Otkritie
Securities Limited

Pillar 3 disclosures

for the year ended 31 December, 2013

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Otkritie Securities Limited

Contents

1. Overview 3

2. Business Model 3

3. Risk overview 3

4. Capital base 4

5. Internal Capital Adequacy Assessment Process 4

6. Risk Appetite 5

7. Credit Risk 5

8. Market risk 7

9. Liquidity Risk 7

10. Operational Risk 7

11. Interest rate risk in non-trading book 8

12. Remuneration Policy Disclosures 8

1) Information concerning the decision-making process used for determining the remuneration policy 8

2) Correlation between pay and performance; 8

13. Capital Requirements Directive Pillar 3 disclosure 10

1. Overview

The new Basel Accord (Basel 2) was implemented in the European Union (EU) through the Capital Requirements Directive (CRD) on 1 January 2007. The new framework consists of three 'pillars' which are complementary and mutually-reinforcing.

- Pillar 1 (minimum capital requirement) of the new standards sets out the minimum capital requirements covering credit, market and fixed overhead requirement risk.
- Pillar 2 (supervisory review process) requires banks and supervisors to take a view on whether a bank should hold additional capital against risks not covered in Pillar 1 and to take action accordingly within the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar 3 (market discipline) disclosures provide the reader with information on a bank's capital structure, capital adequacy, risk management policies and general risk profile of a bank.

In accordance with the requirements of Chapter 11 of BIPRU, the disclosures included in this website relate to the Firm and are required to be made on an annual basis at a minimum and if appropriate some disclosures will be made more frequently. Otkritie Securities Limited ("OSL") has an Accounting Reference Date of 31 December. These disclosures are made as at 31 December 2013.

These disclosures have been put together to explain the basis of preparation and disclosure of certain capital requirements and provide information about the management of certain risks and for no other purposes. These disclosures are not subject to audit, they do not constitute any form of audited financial statement and have been produced solely for the purposes of satisfying Pillar 3 requirements. The Board is responsible for the Firm's system of internal control and for reviewing its effectiveness. Such a system can provide only reasonable and not absolute assurance against material financial misstatement or loss and is designed to mitigate, not eliminate, risk.

2. Business Model

The business model of OSL can be characterised as a broker specialising in prime services and client orders' execution for various financial instruments: fixed income securities, equities and derivatives. OSL's income is generated by earning commissions from transactions on a brokerage basis and by earning interests on margin trading by the clients, securities financing, equities lending and borrowing.

3. Risk overview

Risk is an integral part of OSL business. The main risks faced by OSL are credit risk, market risk, liquidity risk and operational risk.

Risk Management's aims are to identify, quantify and assess all risks and to set appropriate prudential limits consistent with the risk appetite of the group.

OSL Risk Management actively manages the risks through real-time monitoring and daily reporting on credit, market and operational risk. The Frim's Risk Department works closely with the Front Office to ensure relevant limits are being approved and limit breaches are being monitored.

OSL has a set a risk management framework consisting of several layers, including Risk Management Committee, Board Risk and Compliance Committee, Board Audit Committee which focus on the various risks faced by the Firm. Risk Management Committee consists of the Firm's senior management whereas Board Risk and Compliance Committee and Board Audit Committee consist of primarily non-executive directors. The Risk Appetite is defined by the Board along with the strategy of the Firm. Based on that document the management sets the certain limits for various types of exposures.

The Directors in discussions with senior management determine the Firm's business strategy and risk appetite that recognise the risks that the business faces. The Directors meet on a regular basis and discuss current projections for profitability and regulatory capital management, business planning and risk management. The Directors manage the Firm's risks through a framework of policy and procedures having regard to relevant laws, standards, principles and rules, with the aim to operate a defined and transparent risk management framework. These policies and procedures are updated as required. The Firm follows the standardised approach to market risk and the standard approach to credit risk.

