



SMBC NIKKO

SMBC NIKKO CAPITAL MARKETS LIMITED

**Report and Financial Statements**

31 December 2016

Company number 02418137

## Strategic Report

Registered number: 02418137

Incorporated with limited liability in England and Wales

### Directors

T Yazawa

A Yates

B Miura

T Imaeda

K Nakamura

J D Thomas

M Akiyama

### Secretary

P Davé

### Auditor

KPMG LLP

15 Canada Square

London E14 5GL

### Banker

Sumitomo Mitsui Banking Corporation Europe Limited

99 Queen Victoria Street

London EC4V 4EH

### Solicitor

Allen & Overy

One Bishops Square

London E1 6AO

### Registered Office

One New Change

London EC4M 9AF

**AUTHORISED AND REGULATED BY THE FINANCIAL CONDUCT AUTHORITY**

## Strategic Report

The directors present the Group Strategic Report of SMBC Nikko Capital Markets Limited for the year ended 31 December 2016.

### Principal activities

SMBC Nikko Capital Markets Limited Group (“the Group”) is a full scope investment business with securities, business advisory and derivatives divisions.

The Group consolidates the following legal entities:

- SMBC Nikko Capital Markets Limited (“the Company” or “CM LTD”), company number 02418137 incorporated in England and Wales, is a full scope investment firm authorised and regulated by the Financial Conduct Authority (“FCA”). Sumitomo Mitsui Banking Corporation (“SMBC”) of Japan is the majority shareholder and controller. The Company has a representative office in Australia.
- SMBC Derivative Products Limited (“SMBC DP”), a wholly owned subsidiary of CM LTD, which is a full scope investment firm incorporated in England and Wales, authorised and regulated by the FCA. It is structured as a bankruptcy remote derivative products company (“DPC”) and has received a credit rating of Aa1 from Moody’s Investors Service Inc. (“Moody’s”) and AA- from Standard & Poor’s Ratings Group (“S&P”). SMBC DP’s principal activities are the provision of interest rate and foreign exchange risk hedging products to customers seeking a highly rated counterparty and the provision, for a fee, of performance guarantees to affiliates.
- SMBC Capital Markets (Asia) Limited (“CM Asia”) is incorporated in Hong Kong and is authorised and regulated by the Securities and Futures Commission. CM Asia acts as an agent and intermediary for the Company and its affiliated entities in Asian markets outside of Japan and in Australia.

The Group’s and the Company’s investment banking activities are focussed on customer facilitation and maximising order flow in the primary and secondary debt and equity markets, with a particular focus on Japan. The business advisory group provides advice and support to SMBC Group customers seeking new business opportunities. The derivatives business provides interest rate and foreign exchange hedging products to the members of the wider SMBC Group and its customers. Activities are funded from capital and facilities provided by the wider Group. The repo business is primarily a customer service rather than a source of funding.

The Group’s and the Company’s business plan for 2016 focussed on the incremental growth of existing business lines and the development of new products and services where there was an indication of client demand. The directors also considered the enhancement of internal controls and governance as an essential underpinning of business growth. Control of day-to-day business activities is exercised using appropriate measures, risk targets and limits, which define acceptable levels of risk covering all business and support activities. Monitoring of these activities is undertaken using an extensive suite of Key Risk Indicators (“KRIs”) and Key Performance Indicators (“KPIs”), which have been selected for their ability to record small fluctuations in individual risks. The KRIs are an important element within the management information packs presented to the Group’s executive committee on a monthly basis.

### KPI’s

The primary KPI’s monitored by management are: actual revenue and expenses against budget; and capital adequacy measured through the tier 1 capital ratio. In 2016 the derivatives and securities businesses operating profit exceeded budget. Capital ratios are set out in Note 21, and have been maintained at levels that correspond with the Group and Company’s risk appetite, as determined by the Board, throughout the year.

## Strategic Report

### Principal risks and uncertainties

The Group and the Company have investment and ancillary services permissions relating to its business pursuant to the provisions of the Financial Services and Markets Act 2000 and the rules of the Financial Conduct Authority.

The principal risks and uncertainties facing the Group and the Company include credit risk, liquidity risk, market risk- a review of each of which is included in note 17 to the financial statements, and operational risk. Operational risk is defined as the risk of loss resulting from inadequate processes, people and systems or from external events.

The Group's and the Company's Risk Appetite Framework sets out the broad based level of these and other risks that are to be accepted in pursuit of its business goals and strategy. Underpinning this framework day-to-day business activities are managed using appropriate measures, risk targets and limits, which are to be considered as defining acceptable levels of each category of risk under normal conditions and are set-out within the specific policies and procedures in place across the organisation.

The Group and the Company seeks to minimise operational risk through clearly defined responsibilities for management and staff, comprehensive daily risk reporting and regular self-assessment of the operational set-up to identify any weaknesses covering front office, credit, risk management, settlements, legal, compliance and systems functions.

Internal processes and controls are subject to regular verification by an independent internal audit function, reporting to the Board, that has full discretion over the particular processes and controls it chooses to review and the timing of any review.

Other closely monitored risks, all of which are reviewed and assessed at least annually, include regulatory risk, the risk that changes to applicable regulations or laws may have an adverse impact on a business, which is a very significant factor for authorised and regulated investment firms, and conduct risk, which concerns potential detriment to the business, counterparties or employees caused by inappropriate judgements made in the course of our activities.

Additionally the Group and the Company are exposed to macro-economic, geopolitical and other external business risks which include, but are not limited to, the uncertain economic environment, particularly in the Eurozone where there are risks of Sovereign default, and changes to the level and volatility of prices such as foreign exchange rates, credit spreads, commodity and equity prices and, particularly, interest rates. The Brexit referendum in June 2016 resulted in a vote for the United Kingdom to leave the European Union ("EU"). This has generated a degree of market uncertainty which the Group and Company monitors closely. The structure of the Group is being reviewed to ensure that trading activities will be conducted from appropriate jurisdictions.

Counterparty credit risk arises from the potential non-performance of counterparties in fulfilling their contractual obligations pursuant to their derivative transactions. The Group and the Company seek to protect themselves from such risks through the use of industry standard documentation, commonly in the form of master agreements supported by individual transaction confirmations. Such documentation provides for a legally binding contractual framework which allows the application of close-out netting across a range of transactions and products with the same counterparty. The Group and the Company also mitigate credit risk through collateral arrangements. Such arrangements will depend on the nature of the transaction and the nature and credit worthiness of the counterparty. Collateral obtained will be in the form of cash or eligible government securities. These arrangements are supplemented by a series of guarantees from the parent, or other affiliates, that serve to transfer credit risk. Guarantee arrangements are set-out in Note 1.

## Strategic Report

### Principal risks and uncertainties (continued)

Liquidity risk arises primarily from the requirement to fund securities financing transactions, although risk here is significantly mitigated by delivery-versus-payment settlement arrangements, and collateral calls, where there is an imbalance between uncollateralised customer trades and collateralised hedge trades.

The Group's and the Company's funding requirements are met from its own resources, borrowing from affiliates and, occasionally, through repo market transactions. Potential funding risk is mitigated by a policy of holding significant positions in very high quality marketable securities that may be sold to cover any funding gaps. Reliance is also placed on committed and uncommitted facilities provided by SMBC.

Market risk is defined as the risk of losses arising from movements in market prices. Market risks are classified into "traded market risks" and "non-traded market risks". Traded market risk means the potential loss of earnings and capital arising from adverse movements in security prices, commodity prices, interest rates or foreign exchange rates in the trading book. This risk can arise from market making and (inventory) position taking in securities, currencies, commodities, or derivatives. Non-traded market risks includes market risks related to non-traded banking products and services, and residual risks not categorised as "traded market risks". Material non-traded market risks within the Group's and the Company's business include underwriting risk: the risk associated with underwriting issuance of equity or debt securities and illiquidity risk: the risk from holding illiquid assets. Market risk is managed through establishing, monitoring and enforcing a series of complementary position limits.

### Results and dividends

The Group profit for the year, after taxation, amounted to \$79.1 million (2015 - \$64.7 million). No dividend was paid in the year and none has been declared (2015 - \$nil).

Staff numbers increased from 230 to 249 for the Group and from 217 to 233 for the Company in 2016.

The directors take into account a range of strategic, business and operational considerations when reviewing the performance of each business line. Such considerations include the efficient allocation and use of capital, earnings stability, balance sheet quality, operational robustness and the maintenance of good regulatory compliance. Effectiveness is measured through the use of financial indicators such as budgeted revenue targets, new deal revenue and return on capital and also non-financial indicators such as conduct considerations, compliance with relevant internal and external rules and targets and the setting of measurable goals for all employees through a comprehensive assessment process.

The directors pay particular attention to management information relating to regulatory capital, leverage and liquidity.

The financial position of the Group and the Company at the end of the year was satisfactory.

## **Strategic Report**

### **Results and dividends (continued)**

By order of the Board



Parul Davé  
Secretary  
One New Change  
London EC4M 9AF

Date: 21st April 2017

## Directors' Report

The directors present their report and the financial statements of SMBC Nikko Capital Markets Limited for the year ended 31 December 2016.

### Financial risk management

The Group and the Company have adopted a Three Lines of Defence approach to financial risk management to ensure that adequate oversight of risks exists and that a “risk aware” culture is embedded.

Each business function, and its respective head, is required to ensure that all business decisions taken maintain an appropriate balance between risk and return and are in accordance with the Group's and the Company's objectives and risk appetite. The business functions constitute the first line of defence (“1<sup>st</sup> LOD”) and are responsible for identifying and managing risks directly and are accountable for both upside and downside outcomes. Each business function undertakes a regular risk self-assessment that is presented for executive management scrutiny.

The Risk Function, Operations, Financial Control and Compliance all report to the Board, and make up the second line of defence (“2<sup>nd</sup> LOD”) responsible for day-to-day risk identification, assessment and monitoring. It provides oversight and guidance as well as advising, facilitating and challenging the 1<sup>st</sup> LOD in their risk management activities and risk-return considerations. The Risk Function ensures that the Board and senior management are duly informed and engaged.

The Internal Audit department constitutes the third line of defence (“3<sup>rd</sup> LOD”) and provides independent assurance to the Board that the 1<sup>st</sup> and 2<sup>nd</sup> LOD's are fit for purpose and that the risk based information provided to the Board and management is accurate and reliable.

### Future developments

The Group and the Company operate in a highly regulated market in which the relevant authorities are becoming increasingly interventionist. The full scale of the impact of proposed regulatory changes remains to be determined and the Group and the Company will continue to monitor developments in order to ensure full compliance.

### Directors

The directors who served during the year and at the date of this report were as follows:

T Yazawa

A Yates

B Miura (appointed 5 May 2016)

T Imaeda (appointed 13 October 2016)

K Nakamura

J D Thomas

M Akiyama (appointed 15 June 2016)

Y Tsutsumi (resigned 23 March 2017)



## Directors' Report

### Directors (continued)

H Oiwa	(resigned 5 December 2016)
Y Hayashi	(resigned 26 May 2016)
M Oshima	(resigned 13 October 2016)
M Okumura	(resigned 11 April 2016)

The Company maintains directors' and officers' liabilities insurance cover for its directors and officers as permitted by its Articles of Association and the Companies Act 2006. Such insurance policies were reviewed during the period and remain in force.

### Company secretary

J Avery resigned and P Davé was appointed as Company secretary on 20 October 2016.

### Disclosure of information to the auditor

The Directors who held office at the date of approval of this Directors' report confirm that so far as they are each aware there is no relevant audit information of which the Company's auditor is unaware, and each Director has taken all steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

### Auditor

In accordance with section 487 of the Companies Act 2006, an elective resolution is in place that dispenses with the obligation to appoint an auditor annually. As a consequence, KPMG LLP continues to hold the position as the Company's auditor.

By order of the Board

Parul Davé  
Secretary  
One New Change  
London EC4M 9AF  
Date: 21<sup>st</sup> April 2017



## Statement of Directors' Responsibilities

The directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare Group and parent company financial statements for each financial year. Under that law they have elected to prepare both the Group and the parent company financial statements in accordance with IFRS as adopted by the EU and applicable law.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# **Independent auditor's report**

**to the members of SMBC Nikko Capital Markets Limited**

We have audited the financial statements of SMBC Nikko Capital Markets Limited for the year ended 31 December 2016 set out on pages 11 to 69. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

## **Respective responsibilities of directors and auditor**

As explained more fully in the Directors' Responsibilities Statement set out on page 8, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## **Scope of the audit of the financial statements**

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at [www.frc.org.uk/auditscopeukprivate](http://www.frc.org.uk/auditscopeukprivate).

## **Opinion on financial statements**

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2016 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

# **Independent auditor's report**

**to the members of SMBC Nikko Capital Markets Limited**

## **Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report:

- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

## **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



**Mike Heath (Senior Statutory Auditor)**  
**for and on behalf of KPMG LLP, Statutory Auditor**  
*Chartered Accountants*

15 Canada Square  
London E14 5GL  
United Kingdom

Date: 21<sup>st</sup> April 2017

## Group income statement

for the year ended December 31, 2016

	Notes	2016 US\$m	2015 US\$m
Net trading gain	2	221.3	204.6
Interest receivable on trading positions	4	37.5	9.2
Interest payable	5	(27.6)	(6.5)
		<u>231.2</u>	<u>207.3</u>
Personnel expenses	6&7	(77.8)	(75.0)
Depreciation and amortisation	15	(3.0)	(3.3)
Other operating expenses	3	(55.3)	(57.2)
		<u>(136.1)</u>	<u>(135.5)</u>
<b>Operating profit</b>		95.1	71.8
Interest receivable on non-trading positions	4	0.5	0.2
		<u>95.6</u>	<u>72.0</u>
<b>Profit on ordinary activities before taxation</b>		95.6	72.0
Tax charge on profit on ordinary activities	8	(16.5)	(7.3)
		<u>79.1</u>	<u>64.7</u>
<b>Profit for the financial year</b>		<u>79.1</u>	<u>64.7</u>
<b>Profit for the financial year (Company)</b>		<u>78.9</u>	<u>64.7</u>

Group profit for the financial year is entirely attributable to the equity holders of the Parent. All results are from continued operations.

