BrokerCreditService (Cyprus) Limited

# RISK MANAGEMENT DISCLOSURES

YEAR ENDED 31 DECEMBER 2016

APRIL 2017

According to Part Eight of Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012

# Table of Contents

# 1. Introduction

## 1.1 Corporate Information

BrokerCreditService (Cyprus) Limited ("BCS" or "the Company") is authorised and regulated by the Cyprus Securities and Exchange Commission ("CySEC") as a Cyprus Investment Firm ("CIF") to offer Investment and Ancillary Services under license number 048/04, dated October 2004.

The Company has the licence to provide the following investment and ancillary services:

| Investment Services | Ancillary Services |
|---|---|
| Reception and transmission of orders in relation to one or more financial instruments | Safekeeping and administration of financial instruments, including custodianship and related services |
| Execution of orders on behalf of clients | Granting credits or loans to one or more financial instruments, where the firm granting the credit or loan is involved in the transaction |
| Dealing on Own Account | Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings |
| Portfolio Management | Foreign exchange services where these are connected to the provision of investment services |
| Investment Advice | Investment research and financial analysis or other forms |
| Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis | Services related to underwriting |
| Placing of financial instruments without a firm commitment basis | Investment services and activities as well as ancillary services where these are connected to the provision of investment or ancillary services |

## 1.2 Pillar 3 Regulatory Framework

### *1.2.1 Regulatory framework overview*

In 2013, the European Union adopted a legislative package to reinforce the regulation of the banking and financial services sector and to implement the Basel III agreement into the European Union's legal framework. The new package replaced the Capital Requirements Directives (2006/48 and 2006/49) with the Capital Requirements Regulation (EU) No. 575/2013 ("CRR") and the Capital Requirements Directive ("CRD IV") and is considered as a key step towards creating a sounder and safer financial system. The CRR and CRD IV came into force on 1 January 2014.

The CRR establishes the prudential requirements for capital, liquidity and leverage that entities need to abide by. It is immediately binding on all EU member states. CRD IV governs internal governance arrangements including remuneration, board composition and transparency. Unlike the CRR, CRD IV needs to be transposed into national laws, which allows national regulators to impose additional capital buffer requirements. The CRR introduced significant changes in the prudential regulatory regime applicable to credit and financial institutions including amended minimum capital adequacy ratios, changes to the definition of capital and the calculation of risk weighted assets and the introduction of new measures relating to leverage, liquidity and financing. The CRR permits a transitional period for certain of the enhanced capital requirements and certain other measures, such as the leverage ratio, which is not expected to be fully implemented until 2018.

The current regulatory framework comprises of the following three pillars:

- Pillar 1 covers the calculation of risk weighted assets for credit risk, market risk and operational risk;
- Pillar 2 covers the Supervisory Review Process ("SREP"), which assesses the Internal Capital Adequacy Process ("ICAAP") and provides for the monitoring and self-assessment of the Company's capital adequacy and internal processes; and
- Pillar 3 covers external disclosures that are designed to provide transparent information on regulatory capital adequacy, risk exposures and risk management and internal control processes.

### *1.2.2 Purpose of the Disclosures*

The purpose of these disclosures is to provide information on the basis of calculating Basel III capital requirements and on the risk governance and risk management arrangements of the Company.

These may differ from similar information in the Annual Report and Financial Statements, prepared in accordance with the International Financial Reporting Standards ("IFRS") and include balance sheet reconciliation information showing all items affecting regulatory own funds as disclosed in the audited financial statements, in accordance with the requirements of point (a) of Article 437(1) of Regulation (EU) No 575/2013.

The main differences for the Company are summarised below:

- Pillar 3 exposure values are derived from Balance Sheet values, net of provisions where appropriate, with specific off Balance Sheet exposures assigned credit conversion factors based on prescribed regulatory values; and
- Regulatory reporting rules require that the Company makes certain adjustments to own funds; the most material relate to intangible assets and dated Tier 2 capital instruments.

### *1.2.3 Basis and frequency of disclosure*

The 2016 Pillar 3 disclosures report ("Report") of the Company sets out both quantitative and qualitative information required in accordance with Part Eight "Disclosures by Institutions" of the CRR. Articles 431 to 455 of the CRR specify the Pillar 3 framework requirements.

The Report is published annually on the Company's website *www.bcscyprus.com* in accordance with regulatory guidelines.

#### *1.2.4 Verification*

The Report is published by the Company as per the formal disclosure policy approved by the Company's Board of Directors (hereinafter "BoD" or "Board"). The Company's Pillar 3 disclosures are subject to internal review and validation prior to being submitted to the BoD for approval. This includes approval by Directors and Heads of Risk, and the Auditors of the Company.

The 2016 Pillar 3 Report was approved by the BoD on **27 April 2017**.

### 1.3 Scope of Application

The management of BCS, in accordance with the provisions of Part Eight of the CRR and paragraph 32(1) of DI144-2014-14 of the CySEC for the prudential supervision of investment firms, has an obligation to publish information relating to risks and risk management on an annual basis at a minimum.

The information provided in this report is based on procedures followed by the management to identify and manage risks for the year ended 31 December 2016 and on reports submitted to CySEC for the year under review.

The Company is making the disclosures on an individual (solo) basis.

## 2. Risk Management Objectives and Policies

### 2.1 Risk Management Framework and Governance

The Company's activities expose it to a variety of financial risks: Market Risk (including Price Risk, Currency Risk, Cash Flow Interest Rate Risk and Fair Value Interest Rate Risk), Credit Risk and Liquidity Risk arising from the financial instruments it holds; and non-financial risks: Operational Risk, Reputational Risk and Business Risk. The primary objectives of the financial risk management function are to establish risk limits and then to ensure that exposure to risks stays within these limits. The Company's risk management function is designed to identify and analyze these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to date administrative and information systems.

The Company regularly reviews its risk management framework to reflect the changes in markets, products and effective best practice. The current structure of the risk framework implemented by the Company aims to manage risks in order to minimise the exposure of the Company and its stakeholders to any event, or set of occurrences able to cause adverse effects, while concurrently maximising the efficiency and effectiveness of the Company's operations in accordance with best practice. The purpose of managing risks is the prompt identification of any potential problems before they occur so that risk-handling activities may be planned and invoked as needed to mitigate adverse impacts and allow the Company to achieve overall objectives.

For BCS, quality management of risk is one of its hallmarks and a priority in its activity. Throughout its operations, the Company combines prudence in risk management with use of well-established risk management techniques, which have proven to be decisive in generating recurrent and balanced earnings and creating shareholder value.

The risk model is based on the principles of:

- Independent function from the business areas.
- The establishment of separate functions between the business areas (risk takers) and the risk areas responsible for measurement, analysis, control and information provides sufficient independence and autonomy to control risks appropriately.
- Involvement of senior management in all decisions taken.
- Collegiate decision-making, which ensures a variety of opinions and does not make results dependent on decisions solely taken by individuals.
- Defining functions.
- Each risk taker unit needs to have clearly defined types of activities, segments, risks in which they could incur and decisions they might make in the sphere of risks, in accordance with delegated powers.
- Risk control and management is conducted on an integrated basis through the organizational structure.

Management and control of risk is developed in the following way:

- Formulate the risk appetite.
- The purpose is to identify and evaluate, synthetically and explicitly, the levels and types of risk that the Company is ready to assume in the development of its business.
- Establish risk policies and procedures.
- Establish the basic framework for regulating risk activities and processes.
- Execute a system to monitor and control risks, which verifies every day and with the corresponding reports the extent to which the Company's risks profile is in line with the risk policies approved and the limits set up.

The Company's risk management is fully aligned with the Basel principles as it recognizes and supports the industry's most advanced practices and, as a result, it is using various tools and techniques which will be referred to later in this Report.

The Company calculates the minimum regulatory capital in accordance with the CRR and the CySEC legislations.

## 2.2 Board of Directors

The responsibility for the overall framework of risk governance and management lies with the BoD. Management recognises that the risk is embedded in all of the Company's activities and for this reason it understands the need for the continuous identification, assessment, examination and control of each type of risk.

The ultimate responsibility for proper and effective risk governance lies with the Board of Directors, which:

- Provides oversight, direction and input to the establishment of the risk appetite framework.
- Ultimately owns and approves the risk appetite.
- Uses a risk appetite framework and statement as a guide in working with management to assess and set the overall corporate strategy.

- Leverages the risk appetite framework to evaluate individual strategic decisions and establish a consistent and transparent decision-making process.

