Solid Financial Services (Cyprus) Limited

Pillar III Disclosures for the FY 2016

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1. Introduction

Solid Financial Services Limited (hereafter referred to as “the Company”) is an investment firm regulated by the Cyprus Securities and Exchange Commission (hereinafter “the CySEC”) under the license number 065/06.

This report has been prepared in accordance with the requirements of Part Eight of European Regulation (EU) 575/2013 (“the Regulation”) and Directives DII144-2014-14 and DI144-2014-15 issued by the CySEC in scope of exercising its powers pursuant to section 73 and 146 of the Investment Services, Activities and Regulated Markets Law (“the Law”) and for the purpose of harmonization with the actions of the European Community titled “Regulation (EU) No.575/2013 of the European Parliament and the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No.648/2012”.

According to Part Eight of the Regulation, the Pillar III disclosures of information shall be published on an annual basis at a minimum and in conjunction with the date of publication of the Company’s audited financial statements for the year 2016, statement audited and reported for the effective 31 December 2016 that contains supplementary information relating to the requirements of the above mentioned Directive.

The CRD is the framework for implementing Basel II in the European Union. Basel II implements a risk sensitive framework for the calculation of regulatory capital.

The Basel II framework is based on three cohesively strengthening pillars:

- Pillar I has to do with the standards that set out the minimum regulatory capital requirements that are required for credit, market and operational risk. These requirements are covered by regulatory own funds, according to the rules and specifications of Pillar I.

- Pillar II covers the Supervisory Review Process which assesses the internal capital adequacy processes. Investment firms have to evaluate and assess whether they should hold additional capital against risks not covered in Pillar I.

- Pillar III (Market discipline) covers transparency and the obligation of firms to disclose meaningful information to the market related to their risks, capital and generally risk management.

On 9 January 2016 the CySEC has issued Circular C038 regarding Prudential supervision – Implementation of CRDIV package. In this respect CySEC has transported Directive 2013/36/EU and the Regulation as follows:

a. The Investment Services and Activities and Regulated Markets Law, as in force, has been amended in order to accommodate a number of articles of the European Directive. The relevant amendments were published in the Official Gazette on 19 December 2014.

b. A new Directive with number DI2014-144-14 for the Prudential Supervision of Investment Firms (the "Directive 2014-144-14") has been drafted in order to incorporate all the remaining relevant articles of the European Directive. The Directive DI2014-144-14 was published in the Official Gazette on 19 December 2014.

c. The Regulation is binding in its entirely and directly applicable in all Member States. However, a number of discretions are included in the regulation and for this purpose, the CySEC has also drafted a new Directive with number DI144-2014-15 on the discretions of the Regulation, which states how the Commission has exercised these discretions. The Directive DI2014-144-15 was published in the Official Gazette on 19 December 2014.

As a consequence of the above, CySEC's Directives DI144-2007-05 on the capital adequacy of Investment Firms and DI144-2007-06 on large exposures of Investment Firms have been revoked.
The Disclosures below have been prepared using the 31 December 2016 data in accordance with the Directive.

2. Governance Arrangements

The Company's Board of Directors constitutes the ultimate administrative body of Solid Financial Services Limited and is responsible for monitoring and supervising the operations of the Company. Members of the board of directors shall at all times to be of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties. The overall composition of the board of directors shall reflect an adequately broad range of experience. Members of the board of directors shall fulfill the requirements set out of subsections (4) to (10) of the Law.

As per article 12(5) of the Investment Law, the number of directorships which may be held by a member of the board of directors at the same time shall take into account individual circumstances and the nature, scale and complexity of the CIF's activities. Unless representing the Republic, members of the board of directors of a CIF that is significant in terms of its size, internal organization and nature, the scope and the complexity of its activities shall not hold more that one of the following combinations of directorships at the same time:

a) one executive directorship with two non-executive directorships;

b) four non-executive directorships

For the purposes of the above, the following shall count as a single directorship:

a) executive or non-executive directorships held within the same group;

b) executive or non-executive directorships held within:

i. institutions which are members of the same institutional protection scheme provided that the conditions set out in Article 113, paragraph (7) of Regulation (EU) No.575/2013 are fulfilled; or

ii. undertakings (including non-financial entities) in which the CIF holds a qualifying holding.

