



## **BROKERCREDITSERVICE (CYPRUS) LIMITED**

### **Disclosure and Market Discipline**

#### **Obligation for Public Disclosure of Information**

**Under Directive DI144-2007-05 of 2011 of the Cyprus Securities and Exchange Commission for  
the Capital Requirements of Investment Firms of 2010**

**YEAR 2011**

**May 2012**

## **General Notes**

BrokerCreditService (Cyprus) Limited has prepared the following disclosures based on the audited financial statements for the year ended 31<sup>st</sup> December 2011.

While the information included in the Disclosures derives from the Company's audited financial results, the Disclosures do not constitute the Company's Financial Statements nor do they constitute any form of contemporary or forward looking record or opinion of the Company.

They are merely prepared to explain how the Company manages risks, under the requirements of the Cyprus Securities and Exchange Commission (hereafter referred to as "CySEC" or "the Commission") and how much capital is assigned to these risks for their management.

The disclosures have been reviewed and approved by the Company's Board of Directors, while they have been verified by the Company's external auditor on a sample basis.

The figures disclosed on the tables below are to the nearest thousand.

### **Important Note**

It is important to note that some of the figures that are presented in this document may not match the figures presented in the financial statements prepared in accordance with the International Financial Reporting Standards. This is due to the difference in treatment that exists between the two scopes which can generate different outcomes from similar set of data.

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## 1. Overview

Further to the provisions of Directive DI144-2007-05 (namely the “Directive of the Cyprus Securities and Exchange Commission for the Capital Requirements of Investment Firms”), BrokerCreditService (Cyprus) Limited (herewith “BCS Cyprus” or the “Company”) has an obligation to publicly disclose information relating to the risk management objectives and policies of the Company as well as information regarding the capital adequacy requirements of the firm. The information is published on an annual basis at a minimum, and at the latest within five months from the end of each financial year. The following information has been disclosed in accordance with paragraphs 34 to 38 of Chapter 7 Part C of the Directive. Figures included, are according to the audited financial results of 2011. As stated above, such information is disclosed only for the purpose of complying with Directive requirements and not for any other reason or use.

## 2. Materiality of Disclosures

The Directive provides that the Company may omit one or more of the disclosures if it believes that the information is immaterial. Materiality is based on the criterion that the omission or misstatement of information would be likely to change or influence the decision of a reader relying on that information for the purpose of making economic decisions.

Where the Company has considered a disclosure to be immaterial, this was not included in this document.

## 3. Disclosures and Confidential Information

The Directive also permits the Company to omit one or more of the required disclosures if it believes that the information is regarded as confidential or proprietary. The Directive defines proprietary as if sharing that information with the public would undermine the investment firm’s competitive position. It may include information on products or systems which, if shared with competitors, would render an investment firm’s investments therein less valuable. Confidential information is defined thus: Information shall be regarded as confidential if there are obligations to customers or other counterparty relationships binding an investment firm to confidentiality.

In the light of the above, the Company avoided disclosing such confidential information in this report.

## 4. Company Incorporation and Activities

BCS Cyprus was incorporated in Cyprus on 7<sup>th</sup> of December 2004, as a private limited liability company and operates under the CySEC Licence number 048/04.

The Company is a member of the BCS Group. The Company enters into transactions with its related parties, primarily BCS Group Companies. These transactions include, but are not limited to settlements, loans, transactions with securities and derivatives, and repurchase transactions.

The Company’s principal activity is the provision of the following investment and ancillary services with regard to the financial instruments stated in Part III below:

### I. Investment Services

- I. (1) Reception and transmission of orders in relation to one or more financial instruments
- I. (2) Execution of orders on behalf of clients
- I. (3) Dealing on own account
- I. (4) Portfolio management
- I. (5) Investment advice

### II. Ancillary Services

- II. (1) Safekeeping and administration of financial instruments for the account of clients,

## II. Ancillary Services

including custodianship and related services such as cash/collateral management.

II. (2) Granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction.

II. (4) Foreign exchange services where these are connected to the provision of investment services

II. (5) Investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments.

II. (7) Investment services and activities as well as ancillary services of the type included under Parts I and II of Law 144(I)/2007 related to the underlying of the derivatives included under paragraphs 5, 6, 7 and 10 of Part III of Law 144(I)/2007 where these are connected to the provision of investment or ancillary services.

## III. Financial Instruments

III. (1) Transferable securities

III. (2) Money-market instruments

III. (3) Units in collective investment undertakings

III. (4) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash

III. (5) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event)

III. (6) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market or/and an MTF

III. (7) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in paragraph 6 of Part III of the Law which provides for the provision of investment services, the exercise of investment activities, the operation of regulated markets and other related matters (Law 144/2007) and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognized clearing houses or are subject to regular margin calls

III. (8) Derivative instruments for the transfer of credit risk

III. (9) Financial contracts for differences

III. (10) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contract relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Part, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognized clearing houses or are subject to regular margin calls.

## 5. Location and Frequency of Disclosures

According to the Commission's Directive, the risk management disclosures must be included in either the financial statements of the investment firm if these are published, or on their websites. In addition, these disclosures must be verified by the external auditors of the investment firm on a sample basis. The investment firm will be responsible to submit its external auditors' verification report to the Commission.

The Company has included its risk management disclosures as per the Directive requirements on its website as it chose not to publish such in its financial statements. Verification of these disclosures has been made by the external auditors on a sample basis and sent to the Commission.

The Company intends to keep producing its Disclosures annually in a document other than the Audited Financial Statements unless it is decided otherwise by the Company's Board of Directors.

