

Daiwa Capital Markets Europe Limited

Annual report and financial statements for the year ended 31 March 2017

Company registered number: 01487359

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Chairman's Statement

For the financial year ending 31 March 2017, Daiwa Capital Markets Europe Limited ("Daiwa Europe") made a loss of £83.3 million, compared to a loss of £23.2m in the previous financial year. This deterioration in the headline number, however, masked a significant improvement in the underlying performance of the business, with the operating position before litigation and impairments moving from a loss of £20.2m in the previous year to a profit of £0.9m in the current financial year. Included in the current year loss number is a litigation provision for the "Singularis" case, which the company continues to vigorously defend itself against all claims of wrong doing.

The improvement in Daiwa Europe's trading performance in the past year was principally thanks to an exceptional performance from the Fixed Income Division.

The Fixed Income Division, under new management, as a result of last year's strategic changes, generated impressive above-plan revenue. This improvement was largely thanks to more effective book management and a greater emphasis on facilitating customer flow. The Fixed Income Division's investment in new staff has also paid off. Particular mention goes to the Credit Trading and Repo teams for their major contributions to this excellent result.

Our Debt Capital Markets team had another successful year – in fact their second most-successful year ever in terms of the number of deals. DCM led 8 benchmark Yen transactions, 21 US Dollar transactions and 27 Australian Dollar transactions.

Other businesses found conditions more challenging. A decline in primary issuance in the wake of the Bank of Japan's move to negative interest rates proved a significant headwind for the International Convertible Bonds Division, which reported an overall loss despite a relatively good performance in secondary trading. The Equity Division's performance was equally hampered by weak primary flows, with the business additionally affected as the regulatory changes incorporated in MiFID II starting to bite ahead of implementation in January 2018.

Our newest business, Principal Investments (PI), also underperformed, largely due to a decision to be more prudent ahead of, and in the wake of, the Brexit referendum. Since the vote, PI has rebuilt its pipeline of loans with a change in strategy to focus on major cities away from London and the South East. This reaped rewards in the second half of the year and the pipeline is now much stronger.

Meanwhile, Daiwa Europe's corporate advisory subsidiary DC Advisory (not included within these results) is playing an increasingly important role as a provider of cross-border M&A opportunities for Japanese corporate clients. DC Advisory completed 82 deals in the last financial year, of which 57% were cross-border, including 8 Asia/Europe and 8 Europe/US M&A deals. Looking ahead, the pipeline of Asia/Europe M&A deals continues to build alongside growing collaboration with our Asia Access team and colleagues in the wider Daiwa Group. These excellent results position DC Advisory extremely well as we enter the new financial year.

As we look ahead there are of course challenges. MiFID II and the changes it will bring being one, as is the threat posed by Brexit, to DCME's ability to continue to service its EEA-based clients from London. We are well-advanced with our MiFID II implementation while steps are being taken to ensure that we will be able to continue servicing EEA-based clients post-Brexit regardless of the outcome of the negotiation process.

Daiwa Europe's strong links with Japan are at the heart of our competitive advantage. Most of Daiwa Europe's businesses are now directly linked with Japan, providing European investors with a first-class service for sourcing Japanese and Asian financial products, while playing a key role as a supplier of European products to Japanese investors. Daiwa Europe remains an integral part of the Group's strategy and I look forward to building further on the progress that has been made, focussing on our core strengths in pursuit of delivering exceptional service to our clients globally.

Chairman's Statement

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Junichi Arihara', with a long horizontal flourish extending to the right.

Junichi Arihara
Chairman
Daiwa Capital Markets Europe Limited

Strategic Review

Introduction

The purpose of this report is to provide users of these Financial Statements with an insight into Daiwa Capital Markets Europe's ("DCME") business, strategy and the risks and opportunities associated with that strategy. The report includes commentary on the company's performance, Key Performance Indicators (KPIs), an outline of how DCME is structured, an overview of future prospects and the risks the business faces together with the strategy to mitigate these risks.

Business Model

DCME is the UK subsidiary of Daiwa Securities Group Inc. ("DSGI") and as such our business model is closely aligned to that of our parent group. DCME's purpose, within the group, is to provide access to Japan and Asia for European clients and access to Europe for Daiwa Group clients. That access is in both primary and secondary markets. DCME is authorised and regulated by the Financial Conduct Authority ("FCA").

DCME's primary office, in Europe, is based at 5 King William Street, London. It has branches in Geneva and Bahrain and representative offices in Moscow and Paris.

DCME is structured along product lines, consistent across the Group, which allows for global product strategies and management. Global and local product heads, along with DCME senior management, work together to determine business priorities and strategy.

Review of businesses, performance and strategy

DCME's FY2016/17 pre-tax result was a loss of £83.4m (FY2015/16 loss £20.2m) after taking into account £81m of Net litigation expense (2016: Nil) and £3m Goodwill impairment (2016: Nil). At the Operating profit before litigation and impairments level DCME had a much improved FY2016/17 after a very challenging FY 2015/16 and reported a profit of £0.9m for the year (FY2015/16 £20.2m loss). This was DCME's first Operating profit before litigation and impairments since FY 2009/10. Revenues were up £23.3m (27%) year on year whilst Administrative Expenses increased by £2.2m (2%). The main driver for this improvement was a significantly stronger performance by the Fixed Income Division, particularly in the Credit Trading and Repo desks. Performances across the rest of the DCME businesses were mixed, negatively impacted by weak primary revenue on transactions originated in Japan.

Looking forward DCME foresees market conditions remaining largely benign with occasional volatility engendered by the divergent paths of the Federal Reserve (tightening) and the European Central Bank and the Bank of Japan (both easing quantitatively). The main theme from a strategic perspective will be the impact of the changes to the European Markets in Financial Instruments Directive (MiFID II) (in force from January 2018) upon the traditional Equity brokerage model, and the Fixed Income Division's (FI) on-going decreased reliance upon volatile proprietary trading related income streams. Overall DCME expect the trend of improved performance to continue.

Litigation provision

During the financial year, judgment was handed down in the legal claim brought by the liquidators of Singularis Holdings Limited ("SHL"). The Judge dismissed some of the claims against DCME but held that DCME had been negligent (albeit at a reduced level taking into account contributory negligence on the part of SHL). DCME strongly contests the findings and has been granted leave to appeal the decision. In line with accounting standards DCME has

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made a provision of £100m, covering principal, interest and costs.

Equities

The Equity Division includes investment research and advisory related agency brokerage with a core focus on Pan Asian equities. The division provides investment advice in the form of buy and sell recommendations on listed equities to institutional clients using Daiwa Group's research product. It offers execution services using the Group's access to the Tokyo Stock Exchange and to other Asian exchanges. In addition to secondary equity brokerage, the division distributes equity-linked primary issues originated by other parts of the Daiwa Group. The Pan Asian Equity desk serves a wide range of traditional and alternative fund managers throughout Europe and the Middle East. Additionally, the division provides European research and execution services to Japanese institutional investors and to the Daiwa Securities Group through a distribution partnership with Sanford C. Bernstein.

The Equity Division saw a 14% y-o-y fall in total revenue, with primary activity particularly weak, falling 75% y-o-y.

Primary revenues proved disappointing with no meaningful mandates from Asia ex-Japan and a thin calendar in Japanese offerings, relative to history. The highly cash rich balance sheets of 'Japan Inc.' militate against new equity funding and many of the high profile overseas M&A deals of FY2016/17 were cash funded with ease.

Secondary revenues also proved disappointing with virtually no change y-o-y. This was despite the markets trading well for most of the financial year, in contrast to the prior year which was more challenging. Our Japan Equity revenues dropped 30% y-o-y as investor sentiment about Japan dipped following the bright period of early Abenomics, in FY 2012/13. Our Asian equity revenues broadly stood still even as our market share and market rank in Europe improved. By the end of Q4 2016 we had achieved #13 ranking in Europe up from #16 at the same point in the prior year. Unfortunately with the same regulatory-driven downward pressure on client commissions, as seen in the Japan product line, the value of a rank advance was disappointing in revenue terms. In our European equity product the deployment of more resourcing to service Daiwa's retail network with European stock ideas continued to profit us and we reported a healthy increase in revenues. On the institutional side, revenues derived from our agreement with Bernstein have been disappointing, as Japanese institutions have been relatively inactive in Europe, preferring to buy US assets before and after the US presidential election. Despite this client portfolio inactivity we have maintained our broker poll rankings through the year.

Moving on to FY2017/18 we expect global risk appetite towards equities to continue to be heavily influenced by Central Bank policy creating bouts of volatility but generally underpinning constructive markets. Against this relatively benign background, in Europe there is the challenge of the changes being ushered in by MIFID II. The central tenet of MIFID II in respect of equities – that research and execution must be fully unbundled – disrupts the industry brokerage model that has endured since the 1930's. This environmental challenge is, of course, not unique to Daiwa but aspects of our historic business model add to our risk of disruption. The FCA's requirement that research payments are made by fund managers only for research which can be evidenced as being 'substantive' raises the research quality bar sharply. Daiwa's global research has traditionally had multiple constituents (ranging from retail Japanese investors to overseas institutions). We will therefore need to reposition our research offering. This is a process that began in FY2016/17 and will accelerate in FY2017/18.

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Fixed Income (“FI”)

The Fixed Income Division consists of the following core business lines; Credit Trading; Government Bond Trading; Repo; MTN; Debt Syndication and Sales. The Sales desk is responsible for placement of Daiwa's Fixed Income global product range, both secondary and primary, with European clients. The MTN desk primarily provides a facilitation service to Tokyo's MTN and structured product business. The desk does not take any market or credit risk. The Repo desk provides a financing function to the division, by arranging secured funding for its balance sheet positions. In addition the Repo desk provides a client facilitation service to the Group and external clients by undertaking a financing matched book. The Debt Syndication desk provides origination advice to borrowers and coordinates with other members of a transaction underwriting syndicate.

FI had a much improved year, with revenues increasing 362% y-o-y. The improvement was driven by a strong performance by Credit Trading, which had a particularly tough FY2015/16 as a consequence of that year's bond market dislocation, and Repo. All areas within FI reported improved results, despite a background of volatile fixed income markets following the Brexit vote and the US presidential election. The division made a continuous effort to change the business model to generate revenue through its distribution channel and a higher turnover with its global investor base, and has continued to align and refocus on Daiwa's core strengths. There has been a focus on the Yen rates business to support the global product line and provide a diversified revenue source whilst efforts are being made to maximize the opportunity surrounding primary activity.

Looking forward DCME expects the current FI Division strategy to remain largely unchanged. It is anticipated that the Credit Trading and Government Bond Trading desks will continue the trend of placing less reliance upon volatile trading related revenue streams, and more on the client facilitation business that is becoming more profitable. There will be continued focus on Daiwa's strength in Japan with both Japanese government bonds and other domestic Yen assets maintaining investor focus. The Sales desk anticipates commissions from Tokyo to continue to be a major contributor to revenue as placement of Tokyo inventory to European clients expands. The Repo desk foresees increased repo flows from DCME's parent and the Japanese customer base, as well as continued opportunities from involvement in the peripheral bond market.

International Convertible Bonds (“ICB”)

International Convertible Bonds makes markets in Japanese and Asian convertible bonds to its European and Asian client base, aiming to generate revenues by capturing bid-offer spreads. The division has a presence in both London and Hong Kong which allows it to service clients in both Asian and European time zones. It does not always receive simultaneous matching buy and sell orders so carries some bond inventory awaiting sale. In addition to market making activity, ICB seek to participate in the primary market working closely with Daiwa's Equity Capital Markets (ECM) presence in both Japanese and Asian markets. The Japanese market is where Daiwa has strong corporate relationships and the business retains a market leading position in primary CB deals.

International Convertible Bond's revenue was down 38% against the prior year. Markets in FY2016/17 were mixed with secondary market trading seeing favourable conditions in Japan whilst Asia ex-Japan proved more difficult. Primary markets were more challenging with primary issuance in Japan down 46% in the calendar year. However, in Asia ex-Japan, where DCME has less corporate reach, the overall market issuance was healthy. DCME is entirely reliant on the ECM business in Asia to originate primary transactions.

Looking forward to the year ahead, the business is mature and we assume stability in markets. We expect more balance between Asian P&L and Japan P&L as we anticipate Asia becoming more relevant, as primary issuance

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picks up in the region. Primary expectations can be volatile depending on overall market issuance levels and our share of that issuance, however, our expectation is that conditions will be better over the medium term than they were in FY2016/17.

Debt Capital Markets (“DCM”)

The DCM department forms part of the Investment Banking Division and is primarily a marketing and co-ordination function to develop business with international borrowers in the Primary / New Issue market for debt product, targeted at Japanese and non-Japanese based retail and institutional investors.

DCM had a strong year reporting revenue up 24% y-o-y. During the year DCM completed 8 Yen benchmark deals, 21 US Dollar benchmark deals and 27 Australian Dollar deals. Meanwhile Uridashi; (non-yen denominated bonds issued outside of Japan and sold to Japanese investors); revenue was lower, continuing the trend of recent years that has seen this source of revenue contract.

