

**Daiwa Capital Markets Europe Limited**

Annual report and financial statements for the year ended 31 March 2018

Company registered number: 01487359

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## Chairman's Statement

For the year ended 31 March 2018, Daiwa Capital Markets Europe Limited ("DCME") continued to make progress against its core objectives of providing a first class service to clients, building a sustainable business model that delivers a return to the shareholder and creating a culture which attracts and retains top quality staff.

DCME recorded an operating profit of £7.3m up from £0.9m for the prior year. 2018 saw the return of strong primary revenue, with an overall increase of over 400%Y/Y after a very disappointing 2017. This benefited the Equities, Equity Capital Markets and Convertible Bonds businesses. By contrast fixed income markets were challenging and consequently our Fixed Income division had a difficult year. Our Principal Investments business continued to grow its loan portfolio, in the development finance and bridging loan space, which led to stronger revenue and allowed the business to move into profit. The Debt Capital Markets business was impacted by a change of group strategy resulting in reduced Uridashi revenue. Cost control continued to be a focus, resulting in a broadly flat cost base year on year. This meant that the revenue improvement drove an equivalent increase in operating profit.

DCME's corporate advisory subsidiary DC Advisory (not included within these results) has continued to go from strength to strength, cementing itself as one of the top mid-cap M&A advisory businesses in Europe. The acquisition by the group of Signal Hill and Sagent Advisors in the US, now rebranded DCS Advisory, will further help to strengthen Daiwa's global M&A strategy. A second consecutive year of strong profitability and cash generation has meant that the recoverability of DCME's loan to DC Advisory Holdings Limited has improved materially, leading to a reversal of £20m in impairments taken in prior years.

In February 2018, the Appeals Court rejected the company's appeal against the legal claim brought by the liquidators of Singularis Holdings Limited. DCME has applied to the Supreme Court for permission to appeal the decision of the Appeals Court. While DCME continues to strongly defend itself against this claim, in light of the Appeals Court decision the Board has made the prudent decision to fully provide for this claim and all associated interest and costs. This resulted in a charge of £59.7m for the year. Two other legal claims, which were in progress against the firm at the start of the year, namely CalPERs and the Administrators of Kaupthing Bank, concluded in favour of DCME. For the first time in many years the company faces no material downside risk from litigation, and the simplified business model and an enhanced focus on industry best practice has significantly reduced the prospects of future litigation.

Market, political and regulatory forces continue to pose headwinds and challenges to our business model. Brexit is a prime example of the challenges facing the company and our industry in general. Nonetheless, the company remains committed to serving its clients and meeting these challenges with energy and optimism. Brexit provides uncertainty about DCME's ability to continue to service its EU-based clients after Brexit. To ensure continuity for these clients, DCME has established a German subsidiary (Daiwa Capital Markets Deutschland GmbH). An application for regulatory approval was submitted to the BaFin, in December 2017. This new business will be up and running well in advance of Brexit day. Another challenge facing DCME (and the market in general) is MiFID II which came into force in January 2018. DCME is focused on delivering our client's needs, which we hope will help us gain market share and allow us to benefit from a reduction in competition as the market consolidates.

## Chairman's Statement

I believe that DCME's mixture of businesses and its position within the Daiwa group will continue to serve it well. Its strong links to Japan and Asia make it ideally placed to source Japanese and Asian financial products for European investors. At the same time it is well positioned to supply European investment products to Japanese investors. We remain committed to delivering the best quality service to our customers, and I look forward to the future with confidence. I would like to take this opportunity to thank all our staff and clients for their continued commitment to the Daiwa Group.



Yours sincerely,

Shiko Yanagisawa

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 its business model is closely aligned to that of the 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.

DCME provides M&A and Debt Advisory services through its wholly owned subsidiary group DC Advisory. DC Advisory operates through separately incorporated entities in the UK, France and Germany. The UK business (DC Advisory Limited) is regulated by the FCA. The results of DC Advisory are not consolidated in these financial statements.

Following the 2016 referendum on the UK's continued membership of the European Union (EU), the UK gave formal notice of its intention to leave the EU, (effective from 29 March 2019). DCME has established a German subsidiary, Daiwa Capital Markets Deutschland GmbH (DCMD) (incorporated December 2017), which is currently in the process of obtaining regulatory approval in Germany. The initial aim of the entity is to protect Daiwa Group relationships with existing EEA clients and maintain access to EEA clients and products for Daiwa Group's clients. In the medium term the objective is to increase client and product coverage in the EEA through a local presence. The results of DCMD are not consolidated in these financial statements.

## Review of businesses, performance and strategy

DCME's 2018 pre-tax result was a loss on ordinary activities of £32.6m (2017: loss of £83.4m) after taking into account £59.7m of Net litigation expense (2017: £81.3m) and a £20m reversal of Loan Impairment (2017: included a £3m Goodwill Impairment).

At the Operating profit before litigation and impairment adjustments level DCME reported a profit of £7.3m (2017: £0.9m).

Net operating income increased £7m (6.4%) y-o-y, while Administrative Expenses increased by £0.6m (0.6%). The markedly stronger performance was driven by a significant increase in primary Equity and Convertible Bond revenue.

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A strong focus on cost control ensured the increase in costs remained well below inflation and the revenue growth, contributing to the improved operating income.

Looking forward DCME foresees that markets will be generally supportive and that in particular higher interest rates will provide more market opportunity for the Fixed Income and Convertible Bond businesses. We also anticipate that primary revenue will continue to be healthy. On a more cautious note, in common with the market, our Equities business will be negatively impacted by the introduction of MiFID II (in January 2018) and the end of the traditional bundled equity brokerage model. The uncertainties around "Brexit", on our business model and the wider European economy, will continue to provide headwinds to our strategy.

### ***Litigation provision***

During the financial year, DCME appealed unsuccessfully to the Appeals Court following the judgment handed down in 2017 in the legal claim brought by the liquidators of Singularis Holdings Limited. DCME has filed an application for permission to appeal to the Supreme Court and that decision is pending. However, in light of the Appeals Court judgment DCME increased its litigation provision by £59.7m. The provision now covers the full litigation claim, including interest and costs. There is thus no further material downside risk associated with this case.

The two other litigation cases, reported in the prior year, concluded in the firms favour during the year. There are no pending litigation cases as at 31 March 2018, other than the fully provisioned case detailed above.

### ***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 had a good year with a 26% y-o-y increase in total revenue. Primary activity in the year was particularly strong, increasing 285% y-o-y after a particularly poor 2017, with some meaningful mandates from Japanese global offerings, including the Japan Post follow-on offering. Secondary markets also traded well for most of the financial year, on the back of solid global equity markets, including Japanese and Asian markets, hitting recent highs. In Japan, the Liberal Democratic Party's October 2017 general election victory, bolstered investor confidence encouraging overseas investor flows to return to the market with more conviction.