The current Disclosures are based on the position of the Company as at 31<sup>st</sup> December 2011, and are drafted under Directive D1144-2007-05.

## 6. Scope of Disclosures

The Company does not have any subsidiaries thus it does not need to prepare consolidated accounts for either accounting purposes or for regulatory purposes. The Company is making the disclosures on an individual (solo) basis.

According to the Directive, the Company needs to disclose whether “it has any current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities among the parent undertaking and its subsidiaries”. Since the Company did not have any subsidiaries for the year 2011, the above requirement is not applicable. Moreover, there was no material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities among the Company’s parent undertaking.

It should also be noted that the Company does not carry out any securitizations.

## 7. BCS Cyprus’ Risk Management Framework and Structures

The risk management function within the Company is carried out in respect of financial risks (credit, market, currency, liquidity, and interest rate), operational risks, and legal risks. The primary objectives of the financial risk management function are to establish risk limits and then to ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimize operational and legal risks.

The Company’s risk management function is designed to identify and analyze these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to date administrative and information systems. The Company regularly reviews its risk management framework to reflect the changes in markets, products and effective best practice.

The current structure of the risk framework implemented by the Company aims to manage risks in order to minimise the exposure of itself and its stakeholders to any event, or set of occurrences able to cause adverse effects, while concurrently maximising the efficiency and effectiveness of Company operations in accordance with best practice.

For BCS Cyprus, the purpose of managing risks is the prompt identification of any potential problems before they occur so that risk-handling activities may be planned and invoked as needed to mitigate adverse impacts and allow the Company to achieve overall objectives.

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

More specifically, the responsibilities of the Board of Directors and Senior Management in managing risks are to:

- Assess on a continuous basis the effectiveness of the policies, arrangements and procedures in place relating to Risk Management;
- Review any reports and/or information received from the Risk Management Department and take action whenever necessary;
- Decide on the Company’s risk bearing capacity and risk strategy;
- Ensure that the Company has sufficient capital and risk reserves to cover its capital needs and requirements.

The current risk management structure is set for the maintenance by the Company of adequate policies and procedures designed to manage any type of risks relating to the Company’s activities. The current Risk Management process is applied in all activities across the Company, and is designed to identify, assess and report potential events that may affect its business and all operational issues.

Taking into account the nature, scale and complexity of investment services and activities undertaken in the course of this business, the integrated objective of the distinct functions and the main purpose of Internal Audit, Risk Management and Compliance along with the Legal function, the Accounting Department, and all other operations departments is to enhance the accuracy and overall effectiveness of the Company's risk management and monitoring structure.

The present composition of Risk Management mechanisms addresses issues that endanger achievement of critical objectives. At BCS Cyprus, a continuous risk management approach is applied daily to effectively anticipate and mitigate the risks that may pose certain dangers or have critical impact on the Company's operations.

#### **(a) BCS Cyprus' Strategies and Processes in Place**

Within the Company's overall Risk Management structure efficient risk management strategies and procedures which abide with the Company's broad business strategy are established.

The specific policies and strategies aiming at managing each specific risk are determined by the Company's Board of Directors which has the complete oversight role of the Company's Risk Management Function. The Risk Management committee facilitates the Risk Management Function by providing an oversight on risk issues.

In order to achieve the overall risk management process, the Company creates specific tasks and reporting relationships among all Company layers and staff. The Company then specifies permissible and desirable actions according to the Company's permissible risk appetite.

For the critical role of risk management, compliance and internal audit functions, clear strategies and policies exist which relate to each responsibility and framework of the functions.

#### **(b) The Structure and Organization of the Relevant Risk Management Function**

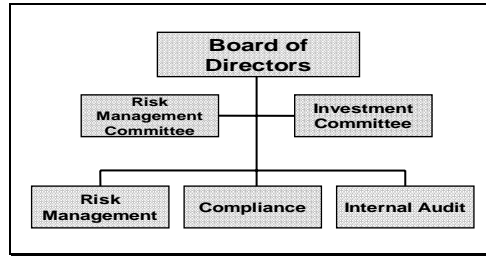
The Risk Management Function is performed at the Group Level. The Risk Manager has developed and implemented relevant processes and systems in order to systematically identify, measure, and manage risk in accordance with the standards set by the Board of Directors of the Company. The Risk Manager facilitates the process and provides adequate assistance and guidance, but responsibility resides with the personnel in each area concerned. Moreover, all personnel are responsible for identifying, exposing, and managing risks in their area of control and departments. The Board of Directors has the ultimate responsibility for addressing such risks in a prompt and proper manner in order to safeguard that the Company is sheltered from possible intolerable risks.

The Accounting Department is responsible for the day-to-day recording of all financial information, control of all receipts and payments, internal management reporting and external financial reporting. The Accounting Department is also responsible for the management accounts, which are feeding into the Capital Adequacy requirements monitoring.

The Internal Auditor, according to paragraph 8 of Directive DI144-2007-01, is responsible for conducting independent appraisals of the Company's activities, functions and operations to ensure that an adequate framework of internal controls has been established and is operating effectively.

The Compliance Officer has the responsibility for ensuring that structures and procedures are in place to ensure compliance with laws and regulations, which relate to minimizing the risk of complying, by the set up of internal policies and procedures as well as fostering standards of behaviour to protect and enhance the compliance of the Company towards the Law and relevant regulation directives.

