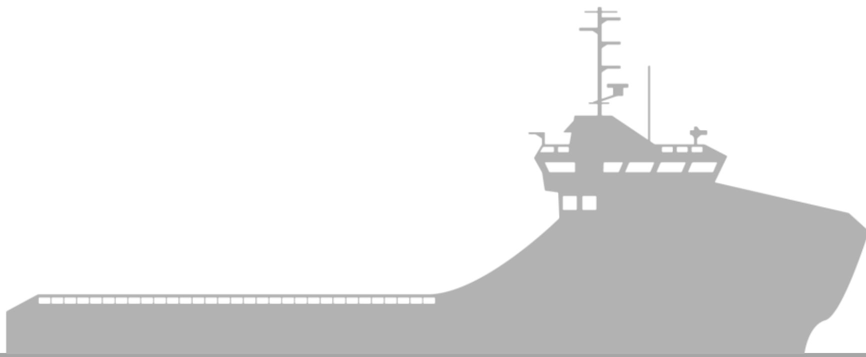

Fearnley Securities

Disclosure of Financial Information 2017

Basel III - Pillar 3

Last updated: 09.03.2020

Fearnley Securities

www.fearnleysecurities.com | An Astrup Fearnley Company

Fearnley Securities

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1. Introduction

The need for managing risks in the financial industry became especially apparent after the collapse of Lehman Brothers and the importance of establishing sound risk management procedures became crucial. As the Basel II entered into force on the 1st of January 2007, Fearnley Securities AS, with its subsidiary Fearnley Securities Inc. were obliged to disclose procedures concerning risk management, risk measurement and financial information related to capital adequacy according to the requirements specified under Pillar 3 of the Capital Adequacy Regulations.

The Capital Adequacy Regulations are constructed around three different Pillars. Pillar 1 describes the quantitative capital adequacy ratios as well as the methods for assessing the risk-weighted volume of counterparty and credit risk, market risk and operational risk. Pillar 2 entails other risks not covered by Pillar 1 and defines requirements as to how the ICAAP process for additional capital shall be addressed. Pillar 3 defines the disclosure requirements of financial information.

2. Basel 3 - The capital adequacy regulations

The main objective of the capital adequacy regulations is to strengthen the stability in the financial system through implementing more risk-sensitive capital requirements, improving risk management and internal control systems, more thorough supervision of the systemic and systematic risks inherent in the financial infrastructure, as well as providing more transparency and information to the financial market.

More precisely the capital adequacy regulations consist of three pillars:

2.1 Pillar 1

The minimum capital requirement in respect of credit-, market- and operational risk exposure is defined in Pillar 1. The different methods applied by the Firm to calculate the risk weighted exposure amounts in Pillar 1 are the following:

Credit risk - the standardized approach

The credit risk weighted assets calculation is based on an estimate of the Exposure at Default (EAD) and assesses capital requirements using standard industry-wide risk weights based on a detailed classification of asset types.

Counterparty credit risk (CCR) - mark-to-market method derivatives (MTM)

CCR differs from credit risk in how the EAD is calculated and applies to traded exposures. It arises where a counterparty default may lead to losses of an uncertain nature, as they are market driven and is the sum of the current market value of the instrument, plus an add-on (dependent on Potential Future Exposure, or PFE) that accounts for the potential change in the value of the contract until a hypothetical default of the counterparty.

Credit valuation adjustment (CVA) - the standardized approach

Credit Valuation Adjustment (CVA) is a regulatory capital charge designed to capture the risk associated with potential mark-to-market losses associated with the deterioration in the creditworthiness of a counterparty. The standardized approach for calculation of CVA applies the external credit rating of each counterparty and incorporates the effective maturity and Exposure at Default from the CCR calculation.

Market risk - the standardized approach

Risk weighted assets calculations for market risk assess the losses from extreme movements in the prices of off-balance-sheet positions related to financial assets and liabilities. The risks pertaining to interest rate-related instruments and equities in the trading book is further dependent on the type of contract, the net position at portfolio level and other inputs relevant to the position. In addition to interest rate-related instruments and equities, the Firm calculates the net open foreign exchange position arising on the entire business activities.

Operational risk - the basic indicator approach

Operational risk is defined as the risk of losses stemming from inadequate or failed internal processes, people and systems or from external events. Operational risk further includes legal risks. According to the basic indicator approach, the Firm must hold capital for operational risk equal to the average over the previous three years of a fixed percentage of positive annual gross income.