The notes on pages 19 to 69 form an integral part of these financial statements.

## Group statement of comprehensive income

for the year ended December 31, 2016

	<i>Notes</i>	<i>2016 US\$m</i>	<i>2015 US\$m</i>
<b>Profit for the financial year</b>		79.1	64.7
<b>Other comprehensive income, net of tax</b>			
Items that will never be reclassified to profit and loss:			
Actuarial gains/(losses) arising on a defined benefit pension plan, net of tax	9	(0.6)	0.1
Items that are reclassified to other reserves:			
Net losses arising on cash flow hedges		(1.4)	-
<b>Total comprehensive income for the year attributable to equity holders of the Group</b>		<u>77.1</u>	<u>64.8</u>

The notes on pages 19 to 69 form an integral part of these financial statements.

## Group statement of financial position

for the year ended December 31, 2016

	Notes	2016 US\$m	2015 US\$m
<b>Assets</b>			
Cash at banks	10	458.6	120.6
Trading securities	11	704.0	833.0
Other trading assets, at fair value		30.3	19.1
Derivative assets	12	7,336.7	5,671.2
Securities purchased under agreements to resell		5,537.3	3,763.0
Due from clients	13	3.6	2.7
Other debtors	14	2,917.8	2,236.9
Property, plant and equipment	15	11.0	13.8
Deferred tax asset	8	1.9	0.9
<b>Total assets</b>		<b>17,001.2</b>	<b>12,661.2</b>
<b>Liabilities</b>			
Derivative liabilities	12	7,337.5	5,708.7
Trading liabilities, at fair value		112.2	102.7
Trading securities sold, not yet purchased		304.0	242.0
Securities sold under agreements to repurchase		5,199.0	3,492.3
Other creditors	16	2,421.7	1,566.5
Pension scheme liability	9	2.5	1.8
<b>Total liabilities</b>		<b>15,376.9</b>	<b>11,114.0</b>
<b>Net assets</b>		<b>1,624.3</b>	<b>1,547.2</b>
<b>Equity attributable to equity holders of the parent</b>			
Called up share capital	19	1,304.0	1,304.0
Retained earnings		323.0	243.9
Other reserves		(2.7)	(0.7)
<b>Total equity</b>		<b>1,624.3</b>	<b>1,547.2</b>

The notes on pages 19 to 69 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 20<sup>th</sup> April 2017 and were signed on its behalf by:



Antony Yates  
Director

Date: 21<sup>st</sup> April 2017  
Company number 02418137

## Company statement of financial position

for the year ended December 31, 2016

	Notes	2016 US\$m	2015 US\$m
<b>Assets</b>			
Cash at banks	10	330.6	8.8
Trading securities	11	608.4	722.4
Other trading assets, at fair value		30.3	19.1
Derivative assets	12	7,319.6	5,643.8
Securities purchased under agreements to resell		5,537.3	3,763.0
Due from clients	13	3.5	2.6
Other debtors	14	2,916.8	2,235.8
Investment in subsidiary undertaking	27	202.0	202.0
Property, plant and equipment	15	10.9	13.8
Deferred tax asset	8	1.9	0.9
<b>Total assets</b>		<b>16,961.3</b>	<b>12,612.2</b>
<b>Liabilities</b>			
Derivative liabilities	12	7,321.9	5,683.0
Trading liabilities, at fair value		112.2	102.7
Trading securities sold, not yet purchased		304.0	242.0
Securities sold under agreements to repurchase		5,199.0	3,492.3
Other creditors	16	2,418.9	1,564.5
Pension scheme liability	9	2.5	1.8
<b>Total liabilities</b>		<b>15,358.5</b>	<b>11,086.3</b>
<b>Net assets</b>		<b>1,602.8</b>	<b>1,525.9</b>
<b>Equity attributable to equity holders of the parent</b>			
Called up share capital	19	1,304.0	1,304.0
Retained earnings		301.5	222.6
Other reserves		(2.7)	(0.7)
<b>Total equity</b>		<b>1,602.8</b>	<b>1,525.9</b>

The notes on pages 19 to 69 form an integral part of these financial statements.

## Group statement of changes in equity

for the year ended December 31, 2016

	Notes	Equity share capital US\$m	Retained earnings US\$m	Other reserve US\$m	Total equity US\$m
<b>At 1 January 2015</b>		654.0	179.2	(0.8)	832.4
Profit for the year		-	64.7	-	64.7
Actuarial gains arising on a defined benefit pension plan, net of tax	9	-	-	0.1	0.1
<b>Total comprehensive income for the period</b>		<u>-</u>	<u>64.7</u>	<u>0.1</u>	<u>64.8</u>
Issuance of share Capital	19	650.0	-	-	650.0
<b>At 31 December 2015</b>		<u>1,304.0</u>	<u>243.9</u>	<u>(0.7)</u>	<u>1,547.2</u>
<b>At 1 January 2016</b>		1,304.0	243.9	(0.7)	1,547.2
Profit for the year		-	79.1	-	79.1
Actuarial losses arising on a defined benefit pension plan, net of tax	9	-	-	(0.6)	(0.6)
Net losses arising on cash flow hedges		-	-	(1.4)	(1.4)
<b>Total comprehensive income for the period</b>		<u>-</u>	<u>79.1</u>	<u>(2.0)</u>	<u>77.1</u>
<b>At 31 December 2016</b>		<u>1,304.0</u>	<u>323.0</u>	<u>(2.7)</u>	<u>1,624.3</u>

The notes on pages 19 to 69 form an integral part of these financial statements.



## Company statement of changes in equity

for the year ended December 31, 2016

	Notes	Equity share capital US\$m	Retained earnings US\$m	Other reserve US\$m	Total equity US\$m
<b>At 1 January 2015</b>		654.0	157.9	(0.8)	811.1
Profit for the year		-	64.7	-	64.7
Actuarial losses arising on a defined benefit pension plan, net of tax	9	-	-	0.1	0.1
<b>Total comprehensive income for the period</b>		<u>-</u>	<u>64.7</u>	<u>0.1</u>	<u>64.8</u>
Issuance of share Capital	19	650.0	-	-	650.0
<b>At 31 December 2015</b>		<u>1,304.0</u>	<u>222.6</u>	<u>(0.7)</u>	<u>1,525.9</u>
<b>At 1 January 2016</b>		1,304.0	222.6	(0.7)	1,525.9
Profit for the year		-	78.9	-	78.9
Actuarial losses arising on a defined benefit pension plan, net of tax	9	-	-	(0.6)	(0.6)
Net losses arising on cash flow hedges		-	-	(1.4)	(1.4)
<b>Total comprehensive income for the period</b>		<u>-</u>	<u>78.9</u>	<u>(2.0)</u>	<u>76.9</u>
<b>At 31 December 2016</b>		<u>1,304.0</u>	<u>301.5</u>	<u>(2.7)</u>	<u>1,602.8</u>

The notes on pages 19 to 69 form an integral part of these financial statements.

## Group statement of cash flows

for the year ended December 31, 2016

	Notes	2016 US\$m	2015 US\$m
<b><i>Cash flows from operating activities</i></b>			
Profit for the financial year		79.1	64.7
<b><i>Adjustments to reconcile net income to net cash (used in) operating activities:</i></b>			
Depreciation	15	3.0	3.3
Tax expense	8	16.5	7.3
Change in trading securities and repurchase contracts		123.5	(261.7)
Change in trading assets, at fair value		(11.2)	4.8
Change in trading liabilities, at fair value		9.5	23.3
Change in other debtors		(687.0)	455.5
Change in derivative assets	12	(1,665.5)	(1,150.3)
Change in deferred tax assets	8	(1.0)	(0.2)
Change in derivative liabilities	12	1,628.8	1,229.0
Change in other creditors		855.2	(867.3)
Net losses arising on cash flow hedges		(1.4)	-
Corporation tax paid	22	(11.3)	(6.5)
Net cash provided by / (used in) operating activities		<u>259.1</u>	<u>(562.8)</u>
<b><i>Cash flows from investing activities</i></b>			
Purchase of property, plant and equipment	15	(0.2)	(1.5)
Net cash outflow from investing activities		<u>(0.2)</u>	<u>(1.5)</u>
<b><i>Cash flows from financing activities</i></b>			
Repayment of subordinated debt		-	(150.0)
Increase in Called up share capital		-	650.0
Net cash inflow from financing activities		<u>-</u>	<u>500.0</u>
Net change in cash		<u>338.0</u>	<u>0.4</u>
Cash and cash equivalents at beginning of year	10	120.6	120.2
Cash and cash equivalents at end of year	10	458.6	120.6
Net increase in cash		<u>338.0</u>	<u>0.4</u>

The notes on pages 19 to 69 form an integral part of these financial statements.

## Company statement of cash flows

for the year ended December 31, 2016

	Notes	2016 US\$m	2015 US\$m
<b><i>Cash flows from operating activities</i></b>			
Profit for the financial year		78.9	64.7
<b><i>Adjustments to reconcile net income to net cash (used in) operating activities:</i></b>			
Depreciation	15	3.0	3.3
Tax expense		16.2	7.3
Change in trading securities and repurchase contracts		108.4	(263.2)
Change in trading assets, at fair value		(11.2)	4.8
Change in trading liabilities, at fair value		9.5	23.3
Change in other debtors		(686.7)	455.7
Change in derivative assets	12	(1,675.8)	(1,161.2)
Change in deferred tax assets	8	(1.0)	(0.2)
Change in derivative liabilities	12	1,638.9	1,240.0
Change in other creditors		854.4	(866.9)
Net losses arising on cash flow hedges		(1.4)	-
Corporation tax paid	22	(11.3)	(6.5)
Net cash provided by / (used in) operating activities		<u>243.0</u>	<u>(563.6)</u>
<b><i>Cash flows from investing activities</i></b>			
Purchase of property, plant and equipment	15	(0.1)	(1.6)
Net cash outflow from investing activities		<u>(0.1)</u>	<u>(1.6)</u>
<b><i>Cash flows from financing activities</i></b>			
Increase in Called up share capital		-	650.0
Repayment of subordinated debt/subsidiary investment		-	(150.0)
Net cash inflow from financing activities		<u>-</u>	<u>500.0</u>
<b><i>Net change in cash</i></b>		<u>321.8</u>	<u>(0.5)</u>
Cash and cash equivalents at beginning of year	10	8.8	9.3
Cash and cash equivalents at end of year	10	330.6	8.8
<b><i>Net increase / (decrease) in cash</i></b>		<u>321.8</u>	<u>(0.5)</u>

The notes on pages 19 to 69 form an integral part of these financial statements.

## Notes to the financial statements

at December 31, 2016

### 1. Accounting policies

#### *Basis of consolidation*

The Group consolidates all entities it controls. Control is judged to exist where the Group has the power to direct the relevant activities of an entity so as to obtain variable returns from its activities. In assessing control, the Group takes into consideration any potential voting rights that are currently exercisable.

The Group financial statements consolidate the financial statements of SMBC Nikko Capital Markets Limited and its subsidiary undertakings, SMBC Derivative Products Limited and SMBC Capital Markets Asia Limited (together “the Group”), drawn up to 31 December 2016.

#### *Basis of preparation*

The Group financial statements have been prepared under the historical cost convention except as set out below for the valuation of the derivative products, trading assets, trading liabilities, trading securities, and pension liabilities and in accordance with applicable accounting standards. Securities purchased under agreements to resell, securities sold under agreements to repurchase are not fair valued. The Directors have undertaken an assessment of the appropriateness of preparing the financial statements on a going concern basis and have concluded that there are no material uncertainties related to events or conditions that may cast significant doubt as to the ability of the Group to continue as a going concern.

#### *Statement of compliance*

Both the Group financial statements and the Company financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards (IFRS) adopted by the European Union. Prior year reclassifications are recorded where applicable to conform to changes in current year presentation.

#### *Company profit and loss account*

On publishing the parent company financial statements here together with the Group financial statements, the Company is taking advantage of the exemption in s408 of the Companies Act 2006 not to present its individual income statement and related notes that form a part of these approved financial statements. The profit dealt with in the financial statements of the Company was \$78.9 million in the year ended 31 December 2016 and a profit of \$64.7 million in the year ended 31 December 2015.

#### *Preparation of financial statements in US dollars*

The directors consider the functional currency of the Group’s activities to be US dollars since the majority of the Company’s income is generated in this currency. The directors have chosen to use US dollars as the presentational currency. All financial information is presented in US\$ millions and has been rounded to one decimal point unless indicated otherwise.

#### *Foreign currency translation*

Foreign currency assets and liabilities are translated into US dollar equivalents at rates of exchange ruling at the balance sheet date. Gains and losses resulting from re-measurement into US dollar equivalents are reflected in the Group income statement within net trading profit.

#### *Segmental analysis*

Segmental analysis of income and net assets has not been prepared because the Group is outside of the scope of reporting per IFRS 8 - Operating Segments. The Group's equity instruments are not traded in a public market and it is not in the process of issuing any class of instrument in a public market.

## Notes to the financial statements

at December 31, 2016

### 1. Accounting policies (continued)

#### *Property, plant and equipment*

Property, plant and equipment is stated at cost less accumulated depreciation and any losses for impairment. Cost includes the original purchase price of the asset and the costs directly attributable to bringing the asset into its working condition.