The Company has designed its risk management support to be proportionate to the scale, nature and complexity of the business, and comprise the following components:



## 8. Disclosures in accordance with Annex XII, Part 2, in Part C of the relevant Directive

The adequacy of the Company's capital is monitored by reference to the rules established by the Basel Committee as adopted by the Commission. In December 2007 the Commission issued the Directive DI144-2007-05 for the calculation of the capital requirements of Investment Firms adopting the relevant European Union's Capital Requirements Directive. The Capital Requirements Directive brought into force the requirements of Basel II, issued by the Basel Committee on Banking Supervision, in European Union. Basel II consists of three pillars: (I) minimum capital requirements, (II) supervisory review process and (III) market discipline.

The Company has implemented the provisions of Directive DI144-2007-05 as of 1<sup>st</sup> October 2008.

### (a) Pillar I – Minimum Capital Requirements

Basel II imposes a minimum required ratio of 8%.

The Company adopted the Standardised approach for Credit and Market risk and the Basic Indicator approach for Operational risk.

According to the Standardised approach for credit risk, in calculating the minimum capital requirement, risk weights are assigned to exposure classes (such as deposits with banks, trade and other receivables, fixed assets, etc.), after the consideration of various mitigating factors, according to the exposure class to which they belong.

The Standardised measurement method for the capital requirement for market risk adds together the positions of equity and foreign exchange risk according to predefined models to determine the capital requirement. The main sources of foreign exchange risk for the Company are certain bank balances in foreign currencies and exposures in foreign currencies from fees receivables.

For operational risk, the Basic Indicator approach calculates the average, on a three year basis, of net operating income to be used in the risk weighted assets calculation. The capital requirement for operational risk under this approach is equal to 15% of the average of three years of net operating income.

### (b) Pillar II – The Supervisory Review Process (SREP)

Pillar II comprises of:

- The Internal Capital Adequacy Assessment Process (ICAAP), and
- The Supervisory Review Process (SREP)

Pillar II connects the regulatory capital requirements to the Company's internal capital adequacy assessment procedures (ICAAP) and to the reliability of its internal control structures. The function of Pillar II is to provide communication with the Commission on a continuous basis through the Supervisory Review Process (SREP) and to evaluate how well BCS Cyprus is assessing its capital needs relative to the risks it undertakes.

The ICAAP uses internal methodologies to assess the risk profile of an Investment Firm and considers whether additional capital is required for Pillar I risks (Credit, Market, and Operational risks), as well



as for risks which are not covered by Pillar I (e.g. Interest Rate Risk in the Banking Book, Liquidity Risk, Concentration Risk, Reputational Risk, Business and Strategic Risk and any other external factors affecting the Company). The ICAAP allows Investment Firms to review their Company-wide risk spectrum, management policies and stress tests to proactively safeguard necessary capitals, preparing themselves adequately for periods of financial distress.

The Supervisory Review Process (SREP) provides rules to ensure that adequate capital is in place to support any risk exposures of the Company in addition to requiring appropriate risk management, reporting and governance structures. SREP is the supervisor's review of the ICAAP report, and is intended to ensure that investment firms have adequate capital to support all the risks in their business and also to encourage investment firms to develop and use better risk management techniques in monitoring and managing their risks.

The Company has not yet initiated an Internal Capital Adequacy Assessment Process though it has employed several mechanisms in order to identify requirements for any additional capital it may require over and above the capital allocated under Pillar I.

### **(c) Pillar III – Market Discipline**

Market Discipline requires the disclosure of information regarding the risk management policies of the Company, as well as the results of the calculations of minimum capital requirements, together with concise information as to the composition of original own funds.

This is the subject matter of this document. It aims at encouraging market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment processes, and hence the capital adequacy of the Company.

## **9. Capital Management and Preservation**

### **(a) Own Funds**

The Company's primary objective is to maintain a strong capital base in order to support the growth of its business and also to meet regulatory capital requirements continuously.

The Company maintained as of 31<sup>st</sup> December 2011 Tier 1 and Tier 2 Capital as eligible own funds. The Company's Tier 1 Capital comprises share capital and reserves less any intangible assets. Share Capital includes the Company's paid up capital and share premium and Reserves include retained earnings. The Tier 2 Capital consists of additional own funds, which contain subordinated loan capital amounting to US\$ 6 million, which was provided in two separate Agreements from the same party in 2009, US\$ 3.5 million in July 2009 and US\$ 2.5 million in December 2009. Under the provisions of paragraph 9 (1)(b) of the Directive, the total qualifying Tier 2 Capital for year-end 2011 cannot exceed 50 percent of Tier 1 Capital. Further, pursuant to the provisions of paragraph 7(2)(a) of Directive DI144-2007-05, the Company has reduced the amount of subordinated loan capital for 2011 that posts as eligible own funds to US\$ 3,293 million. As provided for in paragraph 7(3) of Directive DI144-2007-05, the Company does not include in the calculation of eligible own funds any accrued interest payable on subordinated loans.

The Following is a Table of the Company's eligible own funds for the year ended 31<sup>st</sup> December 2011:

	<b>31.12.2011</b>
	<b>\$000</b>
<b>Tier 1 Capital</b>	
<b>Share capital</b>	<b>7.000</b>
- Paid Up Capital	1.490
- Share Premium	5.510
<b>Reserves</b>	<b>53.373</b>
- Retained Earnings	53.373

<b>Less: Intangible Assets</b>	<b>(2)</b>
<b>Total Qualifying Tier I Capital</b>	<b>60.371</b>
<b>Tier 2 Capital</b>	
<b>Subordinated Loan Capital</b>	<b>3.293</b>
- Subordinated Loan Agreements	3.293
<b>Total Qualifying Tier 2 Capital</b>	<b>3.293</b>
<hr/> <b>Total Regulatory Capital</b> <hr/>	<hr/> <b>63.664</b> <hr/>

The primary objective of the Company's capital supervision is to ensure that the Company complies with externally (regulatory) imposed capital requirements and that the Company maintains healthy capital ratios in order to support its business and to maximise shareholders' value.