The Company's Board of Directors consists of two Executive Directors and two Non-Executive Directors.

Following a careful consideration of the specific characteristics of the Company, such as the scale, size and complexity of its operations, type of financial instruments traded, financial markets in which trading activity is carried out; the Company's Board of Directors has decided that all of the Disclosures need to be published annually. It has also been decided that the Disclosures will be published only on the Company's website.

Background

The Company has got a license from CySEC, CIF 065/06. *Under its license effectively on 31 December 2016 the Company is entitled to provide the following investment and ancillary services:*

- *Reception transmission and execution of clients' orders;*
- *Dealing on own account;*
- *Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management*
- *Granting credits or loans to investors to allow them to carry out transactions in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction*
- *Foreign exchange services where these are connected to the provision of Investment services*

According to the Directive the Company needs to disclose whether "it has any current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities among the parent undertaking and its subsidiaries". Solid Financial Services Limited confirms that there is not legal impediment to the prompt transfer of own funds or repayment of liabilities.

3. Risk Management

The responsibility for the overall framework of risk governance and management lies with the Board of Directors. The Management recognizes that risk is embedded in all the Company's activities and for this reason it recognizes the need to continually identify, assess, monitor and control each type of risk.
More specifically the responsibilities of the Board of Directors and Senior Management with regards to managing risks are to:

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

The Company's Board of Directors also established a Risk Management Department whose primary responsibility is to oversee the risk management of the Company. The Board was also observing on a regular basis the Minutes of the Risk Management and ICAAP Steering Committee. The main responsibilities of the Risk Management Department are to:

- Establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the Company's activities and processes;
- Monitor the adequacy and effectiveness of its risk management policies and procedures;
- Evaluate customer financial data, especially where the Company grants the customers with a credit or loan;
- Manage risks associated with transactions performed on behalf of clients;
- Monitor risks in respect of the investment risks undertaken, both on aggregate and per customer level.

The Risk Management Department is also responsible for preparing on a frequent basis and at least annually, a report for the Board of Directors. Based on the risk management issues identified the Board of Directors is responsible for taking mitigation actions wherever necessary.

3.1. Credit Risk Management

Credit Risk is defined as the risk when a failure by counterparties to discharge their obligations and could cause the Company to incur a financial loss. Credit risk arises primarily on the Group's own funds deposited with bank institutions and amounts due on clients' positions.

<u>Credit Risk Monitoring and Mitigation</u>

Credit Risk is monitored by management and the risk committee on an ongoing basis.
The Company addresses credit risk in a number of ways including inter alia:

a. depositing the Company's own funds as well as client funds only in highly rated banking institutions in different jurisdictions
b. ensuring that clients cannot begin to trade unless money has been deposited into clients' accounts
c. has the right to close positions, at its discretion, at margin level equal or less than 30% starting from the less profitable
d. the Company offers a negative protection balance policy that implies zero credit risk because of:
   - the necessary margin is tied for any open positions
   - the predefined stop-out levels where clients' positions are automatically closed below a certain level. This does not allow the client to go below zero or lose more than the money already deposited into their account
e. uses prime brokers and establishes agreements with counterparties that are considered highly rated, and in addition conducts its own research in those institutions to verify that they are indeed financially sound and healthy.

Furthermore, the credit risk that arises from client positions is further reduced by the Company's policies and tools, which include manual and automatic stop loss limits in order to prevent any open positions exceeding the Company's pre-set margin.

<u>Credit Risk calculation</u>
The Company follows the Standardized Approach for the calculation the capital requirements for credit risk.

3.2. Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal process, people and systems or from external factors, and exhibiting systematic traits.

Operational risk is divided into the following sub-categories of risks relating among others to:

- Internal fraud and External fraud;
- Marketing and Advertising;
- Regulatory reporting;
- Internal procedures and controls;
- Client communication damage to physical assets business disruption and systems failures;
- Chinese walls;
- Employment practices and workplace safety;
- Conflicts of interest;
- Client and Business Practice;
- Legal risk.

