

# Sova Capital Limited

## Pillar 3 disclosures for the year ended 31 December, 2020

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## 1. Overview

These disclosures are made as at 31 December 2020. The Pillar 3 Disclosures are prepared on an individual (solo) basis.

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 (the “Regulations”) and the Final report on the guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 issued in December 2017 and amended in June 2017 by the European Banking Authority (“Guidelines”), the disclosures included in this website relate to Sova Capital Limited (“SCL”, “Sova” or “the Firm”) (previously known as Otkritie Capital International Limited) and are required to be made on at least an annual basis.

These disclosures constitute the 3<sup>rd</sup> pillar set by the Basel Accord:

- **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 that allow market participants to assess the scope of application by an institution of the Basel framework and the rules in their jurisdiction, their capital condition, risk exposures and risk management processes and hence their capital adequacy.

These disclosures have been put together to explain the basis of the preparation and disclosure of certain capital requirements and provide information about the management of certain risks and for no other purpose. These disclosures are not subject to audit; they do not constitute any form of audited financial statement and have been produced solely for the purpose of satisfying the Regulations.

Under this regulatory obligation the Firm is obliged to provide information on its risk management, capital structure, capital adequacy and risk exposures, as well as the most important characteristics of the Firm’s corporate governance including its remuneration system.

The purpose of these disclosures is to promote market discipline and to improve transparency of market participants. The Board of Directors (the “Board”) are responsible for the Firm’s system of internal control and for ensuring its effectiveness. The risk management framework adopted within the Firm can provide reasonable, but not absolute, assurance against material financial misstatement or loss and is designed to manage not eliminate risk.

These disclosures will be reviewed annually, as a minimum, in conjunction with the publication of the Annual Report and, if appropriate, more frequently. These disclosures are not subject to audit and do not constitute any form of financial statement.

Following the end of the transition period following the UK’s withdrawal from the EU, any reference to EU regulations and directives (including technical standards) should be read as a reference to the UK’s version of such regulation and/or directive, as onshored into UK law under the European Union (Withdrawal) Act 2018, as amended.

## 2. Regulatory Developments

### The UK’s withdrawal from the EU

On 31 December 2020, the UK ceased to be subject to the EU’s legal and regulatory framework. In preparation for this, Her Majesty’s Treasury (‘HMT’), the Prudential Regulation Authority (‘PRA’) and the Financial Conduct Authority (‘FCA’) undertook an exercise of converting all of the EU’s existing legislation into UK law, regulatory rules and guidance which broadly entered into force on 31 December 2020.

Only those parts of the EU’s framework that were published and in force on 31 December 2020 have been imported into the UK’s framework. This includes any rules contained in EU Directives, Regulations, Regulatory

Technical Standards ('RTS') and Implementing Technical Standards ('ITS'). In some circumstances, the EU's framework has been amended, principally to make the legislation operable in the UK, but also to reflect the EU's new status as a 'third country' under UK law. Any legislation that was published but not in force on or before the 31 December has not been incorporated into UK law.

In November 2020, the UK made a series of equivalence decisions in relation to the EU, which applied from 31 December 2020. The decisions serve to negate potential RWA uplifts in relation to risk weights for exposures to financial institutions in the EU and give clarity on the continued application of credit valuation adjustment ('CVA') exemptions for intra-group exposures between the UK and the EU.

### 3. Business Model

Sova Capital Limited was authorised by the FCA (reference number 225539) to provide regulated products and services on 26 March 2004. The list of the services the Firm is authorised to provide is set out in Annex 1.

The firm is a core company of Sova Group which includes Sova Capital Limited (UK), Sova Asset Management (Cyprus) and Sova VC (Luxembourg). The group has common shareholders with Concern ROSSIUM, a group of companies headquartered in Russia.

The core activity of the Group is acting as a financial services provider across fixed income, equities, commodities, foreign exchange, derivatives both exchange traded and over the counter, structured products, financing and prime services including custody, clearing and settlement, electronic access and execution services. The Group's three most financially important activities are proprietary trading, broking and financing.

### 4. Governance Policy and The Board

The Board recognises the importance of high standards of corporate governance. It considers that the firm's success is enhanced by the imposition of a strong corporate governance framework which is essential for the effective running of the company. This is achieved through its own decision-making and delegating certain responsibilities to Board Committees and by the authority to manage to the Chief Executive.

The Board has overall responsibility for the Firm's system of internal controls, the objectives of which are the safeguarding of the Firm's assets, the maintenance of proper accounting records and the availability of reliable financial information for use within the business and publication; and ultimately to prevent and mitigate the risk of business failure.