Depreciation is provided on the depreciable amount of items of property plant and equipment on a straight-line basis over their estimated useful economic lives. The depreciable amount is the gross carrying amount less the estimated residual value at the end of its useful economic life. The Group and the Company use the following annual rates in calculating depreciation:

#### *Leasehold assets:*

Leasehold property	Over the remaining life of the lease
Costs of adaption of leasehold property	Over the remaining life of the lease

#### *Other*

Computers and similar equipment	3 years
Fixtures, fittings and other equipment	5 years

When deciding on useful economic life the principal factors taken into consideration are the expected rate of technological change and the expected pattern of usage of the assets.

#### *Intangible assets*

Intangible assets are stated at capitalised cost less accumulated amortisation and accumulated impairment losses. The carrying values of intangible assets are reviewed for impairments at each reporting date and when events or changes in circumstances indicate that the carrying value may not be recoverable. Expenditure on internally developed software is recognised as an asset when the company is able to demonstrate its intention and ability to complete the development and use the software in a manner which will generate future economic benefits, and can reliably measure the costs to complete the development.

The capitalised costs of internally developed software include all costs directly attributable to developing the software and are amortised over its useful life. Intangible assets are amortised on a straight-line basis over their estimated useful lives as follows:

Computer Software	3 years
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#### *Trading securities*

Under IAS 39 an entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the instrument.

IAS 39 permits a choice between trade date and settlement date accounting for recording regular way transactions. In accordance with IAS 39 when applying settlement date accounting it is still required that any movements in fair value between trade date and settlement date are reflected as they occur. The movement in fair value will be taken to profit and loss or to other comprehensive income depending upon the classification of the asset. The company uses settlement date accounting consistently.

## Notes to the financial statements

at December 31, 2016

### 1. Accounting policies (continued)

#### *Credit guarantees*

The Group entered into an unconditional guarantee with SMBC, acting through its Cayman Branch and SMBC Tokyo (the 'Guarantor'), which guarantees the prompt and complete payment when due of any net termination payment payable to the Group under any of the ISDA Master Agreements of specific guaranteed counterparties. Having such an agreement in place means that any required credit valuation adjustment is calculated based upon the probability of the double-default of both the Counterparty and the Guarantor. A fee is payable monthly based on the monthly daily average value of the guaranteed transactions. The fee has been accounted for in line with the substance of the credit guarantee. It has been computed on a fair value basis, discounted to its present value and recorded as a derivative liability on the balance sheet.

#### *Derivative assets and liabilities*

Derivatives are initially measured at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Transactions are recorded on a trade date basis. Changes in the fair value are recognised immediately in the income statement except for derivatives that are used as cash flow hedges.

#### *Cash flow hedges*

The Company's use of cash flow hedges is to reduce the foreign exchange risk on the Company's forecast monthly GBP expenses for each financial year.

For cash flow hedges, any forecast transactions included must be highly probable and must present an exposure to variations in cash flows that could affect the profit and loss.

For qualifying cash flow hedges in respect of financial assets and liabilities, the effective portion of the change in the fair value of the hedging derivative is initially recognised in other comprehensive income and is released to other reserves in the same periods during which the hedged item affects profit and loss. Any ineffective portion of the hedge is immediately recognised in profit and loss.

#### *Trading assets and liabilities*

Fixed income financial instruments included in trading assets and trading liabilities represent contractual agreements with counterparties that provide fixed or variable periodic payments from a stated or contingent date over a specified time period. The Group records these fixed income financial instruments at fair value. Unrealised gains and losses due to changes in fair value are included in trading profit/ (loss) in the accompanying Group income statements.

#### *Fair Value*

The Group assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions either: (a) in the *principal market* for the asset or liability; or (b) in the absence of a principal market, in the *most advantageous market* for the asset or liability. That assumed transaction establishes a basis for determining the exit price.

The Group manages the credit and liquidity risks in their derivatives portfolio on a net basis. The Group provides fair value information on its derivative portfolio on a net basis to management. Therefore, the Group makes adjustments to the valuation of their derivatives by calculating credit, and debit valuation adjustments consistent with IFRS 13 and measures the fair value of the derivative portfolio on a net basis (i.e. the unit of account is the entire portfolio).

## Notes to the financial statements

at December 31, 2016

### 1. Accounting policies (continued)

#### *Fair Value*

The Group assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions either: (a) in the *principal market* for the asset or liability; or (b) in the absence of a principal market, in the *most advantageous market* for the asset or liability. That assumed transaction establishes a basis for determining the exit price.

The Group manages the credit and liquidity risks in their derivatives portfolio on a net basis. The Group provides fair value information on its derivative portfolio on a net basis to management. Therefore, the Group makes adjustments to the valuation of their derivatives by calculating credit, and debit valuation adjustments consistent with IFRS 13 and measures the fair value of the derivative portfolio on a net basis (i.e. the unit of account is the entire portfolio).

#### *Securities sold under agreement to repurchase and securities purchase under agreement to resell*

In the ordinary course of business, the Group lends securities under agreements to repurchase them at a predetermined price ("repos"). Since substantially all of the risks and rewards (generally considered to be at least 90%) are retained by the Group, the securities remain on the consolidated statement of financial position and a liability is recorded in respect of the consideration received. On the other hand, the Group borrows securities under agreements to resell them at a predetermined price ("reverse repos"). Since the Group does not obtain substantially all of the risks and rewards of ownership, these transactions are treated as collateralised loans and the securities are not included in the Group statement of financial position. These collateralised loans are carried at cost.

Securities borrowed are not recognised in the consolidated statement of financial position, unless these are sold to third parties, at which point the obligation to repurchase the securities is recorded as a trading securities sold, at fair value and any subsequent gain or loss is included in "Net trading profit" in the Group statements of comprehensive income.

#### *Intermediation fees*

Where the Group receives an intermediation fee from CM INC for a derivative transaction with an unaffiliated counterparty, the fees are recognised as the present value of estimated future cash flows on a trade date basis.

#### *Cash and Cash equivalents*

Cash comprises demand deposits and short term money market deposits of three months or fewer from the date of acquisition.

#### *Interest receivable*

Interest is receivable on trading securities and cash at banks. Interest receivable is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset.

#### *Fee and commission income*

Fees and commissions for services provided or received by the Group and the Company on securities transactions and advisory business are recognised on completion of the underlying transaction.

## Notes to the financial statements

at December 31, 2016

### 1. Accounting policies (continued)

#### *Fees charged by affiliates*

Fees payable by the Group to SMBC and to CM INC for costs related to the derivative product support functions provided to the Group are recognised as an expense when incurred.

#### *Pension costs*

The Group operates a defined benefit pension plan and a defined contribution plan, both of which require contributions to be made to separately administered funds. The cost of providing benefits under the defined benefit plan is determined using the projected unit actuarial valuation method.

The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Any actuarial gains and losses are recognised in other comprehensive losses, net of tax.

All assumptions are reviewed at each reporting date. In determining the appropriate discount rate management considers the interest rates of high quality corporate bonds, in this case AA rated. The mortality rate is based on publicly available mortality tables in the UK. Future salary increases and pension increases are based on expected future inflation rates in the UK. Further details about the assumptions are given in note 9.

The past service cost is recognised as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to, a pension plan, past service cost is recognised immediately.

The defined benefit asset or liability comprises the present value of the defined benefit obligation less past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. The value of any asset is restricted to the sum of any past service cost not yet recognised and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Due to the long term nature of this plan, such estimates are subject to significant uncertainty.

#### *Deferred taxation*

Deferred tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

#### *Leasing*

A lease is classified as an operating lease if it does not transfer substantially all the risk and rewards incidental to ownership. The Group classifies its office space rental as an operating lease since the risks and rewards mainly lie with the lessor. In addition, the lease term does not constitute a major part of the economic life of the building. Rentals paid under operating leases are charged to income on a straight line basis over the term of the lease.



## Notes to the financial statements

at December 31, 2016

### 1. Accounting policies (continued)

#### *Significant accounting judgements and estimates*

In the process of applying the Group's accounting policies, management has exercised judgement and estimates, gauged in accordance with industry best practice, when determining the amounts recognised in the financial statements in relation to the fair value of derivative assets and liabilities and credit guarantees.

Where the fair value of derivative assets and liabilities recorded on the balance sheet cannot be derived from active markets, it is determined using a variety of valuation techniques that employ mathematical models.

The inputs to these models use observable market data where possible but, where observable market data is not available, judgement is required to establish fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives. Credit Valuation Adjustments ("CVA") and Debit Valuation Adjustments ("DVA") are incorporated into derivative valuations to reflect the value of counterparty and own credit risk. CVAs, calculated on a counterparty exposure basis across instrument type, are derived from management estimates of exposure at default, probability of default and recovery rates. The DVA is an adjustment to the value of the Group's derivative liabilities that seeks to reflect the Group's own default risk.

In line with market practice, the methodology for valuing the Group's collateralised derivative contracts uses the Overnight Indexed Swap curve (OIS) in order to more consistently manage the associated interest rate and funding risks.

The credit guarantees that Group has purchased from SMBC, are recognised on the balance sheet at the present value of future fees payable, calculated with reference to the expected exposure of the derivative transactions.

The funding fair value adjustment ("FVA") is calculated by applying future market funding spreads to the expected future funding exposure of any uncollateralised component of the OTC derivative portfolio. This includes the uncollateralised component of collateralised derivatives in addition to derivatives that are wholly uncollateralised. The expected future funding exposure is calculated by a simulation methodology, where available. The expected future funding exposure is adjusted for events that may terminate the exposure such as the default of the company or the counterparty.

#### *Future accounting developments*

The IASB has issued the following standards which have been endorsed by the EU:

IFRS 9 – *Financial Instruments (replacement of IAS39)* – Classification and Measurement, Impairment, and Hedge accounting: setting out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial instruments. The mandatory effective date of IFRS 9 as a whole will be for annual periods beginning on or after 1<sup>st</sup> January 2018. Management are considering the impact of this standard.

IFRS 15 – *Revenue from Contracts with Customers*: Provides comprehensive guidance on the recognition of revenue from contracts with customers arising from the transfer of services. The new guidance creates a common revenue recognition standard across all industries and requires new disclosures. IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018 and early adoption is not permitted. Therefore, this guidance is effective for the Company beginning 1 January 2018. The Company is evaluating the effect of this new standard on its financial statements.

## **Notes to the financial statements**

**at December 31, 2016**

### **1. Accounting policies (continued)**

#### ***Future accounting developments (continued)***

IFRS 16 – *Leases*: It sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, ie the customer (lessee) and the supplier (lessor). IFRS 16 replaces the previous lease standard, IAS 17 leases, and related interpretations. IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019. A company can choose to apply IFRS 16 before that date but only if it also applies IFRS 15 (*Revenue from Contracts with Customers*). The Company is evaluating the effect of this new standard on its financial statements.

## Notes to the financial statements

at December 31, 2016

### 2. Net trading profit

This comprises the following items of income and expense:

	2016 US\$m	2015 US\$m
Trading gain on derivative instruments	80.5	139.0
Derivatives reserves	30.0	(35.7)
Gains on primary and secondary trading	39.0	43.7
Underwriting and arrangement fees	73.0	57.7
Centralised activities	(1.2)	(0.1)
	<u>221.3</u>	<u>204.6</u>

Funding adjustments are applied to reflect the expected funding cost integrated over the lifetime of the portfolio, with consideration of the default event of the counterparties. In 2015, the Company implemented a FVA framework to incorporate the impact of funding into its valuation estimates. The Company's approach for the funding adjustment assumes that it is reasonable to calculate the funding cost created by the mirror of any uncollateralised derivative assets; the resulting booking is included in derivative reserves. The derivative reserve movements also reflect the impact of credit spreads for customers, own credit spreads, interest rates and foreign exchange rates within derivative contracts.

Due to the global nature of the international capital markets, the directors consider that the disclosure of net trading income by geographical source would not be meaningful.

### 3. Other operating expenses

	2016 US\$m	2015 US\$m
This is stated after charging:		
Auditor remuneration		
audit fees to KPMG LLP	0.4	0.4
audit related service fees to KPMG LLP	0.2	0.2
credit rating assurance fees to KPMG LLP NY	0.3	0.2
	<u>0.9</u>	<u>0.8</u>
Operating lease rentals - land and buildings	4.6	4.9
	<u>4.6</u>	<u>4.9</u>

Audit fees relate to the audit of the financial statements and audit-related services include CASS assurance and quarterly financial reviews.

## Notes to the financial statements

at December 31, 2016

### 4. Interest receivable

	2016 US\$m	2015 US\$m
Due on trading and repo activities from a fellow group undertaking	27.4	8.2
Due on trading and repo activities from non-group undertakings	10.1	1.0
	<u>37.5</u>	<u>9.2</u>
Due on non-trading activities	<u>0.5</u>	<u>0.2</u>

### 5. Interest payable

	2016 US\$m	2015 US\$m
Due on and wholly repayable within five years:		
- to a non-group undertaking	17.4	3.0
- to a fellow group undertaking	10.2	3.2
Due on and not wholly repayable within five years:		
- to a fellow group undertaking	-	0.3
Due on trading and repo activities	<u>27.6</u>	<u>6.5</u>

### 6. Staff costs

	2016 US\$m	2015 US\$m
Wages and salaries	60.7	57.9
Social security costs	5.4	6.0
Pension costs		
Defined benefit scheme	0.2	0.2
Defined contribution scheme	3.5	3.5
Other staff costs	8.0	7.4
	<u>77.8</u>	<u>75.0</u>

The average monthly number of Group and Company employees during the year was 239 (2015 - 217) and 224 (2015 - 204) respectively.

