

PILLAR 3 RISK DISCLOSURES

As of 31st December 2012

Document disclaimer

- The purpose of the Pillar 3 disclosures as contained within this Disclosure Document is solely to explain the basis according to which SMBC Nikko Capital Markets Limited Group (“CM-UK”) and its constituent entities comply with certain capital related requirements and to provide information about the management of risks relating to those requirements.
- This Disclosure Document does not constitute any form of financial statement on behalf of CM-UK.
- This Disclosure Document reflects, where appropriate, information which is contained within the Consolidated Annual Report & Financial Statements of CM-UK.
- The Information has been subject to internal review but has not been audited by CM-UK’s external auditors.
- Although Pillar 3 disclosures are designed to provide transparent capital disclosure by investment firms on a common basis, the information contained in this particular Disclosure Document may not be directly comparable with that made available by other firms. This may be due to a number of factors such as:
 - The mix of approaches allowed under the Capital Requirements Directive (“CRD”);
 - The mix of exposure types;
 - The different risk appetites and profiles of firms;
 - The different waivers applied for and allowed by the Financial Services Authority (“FSA”) and its successor regulator the Financial Conduct Authority (“FCA”).
- Pillar 2 capital requirements are excluded from this Disclosure Document, but nevertheless play a major role in determining both the total capital requirements of CM-UK and any surplus capital available.

1. Overview

The CRD, based upon the Basel 2 Accord, has established a regulatory framework across the European Union governing the amount and nature of the capital financial institutions must maintain.

The objective of the CRD is to promote the safety and soundness of the financial system by requiring banks and investment firms to hold a level of capital appropriate to the risks inherent in their business model. The CRD disclosure requirements (“Pillar 3”) aim to complement the minimum capital requirements (“Pillar 1”) and the supervisory review process (“Pillar 2”) and seek to encourage market discipline by allowing market participants to assess information provided on the risk exposures and risk assessment processes of the firm. This document is designed to meet the Pillar 3 obligations.

The Pillar 3 disclosures herein have been prepared in accordance with the rules of the FCA, as set out in the General Prudential Sourcebook (“GENPRU”) and the Prudential Sourcebook for Banks, Building Societies and Investment Firms (“BIPRU”). BIPRU Section 11 (Disclosure) lays out the disclosure requirements applicable to Investment Firms. The Section 11 requirements are designed to promote market discipline by providing market participants with key information on a firm’s risk exposures, risk management processes and, hence, capital adequacy. Improved public disclosures of such information leads to increased transparency and should lead directly to more effective market discipline.

The rules of BIPRU 11 allow a firm to omit any of the required disclosures that are deemed to be immaterial in that such an omission would not change the understanding of a reader relying on this information. In addition a firm may omit any disclosures where it believes that the information is proprietary or confidential. Information is deemed to be proprietary where we consider that, if shared, it would undermine our competitive position. Information is deemed to be confidential where there are obligations binding us to confidentiality with our counterparties and suppliers.

Unless otherwise stated all figures in this document are denominated in United States dollars.

2. Basis and Frequency of Disclosure

These disclosures have been prepared based upon the consolidated financial position of CM-UK and the financial position of those of its constituent companies that are regulated, United Kingdom domiciled, investment firms as of 31st December 2012.

Future disclosures will be made annually, as of 31st December.

3. Location and Verification

This Disclosure Document has been reviewed by senior management but has not been subject to external audit. However, where data is equivalent to that included in the Annual Report and Financial Statements, such data has been subject to external audit during the formal review and verification process.

This report is published on the corporate website of SMBC Nikko Capital Markets Limited (www.smbcnikko-cm.com).

4. Corporate Structure

CM-UK consists of SMBC Nikko Capital Markets Limited (“CM-LTD”) and its wholly owned subsidiaries SMBC Derivative Products Limited (“SMBC DP”) and SMBC Capital Markets Asia Limited (“CM-Asia”). Both CM-LTD and SMBC DP are full scope BIPRU investment firms domiciled in the United Kingdom and regulated by the FCA, CM-Asia is domiciled in Hong Kong. CM-UK’s activities include customer

facilitation, broking and trading in debt and equity securities and an extensive range of over-the-counter derivative contracts.

CM-UK itself is a wholly owned subsidiary of Sumitomo Mitsui Banking Corporation (“SMBC”) of Japan. CM-UK, together with SMBC Capital Markets Inc. (“CM-INC”) and SMBC Nikko Securities, Inc. (“SI”), both domiciled in New York, make up the SMBC Capital Markets Group (“CMG” or “the Group”), the global securities and derivatives arm of SMBC. CMG is structured as two divisions, the securities products group (“SPG”) and the derivatives products group (“DPG”). These divisions are organised separately for operational purposes. SPG has a collaboration agreement with another SMBC subsidiary, SMBC Nikko Securities Inc. of Japan (“Nikko Tokyo”).

DPG provides pricing and execution capabilities in a wide range of derivative activities. DPG has an integrated business model structured around a number of legal entities including CM-LTD’s derivative operations, CM-INC, SMBC DP and CM-Asia. Its core business strategy is to provide hedging products and capital markets expertise to the international customers of SMBC. It is managed as a global entity operating a single derivative trading book across its constituent legal entities. An integral part of DPG, SMBC DP is a bankruptcy remote derivatives company that has been assigned an AAA counterparty rating by Standard & Poor’s and an Aa1 rating by Moody’s Investor Service.

