



# HARGREAVES LANSDOWN PLC

## PILLAR 3 DISCLOSURES

BASED ON FINANCIAL DATA AS AT 30 JUNE 2013

### TABLE OF CONTENTS

#### Contents

EXECUTIVE SUMMARY .....	1
1 Overview.....	2
2 Risk Identification, Assessment & Management .....	3
3 Capital Resources .....	7
4 Capital Adequacy.....	8
5 Credit Risk .....	10
6 Market Risk.....	13
7 Operational Risk .....	14
8 Reputational Risk.....	14
9 Business Risk.....	14
10 Remuneration Code Disclosure .....	15

*Certain figures contained in this document, including financial information, have been subject to rounding adjustments. Accordingly, in certain instances the sum of the numbers in a column or a row in tables contained in this document may not conform exactly to the total figure given for that column or row*

#### EXECUTIVE SUMMARY

The board of Hargreaves Lansdown plc is pleased to confirm that;

- The CRD Group and Total Group financial resources sufficiently exceed the Pillar 1 capital requirements of £8.3m (Total Group £9.5m) with a surplus of £40.1m (Total Group £185.6m).
- Hargreaves Lansdown has a culture of risk awareness, enabling the Group to be proactive in identifying, controlling and mitigating risk.

# 1 Overview

## 1.1 Background

The European Union Capital Requirements Directive (“CRD”) created a revised regulatory capital framework across Europe, based on the provisions of the Basel II Capital Accord.

The CRD consists of three pillars:

- |          |  |
|----------|--|
| Pillar 1 | The minimum capital requirements of firms to cover credit, market and operational risk;  |
| Pillar 2 | Designed to complement the existing Pillar 1 requirements by assessing the need to hold additional capital under a more risk based assessment; and |
| Pillar 3 | A set of disclosure requirements which enable the market to assess information on firm’s risks, capital and risk management procedures.            |

The detailed assessment of the requirements under Pillars 1 and 2 are carried out within the Internal Capital Adequacy Assessment Process (ICAAP).

The disclosure of this document meets Hargreaves Lansdown’s obligation with respect to Pillar 3. In this document we disclose information in accordance with the Financial Conduct Authority’s (“FCA”) BIPRU 11.5 Rules. The FCA rules governing Pillar 3 disclosures provide that the Group may choose not to disclose information which is not material. The Group 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).

Hargreaves Lansdown plc is a Parent Institution of a Group that is regulated by the FCA. The FCA supervises the Group on a consolidated basis and receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. In addition a number of subsidiaries are directly regulated by the FCA. The Basel II Framework therefore applies to the Parent Company, Hargreaves Lansdown plc, and its regulated subsidiaries.

The principal trading subsidiaries, Hargreaves Lansdown Asset Management Limited (“HLAM”), Hargreaves Lansdown Stockbrokers Limited (“HLSB”), Hargreaves Lansdown Fund Managers Limited (“HLFM”) and Hargreaves Lansdown Advisory Services Limited<sup>1</sup> (“HLAS”), are authorised and regulated by the FCA.

These trading subsidiaries are classed as Limited Licence firms (BIPRU 1.1.12R) subject to CRD, with the exception of HLAS, which is categorised as a type B3 firm under the IPRU (INV) rules for investment firms and as such has not fallen within the remit of CRD. The consolidated figures presented for CRD purposes (the “CRD Group”) only includes the three regulated subsidiaries which are subject to CRD.

The accounting consolidation for the annual financial statements includes all entities controlled by Hargreaves Lansdown plc. A list of the principal Group subsidiaries can be found in Note 15 of the 2013 Annual Report and Financial Statements. The total Group consolidation (“Total Group”) includes the whole of the Hargreaves Lansdown Group and so also includes Library Information Services Limited (“LIS”) (an online fund data repository specifically designed to meet the needs of professional data users), HLAS, the Parent Company, the Employee Benefit Trusts (“EBTs”) and a number of dormant subsidiary companies. All subsidiaries are wholly owned with the exception of LIS (75% owned).

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<sup>1</sup> During the year as part of a restructuring exercise, Hargreaves Lansdown Pensions Direct Limited changed its name to Hargreaves Lansdown Advisory Services Limited.