The Sova Board is sufficiently diverse, regarding a blend of age, gender, ethnicity, geographical location, and independence. Collectively the Board has a mix of skills, expertise and experience to ensure it is equipped to guide the business and strategy of the company.

SCL's corporate governance framework consists of several levels, which include the Board, Board Committees, Executive Committee and Management Committees. The following committees execute risk oversight:

- Board Risk and Compliance Committee ("BRCC")
- Board Audit Committee ("BAC")
- Remuneration Committee ("RemCo")
- Nomination Committee ("NomCom")
- Executive Committee ("ExCo")
- Risk Management & Compliance Committee ("RMCC")

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, as well as to prevent and detect fraud and other irregularities.

The Board, Board committees, Executive Committee and Management Committees regularly review the effectiveness of SCL's internal control systems. There is an ongoing process for identifying, evaluating and managing significant risks throughout the year. The BRCC comprises three members, Howard Snell (Chairman), a Non-Executive Director, and David Newton and Alla Bashenko, both of whom are independent Non-Executive Directors. The BRCC monitors risk factors and the efficacy of controls.

The provision of internal Audit function (sometimes referred to as the "Third Line of Defence") activities provides the Board with flexible resourcing and independence on the review of the control environment

within SCL business practices. The BAC approves the audit plan annually, which covers various topics across divisions and departments within SCL.

## 5. Risk overview

Risk is an integral part of SCL's business. Management sees the principal risks for SCL as market risk, liquidity risk, credit risk (including counterparty credit risk) and operational risk (including the risks related to systems infrastructure and people). However, the overall risk profile of the Firm is wider and the risk management framework has been designed to address the full suite of risks to which the firm is exposed.

The main objective of risk management is to reach an optimal balance between the level of risk taken and reward. Risk management reduces risks to the level accepted by the Firm, as prescribed within its Risk Appetite Statement. The effectiveness of risk management rests on the following aspects: positive corporate culture (implies individual responsibility for the decisions made), actively observed policies and procedures, use of technology (for risk assessment and communication), and independence of risk management professionals. An active programme of reviewing and updating the Firm's policies and procedures is conducted in the Firm leading to systematisation of the processes of risk management. Risk exposure is monitored on a regular basis.

The Risk Management framework within SCL consists of several levels. The first level, or the first line of defence, relates to front office personnel acting in accordance with their approved trading mandates. These document the business idea or trading strategy, along with certain restrictions and limitations related to the execution of those strategies. The four eyes principle is executed at this level where the performance and risk capacity of an individual trader is supervised by a relevant head of the business unit.

The second level is the independent risk management department and compliance department along with the RMCC which is comprised of senior managers from the front office and the support functions.

The third level is the Board executing its risk oversight function via the BRCC and the BAC, both consisting primarily of non-executive directors. The internal audit function provides a full support to the Board's members in executing its risk oversight function.

The Firm, taking into account the nature, scale and complexity of its business activities, as well as the nature and range of its investment services and activities, has established and maintains an internal audit function that is adequately resourced and independent of the management of the business.

The Internal Audit function is responsible for oversight of the Internal Control System (hereinafter, the "ICS") and its proper and effective operation. It undertakes this by periodic reviews of all areas of the Firm judged to be high risk every 2 years at least.

Internal Audit has clear and unrestricted access to the Firm's personnel and all books and records as it sees appropriate. Likewise, the Firm's employees have access to the Chief Internal Auditor for the reporting of any significant deviations from the guidelines provided. The BAC ensures that internal audit issues are considered when presented to it by Internal Audit and appropriate and timely actions are taken. The BAC ensures all issues are dealt with and prioritised according to the BAC's assessment of priority. The BAC provides regular reports in relation to its meetings at each Board meeting.

The senior management in discussion with the directors determine the Firm's business strategy and risk appetite, recognising the risks that the business faces in pursuit of its strategy. The Directors meet on a regular basis and discuss current projections for profitability, regulatory capital management, business planning and risk management matters. The Directors oversee the Firm's risk profile through a framework of policies and procedures having regard to relevant laws, standards, principles and rules with the aim of operating a defined, efficient and transparent risk management framework. These policies and procedures are updated on at least an annual basis, or more frequently as required. The Firm follows the standardised approach to both market risk and credit risk.

The BRCC is updated regarding any risk issues by the Chief Risk Officer ("CRO") and is informed of the RMCC's resolutions. In addition, it receives formal reports on compliance and money-laundering issues at least annually. The Board is subsequently updated by the BRCC.

