of the transaction's cash flows. The credit quality of counterparties with whom CSEL transacts is monitored by the Treasury function. The Company primarily clears its securities transactions through highly rated prime brokers and clearers or directly via its membership with LCH SwapClear. Although concentrated across a small number of prime brokers the total amount of credit risk in the trading book is small given all trading is carried out on-exchange. The exchange margin is reconciled daily with resulting cash flows being closely controlled on a daily basis.

Citadel monitors the amount of business across all trading relationships on a global basis across the entire Citadel Group. Citadel endeavours to maintain a good balance of business across a range of prime brokers and bank counterparts.

Liquidity risk

The nature of the business means that CSEL runs a dynamic intra-day position in cash equities and cleared derivatives that requires liquidity in two forms: First, liquidity to manage risk positions in all market conditions; and second, funding to continue to clear and settle trades intraday and finance overnight positions.

The Company manages liquidity risk in line with its liquidity policy and documents its approach in the Individual Liquidity Adequacy Assessment ('ILAA'). The ILAA is reviewed by senior management and approved by the Board of Directors. The Company aims to ensure, as far as possible, that it has sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking damage to the Company's or the Group's reputation.

The Company monitors its liquidity position in real time and produces a daily summary report which is reviewed by senior management. Key risk indicators associated with liquidity risk are reported on a monthly basis. Cash positions are monitored and reconciled daily by the global cash management function.

Intraday projections of cash balances are monitored on a gross basis to ensure the Company is accurately forecasting any timing mismatches between paying and receiving funds. Both initial and variation margin levels are forecast and verified against the margin calls we receive.

Liquidity risk on derivatives positions are not managed on the basis of contractual maturity as they are typically frequently settled on demand at fair value.

Operational Risk

Operational risk is the risk of a material loss or other adverse impact resulting from inadequate internal processes, people or systems or external events. The Company seeks to minimise operational risk through implementing a structured controls framework and monitoring various Key Risk Indicators ('KRIs'). KRIs are tracked and presented to the LOC on a monthly basis, where the causes of any breaches of amber (monitoring) or red (requires escalation) thresholds together with suggested remedial action if required are discussed. Any breaches of red thresholds are also escalated for discussion at the following Board meeting.

4. Capital resources

CSEL continues to maintain a capital base that is appropriate to support the development of the business and to ensure regulatory capital requirements are met at all times.

The Company's capital resources are entirely made up of Common Equity Tier 1 permanent capital. CSEL has no long term debt and no intangible assets to deduct. There are no current or foreseen material practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities.

The table below summarises the amount and type of capital resources and provides a reconciliation to the balance sheet shareholder's equity as at 31 December 2015:

	31 December 2015 USD 000s
Share capital	8,000
Retained profits	99,361
Tier 1 capital	107,361
Total Capital Resources	**107,361**
Tier 1 capital	107,361
Unaudited earnings	12,092
Total financial statements shareholder's equity	**119,453**

5. Capital resources requirements

Credit Risk ('CR')

Credit risk arises from on and off balance sheet exposures held in the non-trading book. For CSEL this primarily consist of cash balances. The company adopts the standardised approach to calculate credit risk. External credit assessments provided by Moody's are used to assign credit quality step to the Company's exposures in various institutions. Risk weight is then applied to calculate the risk weighted exposure.

Claims on institutions have a residual maturity of less than 90 days with no material amounts falling due after 90 days. The Company has no financial assets which are past due or impaired.

Counterparty Credit Risk ('CCR')

Counterparty credit risk is the risk that a counterparty to a transaction could default before the final settlement of the transaction's cash flows. CSEL uses the mark to market method to calculate the potential future credit exposure.

Credit exposures

CSEL limits its credit risk such that the Pillar 1 credit risk capital charge (excluding the credit risk charge for the LCH Swapclear default fund contribution) is less than 10% of Tier 1 capital.

With respect to CSEL's credit exposure to LCH's default fund, a risk weighting of 1250% is applied to the pre-funded contribution to the default fund.