Although 2018 was a successful year, DCME continues to face a countervailing challenge from the tightening of regulatory constraints, on its brokerage business model, 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 the risk of disruption. This is because our traditional reliance on corporate access has been undermined by the strict enforcement of the FCA rule, forbidding the reward of corporate access through execution commissions. Meanwhile the FCA's requirement that research payments are made by fund managers only

## Strategic Review

for research, which can be evidenced as being 'substantive', raises the research quality bar sharply. Given the multiple constituents for which Daiwa's global research is designed, ranging from retail through Japanese institutional to overseas institutional, our product tends to the lowest common denominator. That being said, our Japan research product remains competitive for Japan specialists. Research discussions with clients have progressed well, with the majority of clients signed up to pay for Daiwa research. That having been said there is clear downward pressure on revenue resulting from unbundling.

For 2019 we expect global risk appetite towards equities to continue to be heavily influenced by the divergent paths of the Federal Reserve (tightening) and the ECB and BOJ (both easing quantitatively) continuing to engender bouts of volatility but generally underpinning solid markets.

Looking forward the Equity Division is still focused on establishing a viable business model for the MiFID II regime. We believe that the new environment will justify two broad strategic emphases:

- A greater focus on Pan Asian execution revenues.
- A deeper degree of integration of our Japan and Asian product sales to sharpen our Pan Asian USP.

Distinctiveness is vital. It is critical to be able to offer a product which stands out from our peers and which clients cannot easily replicate in-house. Our challenge is to make Daiwa indispensable to key clients as they assemble much narrower lists of broking counterparties to work with in the unbundled era.

### **Fixed Income ("FI")**

The Fixed Income Division consists of the following core business lines; investment grade 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 MTN 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 transaction underwriting syndicates.

FI had a disappointing year with markets remaining challenging, resulting in revenue being down 39% y-o-y. With the exception of Government trading and Debt Syndication, all areas were down y-o-y. Credit Trading had a particularly challenging year having to contend with low volatility, tightening of credit spreads and high funding costs. The Debt Syndication desk had a very good year with issuance conditions being extremely strong and transactions were well received.

Looking forward to 2019 we anticipate that higher rates will provide more volatility in both bonds and equities leading to more opportunity. Our core business of high grade fixed income will be in better shape given expectation of higher yields. Therefore we anticipate a significantly stronger year for Credit Trading and Government Bond Trading.

### **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

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simultaneous matching buy and sell orders so carries some bond inventory awaiting sale. In addition to market making activity, ICB seeks 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.

ICB had an excellent 2018 with revenues up 102% y-o-y. This was entirely due to the strong year for primary revenue, but which comes off a record low year in 2017. Primary revenue has seen a significant pick up as overall Japan primary issuance increased 42% y-o-y and Daiwa improved its league position. Secondary revenue remained flat reflecting tougher market conditions, particularly in the first 9 months of the year, with the global low volatility environment putting pressure on CB valuations.

Going forward into 2019 secondary revenue is expected to improve with improved levels of market volatility. Primary revenue whilst lower (after the strong 2018) should remain healthy as primary issuance should be supported by a large expiry calendar over the next 3 years, as deals that came to market at the early stages of Abenomics come up for expiry. Revenue should also be supported by the changing interest rate cycle globally which supports CB issuance generally.

### ***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 reported weaker revenue, down 34% y-o-y. 2018 saw a strong revenue performance from public deals, aimed at International and Japanese institutional investors in USD/JPY/AUD and selected other currencies, despite continued low issuance volumes overall in the Yen markets. Uridashi revenue (non-yen denominated bonds issued outside of Japan and sold to Japanese retail investors), however, was significantly lower due to a change in Daiwa Group retail product distribution methodology and strategy.

Going forward there are 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 grow further. 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. Partially offsetting this we do not see a recovery in Uridashi revenue.

### ***Equity Capital Markets ("ECM")***

The ECM department forms part of the Investment Banking Division and its main role is the origination and execution of International tranches of Equity and Convertible Bonds issued by Japanese and Asian issuers.

2018 was a very strong year for ECM with revenues up 340% y-o-y. The year saw a turn-around in capital raised via equity issuance in Japan, reaching its highest level since 2011 and surpassing 100 deals. The majority of equity offerings were sell-downs from governmental owned entities, taking the opportunity of the robust market environment. Convertible Bond issuance was also strong, as mentioned above, contributing to the significant increase in revenue. It is worth noting the y-o-y improvement was on the back of a poor primary performance in 2017.



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Going forward our expectations are that revenue will remain at an elevated level as we see a bigger pipeline for global secondary public offerings and initial public offerings. The significant Convertible Bond expiry calendar (and thus refinancing requirement) should contribute to a strong performance in Convertible Bond primary revenue. ECM will continue to focus on deepening and increasing its investor relationships.

### **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. Bridging finance is permitted for commercial opportunities.

This relatively new business made its first loan in 2016 and by the end of financial year 2018 PI had underwritten 10 loans of which 7 were outstanding at the year end. Revenue was therefore considerably up (+616%) y-o-y, and is projected to increase over the next three years as the business grows.

### **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. KPIs and KFIs 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.

<b>KPIs</b>	<b>2018</b>	<b>2017</b>
<b>Performance against Plan</b>		
Revenue	-2.5%	+1.4%
Overheads (exc. restructuring costs, goodwill amortisation and impairment adjustments)	+4.0%	-4.0%
Total headcount (including non-perm staff)	-0.2%	+4.5%
Voluntary staff turnover	8%	8%
<b>Actual Performance</b>		
Return on Equity (before goodwill impairment and net litigation expense)	1.5%	0.2%
Loss on ordinary activities before tax	(£32.6m)	(£83.4m)

These KPIs show that DCME’s revenue for 2018 was slightly under plan but this was offset by below plan overheads. Headcount has also been closely managed and ended the year with slightly lower numbers than budgeted.

### **KFIs**

<b>Capital</b>	<b>2018</b>	<b>2017</b>
	<b>£m</b>	<b>£m</b>
Regulatory Capital Resources	<b>476</b>	<b>506</b>
Tier 1 Capital Ratio	<b>45.7%</b>	<b>44.8%</b>

<b>Unsecured Funding Daiwa Group</b>	<b>2018</b>		<b>2017</b>	
	<b>£bn</b>		<b>£bn</b>	
	<b>Usage</b>	<b>Limit</b>	<b>Usage</b>	<b>Limit</b>
	<b>1.12</b>	<b>1.28</b>	<b>0.70</b>	<b>0.88</b>

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DCME derives a significant proportion of unsecured funding from Daiwa Securities Group Inc (DSGI). DSGI is also the majority shareholder in the company. DCME is therefore sensitive to 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. 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.