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.

SCL Risk Management actively manages the risks through real-time monitoring and daily reporting on credit, market, liquidity and operational risk. The Firm's Risk Department works closely with the Front Office to ensure that appropriate risk limits are being issued and applied and any limit breaches are being actively monitored.

## COVID-19

The firm has been closely monitoring the developments around the spread and impact of the Covid-19 virus and the likely responses from various relevant governments, regulators, agencies and counterparties, overseen by the COO. In the short to medium term Sova has taken a number of steps to ensure operational resilience and compliance monitoring integrity, with the safety of our staff in London and Moscow being our first priority. These include remote working, travel restrictions, self-isolation for a number of staff members, and changes to office protocols to ensure safe working if and when staff are in the firm's offices. Given the significant impact of the lockdowns in the UK and Russia in March-May 2020, the firm has required most of its staff to work remotely with full access to Sova's key systems and full IT support.

Sova is able to continue this working model for a prolonged period without compromising operational or compliance activities, and all key functions continue to operate without material disruption. The firm has successfully rolled out a programme of migration to the Virtual Desktop Infrastructure (VDI) in 2020 supported by the global leader in this area in order to enhance the resilience.

Furthermore in order to address the mental health impact for the members of staff the management engaged with the local partners experts in this area.

The management team continue to monitor capital and liquidity needs closely and the firm periodically conducts stress tests to ensure that it could survive severe market stress. These stress scenarios include a significant number of client departures, a reduction in trading activity (for both clients and the firm's proprietary desk) and defaults of the several issuers of fixed income instruments held by the firm within the trading book. The outcomes of such stress scenarios are incorporated into a decision making process.

The Firm has also carried out a Covid-19-related Compliance Risk Assessment to ensure the integrity of its surveillance activities during the changed operating model of the pandemic, where staff are largely working from home without direct supervision. The monitoring programme was adjusted appropriately to mitigate the resulting perceived risks.

## 6. Risk Appetite

The Board articulates the risk appetite for its activities and stipulates it in the Risk Appetite Statement ("RAS"). 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.

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

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 opportunities, increasing the value of the Firm and implementing risk-awareness into the decision-making processes. As part of the annual ordinary business planning process, the Firm's RAS is communicated by the Firm's Board via the BRCC to the RMCC 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 an appropriate mix of KPIs/KRIs.

The Firm has assessed its overall risk appetite and internal control framework, taking into account its systems and controls, and policies and procedures. Notwithstanding this, the Firm has 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 SCL's business over the last few years;
- the Firm's portfolio of well-established and reliable counterparties;
- Scenario Analysis and Stress Tests on the most significant risks identified. This informs the Firm how risks are likely to behave and what, if any, impact there is likely to be to its balance sheet;
- the Firm's Trading Book activities, which includes the facilitation of client orders and principal trading activities;
- the Firm's limited client base, dealing only with professional clients and eligible counterparties, as classified in accordance with MiFID;

- the Firm’s adherence to CASS rules and its approach towards the protection of client money and client assets;
- the Firm’s particular expertise towards emerging Markets - focusing its business activities on various financial instruments traded in, amongst others, Russian financial markets or derived from/ based on those; and
- the Firm’s risk profile and its approach towards risk optimisation through the use of risk transfer and risk mitigation tools.

## 7. Board Declaration - Adequacy of the Risk Management arrangements

The Firm maintains a comprehensive suite of risk management policies and procedures in order to identify the risks relating to its activities, processes and systems and set the level of risk tolerated. These policies and procedures are constantly updated in accordance with the changing supervisory requirements, business environment of the Firm and recommendations of the internal audit and compliance units.

## 8. Capital resources

The Firm’s capital resources comprise only Tier 1 Capital (Common Equity Tier 1 Capital), namely paid-up capital, share premium account and accumulated reserves. At the end of 2020 as per financial statements the Firm’s capital base (including audited financial result) was \$396 316M. The net audited financial result for 2020 was \$39.560M. As at 31/12/2019 the Capital Adequacy Ratio was 20.95%

Throughout 2020 management in light of the new external factors has been calibrating the execution of the business strategy agreed with the shareholders. The ongoing assessment of business line profitability and constant cost control were among the core elements of the strategy deployment process. The Firm benefited from the expansion of its client base and also revisited the “client journey” in order to enhance the client experience without compromising the regulatory and conduct rules. Sova Asset Management (an alternative investment management company incorporated within the EU) which was acquired in 2019 has taken the opportunity to build a robust operational infrastructure with financial support provided by the Firm. The overall 2020 financial result was positive, generating no material change in the risk profile while remaining within the approved risk appetite.