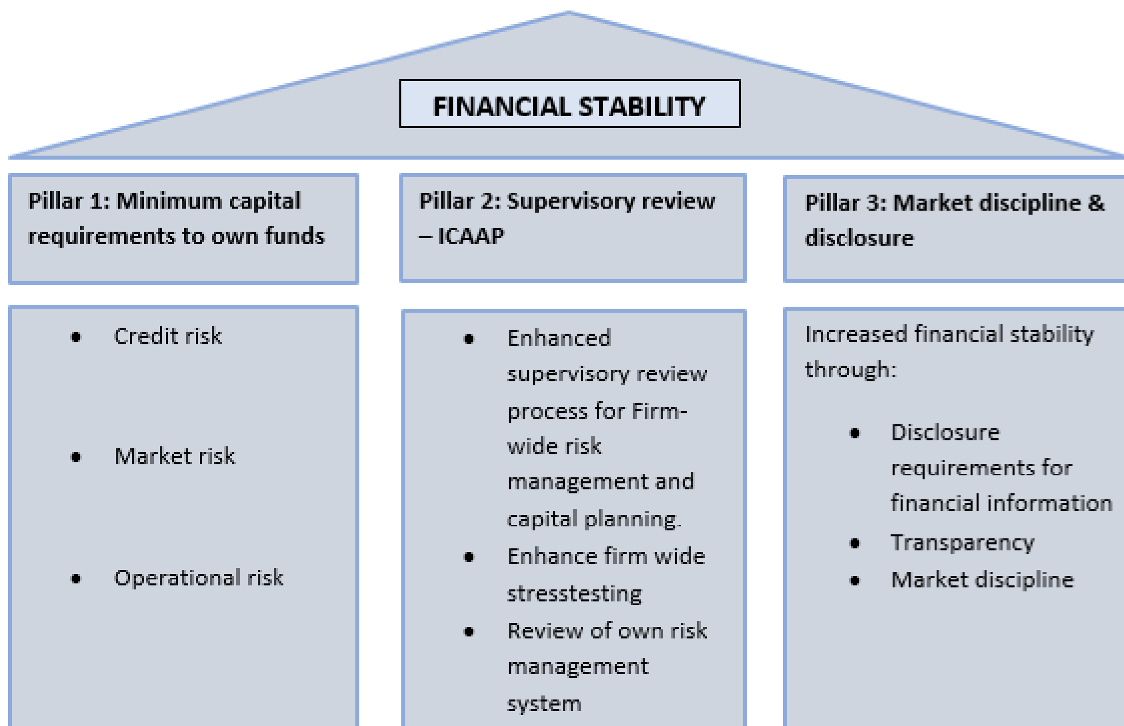
2.2 Pillar 2

The second Pillar in Basel 3 requires firms to assess the risk exposures specific to their business and to calculate the additional capital stemming from the identified risks under Pillar 2.
Pillar 2 entails the requirements imposed on the Firm to have an own process for addressing the risks not being covered by Pillar 1. The internal capital adequacy assessment process (ICAAP) therefore supplements Pillar 1's minimum regulatory capital requirements; it considers a broader range of risk types and the Firm's risk- and capital-management capabilities.
Stress testing is a central element in the Firm's ICAAP process in order to gauge unexpected outcomes related to a variety of risks stemming from worst-case scenarios, and provides the Firm with an indication of how much capital might be needed to absorb losses in case of large shocks.

2.3 Pillar 3

The main objective of Pillar 3 is to contribute to increased market discipline through the disclosure of financial information. Pursuant to the regulations of Basel III, the Firm is obliged to disclose financial information related to its own funds, capital requirements, risk management and internal control processes as well as capital buffers. Through the disclosure of financial information according to common regulatory standards, the market is able to more accurately assess the Firm's chosen risk profile, as well as the internal processes for sound risk management and internal control routines.

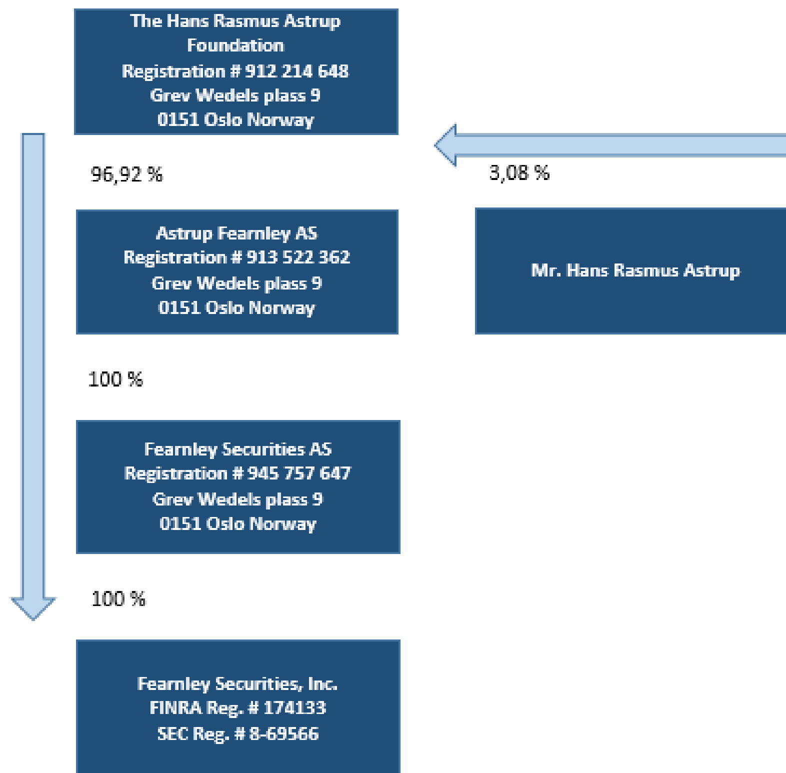
Chart: Basel 3 – The Pillars



3. Group structure and scope of consolidation

Fearnley Securities AS is an independent full-service investment bank, under supervision by the Financial Supervisory Authority of Norway. Fearnley Securities AS has 100% interest in Fearnley Securities Inc. (subsidiary). Fearnley Securities AS is 100% owned by Astrup Fearnley AS.

Chart: The Firm's corporate structure as of September 2017.



3.1 Group structure

Investments in the subsidiary Fearnley Securities Inc. are recognized at acquisition cost in the company accounts. The earnings of subsidiaries and associated companies are recognized by using the equity approach.

3.2 The companies

Fearnley Securities AS is an independent investment bank based in Oslo. The company offers advisory services related to capital raising, IPO, mergers and acquisitions, equity and broking. The Firm focuses mainly on the oil, offshore, shipping and fishing industry. The subsidiary Fearnley Securities Inc., is an independent investment bank with offices in New York. The company was created the 1st of October 2014.