SPG is a sales driven business, with offices in London and Sydney, that is focussed on maximising customer order flow in the primary and secondary debt and equity markets. Although it operates a primarily agency based business model, SPG does take principal positions in order to better meet customer requirements. Additionally, the mergers and acquisitions advisory service focuses on identification and implementation of business opportunities for Japanese firms seeking opportunities in Europe and European firms looking to invest in Japan. Overall, SPG strategy is focussed on expanding the SMBC Nikko Group’s business franchise.

The relationships between the different legal entities within CMG are defined within agency and service level agreements. CMG co-operates closely with SMBC’s international network of branches and subsidiaries.

CM-UK does not have a public rating however, in the event of a credit downgrade in the public rating of either the parent bank or of the publicly rated, bankruptcy remote subsidiary SMBC DP there will be the potential for various liquidity events such as collateral calls or terminations upon downgrade. CM-UK therefore continuously monitors this position.

The CRD framework applies to CM-LTD and SMBC DP on a solo basis and to CM-UK on a consolidated basis. The disclosures below are presented on both a solo and a consolidated basis.

5. Risk Management

CM-UK defines its overall risk appetite as moderate, its focus being on customer driven business. There is no intention to develop a proprietary trading book of any significant size although moderate and controlled risks are accepted in the ordinary course of business.

The Group’s risk management objectives are to identify, assess and manage all material business risks. This is documented within a risk appetite framework and it is the responsibility of the board of each company to ensure that the business profile remains consistent with this. A further board responsibility is to ensure that the business is supported by an effective risk management infrastructure.

The chief risk officer, reporting to the board, and supported by the Risk Management Steering Committee, has primary responsibility for overseeing day-to-day risk management.

The principal risks and uncertainties facing CM-UK are credit risk, liquidity risk, market risk and operational risk. Additionally the Group’s exposure to the principal macro-economic, geopolitical, industry, regulatory and other external business risks, residual risk, concentration risk, pension obligation risk and group risk are

all reviewed and assessed at least annually.

The most significant risk categories that CM-UK is exposed to are set out below:

Market Risk

Market risk is the risk of an adverse change in the value of CM-UK's assets and liabilities arising from movements in market rates, including interest rates, equity prices, commodity prices and currencies.

CM-UK has a minimal appetite for market risk arising from the derivatives business and a low to moderate appetite for the securities business.

CM-UK has no position limits for commodity, equity, interest rate or currency derivatives and, as of 31st December 2012, it had no credit derivative positions. The group fully hedges the market risk of its customer derivative transactions through matching trades with either its associated company, CM-INC, or a market counterparty. As a result the derivatives portfolio is left with minimal market risk.

Market risk does arise on the securities portfolio, where it is mitigated through the monitoring and enforcing of position limits with short unwind periods. In primary bond and equity markets, the standard practice is to ensure that new issues are pre-placed to investors through a book-building process; consequently it would be comparatively rare for the Group to take material unsold risk onto its books. In any such cases the risks of the individual transaction, in particular the market appetite for the issue, will be fully assessed either by the underwriting committee or, if appropriate, at a delegated level.

In the secondary markets the Group's strategy is to focus on customer order flow and this is reflected in conservative position risk limits and short holding periods.

Credit Risk

Credit risk is the risk of a financial loss arising due to the failure of a counterparty to fulfil its contractual obligations. Credit risk can be directly impacted by volatile or illiquid trading markets or by a change in the external credit rating of an entity leading to a fall in the value of any financial instruments the Company is holding.

The Group has a low appetite for credit risk. In DPG, credit risk on customer derivatives business is mitigated through guarantees from either CM-INC or SMBC and interbank business is undertaken subject to collateralised credit support agreements ("CSA"). Portfolio concentration risk is proportionate to the balance sheet capacity and is subject to active monitoring. Credit risk on SPG business arises from repo/reverse repo positions and a limited number of long settlement transactions. Given the collateralised nature of such transactions overall credit exposure is low.

Credit management is a centralised process whereby the counterparty exposure limits are established at the SMBC parent company level and are allocated to the businesses at CMG level. Credit risk is managed at the business level based on allocated counterparty single name limits. The Group has three key approaches to addressing credit risk:

(i) Credit Analysis

The Group outsources credit applications, grading reviews and monitoring to the relevant credit departments of SMBC, so taking advantage of the close understanding SMBC's relationship management and credit analysis staff have of group customers to identify all potential risk factors.

(ii) Credit Value Adjustments

The Group employs a rigorous quantitative system of credit reserves based on scenario simulation and market risk adjusted probabilities of default; this is a "fair value reserve". Such a system cannot by itself assure efficient pricing or monitoring of individual credit exposures but it is a strong incentive for proper trade off of risk and return at the time of transaction, as well as providing an efficient incentive for assignment and

termination of transactions later.

(iii) Credit guarantees and collateral agreements

The counterparty credit risk arising on customer business is mitigated by cross guarantees with CM-INC (which allow for collateral to be called) and, in the case of a number of material exposures, a collateralised guarantee has been purchased from SMBC. As of 31st December 2012 the guarantee from CM-INC covered derivative contracts with a replacement cost of \$1,188,483,251 and the parental guarantee covered derivative contracts with a gross replacement cost of \$567,922,218.

Liquidity Risk

Liquidity risk is the risk that CM-UK is unable to meet its financial obligations as they fall due.

