# Pillar 3 Disclosure and Policy

ZKB Securities (UK) Ltd ("ZKBUK" or "the Company") is incorporated in England and is authorised and regulated by the FCA as an investment Company. At the time of the Internal Capital Adequacy Assessment Process ("ICAAP") dated 31st December 2021, according to the FCA's "Prudential sourcebook for Investment Firms" ("IFPRU"), ZKB UK was a IFPRU €730k limited activity firm. The Company is a Solo regulated entity with a Non-EEA parent. This disclosure has been prepared on that basis.

## SUMMARY

The Capital Requirements Directive (CRD) has three Pillars:

- Pillar 1 sets out the minimum capital requirements that the Company is required to meet based on regulator-determined risk weights;
- Pillar 2 requires the Company to carry out the ICCAP to assess the amount of capital that would be adequate to meet Pillar 1 requirements based on its policies, procedures, systems controls and risk management framework and further determine whether it needs additional capital to cover risks that it may be exposed to; and
- Pillar 3 requires the Company to disclose relevant specific information about the underlying risk management framework, capital adequacy and remuneration to encourage market discipline.

ZKB UK has identified its principal risks as Credit Risk, Business Risk and Operational Risk. ZKB UK is required to disclose its risk management objectives and policies for each separate category of risk, which include the strategies and processes to mitigate those risks.

## BACKGROUND

This document is designed to meet the Pillar 3 obligations as required by the Capital Requirement Regulation Art. 431 et seq. References in this ICAAP to European Union Regulations or Directives include, in relation to the United Kingdom, those Regulations or Directives as they form part of the United Kingdom domestic law by virtue of the European Union (Withdrawal) Act 2018 or have been implemented in United Kingdom domestic law, as appropriate. The FCA permits exemptions from disclosures in cases of immateriality, proprietary or confidential information. In the event that any information is omitted, we shall disclose such and explain the grounds why it has not been disclosed.

## RISK MANAGEMENT OBJECTIVE

The Board of ZKB UK is responsible for determining the level of risk that it considers acceptable for ZKB UK to operate at (i.e. the Company's risk appetite). ZKB UK overall has a conservative approach to risk.

Risks are mitigated through the application of limits and controls and a monitoring process at operational level. On a day-to-day basis, the Company has allocated the responsibility to monitor the Company's risk appetite to either the Compliance Officer or CEO as applicable.

## GOVERNANCE FRAMEWORK

On at least an annual basis the ZKB UK meets to review the assessment and consider whether the level of risk that ZKBUK is operating at (i.e. the Company's risk appetite) is acceptable. The Firm will be making Pillar 3 disclosures at least annually. The disclosures will be as at the Accounting Reference Date ("ARD").

## RISK MANAGEMENT FRAMEWORK

Risk management is used to identify and quantify risks faced by ZKBUK, mitigate and manage such risks within the context of the overall risk appetite, and to provide ongoing monitoring of such risks for escalation as needed throughout the year. This is achieved through the strong governance framework, independent reporting, and robust systems and controls, which are regularly reviewed by senior management and independent third parties.

ZKBUK adopts a three lines of defence model which is integral to the operation of the Company on a day to day basis:

1. Under the first line of defence, operational management will have ownership, responsibility and accountability for directly assessing, controlling and mitigating risks.
2. The second line of defence involves checks by the compliance department to monitor and facilitate the implementation of effective risk management practices by operational management and assists the risk owners in reporting adequate risk related information up and down the organization.
3. Internal audit from Zürcher Kantonalbank, as the third line of defence, provides assurance that the two other lines of defence are functioning effectively and ensures its assurance activities encompass the management of risk within ZKBUK. The internal audit function is a group function provided by Zürcher Kantonalbank.

## RISK GOVERNANCE

The Company determines the risks it faces and policies and procedures to manage and mitigate those risks where they exceed acceptable levels.