# Notes to the financial statements

at December 31, 2016

## 7. Directors' emoluments

	2016 US\$m	2015 US\$m
Emoluments	3.2	3.8
Group pension contributions	-	-
<b>Total</b>	<b>3.2</b>	<b>3.8</b>

  

	2016 US\$m	2015 US\$m
Emolument of highest paid director	1.9	2.5
Group pension contributions	-	-
<b>Total</b>	<b>1.9</b>	<b>2.5</b>

The highest paid director belonged to the Group's defined benefit pension scheme with the Group's contribution of \$28 thousand (2015- one director with contribution of \$33 thousand) in the year. These amounts are included within the directors emoluments figures above. Three directors received a bonus (2015- three directors).

## 8. Income tax expense

	2016 US\$m	2015 US\$m
<i>Current tax expense</i>		
Current year	14.7	7.4
Adjustments for prior years	2.3	0.1
<b>Current tax expense</b>	<b>17.0</b>	<b>7.5</b>
<i>Deferred tax credit:</i>		
Origination and reversal of temporary difference	(0.2)	(0.2)
Decrease in tax rate	(0.3)	-
<b>Deferred tax credit</b>	<b>(0.5)</b>	<b>(0.2)</b>
<b>Total tax charge in income statement</b>	<b>16.5</b>	<b>7.3</b>

### Disclosure of tax in OCI

	2016 Before tax US\$m	Net of tax US\$m	2015 Before tax US\$m	Net of tax US\$m
Actuarial (losses) / gains arising on defined benefit pension plan	(0.8)	(0.6)	0.2	0.1
Cash flow hedges	(1.9)	(1.4)	-	-
	<b>(2.7)</b>	<b>(2.0)</b>	<b>0.2</b>	<b>0.1</b>

## Notes to the financial statements

at December 31, 2016

### 8. Income tax expense (continued)

#### Reconciliation of effective tax rate

The tax assessed on the profit on ordinary activities for the year is not the same as the standard rate of corporation tax in the UK. The differences are explained below:

	2016 US\$m	Effective tax rate	2015 US\$m	Effective tax rate
Profit excluding taxation	95.6		72.0	
Tax using the UK corporation tax rate of 20.00% (2015: 20.25% )	19.1	20.00%	14.6	20.25%
Banking surcharge	3.7	3.87%	-	
APA adjustment	(8.3)	(8.69)%	(7.6)	(10.58)%
Non qualifying depreciation	0.2	0.25%	0.2	0.24%
Adjustments for prior years, including APA	2.4	2.45%	-	
Other	(0.6)	(0.61)%	0.1	0.19%
	16.5	17.27%	7.3	10.10%

The Group is party to an Advance Pricing Agreement (“APA”) between its affiliates CM INC and CM Asia and Her Majesty’s Revenue and Customs (“HMRC”) which defines the basis on which UK tax is charged on global derivative products group profits.

#### Corporation tax rate

A corporation tax rate of 21% was effective until 31st March 2015, and 20% from 1st April 2015. For the current year a corporation tax rate of 20% was effective. Further reductions to 19% (effective from 1 April 2017) and to 18% (effective from 1 April 2020) were substantively enacted from 26 October 2015.

In addition, the Finance (No. 2) Act 2015 introduced a bank surcharge of 8% on the profits of companies within banking groups, with effect from 1 January 2016.

The deferred tax asset at 31 December 2016 has been calculated based on these rates, including the bank surcharge. The effect of bank surcharge is also reflected in this year’s current tax charge.

# Notes to the financial statements

at December 31, 2016

## 8. Income tax expense (continued)

### Deferred tax assets (Group and Company)

	2016 US\$m	2015 US\$m
Property, plant & equipment	0.9	0.6
Employee benefits	0.5	0.3
Cash flow hedges	0.5	-
Tax assets	<u>1.9</u>	<u>0.9</u>

### Movement in deferred tax during the current year

	January 1, 2016	Recognised in income	Recognised in equity	December 31, 2016
Property, plant and equipment	(0.6)	(0.3)	-	(0.9)
Employee benefits	(0.3)	-	(0.2)	(0.5)
Cash flow hedges	-	-	(0.5)	(0.5)
Tax (assets)/liabilities	<u>(0.9)</u>	<u>(0.3)</u>	<u>(0.7)</u>	<u>(1.9)</u>

### Movement in deferred tax during the prior year

	January 1, 2015	Recognised in income	Recognised in equity	December 31, 2015
Property, plant and equipment	(0.3)	(0.3)	-	(0.6)
Employee benefits	(0.4)	-	0.1	(0.3)
Tax (assets)/liabilities	<u>(0.7)</u>	<u>(0.3)</u>	<u>0.1</u>	<u>(0.9)</u>

## Notes to the financial statements

at December 31, 2016

### 9. Pension costs

The Group operates two pension schemes in the UK: a contract-based defined contribution scheme, which covers all of the Group's local employees, with the exception of one employee, and an Executive Personal Pension Plan ("EPP"), which is a trust based scheme that provides benefits on a defined benefit basis to one UK employee. The Group incurred no pension costs in respect of its Japanese expatriate employees.

The contract based scheme, The SMBC Capital Fairs Limited Group Personal Plan, is open to new entrants and future contributions. The pension cost for this scheme for the year was \$3.5 million (2015 - \$3.5 million). The Company recognises expenses as employees render services.

The Group currently contributes to the EPP policy at the rate of 15% of the capped salary.

The defined benefit promise is a pension:

- payable as of right unreduced from age 60, calculated as one-sixtieth of pensionable salary limited to the earnings cap, for each year of service;
- guaranteed for 5 years once in payment;
- Increasing in line with retail price inflation or 5% p.a. whichever is the lower once in payment;
- with a 50% attaching spouse's pension.

The principle assumptions in valuing the Defined Benefit Obligation of the EPP are:

	2016	2015
	%	%
Rate of increase in salaries	4.8	4.6
Rate of increase in pension payment	3.3	3.1
Discount rate	2.6	3.7
Inflation assumption	3.3	3.1

#### Value of scheme assets and liabilities of the EPP

	Value 2016 US\$m	Value 2015 US\$m
Total fair value of assets	1.0	1.1
Present value of scheme liabilities	(3.5)	(2.9)
Deficit in the scheme	(2.5)	(1.8)
Related deferred tax asset	0.6	0.3
Net pension liability	(1.9)	(1.5)



## Notes to the financial statements

at December 31, 2016

### 9. Pensions (continued)

#### Movement in the present value of the defined benefit obligations

	2016 US\$m	2015 US\$m
Defined benefit obligations at the beginning of the year	2.9	3.0
Service cost / interest cost (expense recognised in profit and loss as staff costs)	0.2	0.2
Financial assumption	1.0	(0.1)
Exchange differences on opening balance	(0.6)	(0.2)
Present value of Scheme liabilities at the end of the year	<u>3.5</u>	<u>2.9</u>

#### Movements in actuarial loss

	2016 US\$m	2015 US\$m
Opening capital deficit	(1.5)	(1.6)
Financials assumption	(1.0)	0.1
Cumulative actuarial (loss)/gain	<u>(2.5)</u>	<u>(1.5)</u>
Actuarial (loss)/gain net of tax	(0.6)	0.1

The most recent actuarial valuations of plan assets and the present value of the defined benefit obligation were carried out on behalf of the Company at 31 December 2016. The present value of the defined benefit obligation, the related current service cost and the past service cost were measured using the projected unit credit method.

## Notes to the financial statements

at December 31, 2016

### 9. Pensions (continued)

#### Sensitivity Analysis

The percentage and absolute impact on the defined benefit obligation of changes in the significant assumptions is shown approximately below:

Assumption Varied	Defined Benefit Obligation %	Defined Benefit Obligation US\$m
As at 31 December 2016		
Discount Rate 0.5% p.a. lower	13	0.4
Inflation Rate 0.5% p.a. lower	-12	(0.4)
Minimum rate of improvement of mortality 0.5% p.a. lower	-2	(0.1)

### 10. Cash at banks

	Group 2016 US\$m	2015 US\$m	Company 2016 US\$m	2015 US\$m
Cash at bank	35.1	13.2	30.1	8.8
Short term deposits of three months or less	423.5	107.4	300.5	-
	<u>458.6</u>	<u>120.6</u>	<u>330.6</u>	<u>8.8</u>

For current accounts, \$4.3 million of Group (2015 - \$6.4 million), and \$3.8 million of Company current accounts (2015 - \$5.6 million) were placed with group undertakings. For short term deposits \$1.4 million (2015 - \$1.4 million) of Group short term deposits were placed with group undertakings.

The short term deposit includes a deposit of \$309.0 million with a non-UK credit institution for the Group and \$300.5 million for the Company.

A detailed analysis of the Group's and Company's credit exposure on cash at banks by financial institution is included in note 17.

# Notes to the financial statements

at December 31, 2016

## 11. Trading securities

	<i>Listed on London Stock Exchange US\$m</i>	<i>Listed on non UK Exchanges US\$m</i>	<i>Not Listed US\$m</i>	<i>Total US\$m</i>
Fair value as at 31 December 2016				
<b>Group</b>				
Floating rate notes	5.4	65.5	-	70.9
U.S. treasury securities	-	330.3	16.0	346.3
Foreign government securities	-	37.4	-	37.4
Corporate bonds	25.9	214.9	8.4	249.2
Equity securities	-	-	0.2	0.2
Total	31.3	648.1	24.6	704.0
<b>Company</b>				
Floating rate notes	5.4	20.0	-	25.4
U.S. treasury securities	-	296.3	-	296.3
Foreign government securities	-	37.4	-	37.4
Corporate bonds	25.9	214.8	8.4	249.1
Equity securities	-	-	0.2	0.2
Total	31.3	568.5	8.6	608.4
Fair value as at 31 December 2015				
<b>Group</b>				
Floating rate notes	41.5	144.0	-	185.5
U.S. treasury securities	-	-	311.9	311.9
Foreign government securities	-	8.2	-	8.2
Corporate bonds	36.2	276.0	15.2	327.4
Total	77.7	428.2	327.1	833.0
<b>Company</b>				
Floating rate notes	41.4	83.5	-	124.9
U.S. treasury securities	-	-	261.9	261.9
Foreign government securities	-	8.2	-	8.2
Corporate bonds	36.2	276.0	15.2	327.4
Total	77.6	367.7	277.1	722.4

## Notes to the financial statements

at December 31, 2016

### 12. Derivative assets and liabilities

As required by IFRS 7, and IAS 32, the Company discloses derivative assets and liabilities gross by counterparty because there is no intention to settle net.

	<i>2016</i> <i>US\$m</i>	<i>2015</i> <i>US\$m</i>
<b>Group</b>		
Amounts due from fellow group undertakings	4,903.6	3,558.5
Amounts due from external counterparties	2,477.2	2,177.4
Derivative Reserves	(44.1)	(64.7)
Derivative assets	<u>7,336.7</u>	<u>5,671.2</u>
Amounts due to fellow group undertakings	6,306.5	4,998.1
Amounts due to external counterparties	1,069.9	740.0
Derivative Reserves	(38.9)	(29.4)
Derivative liabilities	<u>7,337.5</u>	<u>5,708.7</u>
<b>Company</b>		
Amounts due from fellow subsidiary undertakings	4,887.4	3,541.4
Amounts due from external counterparties	2,476.3	2,166.8
Derivative Reserves	(44.1)	(64.4)
Derivative assets	<u>7,319.6</u>	<u>5,643.8</u>
Amounts due to fellow subsidiary undertakings	6,305.6	4,987.5
Amounts due to external counterparties	1,054.2	723.2
Derivative Reserves	(37.9)	(27.7)
Derivative liabilities	<u>7,321.9</u>	<u>5,683.0</u>

In line with the requirements of IFRS 13 the Group booked a Debit Value Adjustment (“DVA”), Credit Value Adjustment (“CVA”) and Funding Value Adjustment (“FVA”) when calculating the fair value of its derivatives. These are all classified as derivatives reserves.

## Notes to the financial statements

at December 31, 2016

### 12. Derivative assets and liabilities (continued)

At 31 December 2016 and 31 December 2015 the total notional principal amount related to derivative assets and liabilities, excluding equal and offsetting transactions with CM INC consisted of:

Type	Notional principal		Maturity range	
	2016 US\$m	2015 US\$m	2016 Years	2015 Years
<b>Group</b>				
Interest rate and currency swaps	37,191.5	33,085.4	0-24	0-24
Options	3,331.0	3,379.6	0-4	0-4
Forward contracts	-	88.2	-	0-1
Commodity swaps	146.3	209.6	0-3	0-3
Third party	<u>40,668.8</u>	<u>36,762.8</u>		
<b>Company</b>				
Interest rate and currency swaps	32,668.9	27,017.1	0-24	0-24
Options	3,331.0	3,379.6	0-4	0-4
Forward contracts	-	88.2	-	0-1
Commodity swaps	146.3	209.6	0-3	0-3
Third party	<u>36,146.2</u>	<u>30,694.5</u>		

Total notional amount of transactions with group undertakings were: Group US\$207,738.1 million (2015 - \$159,764.4 million) and Company US\$203,086.3 million (2015 - \$153,688.1 million)

Although the notional principal amounts identified above may be indicative of the significance of the Group's trading activities in these financial instruments, they do not represent the amounts exchanged by the parties to derivative transactions and do not measure the exposure to credit or market risks. The amounts exchanged are based on the notional amounts and other terms of the derivative instrument agreements.

The following paragraphs provide additional information on interest rate, foreign exchange, commodity, credit and equity index derivatives contracts:

#### Interest rate contracts

Interest rate swaps are one of the primary derivative instruments used by the Group. The two parties to an interest rate swap agree to exchange, at particular intervals, payment streams calculated on a specified notional amount with at least one stream based on a floating interest rate. Basis swaps involve two floating rates, such as prime and LIBOR. Inflation swaps are included in this category.

Forward rate agreements are settled in cash at a specified future date based on the differential between agreed upon interest rates and an index applied to a notional amount.