Looking ahead we have a number of positive areas to focus on, which should help drive the business forward. Daiwa has a strong franchise in Socially Responsible Investment bonds, and this should lead to more business if the sector continues to grow. Our new Australian Dollar initiative has taken strong root, and we expect to see revenue from this structure stabilise. We have a larger pool of potential issuers including several debut names in the Samurai Bond (yen denominated bond issued by a non-Japanese company) market as Japanese investors warm to lower rated credits and European names generally. We are seeing new demand from Tokyo’s retail arm for Emerging Market currency issuance by Supra Sovereign Agency names and there are opportunities to grow this niche product. Daiwa is also well placed in the US Dollar Floating Rate Note space, and this should provide an opportunity for arbitrage business needed to win benchmark deals.

Equity Capital Markets (“ECM”)

The ECM department forms part of the Investment Banking Division and it’s role in primary transactions is to facilitate the international tranches of equity and convertible bond new issues originated in Japan and Asia. Additionally ECM provides pricing and origination support for new convertible bond issues. The placing of these issues is done in conjunction with the Equity and ICB Divisions.

ECM revenue was down 67% y-o-y. After a very strong start to the year in Q1, there was very limited primary issuance throughout the rest of the year. While convertible bond issuance in Japan was strong it tended to be away from our client base. Our expectations are that the primary issuance market will continue to be tough; however, we do expect increased activity in both equity and convertible bonds.

Principal Investments (“PI”)

The aim of the division is to diversify DCME’s revenue by investing the firm’s funds via the provision of loans, for development or bridging finance projects, for residential or student accommodation. Geographically the business is concerned with London, the South East, and regional cities with strong transport links to London.

Following the initial volatility witnessed in the real estate market after the Brexit referendum, PI rebuilt its pipeline of loans from August, completing four new loans, totalling £44m, in Q3.

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Due to the uncertainty surrounding Brexit, PI's strategy has been to focus on major cities outside of London and the South East where there are continued signs of investment and regeneration, such as Manchester, Bristol and Birmingham.

Key Financial and Performance Indicators (KFI/KPIs)

DCME's core objectives are to maximise the return for our shareholder whilst maintaining a strong capital base. KPI's and KFI's are therefore focused on measuring business performance against plan, headcount, return on equity and providing clear visibility on the management of capital, funding and liquidity.

KPIs	<u>2017</u>	<u>2016</u>
Performance against Plan		
Revenue	1%	-30%
Overheads (exc. restructuring costs, goodwill amortisation and impairment)	-4%	11%
Total Headcount (including non-perm staff)	5%	-3%
Voluntary staff turnover	8%	10%
Actual Performance		
Return on Equity (before goodwill impairment and net litigation expense)	0%	-3%
Loss on ordinary activities before tax	(£83.4m)	(£20.2m)

These KPIs show that DCME's revenue for 2017 was on plan after a challenging 2016 and that the company's costs are under control. While DCME and its parent have modest ROE expectations this is an area of focus for management, as the recent track record has been poor.

KFIs	<u>2017</u>	<u>2016</u>
	£m	£m
Capital		
Regulatory Capital Resources	506	586
Tier 1 Capital Ratio	44.8%	58.9%

	<u>2017</u>		<u>2016</u>	
	£'bn		£'bn	
	Usage	Limit	Usage	Limit
Unsecured Funding				
Daiwa Group	0.70	0.88	0.30	1.22

DCME uses Daiwa Group for most of its unsecured funding and all of its capital. This means it is highly sensitive to any changes in the Group's resource allocation strategy. As can be seen in the ratios above, DCME has significant levels of excess capital, which on one hand make achieving a reasonable return on equity difficult, but on the other hand is essential for 'business as usual', as the Large Exposure requirements of the European Capital Adequacy Regulation and Directive (collectively referred to as CRD IV) are linked to capital levels. Without this large capital base DCME could face significant trading volume restrictions as a result of limits within the Large Exposure regime.

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Additionally this capital is a source of funding for DCME and would require replacement with an alternative source if reduced. There are currently no indications from the parent that they are requiring repatriation of capital. On-going litigation poses a risk to DCME's capital position, however, management are optimistic that litigation can be resolved in line with the provisions already made.

DCME uses unsecured funding from the Group to fund balance sheet positions which are not suitable for financing through the secured funding market or where secured funding is prohibitively expensive. Additionally a large part of the unsecured funding is used for regulatory liquidity risk management purposes, in the form of funding DCME's Liquid Asset Buffer (LAB). The unsecured funding facility from the Group is reviewed semi-annually in line with the projected business and liquidity reserve requirements. DCME is particularly sensitive to any change in the funding facility from the Group. A reduction in unsecured funding would require DCME to reduce certain activity, which could impact profitability. The tenor of unsecured funding tends to be in excess of 90 days, which would allow DCME sufficient time to manage any changes in funding in an orderly way. There is currently no indication from the Group that they require a change in the funding profile.

Principal Risks and Uncertainties Facing the Company

Brexit

On 23 June 2016 the UK held a referendum on its continued membership of the European Union (EU). The UK voted to leave the EU and the formal process commenced on 29 March 2017 with the triggering of Article 50 of the Treaty of Lisbon. Article 50 allows for a two year process, during which the UK will remain a member of the EU and will continue to be bound by European law and treaties, for the UK to negotiate an exit deal. The outcome of the UK's withdrawal negotiation, its subsequent status and its continued ability to provide financial services in and out of the EU is currently unclear. There are a wide range of possible outcomes including retaining full access and losing all access to the single market. Timing of the final withdrawal is also unclear as there could be a transitional arrangement to allow both sides more time to complete the UK's withdrawal.

The worst case scenario, for DCME, is that the UK loses all rights to transact with EU clients from 29 March 2019. As a result DCME has commenced a project to evaluate how it will operate in this new environment, with a view to protecting DCME and the Group's European revenue base. It is highly likely that DCME will set up a regulated subsidiary within the European Economic Area (EEA) to allow it to protect and expand its European business. The impact on DCME clients, staff and resources is being carefully considered, with a view to providing sufficient time for a smooth and orderly transition.

Geographic and Market Exposure

DCME's business is focused principally in the capital markets, with its key geographic focus being Japan, Asia (ex Japan) and Europe. As such the company is exposed to the economic and regulatory challenges that impact the industry and geographic locations as a whole.

Group Exposure

While the company operates as a stand-alone entity, meeting the regulatory requirements to survive a failure of the parent undertaking, the reality is that it operates within a wider Group and its fortunes are entwined with the successes and failures of the wider Group.

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The Daiwa Group has a distinct Japanese domestic bias, with a significant retail franchise within the Japanese market. As such, the wider strategic risks and uncertainties faced by the company are similar to those which are relevant to the Parent and Japanese economy as a whole. The Daiwa Group has experienced another year of strong profitability, albeit a y-o-y reduction in profit attributable to shareholders (Group ROE was 8.4%). The performance was against the backdrop of favourable market conditions after the US elections and the continued improvement in Japanese domestic finances. "Abenomics" presents a strategic opportunity to the Daiwa Group, as its fortunes are closely correlated to the success of Japanese stock market and the wider Japanese economy. With this opportunity comes the risk that failure will result in a significant under performance in expected results for the Group and the knock-on implications for individual business lines.

A significant portion of DCME's revenue comes from primary activity (i.e. the origination and distribution of new debt and equity issues for our clients). DCME is reliant on other Daiwa offices for revenue relating to those transactions originating in Japan and Asia. DCME thus has very little control over the outturn related to primary activity, which could result in both positive and negative shocks. Conversely transactions originated by DCME and sold into the Daiwa network will result in a distribution of the fee pool across the Daiwa group. While our expectation is that DCME would be a net beneficiary of this two way activity we are reliant on the rest of the group and not in full control of the outcome. This is, however, a key area of business for the group and a core reason for DCME's existence.

Changes in Group strategy and/or product line strategy could have a direct impact on DCME and its strategy. Differences between Group and local strategy need to be actively managed to avoid negatively impacting DCME. The inclusion of Tokyo senior management on DCME's Board, Japanese Chairman and COO and close communication between DCME Division Heads and their global product heads helps to avoid these types of conflicts.

Resource Constraints / Business Focus

DCME is continuing the process of transforming its business to be less reliant on proprietary trading and more focused on customer driven flow. Despite this, a large part of the business is and will continue to require taking on balance sheet positions in both a proprietary and market making capacity. Taking these positions requires access to both funding and capital, which DCME currently has. There is, however, a risk that with increased focus on return on equity, amongst Japanese firms, that the current low returns will result in the Group re-deploying resources currently allocated to Europe, which would severely constrain the business. Any changes in resource allocation would, however, be carefully considered and implemented in an orderly way.

Conversely a shift away from proprietary activity to client driven activity increases our exposure to our client base and the changing landscape of the global investment community. A strong shift away from our key markets by clients will have a greater impact on our revenue generating ability. Regulation, such as MIFID II poses further risks to our client base.

Daiwa Europe Specific Risks and Uncertainties

DCME continues to maintain its balance sheet in high quality liquid assets, with only 10% of the asset base being invested in sub-investment grade credit (refer to note 28 of the accounts for further details).

Outside of those risks and uncertainties faced by the market and the Group, DCME has its own set of risks and uncertainties which it faces and which management are focused on ensuring that mitigating controls and actions are in place to address. The principal risks and uncertainties faced by the company, outside of economic risks, are as follows:

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Risk	Impact / Probability	Change in risk Y-o-Y	Mitigation of risk
Liquidity risk	High Impact / Low Probability	<p>Central bank policy has started to diverge, with the US tightening while the ECB and BOJ continued to persist with accommodative monetary policy. These programs together with increasing regulatory requirements have continued to drain liquidity from the market.</p> <p>Market conditions, however, have been fairly stable, without any significant liquidity constraints for DCME. Daiwa Group's liquidity position also remains strong.</p>	<p>DCME has a dedicated liquidity risk management section focused on assessment, monitoring and reporting of liquidity risk. The section aims to evolve and improve all aspects of liquidity risk management on a continuous basis, as well as implement the associated liquidity regulations.</p> <p>DCME takes a conservative approach to liquidity risk management. DCME manages liquidity at levels such that it remains (i) cash flow positive over all time periods up to 1 month considered under a combined market and name specific liquidity stress, and (ii) cash flow positive for at least one year under a market stress.</p> <p>DMCE holds a significant Liquid Asset Buffer and the trading portfolio consists of high quality assets most of which are deemed extremely liquid.</p> <p>The FCA imposed further short term liquidity requirements on DCME, requiring the firm to be contractually cash flow positive out to two weeks. While adherence to this requirement comes with additional costs it does mean DCME's short term liquidity position is significantly stronger.</p>
Regulatory changes	High Impact / High Probability	<p>Increased oversight and expectations, from the Regulator, has led to greater requirements for capital and liquidity.</p> <p>New regulation and reporting requirements have increased the need for regulatory and compliance resources, as well as absorbing significantly more of senior management and Board time.</p>	<p>The on-going raft of regulatory changes continues to provide significant challenges to the industry, both in terms of implementation and compliance. Meeting regulatory requirements is not just a high priority for DCME Board members but for the Group as a whole.</p> <p>DCME mitigates the implementation risks by employing experienced regulatory and project staff. A dedicated regulatory policy section was created during the year, to ensure we not only dealt with current changes, but could also be forward looking to address future changes in a timely manner. In addition a regulatory quality</p>

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			<p>assurance section was established to further enhance controls and ensure accuracy and completeness of data amidst the on-going change.</p> <p>The appropriate committees within DCME's governance structure are made aware of the changes, the impact on DCME, the cost and resources required to achieve implementation on the mandatory deadline. The Risk Asset & Liability Committee has detailed oversight of all prudential regulatory change while ultimate responsibility lies with the Board.</p> <p>In addition the compliance and business impact of regulatory change is reduced by maintaining a fairly vanilla product and service offering.</p>
Competitive pressure	High Impact / Medium Probability	<p>Unchanged.</p> <p>Staff turnover in the year was 12.7%, and voluntary turnover was below 8%, which is low for the industry. No material risks crystallised during the year as a result of key staff departures.</p>	<p>The key competitive pressure we face is staff retention, which the company attempts to mitigate by ensuring compensation is competitive and promoting a positive culture of work/life balance.</p>
Operational Risks (not covered separately)	High/Medium Impact/ Medium Probability	<p>Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events and covers a variety of risk factors from rogue trading, securities fraud to BCP events, failure of critical systems.</p> <p>Year on year this risk has remained broadly unchanged, with some improvement to the rate of change in DCME's IT infrastructure offset by heightened market concerns around cyber-crime.</p> <p>During the year DCME experienced a significant IT outage as a result of a failure in one of its outsourced</p>	<p>DCME has a common firm-wide framework overseen by a central Operational Risk Management (ORM) function, with ownership of the actual risks residing with the managers responsible for the relevant business process.</p> <p>DCME utilises a number of firm-wide processes and tools for the identification, recording, assessment, monitoring, prevention and mitigation of operational risks.</p> <p>Risk mitigation actions arising from the core components of the firm's Operational Risk Framework are centrally tracked by ORM and the status reported to the Operational Risk & Compliance Committee.</p> <p>A significant firm wide initiative, to address the risks posed by cyber-crime has been</p>