On an annual basis, the Board of ZKBUK will review and approve the top operational risks it considers as having an important business impact and will set the overall risk appetite. Risk appetite represents the amount of risk that ZKBUK is prepared to assume.

Where the risk levels are being reached, details will be escalated to the Board with appropriate analysis. Below these levels the Board will require the CEO and Compliance officer to track and, as appropriate, investigate items below these trigger points and assess the need for additional controls to mitigate control weaknesses.

## RISK APPETITE

In considering the risk appetite levels it is necessary to take into consideration the following factors:

- Is the risk inherent to the business (e.g. the impact of reduced revenues)?
- Is the risk in our control or does the business accept that as part of operating in this market certain outcomes may be unfavourable?
- Is there a necessary trade-off between risk mitigation costs and business returns (e.g. vendor versus in-house, managing people risk)?
- How material is the residual risk exposure in the context of ZKBUK's financial resources and capitalisation (e.g. tail risks versus capital buffers)?

Risk Appetite is communicated from the Board to business areas and teams at four levels: Very Low, Low, Medium and High.

## CATEGORISATION OF RISKS

ZKB UK recognises it is principally exposed to Credit, Operational and Business Risk.

### Credit Risk

As a policy, ZKBUK does not take on unmatched credit risk on its own account, and any position arising from operational issues will be immediately (at end of day at the latest) closed against Zürcher Kantonalbank. Any potential loss or gain out of such a failed transaction will be booked as operational loss (and is therefore captured in the operational risk assessment).

Therefore, there is little exposure to credit risk, with its principle exposure being to its non-trading book cash held at banks. The exposure calculated in accordance with Pillar I charge is £208,992 which is wholly represented by exposure to Institutions. The Company does not use and ECAIs. However, in carrying out its Pillar 2 scenario analysis it was deemed that £400k was a more appropriate level to cover any Pillar 2 charges.

## Operational Risk

The ZKBUK Board is responsible for setting the Company's operational risk capital requirement. The Pillar I capital for operational risk is calculated using the Fixed Overhead Requirement which equated to £690k. However, given the nature of its business, operational risk is the main source of risk to ZKBUK.

Therefore, for Pillar II an additional assessment has been conducted to determine a sufficient capital buffer to be held for operational risk.

For this assessment operational losses of various categories were considered and a loss distribution for each of the categories calculated, such that multiple occurrences of loss events in each category can be taken into account. To derive an estimate for the capital buffer, the individual operational loss distributions were correlated and a loss bound for an appropriate confidence level determined.

Senior management and the ZKBUK Board reviewed and challenged the operational risk scenarios and operating risk loss estimates.

Such operational risks include:

- Regulatory Compliance risk;
- Financial Crime risk;
- Business Continuity risk;
- Employee risk;
- Technology risk; and
- Order Handling risk

Whilst not a proxy for the Operational Risk Requirement, the ZKB UK Board recognises that the Fixed Overhead Requirement (FOR) is the minimum regulatory capital that must be held and considers it appropriate for the FOR to meet ZKB UK's provision for operational risk. Therefore, ZKB UK's Operational Risk Capital Requirement on 31 August 2020 was £167,000, which was considered sufficient capital for Pillar 2.

## Business Risk

The Board looked at a number of areas which may be considered under the genearl heading of Business Risk including economic recession, loss of key indivuduals, competition, downward commission pressure, regulatory/legal chnage, loss of key client and reputational risk. Of these, it considered an economic recesson to pose the greatest risk to the business and decided it prudent to set aside capital for this risk. The Board did not consider the other risks mentioned above to pose significant risk of harm to the business whihc would lead to any further capital requirement.