The Company manages its capital structure and allocations and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities on an on going basis. The monitoring of capital level is performed on a continuous basis.

The Company also recognizes the impact on shareholder returns of the level of equity capital employed and seeks to maintain a prudent balance between the flexibility afforded by a strong capital position and the higher returns on equity possible with greater leverage.

#### **(b) Compliance with Minimum Capital Requirements**

According with section 68 of the Investment Services and Activities and Regulated Markets Law of 2007 (Law No.144(I)/2007, consolidated with Law 106(I)/2009), investment firms shall have in place sound, effective and complete strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they might be exposed.

The strategies and procedures shall be subject to regular internal review to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the activities of the investment firm concerned.

According to Directive D1144-2007-05, the Company calculates the risk-weighted exposure amounts in accordance with paragraphs 2 to 7 of Chapter 1 of Part C. The Company also maintains a minimum ratio of capital to risk weighted assets of 8%. The Commission may impose additional capital requirements for risks not covered by Pillar I.

During 2011, the Company had fully complied with all externally imposed capital requirements. The Company's regulatory capital (as per the audited results) is analysed as follows:

	<b>31.12.2011</b>
	<b>\$000</b>
<hr/> <b>Total Regulatory Capital</b> <hr/>	<hr/> <b>63.664</b> <hr/>
<b>Capital Requirements/Risk Weighted Assets</b>	
Credit, Counterparty Credit and Dilution Risks and Free Deliveries Capital Requirement	1.465
Settlement/Delivery Risk	171
Position, Foreign Exchange and Commodities Capital Requirement	5.837
Operational Risk Capital Requirements	3.022
Other and Transitional Capital Requirements	0
<hr/> <i>Total Risks</i> <hr/>	<hr/> <b>10.495</b> <hr/>

<b>Surplus Capital Against Total Risks</b>	<b>53.169</b>
<b>Total Capital Adequacy Ratio</b>	<b>48,53%</b>

## 10. Credit Risk

The Company adopts the Standardised approach for Credit Risk.

Credit risk arises when a failure by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date. In the ordinary course of business, BCS Cyprus uses various control mechanisms in order to ensure that credit risk is at a minimum level.

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

Under the Risk Management Function, the Risk Manager also examines and manages credit risk for each counterparty separately. The Risk Manager sets counterparty limits in accordance with internally generated methodologies.

The assessment of a counterparty's creditworthiness, on examination of a credit limit application, begins with an analysis of the counterparty's financials and the quality of its business (competitive positioning, corporate and organizational structure, etc), regional and sectoral factors (corporate clients) and account conduct within the Company. The Company is also using credit risk ratings from well recognized ECAs in order to assess the probability of default of a specific counterparty and, if necessary, refers to elements of other approaches, methods and models used to assess and manage these risks.

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

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

The Company in calculating "Credit, Counterparty Credit and Dilution Risks and Free Deliveries" for the year end, takes into consideration the following applicable exposure classes:

	31.12.2011		
	\$000	\$000	\$000
Credit, Counterparty Credit and Dilution Risks and Free Deliveries Capital Requirement – Standardized Method	Original Exposure/ Preconversion Factors	Risk Weighted Exposure Amount	8% Risk Weighted Exposure
Claims or contingent claims on central governments or central banks	-	-	-
Claims or contingent claims on regional governments or local authorities	-	-	-
Claims or contingent claims on administrative bodies and non-commercial undertakings	189	189	15
Claims or contingent claims on multilateral development banks	-	-	-
Claims or contingent claims on international organisations	-	-	-
Claims or contingent claims on institutions	36.979	16.734	1.339
Claims or contingent claims on corporates	-	-	-
Retail claims or contingent retail claims	1.501	1.126	90
Claims or contingent claims secured on real estate property	-	-	-
Past due items	-	-	-
Items belonging to regulatory high-risk categories	-	-	-
Claims in the form of covered bonds	-	-	-
Securitization positions	-	-	-
Short-term claims on institutions and corporates	-	-	-
Claims in the form of collective investment undertaking ("CIU")	-	-	-
Other items	269	269	22
<b>Total</b>	<b>38.938</b>	<b>18.318</b>	<b>1.466</b>

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

For those trade receivables that are 90 days or more past due, in non-accrual status, the Company classifies those as past due, thus an impairment test will emerge.

A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy and default of payments (90 days or more past due) are considered indicators of impairment. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognized in the income statement.

The credit quality of financial assets that are neither past due nor impaired can be assessed by historical information about counterparty default rate and whether those are collateralised or not.

No credit limits were exceeded during the reporting period, and management does not expect any losses from non-performance by these counterparties. There was no past due or impaired amount to date by any counterparty.

Relating to External Credit Assessment, the Company has elected to use Moody's as the External Credit Assessment Institution ("ECAI") and as an alternative the Fitch's Ratings.

	31.12.2011
<b>Exposures to Institutions</b>	<b>\$000</b>
Aaa	6.127
Baa1	30.807
Baa3	0
Ba1	46
<b>Total</b>	<b>36.980</b>

The Company considers that a certain element of credit risk exists regarding the Company's cash and cash equivalents. In order to minimize the possibility of loss, cash and cash equivalents are mostly held with reputable banks and financial institutions.