Interest rate caps and floors require the writer to pay the purchaser at specified future dates the amount, if any, by which a specified market interest rate exceeds the fixed cap rate or falls below the fixed floor rate, applied

## Notes to the financial statements

at December 31, 2016

### 12. Derivative assets and liabilities (continued)

to a notional amount. The cap or floor writer receives a premium for bearing the risk of unfavourable interest rate changes.

#### Currency swaps and foreign exchange contracts

The Group is involved in a variety of currency swaps and foreign exchange contracts in its trading activities. The parties to a currency swap generally agree to the exchange of principal amounts and interest in two currencies, agreeing to re-exchange the principal amounts at a future date and agreed upon exchange rate. These currency swaps relate to major foreign currencies such as Yen, Canadian dollars, Sterling and Euros.

#### Commodity derivatives

The Group has undertaken a series of commodity index swaps and options whereby it receives a fixed rate per contract and guarantees to deliver the average index price to the counterparty or, alternatively, where it guarantees a fixed payment in return for the floating average index price from the counterparty. All counterparty positions are fully hedged with a market maker.

#### Equity index derivatives

The Group has undertaken a number of equity index option transactions. These transactions involve the payment or receipt of amounts which are determined by reference to the movement in an equity index.

As of 31 December 2016 for most of the Group's interest rate and currency swaps, and interest rate and currency options, back to back transactions were made with CM INC. For commodity and equity and other index trades back to back transactions were made with other market counterparties. The Group continued to enter into interest rate, currency, commodity and inflation-linked derivative intermediation trades. A gain of \$80.5 million before CVA, DVA and FVA adjustments, was recognised on the derivative trading portfolio in 2016 and was disclosed in the net trading profit (2015 - \$139.0 million). The fair value of these trades was determined using valuation techniques with significantly observable valuation inputs or internally generated models.

Note 17 describes the risks associated with the uses of derivative products.

## Notes to the financial statements

at December 31, 2016

### 13. Due from clients

	<i>Group</i>		<i>Company</i>	
	<i>2016</i>	<i>2015</i>	<i>2016</i>	<i>2015</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
Amount due from non-group undertakings	3.6	2.7	3.5	2.6
	<u>3.6</u>	<u>2.7</u>	<u>3.5</u>	<u>2.6</u>

### 14. Other debtors

	<i>Group</i>		<i>Company</i>	
	<i>2016</i>	<i>2015</i>	<i>2016</i>	<i>2015</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
Accrued interest income	1.1	0.4	1.1	0.4
Other debtors due from group undertakings	2,342.5	1,864.2	2,341.9	1,863.6
Other debtors due from non-group undertakings	567.8	353.3	567.6	353.1
Prepayments	3.6	2.3	3.5	2.2
Corporation tax	2.8	16.7	2.7	16.5
	<u>2,917.8</u>	<u>2,236.9</u>	<u>2,916.8</u>	<u>2,235.8</u>

Pursuant to the terms of each Collateral Support Agreement ('CSA'), the Group and the Company has placed cash collateral of \$501.3 million (2015 - \$326.5 million) with non-group counterparties, and \$2,341.7 million (2015 - \$1,854.6 million) with group undertakings.

Included within amounts owing from group undertakings is a payable balance for \$310.0 million (2015 - \$nil). This relates to an Independent Amount received from an affiliate, and is offset against amounts owing which are booked within the same CSA agreement.

## Notes to the financial statements

at December 31, 2016

### 15. Property, plant and equipment

The year-end position of the Group and the Company comprised the following classes of assets:

	<i>Leasehold Property US\$m</i>	<i>Personal Computers US\$m</i>	<i>Furniture &amp; Fixtures US\$m</i>	<i>Total US\$m</i>
<b>Group</b>				
<b>Cost</b>				
Balance at 1st January 2015	21.1	5.1	0.3	26.5
Additions	0.8	0.7	-	1.5
Balance at 31st December 2015	21.9	5.8	0.3	28.0
Balance at 1st January 2016	21.9	5.8	0.3	28.0
Additions	-	0.2	-	0.2
Balance at 31st December 2016	21.9	6.0	0.3	28.2
<b>Accumulated depreciation and impairment losses</b>				
Balance at 1st January 2015	6.7	4.1	0.1	10.9
Depreciation for the year	2.7	0.5	0.1	3.3
Balance at 31st December 2015	9.4	4.6	0.2	14.2
Balance at 1st January 2016	9.4	4.6	0.2	14.2
Depreciation for the year	2.4	0.6	-	3.0
Balance at 31st December 2016	11.8	5.2	0.2	17.2
<b>Carrying amounts</b>				
Balance at 31st December 2015	12.5	1.2	0.1	13.8
Balance at 31st December 2016	10.1	0.8	0.1	11.0



## Notes to the financial statements

at December 31, 2016

### 15. Property, plant and equipment (continued)

<b>Company</b>	<i>Leasehold Property US\$m</i>	<i>Personal Computers US\$m</i>	<i>Furniture &amp; Fixtures US\$m</i>	<i>Total US\$m</i>
<b>Cost</b>				
Balance at 1st January 2015	21.1	5.0	0.3	26.4
Additions	0.8	0.8	-	1.6
Balance at 31st December 2015	21.9	5.8	0.3	28.0
Balance at 1st January 2016	21.9	5.8	0.3	28.0
Additions	-	0.1	-	0.1
Balance at 31st December 2016	21.9	5.9	0.3	28.1
<b>Accumulated depreciation and impairment losses</b>				
Balance at 1st January 2015	6.7	4.1	0.1	10.9
Depreciation for the year	2.7	0.5	0.1	3.3
Balance at 31st December 2015	9.4	4.6	0.2	14.2
Balance at 1st January 2016	9.4	4.6	0.2	14.2
Depreciation for the year	2.4	0.6	-	3.0
Balance at 31st December 2016	11.8	5.2	0.2	17.2
<b>Carrying amounts</b>				
Balance at 31st December 2015	12.5	1.2	0.1	13.8
Balance at 31st December 2016	10.1	0.7	0.1	10.9

## Notes to the financial statements

at December 31, 2016

### 16. Other creditors

	<i>Group</i>		<i>Company</i>	
	<i>2016</i>	<i>2015</i>	<i>2016</i>	<i>2015</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
Amounts due to fellow group undertakings	2,182.0	1,370.5	2,180.7	1,369.5
Corporation tax	-	5.7	-	6.0
Other creditors and accruals	239.7	190.3	238.2	189.0
	<u>2,421.7</u>	<u>1,566.5</u>	<u>2,418.9</u>	<u>1,564.5</u>

Pursuant to the terms of each CSA the Group and Company have received cash collateral from non-group counterparties of \$197.1 million (2015 - \$158.7 million), and group undertakings of \$1,922.3 million (2015 - \$1,100 million). Collateral is transferred with full re-hypothecation rights.

### 17. Risk management

#### Strategy in using financial instruments

The principal activities of the Group include customer facilitation, brokering and trading in primary and secondary debt and equity securities and an extensive range of over-the-counter derivative contracts.

The Group and the Company have no market risk limits for their derivative business which is undertaken on either an agency basis or a back-to-back basis where the market risk arising from customer trades is hedged either with CM INC, or a market counterparty.

The Group's business model is subject to a number of risks which are specific to the Group and generic to the sector.

#### Cash flow and fair value interest rate risk

As the Group and the Company operates a fully hedged derivative portfolio (subject to appropriate credit adjustments) and invests in floating rate assets funded through floating rate liabilities or capital there is no significant exposure to changes in cash flow or fair value due to interest rate risk.

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Credit risk

A detailed analysis of the Group's and Company's credit exposure on cash at banks by financial institution is as follows:

	<i>Group</i>		<i>Company</i>	
	<i>2016</i>	<i>2015</i>	<i>2016</i>	<i>2015</i>
<i>S&amp;P rating</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
A-1+	125.6	2.1	18.8	2.1
A-1	321.3	118.5	304.2	6.7
A-2	11.7	-	7.6	-
	<u>458.6</u>	<u>120.6</u>	<u>330.6</u>	<u>8.8</u>
	<i>Group</i>		<i>Company</i>	
	<i>2016</i>	<i>2015</i>	<i>2016</i>	<i>2015</i>
<i>Moody's rating</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
P-1	427.8	118.5	304.2	6.7
P-2	12.0	-	7.6	-
Not Rated	18.8	2.1	18.8	2.1
	<u>458.6</u>	<u>120.6</u>	<u>330.6</u>	<u>8.8</u>

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Credit risk (continued)

A detailed analysis of the Group and Company's credit exposure on Trading Securities by issuer is as follows:

<i>S&amp;P rating</i>	<i>Group</i>		<i>Company</i>	
	<i>2016</i>	<i>2015</i>	<i>2016</i>	<i>2015</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
AAA	22.1	37.8	22.1	37.8
AA+	2.8	205.4	2.8	155.4
AA-	18.3	33.6	4.3	5.6
A+	69.1	71.5	60.3	71.5
A	103.1	122.3	80.4	99.7
A-	37.0	22.3	37.0	22.3
BBB+	22.5	79.8	22.5	69.8
BBB	20.2	12.1	20.2	12.1
BBB-	2.1	44.0	2.1	44.0
Not rated	406.8	204.2	356.7	204.2
	<u>704.0</u>	<u>833.0</u>	<u>608.4</u>	<u>722.4</u>

<i>Moody's rating</i>	<i>Group</i>		<i>Company</i>	
	<i>2016</i>	<i>2015</i>	<i>2016</i>	<i>2015</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
Aaa	76.0	246.9	60.9	196.8
Aa1	2.8	10.4	2.8	10.4
Aa2	17.9	32.6	3.9	4.6
Aa3	1.1	3.6	1.1	3.6
A1	195.8	173.8	164.2	151.2
A2	12.6	20.1	12.6	20.1
A3	8.7	36.7	8.7	36.7
Baa1	11.4	81.6	11.4	71.6
Baa2	4.0	28.7	4.0	28.7
Baa3	11.4	5.6	11.4	5.6
Ba1	1.5	1.4	1.5	1.4
Not rated	360.8	191.6	325.9	191.7
	<u>704.0</u>	<u>833.0</u>	<u>608.4</u>	<u>722.4</u>

The Group is exposed to credit risk associated with the execution of derivative transactions with CM INC and other counterparties. The notional or contractual values of agreements do not represent exposure to credit risk, which is limited to the current cost of replacing those contracts in a gain position.

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Credit risk (continued)

The Group's credit exposure on derivatives arises from the risk of non-performance of its counterparties in fulfilling their contractual obligations pursuant to its derivative transactions. The risk of non-performance can be directly impacted by volatile or illiquid trading markets, which may impair the counterparties' abilities to satisfy their obligations. As of 31 December 2016, cash collateral of \$1,321.9 million (2015 - \$500 million), \$400 million (2015 - \$400 million), \$200 million (2015 - \$200 million) and \$0.4 million (2015 - Nil) was pledged to the Group by SMBC NY Branch, SMBC Cayman Branch, SMBC Tokyo Branch and SMBC Malaysia Berhad respectively. Cash collateral of \$197.1 million (2015 - \$158.7 million) was pledged by unaffiliated counterparties. All collateral balances are in relation to derivatives exposures.

A detailed analysis of the Group's and Company's credit exposures to external counterparties in derivative trades by gross replacement cost excluding CVA, DVA and FVA is as follows:

#### Group

	<i>S&amp;P Rating Gross replacement cost</i>			<i>Moody's Rating Gross replacement cost</i>	
	<i>2016</i>	<i>2015</i>		<i>2016</i>	<i>2015</i>
	<i>US\$m</i>	<i>US\$m</i>		<i>US\$m</i>	<i>US\$m</i>
AAA	102.8	181.0	Aaa	102.8	181.0
AA+	-	0.5	Aa1	-	0.5
AA-	70.9	84.1	Aa2	72.9	37.2
A+	196.6	44.3	Aa3	115.8	56.2
A	45.9	164.4	A1	144.4	108.1
A-	295.6	137.9	A2	18.0	58.0
BBB+	71.1	43.5	A3	258.9	142.3
BBB	23.8	46.8	Baa1	53.9	17.3
BBB-	0.5	7.6	Baa2	29.4	7.1
BB-	3.0	3.7	Baa3	0.5	-
Unrated	1,667.0	1,463.6	Ba1	-	19.5
			Ba3	3.0	6.7
			B2	-	3.7
			Unrated	1,677.6	1,539.8
	<u>2,477.2</u>	<u>2,177.4</u>		<u>2,477.2</u>	<u>2,177.4</u>

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Credit risk (continued)

##### Company

	<i>S&amp;P Rating Gross replacement cost</i>			<i>Moody's Rating Gross replacement cost</i>	
	<i>2016</i>	<i>2015</i>		<i>2016</i>	<i>2015</i>
	<i>US\$m</i>	<i>US\$m</i>		<i>US\$m</i>	<i>US\$m</i>
AAA	102.8	181.0	Aaa	102.8	181.0
AA-	70.9	84.1	Aa2	72.9	37.2
A+	196.6	44.3	Aa3	115.8	56.2
A	45.9	164.4	A1	143.5	104.7
A-	295.6	137.9	A2	18.0	58.0
BBB+	71.1	43.5	A3	258.9	142.3
BBB	23.8	46.8	Baa1	53.9	17.3
BBB-	0.5	0.9	Baa2	29.4	7.1
BB-	3.0	3.7	Baa3	0.5	-
Unrated	1,666.1	1,460.2	Ba1	-	19.5
			Ba3	3.0	-
			B2	-	3.7
			Unrated	1,677.6	1,539.8
	<u>2,476.3</u>	<u>2,166.8</u>		<u>2,476.3</u>	<u>2,166.8</u>

#### Analysis of credit exposure to external derivative counterparties by maturity

##### Group

	<i>Gross replacement cost</i>			<i>Notional Principal</i>	
	<i>2016</i>	<i>2015</i>		<i>2016</i>	<i>2015</i>
	<i>US\$m</i>	<i>US\$m</i>		<i>US\$m</i>	<i>US\$m</i>
<i>Term to maturity</i>					
Up to 5 years	742.0	781.2	11,414.1	10,049.8	
Greater than 5 years	1,735.2	1,396.2	9,143.3	6,932.3	
	<u>2,477.2</u>	<u>2,177.4</u>	<u>20,557.4</u>	<u>16,982.1</u>	

##### Company

	<i>Gross replacement cost</i>			<i>Notional Principal</i>	
	<i>2016</i>	<i>2015</i>		<i>2016</i>	<i>2015</i>
	<i>US\$m</i>	<i>US\$m</i>		<i>US\$m</i>	<i>US\$m</i>
<i>Term to maturity</i>					
Up to 5 years	742.0	773.9	11,414.1	9,968.6	
Greater than 5 years	1,734.3	1,392.9	9,093.9	6,854.4	
	<u>2,476.3</u>	<u>2,166.8</u>	<u>20,508.0</u>	<u>16,823.0</u>	

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Credit risk (continued)

The maximum maturity of exposures rated BBB+ or lower by S&P is 27 years (2015 - 25 years). The maximum maturity of exposures rated Baa3 or lower by Moody's is 8 years (2015 - 19 years).