Liquidity risk arises from the characteristics of the firm's funding of its business activities. Given that CM-UK is not, materially, reliant on the wholesale markets, funding all of its current activities, bar some repo trading, from its own resources and not engaging in trading strategies that involve maturity transformation, management is able to contain potential sources of liquidity risk.

CM-UK's derivative trading portfolios consist of matched intermediation trades. It has minimal funding risk, and it effectively eliminates currency risk. However imbalances may arise from a mismatch of collateral obligations which result from the fact that whilst CSA are increasingly a requirement in the interbank market most customers would neither wish nor be able to manage transactions entered into under such conditions. Such imbalances can result in swings in net collateral and therefore the funding position under volatile market conditions.

As at 31st December 2012 CM-UK had pledged collateral of \$608 million however it was in receipt of collateral of \$820 million. This collateral excess was the result of management identifying its most material, un-collateralised exposures and purchasing a collateralised guarantee, from its parent, to cover potential material deficiencies.

As at 31st December 2012 the SPG business held financial assets and liabilities as a result of its trading activities. For the most part these positions were funded from current capital resources, although the wholesale funding markets were utilised, through repo and reverse repo activity, to fund some positions, efficiently manage general market risk and support customer funding activities. The balance sheet remains substantially unleveraged.

The primary business focus is the provision of an intermediation service that ameliorates any liquidity risk arising through the use of delivery versus payment (DvP) settlement arrangements. As the business develops the intention is to continue to hold a limited securities portfolio as an adjunct to better support customer driven business.

CM-UK reviews its contractual liquidity position in accordance with market standard ratio analysis and runs regular stress tests to determine its potential liquidity position in periods of both firm specific and marketwide stress.

Operational Risk

Operational risk is the risk of losses being incurred as a result of inadequate or failed internal processes, people or systems, or from external events.

Operational risk is a materially important risk category which has the potential for disrupting the business operations and damaging the reputation of the firm. The Group is continuously seeking to strengthen its operational processes particularly through investment in technology and resources.

The Group's primary operational risk mitigants include continual management emphasis on reducing errors, automation and the application of straight-through-processing to minimise manual intervention and strict reporting requirements for any operational errors that do occur. Furthermore, each department is required to

undertake a quarterly review to identify operational risks relating to key business processes, consider their potential impact and implement suitable control procedures.

Other specific risk mitigation factors include strict segregation of duties, no reliance on outsourced IT services, global systems that can be run from alternate sites, a regularly tested and an updated disaster recovery plan.

Remuneration risk

Remuneration risk is the risk that the firm’s remuneration policy incentivises employees to act in ways that may undermine effective risk management by, for example, aligning rewards with short term results which may encourage individuals to take risks that push the boundaries of a firm’s tolerated risk levels.

CM-UK has developed remuneration policies that seek both to implement specific FCA guidance and to abide by general best practice. Management specifically takes into account not only compliance with credit and market risk limits when considering individual compensation packages but also reviews adherence to broader operational, governance and compliance controls.

CM-UK recognises that it is insufficient to simply understand and quantify the above risks as they currently exist and that it must also understand the risks that might arise in times of economic stress. In order to meet this requirement CM-UK regularly undertakes a number of stress tests that model the impact of movements in factors such as interest rates, foreign exchange, credit spreads and equity index levels on the portfolio. CM-UK also runs stress tests and reverse stress tests specifically for capital planning purposes that seek to capture specific vulnerabilities.

6. Capital Resources

Table 1 provides a summary of the relevant capital ratios as at 31st December 2012:

Table 1

	CM-UK	CM-LTD	DP
Tier 1	35%	31%	89%
Total	43%	33%	89%

Ratios are calculated by taking the relevant capital resources as a percentage of risk weighted assets. Total risk weighted assets as at 31st December 2012 were (\$’000):

CM-UK:	1,813,761
CM-LTD:	1,667,324
DP:	250,589

Deductions from the total of tier 1 and tier 2 capital are split in order that 50% are applied to tier 1 capital and 50% to tier 2 capital resources for the purpose of calculating the capital ratios in Table 1 above.

Table 2 provides a summary of the composition of regulatory capital resources as at 31st December 2012:

Table 2

	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
<i>Tier 1 capital</i>			
Called up share capital:	404,000	404,000	200,000
Retained earnings and other reserves:	(10,785)	(34,060)	23,260
Perpetual non-cumulative preference shares:	250,000	250,000	-
Total tier 1 capital:	643,215	619,940	223,260
<i>Tier 2 capital</i>			
Surplus provisions:	-	-	507
Subordinated debt:	150,000	150,000	-
Total tier 2 capital:	150,000	150,000	507
Total tier 1 plus tier 2 capital:	793,215	769,940	223,767
<i>Deductions from total of tier 1 and tier 2 Capital</i>			
Material holdings:	-	202,000	-
Other:	12,589	13,096	-
Total tier 1 plus tier 2 capital after deductions:	780,626	554,844	223,767
Total capital before deductions:	780,626	554,844	223,767
Deductions from total capital:	2,076	1,736	143
Total capital after deductions:	778,550	553,108	223,624

Tier 1 Capital

CM-LTD:

Tier 1 capital includes 404 million US\$1.00 ordinary shares fully paid up and 250 million perpetual, non-cumulative preference shares of \$1.00, fully paid-up. The preference shares are callable, at the option of the Company from December 2012. Only the ordinary shares carry voting rights and are wholly owned by SMBC.

