SMBC Derivatives Products Limited

MIFIDPRU disclosure report

31 March 2022

SMBC SMBC NIKKO

Contents

Document disclaimer

- SMBC Derivatives Products Limited ("the Company", "SMBC DP") is authorised and regulated by the Financial Conduct Authority ("FCA"). The disclosures set out in this document have been provided in accordance with the requirements set out in Chapter 8 of the FCA's MIFIDPRU Prudential Sourcebook for MiFID Investment Firms ("MIFIDPRU 8") under the UK Investment Firms Prudential Regime (IFPR). The IFPR is a single prudential regime for all solo-regulated investment firms in the UK (FCA investment firms) authorised under the UK Markets in Financial Instruments Directive (MiFID), which came into effect on 1 January 2022.
- The purpose of the disclosure, as contained within this document, is to provide sufficient information to enable market participants to assess the risks within the Company.
- This document does not constitute any form of financial statement on behalf of SMBC DP.
- This document reflects, where appropriate, information which is contained within the Annual Report & Financial Statements of SMBC DP.
- The information contained herein has been subject to internal review but has not been audited by SMBC DP's external auditors.
- Although the disclosures are designed to provide transparent capital disclosure by investment firms on a common basis, the information contained in this particular 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 IFPR;
    - The mix of exposure types;
    - The different risk appetites and risk profiles of firms; and/or
    - The different waivers and modifications granted by the FCA.

1. Overview

1.1 Background and scope

The IFPR is the latest regulatory framework for the UK market governing the management of risks and capital requirements for investment firms that are authorised and regulated under the MiFID. The prudential regime for FCA investment firms is more aligned to the way that investment firms run their business. This should reduce barriers to entry and allow for increased competitiveness between investment firms in the UK.

The objective of IFPR is to be simpler and more proportionate to a firm's operations. By enabling investment firms to avoid complexity of the Capital Requirements Regulation ("CRR2") rules the main changes are lower capital requirements, less onerous governance standards and reporting obligations. IFPR disclosure requirements aim to complement the own funds requirements and the Internal Capital Adequacy and Risk Assessment ("ICARA").

The disclosures herein have been prepared in accordance with the disclosure requirements of MIFIDPRU 8. These requirements are designed to promote market discipline by providing market participants with key information on SMBC DP's risk management objectives, governance arrangements, own funds and own funds requirements. Improved public disclosures of such information leads to increased transparency and should lead directly to more effective market discipline.

In addition, for the Disclosure Document as of 31 March 2022, the Company is subject to the transitional provisions under MIFIDPRU TP12. Under MIFIDPRU TP12.6 R, the Company is not required to disclose the following information:

- MIFIDPRU8.2 Risk Management Objectives and Policies
- MIFIDPRU 8.7 Investment Policy

Transitional provisions also apply to the remuneration disclosures as of 31 March 2022. Under MIFIDPRU TP12.8, the Company is not required to disclose the information about its remuneration policies and practices that would ordinarily be required by MIFIDPRU8.6. Instead, the Company must continue to publish the remuneration information under Article 450 of the UK CRR.

1.2 Basis of Disclosure

The IFPR disclosure requirements apply to SMBC DP on an individual entity basis. Unless otherwise stated all figures in this document are denominated in thousands of US Dollars and are as of 31 March 2022.

1.3 Frequency of Disclosure

After due consideration of the size and complexity of the operations, SMBC DP has determined that this disclosure document will be formally updated on an annual basis, to reflect the situation as at the end of each financial year. However, the Company may decide to publish some or all disclosures more frequently than annually if there are future changes in the business that are deemed to be material by the Company's Board of Directors.

1.4 Location and Verification

This Disclosure Document has been reviewed and approved by the Company's Board of Directors 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 of the financial statements.

This report is published on the SMBC Group's corporate website for the EMEA region (EMEA - Corporate Disclosures (smbcgroup.com)).

2. Governance arrangements (MIFIDPRU 8.3)

2.1 Corporate structure

SMBC Derivatives Products Limited (“the Company”, “SMBC DP”), company number 02988637 incorporated in England and Wales, is an investment firm authorised and regulated by the FCA.