Due to the macroeconomic situation in one of the Firm’s primary markets, Russia, the Firm’s performance is under substantial pressure. Further, the sanctions imposed on legal and natural persons in Russia have introduced certain restrictions and constraints on the Firm’s business activity which, coupled with Brexit uncertainties, have had negative effect upon the Firm’s performance. Nevertheless, as expected, the Firm was able to generate a substantial profit, maintain high levels of liquidity resources and manage its working capital requirements very carefully. The Firm continues to maintain a strong client base and client retention is high.

The table below shows the Firm’s regulatory capital resources as at 31 December 2020 (based on audited financials).

\$000’s	Year ended 31/12/2020
<b>Capital instruments eligible as Tier 1 Capital</b>	<b>396 316</b>
Called up share capital	346 032
Share premium account	4 501
FVOCI Reserve	1 561
Foreign Currency Translation Reserve	4 664
<b>Retained earnings</b>	<b>39 560</b>
<b>Other transitional arrangements to CET1 Capital</b>	
<b>TIER 1 CAPITAL</b>	<b>396 316</b>
<b>ADDITIONAL TIER 1 CAPITAL</b>	<b>-</b>
<b>Total Eligible Own Funds</b>	<b>396 316</b>

The Firm manages its capital to ensure that it will be able to continue as a going concern while increasing the return to shareholders through the improvement of the debt to equity ratio. The Firm's overall strategy remains unchanged from the previous year.

The legal and regulatory framework under which the Firm operates stipulates that the Firm must maintain a minimum capital adequacy ratio, being 8% as at 31 December 2020. The method of calculation is set up by the regulatory authority based on the International Basel II capital adequacy requirement directives. The Firm aims to always maintain a high capital adequacy ratio well above the required minimum. This is reported to the Firm's regulatory authority on a quarterly basis.

The Firm's objectives when managing capital are to safeguard the Firm's ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital. The Firm maintains only Tier 1 capital as eligible own funds: share capital, FVOCI reserve, foreign currency translation reserve and retained earnings. The management acknowledges that the new regulatory framework applicable to the investment firms ("IFPR") will have certain impact on the firm's activities. On a continuous basis during 2H2020 and 1H2021 management have been closely monitoring the relevant communications from the respective authorities. The Firm has a dedicated resource allocated to implement these new requirements into the firm's business model.

## 9. Minimum Capital requirements

The total Risk Weighted Assets and capital requirements of the Firm as at 31 December 2020 are set out in the table below.

Risk Category	Risk Weighted Assets (\$000)	Minimum Capital Requirements (\$000)
Credit Risk <sup>1</sup>	794 876	71 989
Market Risk	783 300	62 664
Operational risk	208 864	16 709
<b>Total</b>	<b>1 892 021</b>	<b>151 362</b>

## 10. Internal Capital Adequacy Assessment Process

SCL undertakes an Internal Capital Adequacy Assessment Process (ICAAP) which is a system consisting 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 the outcome is presented in a discrete ICAAP document. The ICAAP covers all material risks to determine the capital requirement necessary to satisfy regulatory requirements.

SCL defines capital as the resources necessary to cover all relevant risks. The ICAAP is the mechanism through 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.

## 11. Credit Risk

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

<sup>1</sup> It includes Total Risk Exposure Amount For Settlement/Delivery, Total Risk Exposure Amount Related To Large Exposures in the Trading Book and Total Risk Exposure Amount For Credit Valuation Adjustment



- Pre-settlement risk is defined as the risk that one party to 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 the other counterparty.

As a significant proportion of the Firm's transactions are conducted on the basis of "delivery versus payment", this minimises 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, SCL sets limits for various counterparties and monitors these limits constantly.

SCL provides services for 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 marked-to-market methods. In all cases where such transactions place the client or SCL at risk, SCL 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.

SCL Risk Management assesses counterparties' creditworthiness and assigns to them internal credit ratings, which are mapped against external ratings. Under the standardised approach for credit risk SCL uses 3 ratings providers, i.e. ECAs - Standard & Poor's, Moody's and Fitch.