### Principal Risks and Uncertainties Facing the Company

#### ***Brexit***

DCME is well advanced in its solution to a worst case Brexit. Expectations are that DCMD will obtain regulatory approval, necessary to protect Group revenue, during the summer of 2018. The project, to build out the infrastructure and hire the necessary staff, is progressing well, with a target date for the first client trade set for January 2019.

Despite the robust preparations to protect the firm from a worst case Brexit scenario, there are significant unknowns regarding the UK's future relationship with the European Union, our client's response, our competitor's response and the impact the final outcome will have on markets. While we anticipate there could be positives in the medium term our expectation is that the short term impact will be negative. The cost associated with setting up the operations in Germany will not be covered by increased business in the short term.

#### ***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.

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 Securities Group has experienced a very strong year, with Net Operating Revenue (+6.9%), Ordinary Income (+14.8%) and Profit Attributable to Owners of Parent (+6.3%) all increasing y-o-y for the first time in 4 years. Group ROE was 8.8% (2017: 8.4%). The performance was against the backdrop of favourable market conditions in Japan, with the Nikkei 225 up over 13% over the financial year, and equity issuance reaching the highest levels since 2011. "Abenomics" presents a strategic opportunity to the Daiwa Group, as its fortunes are closely correlated to the success of the Japanese stock market

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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 material deviations from plan. 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, a 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 a 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 business and that of our client base.

### ***Daiwa Europe Specific Risks and Uncertainties***

DCME continues to maintain its balance sheet in high quality liquid assets, with only 1% of the asset base being invested in sub-investment grade credit (refer to note 30 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 continue to persist with accommodative monetary policy.</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 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, which can be readily converted into cash when required. The trading portfolio also consists of high quality assets, most of which are deemed extremely liquid.</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 exists, to ensure we are not only dealing with current changes, but can also be forward looking to address future changes in a timely manner. In addition, the regulatory quality assurance section seeks 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</p>

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			<p>changes, the impact on DCME, the cost and resources required to achieve implementation on the mandatory deadlines. The Risk and Asset and Liability Committee (RALCO) has detailed oversight of all prudential regulatory change while ultimate responsibility lies with the Board.</p> <p>In addition the compliance with and impact on business, 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 10.5%, and voluntary turnover was below 7.6%, 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, and securities fraud to BCP events, such as the 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>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 &amp; Compliance Committee (ORCC).</p> <p>A significant firm wide initiative, to address the risks posed by cyber-crime has been implemented, led by Tokyo, with material resources allocated, at the Group level.</p> <p>A strategic initiative to improve the firm's IT resiliency following the failure of an outsourced data centre facility in 2016, remains in progress.</p>

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			The action plan for the resiliency initiative is reported to and monitored by the Operations Committee, Executive Committee and Board.
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. The longer the current strategy continues the lower the litigation risk from past activity becomes.</p> <p>Note 25 details the current Singularis litigation case, which has now been fully provided for and possess negligible future downside risk. All other litigation cases outstanding have also been resolved during the financial year.</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. 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>

The strategic report was approved by the Board on 19 June 2018 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 2018.

### 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, and a German subsidiary (Daiwa Capital Markets Deutschland GmbH) established to service EU based customers following the UK's withdrawal from the EU.

### Results and Dividends

The audited financial statements for the year ended 31 March 2018 are set out on pages 21 to 61. The company's loss for the year after taxation was £30.6m (2017: Loss of £83.3m). 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 (2017: £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. 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 30 and 31 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 £40,584 (2017: £40,349) 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/Retired	Committee Members #
Shiko Yanagisawa	Chairman	Japanese	Appointed – 1 October 2017	AC, BR, RC, NC
Junichi Arihara	Chairman	Japanese	Resigned – 30 September 2017	-
Keith Meekins	Chief Executive Officer	British	-	EC, CC
Jun Hayakawa	Chief Operating Officer	Japanese	-	EC, CC
Junichi Arihara	Non-Executive Director	Japanese	Appointed – 1 October 2017	BR, RC, NC
Hiroki Ikeda	Non-Executive Director	Japanese	-	RC, NC
Sung-Ho Kang	Non-Executive Director	Korean	Retired – 31 March 2018	-
Keiko Tashiro	Non-Executive Director	Japanese	-	RC, NC
Douglas van den Aardweg	Independent Non-Executive Director	British	Appointed – 15 May 2017	AC, BR, RC, NC
Peter Goshawk	Independent Non-Executive Director	British	-	AC, BR, RC, NC

# Reflects committee membership as at 31 March 2018 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

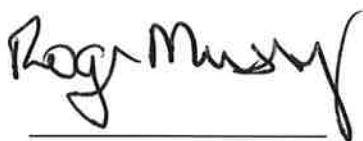
\*Membership of the Board Risk and Audit Committees also includes Alex Monnas who is not a DCME director.

### 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  
19 June 2018

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Annual Report and Financial Statements for the year ended 31 March 2018

## 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.

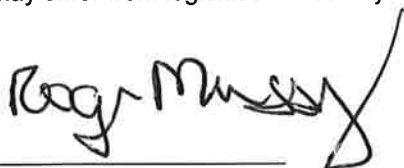
Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 the Financial Reporting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

19 June 2018

# Independent Auditor's Report

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

### Opinion

We have audited the financial statements of Daiwa Capital Markets Europe Limited ("the company") for the year ended 31 March 2018 which comprise the Statement of comprehensive income, Balance sheet, Statement of changes in equity and related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2018 and of its loss for the year then ended;
- have been properly prepared in accordance with UK accounting standards, FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

### Going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

### Strategic report and directors' report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;

## Independent Auditor's Report

- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

### **Matters on which we are required to report by exception**

Under the Companies Act 2006 we are required 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.

We have nothing to report in these respects.

### **Directors' responsibilities**

As explained more fully in their 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; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

### **Auditor's responsibilities**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities).

### **The purpose of our audit work and to whom we owe our responsibilities**

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

## Independent Auditor's Report

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.