3.3 The services

Broking

Fearnley Securities' broker-team consists of experienced stock- and bond brokers with extensive experience in brokerage of Norwegian and global securities. Fearnley Securities AS puts great emphasis on analysis- and knowledge-based brokerage. The combination of dedicated industry focus and global coverage of institutional investors is the basis for a solid placement power by acquiring equity and debt on behalf of the growing shipping and offshore companies.

Research

The research department is divided into fields of shipping, offshore and energy, and two product areas; stocks and bonds. The research department has a strong focus on providing a well-founded global research product with creative and innovative approaches that provides added value to the customers in their decision making process. The research department covers in total approximately 100 publicly traded shipping, offshore and energy companies listed on exchanges in Asia, North America and Europe.

Corporate finance

The corporate finance department offers counselling related to IPOs, mergers, acquisitions, sales and restructurings, as well as facilitating and raising equity and debt. The department consists of experienced consultants with extensive transaction experience in domestic and international transactions. Fearnley Securities AS is closely linked to its sister companies in the Astrup Fearnley Group. This provides the Firm with a unique access to the market expertise and industrial network in the shipping and offshore industry.

4. Own funds and capital adequacy Pillar 1

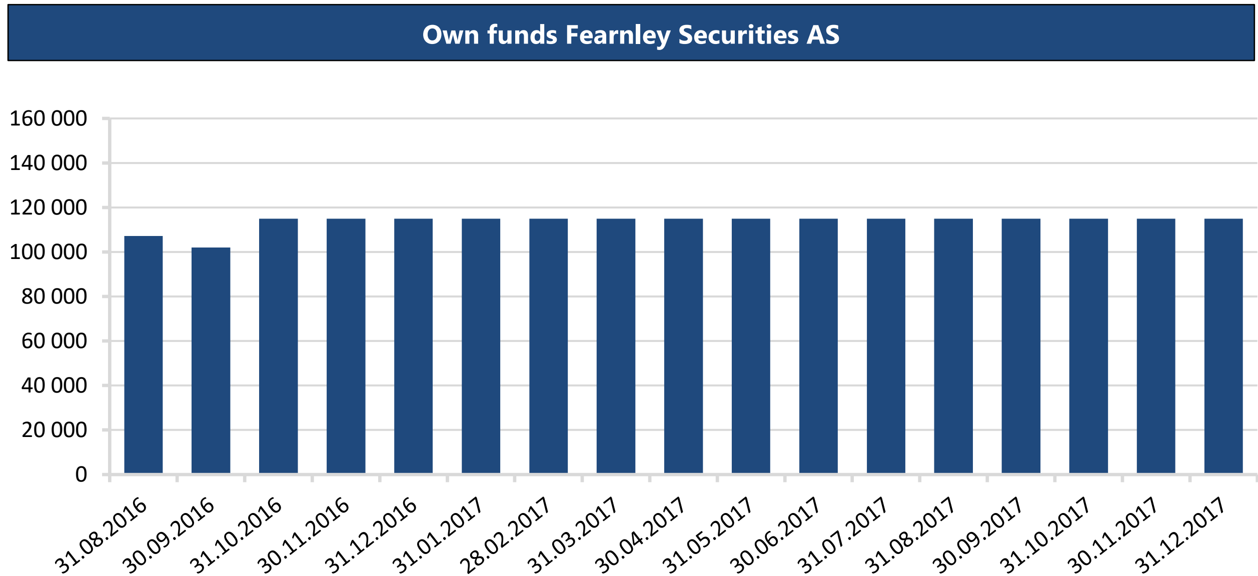
4.1 Own funds and capital adequacy

The own funds and capital adequacy for the Firm at the consolidated level and at parent company level as of 31st of December 2017 are calculated as follows:

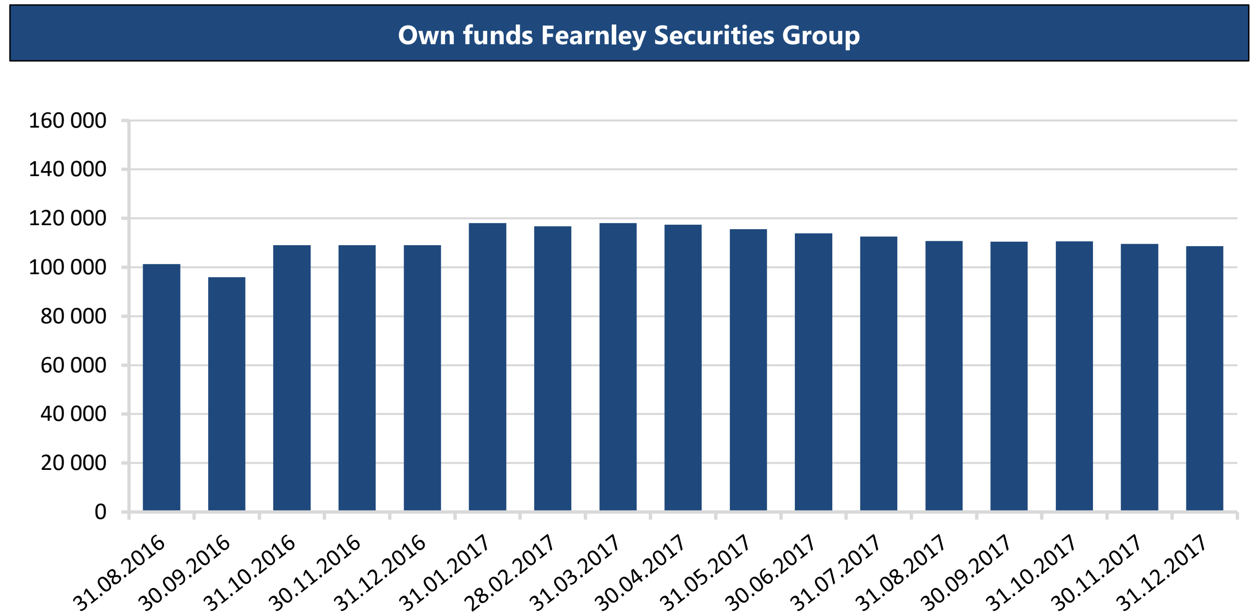
NOK 1.000

Own funds	Fearnley Securities Group	Fearnley Securities AS
Share capital	30 150	30 150
Share premium	70 000	70 000
Other subscribed equity	0	14 850
Other equity	8 530	0
Total core capital	**108 680**	**115 000**

