

NKB INVESTMENTS LIMITED

Pillar III Disclosure and Market Discipline Financial Year 2010

**Under Directive 144-2007-05 of the Cyprus Securities & Exchange Commission (CySEC) for
the Capital Requirements of Investment Firms of 2010**

May 2011

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1. Overview of the Capital Requirements Directive

The E.U. Capital Requirements Directive (“**CRD**”) created a revised regulatory framework (commonly known as Basel II) governing how much capital firms are required to maintain. The main purpose of the Basel II revisions was to make the framework more risk sensitive and representative of actual risk management practices. The new framework consists of three Pillars: Pillar I sets out the minimum capital requirements firms are required to meet; Pillar II requires firms to assess their capital requirements in light of any specific risks not captured in the Pillar I calculations; and Pillar III seeks to improve market discipline by requiring firms to publish certain details of their risks, capital and risk management practices.

In Cyprus, the CRD has been implemented by the CySEC Directive for the Capital Requirements of Investment Firms of 2010, and CySEC Directive for Large Exposures of Investment Firms of 2010 (collectively, “**the Directive**”). The Company has prepared these disclosures in accordance with the requirements of the Directive.

The Directive provides that an investment firm may omit one or more of the disclosures if it believes that the information is immaterial. Materiality is based on the criterion that the omission or misstatement of information would be likely to change or influence the decision of a reader relying on that information for the purpose of making economic decisions. Where the Company has considered a disclosure to be immaterial, it has stated this in the document.

The Directive also permits investment firms to omit one or more of the required disclosures if it believes that the information is regarded as confidential or proprietary. The Directive defines proprietary as “...if sharing that information with the public would undermine its competitive position. It may include information on products or systems which, if shared with competitors, would render an investment firm’s investments therein less valuable.” Confidential information is defined as: “Information shall be regarded as confidential if there are obligations to customers or other counterparty relationships binding an investment firm to confidentiality.” Where the Company has omitted information for either of these two reasons, it has stated this in the relevant section and the reasons for this.

2. Company Profile

NKB Investments Ltd (“**NKB**”, “**the Company**”) is a part of the brokerage division of URALSIB Financial Corporation (hereinafter, the “**Group**”), operating as a broker dealer in the Russian equities and fixed income securities markets. Clients and counterparties include banks, other brokers, fund managers, hedge funds, and private equity funds.

NKB is authorised as a Cypriot Investment Firm regulated by the Cyprus Securities and Exchange Commission, licensed to receive and transmit orders in relation to one or more financial instruments, and to execute orders on behalf of clients. The Company does not deal on own account, or provide the investment services of portfolio management or investment advice.

3. Location and Frequency of Disclosure

This document is prepared according to the Company's Pillar III Disclosure Policy. The Company intends to make its Pillar III disclosures annually in a document other than the financial statements. The Disclosures will be uploaded on the website of the Company where they will be publicly available to view and download and as prescribed by the Directive, NKB will state in its financial statements that its Pillar III disclosures are published on the Company website.

These disclosures are based on the position of the Company after the completion of the audit for the financial statements as at 31/12/2010.

The Company has commissioned independent auditors (KPMG Limited, Cyprus) to verify its Pillar III Disclosures. The Company is required by the Directive to provide a copy of the auditor's verification report to CySEC within five months of each financial year-end.

4. Scope of Disclosure

The Company is making the disclosures on an individual (solo) basis.

5. Capital Management

The primary objective of the Company's capital management is to ensure that the Company complies with its regulatory capital requirements per the Directive and that the Company maintains healthy capital ratios in order to support its business and to maximize shareholder value.

The Company manages its capital structure and may make adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Company may adjust or maintain the amount of dividend payment to shareholders or issue additional capital.

The Company did not adjust its capital structure in 2010.

The Company is currently reviewing its Internal Capital Adequacy Assessment Process ("ICAAP") report, whereby it assesses whether additional capital is required to cover any risks not adequately captured in its Pillar I capital requirements calculations. ICAAP is a forward-looking process in which the firm assesses its exposure to all risk categories, making use of a risk assessment methodology, including the use of extreme but plausible scenarios (stress-testing) that could adversely affect the profitability and capital adequacy of the firm.