4. Capital base

The Firm's capital base comprises only of Original Own Funds (Core Tier 1 Capital), namely permanent share capital and share premium account. In 2011 financial statements due to an exceptional event the Firm incurred a loss of £49,915,118 and had net assets £1,716,178. At the same time the Firm's parent has provided a guarantee against any and all remaining liabilities which the Firm may have in relation to this matter. The regulator was duly informed.

In 2012 the Firm has £162.4M as available capital resources. As consequences of events in 2011 the Firm passed through a series of enhancements in systems and controls area as well as in governance arrangement with revised risk appetite that helps to maintain more sustainable growth. The core strength of the business is its ability to be cash generative, which reflects its ability to manage its working capital requirements and to maintain high levels of liquidity resources. The Firm has a good client base and client retention is high. In the beginning of 2014 the High Court of Justice in UK made a decision in favour of the Firm, whereby the Firm will now seek to recover its stolen assets.

The table below shows the Firm's regulatory capital base as at 31 December 2013 (based on audited financials).

£' 000	**Year ended 31/12/2013**
Original Own Funds	
Permanent Share Capital	209,894
Share premium account	2,730
Profit&Loss	- 9,537
Total Original Own Funds	**202,923**
Additional Own Funds	-
Total Eligible Own Funds	**202,923**

5. Internal Capital Adequacy Assessment Process

OSL undertakes an Internal Capital Adequacy Assessment Process (ICAAP) which is a system of sound, effective and complete strategies and processes that allow institutions to assess and maintain, on an ongoing basis, the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of risks to which they are or might be exposed.

This is undertaken annually or more frequently if required and outcome is presented in a separate ICAAP document. The ICAAP covers all material risks to determine the capital requirement to satisfy regulatory requirements.

OSL defines capital as the resources necessary to cover all relevant risks. The ICAAP by which the Board examines the Firm's risk profile and sets a risk appetite to ensure the level of capital:

- Remains sufficient to support the Firm's risk profile and outstanding commitments;

- Exceeds the Firm's minimum regulatory capital requirements communicated to the FCA; and
- Remains consistent with the Firm's strategic and operational goals.

6. Risk Appetite

The Board articulates the risk appetite for its activities and stipulates it in risk appetite statement. The Firm defines Risk Appetite as representing the amount and type of risk it is prepared to accept, tolerate or be exposed to at any point in time in the context of its business model and in the course of achieving its business objectives.

There are risk policies and procedures, risk operating manuals and risk limits in place, in order to make those risks manageable for the purpose of gaining on market uncertainties, increase the value of the Firm and implement risk-awareness into decision making process. As part of the annual ordinary business planning process, the Firm's Risk Appetite statement is communicated by the Firm's Board to its Risk Management Committee and Senior Management. The Firm incorporates measurements of earnings, capital adequacy, reputation and regulatory compliance against plan targets in its monthly management reporting packs which contain the appropriate KPIs/KRIs.

The Firm has assessed its overall risk appetite and its internal control framework taking into account its systems and controls, policies and procedures that allow us to mitigate most risks before they crystallize. The Firm has however provided for an additional capital buffer under Pillar 2 in order to cover any additional risks.

This assessment is based on:

- The historical track record of OSL business over the last few years.
- The Firm deals with well-established and reliable counterparties.
- The Firm bears credit exposure in non-trading book.
- Scenario Analysis and Stress Tests on the most significant risks identified. This informs the Firm how risk are likely to behave and what, if any, impact there is likely to be to our balance sheet
- The Trading Book activities scope includes the facilitation of clients' orders and principal trading activities.
- The Firm has limited its client base to professional clients and eligible counterparties only classified in accordance with MiFID.
- The Firm reinforces its efforts to comply with CASS rules and maintain the protection to clients' money and clients' assets.
- The Firm mainly focuses its business activities to various financial instruments traded in Russian financial markets or derived from/ based on those.
- The firm's risk profile should also be optimized using risk transfer and risk mitigation tools.