NOK 1.000



NOK 1.000



NOK 1.000

Risk weighted exposure amount	Fearnley Securities Group	Fearnley Securities AS
Credit and Counterparty risk	122 862	135 184
Market risk	26 084	37 094
Operational risk	256 908	236 469
Total risk weighted exposure amount	**405 854**	**408 747**

Capital requirement (min: 8%)	Fearnley Securities Group	Fearnley Securities AS
Capital Adequacy	**26,78%**	**28,13%**

4.2 Leverage Ratio

The CRR/CRD 4 framework introduced a non-risk based leverage ratio as a supplementary measure to the risk based capital requirements. Its objectives are to constrain the build-up of leverage in the financial industry, helping to avoid destabilizing deleveraging processes, which can damage the broader financial system and the economy, and to reinforce the risk-based requirements with a simple, non-risk based "backstop" measure.
Pursuant to Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards the leverage ratio, [...] reporting, disclosure requirements, and amending Regulation (EU) No 648/2012 institutions shall disclose the leverage ratio to their competent authorities.

The Firm's total leverage ratio exposure consists of the components derivatives, securities financing transactions (SFTs), off-balance sheet exposure and other on-balance sheet exposures (excluding derivatives and SFTs).

The Firm reported as of 31.12.2017 a leverage ratio of 13,26% to regulatory authorities for Fearnley Securities AS and a leverage ratio of 12,39% on a group level.
The reported leverage ratio is above the minimum requirement of 3% the unweighted core capital ratio.

5. Internal risk and capital assessment process

5.1 Overview of internal risk and capital assessment process

The responsibility and implementation of the Firm's risk management and control is divided between the Board of Directors, management and operational units. The division of responsibility is operationalized through goals and strategies of the Firm, authorizations and job descriptions as well as internal instructions and procedures. The Firm shall have a risk management and internal control to safeguard the values of the Firm in order to provide an efficient, sound and lawful operation.
Risk analysis is a central component in determining which control measures are necessary to implement. The internal control system provides transparency so that information about the operational processes is available to the management of the Firm and the Board of Directors.
Fearnley Securities has implemented a risk management and internal control model that forms the foundation to identify, manage, monitor and report risks to which the Firm may be exposed. The risk management and internal control model includes all risk areas and is focused around the areas where the risk is assumed to be the greatest. At least annually, in consultation with the risk management and compliance function, the different line managers perform an update of the risk management and internal control model. After the review of the model, the updates are implemented in cooperation with the CEO.

The Board of Directors

Management of the Firm falls under the guidance of the Board of Directors. The Board of Directors shall ensure that the Firm's equity is appropriate to the risk and scale of business and that capital requirements stipulated by laws and regulations are respected. The Board of Directors conducts ongoing assessment of the Firm's capital position and annually reviews the principal areas of risk management and internal control. Based on the report from the CEO, the review aims to document the quality of work in the various areas and identify any weaknesses and needs for improvement. The Board of Directors has

adopted a policy for risk management and internal control and the Board of Directors performs evaluation of the policy at least annually.

CEO

The CEO is in charge of the day-to-day management of the Firm in accordance with the instructions and orders given by the Board of Directors. The CEO defines the ground of the internal control environment by providing leadership and direction to senior managers and reviewing the way they are controlling the business. The CEO is in charge of the risk management process of the Firm and its continuous development, allocation of resources to the work, review of risk management policies as well as defining the principles of operation and overall process. In accordance with the Firm's overall strategy and risk appetite, the CEO defines trading and position limits. At least once a year the CEO reports to the Board of Directors on risk management and internal control based on the reports received from the line managers. The external auditor reviews the report but makes no "judicial" (assessment) of the Firm's own judgments and conclusions.

Line Managers - first line of defence

Line managers have the ongoing responsibility for risk management within their areas of responsibility. They have the primary responsibility for identifying, assessing, managing, controlling and reporting risks. Risk assessment should be an integral part of the daily business processes in the Firm. In order to identify the Firm's operational risks, the line managers assess at least once a year the risks inherent in their respective area of responsibility. The objective is to identify key risks, assessing these risks, gauging whether the established control has proven sufficient to operate as intended and whether there is a need to establish further risk prevention measures. Based on the reports from the line managers, the CEO summarizes the total risk management and internal control in the Firm to the Board of Directors.