<u>Operational risk mitigation</u>

The Company has established various techniques for the mitigation of operational risk. These techniques include the following:

- Maintaining a four eye structure and implementing board oversight. The Board of Directors reviews significant strategic decisions made by management and monitors their activities.
- The Compliance Officer must ensure the adequacy of any statements made during the marketing and advertising processes and ensure that the information addressed to the client is fair, clear and not misleading.

- The Compliance Officer ensures that proper information/reports are sent on time to the CySEC.
- Management formally communicates duties and responsibilities to employees through regular meetings, seminars and trainings.
- Internal audit visits are implemented to ensure that employees comply with the Company's internal procedures.
- Several policies and procedures have been established and followed in an attempt to identify and minimize any fraudulent activities.
- An online web-based screening program called World-Check is used in an attempt to improve KYC (Know Your Client) procedures and to minimize fraud activities.
- The Company has a comprehensive and detailed disaster recovery plan in place with recovery procedures and actions to be followed in case of crisis situations.
- The Company has a conflict of interest policy.
- The Group obtains an advice from its Compliance Officer for all its official documents and before it enters into new markets. - Financial accounts are audited on a regular basis, eliminating the risk of Company statement manipulation or tax evasion.

Operational Risk calculation

Based on the Company's operations and manner of bearing risks for trading desk the Board of Directors has decided that the Basic Indicator Approach ("BIA") is the most appropriate method to be used to measure the Operational Risk capital requirements. Simplicity in application provides with careful reporting estimator and in accordance to the BIA the operational risk capital requirement is calculated by applying 15% rate on the average sum of the net incomes of the last three twelve-month observations, at the end of the fiscal year.

In the table below the requirements for operational risk presented on 31 December 2016:

Operational Risk	Average (USD)
Revenue	580 041.00
Net Gain/Loss on Trading in Financial Instruments	(59 746.00)
Net fair value gains on financial assets at fair value through profit or loss	-
Interest income	253 746.00
Other operating income	46.00
Net Finance Income/(Cost)	423 383.00
Commissions and other fees payable	(287 545.00)
Net exchange Profit/Loss	14 612.00
Dividend income	-
Total Gross Income	924 537.00

Striving for "operating in excellence" and forthcoming MiFID rigorous requirements in transaction reporting would significantly increase operation risks adhered to en-masse deals on OTC and MTF facilities and comparable to systemic, in addition to multijurisdiction practice with major liquidity and counterparties suppliers under regulatory authorities FCA, ESMA in the Republic and states. Configuration bridging and intertwining complexities of crossings endure high rates of malfunctioning and reconciliation administratives.

Capital Requirements	202.659

3.3. Market Risk

The Company defines market risk as the risk of adverse movements in the level of interest rates, in the rate of exchange between currencies and the current prices of securities, commodities and other financial instruments. Accordingly, these movements may affect the Company's profitability.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fluctuation of market interest rates affects the prices of securities.

The Company's management monitors the interest rates fluctuations and act accordingly however it does not consider interest risk as significant since it does not hold any material interest bearing assets and liabilities.

Foreign Exchange Risk

Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates.

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

Price Risk

Price Risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk and currency risk). The Company is exposed to price risk with regards to its investment portfolio in equity shares which have been classified as available for sale. The management of the Company and the Risk Committee continuously monitor market prices and act accordingly in order to maintain price risk at acceptable levels.

Market Risk mitigation

Below are procedures that have been identified by the Company and are used for market risk mitigation purposes:

- The Company employs a risk manager who is responsible for the monitoring of the Company's risk exposure, any deviation ought to be reported to the risk management committee where appropriate action must be taken.

- Risk management committee is an independent unit reporting directly to the Board of Directors.

- The trading activity is recorded so as to allow the risk committee to review and monitor the Company's exposure in real time.

- Aggregate net exposures are monitored as they develop from the opening and/or closing of positions by clients. If risk exceeds desired levels, appropriate actions should be taken to hedge risk until intended levels are achieved.

- The Company must maintain trading accounts with other regulated Companies for engaging in proprietary positions in financial instruments for its own account as a hedging measure and in order to minimize market risk.

Market Risk calculation

The Company uses the Standardised Approach to calculate the capital requirements of market risk.