7. Credit Risk

OSL defines counterparty risk as a combination of pre-settlement and settlement risk:

- Pre-settlement risk is defined as the risk that one party of a contract will fail to meet the terms of the contract and default before the contract's settlement date, prematurely ending the contract. This type of risk can lead to replacement-cost risk.
- Settlement risk is the risk that one party will fail to deliver the terms of a contract with another party at the time of settlement. Settlement risk can be the risk associated with default at settlement and any timing differences in settlement between the two parties. This type of risk can lead to principal risk. Settlement risk is the possibility one counterparty will never pay or deliver to another counterparty.

As a significant proportion of the Firm's transactions are conducted on the basis of "delivery versus payment", this minimises the risk of exposure to any trading positions. This does not however eliminate risk entirely in the combination of circumstances in which the counterparty fails and the value of stock awaiting settlement against

payment has changed adversely. To guard against this, OSL sets limits for various counterparties and monitors these limits constantly.

OSL provides services of trading in exchange traded derivatives, margin trading, securities financing, equities lending and borrowing. Exposure values to clients through the provision of these services are determined using mark to market methods. In all cases where such transactions place the client or OSL at risk, OSL will hold adequate collateral and provisions for netting arrangements. This normally takes the form of a lien over the customer's assets giving a claim on these assets for both existing and future liabilities.

The OSL Risk Management assesses counterparties' creditworthiness, and assigns to them internal credit ratings, which are mapped on external rating.

The total Firm's credit risk capital requirements are presented in the table below ($000)

Risk Weighted Assets for Credit Risk	Pillar 1 Requirement	Additional Capital Requirement (Pillar 2)	Internal Capital allocated for Credit Risk
1 386 763	110 941	19 158	130 099

Additional capital requirement for credit risk under ICAAP was mainly caused by credit concentration risk. In order to obtain the figure for additional capital the firm has taken a Herfindahl Hirschman Index.

Concentration risk is defined as the risk of loss of income through external changes having a disproportionate impact on overall income due to a reliance on revenue from certain sectoral, geographic areas and/ or business lines.

Broking activities represent a significant proportion of total income with the majority relating to financial instruments originated in or related to Russian financial market and consequently is an area where concentration risk exists. Brokerage income is diversified into revenue from securities lending and borrowing, client orders facilitation, proprietary trading, agency dealing commission.

Credit risk concentrations include:

- A significant exposure to an individual counterparty or group of counterparties;
- Credit exposures to counterparties in the same economic sector or geographic region;
- Credit exposures to counterparties whose financial performance is dependent on the same activity or commodity; and
- Indirect credit exposures arising from a bank's CRM activities (e.g. exposure to a single collateral type or to credit protection provided by a single counterparty).

Trigger events that can exercise concentration risk are as follows:

- The Firm uses one settlement agent.
- Amounts due from connected companies.
- Default of a large transaction with a counterparty.

Risk mitigation:

Currently OSL uses the settlement services of a world major financial group entity focused on providing a wide range of such service globally, it is a regulated entity which has an excellent credit rating.

For Russian Local stock the settlement agent is an affiliated entity with very similar risk management approach approved at the group level.

For futures and options business there are two main settlement and clearing agents – entities belonging to 2 independent world major financial groups, both are regulated entities with an excellent credit rating.

Inter-company balances are settled immediately. Members of the group are well capitalised and in addition have the financial support of the ultimate shareholder were further funds required.

8. Market risk

Market risk is the risk that arises from fluctuations in values of, or income from, assets and asset prices or in interest or exchange rates. Based on a voluntary variation of permission and consequently on the change of the firm's strategy market risk of the firm has become one of the main risk factors. The Firm is exposed to the market risk in several instruments – equity business, equity derivatives, fixed income securities. The firm is also exposed to FX risk due to the fact that reporting currency is currently different from main business currency, that deviation was inherited after VVOP.