## 2.3 Risk Management Function

The primary goal of the Risk Management Department is to ensure that any Company operations, activities, market position-taking and trading, credit expansion and client dealing do not expose the Company to any credit losses that could threaten the Company's present and future viability. The process of risk management implies identification and analysis of risks and determination of a strategy aimed at minimization of these risks with possible risk prevention, as well as risk mitigation. The purpose of managing risks is the prompt identification of any potential problems before they occur so that risk-handling activities may be planned and invoked as needed to mitigate adverse impacts and allow the Company to achieve overall objectives.

The Risk Management Department is responsible for administering risk management techniques in order to minimize or mitigate risk exposure due to internal and/or external factors. This includes establishing policies and guidelines for risk management throughout the Company in order to ensure that the basic objective of risk management – the preservation of Company assets (both human and physical), by the minimization of loss – is met at the least possible cost to the Company.

The Company's BoD has appointed a Risk Manager in order to administer the Risk Management Function and be responsible for the operation of the Company's Risk Management Department. The Risk Manager reports directly to the BoD and the Senior Management of the Company.

In addition, the Risk Manager reports to the Senior Management at least once a year on the status of the Company's conformity with risk issues and other issues that may arise. Moreover, the head of the Risk Manager issues further ad hoc reports on the same matter where he/she decides that this is appropriate.

## 2.4 Risk Committee

The Risk Committee's function is to identify and assess the risks undertaken by the Company and to guarantee that the Company has a well-defined policy regarding the assumption, follow up and management of risks, as well as to communicate the risk policy accordingly to each of the Company's Departments and to external third parties where appropriate. The Risk Committee is supported by the Company's Risk Management Function.

The Risk Committee ensures that the Company's activities are consistent with its risk appetite and establishes the limits for the main risk exposures, reviewing them systematically and resolving those operations that exceed the powers delegated to bodies lower down the hierarchy.

The responsibilities of the Risk Committee are to:

- Recommend to the Board and then formally announce, implement and maintain a sound system of risk oversight, management and internal control which:
  - Identifies, assesses, manages and monitors risk, and

- Allows investors and other stakeholders to be informed of material changes to the Company's risk profile.

- Recommend to the Board and then formally announce clear standards of ethical behavior required of directors, employees and contractors and encourage observance of those standards.
- Advise the Board on the Company's overall risk appetite, tolerance and strategy, taking account of the current and prospective macroeconomic and financial environment, and drawing on financial stability assessments such as those published by relevant industry and regulatory authorities including the CySEC and other authoritative sources that may be relevant for the Company's risk policies, and
- Oversee and advise the Board on the current risk exposures of the Company and future risk strategy.

In addition, the Risk Committee may co-ordinate decision-making and provide oversight in relation to the Risk Management Function. The Risk Committee develops Company-wide and specific risk policies, assigns owners of significant risks and evaluates the effectiveness of the policies in place for managing specific risks.

The Risk Committee is composed of four members of which two are non-executive directors, and meets at least two times annually or more frequently as circumstances dictate. Any of the members of the Risk Committee may call meetings if they deem it necessary. During 2016, the Risk Committee has met eleven times and has produced corresponding number of written resolutions or minutes.

### 2.5 Internal Audit Function

The Internal Auditor reports directly to the BoD of the Company. Moreover, the Internal Auditor discusses relevant issues of concern with regards to Internal Audit matters with the Company's Senior Management.

The Internal Auditor is independent and is not subject to any supervision by the Company nor has to report to any of the Heads of the Departments of the Company. The Internal Auditor has the authority to discuss with the Heads of each Department issues of concern with regards to Internal Audit matters that may or would encompass a risk cause and/or may affect the operations of each specific Department.

The Internal Auditor's duty is the constant review and evaluation of the operations and activities of the Company in all aspects, by exploiting its independence and autonomy. Moreover, it is the Internal Auditor's responsibility to offer recommendations and advice in order to ensure that the Company operates at the highest standards, in accordance with best practice and in compliance with the legal framework as formulated by the competent authorities.

The responsibilities of the Internal Audit Department and the Internal Auditor in particular include:

- Providing an objective and independent appraisal of all the Company's activities, financial, operational and others.
- Giving assurance to the BoD on all control arrangements.
- Assisting the BoD by evaluating and reporting to its members on the effectiveness of the controls for which they are responsible and by issuing recommendations.

- Keeping records and books with regards to the internal audit work performed.
- Establishing, implementing and maintaining an audit plan to examine and evaluate the adequacy and effectiveness of the Company's systems, internal control mechanisms and arrangements, and
- Submitting, at least once a year, and no later than four months after the end of the calendar year under review, a report to the Senior Management and the BoD with the findings of the Internal Audit review.

## 2.6 Compliance Function

The Company has established and maintains a permanent and effective Compliance Function. The following have been implemented by the Company in order to ensure compliance with legislative requirements:

- The Company appoints a Compliance Officer, who is responsible for the Compliance Function and for any reporting requirements as necessary under paragraph 9(2) of Directive DI144-2007-01.
- The Compliance Officer has the necessary authority, resources, expertise and access to all relevant information, and
- The relevant members of staff involved in the Compliance Function are not involved in the performance of services or activities they are monitoring.

The responsibilities which have been assigned to the Head of the Compliance Function are the following:

- Monitor and assess the adequacy and effectiveness of the measures and procedures put in place and designed to detect any risk of failure by the Company to comply with its obligations under Law 144(I)/2007, as well as the associated risks.
- Ensure that adequate measures and procedures are in place for minimising compliance risks.
- Advise and assist the relevant persons responsible for carrying out investment and ancillary services and activities, in order to comply with the Company's obligations under Law 144(I)/2007 and the Directives issued pursuant the Law.
- Review the account opening documents kept in files for existing Clients (Agreements).
- Perform a check of the Company's work and operations on a continuous basis. The check should include supervision of record keeping, letters to Clients, counterparties and the CySEC, compliance with the legal and regulatory framework, assessment and review of the activities of all functions/operations/departments of the Company.
- Submit an annual report to the BoD and the Senior Management over the activities of the Compliance Department, with special consideration to the remedial measures that have been taken over the year in the event of the detection of any deficiencies identified within the operations of the Company.

## 2.7 Risk Inventory

The Company's activities expose it to a variety of financial risks: Market Risk (including Price Risk, Currency Risk, Cash Flow Interest Rate Risk and Fair Value Interest Rate Risk), Credit Risk and Liquidity Risk arising from the financial instruments it holds.

**Credit Risk**

Credit Risk arises when a failure by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets held at the balance sheet date. Credit risk arises from deposits with banks and financial institutions, as well as from credit exposures to customers, including outstanding trade receivables, loan receivables and committed transactions.

The management of Credit Risk, including Counterparty Credit Risk, is the primary responsibility of the Risk Management Function, with Senior Management assuming a supervisory role in the process. Under the Risk Management Function, the Risk Manager examines and manages Credit Risk for each counterparty separately. The Risk Manager sets counterparty limits in accordance with internally generated methodologies. Counterparty creditworthiness is reviewed annually by the Risk Management Function on the basis of new information acquired during the year. The Risk Management Department together with the Senior Management are responsible for establishing policies and procedures which identify, analyse, evaluate, treat and monitor risks during the course of business.

The Company as a general rule does not provide direct credit facilities to customers concerned with its retail business section. Instead, the Company may provide fiduciary loans to these clients, which are not considered to carry any element of Credit Risk as the loan advance is fully secured by an equivalent amount which the Company has already received in the form of pledged securities.

Furthermore, the Company monitors closely portfolio concentration limits, as well as cases where limit utilisation is close to a maximum, such that the impact of new transactions on the concentration within the Company's portfolio is consistent with its risk appetite and portfolio limit structure.

The preferred choice is to use independently rated parties with a high rating. If customers are independently rated, these ratings are used. Otherwise, if there is no independent rating, management assesses the credit quality of the customer, taking into account its financial position, past experience and other factors. Individual credit limits and credit terms are set based on the credit quality of the customer in accordance with limits set by the Risk Committee. The utilization of credit limits is regularly monitored. No credit limits were exceeded during the reporting period, and management does not expect any losses from non-performance by these counterparties.

**Liquidity Risk**

Liquidity Risk is the risk that arises when the maturity of assets and liabilities does not match. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The Company has procedures with the object of minimizing such losses such as maintaining sufficient cash and by having available an adequate amount of committed credit facilities.

The balance-sheet Liquidity Risk is managed jointly by the Risk Manager and the Accounting Department. The Accounting Department is responsible for planning and supervising asset flows on accounts, while the Risk Manager is in charge of analyzing risks connected with the failure to receive, partly or in full, incoming projected cash payments and other assets.

Should there be a severe possibility of Liquidity Risk arising, the Company will liquidate existing investments in its portfolio, even at a market loss to cover this risk. Additionally, the Company always keeps the minimum cash requirements for the financial year (the authorised budgeted expenditure) either with local or foreign banking institutions, thus eliminating the risk to run out of cash and be forced to liquate trading positions.