SMBC DP is a wholly owned subsidiary of SMBC Nikko Capital Markets Limited (“CM Ltd.”) and a member of the Sumitomo Mitsui Financial Group (“SMBC Group”).

2.2 Business model and strategy

The Company 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”). It manages its capital in accordance with its regulatory requirements under IFPR as well as specific operating requirements to maintain these enhanced credit ratings.

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 of its affiliates.

All principal trades booked by the Company with its customers are hedged with mirror transactions with an affiliated entity SMBC Capital Markets Inc. (“CM Inc.”). The Company earns a credit intermediation fee for each transaction. A fee is also earned for all credit guarantees written. Additionally, the Company is free to earn a return on its capital.

2.3 Business Environment

The Company operates in a highly regulated business environment with significant requirements in respect of reporting, capital and liquidity management, product design, conduct, customer service and other business aspects from multiple regulators in the countries the Company operates. These regulations constantly change and evolve in response to years of financial instability, new business practices, economic and political developments and become increasingly stringent in order to promote good practice and stability in global financial markets.

The Company operates in an environment of unprecedented uncertainty with respect to the continuing challenges and opportunities presented post-Brexit, alongside the COVID-19 pandemic and IBOR transformation. It follows the Group-wide framework in responding to these challenges.

SMBC DP continues to act as the Group’s primary derivatives specialist and continues to seek opportunities to diversify its customer base and develop its derivatives business working alongside affiliated SMBC Group entities.

Response to COVID-19 Pandemic

In responding to the COVID-19 pandemic, the health and wellbeing of employees has been and remains top priority. The company has no direct employees and is supported by staff of Group companies. The CM Ltd Group has made provision of a range of resources to support staff with their physical and mental wellbeing continues to support its people through the introduction of a hybrid working policy following a phased return to office in line with government guidance.

Both COVID-19 itself and the government's response to the pandemic can have significant impact on financial markets and the business environment, so the Company continues to monitor the situation closely and manage its positions and risks appropriately.

Transition to Risk Free Rates

A significant area of focus for the Company in the year was the transition of its customers to Risk Free Rates as part of discontinuance of Interbank Offer Rates for certain currencies. This project required the mobilisation of resources from across the SMBC Group and support from external legal counsel, which continue to provide expertise on regulatory obligations and developing market conventions, as well as the preparation of legal documentation to support transition. The Company has also liaised closely with colleagues from across SMBC Group.

As of 31 December 2021, the date of discontinuance of certain IBORs, the company has successfully transitioned 100% of applicable LIBOR agreements in advance of the regulatory deadline.

Ukraine conflict

The Board has been engaged in overseeing our response to the issues arising from the conflict in Ukraine, including:

- understanding the actions being undertaken to respond to the imposition of sanctions and other restrictions on certain Russian companies and individuals;
- assessing which of the Company's customers would be most directly and indirectly impacted by the conflict;
- assessing the impacts on the Company's liquidity and capital positions and its wider control environment,
- SMBC Group's approach to managing the risks to ensure alignment within the Group.

While matters of policy remained reserved for the Board, at an operational level, the Board delegated to the Crisis Management Team (CMT) responsibility for implementing the Company's response to the risks arising from the conflict. Membership of the CMT includes the executive Directors, Chief Risk Officer, General Counsel, Chief Compliance Officer and Head of Human Resources.

Through the above steps, the Board believes that it has been able to appropriately understand the impact of the conflict on our stakeholders, primarily our customers, our people, our regulators and SMBC Group, and to take action in recognition of these interests. All principal risk types have been considered in connection with this matter.

2.4 Governance structure

Non-Executive Committee

The Non-Executive Committee is constituted of non-executive directors. The Non-Executive Committee undertakes certain oversight and approval functions that support its ability to assess whether the Company adheres to all relevant internal and regulatory guidelines.

The primary purpose of this committee is to allow the Non-Executive Directors to meet with stakeholders such as external auditors, internal auditors, professional advisers and parties such as the rating agencies, in order to better inform themselves about any issues facing the Company.

