SHINKIN INTERNATIONAL LTD

Pillar 3 disclosures for the year ended 31 December 2018

The following information is unaudited

Introduction

The Capital Requirements Directive 2013/36/EU (ñCRD IVò) of the European Union established a revised regulatory capital framework across Europe governing the amount and nature of capital credit institutions and investment firms must maintain. In the United Kingdom, the Directive was implemented by the Financial Conduct Authority (ñFCAò) and the Prudential Regulatory Authority (ñPRAò) in its regulations through the General Prudential Sourcebook (ñGENPRUò), the Prudential Sourcebook for Investment Firms (ñIFPRUò), Regulation (EU) No 575/2013 of the European Parliament and the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 together (ñEU CRRò).

The FCA framework consists of three ôPillarsô

- Pillar 1 sets out the minimum capital amount to meet the firmøs credit, market and operational risk;
- Pillar 2 requires the firm to assess the adequacy of its Pillar 1 capital to meet its risks through the Internal Capital Adequacy Assessment Process (ñICAAPò) and is subject to annual review by the FCA and PRA; and
- Pillar 3 requires disclosure of specified information about the underlying risk management controls and capital position.

Scope and application of the resources

Shinkin International Limited (ñSILò) is a Limited Licence IFPRU 125k firm subject to IFPRU and EU CRR. SIL provides advisory, arrangement and dealing services for Debt Instruments (ñNotesò). SILøs main business involves dealing as principal in the purchase of Notes in the primary market from highly rated international debt issuers (ñIssuersò) or in the secondary market from other securities firms and selling them (back-to-back) in the secondary market to Shinkin Central Bank (ñSCBò), SCBøs wholly owned subsidiary Shinkin Securities Co., Ltd (ñSSCò) and counterparties in UK and other countries including Japan, the EEC, USA and Hong Kong (ñCounterpartiesò). SIL arranges swap transactions in connection with the Notes between Issuers and highly rated swap providers (ñSwap Providersò) and advises SCB and SSC (ñSCB Groupò) on such transactions.

Statement of risk appetite

SILøs risk appetite is very low by design and limited by its business model, its regulatory permissions, the products it trades, the use of delivery versus payment (DVP) trade settlement. It has small counterparty credit risk on fees owed by swap counterparties, which are large financially regulated securities houses or banks. SIL has in place a Control and Risk Management Framework encompassing various policies and procedures to manage its risk.

Risk appetite is approved at board level.

Risk management objectives and policies

SIL has identified the material risks below.

Concentration risk

The nature of SILøs business means that it has potential large credit concentration risk to the SCB Group, its main counterparty to which it sells Notes. Should the SCB Group fail to meet its obligations to purchase Notes from SIL on settlement date SIL would, in turn, be unable to meet its obligations to purchase such Notes from Issuers. Such a settlement failure would theoretically create a large credit exposure to the SCB Group. However, such exposure is, in SILøs case, to be treated as identical to its counterparty credit risk.

Settlement failure, by SIL would most likely be due to operational error, or insufficiency of clear funds in its Euroclear account (ñOperational Errorsò). Operational Errors are considered below under operational risk. Permanent settlement failure is considered below under credit risk. No separate allowance is considered necessary for concentration risk in the ICAAP.

Liquidity risk

SIL holds fully paid up share capital of £30m and retained earnings of £16.1m which is made up mainly of cash held in short term deposits (£11.5m) and investments in fixed rate bonds (£33.2m).

Under normal trading conditions liquidity risk is not generally an issue, however, liquidity risk could become an issue in the event that the SCB Group suffers an insolvency event and is unable to meet its obligations to purchase Notes from SIL. Liquidity risk is separately analysed in the SIL Liquidity Policy document, covering areas of the organisational structures for liquidity management, liquidity monitoring, management, early warning indicators and strategies followed by scenario analysis. SIL follows the rules and guidance as set out in IFPRU 2.2.2. In the managing of its liquidity risk. SIL has high levels of liquidity. No risk capital allowance has been made for liquidity risk in the ICAAP.

Credit risk (including counterparty risk)

Credit risk is determined pursuant to EU CRR Capital Requirement for Credit Risk, Chapter 1 and Chapter 2 specifically; Art 107, 111 ï 122 and 134. Counterparty credit risk is taken into account in regard to the analysis of counterparty risk within the banking book. SIL is a limited licence firm with a ómatched principal brokerô restriction. It does not technically have trading book risk.

Additionally SIL has carried out an analysis of counterparty risk under specific scenarios covering the three types of counterparties SIL contracts with. For counterparties in Notes in the primary market and secondary market, counterparty credit risk is neutralised by settling on a delivery versus payment basis. Counterparty credit risk to swap providers is limited to the amount of arrangement fees due. It is not considered material.

For primary Note issues, SIL has to trade by long settlement. It has a potentially large counterparty credit risk exposure to the SCB Group should the SCB Group permanently fail to settle transactions due to the occurrence of an insolvency event at the critical time of when performance of the contract for the second leg of the Note transaction by the SCB Group is required.