The EBTs are included within the Total Group consolidation but the EBT Reserves as shown in Section 3 are not distributable by the company, as the assets and liabilities of the EBTs are subject to management by the Trustees in accordance with the EBT trust deeds.

Apart from the restriction on EBT reserves noted above, the FCA requirements to hold regulatory capital in individual regulated entities and corporate law restrictions on the reduction, redemption and purchase of share capital, there are no practical or legal impediments to the prompt transfer of capital between Hargreaves Lansdown plc and its subsidiaries.

### **1.3 Frequency**

Pillar 3 disclosures will be made on an annual basis as soon as practicable after the publication of the Group's annual report.

### **1.4 Location**

The Pillar 3 disclosure report will be published in the Investor Relations section of the Hargreaves Lansdown website ([www.hl.co.uk](http://www.hl.co.uk)), and will also be available on request by writing to Investor Relations.

### **1.5 Verification**

Disclosures will only be subject to external verification to the extent they are equivalent to those taken from the audited annual financial statements. These disclosures explain how the Board have calculated certain capital requirements and information about risk management generally. They do not constitute financial statements and should not be relied upon in making judgements about the Group.

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## **2 Risk Identification, Assessment & Management**

### **2.1 Summary of the Risk Management process**

The Group's overall risk appetite is low. The Group acknowledges that all activities have an associated element of risk and therefore risk tolerance and appetite varies by risk category. Due to the diverse nature of the services offered by Hargreaves Lansdown, and the fact that not all risks can be transferred to third parties through insurance policies, contracts or waivers, the management of residual risk at all levels of the organisation is imperative.

Risk management is embedded in business divisions through a matrix of risk managers who identify, score and action risks. These risk managers report through a Board Executive (the Chief Operating Officer) who is independent of Business Unit Directors and communicates risk appetite and tolerances to them on behalf of the Board. Risk appetites and tolerances are reviewed and approved annually by the Board, led by the Chief Operating Officer, the Director responsible for risk management.

Risk management is a continuous and developing strategy at Hargreaves Lansdown. We believe it is integrated into our culture and led by senior management, who translate the risk strategy into operational objectives. Responsibility for risk is assigned to ensure clear reporting lines and defined areas of responsibility at board, divisional and business level.

### **2.2 Group Risk Management Framework**

Hargreaves Lansdown has adopted a "Three Lines of Defence" model to manage its risks. Primary responsibility for identifying, managing and mitigating risks falls to the senior

management in the individual operational areas (first line of defence). Oversight and day-to-day running of the risk function is provided by the Chief Operating Officer on an executive basis (second line of defence), reporting into the Audit Committee and the Board. Further challenge and interpretation is provided by the Risk Team. Finally, independent assurance is provided by the Group Internal Audit function, reporting into the Audit Committee (third line of defence).

This model is applied to the Group's risk register, which maintains a list of top 10 risks across the business. These risks are reviewed and assessed as part of the Group's Internal Capital Adequacy Assessment Process (ICAAP). For each risk, the following risk management practices have been adopted in line with the Group Risk Management Framework:

Risk measurement  
Risk mitigation  
Risk monitoring and reporting

In addition to this top level risk register, each operational area also maintains their own list of risks related to their areas. These are prioritised and link into both the high level and top level risk registers.

#### **Risk measurement**

Each risk is given a weighting to show its probability and its impact. This is used to rank them as high, medium or low risks.