Gross replacement cost credit exposure to SMBC related parties is Group: \$4,903.6 million (2015 - \$3,558.5 million), and Company: \$4,887.4 million (2015 - \$3,541.4 million)

Credit risk represents the potential losses that the Group would incur if a counterparty failed to perform its obligations under contractual terms and the collateral held was deemed worthless.

Management determines concentrations of counterparty credit risk in accordance with Bank for International Settlements guidance ('BIS Rules'). Management does not believe that the Group is exposed to significant concentrations of risk identified by such factors as geographical area, currency or product. Other trading assets included an exposure to an external counterparty whose credit rating was BBB as at 31 December 2015. The exposure as at 31 December 2016 is \$Nil (2015 - \$9.5 million).

#### Repurchase agreements and reverse repurchase agreements credit risk

The Company's repo trading activities give rise to counterparty risk exposures which are mitigated through the execution of netting agreements and agreements for margin requirements.

The Company monitors repo collateral credit quality, counterparty limits and collateral tenor.

#### Offsetting financial assets and financial liabilities

The disclosure set out in the following tables include financial assets and financial liabilities that are subject to an enforceable master netting arrangement or similar agreement that covers similar financial instruments.

The ISDA and similar master netting arrangements do not meet the criteria for offsetting in the statement of financial position. This is because they create for the parties to the agreement a right of set-off of recognised amounts that is enforceable only following an event of default, insolvency or bankruptcy of the Group or the counterparties or following other predetermined events. In addition, the Group and its counterparties do not intend to settle on a net basis or to realise the assets and settle the liabilities simultaneously.

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Credit risk (continued)

Amount related to recognised financial assets and liabilities that do not meet the offsetting criteria (incl. non-cash collateral).

	<i>Amount of recognised financial assets /liabilities</i>	<i>Amount related to recognised financial liabilities /assets that do not meet the offsetting criteria (incl. non- cash collateral)</i>	<i>Cash collateral</i>	<i>Net amount</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
<b>At 31 December 2016</b>				
<b>Group</b>				
Derivative assets	7,336.7	(5,201.2)	(2,119.3)	16.2
Reverse repurchase agreement	5,537.3	(5,453.5)	(54.5)	29.3
	<u>12,874.0</u>	<u>(10,654.7)</u>	<u>(2,173.8)</u>	<u>45.5</u>
<b>Group</b>				
Derivative liabilities	7,337.5	(4,070.3)	(2,843.2)	424.0
Repurchase agreement	5,199.0	(5,124.1)	(4.3)	70.6
	<u>12,536.5</u>	<u>(9,194.4)</u>	<u>(2,847.5)</u>	<u>494.6</u>
<b>Company</b>				
Derivative assets	7,319.6	(5,200.3)	(2,119.3)	-
Reverse repurchase agreement	5,537.3	(5,453.5)	(54.5)	29.3
	<u>12,856.9</u>	<u>(10,653.8)</u>	<u>(2,173.8)</u>	<u>29.3</u>
<b>Company</b>				
Derivative liabilities	7,321.9	(4,069.5)	(2,843.2)	409.2
Repurchase agreement	5,199.0	(5,124.1)	(4.3)	70.6
	<u>12,520.9</u>	<u>(9,193.6)</u>	<u>(2,847.5)</u>	<u>479.8</u>



## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Credit risk (continued)

	<i>Amount of recognised financial assets /liabilities</i>	<i>Amount related to recognised financial liabilities / assets that do not meet the offsetting criteria (incl. non- cash collateral)</i>	<i>Cash collateral</i>	<i>Net amount</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
<b>At 31 December 2015</b>				
<b>Group</b>				
Derivative assets	5,671.2	(4,149.0)	(1,258.7)	263.5
Reverse repurchase agreement	3,763.0	(3,720.7)	(0.3)	42.0
	<u>9,434.2</u>	<u>(7,869.7)</u>	<u>(1,259.0)</u>	<u>305.5</u>
<b>Group</b>				
Derivative liabilities	5,708.7	(3,318.7)	(2,181.1)	208.9
Repurchase agreement	3,492.3	(3,456.8)	(22.7)	12.8
	<u>9,201.0</u>	<u>(6,775.5)</u>	<u>(2,203.8)</u>	<u>221.7</u>
<b>Company</b>				
Derivative assets	5,643.8	(4,133.5)	(1,258.7)	251.6
Reverse repurchase agreement	3,763.0	(3,720.7)	(0.3)	42.0
	<u>9,406.8</u>	<u>(7,854.2)</u>	<u>(1,259.0)</u>	<u>293.6</u>
<b>Company</b>				
Derivative liabilities	5,683.0	(3,303.2)	(2,181.1)	198.7
Repurchase agreement	3,492.3	(3,456.8)	(22.7)	12.8
	<u>9,175.3</u>	<u>(6,760.0)</u>	<u>(2,203.8)</u>	<u>211.5</u>

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Market risk

All trading instruments are subject to market risk, the potential that future changes in market conditions may create variation in the value of instruments, due to fluctuations in security prices, as well as interest and foreign exchange rates. Market risk is directly impacted by the volatility and liquidity in the markets in which the related underlying assets are traded. As the instruments are recognised at fair value, those changes directly affect reported income.

The Group and the Company have no market risk limits for their derivative business which is undertaken on either an agency basis or a back-to-back basis where the market risk arising from customer trades is hedged either with CM INC, or a market counterparty. Market risk arises in both the primary and the secondary securities business. It is mitigated through the monitoring and enforcing position limits with short unwind periods. Businesses that are subject to market risk limits have these approved annually by the board and these are set out in an official risk appetite statement.

The Group invests its capital in cash deposits, treasury bills, and a portfolio of high quality floating rate notes; through the latter it seeks to earn an interest margin and, when the opportunity arises, to realise a trading profit. In addition, the Group places cash collateral with derivative trading counterparts, upon which it earns overnight interest. The Group has interest-bearing liabilities of cash collateral held on behalf of derivative trading counterparts and inter-group borrowings.

The weighted average yield on the cash deposits was 0.19% as of 31 December 2016 (2015: 0.11%). The weighted average yields as of 31 December 2016 on floating rate notes and U.S. treasury securities were 1.17% and 0.24% (2015: 0.67% and 0.04%) respectively. The Group's sensitivity to interest rates is such that a parallel shift of +/-100bp from year end rates would increase net assets by \$1.1 million (2015 - \$2.0 million) and decrease net assets by \$1.0 million (2015 - \$1.8 million) respectively.

#### Fair value hierarchy

When available, the Group uses quoted market prices to determine fair value, and classifies such items within Level 1. Trading securities are classified in Level 1 of the fair value hierarchy since they are valued using quoted market prices.

In some cases where no market price is available the Group will make use of acceptable practical expedients such as matrix pricing to calculate fair value, in which case the items are classified within Level 2.

If quoted market prices are not available, fair value is based upon internally developed models that use current independently sourced market parameters such as interest rates, exchange rates, option volatilities, etc., the valuation model used generally depends on the specific asset or liability being valued. The determination of fair value considers various factors, including interest rate yield curves, time value and volatility factors, underlying options and derivatives and price activity for equivalent synthetic instruments.

The majority of derivative transactions entered into by the Group are executed over the counter and so are valued using internal valuation techniques as no quoted market prices exist for such instruments. The valuation technique and inputs depend on the type of derivative and the nature of the underlying reference instrument. The principal techniques used to value these instruments are discounted cash flows, Black-Scholes, and Monte Carlo simulation.

The key inputs depend upon the type of derivative and the nature of the underlying instrument and include interest rate yield curves, exchange rates, the spot price of the underlying, and volatility. A given position is categorised as Level 2 or Level 3 depending on the observability of the significant inputs to the model. Where a valuation incorporates material inputs that are not based on observable market data it will be classified as level 3. Unobservable inputs are determined with reference to observable inputs, historical observations (of, for example, correlations) or the use of other analytical techniques.

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Fair value hierarchy (continued)

The following table presents the fair value hierarchy of financial assets and liabilities as at 31 December 2016:

#### Group and Company

	<i>Level 1</i> <i>US\$m</i>	<i>Level 2</i> <i>US\$m</i>	<i>Level 3</i> <i>US\$m</i>	<i>Total</i> <i>US\$m</i>
<i>At 31 December 2016</i>				
<b>Assets - Group</b>				
Derivative assets	-	7,258.0	78.7	7,336.7
Trading securities	702.0	2.0	-	704.0
Other trading assets, at fair value	-	30.3	-	30.3
	<u>702.0</u>	<u>7,290.3</u>	<u>78.7</u>	<u>8,071.0</u>
<b>Liabilities - Group</b>				
Derivative liabilities	-	7,337.5	-	7,337.5
Trading liabilities, at fair value	-	112.2	-	112.2
Trading securities sold, not yet purchased	304.0	-	-	304.0
	<u>304.0</u>	<u>7,449.7</u>	<u>-</u>	<u>7,753.7</u>
<b>Assets - Company</b>				
Derivative assets	-	7,240.9	78.7	7,319.6
Trading securities	606.4	2.0	-	608.4
Trading assets, at fair value	-	30.3	-	30.3
	<u>606.4</u>	<u>7,273.2</u>	<u>78.7</u>	<u>7,958.3</u>
<b>Liabilities - Company</b>				
Derivative liabilities	-	7,321.9	-	7,321.9
Trading liabilities, at fair value	-	112.2	-	112.2
Trading securities sold, not yet purchased	304.0	-	-	304.0
	<u>304.0</u>	<u>7,434.1</u>	<u>-</u>	<u>7,738.1</u>

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Fair value hierarchy (continued)

The following table presents the fair value hierarchy of financial assets and liabilities as at 31 December 2015:

	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>	<i>Total</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
<i>At 31 December 2015</i>				
<b>Assets - Group</b>				
Derivative assets	-	5,578.6	92.6	5,671.2
Trading securities	832.0	1.0	-	833.0
Other trading assets, at fair value	-	19.1	-	19.1
	<u>832.0</u>	<u>5,598.7</u>	<u>92.6</u>	<u>6,523.3</u>
<b>Liabilities - Group</b>				
Derivative liabilities	-	5,708.7	-	5,708.7
Trading liabilities, at fair value	-	102.7	-	102.7
Trading securities sold, not yet purchased	242.0	-	-	242.0
	<u>242.0</u>	<u>5,811.4</u>	<u>-</u>	<u>6,053.4</u>
<b>Assets - Company</b>				
Derivative assets	-	5,551.2	92.6	5,643.8
Trading securities	721.4	1.0	-	722.4
Other trading assets, at fair value	-	19.1	-	19.1
	<u>721.4</u>	<u>5,571.3</u>	<u>92.6</u>	<u>6,385.3</u>
<b>Liabilities - Company</b>				
Derivative liabilities	-	5,683.0	-	5,683.0
Trading liabilities, at fair value	-	102.7	-	102.7
Trading securities sold, not yet purchased	242.0	-	-	242.0
	<u>242.0</u>	<u>5,785.7</u>	<u>-</u>	<u>6,027.7</u>

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Fair value hierarchy (continued)

Transfers between levels are effective as at the end of the reporting period in which they occur. The following table provides a reconciliation of the beginning and ending balances for assets and liabilities measured at fair value using significant unobservable inputs (Level 3) for the year ended 31 December 2016 and 31 December 2015.

	<i>January 1, 2016</i>	<i>Transfer into level 3</i>	<i>Purchases, issuances, and settlements</i>	<i>Realised losses</i>	<i>Unrealised losses</i>	<i>December 31, 2016</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
Assets:						
Interest rate swap	92.6	-	-	-	(13.9)	78.7
Total assets at fair value	92.6	-	-	-	(13.9)	78.7
	<i>January 1, 2015</i>	<i>Transfer into level 3</i>	<i>Purchases, issuances, and settlements</i>	<i>Realised losses</i>	<i>Unrealised losses</i>	<i>December 31, 2015</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
Assets:						
Credit derivative	0.1	-	-	(0.1)	-	-
Interest rate swap	93.8	-	-	-	(1.2)	92.6
Total assets at fair value	93.9	-	-	(0.1)	(1.2)	92.6
Liabilities:						
Credit derivative	0.1	-	-	(0.1)	-	-
Total liabilities at fair value	0.1	-	-	(0.1)	-	-

The table below presents the information of significant unobservable inputs used to value the Group's and Company's level 3 financial instruments. These financial instruments are valued using information from third-party pricing sources without adjustment. The valuation techniques and inputs utilised by these third-party pricing sources are assessed by the Group using internal models to evaluate the significance of quantitative unobservable inputs inherent within these instrument's fair value.