SMBC DP is not required to maintain a risk, remuneration and nomination committee on the basis that the thresholds relating to on-balance sheet and off-balance sheet items in MIFIDPRU 7.1.4R are not exceeded.

Executive Committee

The Board delegates day-to-day management of the Company to the Chief Executive Officer ("CEO") who is further supported by the Executive Committee.

The Executive Committee supports the CEO in his responsibility to implement the strategic vision of the Board and to manage the daily operations of the Company.

2.5 Directorships

The below table shows our directors and the number of both internal and external directorships they each serve as of 31 March 2022 and at the date of this report.

Name	Company Name/Role	Date of Appointment
Thomas Coleman	• Non Executive Director, SMBC Derivative Products Limited	• 14 September 2011
Roger McCormick	• Non Executive Director, SMBC Derivative Products Limited • Sole Director, Roger McCormick Consultants Limited	• 7 October 2005 • 7 October 2006
Timothy Quinn	• Non Executive Director, SMBC Derivative Products Limited	• 12 March 2009
Antony Yates	• Executive Director, SMBC Nikko Capital Markets Limited • Executive Director, SMBC Derivative Products Limited • Non-Executive Director, SMBC Capital Markets Inc. • Director, SMBC Capital Markets Asia Limited • Supervisory Board Member, SMBC Nikko Capital Markets Europe GmbH	• 5 July 1995 • 5 July 1995 • May 2014 • August 2008 • 1 May 2020
Takahiro Yazawa	• Non Executive Director, SMBC Nikko Capital Markets Limited • Non Executive Director, SMBC Derivative Products Limited	• 24 October 2014 • 15 November 2016, resigned 6 April 2022 • 1 May 2020

	• Supervisory Board Member, SMBC Nikko Capital Markets Europe GmbH	
Glenn Swanton	• Non Executive Director, SMBC Derivative Products Limited • Non-Executive Director, SMBC Leasing (UK) Ltd	• 3 April 2020 • 2 December 2019
Mehul Desai	• Executive Director, SMBC Derivative Products Limited	• 19 November 2020
Yukio Ishii	• Executive Director, SMBC Derivative Products Limited • Executive Director, SMBC Nikko Capital Markets Limited	• 6 April 2022

The annual report and accounts set out further information which complements the information that can be found in this MIFIDPRU disclosures document. The annual report and accounts can be found on the SMBC Group's corporate website for the EMEA region **(EMEA - Corporate Disclosures (smbcgroup.com)).**

3. Own funds (MIFIDPRU 8.4)

The following table presents SMBC DP's Own Funds held which is made up of common equity tier 1 capital.

Under MIFIDPRU 8, SMBC DP is required to disclose:

1. A composition of the regulatory own funds and the applicable regulatory deductions and applicable filters – see Table 1 below
2. A reconciliation of 1 (above) with the capital in the balance sheet in the audited financial statements of SMBC DP – see Table 2 below
3. A description of the main features of own funds instruments issued by SMBC DP – see Table 3 below

Table 1: Composition of regulatory own funds of SMBC DP			
	Item	**Amounts**	**Cross reference to Table 2**
1	**OWN FUNDS**	**235,062**	
2	**TIER 1 CAPITAL**	**235,062**	
3	**COMMON EQUITY TIER 1 CAPITAL**	**235,430**	
4	Fully paid up capital instruments	200,000	a
5	Share premium		
6	Retained earnings	35,430	b
7	Accumulated other comprehensive income		
11	(-) TOTAL DEDUCTIONS FROM COMMON EQUITY TIER 1	(368)	

3.1 Common Equity Tier 1 ("CET1") Capital

The Company's Common Equity Tier 1 capital is made up of $200 million of fully paid-up ordinary share capital,

Ordinary shares carry voting rights and are wholly owned by CM Ltd. Further details of the features of ordinary shares are in Table 3 below.