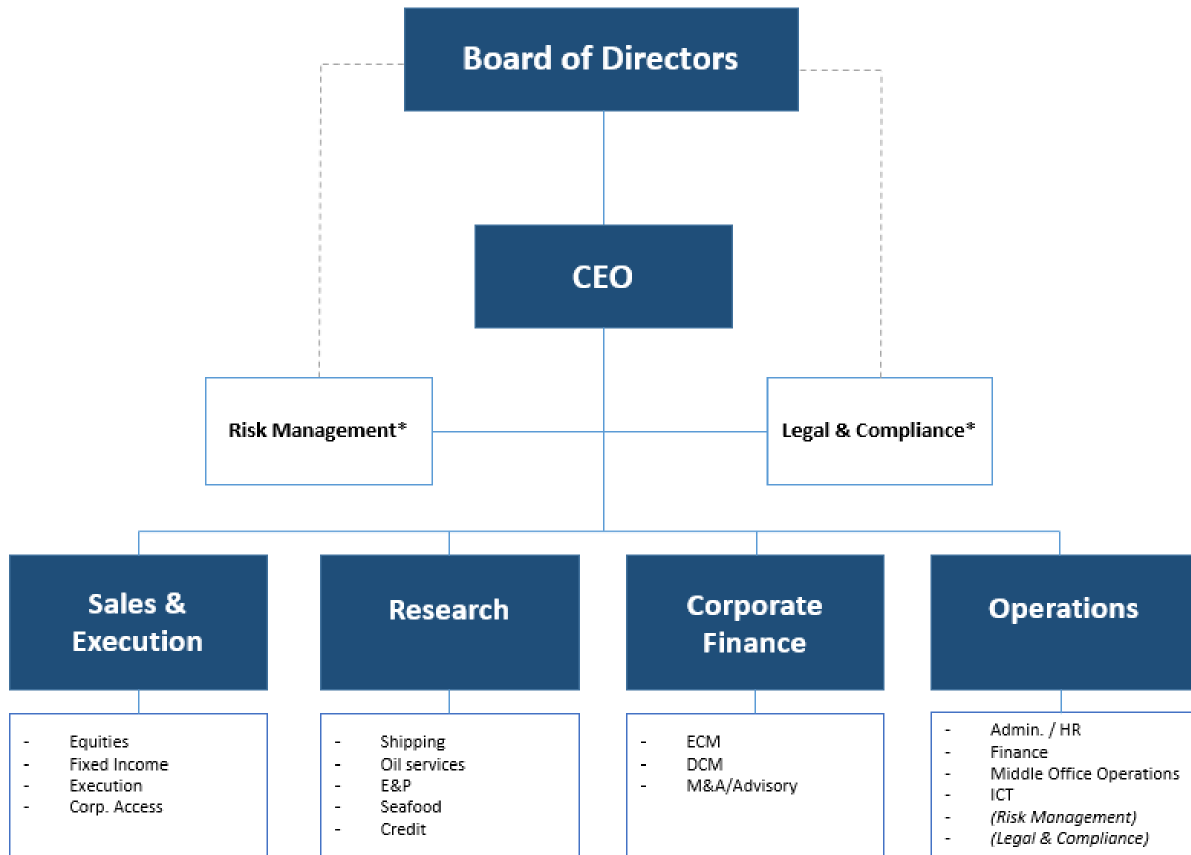
Risk Management and Compliance - second line of defence

The risk management and compliance function shall assist the Board of Directors, the CEO and the line managers with risk management and internal control, and coordinate and oversee the implementation of prudent risk governance and internal control systems throughout the organisation as a whole. The second line of defence monitors and facilitates the implementation of effective risk management practices by operational management and assists the risk owners in reporting adequate risk related information up and down the organisation. As from the 4th quarter 2016, the risk management function in the Firm became independent and separated from the compliance function.

Internal audit - third line of defence

Internal audit forms the Firm's third line of defence. An independent internal audit function provides through a risk-based approach to its work assurance to the Firm's Board of Directors and senior management. This assurance will cover how effectively the organisation assesses and manages its risks and will include assurance on the effectiveness of the first and second lines of defence. It encompasses all elements of an institution's risk management framework (from risk identification, risk assessment and response, to communication of risk related information) and all categories of organizational objectives: strategic, ethical, operational, reporting and compliance. The Internal audit function was established with effect from 1st of January 2016.

Chart: Organizational chart including the Risk Management and the Legal & Compliance function



5.2 Summary of capital adequacy

The capital requirement under Pillar 1 consists of the risk-weighted exposure amounts for credit risk, market risk and operational risk. The Firm's capital requirements under Pillar 1 is as of 31.12.2017 as follows:

NOK 1.000

Capital requirement	Fearnley Securities Group	Fearnley Securities AS
Credit, counterparty and impairment risk	9 829	10 815
Settlement risk	0	0
Market and currency risk	2 087	2 968
CVA risk	0	0
Operational risk	20 553	18 918
Total capital requirement	**32 469**	**32 701**

The Firm has low risk in the balance sheet and low loss potential compared to banks and investment firms that have active proprietary trading and / or credit as an important part of their business strategy. The Firm's exposure and capital requirements are therefore primarily related to operational risk. As

displayed in the table above, the capital requirement related to operational risk represents the largest share of the total capital requirement.

6. Assessment of internal Pillar 2 capital

6.1 Overview of the regulatory Pillar 2 framework

According to Article 73 of the CRD, "Institutions shall have in place sound, effective and comprehensive strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or might be exposed."