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Fair value hierarchy (continued)

The sensitivity of the fair value measurement to changes in these unobservable inputs are considered significant if a change in those inputs to a different amount could result in a significantly higher or lower fair value measurement. The Group's assessment of unobservable inputs that are significant to the fair value measurement are disclosed in the table below.

The following table provides information about significant unobservable inputs for Level 3 fair value measurements:

Level 3 Financial Instruments as of December 31, 2016 and December 31, 2015		
Instrument	Valuation techniques	Unobservable inputs
Interest rate swap	<ul style="list-style-type: none"> <li>Internal interest rate swap model</li> <li>Dealer marks</li> </ul>	<ul style="list-style-type: none"> <li>Liquidity premium</li> </ul>

The Company's Product Control (Market Risk) department is responsible for the valuation policies and procedures. This department is responsible for running daily valuations and risks on the Company's derivatives portfolio, and reports into the Chief Operating Officer. The Company's Risk Management department is responsible for managing model risk and its related policies and procedures, and also reports into the Chief Operating Officer. As all models are owned by the front office under supervision and reporting lines of the Head Trader, independence in the validation process is maintained. All changes in existing models are reported to the Risk Management department and approved by the Model Validation Group ("MVG"). Model use and changes to models are approved by Global Risk Management Committee ("GRMC"), to which the MVG makes its recommendations. The GRMC broader membership extends to include representatives from the Group, which also supports independence within the validation process. Pricing models are validated based on assigned tiers (Tier 1 models are validated annually, Tier 2 models are validated every 2 years, and Tier 3 models are validated every 3 years). Stress tests are run on a weekly/monthly basis.

#### Liquidity risk

Liquidity risk is the possibility that the Group may not be able to adjust rapidly the size of its trading portfolio in times of high volatility and financial stress at a reasonable cost. The Group and the Company have no unfunded forward commitments in the one year forward period.

# Notes to the financial statements

at December 31, 2016

## 17. Risk management (continued)

### Maturity of financial liabilities

As at 31 December 2016	Carrying amount	0-1 year	1-5 years	More than 5 years
<b>Group</b>				
<b>Non-derivative financial liabilities</b>				
Trading liabilities, at fair value	112.2	0.3	12.0	99.9
Trading securities sold, not yet purchased	304.0	304.0	-	-
Securities sold under agreement to repurchase	5,199.0	5,199.0	-	-
Other Creditors	2,421.7	2,421.7	-	-
<b>Derivative financial liabilities</b>				
Derivative Liabilities (excluding reserves and guarantee liabilities)	7,304.5	273.4	2,334.4	4,696.7
<b>Company</b>				
<b>Non-derivative financial liabilities</b>				
Trading liabilities, at fair value	112.2	0.3	12.0	99.9
Trading securities sold, not yet purchased	304.0	304.0	-	-
Securities sold under agreement to repurchase	5,199.0	5,199.0	-	-
Other Creditors	2,418.9	2,418.9	-	-
<b>Derivative financial liabilities</b>				
Derivative liabilities (excluding reserves and guarantee liabilities)	7,287.9	273.4	2,331.9	4,682.6

## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Maturity of financial liabilities (continued)

As at 31 December 2015	Carrying amount	0-1 year	1-5 years	More than 5 years
<b>Group</b>				
<b>Non-derivative financial liabilities</b>				
Trading liabilities, at fair value	102.7	0.1	1.0	101.6
Trading securities sold, not yet purchased	242.0	242.0	-	-
Securities sold under agreement to repurchase	3,492.3	3,492.3	-	-
Other Creditors	1,566.5	1,566.5	-	-
<b>Derivative financial liabilities</b>				
Derivative Liabilities (excluding reserves and guarantee liabilities)	5,661.0	391.7	1,977.2	3,292.1
<b>Company</b>				
<b>Non-derivative financial liabilities</b>				
Trading liabilities, at fair value	102.7	0.1	1.0	101.6
Trading securities sold, not yet purchased	242.0	242.0	-	-
Securities sold under agreement to repurchase	3,492.3	3,492.3	-	-
Other Creditors	1,564.5	1,564.5	-	-
<b>Derivative financial liabilities</b>				
Derivative Liabilities (excluding reserves and guarantee liabilities)	5,633.6	384.9	1,969.2	3,279.5



## Notes to the financial statements

at December 31, 2016

### 17. Risk management (continued)

#### Foreign currency risk

The Group economically hedges its significant foreign exchange exposures including its GBP tax position. The foreign exchange risk is transferred to its affiliate CM INC who transacts to fix the exchange rate at the time the liability is incurred. CM INC bears and manages the risk.

#### Operational risk

Operational risk is the “risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events”.

The primary objective of the Group’s and the Company’s operational risk management framework is to minimise the occurrence and impact of operational risk events, in particular avoiding extreme events, in order to support the Group’s achievement of its strategic objectives.

Operational Risk encompasses areas such as transaction operations, premises and security, external suppliers, payment processes and information, data quality and records management. In accordance with market practice the Group also recognises the importance of ramifications of the way in which the Group operates its business, which might potentially lead to conduct risk failures. Consequences could be regulatory actions including fines, public reprimands, damage to reputation, increased prudential requirements, enforced temporary or permanent suspension of operations and, in extreme cases, withdrawal of authorisation to operate.

The Group has a number of operational risk management specific processes in place, including use of KRIs. The Group recognises the benefits of using scenario analysis to assess and manage the exposure to high severity, low frequency events in order to determine the nature of operational risk losses which could potentially arise in the future.

## Notes to the financial statements

at December 31, 2016

### 18. Classification of financial assets and financial liabilities

#### Group

As at 31 December 2016

	<i>Designated at fair value</i>	<i>Loans and receivables</i>	<i>Other financial liabilities</i>	<i>Total</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
<b>Financial assets measured at fair value</b>				
Trading securities	704.0	-	-	704.0
Derivative assets	7,336.7	-	-	7,336.7
Other trading assets, at fair value	30.3	-	-	30.3
	8,071.0	-	-	8,071.0
<b>Financial assets not measured at fair value</b>				
Cash at banks	-	458.6	-	458.6
Securities purchased under agreements to resell	-	5,537.3	-	5,537.3
Due from clients	-	3.6	-	3.6
Other Debtors	-	2,917.8	-	2,917.8
	-	8,917.3	-	8,917.3
<b>Financial liabilities measured at fair value</b>				
Derivative liabilities	7,337.5	-	-	7,337.5
Trading liabilities, at fair value	112.2	-	-	112.2
Trading securities sold, not yet purchased	304.0	-	-	304.0
	7,753.7	-	-	7,753.7
<b>Financial liabilities not measured at fair value</b>				
Securities sold under agreements to repurchase	-	-	5,199.0	5,199.0
Other creditors	-	-	2,421.7	2,421.7
	-	-	7,620.7	7,620.7

# Notes to the financial statements

at December 31, 2016

## 18. Classification of financial assets and financial liabilities (continued)

### Company

As at 31 December 2016

	<i>Designated at fair value</i>	<i>Loans and receivables</i>	<i>Other financial liabilities</i>	<i>Total</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
<b>Financial assets measured at fair value</b>				
Trading securities	608.4	-	-	608.4
Derivative assets	7,319.6	-	-	7,319.6
Other trading assets, at fair value	30.3	-	-	30.3
	<u>7,958.3</u>	<u>-</u>	<u>-</u>	<u>7,958.3</u>
<b>Financial assets not measured at fair value</b>				
Cash at banks	-	330.6	-	330.6
Securities purchased under agreements to resell	-	5,537.3	-	5,537.3
Due from clients	-	3.5	-	3.5
Other Debtors	-	2,916.8	-	2,916.8
	<u>-</u>	<u>8,788.2</u>	<u>-</u>	<u>8,788.2</u>
<b>Financial liabilities measured at fair value</b>				
Derivative liabilities	7,321.9	-	-	7,321.9
Trading liabilities, at fair value	112.2	-	-	112.2
Trading securities sold, not yet purchased	304.0	-	-	304.0
	<u>7,738.1</u>	<u>-</u>	<u>-</u>	<u>7,738.1</u>
<b>Financial liabilities not measured at fair value</b>				
Securities sold under agreements to repurchase	-	-	5,199.0	5,199.0
Other creditors	-	-	2,418.9	2,418.9
	<u>-</u>	<u>-</u>	<u>7,617.9</u>	<u>7,617.9</u>

# Notes to the financial statements

at December 31, 2016

## 18. Classification of financial assets and financial liabilities (continued)

### Group

As at 31 December 2015

	<i>Designated at fair value</i>	<i>Loans and receivables</i>	<i>Other financial liabilities</i>	<i>Total</i>
	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>	<i>US\$m</i>
<b>Financial assets measured at fair value</b>				
Trading securities	833.0	-	-	833.0
Derivative assets	5,671.2	-	-	5,671.2
Other trading assets, at fair value	19.1	-	-	19.1
	6,523.3	-	-	6,523.3
<b>Financial assets not measured at fair value</b>				
Cash at banks	-	120.6	-	120.6
Securities purchased under agreements to resell	-	3,763.0	-	3,763.0
Due from clients	-	2.7	-	2.7
Other Debtors	-	2,236.9	-	2,236.9
	-	6,123.2	-	6,123.2
<b>Financial liabilities measured at fair value</b>				
Derivative liabilities	5,708.7	-	-	5,708.7
Trading liabilities, at fair value	102.7	-	-	102.7
Trading securities sold, not yet purchased	242.0	-	-	242.0
	6,053.4	-	-	6,053.4
<b>Financial liabilities not measured at fair value</b>				
Securities sold under agreements to repurchase	-	-	3,492.3	3,492.3
Other creditors	-	-	1,566.5	1,566.5
	-	-	5,058.8	5,058.8

## Notes to the financial statements

at December 31, 2016

### 18. Classification of financial assets and financial liabilities (continued)

Company As at 31 December 2015	Designated at fair value	Loans and receivables	Other financial liabilities	Total
	US\$m	US\$m	US\$m	US\$m
<b>Financial assets measured at fair value</b>				
Trading securities	722.4	-	-	722.4
Derivative assets	5,643.8	-	-	5,643.8
Other trading assets, at fair value	19.1	-	-	19.1
	<u>6,385.3</u>	<u>-</u>	<u>-</u>	<u>6,385.3</u>
<b>Financial assets not measured at fair value</b>				
Cash at banks	-	8.8	-	8.8
Securities purchased under agreements to resell	-	3,763.0	-	3,763.0
Due from clients	-	2.6	-	2.6
Other Debtors	-	2,235.8	-	2,235.8
	<u>-</u>	<u>6,010.2</u>	<u>-</u>	<u>6,010.2</u>
<b>Financial liabilities measured at fair value</b>				
Derivative liabilities	5,683.0	-	-	5,683.0
Trading liabilities, at fair value	102.7	-	-	102.7
Trading securities sold, not yet purchased	242.0	-	-	242.0
	<u>6,027.7</u>	<u>-</u>	<u>-</u>	<u>6,027.7</u>
<b>Financial liabilities not measured at fair value</b>				
Securities sold under agreements to repurchase	-	-	3,492.3	3,492.3
Other creditors	-	-	1,564.5	1,564.5
	<u>-</u>	<u>-</u>	<u>5,056.8</u>	<u>5,056.8</u>

## Notes to the financial statements

at December 31, 2016

### 19. Issued share capital

	<i>Allotted, called up and fully paid 2016 US\$m</i>	<i>Allotted, called up and fully paid 2015 US\$m</i>
Ordinary shares of \$1 each	944.0	944.0
Preference shares of \$1 each	360.0	360.0
	<u>1,304.0</u>	<u>1,304.0</u>

On 11<sup>th</sup> June 2015 the Company issued a further 256,944,444 US\$1.00 ordinary shares to its parent SMBC at a premium of \$0.44 per share.

On 29<sup>th</sup> July 2015 the Company issued 118,055,555 US\$1.00 ordinary shares at a premium of \$0.44 per share and 110,000,000 US\$1.00 perpetual, non-cumulative preference shares to an affiliate, SMBC Nikko Securities, Inc.

### 20. Obligations under operating leases

Annual commitments under non-cancellable operating leases are as follows:

<b>Group</b>	<i>Land and buildings 2016 US\$m</i>	<i>Other 2016 US\$m</i>	<i>Land and buildings 2015 US\$m</i>	<i>Other 2015 US\$m</i>
Operating leases which expire:				
Within one year	5.4	0.1	5.2	0.1
Between two and five years	10.9	0.2	11.9	0.1
Over five years	0.9	-	0.7	-
	<u>17.2</u>	<u>0.3</u>	<u>17.8</u>	<u>0.2</u>
<b>Company</b>				
	<i>Land and buildings 2016 US\$m</i>	<i>Other 2016 US\$m</i>	<i>Land and buildings 2015 US\$m</i>	<i>Other 2015 US\$m</i>
Operating leases which expire:				
Within one year	4.1	0.1	4.3	0.1
Between two and five years	9.1	0.2	11.3	0.1
Over five years	-	-	0.7	-
	<u>13.2</u>	<u>0.3</u>	<u>16.3</u>	<u>0.2</u>

## Notes to the financial statements

at December 31, 2016

### 21. Capital [amounts in this note are unaudited]

The primary objective of the Group's and the Company's capital management is to ensure compliance with externally imposed capital requirements.

The Group's and the Company's regulatory capital comprises share capital and retained earnings (common equity tier 1 capital ("CET1")) and perpetual non-cumulative preference shares (qualifying as additional tier 1 capital ("AT1")).