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

19 June 2018

**STATEMENT OF COMPREHENSIVE INCOME**  
**For the Financial Year ended 31 March 2018**

	<b>Note</b>	<b>2018</b>	<b>2017</b>
		<b>£'000</b>	<b>£'000</b>
Fee and commission income	2	83,659	65,741
Fee and commission expense	2	(31,241)	(30,300)
Net trading revenue	3	22,669	33,932
Other income	4	33,631	31,057
<b>Total non-interest income</b>		<b>108,718</b>	<b>100,430</b>
Interest income and similar receivables	5	88,221	73,743
Interest payable and similar charges	6	(80,640)	(64,835)
<b>Net interest income</b>		<b>7,581</b>	<b>8,908</b>
<b>Net operating income</b>		<b>116,299</b>	<b>109,338</b>
Administrative expenses*	7	(109,049)	(108,421)
<b>Operating profit before litigation and impairment adjustments</b>		<b>7,250</b>	<b>917</b>
Goodwill impairment*		-	(3,038)
Loan impairment writeback*	9	19,862	-
Net litigation expense*	10	(59,686)	(81,310)
<b>Loss on ordinary activities before tax</b>		<b>(32,574)</b>	<b>(83,431)</b>
Tax credit on ordinary activities	11	1,989	179
<b>Loss for the financial year</b>		<b>(30,585)</b>	<b>(83,252)</b>
<b>Other comprehensive income</b>			
Exchange adjustments on fair value reserve		33	89
Movement on fair value reserve		97	40
Deferred tax recognised in equity		(24)	(14)
<b>Total comprehensive loss for the financial year</b>		<b>(30,479)</b>	<b>(83,137)</b>

\*Total administrative expenses (including impairment adjustments and net litigation expense) amounted to £148,873k (2017: £192,769k).

The accompanying notes on pages 24 to 61 are an integral part of the financial statements.

# BALANCE SHEET

As at 31 March 2018

Company registered number: 01487359

	Note	2018	2017
		£'000	£'000
<b>Fixed assets</b>			
Intangible assets	12	7,094	8,090
Tangible assets	13	11,479	12,715
Available for sale investments	14	1,402	1,270
Investments in subsidiary undertakings	15	641	-
		<u>20,616</u>	<u>22,075</u>
<b>Current assets</b>			
Debtors	16	8,402,416	8,206,516
Financial assets held for trading	18	2,473,421	2,410,902
Financial assets designated at FVTPL	19	24,411	-
Cash at bank and in hand	20	74,257	110,766
		<u>10,974,505</u>	<u>10,728,184</u>
<b>Current liabilities</b>			
<b>Creditors:</b> amounts falling due within one year	21	(9,504,559)	(8,690,576)
Financial liabilities held for trading	18	(1,032,181)	(1,449,154)
		<u>(10,536,740)</u>	<u>(10,139,730)</u>
<b>Net current assets</b>		<u>437,765</u>	<u>588,454</u>
<b>Total assets less current liabilities</b>		<u>458,381</u>	<u>610,529</u>
<b>Debtors:</b> amounts falling due after more than one year	23	176,688	6,152
<b>Creditors:</b> amounts falling due after more than one year	24	(1,768)	(1,828)
Provisions for liabilities	25	(151,825)	(102,898)
		<u>481,476</u>	<u>511,955</u>
<b>Net assets</b>		<u>481,476</u>	<u>511,955</u>
<b>Capital and reserves</b>			
Called-up share capital	26	732,121	732,121
Reserves		(250,645)	(220,166)
<b>Shareholders' funds</b> (all equity interests)		<u>481,476</u>	<u>511,955</u>

The financial statements were approved by the Board on 19 June 2018 and signed on their behalf by:



Keith Meekins  
Chief Executive Officer

The accompanying notes on pages 24 to 61 are an integral part of the financial statements.

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Annual Report and Financial Statements for the year ended 31 March 2018

## STATEMENT OF CHANGES IN EQUITY

The table below presents the changes in Equity for the year ended 31 March 2018:

	<b>Called-up Share Capital</b>	<b>Fair Value reserve</b>	<b>Capital reserve</b>	<b>Profit and loss account</b>	<b>Total</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Beginning of year	732,121	991	13,908	(235,065)	511,955
Loss for the financial year	-	-	-	(30,585)	(30,585)
Exchange differences	-	33	-	-	33
Revaluation of available for sale investments	-	97	-	-	97
Deferred tax liability on fair value gain on available for sale investments	-	(24)	-	-	(24)
End of year	<u>732,121</u>	<u>1,097</u>	<u>13,908</u>	<u>(265,650)</u>	<u>481,476</u>

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

	<b>Called-up Share Capital</b>	<b>Fair Value reserve</b>	<b>Capital reserve</b>	<b>Profit and loss account</b>	<b>Total</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
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>



# 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 2018 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 34 for details on where the company's ultimate parent company, Daiwa Securities Group Inc.'s, consolidated financial statements may be obtained from.

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 in note 33.

# Notes to the Financial Statements

## 1 Accounting policies (continued)

### d) 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.

### e) 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)

### f) *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*

This category includes:

- Financial assets 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 designated at time of initial recognition at fair value through profit and loss ("FVTPL"). Instruments are classified in this way if either of the following circumstances apply:
  - (i) it significantly reduces a recognition or measurement inconsistency that would otherwise occur (an "accounting mismatch"); or
  - (ii) the instrument forms part of a group of financial assets whose performance is evaluated on a fair value basis in accordance with a documented investment strategy, and that information is provided to key management personnel on this basis.

Financial assets at FVTPL 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.

# Notes to the Financial Statements

## 1 Accounting policies (continued)

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.

Loans and receivables 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 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. 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.

### g) *Investments in subsidiary undertakings*

Investments in subsidiary undertakings are stated at cost less impairment.

### h) *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.

Arrangement and Exit Fees on loans are treated as part of the funding aspect of the loan and are recognised over the life of the loan using the effective interest method. They are disclosed as interest in the financial statements.

### i) *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 liabilities 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).

### *j) 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.

### *k) 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.

### *l) 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.

### *m) 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. Income and expenses 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.

### n) *Leases*

The company enters into operating leases as described in note 27. 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 (2017: £nil).

### o) *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.

### p) *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.

#### q) *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.

#### r) *Share based payments to employees*

Daiwa Securities Group Inc., Daiwa Capital Markets 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.

#### s) *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 that 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.

#### t) *Provisions and contingent liabilities*

Provisions are recognised if the company has a present legal or constructive obligation as a result of a past event, 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.

### *u) 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.

## 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

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Costs recharged to group companies	32,579	30,230
Settlement of claim against IT service supplier	-	827
Release of surplus withholding tax penalty	1,052	-
	<u>33,631</u>	<u>31,057</u>

### 5 Interest income and similar receivables

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Interest and dividend income – held for trading	31,717	25,884
Interest income – other financial assets	56,504	47,859
	<u>88,221</u>	<u>73,743</u>

Included in the above is interest received from group companies amounting to £21.6m (2017: £18.0m).

### 6 Interest payable and similar charges

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Bank loans and overdrafts	18,191	9,217
Interest expense – held for trading	3,063	5,927
Interest expense – other financial liabilities	59,386	49,691
	<u>80,640</u>	<u>64,835</u>

Included in the above is interest paid to group companies amounting to £31.6m (2017: £20.2m).