The following table shows the exposure classes and amounts associated with the credit quality steps and the relevant risk weightings at 31 December 2015:

	Credit Quality Step	Risk Weight ('RW')	CR Exposure USD 000s	CCR Exposure USD 000s	RW Exposure USD 000s
Exposure class					
Institutions (< 90 days)	1	20%	53,668	-	10,734
Institutions (< 90 days)	2	20%	12,243	5,199	3,488
Institutions (< 90 days)	3	20%	25,348	3,400	5,750
Total claims on institutions			**91,259**	**8,599**	**19,972**
Central Governments	1	0%	**36,270**	**-**	**-**
QCCP* (direct clearing)	N/A	2%	7,124	591,054	11,964
QCCP* (via institutions)	N/A	4%	-	39,615	1,585
QCCP* (default fund)	N/A	1250%	19,158	-	239,475
			26,282	**630,669**	**253,024**
Total RW exposures					**272,996**
CR and CCR Component		**8%**			**21,840**

*QCCP stands for qualifying central counterparty

The below table sets out the geographical analysis based on the domicile of the counterparties at 31 December 2015:

	UK USD 000s	Rest of Europe USD 000s	USA USD 000s
Exposure class			
Institutions	34,342	9,638	55,878
Central Governments	-	-	36,270
QCCP	656,951	-	-
Total exposures	**691,293**	**9,638**	**92,148**

Operational risk capital requirement

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, systems or controls. CSEL measures Pillar 1 operational risk using the basic indicator approach. The relevant indicator is the average of the Company's audited net income figures for the last 3 years, which is multiplied by 15% to arrive at the operational risk capital requirement. As at 31 December 2015, the company's operational risk capital requirement is USD 10,137,000.

Market risk capital requirement

Market risk is the risk of loss in the value of financial instruments due to changes in market conditions. Categories of CSEL's market risk include equity position risk, foreign exchange risk and interest rate risk. The Pillar 1 charge for interest rate risk is calculated using the duration-based method, as detailed in Article 340 of the CRR.

	31 December 2015 USD 000s
Capital resources requirements	
Interest rate position risk	4,543
Equity position risk	-
Foreign exchange position risk	438
Total market risk capital requirement	**4,981**

6. Leverage ratio

The leverage ratio is calculated as a percentage of CSEL's Tier 1 capital over its total exposure measure. The total exposure measure is the sum of exposure value of all assets and off-balance sheet items.

	31 December 2015 USD 000s
Tier 1 Capital	107,361
Leverage ratio exposure	874,918
Leverage ratio	**12.3%**

7. Pillar 2

Under Pillar 2, firms are required to undertake a regular assessment of the amounts, types and distribution of capital that they consider adequate to cover the level and nature of risks to which they are, or might be, exposed. The Internal Capital Adequacy Assessment Process ('ICAAP') allows CSEL to identify and assess risks that are inadequately covered or not covered at all under Pillar 1. It forms an integral part of the Company's risk management processes and capital management strategy. It is updated at least annually and is reviewed and approved by the Board of Directors.

CSEL has conducted a comprehensive risk identification exercise by risk category across the business to ensure that all significant risks have been identified and captured by the risk management framework. All significant risks are assessed and documented along with any risk mitigants and associated controls. The resulting risk exposure level is estimated using a matrix of parameters. An aggregate exposure per risk category of 'Medium' (i.e. there is a predominance of medium exposure individual risks within the category) is deemed to be acceptable to the firm as long as it is within CSEL's risk appetite and a Pillar 2 provision is made if appropriate.

8. Remuneration

All staff are employed by a related entity, Citadel Investment Group (Europe) Limited ('CIGE') and an appropriate proportion of employment costs is allocated to CSEL.

The remuneration policy has been adopted by the by the Board of Directors who have the ultimate responsibility for its implementation. CIGE has established a compensation oversight body, made up of US and UK based Citadel senior management who are tasked with overseeing the implementation of the remuneration policy and ensuring that the remuneration of code staff is in line with the principles set out in the policy.

CIGE's compensation plan is composed of base salary (fixed remuneration), participation points (variable remuneration) and benefits. Participation points are issued as short-term points (cash) and long-term points (unvested equity interests in the form of unvested shares in a company formed by the Citadel Group for its employees that itself is invested in certain funds managed by the Citadel Group).

Participation points are awarded in respect of any calendar year during which employees are employed by CIGE. They are awarded on a discretionary basis based on (i) personal performance and demonstration of Citadel values and the Citadel leadership model; and/or (ii) firm-wide or team performance results if appropriate.

Total remuneration allocated to CSEL by CIGE in 2015 was as follows:

	Fixed Remuneration USD 000s	**Variable Remuneration USD 000s**	**Number of Beneficiaries**
Code Staff	1,721	2,642	13
Non-code Staff	2,293	2,447	
Total	**4,014**	**5,089**	