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		<p>datacentres. While the issue caused some business disruption and increased operational risk for a period of time, there was no financial loss or reputational damage as a result.</p>	<p>implemented, led by Tokyo, with material resources allocated, at the Group level.</p> <p>The outsourced datacentre failure provided us with live examples of where our strengths and weaknesses within our systems are. As a result we have commenced a strategic initiative to improve our resiliency.</p>
Litigation Risks	High Impact / Medium Probability	<p>Exposure to the risk of litigation is an inherent risk in the securities market and is further increased during periods of market volatility and corporate failures.</p> <p>DCME faces litigation risk from both current and historic activities, so while the current business model is simpler than in prior years, the risks remain. Notes 23 and 25 detail the current litigation actions faced by the company.</p> <p>Litigation risks in the market have been increasing over the last few years, as regulatory fines and penalties increase litigation risks on those firms being penalised by the regulator. For DCME this increased risk is offset by a simplification in business model and increased allocation of capital resources.</p>	<p>While DCME's business model is relatively simple and our exposure to litigation has in recent years been limited, our capital market and securities trading activities have nevertheless resulted in potential exposure to litigation arising from events such as the Lehman and Kaupthing collapses. Additionally risks arise from operational events, such as settlements, as evidenced by the Singularis litigation.</p> <p>While our primary approach to mitigating these risks is through appropriate on-boarding controls and risk management techniques combined with good quality, market standard legal documentation; our view based on our own experiences and events in the market is that it is difficult to eliminate these risks entirely.</p> <p>With greater focus on these risks and consideration given to tail risk events, more capital resources are being ring-fenced to protect the firm against adverse litigation.</p>

The strategic report was approved by the Board on 20 June 2017 and signed on their behalf by:



Keith Meekins
Chief Executive Officer

Directors' report

The directors present their annual report on the affairs of Daiwa Capital Markets Europe Limited ('the company'), together with the financial statements and independent auditor's report, for the year ended 31 March 2017.

Principal Activities

Daiwa Capital Markets Europe Limited is a wholly owned subsidiary of Daiwa International Holdings Inc, which is a wholly owned subsidiary of Daiwa Securities Group Inc. ('Daiwa Group'), one of the largest brokerage and banking groups in Japan. The primary activities of the company are to provide investment banking services in Equities, Fixed Income, Convertible Bonds, financing for development real estate projects and Corporate Finance Advisory, through its pan-European subsidiary group Daiwa Corporate Advisory. The company also has a branch network across Europe and the Middle East primarily involved in Equity Sales.

Results and Dividends

The audited financial statements for the year ended 31 March 2017 are set out on pages 20 to 63. The company's loss for the year after taxation was £83.3m (2016: Loss of £23.2m). The Strategic Review provides commentary and background on the company's performance.

The directors do not recommend payment of a dividend in respect of the current financial year (2016: £nil).

Risk Management

In the normal course of its business, the company will be exposed to a range of operational and financial risks including market, credit, liquidity, operational and conduct risks.

Risk management is a major focus for the entire company, to which the management is fully committed. A strong risk discipline is vital in maintaining financial health, providing reassurance to regulators and counterparties and ensuring that business decisions are optimised for risk-return considerations.

The Board is responsible for setting an overall risk appetite based on the company's revenue plans, tolerance for risk and underlying capital base. The Board Risk Committee, chaired by an independent non-executive director, has delegated responsibility, from the Board, for oversight of high-level risk management. The risk management framework includes a governance structure of risk committees and officers, together with a dedicated independent risk function to provide comprehensive risk monitoring, reporting and control. Reporting and control of risk is undertaken both locally within the company and globally within the Daiwa Group.

The company actively manages its exposure to market risk (such as interest rates or foreign exchange) and credit risk, using a variety of techniques including value-at-risk, sensitivity limits, exposure limits, stress testing, diversification, mitigation by collateral and hedging. As part of its hedging activity, the company utilises derivative products such as swaps, futures and options. Notes 28 and 29 to the financial statements provide a full explanation of the company's financial and capital risk management objectives and policies, and exposure to market, credit and liquidity risk.

Financial Instruments

Buying and selling financial instruments, including risk management products, is integral to the company's activities.

Directors' report

Directors' and Officers' Indemnities

The company maintained insurance against liabilities for all directors and officers of the company during the financial year and at the date of this report.

Employee Consultation

The company places considerable value on the involvement of its employees and continues its previous practice of keeping them informed on matters affecting them as employees, and on the various factors affecting the performance of the company, through regular senior management forums, news feeds and other measures.

Charitable Contributions

The company contributed £40,349 (2016: £39,530) to charities during the course of the year.

Disabled Employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

Environmental Measures

Environmental measures undertaken during the year include the recycling of waste, the use of biodegradable disposables and the efficient disposal of obsolete electrical items. Procurement decisions relating to premises actively consider the energy efficiency standards of new equipment. Our consultants are helping us identify better energy efficient approaches to electrical systems, where we aim to exceed legislative standards. We have achieved substantial savings in energy consumption due to improvements in equipment efficiency and controls. In addition, the company continues to support the group in the development of financial product offerings with an environmental theme.

Going Concern

The directors' assessment of the company's ability to continue as a going concern is an ongoing management function. This assessment is based upon an assessment of liquidity & funding, capital adequacy and cash flow forecasts that are prepared by the company and its subsidiaries in the normal course of its resource management. For the purpose of the ongoing assessment, various stress scenarios to the normal operating environment have been identified and considered.

The company's directors believe there are no material uncertainties that may cast significant doubt about the company's ability to continue as a going concern.

Directors' report

Directors

The following directors have held office throughout the year and to the date of these accounts, except where otherwise noted:

Name	Title	Nationality	Appointed / Resigned	Committee Members #
Junichi Arihara	Chairman	Japanese	-	AC, BR, RC, NC
Keith Meekins	Chief Executive Officer	British	-	EC, CC
Jun Hayakawa	Chief Operating Officer	Japanese	-	EC, CC
Hiroki Ikeda	Non-Executive Director	Japanese	Appointed – 1 April 2016	RC, NC, BR
Sung-Ho Kang	Non-Executive Director	Korean	Appointed – 1 April 2016	-
Keiko Tashiro	Non-Executive Director	Japanese	Appointed – 1 April 2016	RC, NC
Douglas van den Aardweg	Independent Non-Executive Director	British	Appointed – 15 May 2017	AC, BR, RC, NC
Polly Williams	Independent Non-Executive Director	British	Resigned – 31 March 2017	-
Peter Goshawk	Independent Non-Executive Director	British	-	AC, BR, RC, NC

Reflects committee membership as at 31 March 2017 or subsequently appointed

BR - Board Risk Committee*, AC - Audit Committee*, RC - Remuneration Committee, EC - Executive Committee, NC - Nominations Committee, CC – Conduct and Reputational Risk Committee

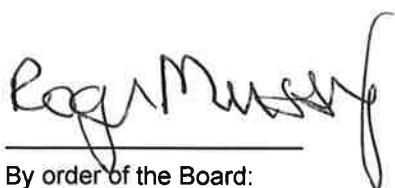
*Membership of the Board Risk and Audit Committees also includes Alex Monnas who is not a DCME Director.

Disclosure of Information to Auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware; and the directors have taken all the steps that they ought to have taken as directors to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Independent Auditors

Pursuant to Section 489 of the Companies Act 2006, the auditors will be deemed to be reappointed and KPMG LLP will therefore continue in office.



By order of the Board:

Roger Massey
Secretary

5 King William Street
London,
EC4N 7DA
20 June 2017

Statement of Directors Responsibilities

Statement of Directors' responsibilities in respect of the Strategic Report, The Directors Report and the Financial Statements

The directors are responsible for preparing the Strategic Report, the Directors Report and the financial statements in accordance with applicable law and regulations.

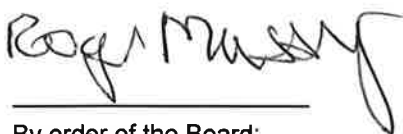
Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 the Financial Reporting Standard applicable in the UK and Republic of Ireland.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



By order of the Board:

Roger Massey
Secretary

5 King William Street
London
EC4N 7DA

20 June 2017

Independent Auditor's Report

Independent Auditor's Report to the Members of Daiwa Capital Markets Europe Limited

We have audited the financial statements of Daiwa Capital Markets Europe Limited for the year ended 31 March 2017 set out on pages 20 to 63. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS 102 the Financial Reporting Standard applicable in the UK and Republic of Ireland.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 17, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2017 and of its loss for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic report and the Directors' report:

- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

Independent Auditor's Report

Independent Auditor's Report to the Members of Daiwa Capital Markets Europe Limited (continued)

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Zaffarali Khakoo (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL

20 June 2017

STATEMENT OF COMPREHENSIVE INCOME
For the Financial Year ended 31 March 2017

	Note	2017 £'000	2016 £'000
Fee and commission income	2	65,741	79,153
Fee and commission expense	2	(30,300)	(21,821)
Net trading revenue	3	33,932	(14,155)
Other income	4	31,057	27,763
Total non-interest income		100,430	70,940
Interest income and similar receivables	5	73,743	62,303
Interest payable and similar charges	6	(64,835)	(47,220)
Net interest income		8,908	15,083
Net operating income		109,338	86,023
Administrative expenses*	7	(108,421)	(106,199)
Operating profit/(loss) before litigation and impairments		917	(20,176)
Goodwill impairment*		(3,038)	-
Net litigation expense*	9	(81,310)	-
Loss on ordinary activities before tax		(83,431)	(20,176)
Tax credit/(charged) on ordinary activities	10	179	(3,050)
Loss for the financial year		(83,252)	(23,226)
Other comprehensive income			
Exchange adjustments on fair value reserve		89	82
Movement on fair value reserve		40	144
Deferred tax recognised in equity		(14)	(46)
Total comprehensive loss for the financial year		(83,137)	(23,046)

*Total administrative expenses (including goodwill impairment and net litigation expense) amounted to £192,769k (2016: £106,199k).

The accompanying notes on pages 23 to 63 are an integral part of the financial statements.

BALANCE SHEET

As at 31 March 2017

Company registered number: 01487359

	Note	2017 £'000	2016 *Restated £'000
Fixed assets			
Intangible assets	11	8,090	14,880
Tangible assets	12	12,715	14,876
Available for sale investments	13	1,270	1,139
		<u>22,075</u>	<u>30,895</u>
Current assets			
Debtors	15	8,206,516	7,251,343
Financial assets held for trading	17	2,410,902	2,555,556
Cash at bank and in hand	18	110,766	91,155
		<u>10,728,184</u>	<u>9,898,054</u>
Current liabilities			
Creditors: amounts falling due within one year	19	(8,690,576)	(7,886,613)
Financial liabilities held for trading	17	(1,449,154)	(1,442,156)
		<u>(10,139,730)</u>	<u>(9,328,769)</u>
Net current assets		<u>588,454</u>	<u>569,285</u>
Total assets less current liabilities		610,529	600,180
Debtors: amounts falling due after more than one year	21	6,152	-
Creditors: amounts falling due after more than one year	22	(1,828)	(1,826)
Provisions for liabilities	23	(102,898)	(3,262)
Net assets		<u>511,955</u>	<u>595,092</u>
Capital and reserves			
Called-up share capital	24	732,121	732,121
Reserves		(220,166)	(137,029)
Shareholders' funds (all equity interests)		<u>511,955</u>	<u>595,092</u>

*2016 comparatives have been restated to reflect DCME's adoption of settlement date accounting (see note 1 (d) page 24).

The financial statements were approved by the Board on 20 June 2017 and signed on their behalf by:



Keith Meekins
Chief Executive Officer

The accompanying notes on pages 23 to 63 are an integral part of the financial statements.

STATEMENT OF CHANGES IN EQUITY

The table below presents the changes in Equity for the year ended 31 March 2017:

	Called-up Share Capital	Fair Value reserve	Capital reserve	Profit and loss account	Total
	£'000	£'000	£'000	£'000	£'000
Beginning of year	732,121	876	13,908	(151,813)	595,092
Loss for the financial year	-	-	-	(83,252)	(83,252)
Exchange differences	-	89	-	-	89
Revaluation of available for sale investments	-	40	-	-	40
Deferred tax liability on fair value gain on available for sale investments	-	(14)	-	-	(14)
End of year	<u>732,121</u>	<u>991</u>	<u>13,908</u>	<u>(235,065)</u>	<u>511,955</u>

The table below presents the changes in Equity for the year ended 31 March 2016:

	Called-up Share Capital	Fair Value reserve	Capital reserve	Profit and loss account	Total
	£'000	£'000	£'000	£'000	£'000
Beginning of year	732,121	696	13,908	(128,587)	618,138
Loss for the financial year	-	-	-	(23,226)	(23,226)
Exchange differences	-	82	-	-	82
Revaluation of available for sale investments	-	144	-	-	144
Deferred tax liability on fair value gain on available for sale investments	-	(46)	-	-	(46)
End of year	<u>732,121</u>	<u>876</u>	<u>13,908</u>	<u>(151,813)</u>	<u>595,092</u>

Notes to the Financial Statements

1 Accounting policies

A summary of the principal company accounting policies is set out below. Except where indicated, they have been applied consistently throughout the current and preceding year.

a) *Statement of compliance*

The financial statements are prepared on the going concern basis, under the historical cost convention, as modified by the revaluation of certain assets, including investments and financial instruments and in accordance with the Companies Act 2006.