## Notes to the Financial Statements

### 7 Administrative expenses

Administrative expenses are analysed as follows:

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Permanent staff costs (see note 8)	65,953	64,139
Non-permanent staff costs	4,306	4,452
Depreciation of tangible assets (see note 13)	2,523	2,535
Amortisation of intangible assets (see note 12)	2,908	4,721
Premises costs	5,906	5,702
External technology, communication and data costs	14,504	15,333
Net costs recharged by group companies	5,792	4,461
Other costs	7,157	7,078
Total	<u>109,049</u>	<u>108,421</u>

Administrative expenses include the following fees paid to the company's auditors:

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Fees payable to the company's auditor for the audit of the company's financial statements	223	206
Fees payable to the company's auditor and its associates for other services:		
- audit related assurance services	192	195
- tax advisory service	-	3
- governance and credit risk review	-	110
- all other services	-	16
Fees payable to un-associated auditor in respect of overseas branch regulatory requirements	74	75

### 8 Staff costs

Employee costs during the year amounted to:

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Wages and salaries	55,616	54,524
Social security costs	6,554	6,162
Pension costs – defined contribution plan	3,783	3,453
	<u>65,953</u>	<u>64,139</u>

## 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:

	2018 Number	2017 Number
Front Office		
Equity	47	45
Fixed Income	39	37
Debt and Equity Capital Markets	17	19
Other (CBs, Derivatives and Principal Investments)	17	21
Back Office Support	245	234
	<u>365</u>	<u>356</u>

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

	2018 Number	2017 Number
<i>Branches</i>		
Bahrain	7	7
Geneva	11	11
	<u>18</u>	<u>18</u>
<i>Representative offices</i>		
Moscow	3	3
Paris	2	2
	<u>23</u>	<u>23</u>

### 9 Loan impairment writeback

In the year £19,862k of loan impairment was written back (see note 16).

### 10 Net litigation expense

In the year £59,686k was the net expense for providing against pending litigation (2017: £81,310k). Details of pending litigation are disclosed in note 25.

## Notes to the Financial Statements

### 11 Tax credit on ordinary activities

The tax credit is based upon the standard UK corporation tax rate of 19% (2017: 20%) and comprises:

	<b>2018</b> <b>£'000</b>	<b>2017</b> <b>£'000</b>
UK and overseas corporation tax:		
Group relief: prior year	168	128
Group relief: current year	1,821	-
Overseas taxation	-	51
Total tax credited on ordinary activities	<u>1,989</u>	<u>179</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:

	<b>2018</b> <b>£'000</b>	<b>2017</b> <b>£'000</b>
Loss on ordinary activities before tax	<u>(32,574)</u>	<u>(83,431)</u>
Taxation at UK standard corporation rate of 19% (2017: 20%)	6,189	16,686
Effects of:		
Permanent differences	3,730	(52)
Effects of unrecognised timing differences including losses	(9,919)	(16,634)
Overseas taxation	-	51
Group relief surrendered	1,989	128
Company tax credit for the year	<u>1,989</u>	<u>179</u>

The company has a net deferred tax liability of £0.3m (2017: £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

### 11 Tax credit on ordinary activities (continued)

A residual deferred tax asset totalling £66.4m (2017: £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.

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 2018 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.

### 12 Intangible assets

<b>Cost</b>	<b>Goodwill £'000</b>	<b>Software £'000</b>	<b>Assets in course of construction £'000</b>	<b>Total £'000</b>
Beginning of year	29,180	31,145	884	61,209
Additions	-	-	1,912	1,912
Disposals	-	(2,959)	-	(2,959)
Transfers	-	1,584	(1,584)	-
End of year	<u>29,180</u>	<u>29,770</u>	<u>1,212</u>	<u>60,162</u>
<b>Amortisation</b>				
Beginning of year	25,980	27,139	-	53,119
Charge	893	2,015	-	2,908
Impairment charge	-	-	-	-
Disposals	-	(2,959)	-	(2,959)
End of year	<u>26,873</u>	<u>26,195</u>	<u>-</u>	<u>53,068</u>
<b>Net book value</b>				
At 31 March 2018	<u>2,307</u>	<u>3,575</u>	<u>1,212</u>	<u>7,094</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

### 12 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 directors believe there has been no impairment to the carrying value of the goodwill (2017: impairment of £3,038k).

### 13 Tangible assets

	Furniture, fittings and equipment £'000	Computer hardware £'000	Motor vehicles £'000	Assets in course of construction £'000	Total £'000
<b>Cost</b>					
Beginning of year	14,656	6,034	39	199	20,928
Additions	-	-	-	1,287	1,287
Disposals	(6)	(62)	-	-	(68)
Transfers	88	842	-	(930)	-
End of year	<u>14,738</u>	<u>6,814</u>	<u>39</u>	<u>556</u>	<u>22,147</u>
<b>Depreciation</b>					
Beginning of year	4,120	4,054	39	-	8,213
Charge	1,280	1,243	-	-	2,523
Disposals	(6)	(62)	-	-	(68)
End of year	<u>5,394</u>	<u>5,235</u>	<u>39</u>	<u>-</u>	<u>10,668</u>
<b>Net book value</b>					
At 31 March 2018	<u>9,344</u>	<u>1,579</u>	<u>-</u>	<u>556</u>	<u>11,479</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

### 14 Available for sale investments

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Unlisted investments	1,402	1,270

The movement in the year was as follows:

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Beginning of year	1,270	1,139
Exchange differences	35	91
Revaluation profit transferred to reserves	97	40
Disposals	-	-
End of year	1,402	1,270

### 15 Investments in subsidiary undertakings

The company had two subsidiary undertakings as at 31<sup>st</sup> March 2018. The percentage of the issued share capital held by the company is equivalent to the percentage of voting rights held.

<b>Name of company</b>	<b>Country of reg office</b>	<b>Principal activity</b>	<b>Percentage of equity and voting rights held</b>
Daiwa Corporate Advisory Holdings Limited	UK	Investment Holding Company	100%
Daiwa Capital Markets Deutschland GmbH ("DCMD")	Germany	Investment Bank and Broker Dealer	100%

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

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Beginning of year	-	-
Addition	641	-
End of year	641	-



## Notes to the Financial Statements

### 15 Investments in subsidiary undertakings (continued)

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.

DCMD was incorporated in December 2017, with £641k of share capital. At the balance sheet date the company held this sum in cash. In the opinion of the directors, the cost is the appropriate carrying value.