3.2 Capital deductions

Our own funds are subject to the following deductions from CET1:

- Deduction of intangible assets; and
- Prudential filters, which include:
    - Reversal of the gain or losses on liabilities that result from changes in the own credit standing of the firm, and
    - Application of the additional value adjustments

The Company's financial statements are prepared in accordance with International Financial Reporting Standards ('IFRS'), and regulatory own funds are prepared under prudential rules. The financial statement under the regulatory scope of consolidation forms the basis for the calculation of regulatory capital requirements. There is no difference in the regulatory and accounting scope of consolidation.

Table 2: Own funds reconciliation of regulatory own funds to balance sheet in the audited financial statements				
		a	b	c
		Balance sheet as in published financial statements	**Under regulatory scope of consolidation**	**Cross Reference to Table 1**
		31 March 2022 (US$'000s)		
Assets - Breakdown by asset class according to the balance sheet in the published financial statements				
1	Cash at banks	196,326		
2	Trading Securities	65,014		
3	Derivative assets	22,483		
4	Other debtors	1,401		
5	Intangible assets	56		
	Total assets	**285,280**		
2	Derivative liabilities	21,949		
3	Other creditors	27,901		
	Total Liabilities	**49,850**		
1	Called up share capital	200,000		a
2	Retained earnings	35,430		b
	Total shareholders' equity	**235,430**		

Table 3: Main features of own funds issued by SMBC DP Capital Instruments' main features template		Common Equity
1	Issuer	SMBC Derivative Products Limited
2	Unique identifier (e.g., CUSIP, ISIN or Bloomberg identifier for private placement)	N/A
3	Governing law (s) pf the instrument	English
	Regulatory treatment	
4	Transitional CRR rules	Common Equity Tier 1
5	Post-transitional CRR rules	Common Equity Tier 1
6	Eligible at solo/ (sub)- consolidated/ solo & (sub)- consolidated	Solo & consolidated
7	Instrument type (types to be specified by each jurisdiction)	Common shares
8	Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	USD 200 million
9	Nominal amount of instrument	USD 200 million
9a	Issue price	USD 1 per security
9b	Redemption price	N/A
10	Accounting classification	Shareholders' equity
11	Original date of issuance	03/01/2012
12	Perpetual or dated	Perpetual
13	Original maturity date	N/A
14	Issuer call subject to prior supervisory approval	No
15	Optional call date, contingent call dates and redemption amount	N/A
16	Subsequent call dates, if applicable	N/A
	Coupons/ dividends	
17	Fixed or floating dividend/ coupon	Floating
18	Coupon rate and any related index	N/A
19	Existence of a dividend stopper	No
20a	Fully discretionary, partially discretionary, or mandatory (in terms of timing)	Fully discretionary
20b	Fully discretionary, partially discretionary, or mandatory (in terms of amount)	Fully discretionary
21	Existence of step up or other incentive to redeem	No
22	Noncumulative or cumulative	Non-cumulative
23	Convertible or non- convertible	Non- convertible
24	If convertible, conversion trigger(s)	N/A
25	If convertible, fully or partially	N/A
26	If convertible, conversion rate	N/A
27	If convertible, mandatory, or optional conversion	N/A
28	If convertible, specify instrument type convertible into	N/A
29	If convertible, specify issuer of instrument it converts into	N/A
30	Write- down features	No
31	If write- down, write- down trigger(s)	No
32	If write- down, full or partial	N/A
33	If write- down, permanent or temporary	N/A
34	If temporary write- down, description of write- up mechanism	N/A
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Preference shares
36	Non- compliant transitioned features	No
37	If yes, specify non- compliant features	N/A

4. Own funds Requirements (MIFIDPRU 8.5)

4.1 Components of the assessment

The Company does not meet the conditions for classification as a Small and Non-Interconnected ("SNI") MIFIDPRU investment firm under MIFIDPRU1.2. As such, The Company's own funds requirements are determined as the highest of the following three requirements under MIFIDPRU 4.3.2 R:

1. Permanent Minimum Capital Requirement (PMR) – £750,000 (MIFIDPRU 4.4.2R)
2. Fixed Overheads Requirement (FOR) – $730,000, one quarter of the Company's annual fixed overheads (MIFIDPRU 4.5.1.R)
3. K-factor requirements – Total K-factor requirements are $354,000, a breakdown of which is provided in Table 4 below.

