SMBC

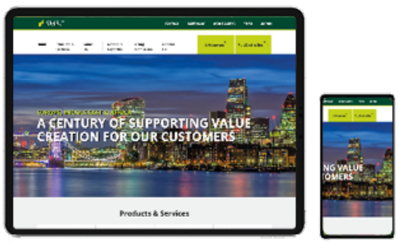
SMBC Group

SMBC DERIVATIVE PRODUCTS LIMITED

MIFIDPRU disclosure report

31 March 2023

Contents



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Document disclaimer

- SMBC Derivative 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.
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- Although the disclosures are designed to provide transparent capital disclosure by banks and 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

Effective 1 January 2022, IFPR is the 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 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.

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 2023.

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. Risk management objectives and policies (MIFIDPRU 8.2)

SMBC DP's Risk function ensures the correct execution of risk management that satisfies all applicable laws, regulations, and best practice. The Risk function is independent from the business areas that generate risk and operates within the overall governance framework of the Company which allows the exercise of professional judgement in an effective and impartial manner.

Per the requirements of MIFIDPRU7.2A, the Risk function is led by the Chief Risk Officer ("CRO") and is independent of operational and business functions, and has sufficient authority, stature, and resources to enact its responsibilities.

The key objectives of the Risk function are:

- To ensure that the Company has in place on an on-going basis a policy framework, which ensures effective identification, measurement, monitoring and reporting of existing key and emerging risks;
- To ensure that the Company has an appropriate Risk Appetite Framework in place, which is observed and maintained in the pursuance of the Company's strategic objectives;
- To ensure that the Company maintains sufficient quality and quantity of capital resources in order to ensure the level and nature of risks being taken are consistent with the Board's expectations at all times;
- To ensure, in conjunction with the Treasury department, that sufficient quality and quantity of liquid resources are in place to meet obligations as they fall due;
- To ensure, in conjunction with the Treasury department, that prudent levels of funding are in place to fund activities even under stressed conditions;
- To manage and minimise risks assumed as a consequence of the business strategy (e.g., Operational Risk, Conduct Risk);
- To maintain an adequate and effective control environment. This includes instances where the Company has outsourced its risk management services (to both internal group companies and external providers);
- To ensure that the Company adheres to the rule and spirit of the laws and regulations governing its business;
- To ensure that relevant risk information is shared with regulators in a timely manner upon request or in circumstances which require escalation in line with Principle 11 requirements.

The Risk Management Framework of SMBC DP sets out the governance arrangements, roles and responsibilities, appetites and limits, reporting and policies that are in place across the Company to manage the risks to the Company. Collectively, these processes meet the requirements of MIFIDPRU 8.2.1 and 8.2.2.

3. Governance arrangements (MIFIDPRU 8.3)

3.1 Corporate structure

SMBC DP, company number 02988637 incorporated in England and Wales, is an investment firm authorised and regulated by the FCA. It is a wholly owned subsidiary of SMBC Nikko Capital Markets Limited ("CM Ltd.") and a member of the Sumitomo Mitsui Financial Group ("SMBC Group").

3.2 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.

3.3 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. The annual report and accounts provide further details for this section and can be found on the SMBC Group's corporate website for the EMEA region (EMEA – Corporate Disclosures (smbcgroup.com).

3.4 Governance structure

The Board retains all decision-making powers though it has delegated some of these to either committees or individuals.

Audit Committee

The Audit Committee is responsible for assisting the Board in i) its oversight and monitoring of the integrity of the financial statements and internal financial controls ii) monitoring and reviewing the effectiveness of the internal audit function. The members of the Committees comprise non-executive directors and it is chaired by an independent non-executive director. The Committee meets quarterly.

Nomination Committee

The Nomination Committee is responsible for assisting the Board in the recommendation and approval of Board and senior management positions. The Nomination Committee also has responsibility for overseeing the process for ensuring that non-executive directors receive a tailored induction on appointment and ongoing development programmes.

The members of the Committee comprise non-executive directors and meets at least once a year.