Market risk capital requirement of OSL under Pillar 1 is US$64.825M. For principal trading activity the firm assumes that amount of additional capital is $9.9M calculated using 99% 10-day VaR. The Firm's Risk Management used 99% 10-day VaR to find the additional amount of capital required to cover FX risks which are not fully covered by Pillar 1.

Business lines	Pillar 1 Requirement	Additional Capital Requirement (Pillar 2)	Internal Capital allocated for Credit Risk
Principal Trading	49,335	9,895	59,230
FX	15,490	1,761	17,251
Total	64,825	11,656	76,481

9. Liquidity Risk

Liquidity risk is the risk that the Firm, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost.

A liquidity risk assessment includes a determination of the extent to which there is a mismatch between assets and liabilities which could occur as a result of the Firm's assets having been pledged, the Firm's inability to sell assets quickly, or the costs and time constraints of reducing asset positions at different levels of market liquidation.

OSL's policy is to ensure that, we maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. The liquidity position is monitored on a daily basis and management information provided daily to the senior management.

Based on the breakdown of major sources of funding the Firm assumes that due to the open nature of its repo book it will be able to close out receivables and payables quickly. However there is a 10% mismatch between direct and reverse repo. The Firm applies the following parameters of the stress: average haircut on the street side goes from current 20% to 50%, interest rate climbs up 200bp, narrowing of collateral list to blue chips and BBB-rated securities only, shock period 2 weeks, aftershock inability to access the liquidity market – 3 months.

Total capital requirement for liquidity risk is estimated at $8.696M

10. Operational Risk

OSL defines Operational Risk as the risk of loss resulting from inadequate or failed internal processes, human behaviour and systems or from external events. OSL' manages this risk through policies, procedures and internal controls to ensure compliance with laws and regulations. The quality and timelines of risk mitigation are

monitored by Board Risk Committee, Risk Management Committee and the Risk Management Department. Further assurance is provided by the Group's internal audit and OSL's compliance departments. Based on an occurrence of a highly exceptional event the Board decided to set additional capital requirements in this area equal to $1,983K.

11. Interest rate risk in non-trading book

Interest rate risk arising from non-trading book activities are primarily assessed via stress test scenario. The Firm uses stress testing in order to evaluate its exposure to the interest rate risk in non-trading activities. There were 2 scenarios used for the purpose of this evaluation – up-change and down-change of 200 basis points in the interest rates. The exposure in question is mainly nominated into 2 currencies – USD and RUR. For USD loans the yield of 1year USA Treasury notes was selected as the discount rate; for RUR-nominated loans and bonds in non-trading book the discount rate is Refinancing Rate of the Central Bank of the Russian Federation. The amount of additional capital required is $21.7M

12. Remuneration Policy Disclosures

1) Information concerning the decision-making process used for determining the remuneration policy

The Board of Directors is responsible for all decisions relating to remuneration. Recommendations are made based on individuals' performance in the prior year, considering non-financial metrics and the firm's overall position.

Heads of departments and business units, in consultation with line management, complete an annual review of all employees' base salaries and recommend amendments where these are considered to be merited. The recommendations are considered by the Board of Directors and, if approved, will usually be implemented with effect from 1 May each year.

Decisions on remuneration are taken by the Board of Directors and they retain the responsibility for ensuring implementation of the Code, ongoing compliance and the identification of Code Staff.

The Employee shall have right to a bonus or a time-apportioned bonus if he/she has been employed throughout the whole of the relevant financial year of the Firm.

2) Correlation between pay and performance;

Bonuses are based on the achievement of a number of previously approved goals. This is combined with an overall review of performance carried out by management. Such a review will consider non-financial metrics.

Given the above, the firm's remuneration practices do not encourage inappropriate risk taking. It follows that in determining the level of bonus, bonus will only be granted when the firm considers that such an award is consistent with the firm's strategy, values and long-term interests.

The allocation of the bonus pool is based on the contribution of each business unit within the firm as demonstrated by the management accounts, and of each individual's contribution to the firm's results as assessed during the performance appraisal process completed during February each year.