The Firm's total 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 Risk
<b>TOTAL</b>	899 857			
<b>Institutions</b>	237 664	71 989	29 155	101 144
<b>Corporates</b>	445 318			
<b>Other</b>	216 875			

The additional capital requirement for credit risk under the ICAAP was predominately caused by the very conservative assessment of:

- the concentration risk attributable to the business model and target market (e.g. derivative transactions hedging or offsetting market risk are mostly executed at the Moscow Exchange); this affects the trading book activities in various aspects - repurchase transactions, funds at MOEX CCP, funds with the broker, etc.;
- settlement risk; and
- the risk of default of a bank or a broker.

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 originating in or related to Russian financial markets and consequently is an area where concentration risk exists. Brokerage income is diversified into revenue from securities lending and borrowing, client order facilitation, proprietary trading and agency dealing commission.

Credit risk concentrations include:

- significant exposure to individual counterparties or a group of counterparties;
- credit exposures to counterparties in the same economic sector or geographical 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 for 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 SCL uses the settlement services of one of the world's largest financial group entities focused on providing a wide range of such services globally. It is a regulated entity which has an excellent credit rating.

For Russian Local stock, the settlement agent used is an independent service provider whose risk profile has been assessed and approved by management.

For futures and options business there are two main settlement and clearing agents - entities belonging to two independent major global financial groups. Both are regulated entities with excellent credit ratings.

## 12. 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 is also one of its main risk factors. The Firm is exposed to market risk in several instruments - equity business, equity derivatives, fixed income securities and currencies.

The Firm's enterprise risk framework incorporates the process of market risk management and articulates the tools and techniques that are used in the management of market risk arising in its day-to-day business activities. This includes the application of various market risk limits, trading mandates, clear and transparent escalation routes, and stress-testing and hedging methodologies.

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

Type of asset	Original exposure amount	Pillar Requirement 1	Additional Capital Requirement (Pillar 2)	Internal Capital allocated for Market Risk
Traded Debt Instruments	521 355	41 708	5 680	68 344
Equity and equity based derivative instruments	132 190	10 575		
FX	129 755	10 380		
Commodities	0	0		
<b>Total</b>	<b>783 300</b>	<b>62 664</b>	<b>5 680</b>	<b>68 344</b>

The additional capital requirement for market risk under the ICAAP was driven by risk factors attributable to the price risk in fixed income and equity instruments and FX rates.

## 13. Liquidity Risk

Liquidity risk is the risk where the Firm, although solvent, either does not have sufficient financial resources available to enable it to meet its obligations as they fall due, or it 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.

SCL’s policy is to ensure that it maintains liquidity resources that 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 is provided daily to the senior management.

Being the subject of the UK national liquidity regime, the Firm evaluates its liquidity risk exposure profile under its Individual Liquidity Adequacy Assessment Process (“ILAAP”). As a result of ILAAP the Firm maintains a substantial amount of high quality liquid assets which is a subject of constant monitoring based on a 4-eyes principle within Treasury and Risk Management functions. The management also maintains a Contingency Funding Plan which is subject to periodical review and testing.

## 14. Operational Risk

SCL defines Operational risk as the risk of loss resulting from inadequate or failed internal processes, human behaviour and systems or from external events. SCL 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 the BRCC, RMCC and the Risk Management department. Further assurance is provided by Internal Audit and SCL’s Compliance department.

The Firm uses the Basic Indicator Approach (BIA) for calculating the amount of regulatory capital on operational risk (Pillar 1). It is based on the calculation of the Gross Income of the Firm, which is calculated by the Finance Department.

The Pillar 1 operational risk capital requirement is calculated as the average gross income for the last 3 years multiplied by 15%. Consequently the operational risk RWA amount is calculated as capital risk requirement divided by 8%.

In \$000	2018	2019	2020
<b>Own Funds Requirement</b>	\$13 662	\$15 882	\$16 709
<b>Operational risk RWA</b>	\$170 770	\$198 526	\$208 864
<b>Additional RWA under ICAAP</b>	-	-	-

In addition to operational risk calculated in relation to the Pillar 1 capital requirements, the Firm has identified additional risk sources as described in the risk register. It defines in detail the impact and probability of each risk that the Firm has considered within the operational risk category. In addition, several stress-tests are performed. Management believes that these stress tests are a useful tool for the assessment of these additional risks.

As a part of operational risk management a framework of Operational risk KRIs/KPIs have been set in the relevant areas based on the risk factors - personnel, business processes, IT and infrastructure systems, and external factors.

Several approaches have employed in assessing the Firm’s capital needs under ICAAP. These are:

1. Self-assessment of operational risk exposures (per each event type) by the heads of departments in accordance with the methodology stated in the SCL ICAAP manual; and
2. Stress testing in accordance with the methodology stated within the SCL Operational risk management policy.