Risk Committee

The Risk Committee is responsible for assisting the Board in its oversight of risk, reviewing the Company's risk appetite and risk profile, reviewing the risk effectiveness of the risk management framework, reviewing the methodology used in determining the Company's capital requirements and stress testing.

The members of the Committee comprise non-executive directors and meets quarterly.

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.

3.5 Directorships

The below table shows our directors and the number of both internal and external directorships they each serve as of 31 March 2023 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 Bank EU AG	– 5 July 1995 – 5 July 1995 – May 2014 – August 2008 – 26 April 2022
Glenn Swanton	– Non-Executive Director, SMBC Derivative Products Limited – Non-Executive Director, SMBC Leasing (UK) Ltd – Supervisory Board Member, SMBC Bank EU AG	– 3 April 2020 – 2 December 2019 – 26 April 2022
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. For the location of the annual report and accounts please refer to section 3.3.

4. Key metrics

The key metrics dashboard below provides a summary of the capital adequacy positions of DP Ltd. under the IFPR rules.

	31 March 2023 US$'000	31 March 2022 US$'000
Common equity tier 1 (CET1) capital		
Called up share capital	**200,000**	200,000
Retained earnings	**42,972**	35,430
	242,972	**235,430**
CET1 regulatory adjustments		
Intangible assets	**(8)**	(56)
Other	**(532)**	(312)
	(540)	**(368)**
Total CET1 capital	**242,432**	235,062
Total Own Funds (A)	**242,432**	**235,062**
IFPR Own Funds Requirement (B)	**928**	**987**
Own Funds Ratio (note below)	**26135%**	**23820%**

Note: Own Funds Ratio is defined as Own Funds v K-factor Requirement (A/B expressed as a %).

5. 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 8.4, 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	**31 March 2023**	31 March 2022	Cross reference to Table 2
1	**OWN FUNDS**	**242,432**	235,062	
2	**TIER 1 CAPITAL**	**242,432**	235,062	
3	**COMMON EQUITY TIER 1 CAPITAL**	**242,432**	235,430	
4	Fully paid-up capital instruments	**200,000**	200,000	a
5	Share premium	**0**	0	
6	Retained earnings	**42,972**	35,430	b
7	Accumulated other comprehensive income			
11	**(-) TOTAL DEDUCTIONS FROM COMMON EQUITY TIER 1**	**(540)**	(368)	

5.1 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.

5.2 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 Balance sheet as in published financial statements	b Under regulatory scope of consolidation	c Cross reference to Table 1
		31 March 2023		
Assets – Breakdown by asset class according to the balance sheet in the published financial statements				
1	Cash at banks	**262,008**		
2	Trading Securities	**49,987**		
3	Derivative assets	**50,870**		
4	Other debtors	**4,946**		
5	Intangible assets	**8**		
	Total assets	**367,819**		
2	Derivative liabilities	**50,082**		
3	Other creditors	**74,765**		
	Total Liabilities	**124,847**		
1	Called up share capital	**200,000**		a
2	Retained earnings	**42,972**		b
	Total shareholders' equity	**242,972**		

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

		Common Equity
36	Non- compliant transitioned features	No
37	If yes, specify non- compliant features	N/A

6. Own funds Requirements (MIFIDPRU 8.5)

6.1 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) – $614,775, one quarter of the Company's annual fixed overheads (MIFIDPRU 4.5.1.R)
3. K-factor requirements – Total K-factor requirements are $123,438, 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 $927,620), which is the highest of these three.

6.2 K-Factor requirements breakdown

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

	Amount (US$000)	
K-factor requirement: (Sum of)	**31 March 2023**	31 March 2022
K-DTF	**0**	0
K-NPR + K-TCD	**123.4**	354.2
Total K factor assessment	**123.4**	354.2

6.3 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, this requirement is based on the internal harms analysis which captures the financial impact arising from potential risks to the firm, risks to clients and risks to the market.
- In the case of liquidity, due to the simplistic nature of the firm's balance sheet this requirement is based on a two week cumulative net cash flow requirement.