In performing its ICAAP, the Company has taken the "Pillar I Plus" approach, taking as a starting point the minimum capital calculated according to the CRD (i.e. for credit risk, operational risk and market risk). The Company has then assessed whether the Pillar I minimum capital requirement fully captures the Pillar I risks identified in the CRD, and also whether additional capital is required to

mitigate Pillar II risks (e.g. interest rate risk in the banking book, liquidity risk, economic and legal environment).

NKB's ICAAP covers the period May 2011 to December 2012. The ICAAP report includes an analysis of historic management information reportage and uses conservative assumptions to generate estimates of future profits, Pillar I capital charges and ratios. Capital requirements are forecast under several plausible stressed scenarios. The ICAAP report also contains a capital contingency plan.

6. Risk Management

a. Risk Management Framework

The Board of Directors, which consists of both executive and non-executive members, has responsibility for the overall risk governance of the Company, including aligning business strategy with risk appetite, and ensuring that all key risks are controlled via a robust risk management framework. The following are part of the responsibilities of the Board of Directors in relation to risk management:

- To carry out regular reviews of the Company's risk management policies and procedures as implemented by the management;
- The regular review (at least annually) of written reports concerning compliance, risk management and internal audit policies, procedures and work.

These responsibilities are clearly stated in the Internal Operation Manual of the Company.

The Board receives updates on risk and regulatory capital matters from management. The risk management framework of the Company is incorporated into the Group's risk management framework and is supervised by the Group's Assets and Liabilities Management Committee.

Management is tasked with ensuring that all key risks are effectively and efficiently controlled, and have unrestricted access to the Board to discuss risk, compliance and control issues on an ongoing basis.

The Company has designed its risk management framework to be proportionate to the scale, nature and complexity of the business, and is comprised of:

- Compliance/Risk Management;
- External Audit (KPMG Limited);
- Internal Audit (outsourced);
- Internal Control (URALSIB Group);
- Line Management;
- Online Credit Risk Limit Monitoring System (URALSIB Group proprietary system).

b. Risk Categorisation

i. Credit Risk

Credit risk, which is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation, is the most significant risk borne by the Company. Accordingly, the Company structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one counterparty or group of counterparties, and to industry and geographical segments. Such risks are monitored on a continuing basis and limits are subject to annual review (or more frequently, as market conditions dictate). The credit risk policy and procedures of the Company is documented in a Risk Management Policy Document.

The exposure to any counterparty, including banks and brokers, is further restricted by sub-limits covering “pre-settlement” and/or “delivery” risk, with limits assigned to both types of risk which are set by the Group’s Credit Committee. Actual exposures against limits are monitored daily.

Exposure to credit risk is therefore managed through:

- The regular analysis of the financial soundness of clients and counterparties;
- The setting of appropriate credit limits;
- The ongoing monitoring of credit limits;
- Undertaking credit reviews and limits amendments where appropriate;
- The application of credit mitigation techniques where appropriate.

There are no current or foreseen material practical or legal impediments to the prompt transfer of own funds or repayment of liabilities among NKB and Group members.

ii. Market Risk

Market risk for the Company is comprised of interest rate risk and FX risk as they are presented below.

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 and is measured by the extent to which changes in market interest rates impact margins and net income. The Company has implemented controls to ensure no interest rate risk arises from an inadvertent house position, including daily reconciliations and monitoring of statements, new trades and settlements. The Company’s assets and liabilities are relatively short term and are not sensitive to interest rate movements, other than cash and cash equivalents and investments available for sale¹. Consequently the Company does not consider itself to be significantly exposed to interest rate risk or consequential cash flow risk. The Group’s interest rate policy is reviewed and approved by the Group’s Assets and Liabilities Management Committee.