The financial statements of the company for the year ended 31 March 2017 have been prepared in accordance with the Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland (FRS 102) issued by the Financial Reporting Council.

b) *Basis of preparation*

The results of the company's overseas branches are incorporated within the company's results. Any exchange gains and losses are reported through the company's profit and loss account.

In accordance with s401 of the Companies Act 2006 the company has not prepared consolidated financial statements on the basis that it is exempt from the obligation to prepare and deliver group financial statements. The company is a wholly owned subsidiary of Daiwa Securities Group Inc. incorporated in Japan, which prepares group financial statements.

These financial statements present information about Daiwa Capital Markets Europe Limited as an individual undertaking and not about its group.

c) *Disclosure exemptions*

In accordance with disclosure exemptions available under FRS 102 set out in paragraph 1.12 (except for the disclosure exemptions from Section 11 Basic Financial Instruments and Section 12 Other Financial Instruments Issues); the directors have adopted certain disclosure exemptions. The directors have not prepared a cash flow statement for the year on the grounds that a parent undertaking included the company in its own published consolidated financial statements.

A reconciliation of the number of shares outstanding at the beginning and at the end of the year has not been presented. The company is exempt from specific share based payment disclosures under share-based payment arrangements that existed during the period and the directors have not made full disclosures. The equivalent disclosures required by FRS 102 are included in the consolidated financial statements of Daiwa Securities Group Inc. in Japan in which the company's results are consolidated. See note 32 for details on where the company's ultimate parent company, Daiwa Securities Group Inc.'s, consolidated financial statements may be obtained from.

Notes to the Financial Statements

1 Accounting policies (continued)

The company is also exempt from disclosing key management compensation in total under Section 33 Related Party Disclosure of FRS 102. Directors' remuneration is disclosed as required by the Companies Act 2006 shown in note 31.

d) Changes in Accounting Policy

Settlement date accounting

The company has adopted the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement. This permits an entity to elect to account for regular way purchases or sales of financial assets on a trade or settlement date basis. During the year ended 31 March 2017 the company voluntarily changed its accounting policy for recognising and derecognising trading financial assets and liabilities to use settlement date accounting. Previously, trade date accounting was applied to recognise and derecognise such transactions. The company believes that this change will better represent the assets and liabilities of the firm for the following reasons:

- It applies a consistent basis for the recognition of all financial instruments at the time at which the contract has been settled, consummated or delivery has otherwise been perfected; and
- It defers the recognition of assets on the statement of financial position at a time when the company is still exposed to settlement risk;
- In accordance with IAS 39 movements in fair value between trade date and settlement date are reflected as they occur, with the movement in fair value taken through profit and loss.

As a result of the change in accounting policy, the prior year comparative balance sheet has been adjusted as follows:

	2016 £'000	Adjustment £'000	2016 Restated £'000
Debtors	8,949,903	(1,698,560)	7,251,343
Financial assets held for trading	2,651,239	(95,683)	2,555,556
Creditors: amounts falling due within one year	(9,604,152)	1,717,539	(7,886,613)
Financial liabilities held for trading	(1,518,860)	76,704	(1,442,156)

As a result of the change in accounting policy, the impact on the current year balance sheet is as follows:

	2017 £'000	Adjustment £'000	2017 Presented £'000
Debtors	9,693,918	(1,487,402)	8,206,516
Financial assets held for trading	2,442,850	(31,948)	2,410,902
Creditors: amounts falling due within one year	(10,250,410)	1,559,834	(8,690,576)
Financial liabilities held for trading	(1,408,670)	(40,484)	(1,449,154)

Notes to the Financial Statements

1 Accounting policies (continued)

e) *Intangible assets*

Goodwill

Goodwill represents the excess of the fair value of purchase price and costs directly attributable to the acquisition over the purchase of identifiable assets acquired and the liabilities assumed on acquisition. Goodwill is capitalised as an intangible asset and amortised through the profit and loss account on a straight line basis over its expected useful economic life. Capitalised goodwill is reviewed for impairment at each reporting date.

Impairment losses recognised for goodwill are not reversed in subsequent periods, even if the reasons for the impairment loss have ceased to apply.

For the purpose of calculating goodwill, fair values of acquired assets and liabilities assumed are determined by reference to market values, where available, or by reference to the current price at which similar assets could be acquired or similar obligations entered into.

Computer software

Computer software is shown at cost less accumulated amortisation and impairment, if any, and reviewed for impairment if necessary. Where appropriate, the labour costs of the company's own employees are capitalised if an asset is self-constructed, provided that those costs are directly attributable to bringing the asset into working condition. Amortisation is provided on these assets at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

Intangible assets:	Rate per annum
Computer software	20 – 33%

Amortisation is not charged on intangible assets until they have been completed and brought into operation.

f) *Tangible assets*

Tangible assets are shown at cost less accumulated depreciation and impairment, if any, and reviewed for impairment if necessary. Depreciation is provided on these assets at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

Tangible assets:	Rate per annum
Computer hardware and other office machinery	20 – 33%
Motor vehicles	25%
Office furniture, fittings and equipment	0 – 33%

Depreciation is not charged on assets in course of construction until they have been completed and brought into operation.

Notes to the Financial Statements

1 Accounting policies (continued)

g) Financial assets and liabilities

The company has adopted the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement (as adopted for use in the EU) and the disclosure requirements of Section 11 Basic Financial Instruments and Section 12 Other Financial Instruments. The scope of IAS 39 applies to all of the company's financial instruments at balance sheet date.

The company classifies its financial assets in the following categories:

Financial assets

The company classifies its financial assets in four categories:

- financial assets at fair value through profit and loss
- loans and receivables (measured at amortised cost)
- held to maturity investments (measured at amortised cost)
- available for sale financial assets (measured at fair value with fair value changes recorded in other comprehensive income)

Management determines the classification of financial assets and liabilities at initial recognition. The company had no assets in the category "held to maturity investments" in the current or prior year.

Financial assets at fair value through profit or loss

Financial assets are classified in this category if they are held for trading. Instruments are classified as held for trading if they are:

- (i) acquired principally for the purposes of selling or repurchasing in the near term, including marketable securities; or
- (ii) part of a portfolio of identified financial assets that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
- (iii) a derivative.

Financial assets included in this category are recognised initially at fair value and transaction costs are taken directly to the profit and loss account. Gains and losses arising from changes in fair value are included directly in the profit and loss account.

Purchases and sales of financial assets held for trading are recognised on settlement date basis, being the date on which legal title to the traded instruments changes hands.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale.

Notes to the Financial Statements

1 Accounting policies (continued)

Loans and receivables with a maturity of greater than one year are initially recognised at fair value including direct and incremental transaction costs. They are subsequently valued at amortised cost, using the effective interest method. Loans and receivables with a maturity of less than one year are recognised at original cost.

Loans and receivables are recognised on a trade date basis, except for cash collateral on repo or similar transactions, which are recognised on a value date basis.

Loans and receivables are assessed at each reporting date to determine whether there is objective evidence of impairment.

An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account. When the company considers that there are no realistic prospects of recovery of the asset, the relevant amounts are written off. If the amount of impairment loss subsequently decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, then the previously recognised impairment loss is reversed through profit or loss.

Available for sale financial assets

Available for sale financial assets are non-derivative financial assets that are designated as available for sale and are not recognised into any of the other categories described above. They are initially recognised at fair value including direct and incremental transaction costs. They are subsequently held at fair value. Gains and losses arising from changes in fair value are included in a fair value reserve until sale when the cumulative gain or loss is transferred to the profit and loss account. The available for sale assets are reviewed for impairment if necessary.

Purchases and sales of financial assets available for sale are recognised on trade date, being the date on which the company commits to purchase or sell the asset.

Financial liabilities

Financial liabilities are measured at the original amount, except for financial liabilities held for trading, which are measured at fair value through profit and loss. Financial liabilities include non-derivative marketable securities, derivative financial instruments or trading liabilities. All financial liabilities not held for trading have a maturity of less than one year. Other financial liabilities (including other payables) are subsequently measured at amortised cost using the effective interest rate method.

Notes to the Financial Statements

1 Accounting policies (continued)

The effective interest rate method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or when appropriate, a shorter period, to the carrying amount of the financial liability on initial recognition. The effective interest rate is determined on the basis of the carrying amount of the financial liability at initial recognition.

h) Investments in subsidiary undertakings

Investments in subsidiary undertakings are stated at cost less impairment.

i) Income and expense

Fee and commission

Fee and commission income is recognised in the profit and loss account when the related services are provided. Fee and commission expense is recognised when services are received.

Net trading revenue

Gains and losses arising from changes in fair value of financial assets and liabilities held for trading are included in the profit and loss account as net trading revenue.

Other income

Other income mainly consists of costs recharged to group companies for services, which are recognised when the services are provided.

Interest income and similar receivables, interest payable and similar charges

Interest income and interest expense are recognised based upon the effective interest method.

j) Determining fair value

Where the classification of a financial instrument requires it to be stated at fair value, this is determined by reference to the quoted bid price or offer price (as appropriate) in an active market wherever possible. Where no such active market exists for the particular asset or liability, the company uses a valuation technique to arrive at the fair value including the use of prices obtained in recent arms-length transactions, discounted cash flow analyses, option pricing models and other valuation techniques commonly used by market participants.

Where appropriate, valuations are adjusted to account for various factors including time value, volatility factors and underlying share prices in respect of options, warrants and convertible bonds; and counterparty credit quality, bid/offer and future administration costs for OTC derivatives.

Profits and losses are only recognised on initial recognition when such profits can be measured solely by reference to observable current market transactions or valuation techniques based solely on observable market inputs.

Notes to the Financial Statements

1 Accounting policies (continued)

For each class of financial assets and/or liability recognised at fair value, the company utilises the following hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities.

Level 2: Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

k) Offsetting of assets and liabilities

Assets and liabilities, which are considered to be financial assets and liabilities for the purposes of FRS 102, are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to either settle on a net basis, or realise the asset and settle the liability simultaneously.

l) Taxation

Current tax is recognised for the amount of tax payable (or receivable) in respect of the taxable profit (or loss) for the current or prior periods using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences arising when items are included in a tax assessment in one period and recognised in the financial statements in another. Deferred tax is calculated using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date that are expected to apply to the reversal of the timing difference.

Deferred tax assets are only recognised to the extent that it is probable they will be recoverable against future taxable profits or deferred tax liability reversals.

Deferred tax assets and deferred tax liabilities are offset only if the group has a legally enforceable right to offset and the amounts relate to taxes levied by the same taxation authority.

m) Pension costs

Pension benefits are provided through a defined contribution scheme (group personal pension plan) to which the company contributes a percentage based on each member's earnings. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

n) Foreign currency

The financial statements are presented in Sterling, which is the functional currency of the company. Items included in the financial statements are measured using their functional currency, being the currency of the primary economic environment in which the company operates.

Notes to the Financial Statements

1 Accounting policies (continued)

Monetary assets and liabilities denominated in foreign currencies at the year end are reported in the functional currency at the rates of exchange prevailing at the year end. Trading profits and losses from dealings in securities denominated in foreign currency are recorded in the functional currency at the exchange rate prevailing at the end of the month in which they arise and any gains or losses arising are reflected in the profit and loss account.

o) Leases

The company enters into operating leases as described in note 25. Rentals under operating leases are charged on a straight-line basis over the lease term. The company has not entered into any finance leases during the year (2016: £nil).

p) Securities purchased/sold subject to resale/repurchase agreements (including stock borrowing and lending)

Securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained on the balance sheet when substantially all the risks and rewards of ownership remain with the company, and the counterparty liability is included separately on the balance sheet as appropriate.

Similarly, where the company borrows or purchases securities subject to a commitment to resell them (a 'reverse repo') but does not acquire the risks and rewards of ownership, the transactions are treated as collateralised loans, and the securities are not included in the balance sheet.

The difference between sale and repurchase price is accrued over the life of the agreement using the effective interest method.

Securities lent to counterparties are retained in the financial statements. Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, at which point the obligation to repurchase the securities is recorded as a trading liability at fair value. Any subsequent gains or losses are included in net trading income.

q) Collateral

The company enters into master agreements with counterparties whenever possible and, when appropriate, obtains collateral. Master agreements provide that, if an event of default occurs, all outstanding transactions with the counterparty will fall due and all amounts outstanding will be settled on a net basis.