The Group has CET1 capital, after deductions, of \$1,239.4 million (2015 - \$1,186.3 million) and total capital of \$1,599.4 million (2015 - \$1,546.3 million). Its CET1 capital ratio, i.e. the comparison of total risk weighted assets against common equity tier 1 capital, is 29.7% (2015 - 32.1%). The Company has CET1 capital, after deductions, of \$1,177.9 million (2015 - \$1,122.3 million) and total capital of \$1,497.0 million (2015 - \$1,439.6 million). Its CET1 capital ratio is 30.3% (2015 - 29.8%).

The adequacy of the Company's capital is monitored daily using the rules and ratios established by the BIS rules and enacted through the European Union's Capital Requirement Regulation ("CRR").

The CRR, enacted to codify the Basel III Accord, was designed to promote safety and soundness in the European financial system. It requires authorised and regulated financial institutions to maintain appropriate levels of capital to cover the risks inherent in their business model. Basel III is a supervisory framework for risk and capital management and is structured on the basis of three pillars. Pillar 1 specifies minimum capital requirements.

Pillar 2 describes the supervisory review process and outlines the internal capital adequacy assessment process ("ICAAP") required by firms applying Pillar 1 methodologies. Pillar 3 requires disclosure of risk and capital information to the market. These disclosures can be found on the SMBC Capital Markets website.

Management believe that the Group and the Company have been in compliance with externally imposed capital requirements throughout the year.

In order to maintain or adjust the capital structure the Group and the Company may adjust its dividend policy or the structure and liquidity of its trading assets and liabilities. The Group and the Company manages capital so as to ensure that the solvency ratio does not fall below 130%.

## Notes to the financial statements

at December 31, 2016

### 22. Country-by-Country Reporting

The table below shows that the majority of the Groups profits are generated in the United Kingdom, and therefore a higher amount of corporation tax is paid in the United Kingdom. The Group paid \$11.3 million of corporation tax (2015 - \$6.5 million) and generated \$95.6 million in profit for 2016 (2015 - \$72.0 million), making the global cash tax rate 12% (2015 - 9%). The cash tax rate is the corporation tax paid in the year divided by total profit before tax. The Advanced Pricing Agreement generates a reduction in tax payable. See note 8 for details.

The basis of preparation is as follows:

*Country:* The geographical location of the Group considers the country of incorporation or residence as well as the relevant tax jurisdiction. In this context, the countries applicable will be:

- United Kingdom, where the Company is a majority owned subsidiary of SMBC Tokyo. The profit of the business is generated from trading securities and derivatives and business advisory activities
- Australia, the branch acts as an agent for the Company in the Australian market.
- Hong Kong, CM Asia acts as an agent and intermediary for the Company and its affiliated entities in Asian markets outside of Japan and in Australia

*Turnover:* The Group defines operating profit, which is used as a proxy for revenue, as the sum of the following consolidated income statement items:

- Net trading (loss) / gain
- Interest receivable on trading positions
- Interest payable

*Profit before tax:* As with turnover, the definition of profit or loss before tax is consistent with that in the Group's financial statements.

*Corporation Tax Paid:* The column discloses the cash amount of corporation tax paid in each country in 2016.

*Public Subsidies Received:* In the context of CBCR, this is interpreted as direct support by the government. There were no subsidies received by the Group in 2016 (2015 - nil).

*Number of Employees:* Employee numbers reported reflect the number of employees on a full time equivalent basis.

*Accounting Framework:* Amounts reported are based on local statutory financial statements, in accordance with applicable law and IFRS (International Financial Reporting Standards), unless another basis has been stated.



## Notes to the financial statements

at December 31, 2016

### 22. Country-by-Country Reporting (continued)

#### Country-by-Country Disclosure 2016

<i>Country</i>	<i>Turnover</i> <i>US\$m</i>	<i>Profit/(Loss)</i> <i>before tax</i> <i>US\$m</i>	<i>Corporation</i> <i>tax paid</i> <i>US\$m</i>	<i>Average number</i> <i>of employees</i>
United Kingdom	222.3	94.8	11.2	222
Australia	1.9	0.8	0.1	2
Hong Kong	7.0	-	-	15
Global Total	<u>231.2</u>	<u>95.6</u>	<u>11.3</u>	<u>239</u>

#### Country-by-Country Disclosure 2015

<i>Country</i>	<i>Turnover</i> <i>US\$m</i>	<i>Profit/(Loss)</i> <i>before tax</i> <i>US\$m</i>	<i>Corporation</i> <i>tax paid</i> <i>US\$m</i>	<i>Average number</i> <i>of employees</i>
United Kingdom	206.9	72.0	6.5	202
Australia	0.4	(0.0)	-	2
Hong Kong	-	-	-	13
Global Total	<u>207.3</u>	<u>72.0</u>	<u>6.5</u>	<u>217</u>

## Notes to the financial statements

at December 31, 2016

### 23. Related party transactions

	<i>2016</i> <i>US\$ m</i>	<i>2015</i> <i>US\$ m</i>
<b>SMBC - Parent</b>		
Cash at banks	5.7	5.5
Net derivative assets	1,128.1	410.0
Cash collateral received	1,921.9	1,100.0
Accrued interest payable	1.1	0.2
Accrued expenses payable - credit service fee	2.0	0.4
Other liabilities	1.6	2.8
Guaranteed liabilities (off balance sheet)	432.0	354.8
Gain on derivative instruments	875.2	14.3
Interest expense	8.4	2.1
Fees and commissions paid	14.3	10.1
<b>SMBC Nikko Securities - Parent</b>		
Securities purchased under resale agreements	5,197.2	3,490.1
Accrued income receivable	2.0	2.6
Net interest receivable	3.1	-
Other receivables - reimbursements	0.5	0.7
Other payables - securities trading fees	0.5	1.9
Interest on securities under resale agreements	16.6	2.0
Fees and commission on securities trading	6.1	9.8
Reimbursements	2.8	2.1
Expenses on securities trading	159.8	92.0
Other fees and commissions paid	1.3	3.7

## Notes to the financial statements

at December 31, 2016

### 23. Related party transactions (continued)

	2016 US\$ m	2015 US\$ m
<b>SMBC Capital Markets Inc.</b>		
Collateral placed	2,625.3	1,854.2
Independent amount	(310.0)	-
Accrued interest receivable	3.5	0.8
Other assets - agency fees	0.6	1.0
Trading instruments	23.3	-
Net derivative instrument liabilities	2,490.3	1,739.5
Funding loans	233.7	270.1
Trading instruments liabilities	67.8	76.9
Accrued expenses payable - guarantee fees / agency fees	45.8	5.9
Creditors - Group relief / other	-	0.8
Interest income	17.0	5.4
Fees and commissions on agency trading	3.2	8.6
Other operating income - guarantee termination / intermediation fees	18.0	36.1
Gain on derivative instruments	-	68.3
Loss on derivative instruments	1,060.7	-
Interest expenses	5.9	2.7
Other fees and commissions paid	0.2	0.3
Other operating expenses	44.6	13.2
Securities pledged by CM Inc.*	66.5	25.0
<b>SMBC Nikko Securities America Inc.</b>		
Accrued income receivable	1.2	8.0
Securities sold under repurchase agreements	210.8	130.9
Accrued expenses payable - securities trading fees / agency fees	0.8	0.6
Other liabilities	0.3	-
Fees and commission on securities trading	4.1	0.4
Other fees and commissions paid on securities trading	2.1	5.3
Interest expense on securities sold under repurchase agreements	0.7	0.1
Other operating expenses	0.3	0.2
<b>Sumitomo Mitsui Banking Corporation of Canada</b>		
Net derivative instrument assets	-	3.3
Loss on derivative instruments	45.6	8.6

\*In the ordinary course of business SMBC DP guarantees the performance of its affiliate, CM INC, in relation to interest rate caps sold to third parties. To protect itself against the risk arising the Company has obtained an indemnity from CM INC. To support this indemnity CM INC pledges securities collateral in the form of US Treasury bills. At 31 December 2016 the termination value of guaranteed interest rate cap transactions, against which collateral was held, was \$54,476 thousand (2015 - \$22,442 thousand). The guarantees are accounted for as financial guarantees.

## Notes to the financial statements

at December 31, 2016

### 23. Related party transactions (continued)

	<i>2016</i> <i>US\$ m</i>	<i>2015</i> <i>US\$ m</i>
<b>Sumitomo Mitsui Banking Corporation Europe Limited</b>		
Collateral placed	26.4	-
Net derivative instrument liabilities	18.8	115.0
Accrued expenses payable - credit service fee	1.1	1.1
Gain on derivative instruments	128.8	-
Loss on derivative instruments	-	106.1
Other fees and commissions paid	1.2	1.6
Other operating expenses	1.1	0.9
<b>Sumitomo Mitsui Banking Corporation (China) Limited</b>		
Net derivative instrument assets	(0.1)	0.1
Gain on derivative instruments	0.1	0.7
<b>Sumitomo Mitsui Banking Corporation Malaysia Berhad</b>		
Net derivative instrument assets	0.4	0.2
Cash collateral received	0.4	-
Gain on derivative instruments	0.4	0.2
<b>SMBC Nikko Securities (Hong Kong) Limited</b>		
Other liabilities	1.2	1.1
Other non-personnel expenses	6.2	5.3
<b>Nikko Systems Solutions, Ltd.</b>		
Other non-personnel expenses	2.7	2.5
<b>SMBC Friend Securities</b>		
Expenses on securities trading	0.2	-

## Notes to the financial statements

at December 31, 2016

### 24. Fee in respect of credit guarantee

The Group has entered into unconditional guarantee arrangements with SMBC, acting through its Cayman Branch as guarantor, and with SMBC Tokyo, under which SMBC is obliged to make the full and prompt payment, when due, of any net termination payment payable to the Group under any of the ISDA Master Agreements with specific guaranteed counterparties.

Fees are payable monthly based on a monthly daily average value of the guaranteed transactions. The fee has been computed on a fair value basis, discounted to its present value and recorded as a derivative liability on the balance sheet. The present value of these credit guarantees, and the associated fees recorded against profit and loss, are set out in the table below:

	2016 US\$m Credit Guarantees	2015 US\$m Credit Guarantees	2016 US\$m Fees	2015 US\$m Fees
<b>Guarantor</b>				
SMBC Cayman Branch	6.2	5.3	2.4	1.5
SMBC Tokyo	65.7	71.8	10.5	7.2
	<u>71.9</u>	<u>77.1</u>	<u>12.9</u>	<u>8.7</u>

The guarantees provided by CM INC are accounted for as an effective enhancement to the value of derivative assets. A CVA of \$3.7 million (2015 - \$7.3 million) would be required if no CM INC guarantees were in place.

In the case of an agreed termination of an existing guarantee the Group books a CVA to ensure that the value of derivative contracts reflects counterparty credit risk. Consequently the Group will charge a termination fee equating to the CVA for any guarantees cancelled. The APA ensures that these guarantee arrangements are treated as arm's length transactions.

### 25. Financial and other commitments

SMBC, under an agreement dated 25<sup>th</sup> November 2010, as amended on 25<sup>th</sup> July 2013, has provided the Group with a \$250.0 million multi-currency revolving committed facility which can be terminated by either party on giving six months' notice. For this the Group pays a fee of 0.05% per annum on the undrawn amount of the facility. SMBC also acts as guarantor for some of the Group's transactions. For this the bank is paid a fee based on the notional amount, maturity and deal type for each transaction. Under a loan agreement dated 18 April 2016, CM INC has committed to providing SMBC DP with a \$200.0 million revolving credit facility for a five year period. A commitment fee on the amount of the undrawn facility is payable to CM INC until the maturity date of the agreement. At 31 December 2016, the entire facility was unused.

SMBC DP, as an AA-/Aa1 derivative product company, is required by Moody's and S&P to have a Contingent Manager. Under such an agreement, an unaffiliated derivatives dealer would provide portfolio management and other general services to the firm in the event that the long term senior rating of Sumitomo Mitsui Banking Corporation ('the bank') is downgraded to Baa3 or below by Moody's, or the event that the bank's short term rating is downgraded to P-3 or below by Moody's, or the event that the long term senior rating of the bank is downgraded to BB or below by S&P, or the event that the bank's short term rating is downgraded to B or below by S&P. On 7th December 2016 the Contingent Manager Agreement with Blackrock Financial Management, Inc. rolled for twelve months as no notice to terminate was issued by SMBC DP.

## **Notes to the financial statements**

**at December 31, 2016**

### **26. Deferred compensation**

A deferred compensation scheme for certain employees was fully vested and paid up in 2015. The scheme payments were based upon a combination of cash and Phantom share elements.

For the year ending 31 December 2016 the amount recognised in income statements under this scheme was \$Nil (2015 - \$0.4 million).

### **27. Investment in subsidiary undertakings**

The Company has invested \$200.0 million in the ordinary shares of SMBC Derivative Products Limited, a 100% subsidiary, registered in England and Wales and \$2.0 million in the ordinary shares of SMBC Capital Markets Asia Limited, a 100% subsidiary, registered in Hong Kong, the results of both of which have been included in these Group financial statements.

### **28. Sponsored unconsolidated structured entities**

The Group sponsors certain structured entities in which it has no interest. The Group is deemed to be a sponsor of a structured entity when it takes a leading role in determining its purpose and design and has been providing operational support to ensure its continued operation.

Income from sponsored unconsolidated structured entities, where the Group did not have an interest at the end of the year, amounted to \$8.7 million (2015 - \$14.8 million).

### **29. Ultimate parent undertaking and controlling party**

The Sumitomo Mitsui Financial Group, Inc., incorporated in Japan, is the Company's ultimate parent undertaking. It is the largest Group of which this Company is a member and which has included this Company in Group financial statements. Copies of these financial statements can be obtained from the following address:

1-2 Marunouchi  
1-chome  
Chiyoda-ku  
Tokyo, Japan