### 16 Debtors

Debtors comprise the following amounts:

	2018			2017		
	Financial Assets Loans and Receivables £'000	Non Financial Assets Other £'000	Total £'000	Financial Assets Loans and Receivables £'000	Non Financial Assets Other £'000	Total £'000
Trade debtors	8,473	-	8,473	8,932	-	8,932
Amounts owed by parent group undertakings *	4,574,216	-	4,574,216	5,286,436	-	5,286,436
Amounts owed by subsidiary undertakings	26,811	1,490	28,301	8,186	-	8,186
VAT	-	785	785	-	1,027	1,027
Deposits paid for reverse repurchase agreements and securities borrowed	3,726,810	-	3,726,810	2,844,768	-	2,844,768
Other debtors	36,120	-	36,120	33,243	-	33,243
Corporation tax recoverable	-	231	231	-	95	95
Prepayments and accrued income	20,288	7,192	27,480	16,261	7,568	23,829
	<u>8,392,718</u>	<u>9,698</u>	<u>8,402,416</u>	<u>8,197,826</u>	<u>8,690</u>	<u>8,206,516</u>

\*Amounts owed by parent group undertakings includes £4,420m for Deposits paid for reverse repurchase agreements (2017: £5,193m).

## Notes to the Financial Statements

### 16 Debtors (continued)

The carrying amount of debtors approximates to their fair value.

The company's accounting policy is to carry loans and receivables at amortised cost and review for impairment where necessary. As at 31<sup>st</sup> March 2018, it is the directors' opinion that there has been sufficient improvement to the recoverability of the intercompany loan to Daiwa Corporate Advisory Holdings Limited to warrant a reversal of part of the impairment booked against the loan in prior years. In the opinion of the directors £19.9m of the £27.7m impairment should be reversed. 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.

Prepayments and accrued income include £64,511 of defined contribution pension scheme prepayments (2017: £91,030) in relation to certain overseas branch pension schemes.

### 17 Deferred tax

	2018 £'000	2017 £'000
Deferred tax liability (note 21)	(266)	(242)
The movement in the year was as follows:		
	2018 £'000	2017 £'000
Beginning of year	(242)	(228)
Charged to the Reserves	(24)	(14)
End of year	(266)	(242)

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.

### 18 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

### 18 Financial assets and liabilities held for trading (continued)

	2018	2017
	£'000	£'000
<b><u>Financial Assets</u></b>		
<b>Non Derivative marketable securities</b>		
Equities	6,278	2,716
Government, Government Agency Bonds, and Municipal Bonds	367,728	463,378
Corporate Debt (inc. Convertible Bonds)	1,603,916	1,429,806
	<hr/>	<hr/>
Total	1,977,922	1,895,900
	<hr/>	<hr/>
of which listed	1,809,044	1,653,496
<b>Derivative financial instruments</b>		
Futures & Forwards	2,629	2,377
Options	47,665	49,645
Swaps	445,205	462,980
	<hr/>	<hr/>
Total	495,499	515,002
	<hr/>	<hr/>
of which listed	147	167
	<hr/>	<hr/>
<b>Total financial assets held for trading</b>	<b>2,473,421</b>	<b>2,410,902</b>
	<hr/>	<hr/>
<b><u>Financial Liabilities</u></b>		
<b>Non Derivative marketable securities</b>		
Equities	136,691	90,728
Government, Government Agency Bonds, and Municipal Bonds	299,635	625,209
Corporate Debt (inc. Convertible Bonds)	116,358	224,495
	<hr/>	<hr/>
Total	552,684	940,432
	<hr/>	<hr/>
of which listed	541,948	781,678
<b>Derivative financial instruments</b>		
Futures & Forwards	4,134	3,320
Options	33,547	42,860
Swaps	437,604	460,762
Other	4,212	1,780
	<hr/>	<hr/>
Total	479,497	508,722
	<hr/>	<hr/>
of which listed	1,449	739
	<hr/>	<hr/>
<b>Total financial liabilities held for trading</b>	<b>1,032,181</b>	<b>1,449,154</b>
	<hr/>	<hr/>

## Notes to the Financial Statements

### 19 Financial assets designated at Fair Value Through Profit and Loss (FVTPL)

	2018	2017
	£'000	£'000
Government, Government Agency Bonds, and Municipal Bonds	10,144	-
Corporate Debt (inc Convertible Bonds)	14,267	-
Total*	<u>24,411</u>	<u>-</u>
of which listed	20,850	-

\*Balance forms part of DCME's liquid asset buffer, and is managed as a new strategy that seeks to minimise cost.

### 20 Cash at bank and in hand

	2018	2017
	£'000	£'000
Cash at bank and in hand	<u>74,257</u>	<u>110,766</u>
of which deposits with parent group undertakings	815	1,608

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

### 21 Creditors: amounts falling due within one year

	2018			2017		
	Financial Liabilities	Non Financial Liabilities	Total	Financial Liabilities	Non Financial Liabilities	Total
	Other £'000	Other £'000	£'000	Other £'000	Other £'000	£'000
Other short term borrowings	71,413	-	71,413	79,911	-	79,911
Overdrafts	28	-	28	15,041	-	15,041
Trade Creditors	6,726	-	6,726	13,335	-	13,335
Amounts owed to parent group undertakings*	1,840,333	-	1,840,333	1,705,366	-	1,705,366
Deposits received for repurchase agreements and securities lent	7,555,072	-	7,555,072	6,841,594	-	6,841,594
Deferred tax liability	-	266	266	-	242	242
Other creditors:						
- social security and PAYE	-	1,582	1,582	-	1,392	1,392
- other creditors	4,351	16	4,367	6,484	11	6,495
Accruals and deferred income	<u>24,772</u>	<u>-</u>	<u>24,772</u>	<u>27,200</u>	<u>-</u>	<u>27,200</u>
	<u>9,502,695</u>	<u>1,864</u>	<u>9,504,559</u>	<u>8,688,931</u>	<u>1,645</u>	<u>8,690,576</u>

\*Amounts owed to parent group undertakings includes £434m for Deposits received for repurchase agreements (2017: £691m).

## Notes to the Financial Statements

### 21 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 ¥190bn/£1.274bn (2017: ¥123bn/£0.881bn) from Daiwa Securities Company Ltd which was provided on an uncommitted basis, as at 31 March 2018 and at 31 March 2017. At 31 March 2018 ¥167bn/£1.12bn (2017: ¥98bn/£0.701bn) was drawn on the facility.

There are no amounts included within overdrafts due to group undertakings (2017: £nil). The company has £27,181 due to clearing agents which is secured principally by securities held on the company's trading accounts with those clearing agents (2017: £15,040,492).

Accruals and deferred income include defined contribution pension schemes accruals of £2,999, (2017: £1,032), all of which relates to certain overseas branch pension schemes.