Liquidity Risk is managed on the basis of the Liquidity Policy and Appetite and the Liquidity Procedures. The former document contains the overall principles and standards of the BCS Liquidity Risk management. It covers both the Liquidity Risk profile and the governance structure. The latter documents defines limits and the methods of calculation.

BCS monitors its Liquidity Risk on at least a daily basis. Group Treasury conducts several intra-day forecasts of liquidity gaps. This includes real-time monitoring of collateral. If the value of collateral falls below parameters agreed with the client, BCS may request additional collateral or, in certain circumstances, unwind the trades.

Management monitors the current liquidity position of the Company based on expected cash flows and expected revenue receipts. On a long-term basis, Liquidity Risk is defined based on the expected future cash flows at the time of entering into new credit facilities or leases and based on budgeted forecasts.

**Market Risk**

Price Risk

Price Risk is the possibility that the Company may suffer a loss resulting from the fluctuations in the values of, or income from equity securities classified at fair value through profit or loss and derivative financial instruments. The Company is exposed to Market Price Risk because of investments held by the Company and classified as financial assets at fair value through profit or loss which are susceptible to Market Price Risk arising from uncertainties about future prices of these investments.

The Company is exposed to equity securities price risk because of investments held and classified on the statement of financial position at fair value through profit or loss.

The Company is susceptible to Market Price Risk arising from financial instruments received under Title Transfer Collateral Arrangements that are measured at fair value through profit or loss if and only if the Company has sold these financial instruments due to obligation to return back to the clients a financial instrument of equivalent fair value. As at 31 December 2016 and 2015 no financial instruments received under Title Transfer Collateral Arrangements have been sold, therefore the Company is not exposed to Price Risk. The Company is also exposed to Market Price Risk and Commodity Price Risk through the Contracts for Differences ("CFDs") that it offers to its clients. As at 31 December 2016 the Company was not materially exposed to Market Price Risk and Commodity Price Risk. The Company is also exposed to Price Risk from CDSs.

To manage its Price Risk arising from investments in equity securities, the Company diversifies its portfolio. Diversification of the portfolio is done in accordance with the limits set by the Company's BoD.

Currency Risk

Currency Risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. Currency Risk arises when future commercial transactions and recognised assets and liabilities are denominated in a currency that is not the Company's functional currency. The Company is exposed to Currency Risk arising from various currency exposures primarily with respect to the Russian Rouble and the Euro.

In order to limit the risk of loss from adverse fluctuations in exchange rates, overall open currency position limits have been set and monitored. The Risk Management Department is responsible for monitoring Foreign Exchange (FX) position limits. In addition, Management monitors the exchange rate fluctuations on a continuous basis and acts accordingly.

Cash Flow and Fair Value Interest Rate Risk

The Company's Interest Rate Risk arises from interest-bearing assets and short and long-term borrowings. Interest-bearing assets and borrowings at variable rates expose the Company to Cash Flow Interest Rate Risk. Interest-bearing assets and borrowings issued at fixed rates expose the Company to Fair Value Interest Rate Risk. At 31 December 2016 and 31 December 2015 the Company did not have significant interest-bearing assets and borrowings at variable rates, thus any small fluctuation of interest rates would not have a material impact on the profit or loss for the year either in 2016 or in 2015.

The Company is also exposed to Interest Rate Risk from CDSs. The Company's management closely monitors the interest rate fluctuations on a continuous basis, and frequently performs a detailed analysis of the Company's asset and liability structure.

**Operational Risk**

Operational Risk is the risk that derives from the deficiencies relating to the Company's information technology and operational systems, as well as the risk of human error and natural disasters. The Company's systems are evaluated, maintained and upgraded continuously.

The Company is monitoring the following causes of Operational Risk:

- Failure of the processes in which it is involved when executing business, including documentation to operate its business, payment or settlement failures, valuation and pricing feed failures, reporting both internal and external.
- Failure of the people or staff employed by the Company. This includes fraud, someone acting outside their authorization level, insufficient staff training, staff not being properly supervised and the Company itself not following employment law.
- Failure of the systems that are developed to support the processes and the people - these failures can occur for a number of different reasons including power failure to a system, back-up systems not working as intended, viruses and bugs affecting the operating systems at the Company or overloading and over usage of the systems so that they are unable to operate.

- External events that affect the Company, its people, processes and/or technology, including external crime, economic conditions, competition, law, tax policy, the labor market, the pace of change and natural disasters.

Operational Risk Management is achieved through policies and procedures for identification, measurement, assessment and monitoring of Operational Risks arising during the Company's activities. Operational Risk events are registered in an internal Loss Database, which is reported to Management. Remedial Action Plans are prepared and implemented for the identified Operational Risks events.

The Risk Management Department has not found any material evidence of any Operational Risk exposure during the reported period. The Company maintains adequate backup systems in order to manage IT system failures. The Company also has a team of IT professionals who manage IT issues on a daily basis.

**Reputation Risk**

Reputation Risk is the current or prospective risk to earnings and capital arising from an adverse perception of the image of the Company on the part of customers, counterparties, shareholders, investors or regulators. Reputation Risk could be triggered by poor performance, the loss of one or more of the Company's key directors, the loss of large clients, poor customer service, fraud or theft, customer claims, legal action and regulatory fines.

The Company has policies and procedures in place when dealing with possible customer complaints in order to provide the best possible assistance and service under such circumstances. In addition, the Company's Directors are made up of high calibre professionals who are recognized in the industry for their integrity and ethos; this adds value to the Company.

**Strategic Risk**

Strategic Risk could occur as a result of adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment. The Company's exposure to Strategic Risk is moderate as policies and procedures to minimize this type of risk are implemented in the overall strategy of the Company.

**Business Risk**

Business Risk includes the current or prospective risk to earnings and capital arising from changes in the business environment including the effects of deterioration in economic conditions. Research on economic forecasts are conducted with a view to minimize the Company's exposure to Business Risk. These are analyzed at a Group level and taken into consideration when implementing the Company's strategy.

**Capital Risk**

This is the risk that the Company will not comply with capital adequacy requirements. The Company's objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, comply with regulatory license requirements and to maintain an optimal capital structure to reduce the cost of capital. The Company has a regulatory obligation to monitor and implement policies and procedures for capital risk management. Specifically, the Company is required to test its capital against regulatory requirements and has to maintain a minimum level of capital.

The Company is further required to report on its capital adequacy every quarter and has to maintain at all times a capital adequacy ratio of at least 8% plus the applicable capital buffers, subject to the transitional implementation arrangements. The capital adequacy ratio expresses the capital base of the Company as a proportion of the total risk weighted assets. Senior management monitors such reporting and has policies and procedures in place to help meet the specific regulatory requirements. This is also achieved through the preparation on a monthly basis of accounts to monitor the financial and capital position of the Company.

**Regulatory Risk**

Regulatory Risk is the risk the Company faces by not complying with the relevant Laws and Directives issued by its supervisory authority, the CySEC. If materialized, Regulatory Risk could trigger the effects of Reputation and Strategic Risk. The Company has documented procedures and policies based on the requirements of the relevant Laws and Directives. Compliance with these procedures and policies are further assessed and reviewed by the Company's Internal Auditor and Compliance Officer and suggestions for improvement are implemented by management. The Internal Auditor evaluates and tests the effectiveness of the Company's control framework at least annually.

**Legal and Compliance Risk**

Compliance Risk is the risk of financial loss, including fines and other penalties, which could arise as a result of breaches or non-compliance with legislation, regulations, agreements or ethical standards. The probability of this risk occurring is relatively low due to the detailed internal procedures and policies implemented by the Company and the regular reviews carried out by the Internal Auditor and the Compliance Officer. Furthermore, the structure of the Company is such as to promote clear coordination of duties, while the senior management consists of individuals with suitable professional experience and integrity, who have accepted responsibility for setting and achieving the Company's strategic targets and goals. In addition, the Board meets at least annually to discuss such issues and any suggestions to enhance compliance are implemented by the Senior Management.

**IT Risk**

IT Risk could occur as a result of inadequate information technology and processing, or from an inadequate IT strategy and policy or inadequate use of the Company's information technology. Policies have been implemented regarding back-up procedures, software maintenance, hardware maintenance, use of the internet, access rights and anti-virus procedures. Materialization of this risk has been minimized to the lowest possible level.

## 2.8 Adequacy of Risk Management Arrangements

The Board is responsible for reviewing the effectiveness of the Company's risk management arrangements, which are designed to manage and mitigate the risks of not achieving business objectives.

The Board considers that it has in place adequate systems and controls with regards to the Company's profile and strategy and an appropriate array of assurance mechanisms, properly resourced and skilled, to avoid or minimize loss.