	31.12.2011
<b>Cash at bank and short-term deposits with Institutions</b>	<b>\$000</b>
Aaa	6.121
Baa1	10.179
Baa3	0
Ba1	46
<b>Total</b>	<b>16.346</b>

The Company applies a risk weight of 20% for exposures to institutions with original maturity of three months or less and/or with residual maturity of three months or less provided that the exposure is expressed in the national currency of the Country where the institution is located.

#### **(a) Settlement/Delivery Risk**

In the case of transactions in which debt instruments, equities, foreign currencies and commodities (excluding repurchase and reverse repurchase agreements and securities or commodities lending and securities or commodities borrowing) are unsettled after their due delivery dates, BCS Cyprus calculates the price difference to which it is exposed. This represents the difference between the agreed settlement price for the debt instrument, equity, foreign currency, or commodity in question and its current market value, where the difference could involve a loss to the Company. The said difference is multiplied by the appropriate factor (see table below) in order to calculate its capital requirement.

As at the 31<sup>st</sup> of December 2011, the Company's Settlement/Delivery Risk exposure was as follows:

	\$000	31.12.2011 \$000	Percentage	\$000
Unsettled Transactions in the Trading Book	Unsettled Transactions at Settlement Price	Price Difference Exposure due to Unsettled Transactions	Risk Weight Factor	Capital Requirements
Transactions unsettled up to 4 Days	-	-	0%	-
Transactions unsettled between 5 to 15 Days	-	-	8%	-
Transactions unsettled between 16 to 30 Days	-	-	50%	-
Transactions unsettled between 31 to 45 Days	-	-	75%	-
Transactions unsettled for 46 Days or more	510	171	100%	171

## **(b) Credit Risk Hedging and Mitigation Policies**

The Credit Mitigation efforts of the Company can be analysed in respect of the two major determinants of Credit Risk:

- "Secured lending transaction": Defined as any transaction giving rise to an exposure secured by collateral which does not include a provision conferring upon the investment firm the right to receive margin frequently. Repurchase transactions and/or securities lending or borrowing transactions fall under this category.
- "Capital market-driven transaction": Defined as any transaction giving rise to an exposure secured by collateral which includes a provision conferring upon the investment firm the right to receive margin frequently. Margin lending is the major activity undertaken by the Company that falls under this category.

The Credit Risk Mitigation techniques utilised by Investment Firms can be classified into two broad categories:

- "funded credit protection": Means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an institution derives from the right of the institution - in the event of the default of the counterparty or on the occurrence of other specified credit events relating to the counterparty - to liquidate, or to obtain transfer or appropriation of, or to retain certain assets or amounts, or to reduce the amount of the exposure to, or to replace it with, the amount of the difference between the amount of the exposure and the amount of a claim on the institution, and
- "unfunded credit protection": Means a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an institution derives from the undertaking of a third party to pay an amount in the event of the default of the borrower or on the occurrence of other specified credit events;

The techniques utilised by BCS Cyprus fall exclusively within the "funded credit protection" category.

In respect of repurchase transactions and/or securities lending or borrowing transactions, the Company's actions revolve around two parameters:

- The use of Master netting agreements: The Company's dealings are based on internationally recognised and acknowledged master netting agreements, like the International Securities Market Association TBMA/ISMA Global Master Repurchase Agreement. Pursuant to the provisions of paragraph 1.2 of Part 1 of Annex VIII of Part C of the Directive, the Company applies the Financial Collateral Comprehensive Method (Supervisory Volatility Adjustments variant).
- Eligibility of Collateral: In order for funded credit protection to be eligible for recognition, the assets relied upon shall be sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved. This requirement is applicable to both, the repurchase transactions and/or securities lending or borrowing transactions activity and the margin lending activity of the Company. Paragraph 1.2 of Part 1 of Annex VIII of Part C of the Directive provides a detailed description of the financial items that meet the eligibility criteria.

## **(c) Securities Financing Transactions**

The Company pledges assets primarily for repurchase agreements which are generally conducted under terms that are usual and customary to standard securitized borrowing contracts.

Securities sold subject to repurchase agreements are reclassified in the Company's audited financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral. The liability to the counterparty is shown separately on the liability face of the

balance sheet. Securities purchased under agreements to resell (reverse repos) are recorded as Receivables under reverse repurchase agreements.

The securities financing positions in the Company's audited financial statements were as follows:

	31.12.2011
	\$000
<b>Current Assets</b>	
Pledged Assets	0
Receivables under Reverse Repurchase Agreements	13.465
<b>Current Liabilities</b>	
Payables under Repurchase Agreements	0

## 11. Market Risk

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

	\$000	31.12.2011 \$000	\$000
Position, Foreign Exchange and Commodities Capital Requirement – Standardised Method	Net Positions	Net Positions subject to Capital Charge	Risk Weighted Exposure
Traded Debt Instruments in Trading Book	8.358	8.707	1.335
Equities in Trading Book	21.914	43.828	2.630
Position Risks in Commodities	-	-	-
Total Positions in Non-reporting Currencies for FX	23.399	23.399	1.872
Excess of Large Exposures in Trading Book	-	-	-
<b>Total</b>	<b>53.671</b>	<b>75.934</b>	<b>5.837</b>

The determinants of market risk are mainly price fluctuations or other market risk factors affecting the value of positions on its own trading book, where the trading book consists of all positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book and which are either free of any restrictive covenants on their tradability or are able to be hedged.

### (a) Management, Measurement and Control of Market Risk

BCS Cyprus currently adopts the Standardised Approach for the calculation of Market Risk. This is the simpler of the two available approaches, and has as its overarching methodological principle the application of certain proportion for the calculation of specific risk and general risk.