A review of historic market falls together with a review of the Bank of England's anchor scenario has shown that a 40% equity market fall would be representative of a severe shock. As a consequence management believe that it is prudent to carry a level of capital which is consistent with such a fall in markets. Management have modelled a 40% fall in both commissions derived from brokerage which after allowing for management actions such as withholding bonus payments and reduction or cancellation of any planned dividend payment would result in an overall loss of approximately GBP 500,000. The assumption that 40% equity market fall would cause a 40% decrease in commissions is extremely conservative – for example the recent equity market fall experienced at the onset of the Corona pandemic was representative of a severe shock however, price volatility stimulated increased trading activity leading to increased trading commissions. This demonstrates that market valuations and commission income are not necessarily linearly correlated. However, the Board believes it to be prudent to model the economic recession scenario with these conservative assumptions.

## Market Risk

The Firm does not hold securitisation positions and therefore there is no Specific Interest Rate Risk to disclose. ZKBUK facilitates each transaction only as a "matched principal transaction", taking on obligations as a riskless intermediary, contracting with both its clients on one side, Zürcher Kantonalbank (which in turn will back out most of the trades to other counterparties in the market) on the other side. ZKBUK will therefore never be exposed to market risk itself throughout the execution of the transaction, with both sides executed simultaneously. There is therefore no separate disclosure to be made.

### Capital Buffers

Due to the size of the firm ZKBUK doesn't have to hold a combined buffer of capital; however, the Board thinks it's prudent to calculate and hold the buffer anyhow. For this ICAAP the Board has agreed to hold £280k combined buffer.

### Other Risks

Although the Firm has substantial cash balances on its Balance Sheet, there is currently no significant exposure to Interest Rate fluctuations. The Firm does not Securitise its assets; is not a Global Systemic Important Institution; has not adopted the Internal Ratings Based Approach; and does not have a Non-Trading Book Exposure to Equities. Therefore no disclosures are made re these items.

## OWN FUNDS DISCLOSURE

As at the 31st December 2021, the Company is an IFPRU Limited Activity Firm. Tier 1 Capital comprises of

Shares and Audited Reserves/LossesThe Pillar 1 capital requirement is defined as the higher of the following:

- Base Capital Requirement (€730,000); OR
- Fixed Overhead Requirement plus the sum of Market and Credit Risk Requirements.

ZKB UK's Pillar 1 requirement as of 31 December 2021, based on the sum of its risks was **£970k**. The Company's Total Capital Resources as of 31st December 2021 are:

| | **£'000** |
|---|---|
| Tier 1 capital | 12,512 |
| Tier 2 capital | 0 |
| Deductions from Tiers 1 and 2 | 0 |
| Total capital resources | **£12,512** |

ZKB UK's Pillar 2 capital requirement is calculated by the Company in accordance with its ICAAP. This includes an assessment of the adequacy of capital resources to support current and future activities and to cover the key risks faced by the business, including relevant stress scenarios. The ICAAP is reviewed and approved at least annually by the ZKB UK board.

Based on its ICAAP assessment, the ZKBUK Board considers that an appropriate level of capital to support current and future business requirements, taking into consideration stress events and various key risk scenarios, is **£2.74m,** which exceeds its Orderly wind-down requirements.

## REMUNERATION POLICY

The ZKBUK Board has delegated the responsibility for its Remuneration Policy to the Remuneration Committee. In determining the Remuneration Policy, the Remuneration Committee may consider, amongst other things, the performance of the individual and the relevant business unit and the overall results of both the Company and the Group.

The Company will ensure that the measurement of performance used to calculate any components of Variable Remuneration: (i) includes a comprehensive adjustment mechanism to integrate all relevant types of current and future risks; (ii) takes into account the cost and quantity of the capital and the liquidity required for the Company; and (iii) reflects the consistency of timing and likelihood of the Company receiving potential future revenues incorporated into current earnings.

It has determined that there are 5 employees that are identified as Code Staff as of 31st December 2021. In line with the proportionality guidance aggregate remuneration has been provided below for Code Staff:

Total remuneration for Code staff in 2021 was:

| | **£'000** |
|---|---|
| Fixed compensation | 317.1 |
| Variable compensation | 150.0 |
| Total | **£467.1** |