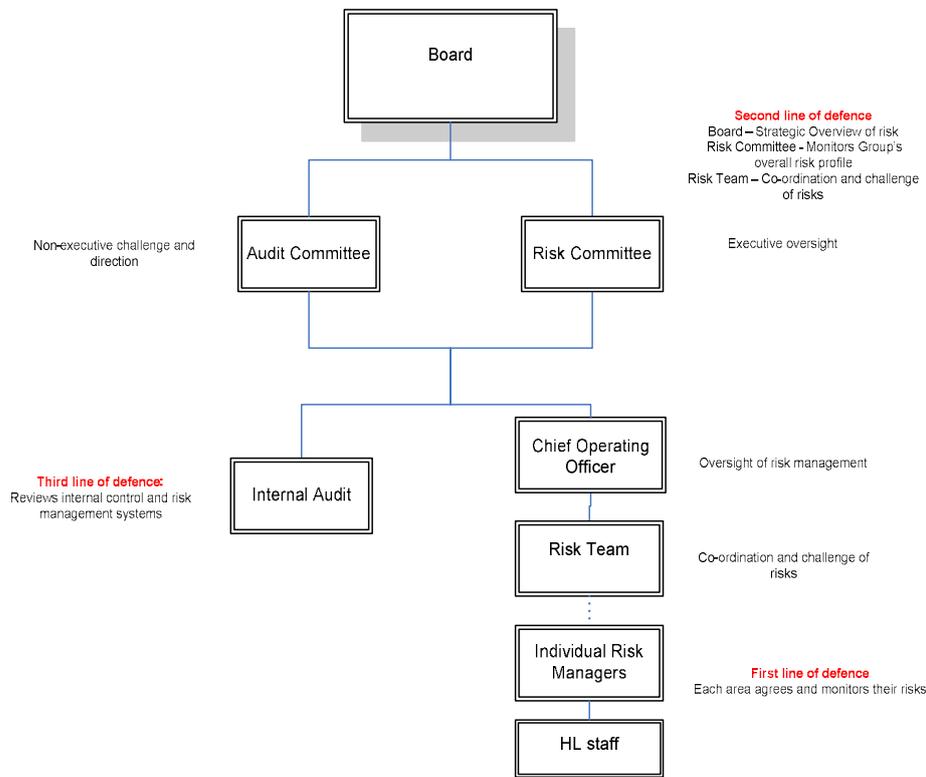
#### **Risk mitigation**

The top 10 risk register contains details of each risk and a list of actions which will be introduced to help mitigate each risk. All red and amber risks on the underlying registers have either an action to mitigate the risk or a moderator note to explain why no further action is currently planned. This could be because we choose to accept the risk.

#### **Risk monitoring and reporting**

A reporting and review structure is required to ensure risks are effectively identified and appropriate controls and responses are in place.

Responsibilities for the Group's main risks have been allocated as follows:



### First line of defence: operational senior management responsibilities

Responsibility for risk management lies with the HL staff. The senior managers appointed for each individual risk area are responsible for promoting risk awareness and ensuring a risk register is maintained for their area. Individuals are held accountable for their own decisions and actions. No-one can assume that risk is not their responsibility. Constant communication is encouraged. Information is provided to staff in the form of risk booklets and email reminders. A guidance document on the risk management framework and ICAAP is provided to all risk managers to support them in carrying out their risk management responsibilities. Further training is provided when a need is identified.

### Second line of defence: Board-Committee responsibilities

Responsibility for risk oversight and governance lies with the Board. The day-to-day oversight of risk management is handled by the Chief Operating Officer and the Risk Committee, which reports into the Audit Committee and the Board. The Board is responsible for determining the strategic direction of the organisation and creating the environment within the company to operate risk management effectively. The “Risk Team”, (made up of the Chief Risk Officer supported by two risk managers), is responsible for co-ordination and challenge of risks, reporting into the Chief Operating Officer.

### Third line of defence: Internal Audit responsibilities

Responsibility for providing assurance on the control of risk within the Group lies with the Internal Audit function, which reports into the Audit Committee. The Internal Audit function also assists with building risk awareness within the culture of the organisation through raising challenges where it deems appropriate. The Audit Committee ensures that internal audit work is focussed on areas of significant risk and provides assurance on the management of risk.

## 2.4 Summary of risks

The Group considers that its exposure to high level risks can be classified into the following FCA prescribed risk classes:

### Pillar 1

Credit risk (see section 5)

Market risk (see section 6)

\*Operational risk (see section 7)

### Pillar 2

Concentration risk (see section 5.4)

Reputational risk (see section 8)

Business risk (see section 9)

\* As a Limited Licence Group, Hargreaves Lansdown is not required to hold capital at Pillar 1 under the FCA's standardised approach to operational risk.

These risks are defined and discussed in detail in sections 5 to 9 of this document.