The company obtains collateral in respect of customer liabilities where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the company a claim on these assets for both existing and future liabilities. The company also receives collateral in the form of cash or securities in respect of other credit instruments, such as stock borrowing contracts, and derivative contracts in order to reduce credit risk. Collateral received in the form of securities is not recorded on the balance sheet. Collateral received in the form of cash is recorded on the balance sheet with a corresponding liability. Any interest payable or receivable arising is recorded as interest expense or interest income respectively.

Notes to the Financial Statements

1 Accounting policies (continued)

The company measures the market value of the securities borrowed and loaned against collateral on a daily basis. Additional collateral is obtained as necessary to ensure such transactions remain adequately collateralised.

r) *Related party transactions*

In accordance with exemptions granted under FRS 102 the directors have not disclosed related party transactions with other entities included in the consolidated financial statements of Daiwa Securities Group Inc.

s) *Share-based payments to employees*

Daiwa Securities Group Inc., Daiwa Capital Market Europe Limited's ultimate parent company, engages in equity settled share-based payment transactions in respect of services received from certain employees of the company. The fair value of the services received is measured by reference to the fair value of the shares or share options granted on the date of the grant. The cost of the employee services received in respect of the shares or share options granted is recognised in the profit and loss account over the period that the services are received, which is the vesting period. The fair value of the options granted is determined using option pricing models, which take into account the exercise price of the option, the current share price, the risk free interest rate, the expected volatility of the share price over the life of the option and other relevant factors. In respect of vesting conditions related to market conditions, the charges for the services received are recognised regardless of whether or not the market related vesting condition is met.

t) *Deferred Compensation*

The company has various deferred compensation arrangements in place at the year end. Staff compensation may include awards in the form of deferred bonuses in cash and cash-settled share based payments. The vesting of deferred bonuses is dependent on future service and can be subject to claw back provisions.

Deferred bonuses are only payable once the conditions of the deferred arrangement have been met and will, at a minimum, require the employee to be an employee in good standing at the payment date. Deferred compensation costs are recognised over the period of service, if it is more likely than not that the amounts will be paid out. The awards are expensed over the required service period and accruals are adjusted for changes to respective vesting dates the awards are expected to be paid out. Any accrued interest and change in value of share based payments, will be booked through the profit and loss account in the period to which they relate.

u) *Provisions and contingent liabilities*

Provisions are recognised if the company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision is recognised. The amount recognised as a provision is measured at the directors' best estimate of the consideration required to settle the obligation as of the balance sheet date, the expense is recognised in the profit and loss account, taking into account the risks and uncertainties surrounding the obligation.

Notes to the Financial Statements

1 Accounting policies (continued)

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised but are disclosed, unless they are remote.

v) *Impairment of non-financial assets*

The carrying amounts of the company's non-financial assets, such as goodwill and investment in subsidiary, are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. If any such indication exists, the asset's recoverable amount is estimated.

An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. The investment in subsidiary is carried at cost and reviewed for impairment at each reporting date. Capitalised goodwill is reviewed for impairment at each reporting date.

Impairment losses are recognised in the profit and loss account. Impairment losses recognised for goodwill are not reversed in subsequent periods, even if the reasons for the impairment loss have ceased to apply.

Calculation of recoverable amount

The recoverable amount of non-financial assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the expected future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the rate of return expected on an equally risky investment. For an asset that does not generate largely independent income streams, the recoverable amount is determined for the cash generating unit to which the asset belongs.

Reversals of impairment

Where the recoverable amount increases as a result of a change in economic conditions or in the expected use of the asset then the resultant reversal of the impairment loss should be recognised in the current period (with the exception of goodwill).

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

w) *Comparatives*

The comparatives have been adjusted, where necessary, to facilitate comparison with the current year amounts.

2 Fee and commission income and expense

Fee and commission income and expense consists mainly of equity related brokerage commissions and new issue related fees, expenses and shared commissions.

Notes to the Financial Statements

3 Net trading revenue

Net trading revenue is the net gains/(losses) on financial assets or financial liabilities classified as held for trading.

4 Other income

	2017 £'000	2016 £'000
Costs recharged to group companies	30,230	27,637
Profit on disposal of available for sale investments	-	126
Settlement of claim against IT service supplier	827	-
	<u>31,057</u>	<u>27,763</u>

5 Interest income and similar receivables

	2017 £'000	2016 £'000
Interest and dividend income – held for trading	25,884	29,911
Interest income – other financial assets	47,859	32,392
	<u>73,743</u>	<u>62,303</u>

Included in the above is interest receivable from group companies amounting to £18.0m (2016: £9.8m).

6 Interest payable and similar charges

	2017 £'000	2016 £'000
Bank loans and overdrafts	9,217	2,990
Interest expense – held for trading	5,927	6,233
Interest expense – other financial liabilities	49,691	37,997
	<u>64,835</u>	<u>47,220</u>

Included in the above is interest payable to group companies amounting to £20.2m (2016: £9.2m).

Notes to the Financial Statements

7 Administrative expenses

Administrative costs are analysed as follows:	2017	2016
	£'000	£'000
Permanent staff costs (see note 8)	64,139	62,089
Non -permanent staff costs	4,452	4,138
Depreciation of tangible assets (see note 12)	2,535	2,650
Amortisation of intangible assets (see note 11)	4,721	5,110
Premises costs	5,702	5,925
External technology, communication and data costs	15,333	15,457
Net costs recharged by group companies	4,461	3,971
Other costs	7,078	6,859
Total	108,421	106,199

Administrative expenses include the following fees paid to the company's auditors:	2017	2016
	£'000	£'000
Fees payable to the company's auditor for the audit of the company's financial statements	206	181
Fees payable to the company's auditor and its associates for other services:		
- audit related assurance services	195	167
- tax advisory service	3	6
- governance and credit risk review	110	-
- all other services	16	-
Fees payable to un-associated auditor in respect of overseas branch regulatory requirements	75	66

8 Staff costs

Employee costs during the year amounted to:

	2017	2016
	£'000	£'000
Wages and salaries	54,524	53,282
Social security costs	6,162	5,240
Pension costs – defined contribution plan	3,453	3,567
Total	64,139	62,089

Notes to the Financial Statements

8 Staff costs (continued)

The average monthly number of staff employed by the company during the year was as follows:

	2017 Number	2016 Number
Front Office		
Equity	45	50
Fixed Income	37	34
Debt and Equity Capital Markets	19	22
Other (CBs, Derivatives and Principal Investments)	21	21
Back Office Support	234	241
	<u>356</u>	<u>368</u>

The average monthly number of staff employed by the company overseas (included above) was as follows:

	2017 Number	2016 Number
<i>Branches</i>		
Bahrain	7	8
Geneva	11	10
	<u>18</u>	<u>18</u>
<i>Representative office</i>		
Moscow	3	3
Paris	2	3
	<u>23</u>	<u>24</u>

9 Net litigation expense

In the year, £81,310k, net of insurance was provided against pending litigation.

Notes to the Financial Statements

10 Tax charge on ordinary activities

The tax credit/(charge) is based upon the standard UK corporation tax rate of 20% (2016: 20%) and comprises:

	2017 £'000	2016 £'000
UK and overseas corporation tax:		
Prior year	128	-
Overseas taxation	51	-
Company tax credit for the year	<u>179</u>	<u>-</u>
Deferred tax:		
Timing differences, origination and reversal	-	(3,050)
Total deferred tax credit/(expense)	<u>-</u>	<u>(3,050)</u>
Total tax credited/(charged) on ordinary activities	<u>179</u>	<u>(3,050)</u>

The tax assessed on the loss on ordinary activities for the year is lower than the standard UK corporation tax rate.

The reconciliation is provided below:

	2017 £'000	2016 £'000
Loss on ordinary activities before tax	<u>(83,431)</u>	<u>(20,176)</u>
Taxation at UK standard corporation rate of 20% (2016: 20%)	16,686	4,035
Effects of:		
Permanent differences	(52)	(54)
Effects of unrecognised timing differences including losses	(16,634)	(3,981)
Overseas taxation	51	-
Effect of reversal of deferred tax on previously recognised losses	-	(3,050)
Group relief surrendered	<u>128</u>	<u>-</u>
Company tax credit/(charge) for the year	<u>179</u>	<u>(3,050)</u>

The company has a net deferred tax liability of £0.2m (2016 £0.2m). This is attributable to deferred taxation that would arise if the timing differences on investments held for sale were realised after the end of the reporting period.

Notes to the Financial Statements

10 Tax charge on ordinary activities (continued)

A residual deferred tax asset totalling £58.1m for all timing differences including UK tax losses and capital allowances has not been recognised because it is the directors' assessment that it is not sufficiently certain that there will be sufficient taxable profits available in the foreseeable future against which these losses and allowances can be utilised (2016: unrecognised deferred tax asset £49.9m).

Reductions in the UK corporation tax rate to 19% from 1 April 2017 and a further reduction to 17% (effective from 1 April 2020) were substantively enacted on 6 September 2016. This will reduce the company's future current tax charge accordingly. The deferred tax liability at 31 March 2017 has been calculated using the rate of 17% substantively enacted at the balance sheet date and is the tax rate applicable for the period in which the asset is expected to realise.

The effect of the rate reductions has created a reduction in the residual tax asset which has been included in the figures above.

11 Intangible assets

	Goodwill	Software	Assets in course of construction	Total
Cost	£'000	£'000	£'000	£'000
Beginning of year	29,180	33,454	1,824	64,458
Additions	-	-	969	969
Disposals	-	(4,218)	-	(4,218)
Transfers	-	1,909	(1,909)	-
End of year	<u>29,180</u>	<u>31,145</u>	<u>884</u>	<u>61,209</u>
Amortisation				
Beginning of year	21,219	28,359	-	49,578
Charge	1,723	2,998	-	4,721
Impairment charge	3,038	-	-	3,038
Disposals	-	(4,218)	-	(4,218)
End of year	<u>25,980</u>	<u>27,139</u>	<u>-</u>	<u>53,119</u>
Net book value				
At 31 March 2016	<u>7,961</u>	<u>5,095</u>	<u>1,824</u>	<u>14,880</u>
At 31 March 2017	<u>3,200</u>	<u>4,006</u>	<u>884</u>	<u>8,090</u>

The assets in course of construction comprise computer software.

Notes to the Financial Statements

11 Intangible assets (continued)

On 19 November 2010 the company acquired the global convertible bond (ex-US) business of KBC, via an asset purchase. The goodwill arising on acquisition is being amortised on a straight-line basis over ten years. This is the period over which the directors estimate as the useful economic life.

The company's accounting policy is to carry goodwill at amortised cost and review for impairment at each reporting date. A review of impairment of goodwill is measured as the difference between the carrying amount of the asset and its recoverable amount, with the recoverable amount being based on the higher of the fair value less costs to sell and value in use of the assets to which it relates.

In the opinion of the directors, the most appropriate estimate of the recoverable amount is the value in use of the Convertible Bond business. The value in use is measured by discounting cash flows, over a period of 3 years plus the terminal value, applying a discount rate of 25% and a perpetuity growth rate of 1.25%, this is consistent with the prior year.

Based on the conservative end of the discount range and a mid-point growth rate, as being the best indication of the value in use, the director's believe there has been an impairment to the carrying value of the goodwill and have written it down by £3,038k.

12 Tangible assets

	Furniture, fittings and equipment £'000	Computer hardware £'000	Motor vehicles £'000	Assets in course of construction £'000	Total £'000
Cost					
Beginning of year	14,609	5,926	39	119	20,693
Additions	-	-	-	374	374
Disposals	-	(139)	-	-	(139)
Transfers	47	247	-	(294)	-
End of year	<u>14,656</u>	<u>6,034</u>	<u>39</u>	<u>199</u>	<u>20,928</u>
Depreciation					
Beginning of year	2,826	2,952	39	-	5,817
Charge	1,294	1,241	-	-	2,535
Disposals	-	(139)	-	-	(139)
End of year	<u>4,120</u>	<u>4,054</u>	<u>39</u>	<u>-</u>	<u>8,213</u>
Net book value					
At 31 March 2016	<u>11,783</u>	<u>2,974</u>	<u>-</u>	<u>119</u>	<u>14,876</u>
At 31 March 2017	<u>10,536</u>	<u>1,980</u>	<u>-</u>	<u>199</u>	<u>12,715</u>

The assets in course of construction comprise furniture, fittings and equipment, and computer hardware.

Notes to the Financial Statements

13 Available for sale investments

	2017	2016
	£'000	£'000
Unlisted investments	1,270	1,139

The movement in the year was as follows:

	2017	2016
	£'000	£'000
Beginning of year	1,139	916
Exchange differences	91	85
Revaluation profit transferred to reserves	40	144
Disposals	-	(6)
End of year	1,270	1,139

14 Investments in subsidiary undertakings

The company had one subsidiary undertaking as at 31st March 2017. The percentage of the issued share capital held by the company is equivalent to the percentage of voting rights held.