DP:

Tier 1 capital consists of 200 million \$1.00 ordinary shares fully paid-up, wholly owned by CM-LTD.

CM-Asia:

CM-LTD holds 2 million \$1.00 ordinary shares in CM-Asia, the subsidiary's entire issued share capital. CM-Asia is not subject to any standalone capital requirements but is consolidated within the consolidated prudential returns of CM-UK.

Tier 2 Capital

CM-LTD's long term subordinated loan facilities can be drawn until 30th June 2015 and mature 30th June 2020. Under FCA rules subordinated loan capital cannot exceed 50% of tier 1 capital and, in the last five years to maturity dated subordinated loans must be amortised on a straight line basis.

CM-UK regularly stresses its financial resources to model the potential effect of extreme impact events on the

Group's capital and its capital resources requirement.

7. Capital Resources Requirement

CM-UK determines its minimum regulatory capital charge (Pillar 1) on a daily basis using a capital calculator compliant with BIPRU rules. A summary report is then distributed to the Capital Management Committee.

Table 3 provides a summary of the minimum capital requirement for each regulated entity and the group.

Table 3

	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Operational risk:	1,834	1,428	406
Counterparty risk:	137,889	129,814	7,912
Credit risk:	2,079	-	2,079
Concentration risk:	-	-	8,522
Market risk:	3,298	2,143	1,129
Capital resources requirement	145,101	133,386	20,047
Surplus / (deficit) of own funds ¹ :	633,449	419,722	203,577
Solvency Ratio ² :	537%	415%	1,116%

Operational risk

CM-UK calculates Pillar 1 operational risk capital using the Basic Indicator Approach. The expansion of the business to cover a number of business lines will necessitate the adoption of the standardised approach once the necessary historical records exist to provide a three year average summation.

Credit risk

CM-UK calculates its Pillar 1 credit and counterparty credit risk capital requirements using the standardised approach. The nominated External Credit Assessment Institutions (ECAIs) for the purpose of calculating risk weighted exposure amounts are Standard and Poor's and Moody's. Ratings are assigned based on the lower of the external ratings obtained and are associated with the credit quality steps prescribed in BIPRU 3 in accordance with the credit quality assessment scale.

The firm makes use of netting for reporting purposes for those jurisdictions where netting is legally enforceable where there is a credit support agreement in place.

Central to the credit assessment is the internal credit grading system. CMG uses SMBC's grading models for all counterparties and outsources credit applications to the relevant credit departments of SMBC, who are independent and accountable for the grading process. Consequently CM-UK operates wholly within the overall credit governance structure of SMBC.

Market risk

CM-LTD calculates interest rate general market risk in accordance with the maturity method and equity market risk in accordance with the standard equity method.

¹ The surplus / (deficit) of own funds is defined as the excess of total capital after deductions over the capital resources requirement.

² The solvency ratio is the ratio of total capital after deductions to the capital resources requirement.

8. Credit risk and counterparty credit risk

Table 4 shows CM-UK's total exposure for credit and counterparty credit risk calculation purposes:

Table 4

Description	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Per financial statements			
Cash	4,973	1,301	991
Short term deposits	129,723	-	128,320
Trading assets	25,249	25,249	-
Derivatives	2,063,386	1,933,385	130,000
Due from government	5,928	-	5,928
Due from group undertakings	4,752	-	4,752
Gross positive fair value of contracts	2,234,011	1,959,935	269,993
Credit valuation adjustments*	16,690	16,145	545
Accrued interest	68	-	68
Adjustment to reflect OIS valuations**	(2,730)	(2,730)	-
Adjusted positive fair value of contracts	2,248,039	1,973,350	270,606
Netting benefits	(133,443)	(110,548)	(22,895)
Netted current credit exposure	2,114,596	1,862,802	247,711
Collateral paid***	9,963	9,963	-
Net replacement cost	2,124,559	1,872,765	247,711
Potential future credit exposure	600,290	517,483	82,807
Exposure at default	2,724,849	2,390,249	330,518
Collateral held****	819,784	818,784	1,000

* This reflects the reversal of credit valuation adjustments which reduce the valuation of derivative assets reported within the financial statements.

** During 2012, in line with changes in market practice, the methodology for calculating the fair value of collateralised derivative contracts moved to use the overnight indexed swap interest rate yield curve (OIS) in order to more consistently manage the associated interest rate and funding risks. However, for credit and counterparty credit risk calculation purposes, derivatives continue to reference other rates, such as the London interbank offered rate (LIBOR).

*** This reflects the excess of collateral paid over the fair value at risk.

**** In line with industry practice CM-UK adjusts counterparty risk weights rather than deducting collateral held from the exposure when calculating risk weighted assets.

Table 5 shows CM-UK's capital requirements (calculated as 8% of risk weighted exposure) for each credit and counterparty credit risk exposure class.

Table 5

Exposure Class	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Bank	12,035	5,101	6,771
Corporates	32,602	31,461	1,141
Project finance	93,252	93,252	-
Counterparty credit risk requirement	137,889	129,814	7,912
Bank	2,079	-	2,079
Credit risk requirement	2,079	-	2,079

Table 6 shows the total amount of CM-UK's credit and counterparty credit exposures by exposure class.