### 3 Capital Resources

The Group has complied with the capital requirements set out by the FCA. The following table shows the breakdown of the total available capital for the CRD Group and Total Group.

#### Tier 1 Capital Resources

	CRD Group Total		Total Group	
	At 30 June 2013	At 30 June 2012	At 30 June 2013	At 30 June 2012
	£'000	£'000	£'000	£'000
Ordinary Share Capital	121	121	1,897	1,897
Capital Redemption Reserve	-	-	12	12
Share Premium	29	29	8	8
Investment Revaluation Reserve	-	-	0	160
Retained earnings	48,953	41,919	203,037	159,356
EBT Reserve (Non Distributable)			(7,809)	(4,016)
Share Option Reserve	0	(18)	0	0
Sub-total	<b>49,103</b>	<b>42,051</b>	<b>197,146</b>	<b>157,418</b>
Less Intangible Assets (1)	(657)	(162)	(686)	(168)
Goodwill			(1,333)	(1,333)
Total Tier 1 Capital Resources	<b>48,446</b>	<b>41,890</b>	<b>195,127</b>	<b>155,917</b>

Note: (1) Intangible assets represent software costs.

The entire base of capital resources can be regarded as Tier 1 Capital, which is the total of issued share capital, retained earnings and reserves created by appropriations of retained earnings, net of the book value of goodwill and other intangible assets, in other words the most robust category of financial resources against which all requirements can be measured.

For accounting purposes, software and development costs are capitalised as intangible fixed assets where they meet certain criteria. Intangibles do not qualify as capital for Tier 1 purposes and are therefore deducted.

Hargreaves Lansdown currently has no innovative Tier 1 capital instruments.

## 4 Capital Adequacy

### 4.1 Capital Management

Capital is defined as the total of share capital, share premium, retained earnings and other reserves. Total capital at 30 June 2013 was £197.1 million (2012 – £157.4m) and this capital is managed via the net assets to which it relates.

Regulatory capital is determined in accordance with the requirements of the CRD prescribed in the UK by the FCA, and the Group's regulatory capital is divided into two tiers:

Tier 1 capital, which is the total of issued share capital, retained earnings and reserves created by appropriations of retained earnings, net of the book value of goodwill and other intangible assets; and

Tier 2 capital is unrealised gains arising on the fair valuation of equity instruments held as available for sale. The Group has had no Tier 2 capital since 30 June 2007.

The Group's objectives when managing capital are i) to comply with the regulatory capital requirements set by the FCA; ii) to safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and iii) to maintain a strong capital base to support the development of its business.

Since 1 January 2007, all qualifying regulated entities within the Group have been required to meet the Pillar 1 regulatory Capital Resources Requirements (CRR) set out in the CRD. The CRR is the higher of i) the fixed overhead requirement and ii) the sum of the credit risk capital requirement and the market risk capital requirement.

Since 1 January 2008, all qualifying regulated entities within the group have also been required to meet further requirements of the Directive under Pillar 2 (operational risk). The Directive requires continual assessment of the Group's risks in order to ensure that the higher of Pillar 1 and 2 requirements is met, the objective being to ensure that the regulated firms have adequate capital to enable them to manage their risks. The Group completes an assessment of regulatory capital requirements at least annually. This includes its Individual Capital Adequacy Assessment Process (ICAAP) under Pillar 2, which is a forward looking exercise undertaken twice a year and reviewed throughout the year. The ICAAP includes stress testing on major risks, such as a significant market downturn or brand destruction, and identifying mitigating action.

During the 2013 financial year we held a healthy margin of at least 7 times the Pillar 1 minimum capital requirement across the four regulated subsidiaries. This was equal to a margin of approximately three times the Pillar 2 capital requirement, which is our own assessment of the minimum amount of capital that we believe is adequate as identified during our Individual Capital Adequacy Assessment Process (ICAAP).

Pillar 2 capital requirements are outside the scope of this disclosure document. The Group does not foresee any significant change in the level of capital required to satisfy prudential regulations.

All of the regulated firms maintained surplus regulated capital throughout the year. Capital adequacy and the use of regulatory capital are monitored by the Group's management.