3.4. Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting payment obligations and potential payment obligations as and when they fall due without incurring unacceptable losses. Liquidity risk also arises from the inability to find buyers on the terms desired. Infrequently traded securities/assets bear higher liquidity risk. The imbalance between the number of buyers and sellers or because the securities/assets are not traded very often cause the liquidity risk. The liquidity risk is usually reflected in a wide bid-ask spread or large price movements.

Liquidity Risk mitigation

- The Company prepares monthly budgets to ensure that it meets its obligations on time;
- The Company ensures that it has sufficient cash on demand to meet expected operational expenses, including the servicing of its financial obligations;
- The finance department monitors rolling forecasts of the Company liquidity requirements based on expected cash flows in order to ensure that it has sufficient cash to meet its operational needs under normal and abnormal market conditions.

The Company does not consider liquidity risk to be significant as it maintains bank balances which are adequate to cover its liquidity need or potential broker margin requirements.

3.5. Regulatory Risk

Regulatory risk is the risk that the Company may fail to report on time certain information/reports to any local or regulatory body, including but not limited to the Cyprus Securities and Exchange Commission (hereinafter “the Commission”).

Liquidity Risk mitigation

- The Company has documented procedures and policies based on the requirements of relevant Laws and Directives issued by the Commission;
- Each person (i.e. Compliance Officer, Risk Manager, Internal and External Auditors etc.) is responsible to timely prepare and send the reports to the Commission or any other local authority;
- The Compliance Officer acts as a second eye to ensure all the Company’s reports are sent by the relevant persons to the Commission on time.

3.6. Legal and Compliance Risk

The Company is exposed to Legal Risk which can be defined as the risk arising out of legal actions or uncertainty in the applicability or interpretation of contracts, laws or regulations. In other words, the legal and compliance risk may arise as a result of breaches or non-compliance with the legislation, regulations or practices or the imposition of possible penalties from the CySEC.

3.7. Reputational Risk

The Company is exposed to the Reputational Risk which can be defined as the possibility that negative publicity concerning the Company's practices or relations result in a loss in its quality of services, its integrity or its financial solidity, causing substantive losses (i.e. deposits, customers). In particular, reputation risk can materialize in the case of non-compliance with regulations, a breach of ethical values or the perception by the customer of an unfavorable discrepancy between the commercial offering and the reality of staff's practices.

<u>Reputational Risk mitigation</u>

In order to manage its Reputational Risk the Company acknowledges that it is responsible to market changes (including regulatory changes) and ensures that policies and procedures are adhered to.

4. Own Funds

Original Own Funds of the Company include the following:

- Share Capital issued and fully paid;
- Audited reserves (include only Retained Earnings-Accumulated Retained Profits and Audited Profit/Loss for the year);
- Intangible Assets (including goodwill, formation and software expenses) must be deducted from original own funds in compliance with the requirements of Directive DI144-2007-05.

The table below shows the Company's Original Own Funds effective on 31 December 2016

Original Own Funds (Tier 1)	USD'000
Share capital	322.140
Reserves	3 812.865
Income from current year	(52.782)
Intangible Assets	-
Compensation funds	91.639
Total Own Funds	3 990.586

4.2. Share Capital

There were no changes in the share capital of the Company during the year.

Effective 31 December 2016 the Share Capital of the Company comprised 150,000 ordinary shares with a nominal value 1.00 Cyprus Pound (1.71 Euros each).

5. Minimum Required Own Funds for Credit, Market and Operational risks

The different methods used to assess the adequacy of the capital for the described above different categories of risks.

The Pillar I regulatory capital of the Company is calculated on the basis of account balances computed and derived based on the adoption by the Company of the International Financial Reporting Standards (hereinafter the "IFRS") as adopted by the European Union (hereinafter the "EU") and the requirements of the Cyprus Companies Law, Cap 113.

The available regulatory capital is classified under two main categories:

- Tier 1 capital (Common Equity Tier 1 Capital plus Additional Tier 1 Capital);
- Tier 2 capital.

Tier 1 Capital of the Company includes the following:

- Issued Share Capital;
- Audited reserves.