The table below indicates the effect on the Company’s statement of comprehensive income from reasonably possible changes in the interest rates. The analysis assumes that all variables remain

¹ The Company has no available for sale instruments this year.

constant. An increase for 50 basis points and a decrease of 50 basis points in interest rates at the reporting date would have the following effect:

| Table 1: Sensitivity analysis | | |
|--------------------------------------|--|--|
| | 50bp increase (‘000USD) | 50bp decrease (‘000USD) |
| Variable Instruments | 186 | (186) |

The Company is exposed to FX risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. FX risk is monitored by the Company’s management and managed by the Group according to Group limits. The Group’s Assets and Liabilities Management Committee sets limits on the level of exposure by currencies as well as in total.

iii. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Company manages its operational risk through the following:

- Regular internal audits, with auditors reporting directly to the Board;
- Regular on-site inspections from Group internal control;
- A Business Continuity Plan;
- An Operational Risk Policy.

To ensure an effective operational risk management framework, the Company has documented an Operational Risk Policy Document, which describes the processes and procedures established by NKB Investments Limited in order to identify, monitor and control the operational risks faced in its day-to-day operations, and to ensure these risks are maintained within the Company’s risk tolerance.

iv. Liquidity Risk

The Company is exposed to liquidity risk, which is the risk that an entity will encounter difficulty in meeting obligations associated with its financial liabilities. The Group has designed and implemented a liquidity risk management framework with the objective of ensuring that funds will be available at all times to honour the cash flow obligations as they become due. The Group’s Asset and Liability Management Committee sets limits on the minimum proportion of maturing funds available to cover such cash outflows. The Company manages its liquidity always in accordance with the Company’s policy and regulatory requirements.

The analysis of the Company’s exposure amounts by asset class and residual maturity is presented in the table below.

| Table 2: Exposures by residual maturity for each asset class | | | | |
|---|--|---|-------------------------------|------------------------------------|
| Exposure Classes | On Demand and up to one month ('000USD) | Between one and three months ('000USD) | Over 5 years ('000USD) | Total² ('000USD) |
| Claims or contingent claims on institutions | 77.234 | 795 | - | 78.029 |
| Claims or contingent claims on corporates | 17.802 | - | - | 17.802 |
| Other Items | 119 | - | 84 | 203 |
| TOTAL | 95.155 | 795 | 84 | 96.034 |

7. Capital Base and Adequacy

The own funds of the Company are comprised entirely by Tier 1 capital. Tier 1 capital comprise of share capital, share premium, reserves and the audited income from current year. From Tier 1 capital, intangible assets are deducted. As at the 31/12/2010, the level of own funds was USD 49.346 thousands. **Table 3** below shows a breakdown of the own funds as at 31/12/10.

As at 31/12/2010 the Capital Adequacy Ratio was 111,66% (compared to 79,35% as at 31/12/2009).

The Directive stipulates a minimum capital ratio of 8%.

| Table 3: Capital for regulatory purposes | |
|---|-------------------|
| Description | 31/12/2010 |
| | ('000USD) |
| Ordinary Share Capital | 438 |
| Share Premium | 4.669 |
| Retained Earnings | 43.715 |
| Audited Income from current year | 602 |
| Less: Intangible Assets | (78) |
| Total | 49.346 |

² The analysis in this table does not include the amounts of the total non-current assets i.e. intangible assets and property and equipment

8. Credit, Market and Operational Risk Capital Requirements

Table 4 below shows the capital requirements for the three risks covered by Pillar I of the Directive.

| Table 4: Capital requirements and risk weighted assets by type of risk | | |
|--|----------------------|----------------------|
| Type of Risk | Risk Weighted Assets | Capital Requirements |
| | 31/12/2010 | |
| | ('000USD) | |
| Credit Risk | 35.254 | 2.820 |
| Market Risk | 2.515 | 201 |
| <i>Interest rate risk</i> | 0 | 0 |
| <i>Equity Risk</i> | 0 | 0 |
| <i>Commodity Risk</i> | 0 | 0 |
| <i>FX Risk</i> | 2.515 | 201 |
| Operational Risk | 6.423 | 514 |
| Total | 44.192 | 3.535 |

The exposures and calculation of capital requirements for each risk are analysed below.

a. Credit Risk

The Company has adopted the Standardised Approach for the assessment of capital requirements for credit risk, and has elected to use Fitch Ratings as the External Credit Assessment Institution (“ECAI”) for all classes of exposure. The Company has used the credit step mapping tables provided in the Directive to map credit assessment from the ECAI to risk weightings.