## 4.2 Pillar 1 minimum capital requirement

Hargreaves Lansdown's overall minimum capital resource requirement under Pillar 1 is the greater of the Credit (+ Market) risk and the Fixed Overhead requirement for those firms subject to the CRD.

### Minimum capital requirement for credit risk:

The following table shows Hargreaves Lansdown's overall minimum capital requirement for credit risk under the standardised approach (expressed as 8% of the risk weighted exposure amounts for each of the applicable standardised credit risk exposure classes):

Exposure classes	CRD Group	
	At 30 June 2013 £'000	At 30 June 2012 £'000
Central Governments	121	79
Financial Institutions	1,693	580
Corporate clients	59	42
Individual clients	65	67
Past Due Items	32	13
Fixed assets	773	458
Investments	44	42
Intra Group	29	82
Credit risk minimum capital requirement	<b>2,816</b>	<b>1,363</b>

Hargreaves Lansdown's capital requirement is calculated by adding the Credit Risk requirement detailed above to the Position Risk Requirement (CIU PRR) element of Market Risk.

### Minimum capital requirement for operational risk:

Operational risk is defined by the FCA as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk. As a Limited Licence Group, Hargreaves Lansdown is not required to hold capital at Pillar 1 under the FCA's standardised approach to operational risk (BIPRU 6.1.1 (1)) and has not done so.

### Minimum capital requirement for market risk:

The Pillar 1 Market Risk requirement is based on trading book positions undertaken by the Group. None of the subsidiary companies trades as principal and therefore the Group has little direct exposure to Market Risk. The only position held is in the books of HLFM, this being the "manager's box" which is required as a day to day trading balance for the creation and cancellation of units. This position is assigned a 32% risk weighting in accordance with BIPRU 7.7.5 and as at 30 June 2013 the market risk requirement was £19,000 (2012 - £16,000).

## Total Pillar 1 Minimum capital requirement:

	CRD Group Total		Total Group	
	At 30 June 2013 £'000	At 30 June 2012 £'000	At 30 June 2013 £'000	At 30 June 2012 £'000
Credit Risk (Standardised)	2,816	1,363	2,816	1,363
Market Risk (CIU PRR)	19	16	19	16
(A) Total Credit risk + Market risk	2,835	1,379	2,835	1,379
(B) Fixed Overhead Requirement	8,297	6,771	9,526	8,363
Pillar 1 capital requirement equals the higher of (A) & (B)	8,297	6,771	9,526	8,363
Total tier 1 capital	48,446	41,890	195,127	155,917
Excess of own funds over minimum capital requirement under Pillar 1	<b>40,148</b>	<b>35,118</b>	<b>185,602</b>	<b>147,554</b>

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## 5 Credit Risk

### 5.1 Credit Risk overview

Credit risk is the risk of loss if another party fails to perform its obligations or fails to perform them in a timely fashion.

Within the Group's stockbroking operations, the Group is exposed to credit risk from counterparties to a securities transaction during the period between the trade date and the settlement date. This period is generally three business days. The Group has credit exposure that extends beyond the original settlement date if the counterparty fails either to make payment or to deliver securities. These transactions are with financial institutions and clients.

Settlement risk is substantially mitigated as a result of the delivery versus payment mechanism whereby if a counterparty fails to make payment, the securities would not be delivered to the counterparty. In that instance, the securities could be sold in the market and therefore the economic substance of the transaction is that securities serve as collateral in the case of delivery versus payment trade debtors. As a result, the risk exposure is effectively limited to an adverse movement in market prices between the time of trade and settlement. Client side settlement risk is mitigated by the procedures and controls operated within the settlements function. Also, in general, deal sizes are relatively small (average deal size in the year to 30 June 2013 was £2,811 (2012 – £2,537) therefore the firm's exposure to large deals is limited.

Other credit risk within the Group is primarily attributable to fixed assets and trade receivables. The majority of trade receivables represent balances due from other regulated financial institutions where there is an ongoing relationship between the Group and institution. The amounts presented in the balance sheet are net of allowances for doubtful receivables. An allowance for impairment is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of the cash flows.

Cash is held with UK banks. The group considers the credit risk on liquid funds to be limited. The counterparties are UK licensed banks, some of which have significant government ownership. The Group takes what it considers to be a conservative approach to treasury management and selection of banking counterparties, and carries out frequent reviews of all its banks' and custodians' ratings in addition to ongoing monitoring of treasury policy and suitability of banking counterparties.