Based on the two approaches the management considers the resultant economic capital as sufficient to cover operational risk. As this amount is less than the regulatory capital requirement, we consider the latter to be sufficient to offset operational risk losses. Additional capital under Pillar II is therefore not required.

## 15. Technology (IT risk)

In 2019 the Firm restructured its technology department by splitting IT and Cyber security. It also conducted an internal audit review of Cyber Security in conjunction with external specialists. Given the reliance of the Firm’s activities upon a stable IT infrastructure for its day-to-day activities, management have decided to

consider technology risk as a stand-alone risk. Accordingly, it has incorporated various mitigation techniques around the different types of technology/IT risks.

The Firm's IT department has created an inventory of critical systems, along with key risk factors, such as time required for functionality restoration and cross-references between the systems in order to assess dependencies and any integrity risk. Addressing this type of risk also forms one of the basic layers in the Business Continuity Plan, Disaster Recovery and Resolution Plan and procedures and global Recovery and Resolution Plan. The Firm conducts annual testing of the Disaster Recovery and Resolution Plan,

## 16. Cyber risk

During 2019 the firm undertook a review of SCL cyber and data security systems. As a result of this review the Board approved a plan of phased improvements to our systems and controls. The Board also approved two new appointments being a new position of Chief Information Security Officer and a Data Protection Officer to ensure compliance with applicable data security regulation and establishment of holistic cyber security and data privacy programmes. Since then Sova has built a Cyber Security department comprising three employees by the end of 2020, migrated the firms outsourced security services from one provider to its local IT environment, and partly to another providers. The later include such services as Security Operations Centre (SOC) and Knowledge Management and Security Awareness Training system. New services and systems were built, including Governance, Risk and Compliance system (GRC) to support cyber risk management, tracking compliance with security requirements, and assessing vendors during their onboarding and management lifecycles in Sova. New Mobile Device Management system was deployed to further enhance security and maintain a good level of IT services for remote workers.

Through 2020 Sova was implementing ISO/IEC 27001 (Information Security) and ISO 22301 (Business Continuity) international standards, established an Integrated Management System and gained UK Government certificates, including:

- Cyber Essentials Scheme (CES) Certificate on 30/12/2019;
- Cyber Essentials Scheme Plus (CES+) Certificate on 01/10/2020.

Based on the audit results and internal assessment the Firm estimates the additional capital requirement for this risk as \$10M.

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

The Firm's principal activity is the trading book, hence there is no non-trading book activity and therefore no capital has been provided for this type of risk.

## 18. Regulatory and conduct risk

The Board considers the following risks to be key ones among the broad range regulatory risks in light of business activities of the Firm:

- conduct risk (general compliance, including Market Abuse);
- financial crime risk; and
- sanctions risk.

SCL has adopted a proactive approach in addressing our customer strategies, culture and conduct risk appetite. This covers culture and governance, from the mindsets, behaviour, competence and compliance of the Firm's leadership, through to the Firm's approach to managing and rewarding people, as it puts the interests of its customers first as part of its business decision-making process and in formulating its suite of policies.

Market Abuse is considered a key conduct risk to the business. Further, to support its customers and the different client services SCL offers, the management is mindful of potential conflicts of interest and the key risk factors across markets. Systems and controls and key processes are supported by policies, procedures and proper review and approval processes and oversight arrangements.

The effective implementation of the FCA's SMCR regime is considered central to the task of embedding the accountability culture necessary to contain risks within each business division. The firm has accordingly allocated dedicated resource to ensure that this regime is implemented fully, in spirit as well as by the letter. In parallel, throughout the past year SCL has been engaged in a programme of re-enforcing within the Firm the 'three lines of defence' ("3OLoD") model whereby compliance with regulatory and legal obligations sits firmly with the business, monitored and controlled by the second line - Compliance and Risk. . The ethos of the firm

is that “Every employee is a compliance officer” - as emphasised by the CEO, Sergey Sukhanov, to his entire staff during a town hall meeting in July 2020.

The Firm expects Senior Management to take responsibility for managing financial crime risks, which should be treated in the same manner as other risks faced by the business, but with particular regard to the number of high risk clients with whom the Firm does business. Senior managers are actively engaged as well as set the right tone and demonstrate leadership in the Firm’s approach to addressing the risks.

Customer due diligence is key in managing AML risk. The Firm has robust client on-boarding and KYC refresh procedures. The Client’s ownership structure and UBOs, political connections, country risk, source of wealth / source of funds and account activity are thoroughly examined.