Name of company	Country of reg office	Principal activity	Percentage of equity and voting rights held
Daiwa Corporate Advisory Holdings Limited	UK	Investment Holding Company	100%

The movement in the company's investments in subsidiary undertakings was as follow:

	2017	2016
	£'000	£'000
Beginning of year	-	-
Disposal	-	-
End of year	-	-

Notes to the Financial Statements

14 Investments in subsidiary undertakings (continued)

The company's accounting policy is to carry investments in subsidiary undertakings at cost and review for impairment at each reporting date. Impairment of the investment in subsidiary was measured as the difference between the carrying amount of the asset and its recoverable amount, with the recoverable amount being based on the higher of the fair value less costs to sell and its value in use.

In the opinion of the directors, the most appropriate estimate of the recoverable amount is the value in use of Daiwa Corporate Advisory Holdings Limited. The value in use is measured by discounting cash flows, over a period of 3 years, plus the terminal value, applying a discount rate using a high – low range of 14% – 22% and a perpetuity growth rate range of 1.5% to 2.0%, consistent with the prior year. In the opinion of the directors, the nil carrying value of the investment remains appropriate.

15 Debtors

Debtors comprise the following amounts:

	2017			2016		
	Financial Assets	Non Financial Assets	Total	Financial Assets	Non Financial Assets	Total
	Loans and Receivables	Other		Loans and Receivables	Other	
	£'000	£'000	£'000	£'000	£'000	£'000
Trade debtors	8,932	-	8,932	8,939	-	8,939
*Amounts owed by parent group undertakings	5,286,436	-	5,286,436	3,902,511	-	3,902,511
Amounts owed by subsidiary undertakings	8,186	-	8,186	19,667	-	19,667
VAT	-	1,027	1,027	-	687	687
Deposits paid for reverse repurchase agreements and securities borrowed	2,844,768	-	2,844,768	3,274,201	-	3,274,201
Other debtors	33,243	-	33,243	17,708	-	17,708
Corporation tax recoverable	-	95	95	-	88	88
Prepayments and accrued income	16,261	7,568	23,829	18,053	9,489	27,542
	<u>8,197,826</u>	<u>8,690</u>	<u>8,206,516</u>	<u>7,241,079</u>	<u>10,264</u>	<u>7,251,343</u>

*Amounts owed by parent group undertakings includes £5,193m for Deposits paid for reverse repurchase agreements ; (2016: £3,859m).

Notes to the Financial Statements

15 Debtors (continued)

The carrying amount of debtors approximates to their fair value. All debtors are due within one year.

The company's accounting policy is to carry loans and receivables at amortised cost and review for impairment where necessary. As at 31st March 2017, in the opinion of the directors, the £27.7m impairment against the intercompany loan to Daiwa Corporate Advisory Holdings Limited remained appropriate. For purposes of valuation the loan is treated as an equity investment and compared against the value in use. The value in use is measured by discounting cash flows, over a period of 3 years, plus the terminal value, applying a discount rate using a high – low range of 14% – 22% and a perpetuity growth rate range of 1.5% to 2.0%, consistent with the prior year. The directors are comfortable that the carrying value of the loan is reasonable based on the value in use calculation.

Prepayments and accrued income include £91,030 of defined contribution pension scheme prepayments (2016: £112,825) in relation to certain overseas branch pension schemes.

16 Deferred tax

	2017 £'000	2016 £'000
Deferred tax liability (note 19)	(242)	(228)
The movement in the year was as follows:		
	2017 £'000	2016 £'000
Beginning of year	(228)	2,868
Charged to the Income Statement	-	(3,050)
Charged to the Reserves	(14)	(46)
End of year	(242)	(228)

The deferred tax liability is attributable to the taxation that would arise if the timing differences on Available for sale investments was realised after the end of the reporting period.

17 Financial assets and liabilities held for trading

The company's financial assets and liabilities held for trading consist of marketable securities, classified as held for trading, and derivative financial instruments, comprising futures and forwards, options, swaps and forward foreign currency contracts. Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale and excludes accrued interest.

Notes to the Financial Statements

17 Financial assets and liabilities held for trading (continued)

	2017	2016
	£'000	£'000
Financial Assets		
Non Derivative marketable securities		
Equities	2,716	4,061
Government, Government Agency Bonds, and Municipal Bonds	463,378	727,975
Corporate Debt (inc Convertible Bonds)	1,429,806	1,231,311
Total	1,895,900	1,963,347
of which listed	1,653,496	1,904,972
Derivative financial instruments		
Futures & Forwards	2,377	3,134
Options	49,645	33,595
Swaps	462,980	555,096
Other	-	384
Total	515,002	592,209
of which listed	167	118
Total financial assets held for trading	2,410,902	2,555,556
Financial Liabilities		
Non Derivative marketable securities		
Equities	90,728	30,820
Government, Government Agency Bonds, and Municipal Bonds	625,209	550,726
Corporate Debt (inc. Convertible Bonds)	224,495	254,682
Total	940,432	836,228
of which listed	781,678	799,550
Derivative financial instruments		
Futures & Forwards	3,320	2,137
Options	42,860	28,983
Swaps	460,762	573,094
Other	1,780	1,714
Total	508,722	605,928
of which listed	739	263
Total financial liabilities held for trading	1,449,154	1,442,156

Notes to the Financial Statements

18 Cash at bank and in hand

Cash at bank and in hand for the company includes deposits of £1,608,234 (2016: £7,019,572) with the parent group undertakings.

The carrying amount of cash at bank and in hand approximates to its fair value.

19 Creditors: amounts falling due within one year

	2017			2016		
	Financial Liabilities	Non financial Liabilities	Total	Financial Liabilities	Non financial Liabilities	Total
	Other	Other		Other	Other	
	£'000	£'000	£'000	£'000	£'000	£'000
Other short term borrowings	79,911	-	79,911	34,732	-	34,732
Overdrafts	15,041	-	15,041	6,164	-	6,164
Trade Creditors	13,335	-	13,335	21,082	-	21,082
*Amounts owed to parent group undertakings	1,705,366	-	1,705,366	1,032,191	-	1,032,191
Deposits received for repurchase agreements and securities lent	6,841,594	-	6,841,594	6,762,628	-	6,762,628
Deferred Tax Liability	-	242	242	-	228	228
Other creditors:						
- social security and PAYE	-	1,392	1,392	-	1,669	1,669
- other creditors	6,484	11	6,495	3,171	10	3,181
Accruals and deferred income	27,200	-	27,200	24,738	-	24,738
	<u>8,688,931</u>	<u>1,645</u>	<u>8,690,576</u>	<u>7,884,706</u>	<u>1,907</u>	<u>7,886,613</u>

*Amounts owed to parent group undertakings includes £691m for Deposits received for repurchase agreements; (2016: £472m).

Notes to the Financial Statements

19 Creditors: amounts falling due within one year (continued)

The carrying amount of creditors approximates to their fair value.

The company had a total unsecured borrowing facility of ¥123bn/£0.881bn (2016: ¥198bn/£1.224bn) from Daiwa Securities Company Ltd which was provided on an uncommitted basis, as at 31 March 2017 and at 31 March 2016. At 31 March 2017 ¥98bn/£0.701bn (2016: £¥48bn/£0.3bn) was drawn on the facility.

There are no amounts included within overdrafts due to group undertakings (2016: £nil). The company has £15,040,492 due to clearing agents which is secured principally by securities held on the company's trading accounts with those clearing agents (2016: £6,164,462).

Included in accruals and deferred income is an amount of £953,914 for penalties and interest on a US withholding tax assessment, currently in dispute. While the likelihood of the company having to pay penalties is high the amount is uncertain, as the IRS may apply a range of penalties. The company is in regular dialogue with the IRS on this subject. The company has provided for the likely penalties plus interest.

Accruals and deferred income include defined contribution pension schemes accruals of £1,032 all of which relates to certain overseas branch pension schemes (2016: £777 all of which related to certain overseas branch pension schemes).

20 Analysis of Financial Assets and Liabilities by Measurement Basis

	Financial Assets and Liabilities measured at fair value £'000	Available for Sale Investments £'000	Financial Assets and liabilities at amortised cost £'000	2017 Total £'000
Financial Assets				
Cash at bank and in hand	-	-	110,766	110,766
Financial assets held for trading	2,410,902	-	-	2,410,902
Available for sale investments	-	1,270	-	1,270
Debtors – Loans and Receivables	-	-	8,197,826	8,197,826
	<u>2,410,902</u>	<u>1,270</u>	<u>8,308,592</u>	<u>10,720,764</u>
Financial Liabilities				
Financial liabilities held for trading	1,449,154	-	-	1,449,154
Creditors falling due within one year – Financial Liabilities	-	-	8,688,931	8,688,931
Creditors falling due after one year	-	-	1,828	1,828
	<u>1,449,154</u>	<u>-</u>	<u>8,690,759</u>	<u>10,139,913</u>

Notes to the Financial Statements

20 Analysis of Financial Assets and Liabilities by Measurement Basis (continued)

	Financial Assets and Liabilities measured at fair value	Available for Sale Investments	Financial Assets and liabilities at amortised cost	2016 Total
	£'000	£'000	£'000	£'000
Financial Assets				
Cash at bank and in hand	-	-	91,155	91,155
Financial assets held for trading	2,555,556	-	-	2,555,556
Available for sale investments	-	1,139	-	1,139
Debtors – Loans and Receivables	-	-	7,241,079	7,241,079
	<u>2,555,556</u>	<u>1,139</u>	<u>7,332,234</u>	<u>9,888,929</u>
Financial Liabilities				
Financial liabilities held for trading	1,442,156	-	-	1,442,156
Creditors falling due within one year – Financial Liabilities	-	-	7,884,706	7,884,706
Creditors falling due after one year	-	-	1,826	1,826
	<u>1,442,156</u>	<u>-</u>	<u>7,886,532</u>	<u>9,328,688</u>

21 Debtors: amounts falling due after more than one year

	2017 £'000	2016 £'000
Financial Assets – Loans and Receivable	2,652	-
Financial Assets – Other Debtors	3,500	-
	<u>6,152</u>	<u>-</u>

22 Creditors: amounts falling due after more than one year

	2017 £'000	2016 £'000
Accruals and deferred income	<u>1,828</u>	<u>1,826</u>

Accruals and deferred income comprises deferred compensation costs and social security costs, falling due after more than one year.

Notes to the Financial Statements

23 Provisions for liabilities

The company recognises a provision for a liability if the company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The table below represents the present value of the anticipated liability of the company:

	2017			2016		
	Pending litigation	Redundancy, restructuring and onerous contracts	Total	Pending litigation	Redundancy, restructuring and onerous contracts	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Beginning of year	1,389	1,873	3,262	1,347	885	2,232
Change in provision	100,271	828	101,099	-	1,510	1,510
Exchange adjustments	209	-	209	42	-	42
Utilised during the year	-	(1,672)	(1,672)	-	(522)	(522)
Total	101,869	1,029	102,898	1,389	1,873	3,262

Pending litigation

Singularis Holdings Limited

During the financial year, judgment was handed down in the legal claim brought by the liquidators of Singularis Holdings Limited ("SHL"). The Judge dismissed some of the claims against DCME but held that DCME had been negligent (albeit at a reduced level taking into account contributory negligence on the part of SHL). DCME strongly contests the findings and on 21 April 2017 was granted leave to appeal the decision. A Court date for the appeal has not been finalised, but it is anticipated in the final quarter of 2017.

Claimed amount/financial impact

In line with accounting standards DCME has made a provision of £100m covering principal, interest and costs.

Notes to the Financial Statements

23 Provisions for liabilities (continued)

Lehman Brothers underwriting

On 7th February, 2011 CalPERs commenced proceedings against the company in the United States District Court Northern District of California San Francisco Division alleging violations of Sections 11 and 12(a)(2) of the Securities Act.

The company together with a number of other underwriters is a party to litigation in the United States arising out of the underwriting of bonds or notes for Lehman Brothers' entities. On 9th August, 2013 Mr Justice Kaplan of United States District Court Southern District of New York gave a judgment in favour of the defendants (including the company) dismissing the case. After subsequent appeals by CalPERs were dismissed, CalPERs filed a petition for review with the Supreme Court on 22nd September, 2016. On 13th January, 2017 the Supreme Court issued an order agreeing to hear CalPERs appeal and to consider the issue of whether statutes of repose are subject to class action tolling. Oral arguments were held on 17th April 2017 in the Supreme Court. The decision of the Supreme Court is pending.

Claimed amount/financial impact

The maximum recoverable amount solely from the company is up to \$12.4m. However, under the terms of underwriting agreements, liability is shared amongst the underwriters. The company's exposure if the maximum recoverable amount is divided equally amongst underwriters is approximately \$4.53m. The company is defending the proceedings. Whilst the outcome of this litigation is not predictable, the company's directors believe that, based on the information available to it, appropriate provision has been made in respect of the present state of proceedings.

Recent developments

There have been no material recent developments.

Redundancy, restructuring and onerous contracts

Provision is made for anticipated costs of restructuring and reorganisation, including redundancy costs, and contractual obligations. An obligation exists when the company has a detailed formal plan for restructuring a business and has raised valid expectations in those affected by the restructuring by announcing its main features or starting to implement the plan.