Tier 2 Capital of the Company includes the following:

- Subordinated Loan

The table below represents the minimum capital requirements effective 31 December 2016

Risk Category	Pillar I Capital Requirement
	USD '000
Credit and counterparty risk	825.636
Market risk	177.231
Market risk Equity + FX	1 160.975
Operational risk	202.659
Risk related to Large Exposures in the Trading Book	220.885

TOTAL **2 587 385**

In accordance with Directive of the Cyprus Securities and Exchange Commission DI144-07-05 the Company is submitting capital adequacy reports to the CySEC. These reports include calculation of credit risk, market risk and operational risk. By the end of the year 2016 **the exposure limits capital adequacy ratio was 12.34%**

Comparing to the previous reporting period company with management response has reduction in REPO deals to surpass the regulator requirements, with accounting schema find more appropriate Special Purpose Vehicle for multisided and structured financing deals;

Final Exposures

In the following table the Company's final exposures are represented in geographically, indicating specifically the most material exposures broken down by significant areas.

Cyprus	Russia	England
93,400	6,013,415	980,096

The Company uses Moody's Investor Services for rating its entire portfolio, and is in compliance with the requirements of Directive DI144-2007-05.

The standardized approach: long term mapping

Moody's assessment	Corporate
Aaa to Aa3	20%
A1 to A3	50%
Baa1 to Baa3	100%
Ba1 to Ba3	100%
B1 to B3	150%
Caa1 and below	150%

Exposures by Industry or Counterparty type
The Company's exposures are concentrated in the Financial Services sector. The Company does not have any exposures in other sectors thus the Company has not performed a classification of exposures by counterparty or industry.

6. *ICAAP Process and Capital Management*

2016 the establishment of the Internal Capital Adequacy Assessment Process of Solid Financial Services Ltd has been finalized and ICAAP report was prepared in accordance with the Regulation (EU) No.575/2013 of the European parliament and with the Directive DI144-2014-14 of the Cyprus Securities and Exchange Commission.

The Company used the Minimum Capital Requirement Approach in design of its ICAAP, given the low complexity of its operations and its relatively small size.

Specifically, the ICAAP is designed and implemented in the following steps:

- Identification and articulation of future business plans and objectives;
- Procedure for identification and assessment of risks before and after internal controls;
- Aggregation of identified risks;
- Assessment of the impact of stress test scenarios on forecasted capital plan;
- Capital allocation in accordance with the profile of the risks identified and in line with stress test results.

The Company should enhance its procedures in examining and assessing all material risks and to identify controls to mitigate the risks. In assessing the risks the multiple scenarios were used, not single and the models were run and revaluated to adjust for changes in future expectations.

Were added new dimensions as it assumes breakdowns, illiquidity, market inefficiency, opposed to risk management that takes place under normal market conditions. The Board and senior management was identifying the amount and quality of internal capital in relation to risk profile, strategies and business plan and produce the ICAAP number and assessment. The Company was monitoring closely the risk imposed by the liquidation of MF Global and assess the impact on its capital requirements. The Company enhanced the supervisory review of risk management and regulatory capital and analyzed all relevant portfolios to detect concentration risks.

The Company reinforced the relationship between:

- The Company's risk profile
- Risk Management and mitigation techniques
- Capital

The Company developed and own adequate assessment process that encompasses all the key elements of capital planning and management, and generates an adequate amount of capital against those risks. The budgets and business plans were aligned with capital adequacy and risk management i.e. capital planning.

7. REMUNERATION POLICIES

When establishing and applying the total remuneration policies, inclusive of salaries, for categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on their risk profile, the Company complies with the following principles:

(a) the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the Company;

(b) the remuneration policy is in line with the business strategy, objectives, values and long-term interests of the Company and incorporates measures to avoid conflicts of interest;

(c) the management body, in its supervisory function, adopts and periodically reviews the general principles of the remuneration policy and is responsible for its implementation;

(d) the implementation of the remuneration policy is subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function;
(e) staff engaged in control functions are independent from the business units they oversee, have appropriate authority, and are remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control;
(f) the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the management of the Company;
(g) where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual and of the business unit concerned and of the overall results of the Company and when assessing individual performance, financial and non-financial criteria are taken into account;

The management of the Company is responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the Company concerned. When preparing such decisions, the management takes into account the long-term interests of shareholders, investors and other stakeholders in the Company.