It is essential to state that different methodologies are used for the calculation of market risk for capital requirement reporting purposes and the calculation of daily limits for internal purposes by the Risk Manager.

**Specific Risk:** In the case of equities, the capital requirement against specific risk is calculated by multiplying the overall gross position by four percent (4%). Subject to certain conditions pertaining (the most notable one being that the equities must be deemed highly liquid) the applicable rate can be reduced to two percent (2%) for these equities satisfying the conditions. In the case of Traded Debt Instruments, the capital requirement against specific risk is calculated by applying a factor ranging

from zero percent (0%) to twelve percent (12%), depending on a combination of the characteristics of the issuer and the residual term to final maturity.

General Risk: In the case of equities, the capital requirement against general risk is calculated by multiplying the overall net position by eight percent (8%). In the case of Traded Debt Instruments, the Maturity-based approach is used, whereby the capital requirement depends, as the name denotes, in the case of fixed-rate instruments, on the residual maturity and on the basis of the period until the interest rate is next set in the case of instruments on which the interest rate is variable before final maturity.

### **(b) Financial assets at fair value through profit or loss**

This category has two sub-categories: financial assets held for trading and those designated at fair value through profit or loss at inception. A financial asset is classified as held for trading if acquired principally for the purpose of selling in the short term. Financial assets designated as at fair value through profit or loss at inception are those that are managed and their performance is evaluated on a fair value basis and in accordance with the Company's trading and investment strategy. Information about these financial assets is provided internally on a fair value basis to the Company's key management personnel. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within twelve months of the balance sheet date as this has also been defined in the Company's Trading Book Policy Statement.

The fair values of quoted investments are based on readily available bid prices that are sourced independently, e.g. exchange closing prices for liquid securities. Where the financial instrument is normally OTC traded, BCS Cyprus utilizes screen prices, or quotes from independent reputable brokers (mark-to-market). If the market for a financial asset is not active (and for unlisted securities), the Company establishes fair value by using valuation techniques.

The Company holds a portfolio with investments in all basic sectors of the economy and all the Company's equity and traded debt instruments are related with the global market movements.

	<b>31.12.2011</b>
<b>Year end market value of Company's own portfolio</b>	<b>\$000</b>
<b>Securities</b>	<b>30.272</b>
Listed Securities	22.280
Unlisted Securities	7.992
Securities under Repurchase Agreements	0

Another way of measuring the risk associated with trading book is the use by the Company of Value at Risk (VaR) methodology, expected losses in excess of the VaR (ES – expected shortfall) and analysis of sensitivity to detrimental factors. The use of the VaR model is an important tool for monitoring foreign exchange and price risk, as it estimates the maximum potential loss that may be incurred as a result of adverse market conditions.

The following analytical approaches are also utilized for identification of market risk: expert assessment, fundamental analysis, and stress-testing.

### **(c) Trading book exposures**

The trading book of the Company consists of all positions in financial instruments held either with trading intent or in order to hedge other elements of the trading book and which are free of any restrictive covenants on their tradability or able to be hedged. Positions held with trading intent are those held intentionally for short-term resale and/or with the intention of benefiting from actual or short-term price differences between buying and selling prices or from other price or interest rate variations.



The Company takes on exposure to market risks. Market risks arise from open positions in interest rate and, currency and equity products, all of which are exposed to general and specific market movements.

In respect of its trading book business, the Company calculates capital requirements for position risk.

#### **(d) Contracts for Difference in the Trading Book**

A Contract for Difference (CFD) is a contract between two parties, typically described as the Buyer and seller, stipulating that the buyer will pay to the seller the difference between the current value and its value at contract time. Where the difference is negative, the seller pays instead the buyer.

CFDs are financial derivatives that allow investors to take an advantage of prices moving up (long positions) and prices moving down (short positions) in exchange rates and quoted prices obtained from the international money markets and stock exchanges.

The Company acts as a counterparty to the positions held by its clients, hence the positions are subject to the following risks:

1. FX Market Risk on notional positions and current replacement cost (gain/loss)
2. Interest Rate Position Risk on notional positions
3. Counterparty Credit Risk

The net unrealized gains relative to Clients' open positions at the year-end were as follows:

	31.12.2011
	\$000
<b>Net unrealized gains on contracts for differences</b>	<b>17</b>
Euro (EUR)	6
Rubble (RUB)	0
United States Dollar (USD)	11

The notional values of the overall currency long and short positions of CFDs at the year-end were as follows:

	31.12.2011		
	\$000	\$000	\$000
<b>Company's Counterparty Currency Position in CFDs</b>	Long Positions	Short Positions	Net Currency Position of CFDs
Australian Dollar (AUD)	1.318	246	1.072
Canadian Dollar (CAD)	45	1.091	(1.046)
Swiss Franc (CHF)	550	258	292
Euro (EUR)	2.796	2.670	126
Great Britain Pound (GBP)	1.088	972	116
Japanese Yen (JPY)	1.432	761	671
New Zealand Dollar (NZD)	106	31	75
Rubble (RUB)	708	60	648
United States Dollar (USD)	2.276	4.247	(1.971)
<b>Total</b>	<b>10.319</b>	<b>10.336</b>	<b>(17)</b>

Using the aforementioned values and by attaching current market values to CFDs (mark-to-market method), the current replacement cost of all contracts with positive values is obtained. The Company considers that all CFDs have a residual maturity of one year or less and carry a percentage of potential future credit exposure relating to Contracts concerning foreign exchange rates of 1%.