Notes to the Financial Statements

24 Called-up share capital

	2017 £'000	2016 £'000
<i>Allotted, called-up and fully paid</i>		
Ordinary shares of £1 each	<u>732,121</u>	<u>732,121</u>

25 Financial commitments

a) *Loan commitments*

As at 31 March 2017 undrawn but committed loan facilities amounted to £38.2m.

b) *Capital commitments*

As at 31 March 2017, capital expenditure contracted for but not provided for amounted to £0.02m (2016: £0.05m).

c) *Contingent liabilities*

Pending litigation

Administration of Kaupthing Bank

On 25th June 2012, the administrators of Kaupthing Bank commenced proceedings against the company as the reserve defendant (with a broker, as the primary defendant) in the District Court of Reykjavik alleging that certain repurchase transactions by Kaupthing should be set aside and the sale of the proceeds repaid.

Background information

The proceedings relate to the sale by the company of bonds issued by Kaupthing Bank to a broker in 2008. It transpires that the broker was acting on behalf of the Issuer. The reference date for Kaupthing's winding up was 15 November 2008. The company believes it acted in good faith as a professional intermediary between two financial services institutions. Judgment was given on Friday 15 July 2016 in the Icelandic District Court against Kaupthing and in favour of DCME.

On 13th October, 2016, Kaupthing filed its notice to appeal. DCME submitted its written pleadings on 25th January 2017. The parties are waiting for the court to decide on a hearing date.

Claimed amount / financial impact

The value of the claim is ¥870m plus interest and costs. The company is defending the proceedings. The directors estimate that the likelihood of the proceedings being successful as unlikely. The directors have formed their view based on external legal advice and believe that it is not necessary to make any provision in relation to this matter.

Recent developments

There have been no material recent developments.

Notes to the Financial Statements

25 Financial commitments (continued)

d) Lease commitments

The company leases a number of properties and certain items of office machinery under operating leases. The minimum annual rentals under these leases are as follows:

	2017			2016		
	Property £'000	Other £'000	Total £'000	Property £'000	Other £'000	Total £'000
Operating leases which expire						
- within 1 year	14	18	32	12	-	12
- within 2-5 years	196	-	196	122	18	140
- after 5 years	2,975	-	2,975	2,975	-	2,975
	<u>3,185</u>	<u>18</u>	<u>3,203</u>	<u>3,109</u>	<u>18</u>	<u>3,127</u>

e) Pension arrangements

Pension benefits for the majority of staff are provided in the UK through a defined contribution scheme (group personal pension plan) to which the company contributes a percentage based on each member's pensionable salary, between 8% and 20%. Under the core scheme, employee contributions are voluntary. A contribution matching scheme is in operation to encourage a good pension outcome for the members. All aspects of the scheme including governance, communication and the scheme design are fully compliant with automatic enrolment. Due to legislative reasons, the Company may choose to provide a cash allowance to those members of staff who are impacted by the Lifetime Allowance or Annual Allowance.

The amount charged in the profit and loss account for pension costs of the company under both the contributory and non-contributory sections of the group personal pension plan was £3.5m (2016: £3.6m).

The UK scheme also covers the following companies: Daiwa Asset Management (Europe) Ltd, Daiwa SB Investments (UK) Ltd and the Daiwa Anglo Japanese Foundation. Separate schemes are administered in respect of staff employed in the company's overseas branches and representative offices. The total cost in relation to branch pension schemes was £192,684 (2016: £154,258).

The company's ultimate parent undertaking, Daiwa Securities Group Inc., operates separate pension schemes of which certain employees seconded to the company from Japan are members. The total cost in relation to these pension schemes was £194,828 (2016: £61,312).

Notes to the Financial Statements

25 Financial commitments (continued)

f) VAT

The company is registered for VAT purposes in a group of undertakings which share a common registration number. As a result, it has jointly guaranteed the VAT liability of the VAT group, and failure by other members of the group would give rise to additional liabilities for the company. The directors are of the opinion that no such liability is likely to arise.

26 Share based payments

The company's ultimate parent company, Daiwa Securities Group Inc., operates a share scheme of which certain employees seconded to the company from Japan are members.

The "Daiwa Securities Group Inc. Head Office New Stock Reservation Rights" scheme was introduced in September 2004, and is open to certain selected employees of the Daiwa Securities Group. Under the plan the employees were granted share options over Daiwa Securities Group Inc. shares.

In accordance with FRS 102 the fair value of the equity-settled share based payments to employees is determined at the date of grant and is expensed on a straight line basis over the vesting period based on the company's estimate of options that will eventually vest. The weighted average fair value of options granted in the year was ¥90.03 (2016: ¥155.11) and the total charge for the year was £40,737 (2016: £30,635).

The company is exempt from specific share based payment disclosures under share based payment arrangements that existed during the period and the full disclosures as required by FRS 102 have not been disclosed as explained within accounting policies set out in note 1. The equivalent disclosures required by FRS 102 are included in the consolidated financial statements of the Daiwa Securities Group Inc. in Japan in which the company's results are consolidated.

Notes to the Financial Statements

27 Collateral

The company enters into repurchase agreements and engages in stock borrowing and lending as part of its funding, market-making and position management activities. The table below summarises the position at the reporting date:

	2017	2016
	£ bn	£bn
Securities Received		
Securities received as collateral/borrowed	8.6	7.3
Source:		
Matched Book Repo Activity	6.8	5.8
Liquid Asset Buffer	0.9	0.5
Securities Borrowed	0.9	1.0
Total	8.6	7.3
Securities Pledged		
Securities pledged as collateral/lent	8.1	7.4
Use:		
Firm Funding Repo Activity	1.3	1.6
Matched Book Repo Activity	6.8	5.8
Total	8.1	7.4

28 Financial risk management

Exposures to risk

In the normal course of its business the company is exposed to a range of financial risks including market, credit and liquidity risk. Market risk exposures arise from trading book positions held in Fixed Income, Equity, Derivative and Convertible instruments. Credit risk exposures arise from unsettled/outstanding trades in the event of counterparty failure and the deterioration of the credit quality of issuers of debt securities, resulting in a fall in the value of the

Notes to the Financial Statements

28 Financial risk management (continued)

company's holding of assets. Liquidity risk is the risk that the company does not have sufficient financial resources to meet its obligations when they fall due, or can secure such resources only at excessive cost.

Objectives, policies and processes for managing risk

The Board is responsible for setting and monitoring the company's risk appetite and is responsible for oversight of the risk management function. The Board Risk Committee is directly accountable to the Board and has delegated responsibility for oversight of the risk management at a high level. The company's objective is to have comprehensive and timely control and disclosure of key risk measures and exposures with daily reports being made available to all division heads, local senior management and the immediate parent company in Tokyo. Senior management participate in the risk management process through the firm's Risk and Assets & Liabilities Committee and other division-specific risk focus groups.

Responsibility for day-to-day control and monitoring rests with the Risk Management Division for market and credit risk and the Finance & Operations Division for liquidity risk, both of which have a reporting line that is independent from the sales and trading areas. For liquidity risk there is also a secondary reporting line into the head of the Risk Management & Compliance Division in order to ensure a comprehensive and consistent approach to risk management across the firm. The divisions employ a variety of risk management tools including a policy of limit control and exception reporting for both the proprietary and unsettled client positions.

Market risk

Market risk is controlled and monitored using a range of risk management tools including VaR, basis point value (BPV) limits, and scenario and stress testing. A variety of limits are set locally within parent company rules – by instrument rating, issuer, geographic location, and both cumulative and aged holdings. External ratings, where available, are applied to all securities. Should the security not be rated, an external issuer rating is used and in the absence of any external rating an internal issuer rating would be applied.

All material market risks, including those arising from market making and proprietary trading, are subject to VaR analysis on a daily basis. The VaR analysis for the year was as follows:

	2017	2016
	£'000	£'000
Year-end	1,535	1,406
Average	1,394	2,141
Maximum	1,786	3,300
Minimum	1,085	1,289

Notes to the Financial Statements

28 Financial risk management (continued)

VaR is measured using an historic simulation methodology at a 99% confidence level, with a 1-day holding period and a 560 day observation period. All trading book positions are also subject to other sensitivity analyses including BPV (gross and net) and credit spread (by rating, per issuer, per country, cumulative net and gross).

The VaR numbers shown for 2017 incorporate full diversification offsets between businesses. The decrease in VaR, compared to 2016, is mostly due to reductions in secondary credit trading inventory throughout the year.

Credit risk

Counterparty exposure is managed by rigorous on boarding procedures, counterparty rating, limit setting (notional, credit and settlement, where necessary), exposure monitoring and exception reporting. Appropriate legal agreements are entered into according to product. Risk mitigation is also conducted daily via collateral management activity.

Internal ratings are applied to all counterparties and are a key component in determining the risk appetite and size of limit assigned to each client. The company determines internal ratings through a scorecard-based approach using publicly available information and accounts and verifying broad consistency with external ratings provided by external credit rating assessment institutions (ECAI). No material counterpart losses were suffered during the year.

The maximum exposure to credit risk, gross of collateral, by class of financial asset as at the year-end was represented by the carrying amount as follows:

	2017	2016
	£'000	£'000
Available for sale investments	1,270	1,139
Financial assets at fair value through profit and loss:		
Derivative financial instruments	515,002	592,209
Marketable securities	1,895,900	1,963,347
Loans and receivables:		
Debtors - Loans and receivables	8,197,826	7,241,079
Cash at bank and in hand	110,766	91,155
	<u>10,720,764</u>	<u>9,888,929</u>

Notes to the Financial Statements

28 Financial risk management (continued)

The credit quality by class of financial asset can be assessed by reference to the company's credit monitoring process, described above, as follows:

Credit Rating	2017						2016					
	AAA	AA	A	BBB	Sub- Investment Grade	Total	AAA	AA	A	BBB	Sub- Investment Grade	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Available for sale investments	-	1,270	-	-	-	1,270	-	1,139	-	-	-	1,139
Debtors - Loans and Receivables	5,345	503,648	6,167,461	501,470	1,019,902	8,197,826	2,888	470,901	2,306,473	3,953,810	507,007	7,241,079
Derivative financial instruments	-	221,210	292,710	509	573	515,002	-	270,588	9,111	311,558	952	592,209
Marketable securities	605,810	720,932	338,905	188,278	41,975	1,895,900	490,414	1,023,728	242,931	184,822	21,452	1,963,347
Cash at bank and in hand	-	7,868	96,768	3,943	2,187	110,766	-	38,551	44,230	8,322	52	91,155
	<u>611,155</u>	<u>1,454,928</u>	<u>6,895,844</u>	<u>694,200</u>	<u>1,064,637</u>	<u>10,720,764</u>	<u>493,302</u>	<u>1,804,907</u>	<u>2,602,745</u>	<u>4,458,512</u>	<u>529,463</u>	<u>9,888,929</u>

Funding and Liquidity Risk Management

The firm's funding and liquidity risk management objective is to ensure that the company has adequate funding and liquidity resources to support its business activities and meet its financial obligations as they fall due under normal and stressed conditions. In order to achieve this objective, the company's funding mix is calibrated to provide stable and cost effective sources of finance to accommodate market disruptions over both the short and long term.

DCME is governed by the Financial Conduct Authority's (FCA's) prudential liquidity regime in the UK. The FCA requires the company to undertake an annual assessment into the adequacy of its liquidity resources and liquidity risk management framework. This self-assessment process is called an Individual Liquidity Adequacy Assessment (ILAA) and it is subject to a Supervisory Liquidity Review Process (SLRP), conducted by the FCA. The SLRP leads to Individual Liquidity Guidance (ILG) being conferred on the company that requires the company to adhere to minimum quantitative standards on liquidity. The company maintains an adequate liquid asset buffer and sufficient funding sources which ensures that it meets regulatory requirements at all times.

Notes to the Financial Statements

28 Financial risk management (continued)

Funding

Primary sources of funding include:

1. The firm's own capital and reserves which serve as the longest dated and most stable form of finance;
2. Secured financing (repos collateralised with the company's highly liquid trading book assets) from a diverse pool of counterparties, with the largest volume of trading conducted through Central Clearing Counterparties (CCPs);
3. Additional ISDA collateral posted by the parent company to cover regulatory capital exposure on certain back to back derivative trades; and
4. Access to an unsecured, uncommitted funding facility from the parent.

Liquidity Risk

Liquidity risk is quantified through stress tests that assess the impact of a variety of scenarios that could affect the liquidity profile of the balance sheet. To assess the impact from the liquidity risk drivers, assumptions have to be made regarding the evolution of DCME's balance sheet following a liquidity shock being described in the scenario and include (but are not limited to) multiple downgrades of the parent's credit rating, severe disruptions in the wholesale markets, impaired functioning of the FX markets, increase in margin calls at the firm's clearers and counterparties being unable to settle trades on contractual settlement dates. Management actions are modelled to counterbalance the outflows incurred, including liquidation of liquid asset buffer with an estimated haircut and assumed speed of execution. Results are expressed in the form of 'liquidity coverage ratio' which quantify the mismatch between liquidity resources and liquidity requirements.