## 2.9 Risk Appetite Statement

The Company's strategy is pursued within a defined Risk Appetite. The Company defines its Risk Appetite as the amount and type of risks considered reasonable to assume for implementing its business strategy, so that it can maintain its ordinary activity in the event of unexpected events that could have a negative impact on the level of its capital, profitability and/or its share price.

Risk Appetite is expressed in both quantitative and qualitative terms and covers all risks, both on-balance sheet and off-balance sheet. The Company's Risk Appetite framework includes specific objectives for all the types of risk. Qualitative objectives include a general medium-low and predictable risk profile based on a diversified business model and maintaining an independent risk function and intense involvement by Senior Management that guarantees a strong risk culture centred on protecting and ensuring an adequate return on capital. Quantitative objectives include the maximum losses that the Company has to assume and the minimum capital adequacy position that it wants to maintain.

Such risks include Credit, Market, Operational, Compliance/Legal/Conduct/Reputational and Liquidity/Concentration Risk. The Board revises at least once a year the Company's Risk Appetite and its management framework, analyzing the impact of unlikely but plausible tension scenarios and adopting the pertinent measures to ensure that the policies set are met.

The Risk Appetite measures are integrated into decision making, monitoring and reporting processes, with early warning trigger levels set to drive any required corrective action before overall tolerance levels are reached.

## 2.10 Internal Capital Adequacy Assessment Process and Pillar 2

### ICAAP Overview

In accordance with Directives DI144-2014-14 and DI144-2014-15 of the CySEC on the Capital Requirements of Investment Firms:

- BCS shall have in place sound, effective and complete strategies and processes to assess and maintain, on an ongoing basis, the amounts, types and distribution of internal capital that it considers adequate to cover the nature and level of the risks to which it is or might be exposed. In this respect, BCS shall adopt the relevant guidelines issued by CySEC.
- These strategies and processes shall be subject to regular internal review to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the activities of the Company.

As a result of the above mentioned requirements, BCS has in place an Internal Capital Adequacy Assessment Process. The ICAAP is an internal tool which allows BCS to assess its position and determine the amount of internal capital it needs to hold in order to be covered against all the risks it is facing or against the risks to which it may be exposed in the future.

The ICAAP falls under the scope of Pillar 2, which can be described as a set of relationships between the CySEC and the investment firm, the objective of which is to enhance the link between the investment firm's risk profile, its risk management and risk mitigation systems, and its capital.

Pillar 2 establishes a process of prudential interaction that complements and strengthens Pillar 1 by promoting an active dialogue between the regulator and the investment firm such that, any inadequacies or weaknesses of the internal control framework and also other important risks, the fulfillment of which may entail threats for the investment firm, are identified and managed effectively with the enforcement of additional controls and mitigating measures.

The ICAAP comprises of all the measures and procedures adopted by BCS, with the purpose of ensuring:

- The appropriate identification and measurement of risks.
- An appropriate level of internal capital in relation to the Company's risk profile, and
- The application and further development of suitable risk management and internal control systems and tools.

The ICAAP is clearly owned and approved by BCS's BoD.

From BCS's perspective, the ICAAP:

- Promotes a comprehensive risk management framework for the Company.
- Aligns capital with risk management and strategy, and
- Provides a tool for communicating to the Board and the regulator the key aspects of its risk management and governance structure.

**ICAAP Profile and Methodology**
According to the size of BCS and the complexity of its operations, the Company utilizes the *minimum capital requirement approach* for the calculation of the additional capital for Pillar 2.

The Company has implemented the minimum capital requirement approach in two stages:

- The Pillar 1 minimum capital requirement was used as the foundation, since it reflects the Company's exposure to Pillar 1 risks (i.e. Credit Risk, Operational Risk and Market Risk).
- The adequacy of the minimum capital required under Pillar 1 was then assessed, in relation to risks arising from the following three categories:

  i. Risks covered in Pillar 1.
  ii. Risk not fully covered in Pillar 1 (e.g. Concentration Risk which is part of Credit Risk), and
  iii. Risks not covered in Pillar 1 (e.g. Liquidity Risk, Strategic Risk and Reputation Risk).

**ICAAP results**
The results of the ICAAP relative to additional capital requirements can be included in the capital adequacy report, upon demand by CySEC. The present report does not include such information as CySEC has not requested their disclosure.

### 2.11 Recruitment Policy

Recruitment into the BoD combines an assessment of both technical capability and competency skills referenced against the Company's leadership framework. Candidates must have specialised skills and/or knowledge to enhance the collective knowledge of the BoD and must be able to commit the necessary time and effort to fulfil their responsibilities. Recruitment as a member of the BoD is subject to the approval by the BoD itself.

Prior to the appointment, the Company must comply with the relevant fitness and probity requirements and obtain the approval of the CySEC.

### 2.12 Number of Directorships

The table below provides the number of directorships held by each member of the Company's management body in other entities, excluding the one in BCS. Directorships in companies belonging to the same group are considered as one directorship.

| Name of Director | Position with BCS | Other Directorships Executive | Other Directorships Non-Executive |
|---|---|---|---|
| Ms. Olha Sidleruk | Executive | 0 | 0 |
| Mr. Marios Yiasoumi | Executive | 0 | 1 |
| Dr. Roman Lokhov | Executive | 1 | 2[1] |
| Ms. Tonia Antoniou | Non- Executive | 1 | 1 |
| Mr. George Yiallourides | Non- Executive | 1 | 1 |
| Mr. Andrei Aletdinov | Non- Executive | 0 | 0 |

Mr. Marios Yiasoumi resigned from the Board of Directors on November 25th, 2016, and Mr Christakis Pavlides was appointed on January 10th, 2017.

### 2.13 Diversity Policy

The Company recognises the benefits of having a diverse Board of Directors which includes and makes use of differences in the skills, experience, background, race and gender between directors. A balance of these differences is considered when determining the optimum composition of the Board of Directors. The Nomination Committee is responsible for promoting diversity and ensuring there is an appropriate balance of skills and experience across the Board.

### 2.14 Reporting and Control

The management body receives:

- the Company's Annual Report, and

[1] Other Non-Executive Directorship relates to BCS Group's companies.

- Risk information which flows up to the Board through the Risk Committee.

The following reports are submitted to the BoD for review and approval on a yearly basis:

- Risk Management Report
- Internal Audit Report
- AML Report
- Compliance Report
- Suitability Report
- ICAAP Report

## 3. Own Funds

### 3.1 Balance sheet reconciliation

| Eligible Own funds as at December 2016 | $'000 |
|---|---:|
| Share Capital | 1.640 |
| Share Premium | 25.360 |
| Retained Earnings | 92.896 |
| Profit & Loss | 24.789 |
| Intangible assets/Goodwill | -8 |
| CIF contribution into ICF | -116 |
| **Original Own Funds (Tier 1 Capital)** | **144.561** |

### 3.2 Own funds disclosure template under the Transitional and Fully-Phased In definition

| As at 31 December 2016 | Transitional Definition | Prescribed residual amount of Regulation (EU) No 575/2013 | Fully - Phased in Definition |
|---|---:|---:|---:|
| | **$'000** | **$'000** | **$'000** |
| **Common Equity Tier 1 capital: instruments and reserves** | | | |
| Capital instruments and the related share premium accounts | 27.000 | | 27.000 |
| Retained earnings | 117.685 | | 117.685 |
| **Common Equity Tier 1 (CET1) capital before regulatory adjustments** | **144.685** | | **144.685** |

| | | | |
|---|---|---|---|
| **Common Equity Tier 1 (CET1) capital: regulatory adjustments** | | | |
| Intangible assets (net of related tax liability) | (8) | | (8) |
| CIF contribution into ICF | (116) | | (116) |
| Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability) | | | |
| **Total regulatory adjustments to Common Equity Tier 1 (CET1)** | **(124)** | | **(124)** |
| **Common Equity Tier 1 (CET1) capital** | **144.561** | | **144.561** |
| **Additional Tier 1 (AT1) capital** | **0** | | **0** |
| **Tier 1 capital (T1 = CET1 + AT1)** | **144.561** | | **144.561** |
| **Tier 2 (T2) capital** | **0** | | **0** |
| **Total capital (TC = T1 + T2)** | **144.561** | | **144.561** |
| **Total risk weighted assets** | **412.137** | | **412.137** |
| **Capital ratios and buffers** | | | |
| Common Equity Tier 1 | **35,08%** | | **35,08%** |
| Tier 1 | **35,08%** | | **35,08%** |
| **Total capital** | **35,08%** | | **35,08%** |

### 3.3 Main terms and conditions of capital resources

As at 31st December 2016, the Company's eligible own funds consisted entirely of Common Equity Tier 1 ("CET1") capital. The Company's CET1 capital comprises of share capital, share premium and reserves, less intangible assets and contribution to the Investors Compensation Fund. Share Capital includes the Company's paid up capital and share premium and Reserves include retained earnings.

