BCS

Broker Credit Service

BROKERCREDITSERVICE (CYPRUS) LIMITED

RISK MANAGEMENT DISCLOSURE

YEAR 2008

April 2009

ACCORDING TO CHAPTER 7 (PAR.34-38) OF PART C AND ANNEX XII OF CYPRUS SECURITIES AND EXCHANGE COMMISSION DIRECTIVE DI144-2007-05 FOR THE CAPITAL REQUIREMENTS OF INVESTMENT FIRMS

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1. SCOPE OF APPLICATION

The following information is disclosed in accordance with Chapter 7 (paragraphs 34-38) of Part C and Annex XII, Part 2 of the final text of Directive DI144-2007-05 of the Cyprus Securities and Exchange Commission for the Capital Requirements of Investment Firms.

BROKERCREDITSERVICE (CYPRUS) LIMITED (BCS) was incorporated in Cyprus on 7 December 2004 as a limited liability company. BCS principal activity is the provision of Investment and Ancillary Services, Investment Activities for the Financial Instruments under license number 048/04 dated 8 October 2004 granted by the Cyprus Securities and Exchange Commission.

2. CAPITAL BASE

Capital base of BCS is comprised of original own funds, which include share capital, share premium and audited accumulated revenue reserve retained over the years.

At 31 December 2008 own funds of BCS were analyzed as follows:

Original own funds	2008 USD
Share capital	1,490,000
Share premium	5,510,000
Revenue reserve	2,749,903
Total own funds	9,750,403

3. CAPITAL REQUIREMENTS

BCS follows the Standardized Approach for the calculation of capital requirement for credit risk. The breakdown of credit risk requirements used for calculating the Capital Adequacy Ratio is presented below.

Asset Classes	Risk Weighted Amounts USD	Minimum Capital Requirement USD
Administrative Bodies and Non-Commercial Undertakings	40,000	3,000
Corporates	5,095,000	408,000
Institutions	6,339,000	507,000
Other items	230,000	18,000
Total	11,704,000	936,000

For the purpose of applying the Standardized Approach BCS has selected Fitch Ratings in determining the risk weights for exposures to institutions.

4. PROCEDURES FOLLOWED TO IDENTIFY ANY ADDITIONAL CAPITAL REQUIREMENTS

In order to anticipate and take necessary measures with regard to additional capital requirements and maintaining existing capital adequacy ratio BCS on a monthly basis calculates the capital adequacy ratio and monitors its direction over the medium term period. During the year 2008 the ratio never fell below twice of what is deemed minimum by CySEC. Should this situation ever present itself, BCS will take all necessary steps to impose limits on what level of assets must be kept with high risk institutions, shifting funds into less risky places of custody and consider the possibility of injecting additional capital in order to always be in line with the rules set out by Directive 144-2007-05.

5. BCS RISK MANAGEMENT

The Board of Directors has the ultimate responsibility for the risk appetite of BCS and the monitoring of risks on a regular basis. Board of Directors has appointed a Risk Management Committee with the following mandates:

(a) the formation of BCS policy in respect of the limits and the pricing terms for the undertaking of risks by BCS
(b) to ensure that BCS has sufficient capital and reserves to support the risks undertaken
(c) the continuous review of the adequacy of the limits set for the undertaking of risks.

The Head of Risk Management Department reports to the Risk Management Committee and the latter directly to the Board of Directors.

In the course of its operating activities BCS has to face and tackle the following risks:
1) Financial risks:
1.1) Credit risk.
1.2) Market risks:
1.2.1) Price-related risk (stock market risk).
1.2.2) Asset liquidity risk (liquidity of securities and derivatives).
1.3) Risk of balance-sheet liquidity (funding risk).
1.4) Interest rates risk.*
1.5) Currency exchange risk.*
2) Operational risks.

*Out of the list of financial risks, those related to interest rates and currency exchange rates are the least crucial for BCS, and this is why are not analyzed separately.

To assess and manage the aforementioned risks, BCS employs special, internally generated valuation methodologies. Risks are controlled automatically, via specially developed software solutions.

The enhancement of the system employed by BCS to assess and manage various risks is based on the following principles:

1) BCS is committed to constantly updating its system of risk analysis and risk monitoring and to identifying new types of risks.

2) The registry of risks undergoes regular revision and upgrade. In the course of work with this registry, BCS experts identify areas of risk concentration, carry out detailed analysis and register newly identified risk areas.

3) Monitoring, modeling and analysing of critical situations.

6. CREDIT RISK MANAGEMENT

Credit risk is the risk BCS suffers losses as a result of counterparties defaulting on their contractual obligations.

A counterparty's credit risks are assessed via the analysis' of a counterparty's and clients' reliability, i.e, the analysis of their financial statements and non-financial indicators, including constant monitoring of the news flow regarding BCS counterparties.

Out of all credit risks, BCS is most exposed to a counterparty risk. Risks inherent to issuers and clients are managed via methods, basically similar to those used to assess the counterparty risk. The counterparty risk is managed via imposing of trading limits on transactions executed with the counterparty.

BCS sets counterparty limits in accordance with the internally generated methodology. BCS also employs Altman's Z-score model and ZETA model to evaluate a probability of a counterparty's bankruptcy and, if needed, resorts to elements of other approaches, methods and models used to assess and manage various risks.

In order to manage credit risks during the current economic and financial crisis, BCS revises limits regularly, at least once a month, to keep changes in counterparties' solvency profiles under strict control. At the same time, BCS introduces amendments into the existing methods of limits assessment, reflecting results of stress-tests.