## 5.2 Gross & average credit risk

The gross credit risk exposure as at 30 June 2013 and the average exposure for the year was as follows;

	<b>CRD Group Total £'000</b>	<b>Total Group £'000</b>	<b>Average Total Group exposure £'000</b>
<b>Financial Institution:</b>			
Counterparties	29,286	13,614	
Past Due counterparties	(297)	(297)	
<b><i>Total Financial Institution counterparties</i></b>	<b><i>28,990</i></b>	<b><i>13,317</i></b>	<b><i>11,157</i></b>
Revenue items	42,735	44,586	
Past Due revenue items	1,149	1,860	
<b><i>Total Financial Institution revenue items</i></b>	<b><i>43,884</i></b>	<b><i>46,445</i></b>	<b><i>52,944</i></b>
<b>Corporates</b>			
Corporates	3,701	3,830	
Past Due Corporates	98	98	
<b><i>Total Corporates</i></b>	<b><i>3,799</i></b>	<b><i>3,928</i></b>	<b><i>2,588</i></b>
<b>Individual Clients:</b>			
Individual client counterparties	198,040	198,040	
Past Due counterparties	778	778	
<b><i>Total Individual Client counterparties</i></b>	<b><i>198,818</i></b>	<b><i>198,818</i></b>	<b><i>155,410</i></b>
Revenue items	1,475	2,137	
Past Due revenue items	(241)	(241)	
<b><i>Total individual client revenue items</i></b>	<b><i>1,234</i></b>	<b><i>1,896</i></b>	<b><i>2,550</i></b>
<b>Total Exposure</b>	<b>276,725</b>	<b>264,403</b>	<b>224,648</b>
<b>Institutions – Banks</b>			
Restricted cash – client settlement account balances	3,250	19,812	16,342
Restricted cash – held by EBT	-	37	1,031
Group cash balances (unrestricted)	43,819	177,717	139,022
<b>Total cash and cash equivalents</b>	<b>47,069</b>	<b>197,566</b>	<b>156,395</b>

In relation to amounts due to the Total Group from financial institutions, £13.6 million is due in the course of settlement as a result of daily trading. In addition, (£297k) is Past Due in respect to daily trading. The remaining £46.4 million is mainly made up of accrued interest and renewal commission due from financial institutions regulated by the FCA.

Corporate items due are prepayments relating to businesses other than financial institutions - mainly suppliers.

Of the individual client balances due, £198.8million relates to amounts due in the course of settlement as a result of daily trading. The remaining £1.9 million is mainly management fees and initial charges relating to the Portfolio Management Service.

An asset is Past Due when the counterparty has failed to make a payment when contractually due. The date of settlement of market transactions is set at the time that the relevant sale or purchase order is placed with the market. In the normal course of business certain transactions may not complete by the recorded settlement date, for instance an extended settlement period may result from a shortage of the relevant stock in the market, in which case the order remains outstanding until all of the required quantity of stock has become available. The balances that remain outstanding after the settlement date are classified as Past Due in the table above, but the extended settlement period does not indicate a lower credit quality of the balances, as the related cash or stocks to which the balances relate are retained by the Group until settlement occurs.

### 5.3 Credit Risk Maturity

The residual maturity of the exposures as at 30 June 2013 is as follows:

	Neither Impaired Nor Past Due	0-3 months Past Due	More than 3 months Past Due	Total
	£'000	£'000	£'000	£'000
Financial Institutions	72,021	667	186	72,874
Corporates	3,701	45	53	3,799
Individual clients	199,515	725	(188)	200,052
<b>CRD Group Total</b>	<b>275,238</b>	<b>1,436</b>	<b>50</b>	<b>276,725</b>
Financial Institutions	58,199	1,239	324	59,762
Corporates	3,830	45	53	3,928
Individual clients	200,178	725	(188)	200,714
<b>Total Group</b>	<b>262,207</b>	<b>2,008</b>	<b>189</b>	<b>264,403</b>

### 5.4 Concentration Risk

Concentration risk is a component of credit risk, arising from a lack of diversity in business activities or geographical risk.