As at 31 December 2016, the Company's issued share capital amounted to US$ 1.640.100, divided into 5.467 issued and fully paid shares with a par value of US$ 300 per share. Share premium amounts to US$ 25.360.400.

# 4. Minimum required own funds for Credit, Market and Operational Risk

## 4.1 Risk weighted assets and Capital Adequacy Ratio

| Type of Risk | 31 December 2016 | |
|---|---|---|
| | Minimum Capital requirements | Risk-weighted amounts |
| | $'000 | $'000 |
| Credit Risk | **23.684** | **296.049** |
| Credit Valuation Adjustment Risk | **279** | **3.484** |
| Market Risk | **5.494** | **68.683** |
| *of which FX market risk* | 5.403 | 67.535 |
| *of which Commodity market risk* | 71 | 892 |
| *of which Equity market risk* | 20 | 254 |
| *of which Interest Rate market risk* | 0 | 2 |
| Operational Risk | **3.514** | **43.921** |
| | | |
| **Total** | **32.971** | **412.137** |
| | | |
| ***Capital Adequacy Ratio*** | **35,08%** | |

As at 31st December 2016, the capital adequacy ratio of BrokerCreditService (Cyprus) Limited stood at 35,08%.

The CySEC requires each investment firm to maintain a minimum ratio of capital to risk weighted assets of 8% plus capital buffers, as applicable. The CySEC may impose additional capital requirements for risks not covered by Pillar 1. For the year ended 31st December 2016, the Company was subject to a minimum Pillar 1 capital adequacy ratio of 8%, plus a capital conservation buffer of 0,625% as per the transitional implementation arrangements, as well as an additional 0,5% O-SII buffer (since BCS was considered a Systemically Important Institution for 2016 by the Macroprudential Authority – CBC), resulting to a minimum of 9,125%. As evidenced by the information presented in the table above, the Company's actual capital adequacy ratio was well above the required minimum for Pillar 1 plus buffers.

### 4.2 Credit Risk

The Company uses the Standardized Approach for measuring Credit Risk. The table below presents the allocation of Credit Risk by exposure class as at 31st December 2016:

| Asset Class | 31 December 2016 | |
|---|---|---|
| | Risk-weighted amounts | Minimum capital requirement |
| | $'000 | $'000 |
| Institutions | 31.728 | 2.538 |
| Corporates | 256.655 | 20.532 |
| Retail | 7.499 | 600 |
| Other Items | 167 | 14 |
| **Total** | **296.049** | **23.684** |

### 4.3 Market Risk

The Company adopted the Standardised approach for Market risk. The standardised measurement method for the capital requirement for position risk in equities adds together all positions of financial instruments and funds according to predefined models and according to capital requirements.

The table below shows the Capital Requirements for Market Risk as at 31st December 2016:

| Risk Type | 31 December 2016 | |
|---|---|---|
| | Risk-weighted amounts | Minimum capital requirement |
| | $'000 | $'000 |
| Market Risk | | |
| *of which FX market risk* | 67.535 | 5.403 |
| *of which Commodity market risk* | 892 | 71 |
| *of which Equity market risk* | 254 | 20 |
| *of which Interest rate market risk* | 2 | 0 |
| **Total** | **68.683** | **5.494** |

### 4.4 Operational Risk

The Company adopted the Basic Indicator Approach ("BIA") for Operational risk. The BIA calculates the average of positive income, on a three year basis, of net income to be used in the risk weighted assets calculation. The capital requirement for operational risk is equal to 15% of the relevant indicator.

The table below shows the Capital Requirements for Operational Risk as at 31st December 2016:

| Income Item Description | 2014<br>$'000 | 2015<br>$'000 | 2016<br>$'000 |
|---|---|---|---|
| Commissions and fees from brokerage services | 12.871 | 13.073 | 18.339 |
| Net gains on derivative financial instruments | 8.230 | 18.954 | 33.279 |
| Net gains on financial assets at fair value through profit or loss - held for trading | -5.740 | 7.196 | 1.521 |
| Direct costs | -19.198 | -16.244 | -11.415 |
| Other operating income | 2.060 | 3.604 | 2.821 |
| Net foreign exchange gains/losses | -3.590 | -28.645 | -36.198 |
| Finance income | 28.919 | 30.727 | 37.292 |
| Finance costs | -7.153 | -4.374 | -16.054 |
| | | | |
| **Total** | **16.399** | **24.291** | **29.585** |
| **Average of 3 years** | **23.425** | | |
| **Capital Requirement** | **3.514** | | |
| **Risk Weighted Assets** | **43.921** | | |

## 5. Counterparty Credit Risk

### 5.1 Internal capital and credit limits for Counterparty Credit Risk exposures

Counterparty Credit Risk arises from the possibility that a counterparty will fail to perform on an obligation arising from transactions such as money market placements, FX, derivatives and other transactions.

The Company considers that there is a certain element of Counterparty Credit Risk which arises from trading operations. The Company considers that this pre-settlement and settlement Credit Risk is limited due to the fact that for the majority of transactions the duration of this risk exposure is limited to the hours or days from the time a transaction is agreed upon until settlement. Beyond that, most transactions are executed under the Delivery Versus Payment ("DVP") method, thus minimizing Counterparty Credit Risk.

Under the Risk Management Function, the Risk Manager also examines and manages Credit Risk for each counterparty separately. The Risk Manager sets counterparty limits in accordance with internally generated methodologies. The use of limits for Credit Risk and Counterparty Credit Risk contributes to the effective management of the Company's exposure to such risks. The assessment of a counterparty's creditworthiness, on examination of a credit limit application, begins with an analysis of the counterparty's financials and the quality of its business (competitive positioning, corporate and organizational structure, etc.), regional and sectorial factors (corporate clients) and account conduct within the Company. The Company is also using credit risk ratings from well recognized External Rating Agencies (Moody's Investors Service, Standard & Poor's Financial Services LLC and Fitch Ratings Inc.) in order to assess the probability of default of a specific counterparty and, if necessary, refers to elements of other approaches, methods and models used to assess and manage these risks.

Counterparty creditworthiness is reviewed annually by the Risk Management Function on the basis of new information acquired during the year. The counterparty is assessed within its business sector, where relevant, thus considering the maximum exposure of the Company. In fierce market and economic conditions, the Company reviews limits more regularly to keep changes in counterparties' solvency profiles under strict control. At the same time, the Company introduces amendments into the existing methods of limits assessment, reflecting results of stress-tests.

The Company as a general rule does not provide direct credit facilities to customers concerned with its retail business section. Instead, the Company may provide fiduciary loans to these clients, which are not considered to carry any element of Credit Risk as the loan advance is fully secured by an equivalent amount which the Company has already received in the form of pledged securities.

## 5.2 Policies for securing collateral and establishing credit reserves

The Counterparty Credit Risk mitigation techniques utilised by the Company are classified into two broad categories:

- "Funded Credit Protection": A technique of Credit Risk mitigation where the reduction of the Credit Risk on the exposure of an institution derives from the right of the institution - in the event of the default of the counterparty or in the occurrence of other specified credit events relating to the counterparty - to liquidate, or to obtain transfer or appropriation of, or to retain certain assets or amounts, or to reduce the amount of the exposure to, or to replace it with, the amount of the difference between the amount of the exposure and the amount of a claim on the institution, and

- "Unfunded Credit Protection": A technique of Credit Risk mitigation where the reduction of the Credit Risk on the exposure of an institution derives from the undertaking of a third party to pay an amount in the event of the default of the borrower or on the occurrence of other specified credit events.

The Company's policies for securing collateral, in relation to repurchase transactions and/or securities lending or borrowing transactions, revolve around two parameters:

- The use of Master Netting agreements: The Company's dealings are based on internationally recognised and acknowledged Master Netting agreements, like the International Securities Market Association TBMA/ISMA Global Master Repurchase Agreement.

- Eligibility of Collateral: In order for Funded Credit Protection to be eligible for recognition, the assets relied upon shall be sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved. This requirement is applicable to both the repurchase transactions and/or securities lending or borrowing transactions activity and the margin lending activity of the Company.

### *5.2.1 Main types of collateral accepted*

The Company receives the following types of collateral:

- Collateral received under fiduciary services.

- Collateral received under Title Transfer Collateral Arrangements ("TTCA"), and
- Third party collateral (belonging to third party, not being the borrower).

**Collateral received under fiduciary services**
Cash and non-cash collateral, received under fiduciary services is held by the Company in a fiduciary capacity and is not recognized on the Company's Balance Sheet.