### 22 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	2018 Total £'000
<b>Financial Assets</b>				
Cash at bank and in hand	-	-	74,257	74,257
Financial assets held for trading	2,473,421	-	-	2,473,421
Financial assets designated at FVTPL	24,411	-	-	24,411
Available for sale investments	-	1,402	-	1,402
Debtors – Loans and Receivables	-	-	8,392,718	8,392,718
	<u>2,497,832</u>	<u>1,402</u>	<u>8,466,975</u>	<u>10,966,209</u>
<b>Financial Liabilities</b>				
Financial liabilities held for trading	1,032,181	-	-	1,032,181
Creditors falling due within one year – Financial Liabilities	-	-	9,502,695	9,502,695
Creditors falling due after one year	-	-	1,768	1,768
	<u>1,032,181</u>	<u>-</u>	<u>9,504,463</u>	<u>10,536,644</u>

## Notes to the Financial Statements

### 22 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	2017 Total
	£'000	£'000	£'000	£'000
<b>Financial Assets</b>				
Cash at bank and in hand	-	-	110,766	110,766
Financial assets held for trading	2,410,902	-	-	2,410,902
Financial assets designated at FVTPL	-	-	-	-
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>
<b>Financial Liabilities</b>				
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>

### 23 Debtors: amounts falling due after more than one year

	2018 £'000	2017 £'000
Financial Assets – Loans and Receivables	34,533	2,652
Financial Assets – Other Debtors*	142,155	3,500
	<u>176,688</u>	<u>6,152</u>

\*the balance represents funds held by the Courts Funds Office in an Escrow account pending the conclusion of litigation detailed in Note 25.

### 24 Creditors: amounts falling due after more than one year

	2018 £'000	2017 £'000
Accruals and deferred income	<u>1,768</u>	<u>1,828</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

### 25 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, 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:

	2018			2017		
	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	101,869	1,029	102,898	1,389	1,873	3,262
Additional provision	61,226	440	61,666	100,271	828	101,099
Release of provision	(1,540)	-	(1,540)	-	-	-
Exchange adjustments	(9,671)	-	(9,671)	209	-	209
Utilised during the year	(600)	(928)	(1,528)	-	(1,672)	(1,672)
<b>Total</b>	<b>151,284</b>	<b>541</b>	<b>151,825</b>	<b>101,869</b>	<b>1,029</b>	<b>102,898</b>

#### *Pending litigation*

#### **Singularis Holdings Limited**

On 1 February 2018, the Appeals Court rejected the company's appeal against the legal claim brought by the liquidators of Singularis Holdings Limited ("SHL"). The company has applied to the Supreme Court for permission to appeal the decision of the Court of Appeal. At the date of the accounts the Supreme Court decision is pending. In light of these developments the directors believe that it is appropriate to make a full provision for the award amount plus interest and expenses totalling £151m.

#### *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

### 26 Called-up share capital

	2018 £'000	2017 £'000
<i>Allotted, called-up and fully paid</i>		
Ordinary shares of £1 each	732,121	732,121

### 27 Financial commitments

#### a) *Loan commitments*

As at 31 March 2018, undrawn but committed loan facilities amounted to £37.6m (2017: £38.2m).

#### b) *Capital commitments*

As at 31 March 2018, capital expenditure contracted for but not provided for amounted to £0.4m (2017: £0.02m).

#### c) *Contingent liabilities*

As at 31 March 2018 there was no pending litigation.

#### 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:

	2018			2017		
	Property £'000	Other £'000	Total £'000	Property £'000	Other £'000	Total £'000
Operating leases						
which expire						
- within 1 year	14	-	14	14	18	32
- within 2-5 years	142	8	150	196	-	196
- after 5 years	3,008	-	3,008	2,975	-	2,975
	<u>3,164</u>	<u>8</u>	<u>3,172</u>	<u>3,185</u>	<u>18</u>	<u>3,203</u>



## Notes to the Financial Statements

### 27 Financial commitments (continued)

#### e) *Pension arrangements*

Pension benefits for the majority of staff are provided in the UK through a defined contribution scheme 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 £3.8m (2017: £3.5m).

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 £184,102 (2017: £192,684).

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 £190,086 (2017: £194,828).

#### 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.

### 28 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.

## Notes to the Financial Statements

### 28 Share based payments (continued)

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 ¥60.26 (2017: ¥90.03) and the total charge for the year was £44,431 (2017: £40,737).

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.

### 29 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:

	<b>2018</b>	<b>2017</b>
	<b>£bn</b>	<b>£bn</b>
<b>Securities Received</b>		
Securities received as collateral/borrowed	<u>8.9</u>	<u>8.6</u>
Source:		
Matched Book Repo Activity	7.3	6.8
Liquid Asset Buffer	1.0	0.9
Securities Borrowed	<u>0.6</u>	<u>0.9</u>
Total	<u><b>8.9</b></u>	<u><b>8.6</b></u>
<b>Securities Pledged</b>		
Securities pledged as collateral/lent	<u>8.7</u>	<u>8.1</u>
Use:		
Firm Funding Repo Activity	1.4	1.3
Matched Book Repo Activity	<u>7.3</u>	<u>6.8</u>
Total	<u><b>8.7</b></u>	<u><b>8.1</b></u>

## Notes to the Financial Statements

### 30 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 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 company's Risk and Assets and Liabilities Committee (RALCO) 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 Chief Risk Officer in order to ensure a comprehensive and consistent approach to risk management across the company. 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:

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Year-end	1,246	1,535
Average	1,192	1,394
Maximum	1,574	1,786
Minimum	832	1,085

## Notes to the Financial Statements

### 30 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 2018 incorporate full diversification offsets between businesses. The decrease in VaR, compared to 2017, 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 counterparty 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:

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Available for sale investments	1,402	1,270
Financial assets at fair value through profit and loss:		
Derivative financial instruments	495,499	515,002
Marketable securities	1,977,922	1,895,900
Financial assets designated at FVTPL	24,411	-
Loans and receivables:		
Debtors - Loans and receivables	8,392,718	8,197,826
Cash at bank and in hand	74,257	110,766
	<u>10,966,209</u>	<u>10,720,764</u>

## Notes to the Financial Statements

### 30 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	2018						2017					
	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	-	1,402	-	-	-	1,402	-	1,270	-	-	-	1,270
Debtors - Loans and Receivables	7,880	703,594	6,403,892	1,180,233	97,119	8,392,718	5,345	503,648	6,167,461	501,470	1,019,902	8,197,826
Derivative financial instruments	18	217,030	277,823	628	-	495,499	-	221,210	292,710	509	573	515,002
Marketable securities	581,670	575,567	480,421	307,123	33,141	1,977,922	605,810	720,932	338,905	188,278	41,975	1,895,900
Fin assets designated at FVTPL	14,267	10,144	-	-	-	24,411	-	-	-	-	-	-
Cash at bank and in hand	-	60,400	11,546	1,349	962	74,257	-	7,868	96,768	3,943	2,187	110,766
	<u>603,835</u>	<u>1,568,137</u>	<u>7,173,682</u>	<u>1,489,333</u>	<u>131,222</u>	<u>10,966,209</u>	<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>

#### *Funding and Liquidity Risk Management*

The company'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) which is reviewed and approved by the Board, 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

### 30 Financial risk management (continued)

#### *Funding*

Primary sources of funding include:

1. The company'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 company'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 the liquid asset buffer with an estimated haircut and assumed speed of execution. Results are expressed in the form of a 'liquidity coverage ratio' which quantify the mismatch between liquidity resources and liquidity requirements. Our stress testing assumptions are reviewed on a regular basis throughout the year.