Table 6

Exposure Class	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
<i>Counterparty credit exposure</i>			
Bank	313,646	142,720	166,842
Corporate	1,118,085	1,088,726	29,359
Sovereign	5,928	-	5,928
Project finance	1,159,473	1,159,473	-
Total counterparty credit exposure	2,597,131	2,390,919	202,129
<i>Credit exposure</i>			
Bank	128,388	-	128,388
Total credit exposure	128,388	-	128,388

Credit risk represents the potential losses that CM-UK would incur if a counterparty failed to perform its obligations under contractual terms and as such exposure to credit risk is calculated based on the current cost of replacing contracts in a gain position and potential future credit exposure as estimated based on scenario analysis.

Table 7 shows the total amount of CM-UK's credit and counterparty credit exposure by industry.

Table 7

Industry	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
<i>Counterparty credit exposure</i>			
Commercial and industrial	808,963	799,923	9,040
Insurance	64,644	64,644	-
Securities	18,883	18,883	-
Bank	294,763	123,837	166,842
Other corporate	244,396	224,159	20,237
Public sector	81	-	81
Sovereign	5,928	-	5,928
Project finance	1,159,473	1,159,473	-
Total counterparty credit exposure	2,597,131	2,390,919	202,129
<i>Credit exposure</i>			
Bank	128,388	-	128,388
Total credit exposure	128,388	-	128,388

Table 8 shows CM-UK's total credit and counterparty credit exposure by geographical area and exposure class.

Table 8

Geographical area	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Asia Pacific			
Bank	4,092	9	-
Corporate	5,817	5,817	-
Specialised lending	3,441	3,441	-
Total Asia Pacific	13,350	9,267	-
Europe			
Bank	71,076	67,653	3,423
Corporate	73,684	67,639	6,045
Sovereign	5,928	-	5,928
Specialised Lending	1,059,153	1,059,153	-
Total Europe	1,209,842	1,194,445	15,397
North America and Latin America			
Bank	237,045	74,614	162,431
Corporate	1,026,477	1,003,163	23,314
Specialised lending	64,848	64,848	-
Total North America and Latin America	1,328,370	1,142,625	185,744
Rest of the world			
Bank	1,433	444	988
Corporate	12,107	12,107	-
Specialised lending	32,030	32,030	-
Total rest of the world	45,570	44,582	988
Total counterparty credit exposure	2,597,131	2,390,919	202,129
Asia Pacific			
Bank	127,329	-	127,329
Total Asia Pacific	127,329	-	127,329
Europe			
Bank	36	-	36
Total Europe	36	-	36
North America and Latin America			
Bank	1,000	-	1,000
Total North America and Latin America	1,000	-	1,000
Rest of the world			
Bank	23	-	23
Total rest of the world	23	-	23
Total credit exposure	128,388	-	128,388

Table 9 shows CM-UK's credit exposure by residual maturity and exposure class.

Table 9

Residual Maturity	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Less than one year			
Bank	128,352	-	128,352
Total less than one year	128,352	-	128,352
One to five years			
Bank	36	-	36
One to five years	36	-	36
Total credit exposure	128,388	-	128,388

Table 10 shows the average amount of CM-UK's credit and counterparty credit exposures over the year ended 31st December 2012.

Table 10

Exposure Class	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
<i>Counterparty credit exposure</i>			
Bank	514,983	326,953	185,438
Corporate	1,250,097	1,202,595	47,503
Sovereign	24,015	22,075	1,940
Specialised lending	1,101,815	1,100,431	1,384
Total counterparty credit exposure	2,890,910	2,652,054	236,264
<i>Credit exposure</i>			
Bank	156,462	-	156,462
Total credit exposure	156,462	-	156,462

A major element of CM-UK's credit risk management is a rigorous quantitative credit value adjustment based on scenario simulation and market risk adjusted probabilities of default; this is a "fair value reserve". Such a system cannot by itself assure efficient pricing or monitoring of individual credit exposures but it is a strong incentive for proper trade off of risk and return at the time of transaction, as well as providing an efficient incentive for assignment and termination of transactions later. The reserve is arrived at by calculating an expected loss in the simulation model using market implied default probabilities. The calculation method uses risk adjusted probabilities derived from prevailing market credit spreads for various rating categories from third party sources.

The result of this calculation methodology is that the reserve for each name effectively reflects the market credit spread charged on the expected exposure to the counterparty at each time point. This is a good proxy for the transaction unwind cost in the market. Management uses this reserve as its main tool for credit monitoring on a portfolio basis, supplemented by reports from the Credit department, especially breaking news of sharply deteriorating credits. Additionally management reviews a series of reports on specific exposures identified as high risk.

Table 11 shows the notional value of the credit derivative positions held by CM-UK.

Table 11

Credit derivative product type	Notional credit derivative positions			
	Own credit portfolio		Intermediation activities	
	Purchased	Sold	Purchased	Sold
	\$m	\$m	\$m	\$m
Single name credit default swaps	-	-	-	-
Basket credit default swaps	-	-	5,100	5,100
Total return swaps	-	-	-	-
Total	-	-	5,100	5,100

Table 12 shows the notional value of credit derivative transactions completed by CM-UK in the year to 31st December 2012.

Table 12

Credit derivative product type	Notional credit derivative positions			
	Own credit portfolio		Intermediation activities	
	Purchased	Sold	Purchased	Sold
	\$m	\$m	\$m	\$m
Single name credit default swaps	-	-	-	-
Basket credit default swaps	-	-	-	-
Total return swaps	-	-	-	-
Total	-	-	-	-

Of the notional credit derivatives held at 31st December 2012, \$2,000m sold were guaranteed. All reference entities were corporate entities with an Aaa credit rating.