The sum of the current replacement cost and potential future credit exposure at the year-end was as follows:

<b>Counterparty Credit Risk Exposure from CFDs</b>		<b>31.12.2011</b>
		<b>\$000</b>
Current Replacement Cost		17
Potential Future Credit Exposure	10.319 * 1%	103
<b>Total</b>		<b>120</b>

### **(e) Interest rate risk**

The Company's management closely monitors the interest rate fluctuations on a continuous basis, and frequently performs a detailed analysis of the Company's asset and liability structure.

It shall be noted though that interest rate risk arises from the possibility that changes in the market interest rates will affect future income or the fair values of financial instruments. The Company is exposed to interest rate risk, principally as a result of holding interest-bearing assets comprising of cash and cash equivalents or lending at fixed interest rates in amounts and for periods that differ from those of its term borrowings at fixed or floating interest rates. Interest margins on assets and liabilities having different maturities may decrease as a result of changes in market interest rates.

Verification and management of interest rate risk is done by the Company's Senior Management and Accounting Department for interest rate bearing instruments such as cash and cash equivalents, repurchase transactions, and margin loans.

The Company's interest-bearing assets are approximately equal to its interest-bearing liabilities and therefore, any small fluctuation of Interest Rates would not have a material impact on the profit for the year.

### **(f) Foreign Exchange Risk**

Foreign Exchange Risk is also an important aspect of market risk management. The Company takes all reasonable steps to ensure that its capital requirements with regards to Foreign Exchange Risk are not excessive so that they can cause the Company to be in any financial impediment.

The capital requirement for foreign exchange risk is calculated for all of the Company's business activities. The calculation of the capital requirement involves the following stages:

The Company calculates its net open position in each currency (including the reporting currency) and in gold. The net open position consists of the sum of the following elements (positive or negative):

- a. The net spot position (i.e. all asset items less all liability items, including accrued interest, in the currency in question or, for gold, the net spot position in gold)
- b. The net forward position (i.e. all amounts to be received less all amounts to be paid under forward exchange and gold transactions, including currency and gold futures and the principal on currency swaps not included in the spot position)
- c. Irrevocable guarantees (and similar instruments) that are certain to be celled and likely to be irrecoverable
- d. Net future income/expenses not yet accrued but already fully hedged (at the discretion of the Company and with the prior consent of the Commission, net future income/expenses

- not yet entered in accounting records but already fully hedged by forward foreign-exchange transactions may be included here). The Company must implement the method chosen on a consistent basis
- e. The net delta (or delta-based) equivalent of the total book of foreign-currency and gold options, and
  - f. The market value of other (i.e. non-foreign-currency and non-gold) options.

Any positions which the Company has deliberately taken in order to hedge against the adverse effect of the exchange rate on its capital ratio may be excluded from the calculation of net open currency positions. Such positions should be of a non-trading or structural nature and their exclusion, and any variation of the terms of their exclusion, shall require the consent of the Commission. The same treatment subject to the same conditions as above is applied to positions which the Company has and which relate to items that are already deducted in the calculation of own funds.

In respect of Collective Investment Units (CIUs), the actual foreign position of the CIU is taken into account. The Company relies on third party reporting of the foreign exchange positions in the CIU, where the correctness of the reporting is adequately ensured by the Company.

Net short and long positions in each currency other than the reporting currency and the net long or short position in gold are converted at spot rates into the reporting currency. They are then summed separately to form the total of the net short positions and the total of the net long positions respectively. The higher of these two totals is the Company's overall net foreign exchange position.

If the sum of the Company's overall net foreign exchange position and its net gold position exceeds two percent (2%) of its total own funds, the sum of the net foreign exchange position and the net gold position is multiplied by eight percent (8%) in order to calculate the Company's own funds requirement against foreign exchange risk.

Applying the methodology described above with the United States Dollar as the Company's reporting currency, the following capital requirement occurred as at 31<sup>st</sup> December 2011:

	31.12.2011
	\$000
<b>Total Positions in Non-reporting Currency</b>	<b>23.399</b>
Euro (EUR)	-
Great Britain Pound (GBP)	133
Swiss Franc (CHF)	323
Canadian Dollar (CAD)	-
Australian Dollar (AUD)	1.072
Japanese Yen (JPY)	671
Other Non-EEA Currencies	21.200
Capital Base	63.664
Limit: 2% of Capital Base	1.273
<b>Capital Requirement (above the 2% Capital Base Limit)</b>	<b>1.872</b>

### (g) Liquidity Risk

The possibility of this risk arising is higher when there is increased volatility in the markets where the Company invests its own account funds.

Liquidity risk is the risk that the Company, even if it has adequate capital resources, does not have sufficient financial resources that can be used to enable it to meet its obligations as they fall due, or can secure them only at excessive cost. The Company finances its operations from the cash flow generated by its operations.

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

As at the 31<sup>st</sup> of December 2011, the Company's borrowings and other payables were as follows:

	Up to 3 months	3 to 6 months	6 months to 1 year	1 to 2 years	2 to 5 years	Over 5 years
	\$000	\$000	\$000	\$000	\$000	\$000
Borrowings	93	-	-	-	7.801	-
Trade & Other Payables	758	-	-	-	-	-
Payables to related Parties	-	-	-	-	-	-
Payables under Rep. Agreem.	-	-	-	-	-	-
<b>Total</b>	<b>851</b>				<b>7.801</b>	

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

## 12. Operational Risk

Operational risk is the risk of loss arising from inadequate or failed internal procedures, human behaviour, fraud, unauthorized activities, error, omission, inefficiency, systems failure or external events. It is inherent in every business organization and covers a wide range of issues.