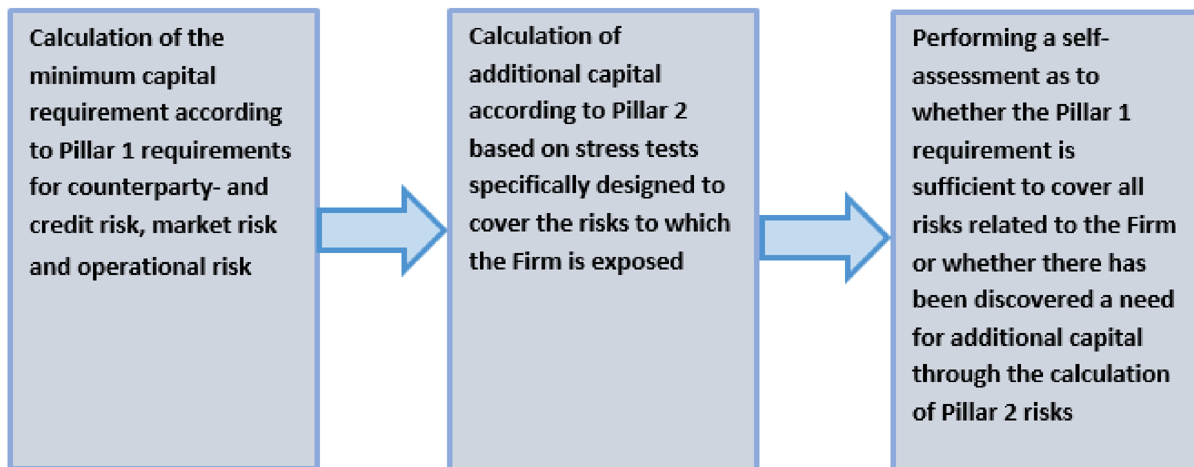
Pillar 2 imposes requirements as to the self-assessment of the Firm's risks and internal capital needs beyond those implied by Pillar 1, under the designation ICAAP (Internal Capital Adequacy Assessment Process).
The Firm shall at all times have an established framework and guidelines for the ICAAP process which is to be reviewed and undertaken at least annually and on request from the FSA. The process for updating the ICAAP shall be subject to an independent internal review and quality control.

The ICAAP process shall be risk-based and cover all significant risks to which the Firm is exposed, including the risks stemming from Pillar 1 and Pillar 2. Risk and capital assessments in the ICAAP documentation shall be perceived as relevant and appropriate. The ICAAP should be forward looking and contain a list of contingency measures to improve the Firm's capital in case of crisis.
The capital identified through the ICAAP process in addition to the regulatory minimum capital requirement from Pillar 1 forms a basis for defining a lower limit below which the capital adequacy ratio at all times shall not fall. If the capital adequacy ratio falls below this lower limit, the Board of Directors shall assess whether additional capital is needed to maintain the minimum capital required from Pillar 2.

Central to the assessment of the Firm's long-term capital are processes and models for stress tests. The aim is to identify factors that may affect the risks and capital adequacy negatively. Stress tests shall include all essential elements of risks and shall include an assessment of the implications for the Firm's solvency. The scenario stress test shall cover a period of three years.
The stress tests shall estimate relevant conditions that might occur in a worst-case scenario, which the Firm should take into account when considering its long-term operations. Estimate and determination of the capital level shall be included in an overall risk assessment together with assessment of future growth plans and strategy.

The Firm has developed quantitative stress tests to calculate capital requirements under Pillar 2 of the following categories: credit- and counterparty risk, market risk, liquidity risk and concentration risk, and has defined a forward-looking scenario with substantial loss of income due to macroeconomic downturns (commercial risk).

Chart: Illustration of the process of assessing the internal capital under Pillar 2



6.2 Risk categories, management and control

The Firm analyzes the risk and evaluates if additional capital is required under Pillar 2 for the following risk categories:

- Credit and counterparty risk
- Market risk
- Operational risk
- Liquidity risk
- Concentration risk
- Interest rate risk
- Pension obligation risk
- Ownership risk
- Commercial risk, including reputational risk
- Regulatory risk
- Systemic risk

The Pillar 2 capital requirement for the above risk categories is calculated separately.

In general about the Firm

The Management and other employees have a strong awareness of risk and compliance culture as the Firm has a conservative approach to risk and low risk tolerance.

The Firm does not currently offer credit to customers and does not engage in proprietary trading of financial instruments related to management of own assets. Investments in the trading portfolio are related to brokerage or capital procurement. Investments in the trading portfolio in connection to brokerage or capital procurement shall only be performed by authorized employees and shall have a short time horizon.

The Firm and its employees shall at all times comply with laws, rules and regulations and hold the necessary permits from regulatory authorities in Norway and abroad.

Operational risk constitutes a significant risk for the Firm and is safeguarded through internal instructions and procedures, training of staff and a strong awareness of regulatory compliance. Internal control is an important measure and is deliberately applied to limit operational risks in business.

Credit and counterparty risk

Credit and counterparty risk is the risk of loss due to the Firm's counterparties or customers not being able to meet their obligations towards the Firm, and when the collateral cannot be realized or has to be realized with loss.

The Firm does normally not grant credit to customers and does not apply credit derivatives, neither for hedging, nor held for own exposure or on behalf of others. The Firm does not accept guarantees as collateral.

The Firm is primarily exposed to credit and counterparty risk in connection with the settlement of financial instruments, i.e. the period from when a transaction is entered into until the agreed settlement date (usually 2 days for transactions in the secondary market and usually slightly longer period for private placements).

The Firm conducts credit evaluation of customers. Transactions that are not settled on the settlement date are in line with internal instructions closely supervised by Middle Office. Larger unsettled transactions are reported to management, who may initiate necessary action. To the extent possible and practicable, the Firm routes the transactions through a clearinghouse as part of managing the credit and counterparty risk.

The Firm assumes credit and counterparty risk in derivatives positions. Counterparty risk is managed by derivative contracts traded on regulated markets and cleared through clearing houses. The Firm further assumes credit and counterparty risk in connection with borrowing financial instruments (borrowing from counterparties, being banks and loans to customers). Middle Office daily monitors the margin calculation system in close coordination with risk management in order to ensure that satisfactory collateral for the exposure of the short loans is posted within defined deadlines.

The credit and counterparty risk related to the Customer positions of short loans is considered moderate. Accordingly, the Firm holds additional Pillar 2 capital for credit and counterparty risk.

Market risk

Market risk can be defined as the risk of losses in on and off-balance sheet positions arising from adverse movements in market prices. From a regulatory perspective, market risk stems from all the positions included in institutions' trading book as well as from commodity and foreign exchange risk positions in the whole balance sheet.