Table 13 shows the distribution of the credit reserve by industry.

Table 13

Industry	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Exposures to impaired obligors	-	-	-
Total	-	-	-
Past due exposures	-	-	-
Total	-	-	-
Credit value adjustments			
Commercial and industrial	354	96	258
Securities	275	275	-
Bank	1,164	1,097	67
Other corporate	14,888	14,668	220
Public sector	-	-	-
Project finance	10	10	-
Other specialised lending	-	-	-
Total	16,690	16,145	545
Movement in year on credit value adjustments			
Commercial and industrial	(1,273)	(348)	(924)
Insurance	-	-	-
Securities	(86)	(86)	-
Bank	(339)	(109)	(230)
Other corporate	1,240	1,618	(378)
Public sector	(1)	-	(1)
Project finance	(14)	(14)	-
Other specialised lending	-	-	-
Total	(473)	1,061	(1,533)

Exposures to impaired obligors are based on the current exposure of counterparties for which specific credit reserves have been raised. Credit value adjustments include both specific and general credit reserves.

Table 14 shows the distribution of the credit reserve by geographical area.

Table 14

Geographical area	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Exposures to impaired obligors	-	-	-
Total	-	-	-
Past due exposures	-	-	-
Total	-	-	-
Credit value adjustments			
Asia Pacific	62	62	-
Europe	1,706	1,367	339
North America and Latin America	14,916	14,710	206
Rest of the world	6	6	-
Total	16,690	16,145	545
Movement in year on credit value adjustments			
Asia Pacific	(212)	(200)	(12)
Europe	(14,091)	(13,089)	(1,002)
North America and Latin America	13,879	14,398	(519)
Rest of the world	(49)	(49)	-
Total	(473)	1,060	(1,533)

Table 15 shows the reconciliation of changes in specific provisions.

Table 15

Item	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Provisions at the beginning of the period	9	9	-
Bad debts written off during the period	-	-	-
Recoveries	(9)	(9)	-
Increases or decreases in provisions	-	-	-
Provisions at the end of the period	-	-	-

Table 16 shows the reconciliation of changes in the general credit reserve.

Table 16

Item	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Provisions at the beginning of the period	17,162	15,084	2,078
Bad debts written off during the period	-	-	-
Recoveries	(14,317)	(1,724)	(12,593)
Increases or decreases in provisions	13,845	2,785	11,060
Provisions at the end of the period	16,690	16,145	545

9. Standardised Methodologies

Table 17 shows CM-UK's credit exposures by exposure class and obligor grade.

Table 17

Exposure Class	Obligor Grade	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
<i>Bank</i>				
	1	6,475	795	5,679
	2	281,199	119,376	157,740
	3	-	-	-
	4	25,646	22,223	3,423
	5	326	326	-
Total bank		313,646	142,720	166,842
<i>Corporate</i>				
	1	768,935	766,239	2,696
	2	42,767	16,880	25,887
	3	8,093	7,442	651
	4	179,034	178,909	125
	5	3,801	3,801	-
	6	62	62	-
	7	115,392	115,392	-
Total corporate		1,118,085	1,088,726	29,358
<i>Project Finance</i>				
	1	-	-	-
	2	-	-	-
	3	9,427	9,427	-
	4	1,137,693	1,137,693	-
	5	12,352	12,352	-
Total project finance		1,159,473	1,159,473	-

<i>Sovereign</i>			
1	5,928	-	5,928
2	-	-	-
3	-	-	-
4	-	-	-
5	-	-	-
Total sovereign	5,928	-	5,928
<hr/>			
Total counterparty credit exposure	2,597,131	2,390,919	202,129
<i>Bank</i>			
1	36	-	36
2	128,352	-	128,352
3	-	-	-
4	-	-	-
5	-	-	-
Total bank	128,388	-	128,388
<hr/>			
Total credit exposure	128,388	-	128,388

CM-UK adjusts counterparty risk weights rather than deducting collateral held from the exposure when calculating risk weighted assets. 95% of exposures to obligor grade 7 are fully collateralised.

10. Credit Risk Mitigation

Credit risk mitigation is a high priority of CM-UK management and a variety of mitigants are employed. The credit reserve, as explained above, is based upon market fair values. Additionally management requires that credit procedures and limits are meticulously adhered to by all front office staff who are required to incorporate a comprehensive credit assessment in their approach to pricing. Collateral agreements are actively pursued from the standpoint of both credit and liquidity risk.

In addition to the above management has sought to use the financial strength of the wider SMBC Group. In order to address the volatility of a fair value credit reserve in times of economic stress, where the reserve increases, decreasing trading revenue as conditions deteriorate, the Company has purchased parental guarantees to cover specifically identified credit risks. The guarantee fees arising are calculated as an agreed credit charge applied to the expected exposure over the lifetime of the guaranteed transactions discounted at a risk adjusted spread over Libor. Where the firm has entered into an interest rate or currency derivative it not only backs out market and liquidity risk through an offsetting transaction with CM-INC it also mitigates the credit risk of the resulting third party exposure through obtaining a guarantee from the same party. Additionally the derivative business model has developed so as to reduce potential future stresses on the CM-UK balance sheet. Where a new customer wishes to transact a longer term trade (defined as having a tenor greater than seven years) then, other things being equal, it is SMBC group policy to book the transaction in a SMBC branch, i.e. the credit risk will be borne directly by the parent bank's balance sheet so limiting the potential impact of widening credit spreads on the firm's credit reserve. CM-LTD acts as agent rather than principal in such transactions having responsibility for the customer relationship and for structuring and executing any transactions, but it does not bear principal risk for trades.