Sanctions-related checks are embedded into the KYC/ due diligence processes employed by Sova to ensure sanctions-related issues are identified, escalated to Senior Management, addressed prior to the conclusion of any transaction, and incorporated into the risk assessment process.

All employees receive regular mandatory training that covers, in particular, sanction compliance aspects.

## 19. Remuneration Policy Disclosures

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

The Board of Directors has established the Remuneration Committee (“RemCo”), which has the following responsibilities:

- Exercising competent and independent judgment on remuneration policies and practices and the incentives created for managing risk, capital and liquidity; and
- Preparing the decisions regarding remuneration, including those which have implications for the risk and risk management of the company concerned and which are to be taken by the board of directors.

The RemCo shall take into account the long-term interests of shareholders, clients and other stakeholders in the company and the public interest.

The RemCo consists of three Non-Executive Directors of the Company including 2 Independent NEDs (2020 - 2 NEDs and 1 Non-Executive Chairman) and invitees including Chief Executive Officer, Chief Administrative Officer and Head of HR. The Remuneration Committee met in June 2020. Any further meetings are called as and when required.

The Committee on behalf of the Board retains responsibility for ensuring implementation of the FCA remuneration code ongoing compliance and the identification of Code Staff.

The RemCo Terms of Reference further sets out their duties around the firm’s remuneration practices

### *Correlation between pay and performance*

The company operates a discretionary bonus scheme and may in its absolute discretion pay a bonus to eligible employees. Employees who have been with the company for the whole of the relevant financial year, will be considered if bonuses are payable.

Bonuses are based on the achievement of a number of previously approved goals and competencies that reflect conduct. This is combined with an overall review of performance carried out by management. Such reviews will consider non-financial metrics, including breach of regulatory rules or guidelines.

To ensure that the proper balance of variable and fixed remuneration is maintained, the company applies a market and performance driven approach to the fixed remuneration, with annual reviews and payrises based on market benchmarks analysis, individual performance and conduct and overall firm performance to ensure fair and relevant remuneration.

Given the above, the Firm’s remuneration regime is designed so as not to encourage inappropriate risk taking. It follows that in determining the level of bonus, a bonus will only be granted when the Firm considers that such an award is consistent with the Firm’s strategy, values, long-term interests, regulatory requirements and capital base.

The allocation of the bonus pool is based on the contribution of each business/support 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.

However it is also based on the long-term profitability of the firm for the relevant year, and adjusted to account for the following factors;

- Business forecast and strategy for a following year;
- Reputational risk, conduct risk, client outcomes, and values of the firm;
- Prospective regulatory risks to the business for a following year;
- the timing and likelihood of potential future revenues incorporated into current earnings or future losses;
- the strength of the capital and liquidity position of the firm; and
- such other factors as RemCo shall consider appropriate in that year (if any).

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 and complaints (i.e. FCA conduct rule breaches), 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 and performance-based components and the 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;
- awarded performance-based pay may be forfeited in full or in part if granted on the basis of unsatisfactory results of the appraisal; and
- the bonus may be adjusted to reflect performance even after the employee has been notified of the bonus.

Performance-based remuneration pools must be based on an assessment of the Firm's budget performance. The RemCo has responsibility to decide on the funds to be allocated to the performance-based remuneration pools.

The RemCo can make recommendations on the allocation of the pool to the business/support units.

Line Managers for each business/support units 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 RemCo may consider other factors, i.e.:

- contribution of the division to earnings;
- assessment of the contribution to risk management and compliance by that function (in the case of a support function);
- assessment of risk management and compliance by the division (in the case of a business unit);
- appraisal results;
- length of service;
- disciplinary records;
- non-compliance with mandatory training requirements;
- compliance breach records;
- breach of trading limits;
- breach of conduct rules; and
- breach of the Firm's policies and procedures.

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.

Individual bonuses are calculated by HR with consideration of Company's financial results, individual performance results as well as assessment of conduct. Further to RemCo approval of the bonus pool based on the base calculations, Line Managers for each business/support units have discretion in adjusting the bonus payments to individuals in their department. The appraisal results are taken into consideration when the bonus pool is distributed. Additionally the bonus amount approved by line manager may be amended further to RemCo confirmation of the list of breaches.

The following forms of financial compensation are prohibited:

- payments from a Firm within the Sova group of companies other than SCL unless approved by the Board of SCL;
- money or cash convertible gifts or inducements (as described in Conflicts of Interest Policy); or
- bribes (further information in the Anti-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 Sova group must be pre-approved in accordance with the Outside Business Interests Policy, found in the Compliance Policy.