The Firm has a pure and focused business model based on customer trading, brokerage and advisory services in connection with capital procurement.

The Firm does not engage in proprietary trading in equities, bonds or derivatives as part of asset management of own funds. The Firm may assume equity or fixed income positions in the trading portfolio in connection with brokerage, issues or private placements. Positions in the trading portfolio shall have a short horizon and shall be exercised by authorized employees. The risk management function is responsible for the daily control and reporting of risk in the trading portfolio and supervises

that the positions are within acceptable limits and defined guidelines. Derivatives and short positions are not part of the trading portfolio.
The Firm does normally not hold positions outside the trading portfolio, except from the ownership in the subsidiary Fearnley Securities Inc.
The market risk related to proprietary trading is considered low. However, in some exceptional cases positions can be included in the trading portfolio. Accordingly, the Firm has concluded to hold additional Pillar 2 capital for market risk related to proprietary trading.

The Foreign Exchange risk is considered part of the market risk. The Firm's revenues are mainly in NOK, EUR and USD. Foreign currencies are normally converted into NOK when the income is earned. Through ownership of the subsidiary (Fearnley Securities Inc.), the parent company experiences currency risk in relation to both the asset side as well as revenues and expenses. The currency risk on the asset side is linked to the Firm's investment in the subsidiary. The ownership is however considered to be long-term and the Firm normally does not undertake any hedging of the foreign exchange risk.
Even though the foreign exchange risk is considered to be low as the ownership in the subsidiary is considered long term, the Firm has chosen to hold additional Pillar 2 capital for foreign exchange risk and equities on own book.

Operational risk

Operational risk is the risk of financial losses or loss of reputation for the Firm stemming from inadequate or failed internal processes, human error, incorrect systems or external events. The definition includes all aspects of the Firm's activities, including administrative risks as personnel, finance, IT security, physical security, operations, legal risk, control and daily operations.
Operational risks are controlled and prevented through appropriate internal systems and internal controls, instructions and procedures for operations, employee training, quality assurance and reporting. The line managers and employees are responsible for regularly identify, quantify and prevent operational risk when implementing new processes and appropriate risk management procedures.
Monitoring and control of operational risks is performed by the risk management function and the compliance function. Regularly and at least annually, a documented self-assessment (internal control) is performed in order to identify the operational risks and further to identify eventual appropriate preventive measures.
In relation to operating income, compared to banks and investment firms that have proprietary trading and/or granting of credit as an important part of their strategy, the Firm experiences low risk in the balance sheet related to operating income. Consequently, the Firm's exposure and capital requirement is primarily due to operational risk. The Firm has signed a liability and crime insurance.
As no severe incidents related to operational risk have resulted in any significant financial losses, the operational risk is considered low. In the ICAAP however, the Firm holds additional Pillar 1 and Pillar 2 capital for operational risk.

Liquidity risk

Liquidity risk is the risk of financial loss as the Firm is unable to meet its ongoing payment obligations and/or fund increases in assets without incurring significant extra costs due to decline in prices of assets that must be realized or in the form of additional cost financing cost. The Firm is not dependent on external funding for ongoing operations and surplus liquidity is allocated to solid Nordic banks.
The Board of Directors has in the liquidity strategy adopted specific instructions and contingency plans for liquidity risk management.

The funding liquidity risk is considered low and no additional Pillar 2 capital is held to cover the funding risk. The Firm holds however, additional Pillar 2 capital related to the liquidity risk from unsettled equities that could be bought in/sold out.

Concentration risk

The Firm allocates surplus liquidity to solid Nordic banks. Even though there is some concentration risk related to the Firm’s allocation of surplus liquidity to solid Nordic banks, the Firm estimates the risk to be low.

The Firm operates brokerage (equities, bonds and derivatives) services. The counselling and income side is therefore dependent on the continued well performance of these areas. Revenue is diversified in terms of industries and regions. Despite the fact that revenue is diversified between various industries and regions, the income stems from a few large customers in the second hand market. Firm complies with regulations for large exposures.

As the income stems from a few large customers, the concentration risk is considered moderate and accordingly the Firm holds additional Pillar 2 capital for that risk type.

Interest rate risk

Interest rate risk is the risk of losses arising from changes in interest rates and different remaining fixed-rate periods of the individual assets and liabilities. Interest rate risk is measured both on and off the balance sheet. The Firm has low interest rate risk related to the balance sheet.

Excess liquidity is placed in the major Nordic banks without maturity. The Firm has no interest bearing debt. The objective of interest rate risk management is that the Firm is familiar with the risks and that this risk is within the established management objectives. The Firms interest rate exposure is mostly short-term and Middle Office monitors and measures daily the majority of the interest rate risk.

The Firm considers the interest rate risk to be low and no additional Pillar 2 capital is held to cover the interest rate risk in the Firm.

Pension obligation risk

Fearnley Securities AS has defined contribution plans for its employees, and the scheme consists of monthly deposits being paid in according to the pension obligation.

Risks related to pension liabilities are considered low no additional Pillar 2 capital is held to cover the risk stemming from the risk type described above.

Ownership risk

Ownership risk is defined as the risk that the Firm will incur negative results from ownership in strategically owned companies and/or the need to inject new equity.

The COO is the chairman of the subsidiary. Ownership risk related to the subsidiary consists primarily of the underlying operational risk stemming from the coverage of any eventual deficit that might occur. Any loans to the subsidiary will be included under credit risk and concentration risk.

Ownership risk is considered low and no additional Pillar 2 capital is held to cover the risk stemming from the risk type described above.