The business of Hargreaves Lansdown is undertaken within the financial services sector and predominantly with UK based clients and financial institutions. The risks arising are therefore concentrated within this business sector and geographical location.

The client base is broad without significant exposure to any individual client or group of clients. HLFM does have a greater exposure to concentration risk by virtue of a collection of client assets held within five multi-manager funds.

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## **6 Market Risk**

### **6.1 Market Risk overview**

Market Risk is the risk of an impact on the Group's financial position due to movements in interest rates, exchange rates or other market movements affecting the value of its trading book or any investments held.

The Group is exposed to Business risk arising from a downturn in stock markets and the subsequent fall in revenue from assets under administration.

### **6.2 Interest rate risk in the non-trading book**

The Group is directly exposed to interest rate risk. Interest rate risk is the risk that the Group will sustain a loss of revenue from adverse movements in its interest bearing assets. There is an exposure to interest rates on banking deposits held in the ordinary course of business. At 30 June 2013 the value of financial instruments on the Group balance sheet exposed to interest rate risk was £198 million (2012- £158 million) comprising cash and cash equivalents. Exposure to interest rate risk arising on the Group's cash deposits is mitigated by cash deposits generally being held on terms that allow for repayment on demand.

The Group has no external borrowings and as such is not exposed to interest rate or refinancing risk on borrowings.

As a source of revenue is based on the value of client cash under administration, the Group has an indirect exposure to interest rate risk on cash balances held for clients. These balances are not on the Group balance sheet.

The Group is also exposed to Business risk arising from the impact of interest rates on the wider investment market as the Group derives revenue from assets under administration.

### **6.3 Foreign exchange risk**

The Group is not exposed to any material foreign exchange risk.

### **6.4 Trading book position risk**

HLAM and HLSB have no trading books, and thus do not attract a Pillar 1 requirement for Market Risk. The only trading book exposure is the box position in HLFM which arises in its role as manager of unit trusts. This is calculated under Pillar 1 as explained in section 4.2 above and is not considered to be material for Pillar 2 purposes.

### **6.5 Non-trading book exposures in equities**

At 30 June 2013, the Group had £0.6 million (2012 - £2.2 million) of equity investments in the non-trading book, of which £0.3 million (2012 - £1.9 million) were classified as available for sale and £0.3 million (2012 - £0.3 million) as held at fair value through profit or loss under the fair value option. Listed investments amounted to £0.3 million (2012 £1.5 million) with the remainder being unlisted.

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## 7 Operational Risk

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. It includes legal and financial crime risks, but does not include strategic, reputation and business risks. The Group seeks to mitigate Operational Risk in accordance with its risk management process outlined in section 2.

As a Limited Licence Group, Hargreaves Lansdown is not required to hold capital at Pillar 1 under the FCA's standardised approach to Operational Risk and has not done so.

In assessing Operational Risk under Pillar 2, particular consideration was given to technology, IT and systems, and areas that can give rise to regulatory penalties. A potential loss value was then calculated using hypothetical scenarios, taking into account the likelihood of the event arising. Mitigating actions to reduce the impact were then also considered in calculating an adequate amount to be held as Pillar 2 capital. The Group maintains insurance against a number of major operational risks.

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## 8 Reputational Risk

Reputational Risk is the risk that any event or circumstance occurs that could adversely impact the Group's reputation. The effect could be a loss of confidence in the business by clients which would ultimately affect the ability to generate income.

In addition to the risk management process in section 2, the Group's main mitigation against Reputational Risk is to employ appropriately qualified staff in all areas of the business to ensure high standards of client service, adequate processes and controls, and to ensure that industry requirements are satisfied. Appropriate training is provided to ensure that the technical knowledge and competence of staff remains consistent with current FCA requirements and industry standards. For CRD purposes, the Pillar 2 capital requirement for reputational risk has been assessed and a potential loss value was then calculated. Mitigating actions to reduce the impact were then also considered in calculating an adequate amount to be held as Pillar 2 capital.

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## 9 Business Risk

Business Risk is the exposure to uncertainty in the macroeconomic environment. Business Risk is managed with a long-term focus, assisted by appropriate management oversight and a corporate governance framework.