For the purpose of managing operational Risk, the following risks are also verified and managed:

- Business Process risk (incorrect orders, lack of control, operating bottlenecks);
- Technological risk (computer failures, software errors, unauthorized access, etc.);
- Personnel risk (misdemeanour, employee's incompetence, human errors, corporate abuse)
- Risks of unforeseen situations and external events (disasters, partners' misdemeanour, external technical failures, regulatory risks, legal risks, etc.)

### (a) Management of Operational Risk

Operational Risk is inherent to all Company operations. The Company's senior management and its Risk Management Function successfully manages and control Operational Risk by identifying, measuring, monitoring reporting, controlling and mitigating operational risks.

The Risk Manager prepares management reporting information which is sent to the Company's Senior Management. The Senior Management, in close cooperation with the Risk Manager, review the information reported, taking corrective actions to mitigate risk if and when necessary.

Moreover, to set control over operational risks, the Company has set and formalized all business processes.

1. The Company has a four-eye structure and a board oversight. This structure ensures the separation of powers regarding vital functions of the Company. The Board further reviews any decisions made by management and monitors their activities;

2. Several detection methods are in place by the accounting department in order to detect incorrect activities;
3. Senior Management ensures the accuracy of any statements. Senior Management also ensures that the information addressed to the client is fair, clear and not misleading;
4. To mitigate the risk of Money Laundering and Terrorist Financing Activities from Clients, the Company has employed on a full time basis an Anti-Money Laundering Compliance Officer;
5. Internal auditor visits to ensure that the Company complies with internal procedures and operations;
6. The Company has prepared a comprehensive business contingency and disaster recovery plan with recovery procedures and actions to be followed in the case of damage to any vital part of the Company's structure;
7. The Company obtains continuous legal advice and suggestions on the preparation of its legal documents and any issues that may arise relating to compliance and Risk Management.

The Company also applies all Risk Management controls with regard to the following:

- compliance with license requirements;
- internal registration of executed transactions in accordance with rules stipulated in regulatory statutes;
- timely release of a financial statement and audit checks;
- business processes automation;
- introduction of new services/new types of business activities;
- compliance with regulatory statutes during margin trading.

#### **(b) Evaluation of Operational Risk according to the Directive**

The Company adopted the Basic Indicator Approach (BIA) for Operational risk. The Basic Indicator Approach calculates the average of positive income, on a three year basis, of net income to be used in the risk weighted assets calculation. This includes the average over the positive figures of a 3 year period of brokerage income, asset management fees, dividend income and other revenues. The capital requirement for operational risk is equal to 15% of the relevant indicator defined in points 2 to 9 of Annex X, Part C of the Directive.

The Company manages operational risk through a control-based environment in which processes are documented and transactions are reconciled and monitored. This is supported by continuous operational risk monitoring.

In the following Table, there is an analysis regarding Capital Requirements for Operational Risk under the Basic Indicator Approach:

Operational Risk Capital Requirements	2009	2010	2011	Average	Capital Requirement (15%)
	\$000	\$000	\$000	\$000	\$000
Basic Indicator approach for operational risk calculation	16.156	12.807	31.472	20.145	3.022

### **13. Other Risks**

#### **(a) Reputation Risk**

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

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

#### **(b) Strategic Risk**

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

#### **(c) Business Risk**

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

#### **(d) Capital Risk Management**

This is the risk that the Company will not comply with capital adequacy requirements. The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders. The Company has a regulatory obligation to monitor and implement policies and procedures for capital risk management. Specifically, the Company is required to test its capital against regulatory requirements and has to maintain a minimum level of capital. This ultimately ensures the going concern of the Company. Such procedures are explained in detail in the Policies and Procedures Manual ("the PPM") of the Company.

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

#### **(e) Regulatory Risk**

Regulatory risk is the risk the Company faces by not complying with the relevant Laws and Directives issued by its supervisory authority the Cyprus Securities and Exchange Commission. If materialized, regulatory risk could trigger the effects of reputation and strategic risk. The Company has documented procedures and policies based on the requirements of relevant Laws and Directives issued by the Commission; these can be found in the PPM. Compliance with these procedures and policies are further assessed and reviewed by the Company's Internal Auditors and Compliance Officer and suggestions for improvement are implemented by management. The Internal Auditors evaluate and test the effectiveness of the Company's control framework at least annually. Therefore the risk of non-compliance is very low.

#### **(f) Legal and Compliance Risk**

This could arise as a result of breaches or non-compliance with legislation, regulations, agreements or ethical standards and have an effect on earnings and capital. The probability of such risks occurring is relatively low due to the detailed internal procedures and policies implemented by the Company and regular reviews by the Internal Auditors and the Compliance Officer. The structure of the Company is such to promote clear coordination of duties and the senior management consists of individuals of suitable professional experience and integrity, who have accepted responsibility for setting and achieving the Company's strategic targets and goals. In addition, the board meets at least

annually to discuss such issues and any suggestions to enhance compliance are implemented by the senior management.

**(g) IT Risk**

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

**(h) Operational Risk**

As stated in section 12, Operational risk is the risk of loss arising from fraud, unauthorized activities, error, omission, inefficiency, systems failure or external events. It is inherent in every business organization and covers a wide range of issues.

The Company manages operational risk through a control-based environment in which all processes are monitored and documented. All procedures at all levels of the Company's hierarchy are the object of systematic internal control. Inspections are carried out on a regular basis and any operational risk incidents are continuously monitored.