The company's liquidity risk appetite statement requires the firm to be able to survive a combined liquidity event (market specific and idiosyncratic scenario) on a stand alone basis (without parental support) for at least one month before senior management intervention e.g. through a forced sale of inventory or closure of elements of the business. The Board has also set a risk appetite statement around the firm's expected survival period (a minimum of 1 year) during severe market shocks and a risk appetite statement around average residual tenor of unsecured deposits (funding) from the parent.

Liquidity risk is managed through:

1. Balance sheet controls that ensure current and planned divisional funding usage is in line with Board agreed business plans;
2. Mismatch controls that limit the amount of funding gaps that the firm/individual business lines can run;
3. Material currency gap limits, which ensures access to core currencies in the event of a stress;
4. A suite of early warning indicators (EWIs) that monitor emerging vulnerabilities in markets where the firm has business interests;
5. Holding an unencumbered liquid asset buffer commensurate with the results of stress testing that enable the firm to absorb the short term effects of a severe liquidity shock; and
6. A comprehensive contingency funding plan (CFP) that details senior management action during a liquidity event to ensure that the firm's core franchise remains intact.

Notes to the Financial Statements

28 Financial risk management (continued)

Governance

DCME's Board is ultimately responsible for the management of funding and liquidity risk. The Board delegates this responsibility, via the Chief Executive Officer, to the Executive Committee which further delegates the responsibility for operational oversight and management of funding and liquidity risk to DCME's Risk and Asset Liability Committee (RALCO). Independent non-executive review of the company's liquidity framework is undertaken by the firm's Board Risk Committee on behalf of the Board. The Liquidity Risk Management (LRM) section undertakes day on day monitoring of the firm's funding and liquidity position. Treasury is responsible for operational liquidity management in respect of raising unsecured financing for the firm and managing the firm's Liquid Asset Buffer (LAB) portfolio. The Operations, LRM, Credit Risk and Treasury sections at DCME coordinate elements of intra-day liquidity management.

Liquidity Reserves

The company maintains a pool of high quality liquid assets that consists exclusively of unencumbered assets, representing resources immediately available to meet liquidity requirements in a market stress situation. The liquidity buffer typically comprises high credit quality government bonds denominated in multiple currencies reflecting the currency mix of the firm's underlying balance sheet. On occasion, the firm also includes in its liquidity pool, certain highly liquid senior bonds issued by multilateral development banks such as the International Bank for Reconstruction & Development.

The contractual maturity profile of financial liabilities is as follows:

						2017
	On demand	Less than 1 month	1 to 3 months	3 months to year	Between 1-5 years	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Marketable Securities	940,432	-	-	-	-	940,432
Derivative Financial Instruments	508,722	-	-	-	-	508,722
Deposits received for repurchase agreements and securities lent	847,311	5,710,552	965,420	-	-	7,523,283
Other Financial Liabilities	352,937	119,819	334,919	357,973	1,828	1,167,476
Total	2,649,402	5,830,371	1,300,339	357,973	1,828	10,139,913

Notes to the Financial Statements

28 Financial risk management (continued)

	On demand	Less than 1 month	1 to 3 months	3 months to year	Between 1-5 years	2016 Total
	£'000	£'000	£'000	£'000	£'000	£'000
Marketable Securities	836,228	-	-	-	-	836,228
Derivative Financial Instruments	605,928	-	-	-	-	605,928
Deposits received for repurchase agreements and securities lent	2,211,074	3,895,852	1,114,682	-	-	7,221,608
Other Financial Liabilities	326,507	10,440	16,406	309,745	1,826	664,924
Total	3,979,737	3,906,292	1,131,088	309,745	1,826	9,328,688

The "On demand" time bucket includes balances with open maturity or due over night.

Derivative financial instruments and marketable securities have been included in the 'On demand' time bucket at their fair value or approximate thereto. Classification of derivative instruments in the on demand bucket, rather than presentation based on contractual maturity, is considered to be prudent given the potential for various triggers embedded in some of DCME's derivative contracts.

Financial liabilities not in the trading portfolio are presented on an undiscounted contractual cash flows basis and (with the exception of deferred staff bonuses) they all fall due within one year. As at 31 March 2017, the undiscounted contractual cash flows approximates to the carrying amounts on the balance sheet (2016: approximates to the carrying amounts).

29 Capital risk management

Regulatory capital resources requirement

The company is regulated by the Financial Conduct Authority (FCA) in the UK and is subject to minimum capital requirements imposed by the regulator and by the European Capital Adequacy Regulation and Directive (collectively referred to as CRD IV¹). The EU Capital Adequacy framework, like its predecessor, consists of three "pillars".

Pillar 1 sets forth the rules for calculating the minimum capital requirements for market risk, credit risk and operational risk. The company has adopted the standardised approach for its Pillar 1 capital resources requirement calculation.

29 Capital risk management (continued)

¹ The "CRD IV" package of regulation (EU/575/2013) and directive (2013/36/EU) came into force on 1 January 2014 and covers capital resources ("own funds"), capital requirements ("own funds requirements") and liquidity & stable funding requirements.

Notes to the Financial Statements

The Pillar 2 rules require regulated firms to establish an Internal Capital Adequacy Assessment Process (ICAAP), which forms the basis for an on-going self-assessment of their risk profile; with this being used to determine a "Pillar 2" capital resources requirement independent of, but no lower than, the minimum capital requirements imposed by Pillar 1.

The Pillar 2 process involves a supervisory review ("SREP") as a result of which the FCA provides firms with individual capital guidance (ICG); which is effectively an additional capital resources requirement to be applied to the Pillar 1 minimum.

The Pillar 3 rules require regulated firms to publish certain risk and capital disclosures typically either as part of the annual financial statements, or by being made available on the company's website. Disclosures will be updated as a minimum on an annual basis and made available on the company's website as soon as practicable.

Since the coming into force of CRD IV, the company has been categorised as a "full scope" IFPRU 730K investment firm under the revised framework. "IFPRU" refers to the "Prudential Sourcebook for Investment Firms", part of the FCA's Handbook of Rules and Guidance. During the year, no breaches of the company's capital requirement were reported to the FCA.

Capital Management

The company's capital management objectives are to ensure that the company maintains sufficient capital resources to support its business and planned strategic developments and that it complies with the regulatory capital requirements at all times. It is the company's policy to maintain a strong capital base commensurate with its risk appetite.

Formal procedures are in place to monitor and manage capital resources on an active and timely basis. Responsibility for day to day monitoring of capital adequacy rests with the regulatory reporting function. Daily and periodic reports are prepared and distributed to local senior management and reported to head office in Tokyo.

The company manages its capital usage through limit setting, capital allocation and capital planning. A Risk, Asset and Liability Management Committee (RALCO), reporting to the Executive Committee, is in place to oversee the management of capital and carry out periodic assessment of the company's capital resources requirements.

<i>Regulatory Capital</i>	2017	2016
	£'000	£'000
Common Equity Tier 1 Capital	506,478	586,189
Additional Tier 1 Capital	-	-
Total Tier 2 Capital	-	-
Regulatory capital resources	<u>506,478</u>	<u>586,189</u>

Notes to the Financial Statements

29 Capital risk management (continued)

	2017	2016
	£'000	£'000
Shareholders' Funds	511,955	595,092
Prudent Valuation adjustment (unaudited)	(2,277)	(942)
Intangible Assets – Goodwill	(3,200)	(7,961)
	<u>506,478</u>	<u>586,189</u>
Regulatory capital resources	<u>506,478</u>	<u>586,189</u>

30 Fair Value estimation

The following table sets out fair value measurements as at 31 March 2017 using the FRS 102 fair value measurement hierarchy.

	Level 1	Level 2	Level 3	2017
	£'000	£'000	£'000	Total
				£'000
Assets				
Available for sale investments	-	-	1,270	1,270
Financial assets at fair value through profit and loss:				
Derivative financial instruments	167	514,835	-	515,002
Marketable securities	1,851,857	42,296	1,747	1,895,900
Total assets	<u>1,852,024</u>	<u>557,131</u>	<u>3,017</u>	<u>2,412,172</u>
Liabilities				
Financial assets at fair value through profit and loss:				
Derivative financial instruments	739	507,983	-	508,722
Marketable securities	940,432	-	-	940,432
Total liabilities	<u>941,171</u>	<u>507,983</u>	<u>-</u>	<u>1,449,154</u>

Notes to the Financial Statements

30 Fair Value estimation (continued)

There have been no transfers into Levels 3 from Level 2. A reconciliation of fair value measurement in Level 3 is set out below.

Level 3 financial assets are valued based upon parameters which are unobservable in the market. The level 3 marketable securities are valued based upon a fundamental analysis of expected recovery value. The level 3 available for sale investments are valued by reference to the published net asset per share.

The following table presents the changes in level 3 instruments for the year ended 31 March 2017.

	Available for sale investments	Derivative financial instruments	Marketable securities	2017 Total
	£'000	£'000	£'000	£'000
Assets				
Beginning of the year	1,139	-	3,142	4,281
Transfers into Level 3	-	-	-	-
Purchases/Issues				
Sales/Maturities	-	-	(1,311)	(1,311)
Revaluation	40	-	(312)	(272)
Exchange differences	91	-	228	319
Gains/(losses)				
End of year	1,270	-	1,747	3,017

There were no level 3 liabilities in the year ended 31 March 2017.

Notes to the Financial Statements

30 Fair Value estimation (continued)

The following table sets out fair value measurements as at 31 March 2016 using the FRS 102 fair value measurement hierarchy.

	Level 1	Level 2	Level 3	2016
	£'000	£'000	£'000	Total £'000
Assets				
Available for sale investments	-	-	1,139	1,139
Financial assets at fair value through profit and loss:				
Derivative financial instruments	118	592,091	-	592,209
Marketable securities	1,937,794	22,411	3,142	1,963,347
Total assets	1,937,912	614,502	4,281	2,556,695
Liabilities				
Financial assets at fair value through profit and loss:				
Derivative financial instruments	263	605,665	-	605,928
Marketable securities	834,972	1,256	-	836,228
Total liabilities	835,235	606,921	-	1,442,156

The following table presents the changes in level 3 instruments for the year ended 31 March 2016.

	Available for sale investments	Derivative financial instruments	Marketable securities	2016 Total
	£'000	£'000	£'000	£'000
Assets				
Beginning of the year	916	-	3,946	4,862
Purchases/Issues	-	-	23	23
Sales/Maturities	(6)	-	-	(6)
Revaluation	144	-	(924)	(780)
Exchange differences	85	-	97	182
Gains/(losses)				
End of year	1,139	-	3,142	4,281

There were no level 3 liabilities in the year ended 31 March 2016.

Notes to the Financial Statements

31 Related party transactions

Directors' remuneration

The remuneration of the directors was as follows:

	2017 £'000	2016 £'000
Emoluments	1,327	1,549
Company contributions to group personal pension plans	11	64
	<u>1,338</u>	<u>1,613</u>

Pensions

The number of directors who were members of group personal pension plans was as follows:

	2017 Number	2016 Number
Money purchase schemes	<u>1</u>	<u>3</u>

Highest paid director

The above amounts for remuneration include the following in respect of the highest paid director:

	2017 £'000	2016 £'000
Emoluments	907	620
Company contributions to group personal pension plans	-	50
	<u>907</u>	<u>670</u>

Emoluments include all salary and benefits accruing to directors, plus the current year cash portion of bonus awards and the vesting cash position of deferred awards.

32 Ultimate parent company

The company is a wholly owned subsidiary of Daiwa International Holdings Inc., itself a wholly owned subsidiary of Daiwa Securities Group Inc. incorporated in Japan. The parent company of the largest and smallest group that includes the company and for which group financial statements are prepared is Daiwa Securities Group Inc. The consolidated financial statements of this group, prepared under Japanese generally accepted accounting practice, are available to the public and may be obtained from 5 King William Street, London EC4N 7DA.

Notes to the Financial Statements

33 Country by Country Reporting and Disclosure of Return on Assets

a) Country by country reporting

The following reporting has been prepared to comply with the requirements set out in Article 89 of the European Union Capital Requirements Directive IV.

Location	Principal Activities	Turnover £'000	Profit or (Loss) before tax £'000	Corporation Tax (amount paid) £'000	Average Headcount
United Kingdom	1	102,161	(83,866)	179	333
Switzerland	2	4,314	447	-	11
Bahrain	2	1,968	416	-	7
Russia	3	614	(167)	-	3
France	3	281	(261)	-	2
		<u>109,338</u>	<u>(83,431)</u>	<u>179</u>	<u>356</u>

The above analysis takes into account the internal allocation of costs based upon estimated usage of support functions.

Principal activities:

1. The primary activities of the head office are to provide investment banking services in Equities, Fixed Income, Convertible Bonds, and financing of development real estate projects.
2. The branches in Switzerland and Bahrain exist to facilitate sales activity in their local regions on behalf of DCME London.
3. The representative offices in France and Russia exist to source business opportunities for DCME London in those countries.

Public subsidies received:

The company receives no public subsidies.

b) Return on Assets

According to Article 90 of the European Union Capital Requirements Directive IV DCME are required to disclose the return on net assets (being defined as net profit after tax). For the year ended 31 March 2017 this was -16.3%.