Each employee's performance appraisal is properly documented by the appraising manager so that the link between performance and bonus allocation is clear. Non-financial performance criteria form a significant part of the performance assessment process, with explicit reference to the firm's breaches, dealing errors, complaints,

CPD training records and any outstanding audit points. Poor performance in non-financial metrics is likely to override metrics of financial performance.

Bonuses are awarded in a manner that promotes sound risk management and does not induce excessive risk-taking. This is done by ensuring that:

- An appropriate balance exists between fixed, performance-based components and deferred bonus component.
- The fixed component represents a sufficiently high proportion of the total remuneration to make non-payment of the performance-based component possible.
- The performance-based component reflects the risk underlying the achieved result.
- The deferred bonus component focuses on risk and sustainability, as well as aids the retention.
- Awarded performance-based pay may be forfeited in full or in part if granted on the basis of unsatisfactory results of the appraisal.
- The bonus may be adjusted to reflect performance even after the employee has been notified of the bonus.
- Employees with less than 1 year of service are not entitled to the bonus.

Performance-based remuneration pools must be based on an assessment of the Firm's budget performance. The Board has responsibility to decide on the funds to be allocated to the performance-based remuneration pools. The Firm's Risk control function is involved to ensure that risk, capital and liquidity limits are not exceeded.

The Board has discretion in the allocation of the pool to business divisions. The Board must make recommendations on allocation of the pool to the Business/Support Units.

Line Managers for each Business/Support Unit have discretion on allocating bonus payments to individuals in their department. The appraisal results are taken into consideration when the bonus pool is distributed.

When allocating the bonus pool, the Board may consider other factors:

- Contribution of the division to earnings;
- Assessment of the contribution to risk management and compliance by function (in case of a support function);
- Assessment of risk management and compliance by the division (in case of a business unit);
- Appraisal results;
- Length of service;
- Disciplinary records;
- Compliance breach records

For the avoidance of doubt, any instance of failure to comply with relevant legislation, regulations, or internal policies and procedures will be taken very seriously and will impact upon the level of any element of variable remuneration which might otherwise have been awarded.

The following forms of financial compensation are prohibited:

- Payments from a Firm within the Financial Corporation OTKRITIE JSC group of companies other than OSL unless approved by the Board of OSL.
- Money or cash convertible gifts or inducements (as described in Conflicts of Interest Policy).
- Bribes (further information in Bribery and Corruption Policy).

In addition, employees are prohibited from entering into a personal hedging strategy or taking out insurance contracts against any downward adjustment to their remuneration, or any other practice that largely or wholly negates this Policy's purpose to achieve risk alignment.

Any paid work not forming part of the employee's employment contract with a member of the Otkritie Financial Corporation must be pre-approved in accordance with the Outside Business Interests Policy, found in the Compliance Policy.

13. Capital Requirements Directive Pillar 3 disclosure

The following table summarizes OSL's regulatory capital resources at 31 December, 2013 (prior to audited financials):

Capital Requirement Calculation Breakdown	$000
Base capital resources requirement	**1 003**
Total variable capital requirement	**184 676**
Credit risk	86 471
Market risk	64 826
Operational risk	7 914
Concentration risk	24 470
Total Capital requirement under Pillar 1	**184 676**
Capital resources	281 806
Excess over Pillar 1 requirements	97 450
Total Capital requirement under Pillar 2	**79 015**
Total Internal Capital Requirements	**263 691**
Excess over Internal Capital	18 019

There is currently a surplus between the capital resources of the Firm and the capital requirements of the Firm as detailed above.

The information contained in this document has not been audited by the Firm's external auditors and does not constitute any form of financial statement and must not be relied upon in making any judgment on the Firm.

The Firm is subject to the disclosures under the Banking Consolidation Directive however, it is not a member of a UK Consolidation Group and consequently, does not report on a consolidated basis for accounting and prudential purposes.

Further enquiries

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