**Collateral received under TTCA**
Cash collateral received by the Company under TTCA is cash by which a client agrees that full ownership of such monies is unconditionally transferred to the Company. Cash collateral under TTCA is accordingly held on the Company's Balance Sheet with a corresponding liability to clients within trade payables. All cash collateral received under TTCA is deposited in the Company's own bank accounts.

Non-cash collateral received by the Company under TTCA consists of financial instruments by which a client agrees that full ownership of such financial instruments is unconditionally transferred to the Company. Non-cash collateral under TTCA is not held on the Company's Balance Sheet unless the non-cash collateral is sold where the Company recognises the proceeds from the sale and a respective liability measured at fair value through profit and loss, for its obligation to return the non-cash collateral.

**Third Party Guarantors and hedging certain exposures using credit derivatives**
The Company may accept guarantees from third parties to mitigate Credit Risk for customers. Such arrangements represent obligations for the guarantor to make payments to the Company if a customer fails to fulfill its obligation under a borrowing arrangement or other contractual obligation. The Company typically accepts guarantees from banks, investment grade corporate entities and financial institutions within the Institutional Securities business segment. Guarantees are monitored against eligibility requirements on an ongoing basis, and eligible guarantees for exposures may be recognized when determining the Company's overall capital requirements.

All guarantors must be evaluated through the credit scoring or other evaluation processes that are issued from time to time, using relevant assets and liabilities statements.

Guarantors are required to provide audited financial statements as well as various documents depending on the case. In calculating the repayment ability of the customer (borrower), guarantors are assessed for creditworthiness and may be rejected for any negative financial or other reasons.

The Company may also hedge certain exposures using credit derivatives. The Company may enter into credit derivatives, principally through credit default swaps, under which it receives or provides protection against the risk of default on a set of debt obligations issued by a specified reference entity or entities.

The Company recognizes certain third-party guarantees and credit derivatives for the reduction of its capital requirements.

***Collateral management/valuation***

The collateral management process of the Company is based on the following principles:

- Common approach for assets valuation, describing market data sourcing and pricing sequence.
- Continuous controls for sufficiency of clients and counterparties' collateral, including real-time and daily-based automated monitoring tools with alerting and processes which cover margin calls and liquidation, and
- Continuous monitoring of sufficiency of funds placed on different market venues, custodians, clearing partners and external brokers for covering Company obligations.

***Exposures covered by eligible financial collateral and credit protection***

The table below outlines the Company's exposures by asset class which are covered by financial collaterals:

| Asset Class | 31 December 2016 | | |
|---|---|---|---|
| | Exposure values before credit risk mitigation | Exposure values after credit risk mitigation | Value of Exposures secured by Financial Collaterals |
| | $'000 | $'000 | $'000 |
| Institutions | 158.641 | 158.641 | - |
| Corporates | 772.601 | 256.164 | 516.713 |
| Retail | 17.734 | 9.999 | 7.735 |
| Other Items | 167 | 167 | - |
| **Total** | **949.143** | **424.971** | **524.448** |

## 5.3 Policies with respect to wrong-way risk exposures

Wrong way risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty, i.e. changes in market rates (interest rates, FX or other rates which are the main underlying factors of the Company's counterparty transactions) have an adverse impact on the probability of default ("PD") of a counterparty.

This risk is not currently measured as it is not anticipated to be significant given the existence of Credit Support Annexes for almost all derivative transactions, with daily settlement of margins that significantly reduce Credit Risk.

The Company also prohibits the repurchase counterparty and the issuer of the collateral being the same, or related, entities. The Company has no exposure to wrong-way risk in this respect.

## 5.4 Collateral the Company would have to provide given a downgrade in its credit rating

There were no instances where the Company had to provide additional collateral in the event of a downgrade during the year ending 31 December 2016.

### 5.5 Derivative exposures and mark-to-market method

The Company’s total exposure to derivatives as at 31 December 2016, after the recognition of collaterals, amounted to $53,4 million and was calculated using the “Mark-To-Market Method” as the sum of the current replacement cost and potential future credit exposure.

The minimum capital requirement calculated for the Company’s open derivative positions as at 31/12/2016 is presented in the following table:

| Derivative Description | 31 December 2016 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Positive Fair Value | Negative Fair Value | Nominal Value | Exposure Amount before CRM | Exposure Amount after CRM | Risk Weighted Assets | Capital Requirements |
| | $‘000 | $‘000 | $‘000 | $‘000 | $‘000 | $‘000 | $‘000 |
| Commodity CFDs | 10 | -1 | 476 | 53 | 53 | 40 | 3 |
| Equity CFDs | 3 | -1 | 95 | 9 | 9 | 7 | 1 |
| FX CFDs | 909 | -339 | 33.763 | 1.247 | 1.247 | 961 | 77 |
| Gold CFDs | 43 | -7 | 2.890 | 72 | 72 | 54 | 4 |
| Index CFDs | 1 | -1 | 220 | 14 | 14 | 10 | 1 |
| Other OTC Derivatives | 54.728 | -22.996 | 724.302 | 131.553 | 51.991 | 52.482 | 4.199 |
| **Total** | **55.694** | **-23.345** | **761.746** | **132.948** | **53.386** | **53.554** | **4.285** |

### 5.6 Repos and securities lending transactions

The table below outlines the Company’s exposure to Repos and Securities Lending agreements:

| Type of exposure | 31 December 2016 | | | |
|---|---|---|---|---|
| | Exposure values before credit risk mitigation | Volatility adjustment to the exposure (E.HE) | Financial collateral: adjusted value (Cvam) | Exposure values after credit risk mitigation |
| | $‘000 | $‘000 | $‘000 | $‘000 |
| Repos | 57.907 | 277 | 45.416 | 12.768 |
| Securities lending agreements | - | - | - | - |
| **Total** | **57.907** | **277** | **45.416** | **12.768** |

## 6. Exposure to Credit Risk and Impairment Risk

### 6.1 Past due and impaired financial assets

A financial asset is past due when a counterparty has failed to make a payment when contractually due.

A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. The criteria that the Company uses to determine that there is objective evidence of an impairment loss include:

- Significant financial difficulty of the issuer or obligor.
- A breach of contract, such as a default or delinquency in interest or principal payments.
- The Company, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower a concession that it would not otherwise consider.
- It becomes probable that the borrower will enter into bankruptcy or other financial reorganisation.
- The disappearance of an active market for that financial asset because of financial difficulties, or
- Observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
    - Adverse changes in the payment status of borrowers in the portfolio, and
    - National or local economic conditions that correlate with defaults on the assets in the portfolio.

The Company first assesses whether objective evidence of impairment exists. For loans and receivables the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The asset's carrying amount is reduced and the amount of the loss is recognised in profit or loss. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

As a practical expedient, the Company may measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in profit or loss.

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. As at 31 December 2016, no financial assets, loans or receivables, or trade and other receivables, were past due or impaired.

### 6.2 Exposures post value adjustments by exposure class

The table below outlines the Company's exposures by exposure class net of any specific provisions but before applying Credit Risk Mitigation:

| Asset Class | 31 December 2016 | |
|---|---|---|
| | Original exposure amount, net of specific provisions | Average exposure |
| | $'000 | $'000 |
| Public sector entities | - | 60 |
| Institutions | 158.641 | 130.430 |
| Corporates | 772.601 | 605.365 |
| Retail | 17.734 | 14.943 |
| Other Items | 167 | 163 |
| **Total** | **949.143** | **750.961** |

### 6.3 Exposures post value adjustments by significant geographic area and exposure class

The table below outlines the Company's exposures by exposure class and geographic area net of any specific provision but before applying Credit Risk Mitigation:

| Asset Class | Country of exposure (31 December 2016) | | | | | |
|---|---|---|---|---|---|---|
| | Cyprus | Russia | British Virgin Islands | Netherlands | Other | Total |
| | $'000 | $'000 | $'000 | $'000 | $'000 | $'000 |
| Institutions | 157 | - | - | 8 | 158.476 | 158.641 |
| Corporates | 533.092 | 141.927 | 58.285 | 28.359 | 10.938 | 772.601 |
| Retail | 1 | 17.672 | - | - | 61 | 17.734 |
| Other Items | 167 | - | - | - | - | 167 |
| **Total** | **533.417** | **159.599** | **58.285** | **28.367** | **169.475** | **949.143** |

### 6.4 Exposures post value adjustments by industry and exposure class

The table below outlines the Company's exposures by exposure class and industry area net of any specific provision but before applying Credit Risk Mitigation:

| Asset Class | Industry Sector (31 December 2016) | | | |
|---|---|---|---|---|
| | Banking/Financial services | Private Individuals | Other | Total |
| | $‘000 | $‘000 | $‘000 | $‘000 |
| Institutions | 158.641 | - | - | 158.641 |
| Corporates | 118.328 | - | 654.272 | 772.601 |
| Retail | - | 17.734 | - | 17.734 |
| Other Items | - | - | 167 | 167 |
| **Total** | **276.969** | **17.734** | **654.439** | **949.143** |

### 6.5 Exposures post value adjustments by residual maturity and by exposure class

The table below outlines the Company’s exposures by exposure class and residual maturity net of any specific provision but before applying Credit Risk Mitigation:

| Asset Class | Residual Maturity (31 December 2016) | | |
|---|---|---|---|
| | Up to 3 months | More than 3 months | Total |
| | $‘000 | $‘000 | $‘000 |
| Institutions | 158.641 | - | 158.641 |
| Corporates | 248.150 | 524.451 | 772.601 |
| Retail | 17.734 | - | 17.734 |
| Other Items | 167 | - | 167 |
| **Total** | **424.692** | **524.451** | **949.143** |

## 7. External Credit Assessment Institutions (ECAIs) used for calculating Risk-weighted Assets under the Standardised Approach

The Company has elected to use Moody’s as the External Credit Assessment Institution (“ECAI”) and as an alternative Fitch Ratings.

