

# Otkritie Capital International Limited

Pillar 3 disclosures  
for the year ended 31 December, 2015

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## 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 standards sets out the minimum capital requirements covering credit, market and fixed overhead requirement risk.
- **Pillar 2** (supervisory review process) requires institutions 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 an institution's capital structure, capital adequacy, risk management policies and general risk profile of an institution.

In accordance with the requirements of Title VII Chapter 2 of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("Regulations"), 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 Capital International Limited ("OCIL") (previously known as Otkritie Securities Limited) has an Accounting Reference Date of 31 December. These disclosures are made as at 31 December 2015.

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 the Regulations. The Board of Directors ("the Board") is responsible for the Firm's system of internal control and for reviewing its effectiveness. The risk management framework set in the Firm, can provide only reasonable and not absolute assurance against material financial misstatement or loss and is designed to manage, not eliminate risk.

## 2. Business Model

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

## 3. Risk overview

OCIL has the following oversight committees:

- Board Risk and Compliance Committee
- Board Audit Committee
- Risk Management & Compliance Committee
- Remuneration Committee

The Board has overall responsibility for the OCIL's system of internal controls, the objectives of which are the safeguarding of the company's assets, the maintenance of proper accounting records and the availability of reliable financial information for use within the business and for publication; and ultimately to prevent and mitigate the risk of business failure. The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives and provide reasonable assurance against material misstatement and loss, and to prevent and detect fraud and other irregularities.

The Board regularly reviews the effectiveness of the OCIL's internal control system. There is an ongoing process for identifying, evaluating and managing significant risks which was in place throughout the year. The Board Risk and Compliance Committee is comprised of two independent Non-executive Directors – Martin Graham (Chairman) and Richard Ogdon. It monitors risk factors and the efficacy of controls.

The provision of internal audit activities provides the Board with flexible resourcing and independency on the review of business practices. The Board Audit Committee approves annually the audit plan, which covers various divisions and departments within OCIL.

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

The Risk Management framework within OCIL consists of several levels. The first level, or the first line of defense, is the front office personnel acting in accordance with the approved trading mandates which contain the business idea or trading strategy and certain restrictions and limitations related to the executed strategy.

The second level is independent risk management department and the Risk Management and Compliance Committee who are comprised of senior managers on a balanced basis, as from front office as from support.

The third level is the Board of Directors executing its risk oversight function via the Board Risk and Compliance Committee and the Board Audit Committee, both fora consist primarily of non-executive directors.

The Risk Appetite is defined by the Board along with the strategy of the Firm. Based on this document, the management sets certain limits for various types of exposures.

The Directors in discussions with senior management determine the Firm's business strategy and risk appetite that recognises the risks that the business faces. The Directors meet on a regular basis and discuss current projections for profitability, regulatory capital management, business planning and risk management. The Directors oversee the Firm's risk profile 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.

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 Firm.

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

## 4. Capital resources

The Firm's capital resources comprise only of Tier 1 Capital (Common Equity Tier 1 Capital), namely paid-up capital and share premium account. During 2015 the Firm's capital base was \$310.2M. The net audited financial result for 2015 was \$57.2M. The Board of Directors approved the payment of the dividends to the shareholders for the amount of \$55M and the total available capital resources were adjusted by this amount accordingly.

In 2015 the management had revisited the business strategy, there were certain actions undertaken including the review of the cost policies and profitability assessment of the business lines. As a result the size of the business portfolios of some business lines were reduced. Due to macroeconomic situation in 1 of the primary markets – Russia, the Firm's performance was under constant pressure in 2015. However as expected the Firm was able to generate profit, maintain high levels of liquidity resources and manage its working capital requirements. The Firm has a good client base and client retention is high.

The table below shows the Firm's regulatory capital resources as at 31 December 2015 (based on audited financials).

\$000's	Year ended 31/12/2015
<b>Capital instruments eligible as CET1 Capital</b>	<b>356 029</b>
Called up share capital	346 032
Share premium account	4 501
<b>Retained earnings</b>	<b>57 082</b>
<b>Other reserves</b>	<b>3 414</b>
<b>Dividends</b>	<b>(55 000)</b>
<b>COMMON EQUITY TIER 1 CAPITAL</b>	<b>356 029</b>
<b>ADDITIONAL TIER 1 CAPITAL</b>	<b>0</b>
<b>TIER 2 CAPITAL</b>	<b>0</b>
<b>Total Eligible Own Funds</b>	<b>356 029</b>

## 5. Internal Capital Adequacy Assessment Process

OCIL 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.

OCIL 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; 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 and Compliance 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 crystallise. 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 OCIL business over the last few years;

- the Firm deals with well-established and reliable counterparties;
- 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; and
- the firm’s risk profile should also be optimized using risk transfer and risk mitigation tools.

## 7. Credit Risk

OCIL 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 not pay or deliver to other counterparty.

As a significant proportion of the Firm’s transactions are conducted on the basis of "delivery versus payment", this minimizes the settlement risk exposure. 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, OCIL sets limits for various counterparties and monitors these limits constantly.

OCIL 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 OCIL at risk, OCIL 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 OCIL Risk Management assesses counterparties’ creditworthiness and assigns to them internal credit ratings, which are mapped on external rating.

Under standardized approach for credit risk OCIL uses 3 ratings provided ECAs – Standard & Poor’s, Moody’s and Fitch.