The duration and level of such exposure rests on the ability to cancel the Note issuance prior to settlement. A failure to perform the contract by SCB in the second leg of the transaction would cause a failure of the first leg of the transaction. In this event SIL would failure to perform its contract with a potential to pay some form of ñcostsò based on the difference in price (covering market volatility) to the Issuer for issuing the Notes via another dealer or the lost opportunity to issue Notes at a price advantageous to an Issuer. This again has a low financial impact on SILõs financial soundness.

Credit risk to SCB Group is mitigated by the following factors:

- SIL has clear visibility of SCB Groupõs financial position as a group company and is likely to be notified of financial difficulties and be able to complete outstanding trades and wind down trading in an orderly fashion;
- SCB Group segregates client money and only enters into transactions for Notes with SIL on the basis of back-to-back agreements with clients in Japan; and
- Transactions are cleared through SILõs account at Euroclear which has a US$30million overdraft facility.

The risk relating to SCB Group is included in the counterparty risk capital component for the Credit Risk Requirement in the ICAAP. It is calculated using the EU CRR Mark to Market method for long settlement exposures. Under this analysis settlement exposures were within market convention levels for settlement times. No additional capital was allocated for settlement risk.

SIL holds cash and short term cash deposits with several highly rated Japanese institutions. Most of its bond investments are for terms of 8 years or less issued by supra-nationals, government related institutions and AA or A rated institutions. The associated credit risk is included in the credit risk capital component. In addition SIL has on its balance sheet several non-trading book assets including accrued income, prepaid expenses, VAT due etc. These are included in the calculation of the credit risk capital component.

Internal Capital Adequacy Assessment Process ("ICAAP")

As required by the FCA rules, SIL has an Internal Capital Adequacy Requirement Process. SIL monitors the adequacy of its capital and other resources relative to its risks on a regular basis. The board members review and approve the ICAAP document at least once a year.

Capital Adequacy as at 31 December 2018	£
Own funds	
Paid up capital instruments	30,000,000
Previous years retained earnings	16,092,491
Total capital / Tier 1 capital / Common equity tier 1 (CET1) capital	46,092,491
Risk Exposure Amounts	
Multilateral Development Banks	-
Institutions	12,241,602
Corporates	1,992,771
Covered bonds	99,726
Other items	290,450
Risk weighted exposure amounts for credit	14,624,549
Risk exposure amount for operational risk	5,675,625
Total risk exposure amount	20,300,174
Base own funds requirement: IFPRU 125k firm	112,270
Pillar 1 own funds requirement	
Total capital ratio Requirement : 8% of the total risk exposure amount	1,624,014
Tier 1 capital ratio Requirement : 6% of the total risk exposure amount	1,218,010
CET 1 capital ratio Requirement: 4.5% of the total risk exposure amount	913,508
Surplus of Total capital ratio requirement	44,468,477
Surplus of Tier 1 capital ratio requirement	44,874,481
Surplus of CET 1 capital ratio requirement	45,178,983
Pillar 2 own funds requirement	0
Capital Ratio: Total capital ratio / Tier 1 capital ratio / CET 1 capital ratio	227%
Memorandum Items	
Non-domestic original exposures	41,427,604
Total original exposures	46,682,731

Pillar 3 Remuneration Disclosure

The FCA Remuneration Code (SYSC 19A) applies to solo-regulated IFPRU investment firms within scope of the Capital Requirements Directive (ñCRDò) IV.

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SIL is a solo Remuneration Code Firm. As an IFPRU limited license firm it is categorised as a proportionality level three firm.

The decision-making process used for determining the remuneration policy

The Board of Directors is responsible for human resource issues including terms and conditions of employment, remuneration (fixed and variable).

SIL does not have a remuneration committee. The Board of Directors determines remuneration policy taking full account of business strategy, objectives, values and long term interests of the firm. The Remuneration Policy encourages staff to improve how they undertake work rather than with a focus on how much revenue or profit they can make. Variable remuneration is mostly determined by non-financial performance criteria.

Remuneration Code Staff hold significant influence functions, are senior management, risk takers, or staff who undertake controlled functions and employees receiving remuneration on a par with senior management.

The link between pay and performance

SIL operates two cash bonus (variable remuneration) schemes. One is based on an annual assessment (1 January - 31 December) for local staff who are defined as staff hired in the United Kingdom by SIL (ñLocal Staffò). The second is based on a semi-annual assessment (1 April - 31 March annual time period) for secondee staff from the parent entity, SCB (ñSecondee Staffò). Each of the schemes incentivises staff to deliver a higher than average standard of performance based on a variety of criteria including specific targets agreed by the relevant staff member and their line manager. There is no executive incentive scheme.

Design characteristics of the remuneration system

The financial performance measures for Local Staff are set by the Managing Director and reviewed annually. Financial performance measures for Secondee Staff are limited in scope and are related to the performance of SCB. The financial performance measures do not take into account future earnings streams. The determination of the bonus pool for SIL is made by the Board of directors annually and will be reduced where there is a reduction in profits for the firm.

Code Staff remuneration

SIL has 6 Code Staff whom are Senior Management. Aggregate remuneration expenditure in respect of Code Staff was £921,284. For all Code Staff total fixed remuneration was £833,886 (90.5%). Total variable remuneration was £87,398 (9.5%).