### 7.1 Application of External Ratings from Recognised ECAIs

The Company has used the credit quality step mapping table below to map the credit assessment to credit quality steps:

| Credit Quality Step | Moody’s | Fitch |
|---|---|---|
| CQS 1 | Aaa to Aa3 | AAA to AA- |
| CQS 2 | A1 to A3 | A+ to A- |
| CQS 3 | Baa1 to Baa3 | BBB+ to BBB- |
| CQS 4 | Ba1 to Ba3 | BB+ to BB- |
| CQS 5 | B1 to B3 | B+ to B- |
| CQS 6 | Caa1 and below | CCC+ and below |

The table below outlines the exposure classes for each ECAI used:

| Asset Class | Credit Quality Step (31 December 2016) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | CQS 1 | CQS 2 | CQS 3 | CQS 4 | CQS 5 | CQS 6 | Unrated / N/A | Total |
| Institutions | 6.922 | 42.250 | 14.179 | | | 126 | 95.164 | 158.641 |
| Corporates | - | - | - | - | 720 | | 771.881 | 772.601 |
| Retail | - | - | - | - | - | - | 17.734 | 17.734 |
| Other Items | - | - | - | - | - | - | 167 | 167 |
| **Total** | **6.922** | **42.250** | **14.179** | | **720** | **126** | **884.946** | **949.143** |

### 7.2 Transfer of Credit Assessments onto items not included in the Trading Book

For exposures to regional governments or local authorities, public sector entities, institutions and corporates, the ECAIs are applied in the following priority:

1) Issue/Exposure
2) Issuer/Counterparty, and
3) Sovereign.

For exposures to central governments or central banks, multilateral development banks and CIUs, the ECAIs are applied in the following priority:

1) Issue/Exposure, and
2) Issuer/Counterparty.

The ECAIs are not taken into account where all relative exceptions per the CRR apply.

### 7.3 Exposures before and after Credit Risk Mitigation

The table below analyses exposures per Credit Quality Step before and after Credit Risk Mitigation:

| Credit Quality Step | 31 December 2016 | |
|---|---|---|
| | Exposure values before credit risk mitigation | Exposure values after credit risk mitigation |
| | $‘000 | $‘000 |
| CQS 1 | 6.922 | 6.922 |
| CQS 2 | 42.250 | 42.250 |
| CQS 3 | 14.179 | 14.179 |
| CQS 4 | - | - |
| CQS 5 | 720 | 720 |
| CQS 6 | 126 | 126 |
| unrated/N/A | 884.946 | 360.774 |
| **Total** | **949.143** | **424.971** |

## 8. Exposures in Equities not included in the Trading Book

As at 31 December 2016, the Company did not have any exposures in equities which were not included in the Trading Book.

## 9. Exposures to Interest Rate Risk on positions not included in the Trading Book

The Company's Interest Rate Risk arises from interest-bearing assets and long-term borrowings. Interest-bearing assets and borrowings at variable rates expose the Company to cash flow interest rate risk. Interest-bearing assets and borrowings issued at fixed rates expose the Company to fair value interest rate risk.

As at 31 December 2016 the Company did not have significant interest-bearing assets and borrowings at variable rates thus any small fluctuation of interest rates would not have a material impact on the profit or loss for the year.

## 10. Remuneration Policy and Practices

The aim of the Company's remuneration policy is to ensure that the Company has risk-focused remuneration policies which are consistent with and promote effective risk management, do not expose the Company to excessive risk, avoid conflicts of interest and do not encourage inappropriate risk taking, attract, motivate and retain high calibre directors, officers and employees, operate a fair and consistent policy that rewards individual contributions to the Company's overall performance, and are competitive with industry standards.

The BoD is responsible for determining the Remuneration Policy, taking into account the Company's risk management, best market practices and any applicable regulatory guidelines. The BoD has the responsibility for ensuring the implementation of this Policy and ongoing compliance by Company staff.

### 10.1 Remuneration Committee

The Remuneration Committee shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk management of the Company and which are to be taken by the BoD of the Company.

More specifically, the Remuneration Committee shall be responsible for:

- Ensuring that contractual terms on termination and any payments made are fair to the individual and the Company and that failure is not rewarded, while the duty to mitigate loss is properly recognised.
- Ensuring that its decisions are consistent with the assessment of the Company's financial condition and future prospects. In particular, practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain should be evaluated

carefully and the Committee should work closely with the Company's functions in evaluating the incentives created by its remuneration system.

- Overseeing any major changes in employee benefit structures throughout the Company, and
- Agreeing the policy for authorising claims for expenses from the directors.

The members of the Committee shall be appointed by the Board of Directors and shall consist of Non-Executive directors the majority of which shall be independent. The Board shall also appoint the chairman of the Committee.

As at 31 December 2016, the Remuneration Committee comprised of three Non-Executive Directors and met one time.

### 10.2 Remuneration Policy Principles and Structure

The principles of the Company's remuneration policy apply to the following categories of the Company's employees:

- Employees and appointees of the Company whose professional activities have a material impact on the Company's risk profile, and
- Any employee who is deemed to have a material impact on the Company's risk profile in accordance with Regulation (EU) 604/2014 of 4 March 2014 (material risk takers), where the key positions that are within the Company's definition of staff who are risk takers are members of the Board of Directors, deputy managing directors, heads of significant business lines and of support and control functions.

The remuneration of the Company's Executive Directors is set and approved by the shareholder(s), following approval by the Remuneration Committee and the BoD. The remuneration of Non-executive Directors is set and approved by the shareholder(s), following approval by the BoD. Finally, the remuneration of Policy staff and other employees is set by the relevant line manager and approved by the Remuneration Committee.

**Independent Control Functions**

Staff engaged in control functions are independent from the business units they oversee, have appropriate authority, and are remunerated adequately to attract qualified and experienced staff and in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control. The remuneration of the senior officers in the risk management and compliance functions is directly overseen by the Remuneration Committee.

**Combined Assessment**

Where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual, the business unit concerned and the overall results of the Company and when assessing individual performance, financial and non-financial criteria are taken into account.

The assessment of the performance is made in a multi-year framework in order to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of remuneration is spread over a period which takes account of the underlying business cycle of the Company and its business risks.

**Fixed and Variable Components**

The fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy, on variable remuneration components, including the possibility to pay no variable remuneration component. The Company sets the appropriate ratios between the fixed and the variable component of the total remuneration.

**Variable Remuneration – Profit-based Measurement, Risk Adjustment and Deferral**

Variable remuneration shall reflect performance in excess of that required to fulfil the employee's job description and terms of employment and shall be subject to performance adjustment in accordance with the Remuneration Policy.

The measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes an adjustment for all types of current and future risks and takes into account the cost of the capital and the liquidity required.

During 2016, the variable component of the remuneration for those employees that were awarded variable remuneration, was considerably lower than the 100% of the fixed component of the total remuneration of each such employee.

When awarding, paying or providing variable remuneration, the Company shall defer 40% of that amount over a period of three years. For variable remuneration amounts over a specified threshold awarded to an executive director, 60% of the amount awarded must be deferred. Variable remuneration shall vest no faster than on a pro-rata basis.

The BoD shall oversee the payment of variable remuneration to ensure that no payment is made through vehicles or methods that facilitate the avoidance of applicable statutory and regulatory requirements.

The appraisal process measures the previous year's performance against officers' and employees' agreed goals and targets and the results are taken into account in determining the final variable remuneration payments.