The most significant Business Risk exposure to Hargreaves Lansdown is a severe and prolonged downturn in financial markets. The Group assesses a Pillar 2 capital requirement in respect of this risk by projecting the effects of this scenario and also by considering the mitigating action which could be taken to reduce the effect.

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## 10 Remuneration Code Disclosure

The Remuneration Committee is responsible for the framework or broad policy for the fair remuneration of the “Code Staff” (as defined in accordance with the FCA’s Remuneration Code (“the Code”)) as well as their performance management. The policy is determined with due regard to the interests of the Company and the Shareholders. The Committee makes recommendations to the Board. No director plays a part in any discussion about his or her own remuneration.

The Remuneration Committee meets at least twice per year and is governed by formal Terms of Reference, which are reviewed annually. The Remuneration Committee is comprised of three independent non-executive directors and the non-executive Chairman of the Group. The Committee appointed and received advice from:

TLT LLP: legal advice drafting the rules for the executive share option scheme and bonus deferral plan. They also provided employment law advice to the Group.

The Committee’s purpose is to:

- determine and recommend to the Board the remuneration policy for the executive Directors of the Company and of the subsidiary companies “Directors” and other “Code Staff”;
- ensure the level and structure of remuneration is designed to attract, retain, and motivate the executive Directors needed to run the Company and the Group; and
- monitor the level and structure of remuneration for senior management.

The performance measurement of the Directors and key members of senior management and the determination of their annual remuneration package are undertaken by the Committee. The Committee also ensures that the remuneration relationship between the Directors and senior employees of the Company is appropriate. Any exceptional remuneration arrangements for senior employees are advised to the Committee.

The principles of the Hargreaves Lansdown Remuneration Policy for Directors is as follows:

- Attract and retain Directors of the calibre needed to maintain the Group’s position as a market leading financial services company.
- Reward Directors for enhancing shareholder value and acting in the long-term interests of the Company.
- A significant proportion of total remuneration should be performance-related.
- Pay moderate base salaries but give Directors the opportunity to earn performance-related bonuses for exceptional performance.
- Long-term retention is achieved through participation in long-term incentives and direct share ownership.
- Provide a modest defined contribution pension scheme with the opportunity for staff and directors to contribute more through salary and/or bonus sacrifice.

Directors may be paid a discretionary Performance Bonus for each financial year of the Company. Performance Bonuses are determined based on performance in the year assessed against a number of key areas of performance. Annual Performance Bonuses are non-pensionable. Performance Bonuses will be materially affected if either the Group or an individual falls short of performance expectations. No Performance Bonus will be paid should the Committee consider it inappropriate.

There is a deferral element to the Performance Bonus. For the year ended 30 June 2013, 10% of all Performance Bonuses were waived in favour of deferred awards. The deferred awards will ordinarily be over shares on which dividends (or dividend equivalents) are earned. However, providing the Director satisfies the minimum shareholding target with reference to base salary, the option is given for deferred awards to be in shares on which dividends (or dividend equivalents) are earned, in cash on which no interest will be earned, or a mixture of shares and cash. The right to exercise deferred awards will vest after three years provided the individual remains employed by the Hargreaves Lansdown Group.

Criteria for the annual performance bonus are determined by the Group's performance and personal performance as follows:

Group performance:

- Success in gathering profitable client assets
- Improving and maintaining long-term profitability
- Robustness, sustainability and scalability of operations
- Risk management
- Compliance
- Client satisfaction

Personal performance:

- Setting direction
- Executing new initiatives
- Improving and protecting the client base
- Cost control
- Process improvement
- At least 3 role-specific objectives

Long term incentives are provided by the Share Option Plan under which regular grants are made each year at market value at the time of the grant. The extent to which a number of performance tests are met over a period of three years will determine the proportion of the share options that can be exercised by Directors.

Clawback provisions exist on the deferred element of the annual Performance Bonuses and unvested awards made under the Share Option Plan.

In the performance year ending 30 June 2013, 22 Code Staff received total remuneration of £9,460,000.

Hargreaves Lansdown is a Tier 3 firm for Remuneration Code purposes.