The Company is additionally considered within its parent CM Ltd.'s Solvent Wind Down Plan (SWDP) where an assessment is made of the resources and actions required in order to achieve an orderly wind down (and as a final step, the closure of CM Ltd. Group's regulated business). The SWDP has been structured in accordance with key regulatory expectations and industry practices, such as the guidance set-out in the FCA handbook (MIFIDPRU 7.5).

The above requirements represent the Company's 'threshold requirements' for solvency and liquidity as per the requirements of MIFIDPRU 7.6 and 7.7 respectively.

7. Remuneration policy and practices (MIFIDPRU 8.6)

SMBC DP is classified as a non-SNI MIFIDPRU firm and is subject to the FCA's MIFIDPRU Remuneration Code.

SMBC DP has a Board of Directors that is made up of three Independent Non-Executives Directors (INEDs), one Group Non-Executive Director and three Executive Directors. The three Executive Directors and the one Group Non-Executive Director are members of senior management of other SMBC group entities who provide their services to SMBC DP. In addition, key control function roles in SMBC DP are provided to SMBC DP under the terms of Agency Agreement and Service Level Agreements with other SMBC group companies. Relevant individuals performing activities on behalf of SMBC DP have been identified as material risk takers (MRTs) by virtue of their roles and responsibilities in the Company. SMBC DP has no direct employees.

SMBC Group applies a consistent set of principles across its entities and these are reflected in the principles used to determine the remuneration of those employees and members of staff of other SMBC Group entities who provide their services to SMBC DP.

The principles that guide and support remuneration policies and practices are intended to ensure that these are operated in line with business philosophy, aims and objectives, are in line with all relevant regulations, are risk-focused, and promote effective risk management.

The principles support the operation of gender neutral policies with male and female workers being paid equal pay for equal work or work of equal value.

Incentives are intended to reflect:

- financial performance including capital requirements
- current and future financial and non-financial risk exposures with information provided by the risk function to ensure all relevant financial and non-financial risk exposures are taken into account
- adherence to applicable risk and control frameworks
- conduct behaviours

Core performance criteria include: Customer Focus, Diversity and Inclusion, Enterprise Leadership, Trust & Integrity, Risk, Judgement & Decision Making, Driving Results, Driving Change and Strategic and Visionary.

Remuneration components include:

- Fixed remuneration – salary, benefits and allowances
- Variable remuneration – annual incentive awards

Salary levels are assessed using the following factors and reviewed annually:

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.

Annual incentives are discretionary, and performance based and are awarded based on group, firm and departmental results and individual performance.

Guarantees are used only in exceptional circumstances, only in the case of new hires and only in their first 12 months of service.

Severance payments can be made on termination of employment. Severance payments are not made where there is evidence of poor performance or poor conduct behaviours.

Variable remuneration is subject to malus and clawback that can be applied in situations that include: a deliberate or malicious act, error, accident or negligence. Grounds for performance adjustment of variable pay can also reflect a responsible person's failure to act either to prevent a risk event or where timely action would have mitigated the effects of a risk event. Performance adjustment seeks to take account of matters that were not apparent at the time of the original variable award and may result in the loss of bonus.

Remuneration in performance year 2022

Total amount of remuneration awarded to all staff in USD	
Total fixed remuneration	4,141
Total Fixed remuneration	2,550
Total variable remuneration	1,592

MRTs	
Total number of MRTs	10

Remuneration of all staff	Senior Management	Other MRTs
Total remuneration awarded	3,397	744
Total fixed remuneration awarded	2,062	488
Total variable remuneration awarded	1,335	256

No guarantees or severance payments were made in the relevant time period.

The figures above are in respect of the financial period ending 31 March 2023 – including 12 months of fixed pay to 31 March 2023, and the bonus awards paid in June 2023 for the performance year FY 2022.

The three Executive Directors who are on the Board of SMBC DP receive remuneration for their role in CM Ltd and the Group Non-Executive Director on the Board of SMBC DP receives remuneration for their role in SMBC BI. No additional remuneration is provided for their role in SMBC DP.

SMBC