BCS recognizes as well provision for impairment in respect of held to maturity and available for sale investment securities where there is objective evidence of impairment during BCS' assessment at each reporting date.

BCS continuously evaluates, on a monthly basis, the value of its securities that are available for sale and monitors relevant information regarding the issuers of the securities in its portfolio.

For securities that regularly trade on the stock exchanges BCS takes the closing price of the last day of the month as a fair value.

For securities that have relevant bid and ask price BCS takes the average price of the two as a fair value.

For securities of the mutual fund BCS takes the value of such security on the website of its issuer and that is later officially confirmed by the issuer.

7. MARKET AND LIQUIDITY RISK MANAGEMENT

Market risk is the risk associated with changes in the market prices, such as interest rate changes, changes in equity prices and foreign exchange, which may eventually impact BCS net income or the value of BCS assets and liabilities.

Valuation risks and an asset liquidity risk are assessed via statistical and analytical methods. The most widely used methods are as follows:

1. VaR-methodology (value at risk).
2. Expected losses in excess of the VaR (ES – expected shortfall).
3. Analysis of sensitivity to some detrimental factors.

The following analytical approaches are used:

1. Expert assessment
2. Fundamental analysis
3. Stress-testing (is used to evaluate how much BCS counterparties and the target securities which BCS is focused on are vulnerable to critical situations)

When entering into new business niches, BCS carries out a comprehensive analysis of financial instruments it intends to work with.

BCS evaluates currency-related risks using statistical and analytical methods, similar to those applied to assess market risks inherent to stocks and depositary receipts.

BCS is almost entirely protected against interest rate risks, because the share of fixed income securities in the total trading turnover is insignificant.

Liquidity risk is the risk of profit or capital reduction arising from the inability of BCS to satisfy its immediate obligations.

Liquidity is evaluated using several indicators, which have different weightings in the liquidity valuation formula. BCS in-house documents outline an acceptable value range for each indicator, with each value level standing for this or that notch. The cumulative liquidity measure is a sum of these notches for each indicator. The value of the final cumulative measure is a rating criterion, which is applied to classify stocks and put them into different liquidity tiers.

The balance-sheet liquidity risk is managed jointly by the Risk Management Department and the Financial Department. The Financial Department is responsible for planning and supervising asset flows on BCS accounts; the Risk Management Department is in charge of analyzing risks connected with the failure to receive, partly or in full, incoming projected cash payments and other assets.

Financial risks management is one of the key elements of the market risks management system. In terms of timing, BCS singles out the proactive and ensuing control. The proactive control is carried out right before the execution of a transaction, which makes BCS assume additional risks. The ensuing control is associated with the constant monitoring of prices for financial instruments, the overall assessment of the market environment after the execution of a transaction which exacerbates BCS market risk exposure, the control over financial health of BCS counterparties during periods between official rating assignment, etc.

<u>BCS employs the following procedures of proactive control:</u>

- Supervision of transactions in order to eliminate a probability of excessive, unacceptable market risks;
- Control over compliance of transaction- and market-related risks with the requirements;
- Checking financial instruments in BCS internal registry of securities which are not eligible for transactions;

- Checking a counterparty's compliance with the requirements set by BCS.

Procedures of ensuing control:

- On-line monitoring of actual and acceptable risk levels;
- Control over the highest possible levels of risk for different types of transactions and market segments;
- Compliance between the volatility measure, used to assess the likely risk before the execution of a transaction, and the current intraday volatility of returns generated from a financial instrument;
- Assessment of probable instability of a financial instrument (or market as a whole) with the help of special indicators;
- Regular monitoring of changes in financial standing of BCS counterparties;
- Monitoring and projecting critical situation.

BCS employs the system of on-line monitoring of stock market transactions and over-the-counter transactions with the help of the internally generated software programme. This programme is capable of assessing credit, market and liquidity risks.

8. OPERATIONAL RISKS

Operational risk is the risk of loss arising from inadequate of failed internal procedures, human behavior and systems or from external events.

Internal risks are split into:

- individual risks (misdemeanor, employee's incompetence, human errors, corporate abuse);
- procedural risks (incorrect orders, lack of control, operating bottlenecks);
- technical risks (computer failures, software errors, unauthorized access, etc.), others.

External risks include disasters, partners' misdemeanor, external technical failures, regulatory risks, legal risks, etc.

To execute control over operational risks, there exist formalized business processes which comply with goals pursued by BCS. All business processes are interrelated via quality-control checkpoints responsible for identifying and eliminating the system's bottlenecks and weaknesses. All these checkpoints are subject to constant monitoring and internal audit control.

The compliance with the requirements of the acting legislation is under particularly strict control:

- control over compliance with license requirements;
- internal registration of executed transactions in accordance with rules stipulated in regulatory statutes;
- control over timely release of a financial statement and audit checks;
- imposing of anti-money laundering measures and anti-terrorist financing initiatives;
- control over business processes automation;
- control over introduction of new services/new types of business activities;

- control over compliance with regulatory statutes during margin trading.

BCS calculates its operational risk using basic indicator approach, i.e. the average of net income for the past three years.

The breakdown of components that are included in the calculation of the operational risk are the following:

	2008 USD
Profit from trading in financial instruments	1,668,274
Dividends received	122,714
Commissions	1,498,690
Interest income	331,308
Profit from contracts for differences	951,922
Total	4,572,908

The above total is summed with a net income of 1,443,000 and 6,452,000 for the years 2007 and 2006 respectively; this produces a total of 12,467,908. An average of that sum is 4,155,969 in accordance with Directive 144-2007-05, we take 15% of that amount (623,395) as the current operational risk for BCS.