The Company's Own Funds Requirements are therefore determined by the PMR, i.e., £750,000 (equivalent of $987,000), which is the highest of these three.

4.2 K-Factors break down

The 'K-factor' approach is a new approach introduced by the IFPR to determine the minimum own funds requirements of an investment firm that is not an SNI. The aim of the K-factors is to provide a tailored and more appropriate method for setting a risk-based minimum own funds requirement for all types of investment firm compared to the CRR regime.

The K-factors relevant to SMBC DP's business model include the following:

- K-factor requirement calculated on the basis of the Daily Trading Flow (K-DTF) – designed to capture the operational risks relating to the value of trading activity a firm conducts throughout each business day. First component is 'cash trades' which includes both outright security purchase/sales and securities financing transactions ("SFTs"), which the Company does not have. Second component are derivative trades. DTF is measured as a rolling average over the previous 9 months but excluding the 3 most recent months.
- K-factor requirement calculated on the basis of the Net Position Risk ("K-NPR") – this approach carries forward the market risk requirements under the UK CRR.
- K-factor requirement calculated on the basis of the Trading Counterparty Default risk (" K-TCD") – captures the risk of the Company's exposure to the default of its trading counterparties. This includes derivative transactions designated as trading book.

Table 4: K-factor requirements

K-factor requirement: (Sum of)	**Amount (US $000)**
K-DTF	0
K-NPR + K-TCD	354.2
Total K factor assessment	**354.2**

4.3 Overall financial adequacy

The Company utilises a number of approaches to ensure that it remains compliant with the overall financial adequacy rule under MIFIDPRU7.4.7R, both in terms of own funds and liquidity resources.

Foremost is the annual assessment of own funds and liquidity adequacy conducted during the internal Capital Adequacy and Risk Assessment ('ICARA') process, which considers the Company's resource requirements under 'business as usual' and a variety of stressed scenario contexts. In the case of own funds, these requirements are forecast over a three-year time horizon and test a number of the key sensitivities of the firm's business lines and balance sheet. The Company then ensures that its current level of financial resources is adequate to remain a going concern during this period under all scenarios considered.

The ICARA process is otherwise supported on an ongoing basis by a comprehensive Enterprise-Wide Risk Management framework, which defines the following key components:

- Risk Governance Structure – who is responsible for the Company's risk management and what authorities are given
- Risk Identification and Assessment – what risks the Company faces and how important each risk is
- Risk Appetite – what level of risk for each risk type and on an aggregate basis the Company is prepared to take in the pursuit of strategic objectives of the Company
- Risk Measurement – how risks are individually and collectively measured and recognised
- Risk Monitoring and Reporting – how risks are monitored, controlled and reported to the Board, executive management and business owners
- Stress Testing – Scenario analysis of potential downside risks
- Capital, liquidity and funding planning and management – how the Company's capital and liquidity resources should be managed

5. Remuneration policy and practices (MIFIDPRU 8.6) [1]

Remuneration disclosures will still follow CRR requirements due to the remuneration performance period ending after 1 Jan 2022.

SMBC DP currently has no employees and outsources all functions to other SMBC Group companies through an Agency Agreement and Service Level Agreements. SMBC DP has appointed three Independent Non-Executives Directors (INEDs) on its Board that receive a fixed fee for their time. Their aggregate remuneration amounts to $113,000 for FY2021.

As SMBC DP is a proportionality Level 3 firm and forms part of the CM Ltd. Group (also Level 3 on a consolidated basis), which applies the principles of the FCA Remuneration Code through its Remuneration Policy. Due to SMBC DP not meeting the set criteria to be measured as a "significant firm" on an individual basis, the requirement for SMBC DP to have a remuneration committee and other remuneration policies are exempt and are not applicable. Further information on these wider Group policies can be found on the CM Ltd. section of Remuneration disclosures.

[1] Under the Transitional provisions MIFIDPRU TP12.8, the Company is not required to disclose the information about its remuneration policies and practices that would ordinarily be required by MIFIDPRU8.6. Instead, the Company must continue to publish the remuneration information under Article 450 of the UK CRR.