Table 18 shows CM-UK's collateral held by exposure type. All collateral held is financial collateral.

Table 18

Exposure Class	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
<i>Counterparty credit risk</i>			
Bank	18,784	18,784	-
Corporate	801,000	800,000	1,000
Sovereign	-	-	-
Project finance	-	-	-
Total counterparty credit risk collateral	819,784	818,784	1,000
<i>Credit risk</i>			
Bank	-	-	-
Total credit risk	-	-	-

Table 19 shows CM-UK's total exposure covered by guarantees. No credit derivatives are held by CM-UK in relation to its own credit portfolio.

Table 19

Exposure Class	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
<i>Counterparty credit risk</i>			
Bank	-	-	-
Corporate	876,189	876,189	-
Sovereign	-	-	-
Project finance	-	-	-
Total counterparty credit risk collateral	876,189	876,189	-
<i>Credit risk</i>			
Bank	-	-	-
Total credit risk	-	-	-

11. Market Risk

As a result of the establishment of the securities trading business within CM-LTD, specifically the taking of securities positions in order to facilitate customer transactions, market risk has increased. This is consistent with the low to moderate risk appetite of management.

Table 20 shows CM-UK's market risk capital requirement and risk weighted exposures by exposure type.

Table 20

Exposure Type	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Credit derivatives	4	4	-
Equity	-	-	-
Foreign exchange	2,286	1,403	856
Interest rate	1,009	736	273
Total market risk capital requirement	3,299	2,143	1,129
Credit derivatives	51	51	-
Equity	-	-	-
Foreign exchange	28,575	17,540	10,704
Interest rate	12,608	9,201	3,407
Total risk weighted exposures	41,234	26,792	14,111

The market risk capital requirement arising on credit derivatives results from slight differences in delta values

The market risk capital requirement arising on credit derivatives results from slight differences in delta values between back to back trades. No un-hedged credit derivative positions are held.

Table 21 shows CM-UK's foreign exchange market risk capital requirement by currency.

Table 21

Currency	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
GBP	2,215	1,360	856
HKD	27	-	-
JPY	43	43	-
Total foreign exchange market risk requirement	2,286	1,403	1,129

All foreign exchange market risk exposures related to foreign currency cash accounts and long settlement transactions. Principal securities positions held as at 31st December 2012 were all denominated in USD.

Table 22 shows CM-UK's interest rate market risk capital requirement by type.

Table 22

Type	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
General market risk	254	254	-
Specific market risk	755	482	273
Total interest rate market risk requirement	1,009	736	273

Table 23 shows CM-UK's general interest rate market risk capital requirement by maturity zone.

Table 23

Maturity Zone	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
One	-	-	-
Two	101	101	-
Three	153	153	-
Total general market risk requirement	254	254	-

Table 24 shows CM-UK's specific interest rate market risk capital requirement by exposure type.

Table 24

Exposure Class	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
Bank	542	269	273
Corporate	181	181	-
State local government	32	32	-
Total specific market risk requirement	755	482	273

Table 25 shows CM-UK's specific interest rate market risk capital requirement by credit quality step.

Table 25

Credit Quality Step	CM-UK (\$'000)	CM-LTD (\$'000)	DP (\$'000)
1	555	310	245
2	200	172	28
Total specific market risk requirement	755	482	273

12. Remuneration

This section discloses the remuneration awards made by CM-UK to 28 Code Staff identified in CM-UK in respect of the 2012 performance year. Additional information summarising CM-UK's decision-making policies for remuneration is also provided. These disclosures deliver the requirements of the FCA Policy Statement PS10/21 'Implementing CRD3 requirements on the disclosure of remuneration' issued in December 2010.

i. Remuneration Policy

The Remuneration Policy ("Policy") sets out the policies, procedures and practices of remuneration for all locally hired employees of CM-UK, and is intended to reflect CM-UK's overall business philosophy, aims and objectives.

Except for certain aspects of variable pay for Code Staff and other employees as defined below, it does not apply to employees of SMBC seconded from SMBC in Japan, or to employees of Nikko Tokyo seconded from Nikko Tokyo in Japan, whose remuneration is governed by rules established in Japan by SMBC and Nikko Tokyo respectively.

SMBC DP is a wholly-owned subsidiary of CM-LTD, and is a special purpose booking vehicle for certain derivative transactions. SMBC DP currently has no employees apart from three non-executive directors as it relies on an Agency Agreement with CM-INC, in New York to provide all of its required services.

A continuing focus during 2012 has been to ensure that CM-LTD's approach to discretionary remuneration is structured in accordance with the FCA's Remuneration Code (the FCA Code).