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

Exposure classes	Risk Weighted Assets for Credit Risk	Pillar Requirement 1	Additional Capital Requirement (Pillar 2)	Internal Capital allocated for Credit Risk
TOTAL	502 146	40 172	62 171	102 343
Institutions	82 206			
Corporates	378 928			
Other	41 012			

Additional capital requirement for credit risk under ICAAP was mainly caused by worsened credit quality of OCIL's counterparts (due to launch of Russia-related sanctions some financial institutions ceased to be exposed at Russian financial market at all and the Firm in terms of funding, had to switch to higher haircuts or to Russia-based financial institutions with shortening the maturity profile of the exposure). Concentration risk has also become significant to the Firm and 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:

- 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; or
- default of a large transaction with a counterparty.

Risk mitigation:

Currently OCIL 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 promptly. 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 the Firm's strategy, market risk of the Firm is also the one of the main risk factors. The Firm is exposed to the market risk in several instruments – equity business, equity derivatives, fixed income securities, currencies.

In managing market risk arisen in day-to-day business activities of the firm there is an arranged enterprise risk framework incorporated into the management process. This includes various market risk limits, trading mandates, clear and transparent escalation routes, stress-testing and hedging.

Market risk capital requirement of OCIL under Pillar 1 is US\$58.7M. Based on the maximum risk appetite allocated for principal trading activity the Firm assumes that amount of additional capital is \$85.2M calculated using 95% 10-day VaR. The Firm's Risk Management used 95% 10-day VaR to find the additional amount of capital required to cover FX risks which are not fully covered by Pillar 1.

Type of asset	Original exposure amount	Pillar Requirement 1	Additional Capital Requirement (Pillar 2)	Internal Capital allocated for Market Risk
Fixed income instruments	294 350	23 548	31 459	55 007
Equity and equity based derivative instruments	383 413	30 673	23 335	54 008
FX and other instruments	56 338	4 507	30 429	31 537
<b>Total</b>	<b>734 100</b>	<b>58 728</b>	<b>85 223</b>	<b>140 522</b>

## 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.

OCIL'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.

Being the subject of UK national liquidity regime the Firm evaluates its liquidity risk exposure profile under ILAA. In terms of additional capital requirements the management considers \$1.5M as a sufficient capital buffer based on the structure of the liquidity resources.

## 10. Operational Risk

OCIL defines Operational risk as the risk of loss resulting from inadequate or failed internal processes, human behavior and systems or from external events. OCIL' 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 and Compliance Committee, Risk Management and Compliance Committee and the Risk Management department. Further assurance is provided by the Group's Internal Audit and OCIL'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 \$4,168K.

## 11. Technology (IT risk)

The management decides to consider the technology risk separately. In its day-to-day business the Firm heavily relies upon the stable infrastructure, especially IT technologies. Therefore the management has incorporated various mitigations around different types of risk. The management considers this type of risk may consist of:

- IT system failure (due to various reasons);
- Disintegration of a number of systems.

However the second type results ultimately in the failure of the particular IT system to perform its function. Therefore IT department has created the list of critical systems, required time for functionality restoration and made cross-references between the systems in order to assess the integrity risk. Addressing this type of risk also forms one of the basic layers in Business Contingency Policy, Disaster Recovery and Resolution Plan and procedures and global Recover and Resolution plan

The Firm estimates the additional capital requirement to address the IT failure event as \$905,000.

## 12. Interest rate risk in non-trading book

The Firm has reduced its non-trading book activity to the immaterial level and no capital was provided for that type of risk.

## 13. Remuneration Policy Disclosures

### *13.1. Information concerning the decision-making process used for determining the remuneration policy*

The Board 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 and, if approved, will usually be implemented with effect from 1 May each year.

Decisions on remuneration are taken by the Board 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.

### *13.2. 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 reviews 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 over-ride 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; and
- 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; and
- 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 Otkritie Holding group of companies other than OCIL unless approved by the Board of OCIL;
- money or cash convertible gifts or inducements (as described in Conflicts of Interest Policy); or
- 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 Holding must be pre-approved in accordance with the Outside Business Interests Policy, found in the Compliance Policy.

The following table contains remuneration of staff and directors

	2015
	USD
<b>Employees</b>	<b>23 616 434</b>
<i>Wages and salaries</i>	<i>17 625 849</i>
<i>Social security costs</i>	<i>2 857 646</i>
<i>Other staff costs</i>	<i>3 129 939</i>
<i>Average number of staff members</i>	<i>182</i>
<b>Directors</b>	<b>1 596 668</b>
<i>Emoluments</i>	<i>1 460 616</i>
<i>Payment to pension schemes</i>	<i>136 052</i>
<i>Number of directors</i>	<i>6</i>

## 14. Capital Requirements Directive Pillar 3 disclosure

The following table summarises OCIL's regulatory capital resources at 31 December, 2015:

<b>Capital Requirement Calculation Breakdown, \$000</b>	<b>2014</b>	<b>2015</b>
Credit risk	134 547	40 172
Market risk	42 888	58 728
Operational risk	20 516	20 516
Concentration risk	24 079	-
<b>Total Capital requirements under Pillar 1</b>	<b>222 031</b>	<b>116 038</b>
<b>Capital requirements for risks not fully covered under Pillar 1</b>	<b>44 038</b>	<b>152 075</b>
Capital Planning Buffer	15 700	16 000
<b>Total Internal Capital Requirements</b>	<b>302 564</b>	<b>284 113</b>
<b>Capital resources</b>	<b>366 762</b>	<b>356 029</b>
Excess over Pillar 1 requirements	144 731	239 991
Excess over Internal Capital Requirements	64 198	71 916

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.

## 15. Governance

This document was discussed at the Risk Management and Compliance Committee and further at the Board Risk and Compliance Committee, which was formally approved for publishing in the Firm's website

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