Sova is aware of the UK Investment Firm Prudential Regime which comes into force for all FCA investment firms as from January 2022 and await final FCA guidance on this matter. This is expected to lead to fundamental changes to the FCAs approach on prudential standards for investment firms, including compliance with enhanced requirements around variable pay of staff classified as material risk takers.

The table below presents a breakdown for 2020 of the annual remuneration for those categories of staff whose professional activities have a material impact on the risk profile of the Company, by business area:

Business area	Fixed remuneration (\$000)	Variable remuneration (\$000)	Aggregate Remuneration (\$000)
Control function	2 870	2 054	4 925
Trading function	4 015	1 949	5 964
<b>Total</b>	<b>6 886</b>	<b>4 003</b>	<b>10 889</b>

The aggregate remuneration for 2020, for personnel whose actions have a material impact on the risk profile of the Company, (broken down by Senior Management & Executive and Non-Executive Directors and members of staff) is as follows:

Personnel	No. of people	Fixed (\$000)	Variable (\$000)	Aggregate (\$000)
Senior management (including executive and non-executive directors)	37 <sup>2</sup>	5 794	4 040	9 834
Other risk staff	47	4 049	1 949	5 998
<b>Total</b>	<b>84</b>	<b>9 843</b>	<b>5 989</b>	<b>15 832</b>

## 20. Capital Requirements Directive Pillar 3 disclosure

The following table summarises SCL's regulatory capital resources at 31 December, 2020

<sup>2</sup> The number is based on Code List staff 2020 approved by the RemCo

Capital Requirement Calculation Breakdown, \$000	2020
Credit risk	71 989
Market risk	62 664
Operational risk	16 709
<b>Total Capital requirements under Pillar 1</b>	<b>151 362</b>
<b>Capital requirements for risks not fully covered under Pillar 1</b>	<b>61 301</b>
Combined Capital Buffer (“CCB”)	49 193
<b>Total Internal Capital Requirements and CCB</b>	<b>261 856</b>
<b>Capital resources</b>	<b>396 316</b>
Excess over Pillar 1 requirements	244 954
Excess over Internal Capital Requirements and CCB	134 460

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.

## 21. Governance

This document was discussed at the Risk Management and Compliance Committee and further at the Board Risk and Compliance Committee. The latter formally approved the document for publishing in the Firm’s website

**Further enquiries should you have any queries, please contact:**

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## Annex 1 Permitted activities

Permission for customers type		Activity									
		Advising on investments	Arranging (bringing about) deals in investments	Arranging safeguarding and administration of assets	Causing dematerialised instructions to be sent	Dealing in investments as <u>agent</u>	Dealing in investments as <u>principal</u>	Making arrangements with a view to transactions in investments	Managing investments	Safeguarding and administration of assets (without arranging)	Sending dematerialised instructions
Investment instruments	Certificates representing certain security	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional
	Commodity Future	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Not Permitted	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Not Permitted
	Commodity option and option on commodity future	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Not Permitted	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Not Permitted
	Contract for Differences (excluding a spread bet and a rolling spot forex contract)	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Not Permitted	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Not Permitted
	Debenture	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional
	Future (excluding a commodity future and a rolling spot forex contract)	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Not Permitted	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Not Permitted
	Government and public security	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional
	Option (excluding a commodity option and an option on a commodity future)	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional	Eligible Counterparty Professional
	Rolling spot forex contract	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Not Permitted	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Not Permitted

		Professional	Professional	Professional		Professional	Professional	Professional	Professional	Professional	
	Share	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty
		Professional	Professional	Professional	Professional	Professional	Professional	Professional	Professional	Professional	Professional
	Unit	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty
		Professional	Professional	Professional	Professional	Professional	Professional	Professional	Professional	Professional	Professional
	Warrant	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty	Eligible Counterparty
		Professional	Professional	Professional	Professional	Professional	Professional	Professional	Professional	Professional	Professional
<b>LIMITATIONS</b> <i>(Also note general restrictions on dealing with clients from certain jurisdictions, in particular with US clients)</i>		Rights to or interests in (both).	Rights/interests - securities limited to securities listed	Rights/interests - securities limited to securities listed	Rights to or interests in (both).	Rights to or interests in (both).	Rights to or interests in (both).	Rights to or interests in (both).	Rights to or interests in (both).	Rights/interests - securities limited to securities listed	Rights to or interests in (both).