Pillar 3 disclosures

for the year ended 31 December, 2011

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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 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 company 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 2011.

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 company'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 an agency broker specialising in execution services for both equities and derivatives. OSL's income is generated by earning commissions from transactions on a brokerage basis and by earning interests on margin buying 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 Company's Risk Department works closely with the Trading Department to ensure relevant limits are being approved and limit breaches are being monitored.

OSL has a Risk Management Committee which focuses on the risks of significant degree faced by the Company. The minutes of the Risk Committee are reviewed by OSL's Directors.

OSL Senior Management also meet on a frequent basis for conducting the review of the business to ensure day-to-day responsibilities are being discharged and the efficient running of the business. Senior management is responsible for the formulation and implementation of the Board strategy.

The Directors determine the company's business strategy and risk appetite along with designing and implementing a risk management framework that recognises the risks that the business faces. They also determine how those risks may be mitigated and assess on an ongoing basis the arrangements to manage those risks. 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 though 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 simplified standard approach to credit risk.

4. Capital base

The Company's capital base comprises only of Original Own Funds (Core Tier 1 Capital), namely permanent share capital and share premium account. As it was disclosed in the 2011 financial statements due to an exceptional event the company incurred a loss of £49,915,118 and had net assets £1,716,178. At the same time the company's parent has provided a guarantee against any and all remaining liabilities which the company may have in relation to this matter. The regulator was duly informed and company used the following capital base for its calculations of capital requirements prior to capital increase in May 2012.

The table below shows the Company's capital base as at 31 December 2011.

	Year ended 31/12/2011
Original Own Funds	
Permanent Share Capital	48,894
Share premium account	2,730
Profit&Loss	7
Total Original Own Funds	**51,631**
Additional Own Funds	-
Total Eligible Own Funds	**51,631**

Figures are represented in £ '000

Consequently as of June 30, 2011 the capital base was as following

	Year ended 31/12/2011
Original Own Funds	
Permanent Share Capital	128,894
Share premium account	2,730
Profit&Loss	-49,185
Total Original Own Funds	**82,439**
Additional Own Funds	-
Total Eligible Own Funds	**82,439**

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 Company's risk profile and sets a risk appetite to ensure the level of capital:

- Remains sufficient to support the Company's risk profile and outstanding commitments;
- Exceeds the Company's minimum regulatory capital requirements communicated to the FSA; and
- Remains consistent with the Company'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 Company 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 company and implement risk-awareness into decision making process. As part of the annual ordinary business planning process, the Company's Risk Appetite statement is communicated by the Company's Board to its Risk Management Committee and Senior Management. The Company 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 also 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 which had been consistently profitable over the last few years.
- The Firm deals with well-established and reliable counterparties.
- The Firm bears credit exposure in non-trading book.
- The Trading Book activities scope includes the facilitation of clients' orders.
- The Firm has limited its principal trading facility up to 0.
- 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.

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 Company'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 as shown in Table 1 below.

Table 1. Internal rating scale and mapping of external ratings

Internal Rating Group	Internal rating sub-division	External rating			Maximum OSL capital, allocated to counterparty exposure in this rating group
1 group	1_INV	Aaa	Aaa	AAA	50,00%
	2_INV	Aa+	Aa1	AA+	48,00%
	3_INV	Aa	Aa2	AA	46,00%
	4_INV	Aa-	Aa3	AA-	44,00%
	5_INV	A+	A1	A+	41,00%
	6_INV	A	A2	A	38,00%
	7_INV	A-	A3	A-	35,00%
	1	BBB+	Baa1	BBB+	32,00%
	2	BBB	Baa2	BBB	29,00%
	3	BBB-	Baa3	BBB-	26,00%

2 group	4	BB+	Ba1	BB+	24,00%
	5	BB	Ba2	BB	22,00%
	6				20,00%
	7	BB-	Ba3	BB-	18,00%
	8				16,00%
3 group	9				15,00%
	10	B+	B1	B+	14,00%
	11				13,00%
	12				12,00%
	13	B	B2	B	11,00%
	14				10,00%
	15				9,00%
4 group	16	B-	B3	B-	8,00%
	17	CCC+	Caa1	CCC+	7,00%
	18	CCC	Caa2	CCC	6,00%
5 group	19	D	D	D	0,00%

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

Pillar 1 Requirement	Additional Capital Requirement (Pillar 2)	Internal Capital allocated for Credit Risk
23 424	6 137	29 561

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.

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

Risk mitigation:

Currently OSL uses the settlement agent 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 or in interest or exchange rates. Whilst the Company engages in matched principal dealing this is primarily on a 'riskless' basis (back to back trades), the only risk in such circumstances being of counterparty failure, which is addressed under "Counterparty Risk" above. The Company has small currency exposures and runs positions in a variety of currencies, mainly in US dollars, to support clients' dealing activities. Policy permits but does not require that any significant net exposures to be hedged using forward currency contracts as soon as a commitment is made. While changes in interest rates will affect our income, they should not pose a significant risk to the company.

Market risk capital requirement of OSL under Pillar 1 is GBP 6,098 mln, most of it allocated to FX risk exposure. The company'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.

Pillar 1 Requirement	Additional Capital Requirement (Pillar 2)	Internal Capital allocated for Credit Risk
6 098	1 993	8 092

9. Liquidity Risk

Liquidity risk is the risk that OSL will encounter difficulty in meeting its obligations from its financial liabilities. OSL' policy is to ensure that, as far as possible, it will always have sufficient liquidity to meet its financial liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to its reputation. OSL maintains a portfolio of short-term deposits to ensure that sufficient liquidity is maintained. The liquidity position is monitored on a daily basis and management information provided daily to the senior management. The Company deems there is sufficient liquidity for the near future. Risk Management together with Treasury applied stress-test scenario (extension of the spread up to 250 bp to LIBOR) for liquidity matrix and based on that the company assumes that additional requirement of £150K would be sufficient to cover this type of risk.

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 Risk Management, 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 £3,230K.

11. Capital Requirements Directive Pillar 3 disclosure

The following table summarizes OSL's regulatory capital resources at 31 December, 2011:

Capital Requirement Calculation Breakdown	**£**
Base capital resources requirement	**610 000**
Total variable capital requirement	**30 675 000**
Credit risk	23 425 000
Market risk	6 098 000
Operational risk	1 152 000
Total Capital requirement under Pillar 1	**31 285 000**
Capital resources	51 631 000
Excess over Pillar 1 requirements	19 654 000
Total Capital requirement under Pillar 2	**10 710 000**
Total Internal Capital Requirements	**41 995 000**
Excess over Internal Capital	9 636 000

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

Further enquiries

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