Commercial risk, including reputational risk

Commercial risk is defined as the risk of unexpected income and cost fluctuations in next year's operation, due to changes in external factors such as economic cycles or customer behaviour and regulatory oversight by public authorities, i.e. other than credit risk, market risk and operational risk. Reputation risk is included in commercial risk.

Lack of compliance with regulations is a significant risk in the business. Compliance with rules and regulations is ensured by the Firm's own Risk Management and Compliance function, which are regulated by defined instructions issued by the Board of Directors.
Competition in the market is closely monitored and management and the Board of Directors continuously make adjustments.
Commercial risk is manifested through unexpected decline in profits. This may be due to competitive conditions resulting in lower volumes, price pressure, government regulations or negative media coverage. Losses arise unless the Firm is able to adapt costs to such changes, or compensate loss through increasing other revenues.
Sound strategic planning, prudent monitoring of budgets and results and focused cost control, is the main tool to reduce commercial risk. The Firm endeavours diversified earnings and consequently the business area has expanded both in terms of product range, business and geography.
Specific management objectives concerning the commercial risk area have not been implemented. The Firm's costs and results are therefore reported quarterly to the Board of Directors and are continuously monitored by the management.
The Firm's income diversification, low cost, flexible solutions and the management's continuous monitoring and control routines enable our business to quickly adapt to altering market conditions.
As it takes many good deeds to construct a good reputation and only one bad to lose it, the Firm considers it a major importance to maintain close relations with its customers and stakeholders. Hence, the Firm strives to hold the highest level of professionality towards existing as well as potential customers and stakeholders in an environment with constantly altering expectations.
As the commercial risk is considered moderate, the Firm holds additional Pillar 2 capital in order to take into consideration a possible shortfall in revenues due to a macroeconomic downturn scenario.

Regulatory risk

Regulatory risk is the risk that a change in laws and regulations will materially affect a security, business, sector or market. A change in laws or regulations made by the government or a regulatory body can increase the costs of operations a business, reduce the attractiveness of investment and/or change the competitive landscape.
The Firm operates in a business environment where laws and regulations are constantly changing and the Firm's Compliance and Risk Management department are continuously monitoring these changes so that that the Firm smoothly can adapt its business accordingly.

Investment firms are currently according to CRD IV exempt from holding additional capital to cover the Capital Conservation Buffer and the Countercyclical Capital Buffer:

Capital Conservation Buffer

The capital conservation buffer is designed to ensure that banks build up capital buffers outside periods of stress, which can be drawn down as losses are incurred. The requirement is based on simple capital conservation rules designed to avoid breaches of minimum capital requirements.

Countercyclical Capital Buffer

The countercyclical capital buffer is part of a set of macroprudential instruments, designed to help counter pro-cyclicality in the financial system. Capital should be accumulated when cyclical systemic risk is judged to be increasing, creating buffers that increase the resilience of the financial sector during periods of stress when losses materialise. This will help maintain the supply of credit and

dampen the downswing of the financial cycle. The countercyclical capital buffer can also help dampen excessive credit growth during the upswing of the financial cycle.

Even though the Firm according to CRD IV does not have to hold additional capital to cover the buffer requirements, the Firm will have to hold additional capital for the Capital Conservation Buffer and the Countercyclical Capital Buffer when the rest of the CRD IV has been implemented in the Norwegian law. The regulatory risk is therefore considered moderate and consequently the Firm has decided to hold additional Pillar 2 capital for this risk type.

Systemic risk

Systemic risk is the possibility that an event at the company level could trigger severe instability or collapse an entire industry or economy. A company that is highly interconnected with others is also a source of systemic risk. The Firm has no direct exposure to the housing market and the exposure in the derivatives market is low. The Firm allocates its liquidity to a few solid Nordic banks.

The systemic risk is considered low and the Firm does not hold additional Pillar 2 capital for the systemic risk.

6.3 Contingency plans

Based on stress tests of positions, liquidity and capital need, the Firm has developed contingency plans for: 1) The need for additional capital, and 2) Liquidity.

Contingency plan for additional capital

Category	Responsibility
Cost - significant downsizing and other cost cuts	Management evaluates and implements appropriate measures.
Issue - raising capital from Astrup Fearnley AS	Management evaluates and presents proposals to increase regulatory capital to the Board of Directors.
Management considers and presents suggestions for short-term borrowing to the Board of Directors	Management considers and presents suggestions for short-term borrowing to the Board of Directors.
Short-term borrowing from banks	Management considers and presents suggestions for short-term borrowing from selected banks to the Board of Directors
Short-term guarantees from banks	Management evaluates and presents proposals to guarantee admission to the Board of Directors
Large exposures with customers/ counterparties	Management assesses additional counterparties related to borrowing of shares, lower exposure limits for each

	customer or generally an increase in the capital base

Contingency plan for additional liquidity

Below is a priority list of measures in a crisis where the Firm experiences a significant loss of liquidity. Head of Middle Office Operations is responsible for immediately reporting to the CRO, COO and Compliance in the event of a liquidity crisis. Head of Middle Office Operations prepares in consultation with the CRO, COO and Compliance a statement to the CEO of the situation. The contingency plan shall to be prepared within a few hours.

The CEO shall report the status to the Board of Directors.

Priority list of actions taken in an emergency by a shortage of liquidity for the Firm:

- Deduct cash allocated to different banks (excess liquidity)
- Not perform «free of payment» transactions
- Draw on credit facilities at the Firm's main bank
- Request overnight credit from the Firm's bank (cash settlement in connection to the settlement of foreign securities)
- Request additional guarantee from Norges Bank/VPS
- Sell out positions in the trading book
- Sell out warehoused positions/non approval of warehousing of positions
- Close or liquidate credit contracts granted to customers – has to be executed within the agreed deadlines
- Enter into agreements for credit facilities with other banks than the main bank of the Firm