The Company makes use of legally enforceable on-balance sheet netting agreements for credit risk mitigation (“CRM”) purposes with a small number of counterparties in order to manage credit exposures more effectively and thereby minimise aggregate credit risk.

There were no material impaired³ or past due exposures⁴ as at the 31/12/2010 and no provisions were made up to that date.

The exposure classes under which the assets of the company have been allocated under the Standardised Approach for credit risk are as shown in **Table 5** below. The exposures are presented before and after credit risk mitigation techniques have been applied.

³ A financial asset or a group of financial assets is **impaired** if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred ‘loss event’) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets, that can be reliably estimated.

⁴ A financial asset is **past due** when a counterparty has failed to make a payment when contractually due.

| Table 5: Analysis of credit risk exposures, by exposure class | | | | | |
|--|---|-------------------------|--------------------------|-----------------------------|----------------------------|
| Exposure Class Standardised Approach | Average Exposure Pre-CRM during 2010 | Exposure Pre-CRM | Exposure Post-CRM | Risk Weighted Assets | Capital Requirement |
| | (‘000USD) | | | | |
| Claims on central governments | 19 | - | - | - | - |
| Claims or contingent claims on institutions | 80.332 | 78.029 | 69.503 | 17.455 | 1.396 |
| Claims or contingent claims on corporates | 15.046 | 17.802 | 17.588 | 17.588 | 1.407 |
| Other Items | 167 | 212 | 8.952 | 211 | 17 |
| TOTAL | 95.564 | 96.043 | 96.043 | 35.254 | 2.820 |

The tables below present a breakdown of the credit risk exposures by geography, by credit quality step, by exposure asset class, and by industry.

| Table 6: Analysis of credit portfolio credit risk exposures, by geography | | |
|--|-------------------------|--------------------------|
| Region | Exposure Pre-CRM | Exposure Post-CRM |
| | (‘000USD) | |
| Austria | 18.132 | 18.132 |
| United Kingdom | 42.313 | 42.313 |
| Russian Federation | 15.183 | 15.183 |
| British Virgin Islands | 13.767 | 13.767 |
| Cyprus | 2.864 | 2.864 |
| Sweden | 106 | 106 |
| Ireland | 2.130 | 2.130 |
| Other EU | 803 | 803 |
| Rest of the World | 745 | 745 |
| TOTAL | 96.043 | 96.043 |

| Table 7: Pre and post CRM exposures by credit quality step for each asset class | | | |
|--|------------------------------------|-----------------------------------|------------------------------------|
| Exposure Classes | Credit Quality Step (Fitch) | Pre-CRM Exposure ('000USD) | Post-CRM Exposure ('000USD) |
| | | ('000USD) | |
| Claims or contingent claims on institutions | 1 | 62.846 | 54.320 |
| | 3 | 15.183 | 15.183 |
| Claims or contingent claims on corporates | unrated | 17.802 | 17.588 |
| Other Items | n/a | 212 | 8.952 |
| TOTAL | | 96.043 | 96.043 |

| Table 8: Exposures after accounting adjustments but before CRM, by industry | |
|--|---|
| Industry | Exposure as at 31st December 2010 |
| | ('000USD) |
| Governments | 99 |
| Financial Services | 78.029 |
| Other | 17.915 |
| TOTAL | 96.043 |

b. Operational Risk

Given the relatively small size and scale of operations, the Company considers the Basic Indicator Approach the most appropriate method to assess its ongoing operational risk capital requirements. An operational risk capital charge of USD 513.856 has been calculated using this method. In the following table we analyse the calculation of the capital requirements for Operational Risk with the Basic Indicator Approach.

No operational losses (expenses) were taken into account for the calculation of the total net operating income for the three financial years 2008, 2009 and 2010

| Table 9: Operational Risk Capital Requirement – Basic Indicator Approach | |
|---|-----|
| Capital Requirement ('000USD) | 514 |

c. Market Risk

The Company has a market risk capital charge of USD 201.219 relating entirely to FX Position Risk.