The company's liquidity risk appetite statement requires the company to be able to survive a combined liquidity event (market wide 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 company'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 company/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 company has business interests;
5. Holding an unencumbered liquid asset buffer commensurate with the results of stress testing that enable the company 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 company's core franchise remains intact.

## Notes to the Financial Statements

### 30 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 RALCO. Independent non-executive review of the company's liquidity framework is undertaken by the company's Board Risk Committee on behalf of the Board. The Liquidity Risk Management (LRM) section undertakes day to day monitoring of the company's funding and liquidity position. Treasury is responsible for operational liquidity management in respect of raising unsecured financing for the company and managing the company's liquid asset buffer 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 stress situation. The liquidity asset buffer typically comprises high credit quality government bonds denominated in multiple currencies reflecting the currency mix of the company's underlying balance sheet. The company also includes in its liquidity pool, certain highly liquid senior bonds issued by multilateral development banks such as the European Investment Bank.

The contractual maturity profile of financial liabilities is as follows:

						<b>2018</b>
	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	552,684	-	-	-	-	552,684
Derivative Financial Instruments	479,497	-	-	-	-	479,497
Deposits received for repurchase agreements and securities lent	670,976	6,559,752	736,222	-	-	7,966,950
Other Financial Liabilities	309,369	192,929	763,931	269,516	1,768	1,537,513
<b>Total</b>	<b>2,012,526</b>	<b>6,752,681</b>	<b>1,500,153</b>	<b>269,516</b>	<b>1,768</b>	<b>10,536,644</b>

## Notes to the Financial Statements

### 30 Financial risk management (continued)

	On demand	Less than 1 month	1 to 3 months	3 months to year	Between 1-5 years	2017 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
<b>Total</b>	<b>2,649,402</b>	<b>5,830,371</b>	<b>1,300,339</b>	<b>357,973</b>	<b>1,828</b>	<b>10,139,913</b>

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) all fall due within one year. As at 31 March 2018, the undiscounted contractual cash flows approximates to the carrying amounts on the balance sheet (2017: approximates to the carrying amounts).

### 31 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 IV<sup>1</sup>). 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.

<sup>1</sup> 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

### 31 Capital risk management (continued)

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, 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>	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Common Equity Tier 1 Capital	475,993	506,478
Additional Tier 1 Capital	-	-
Total Tier 2 Capital	-	-
Regulatory capital resources	<u>475,993</u>	<u>506,478</u>

## Notes to the Financial Statements

### 31 Capital risk management (continued)

	<b>2018</b>	<b>2017</b>
	<b>£'000</b>	<b>£'000</b>
Shareholders' funds	481,476	511,955
Prudent Valuation adjustment (unaudited)	(2,535)	(2,277)
Intangible Assets – Goodwill	(2,307)	(3,200)
Material holdings	(641)	-
Regulatory capital resources	<u>475,993</u>	<u>506,478</u>

### 32 Fair Value estimation

The following table sets out fair value measurements as at 31 March 2018 using the FRS 102 fair value measurement hierarchy.

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>2018</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>Total</b>
				<b>£'000</b>
<b>Assets</b>				
Available for sale investments	-	-	1,402	1,402
Financial assets at fair value through profit and loss:				
Derivative financial instruments	147	495,352	-	495,499
Marketable securities	1,917,610	59,019	1,293	1,977,922
Financial assets designated at FVTPL	24,411	-	-	24,411
<b>Total assets</b>	<u>1,942,168</u>	<u>554,371</u>	<u>2,695</u>	<u>2,499,234</u>
<b>Liabilities</b>				
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments	1,449	478,048	-	479,497
Marketable securities	546,261	6,423	-	552,684
<b>Total liabilities</b>	<u>547,710</u>	<u>484,471</u>	<u>-</u>	<u>1,032,181</u>

## Notes to the Financial Statements

### 32 Fair Value estimation (continued)

There have been no transfers into Level 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 2018.

	Available for sale investments	Derivative financial instruments	Marketable securities	2018 Total
	£'000	£'000	£'000	£'000
<b>Assets</b>				
Beginning of the year	1,270	-	1,747	3,017
Transfers into Level 3	-	-	-	-
Purchases/Issues	-	-	-	-
Sales/Maturities	-	-	(276)	(276)
Revaluation	97	-	(22)	75
Exchange differences	35	-	(156)	(121)
Gains/(losses)	-	-	-	-
<b>End of year</b>	<b>1,402</b>	<b>-</b>	<b>1,293</b>	<b>2,695</b>

There were no level 3 liabilities in the year ended 31 March 2018.

## Notes to the Financial Statements

### 32 Fair Value estimation (continued)

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
<b>Assets</b>				
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
Financial assets designated at FVTPL	-	-	-	-
<b>Total assets</b>	<b>1,852,024</b>	<b>557,131</b>	<b>3,017</b>	<b>2,412,172</b>
<b>Liabilities</b>				
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments	739	507,983	-	508,722
Marketable securities	940,432	-	-	940,432
<b>Total liabilities</b>	<b>941,171</b>	<b>507,983</b>	<b>-</b>	<b>1,449,154</b>

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
	£'000	£'000	£'000	Total £'000
<b>Assets</b>				
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)	-	-	-	-
<b>End of year</b>	<b>1,270</b>	<b>-</b>	<b>1,747</b>	<b>3,017</b>

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

## Notes to the Financial Statements

### 33 Related party transactions

#### *Directors' remuneration*

The remuneration of the directors was as follows:

	<b>2018</b> <b>£'000</b>	<b>2017</b> <b>£'000</b>
Emoluments	2,002	1,327
Company contributions to group personal pension plans	11	11
	<u>2,013</u>	<u>1,338</u>

#### *Pensions*

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

	<b>2018</b> <b>Number</b>	<b>2017</b> <b>Number</b>
Money purchase schemes	<u>1</u>	<u>1</u>

#### *Highest paid director*

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

	<b>2018</b> <b>£'000</b>	<b>2017</b> <b>£'000</b>
Emoluments	908	907
Company contributions to group personal pension plans	-	-
	<u>908</u>	<u>907</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.

### 34 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

### 35 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 credited) £'000	Average Headcount
United Kingdom	1	108,701	(32,975)	1,989	342
Switzerland	2	4,721	473	-	11
Bahrain	2	1,918	405	-	7
Russia	3	620	(174)	-	3
France	3	339	(303)	-	2
		<u>116,299</u>	<u>(32,574)</u>	<u>1,989</u>	<u>365</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 2018 this was -6.4%.