In summary, the aims of the Policy include the following statements:

- a) Employees should be remunerated by means of a mix of basic salary, benefits and discretionary bonus relevant to their function and responsibilities
- b) The amount of fixed remuneration, including salary and benefits, should be sufficient for an acceptable standard of living without a dependency on discretionary bonus
- c) Employees should have the opportunity to share in the success of CM-LTD and SMBC, and also share the impact of losses in years of poor performance
- d) Any discretionary bonus should be based on a mixture of SMBC results, CMG results, department results and individual contribution
- e) There should be no individual formula-based bonuses in CM-LTD
- f) Remuneration should be affordable and appropriate in terms of value allocated to CM-LTD's shareholder and employees
- g) Any discretionary bonus should take account of a range of factors, including the risk profile of the business and the skills, knowledge and behaviours of the employee
- h) Variable compensation should not normally be guaranteed, and only used exceptionally as a recruitment tool, and not exceeding 12 months

ii. Regulation

CM-LTD is committed to the maintenance of robust remuneration arrangements that are in accordance with regulatory requirements including the FCA Code. Here are some of the ways in which CM-LTD fulfils this commitment:

- a) Scope and Application – CM-LTD has a clear process to identify employees whose professional activities could have a significant impact on the firm’s risk profile, including senior risk and compliance officers. These staff are designated as Code Staff and they are made aware of the implications of their status
- b) Governance – This year, due to changes in proportionality level, CM-LTD is categorised as Level 3 firm. Although it is not required for Level 3 firm, CM-LTD decided to maintain a UK Remuneration Operating Committee to strengthen the remuneration governance. The committee is responsible for 1) ensuring CM-LTD’s remuneration policies complies with FCA Remuneration Code, 2) the oversight and implementation of CM-LTD’s remuneration policy in line with SMBC and Nikko Tokyo, and, 3) reviewing and approval of the salary and bonus recommendations for all CM-LTD’s staff after carefully reviewed and approved by SMBC.

CM-LTD believes that the independence for remuneration matters has been evidenced by the independent oversight of senior management of SMBC on behalf of the shareholder

- c) Capital – The aggregate total of variable remuneration in 2012 was considered in the context of CM-LTD’s overall capital resources
- d) Guarantees – The Policy is that guarantees are used only in exceptional circumstances in the case of new hires and for only one year
- e) Risk–focused Remuneration Policies – CM-LTD’s policies, procedures and practices promote sound risk management. This is an important part of CM-LTD’s Policy which links risk and remuneration through the governance process, the performance evaluation process, deferral structures and performance adjustment provisions
- f) Deferral and payment in share based schemes – As a Level 3 firm, CM-LTD decided to dis-apply 1) Retained shares and other instruments, 2) Deferral, and 3) Performance Adjustment for 2012 remuneration cycle. The decision was made in accordance with the FCA Code. Non Cash Instrument, Deferral Policy, and Performance Adjustment for previous years when CM-LTD was a Tier One firm will continue to be applied until its maturity.

iii. Code Staff

Code Staff have been assessed as those staff whose professional activities could have a material impact on CM-LTD’s risk profile. Employees to be included are:

- Significant Influence Function employees – i.e. those performing controlled functions CF1 through CF29
- All staff with a corporate title of JGM/Managing Director or higher, unless they are exempt because they have very limited or no approval authority (currently no exemptions are in place)
- Staff whose duties can have a material impact on the firm’s risk profile whose total remuneration is within the same remuneration bracket as senior management

For performance year 2012 there were 28 Code Staff identified in the CM-UK.

iv. Control Functions

Employees engaged in Risk and Compliance functions are independent of the business units they oversee. Their remuneration, both fixed and variable, is determined centrally and front line business units are not involved in this process

v. Base Salary

Base Salary is the fixed payment made to an employee for his or her services. It does not include allowances or benefits and is the basis for salary-related benefits such as pension contribution.

The amount of salary paid to an employee will depend on the following factors

- a) The market rate for the function
- b) The consistency of the market rate with internal peer groups
- c) The knowledge, experience and competencies of the individual

Base Salary is reviewed annually on 1 January

vi. Variable Pay

Variable Pay in CM-LTD is defined as annual discretionary bonus, which is awarded based on SMBC results, CMG results, departmental results and individual performance.

The total bonus pool amount is determined by reference to CM-LTD's risk-adjusted criteria, which include both quantitative and qualitative measures.

Individual discretionary bonuses are based on performance and non-performance based criteria. Adherence to applicable risk and control frameworks is part of the performance assessment.

CM-LTD set leverage cap of individual bonus at 400% of the individual's base salary.

vii. Deferral and Performance Adjustment

CM-LTD decided to dis-apply 1) Retained shares and other instruments, 2) Deferral, and 3) Performance Adjustment for 2012 remuneration cycle. The decision was made in accordance with the FCA Code. Non Cash Instrument, Deferral Policy, and Performance Adjustment for previous years when CM-LTD was a Tier One firm will continue to be applied until its maturity.

viii. Remuneration of SMBC Nikko Capital Markets Limited in Remuneration Year 2012

Aggregate remuneration amount for Code Staff

	Derivative Products Group		Securities Products Group		NED		Other(No CM-LTD remuneration)		Total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Number of Code Staff	3	3	14	10	3	3	8	6	28	22
Remuneration Amount £k	1,971	1,522	3,140	2,877	63	59	-	-	5,174	4,459

Analysis of remuneration between fixed and variable amounts

	Total		Senior Managers		Risk Taker		Others	
	2012	2011	2012	2011	2012	2011	2012	2011
Number of Code Staff	20	16	7	5	3	4	10	7
Base Salary £k:								
Cash	2,790	2,377	1,705	1,335	444	570	640	472
Total Base Salary	2,790	2,377	1,705	1,335	444	570	640	472
Variable £k:								
Cash	2,465	1,190	2,088	928	172	196	205	66
Deferred Instrument	-	892	-	892	-	-	-	-
Total Variable Pay	2,465	2,082	2,088	1,820	172	196	205	66