## 10.3 Aggregate Information on Remuneration

The table below provides aggregate quantitative information on remuneration, broken down by senior management and other members of staff whose actions have a material impact on the risk profile of the Company:

| Role | 31 December 2016 | | | |
|---|---|---|---|---|
| | No. of Beneficiaries | Fixed Remuneration $'000 | Variable Remuneration[2] $'000 | Total $'000 |
| Senior Management[1] | 14 | 1.520 | 82 | **1.602** |
| Other staff whose actions have a material impact on the risk profile of the Company | 16 | 521 | - | **521** |
| **Total** | **30** | **2.041** | **82** | **2.123** |

***Notes:***
1. Directors and heads of significant business lines
2. Variable remuneration awarded during the year was in the form of cash.

The following table provides aggregate quantitative information on remuneration, broken down by business line:

| Business Line | 31 December 2016 |
|---|---|
| | Aggregate quantitative information on remuneration $'000 |
| Control Functions & Legal Department | 884 |
| Trading & Sales, Dealing on Own Account | 508 |
| Portfolio Management, Investment Advice | 59 |
| Underwriting, Capital Structure & Financing, Operations, Clients & Counterparties | 346 |
| **Total** | **1.797** |

There was no deferred remuneration, sign-on or severance payment made in 2016 to senior management or other members of staff whose actions have a material impact on the risk profile of the Company.

## 11. Leverage Ratio

An underlying cause of the global financial crisis was the build-up of excessive on- and off-balance sheet leverage in the financial system. In many cases, institutions built up excessive leverage while apparently maintaining strong risk-based capital ratios. At the height of the crisis, financial markets forced the banking and financial services sector to reduce its leverage in a manner that amplified downward pressures on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling bank capital and shrinking credit availability.

The Basel III framework introduced a simple, transparent, non-risk based Leverage Ratio to act as a credible supplementary measure to the risk-based capital requirements.

Leverage Ratio is defined as the capital measure (i.e. the institution’s Tier 1 capital) divided by the exposure measure as this is defined in the European Commission’s Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No. 575/2013 of the European Parliament and of the Council with regards to the Leverage Ratio. It is noted that the final calibration, and any further adjustments to the definition, will be completed by 2017, with a view to migrating to a Pillar 1 minimum capital requirement on 1 January 2018.

The proposed minimum requirement for the purposes of the Leverage Ratio is currently assessed at 3%.

The Company’s Leverage Ratio as at 31 December 2016 stood at 15,23%.

The table below provides a reconciliation of accounting assets and Leverage Ratio exposures:

| **Summary reconciliation of accounting assets and leverage ratio exposures** | | |
|---|---|---|
| | | **Applicable Amounts $‘000s** |
| 1 | Total assets as per published financial statements | 779.466 |
| 2 | Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation | - |
| 3 | (Adjustment for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio exposure measure in accordance with Article 429(13) of Regulation (EU) No 575/2013 "CRR") | - |
| 4 | Adjustments for derivative financial instruments | 76.887 |
| 5 | Adjustments for securities financing transactions "SFTs" | 31.545 |
| 6 | Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures) | - |
| EU-6a | (Adjustment for intragroup exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (7) of Regulation (EU) No 575/2013) | - |
| EU-6b | (Adjustment for exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (14) of Regulation (EU) No 575/2013) | - |
| 7 | Other adjustments | 61.562 |
| 8 | **Total leverage ratio exposure** | **949.460** |

The table below provides a breakdown of the exposure measure by exposure type:

| Leverage ratio common disclosure | | |
|---|---|---|
| | | **CRR leverage ratio exposures $'000s** |
| **On-balance sheet exposures (excluding derivatives and SFTs)** | | |
| 1 | On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral) | 670.469 |
| 2 | (Asset amounts deducted in determining Tier 1 capital) | (124) |
| **3** | **Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)** | **670.345** |
| **Derivative exposures** | | |
| 4 | Replacement cost associated with *all* derivatives transactions (i.e. net of eligible cash variation margin) | 55.695 |
| 5 | Add-on amounts for PFE associated with *all* derivatives transactions (mark-to-market method) | 77.253 |
| EU-5a | Exposure determined under Original Exposure Method | - |
| 6 | Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the applicable accounting framework | - |
| 7 | (Deductions of receivables assets for cash variation margin provided in derivatives transactions) | - |
| 8 | (Exempted CCP leg of client-cleared trade exposures) | - |
| 9 | Adjusted effective notional amount of written credit derivatives | - |
| 10 | (Adjusted effective notional offsets and add-on deductions for written credit derivatives) | - |
| **11** | **Total derivative exposures (sum of lines 4 to 10)** | **132.948** |
| **Securities financing transaction exposures** | | |
| 12 | Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions | - |
| 13 | (Netted amounts of cash payables and cash receivables of gross SFT assets) | - |
| 14 | Counterparty credit risk exposure for SFT assets | 146.167 |
| EU-14a | Derogation for SFTs: Counterparty credit risk exposure in accordance with Article 429b (4) and 222 of Regulation (EU) No 575/2013 | - |
| 15 | Agent transaction exposures | - |
| EU-15a | (Exempted CCP leg of client-cleared SFT exposure) | - |
| **16** | **Total securities financing transaction exposures (sum of lines 12 to 15a)** | **146.167** |
| **Other off-balance sheet exposures** | | |
| 17 | Off-balance sheet exposures at gross notional amount | - |
| 18 | (Adjustments for conversion to credit equivalent amounts) | - |
| **19** | **Other off-balance sheet exposures (sum of lines 17 to 18)** | **-** |

| Exempted exposures in accordance with CRR Article 429 (7) and (14) (on and off balance sheet) | | |
|---|---|---|
| EU-19a | (Exemption of intragroup exposures (solo basis) in accordance with Article 429(7) of Regulation (EU) No 575/2013 (on and off balance sheet)) | - |
| EU-19b | (Exposures exempted in accordance with Article 429 (14) of Regulation (EU) No 575/2013 (on and off balance sheet)) | - |
| **Capital and total exposures** | | |
| **20** | **Tier 1 capital** | **144.561** |
| **21** | **Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)** | **949.460** |
| **Leverage ratio** | | |
| **22** | **Leverage ratio** | **15,23%** |
| **Choice on transitional arrangements and amount of derecognised fiduciary items** | | |
| EU-23 | Choice on transitional arrangements for the definition of the capital measure | - |
| EU-24 | Amount of derecognised fiduciary items in accordance with Article 429(11) of Regulation (EU) NO 575/2013 | - |

The table below provides a breakdown of total on balance sheet exposures (excluding derivatives, SFTs and exempted exposures) by asset class:

| Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures) | | |
|---|---|---|
| | | **CRR leverage ratio exposures $'000s** |
| **EU-1** | **Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:** | **670.345** |
| **EU-2** | **Trading book exposures** | **318** |
| **EU-3** | **Banking book exposures, of which:** | **670.027** |
| EU-4 | Covered bonds | - |
| EU-5 | Exposures treated as sovereigns | - |
| EU-6 | Exposures to regional governments, MDB, international organisations and PSE NOT treated as sovereigns | - |
| EU-7 | Institutions | 158.641 |
| EU-8 | Secured by mortgages of immovable properties | - |
| EU-9 | Retail exposures | 16.442 |
| EU-10 | Corporate | 494.777 |
| EU-11 | Exposures in default | - |
| EU-12 | Other exposures (e.g. equity, securitisations, and other non-credit obligation assets) | 167 |

**Description of the processes used to manage the risk of excessive leverage**

The Company adopted the standardized approach for Market risk according to BCS internal methodologies. The Company holds collateral from clients in order to provide leverage to margin trading clients. Clients and repo collateral balances are monitored on a real-time basis to ensure that the Company is not at risk to market deterioration.

Furthermore, the Company uses the "haircut"-based framework and defines additional controls (including fat fingers, position, loss and other controls – the list depends on the account strategy) in order to limit the risk exposure of margin trading. The main criteria determining capital requirements are the difference between discounted collateral and discounted marginal requirements.

In addition, the Company has a complex risk control environment for marginal trading, which includes pre-trade and post-trade systems. All new orders are subject for full pre-trade check according to pre-defined limits before being sent for execution. For high-frequency trading the Company uses specialized low-latency system with similar full pre-trade controls. Post-trade system performs online M2M revaluation of portfolio and notifies risk officers in case of any deviations or margin calls.

The Company monitors its Leverage Ratio at least on a quarterly basis.

**Description of the factors that had an impact on the Leverage Ratio during the period to which the disclosed Leverage Ratio refers**

The regulatory Leverage Ratio of the Company over the financial year 2016 ranged between 11,30% and 24,67%.

The Risk Committee is mandated to oversee and control integrated planning and to monitor the risk profile and capital capacity. The limits are actively managed:

- To support business achievement of strategic performance plans.
- To provide a firm basis for achieving the target Leverage Ratio.
- To maintain risk discipline.