



# **Mizuho International plc**

## **Pillar 3 disclosures**

***31 March 2017***

***Mizuho International plc***

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# 1. Introduction

## 1.1. Objective

This document sets out disclosures in respect of Mizuho International plc (MHI) required under European Union (EU) CRD IV legislation, consisting of the Capital Requirements Regulation<sup>1</sup> (CRR) and the Capital Requirements Directive<sup>2</sup> (CRD).

Pillar 3 disclosures, as required under Part Eight of the CRR provide market participants with information on a firm's risk governance, risk management processes, risk exposures, and capital resources.

Directive imposed disclosure requirements are implemented within the UK through Prudential Regulation Authority (PRA) rules<sup>3</sup>. These disclosures provide market participants and other stakeholders with information in relation to a firm's governance and remuneration practices.

## 1.2. Regulatory information

MHI is authorised by the PRA and regulated by the Financial Conduct Authority (FCA) and the PRA. MHI is entered into the Financial Services Register and its register reference number is 119256.

## 1.3. Forward looking statements

Certain statements in this disclosure document are forward looking with respect to plans, goals and expectations relating to the future financial position, business performance and results of MHI. Although MHI believes that the expectations reflected in these forward-looking statements are reasonable, MHI can give no assurance that these expectations will prove to be an accurate reflection of actual results. Because these statements involve risks and uncertainties, actual results may differ from those expressed or implied by these forward-looking statements.

## 1.4. Overview of Basel framework and Pillar 3

The CRD IV legislation, designed to implement the Basel III reforms of the Basel Committee on Banking Supervision, came into force in the EU on 1 January 2014. However, certain aspects of CRD IV are subject to phased implementation and may also be dependent on final technical standards to be issued by the European Banking Authority (EBA) and adopted by the European Commission, and ultimately implemented in the UK.

Prudential requirements under the Basel framework are categorised under three pillars as described below.

### ***Pillar 1: Minimum capital requirements***

#### *Risk based requirements*

The first pillar of the Basel framework focuses on the determination of minimum capital requirements applicable to all firms to support exposures to credit, counterparty credit, market and operational risks. Capital requirements may also be expressed as risk weighted assets (RWAs), being a notional amount 12.5 times the size of the capital requirement.

Risk based minimum capital requirements may be determined using a number of approaches. These are summarised below, together with the approach which has been adopted by MHI:

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<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms.

<sup>2</sup> Directive 2013/36/EU of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

<sup>3</sup> Section 4.3A.11 of the PRA's Senior Management Arrangements, Systems and Controls (SYSC) sourcebook.

Table 1: Basel Pillar 1 risk based approaches

Approach	MHI	Summary
<b>Credit risk and counterparty credit risk</b>		
Standardised approach	✓	<p>Standardised risk weightings are applied to credit risk exposures.</p> <p>Credit exposures in respect of counterparty risk are calculated using the current exposure method (i.e. mark-to-market approach).</p> <p>Credit ratings supplied by external credit assessment institutions (ECAIs) are used to determine the appropriate risk weight to be applied to exposure amounts.</p> <p>Credit risk mitigation techniques are recognised.</p>
Internal ratings based (IRB) approach	✗	<p>There are two main IRB approaches for wholesale exposures:</p> <ol style="list-style-type: none"> <li>1. The foundation IRB approach allows banks to make their own internal assessment of a counterparty's probability of default (PD), but subjects their quantified estimates of exposure at default (EAD) and loss given default (LGD) to standard supervisory parameters.</li> <li>2. The IRB advanced approach allows banks to use their own internal assessment in determining PD, quantifying EAD and LGD.</li> </ol>
<b>Market risk</b>		
Standardised approach	✓	<p>Requires the calculation of position risk requirements for each type of market risk within the trading book, and FX risk in the banking book, in accordance with standard rules.</p> <p>Credit valuation adjustment (CVA) risk is calculated using the standardised method.</p>
Internal models approach	✗	Capital requirements are calculated using internal Value at Risk (VaR) models.
<b>Operational risk</b>		
Basic indicator approach	✓	Capital requirements are calculated as 15% of three year average gross income.
Standardised approach	✗	Capital requirements are calculated from the three year average of aggregate risk weighted indicators. A firm's business must be split into defined business lines with specific risk weights applied to each business line.
Advanced measurement approach	✗	Capital requirements are calculated through the use of internal operational risk measurement systems.

### *Non-risk based requirements*

Under CRD IV risk based requirements are supplemented by a leverage ratio, under which firms are required to maintain Tier 1 capital in excess of a minimum ratio to a gross measure of exposures. Exposures comprise on and off balance sheet items, calculated from the accounting balance sheet subject to a defined set of adjustments. Whereas risk weighted capital ratios differentiate capital requirements according to estimates of the relative riskiness of different asset classes, a leverage ratio weights all assets equally. The leverage ratio is intended to limit the risk of excessive leverage across the banking sector and to reinforce risk based requirements with a simple backstop measure.

In accordance with CRD IV banks are required to publish their leverage ratios, with a binding requirement across the EU expected to come into force from 2019 onwards. Institutions will from this point be required to maintain capital in excess of the greater of the risk based and non-risk based requirements. MHI's current leverage ratio is provided in section 6.2 of this document.

***Pillar 2: Supervisory review process***

The second pillar of the Basel framework is designed to assess the adequacy of a firm's capital resources by considering all material risks to the firm's business, including those not covered or adequately addressed by the first pillar, together with the impact upon the capital position that is forecast to occur using stressed macroeconomic scenarios.

Firms are required to conduct an Internal Capital Adequacy Assessment Process (ICAAP) at least annually to review their capital resources in light of material risks identified and the outcome of stress testing procedures performed. This internal assessment is subject to the Supervisory Review and Evaluation Process (SREP) and forms part of the PRA's own assessment of the risks to which firms are exposed, their risk management and capital adequacy.

The PRA sets minimum capital requirements by issuing firms with specific Individual Capital Guidance (ICG). Where the PRA issues ICG to a firm it will require firms to hold additional capital (Pillar 2A) in respect of risks not adequately covered within Pillar 1. ICG is set as a percentage of RWAs.

The PRA may also notify firms of an amount and quality of capital that should be held for the PRA Buffer. This buffer is an amount of capital that firms should hold, in addition to their ICG, to cover losses that may arise under a severe stress scenario, but avoiding duplication with the CRD IV buffer, being the Capital Conservation Buffer and the Capital Countercyclical Buffer. When setting the PRA Buffer, the PRA considers the extent to which the CRD IV buffers already capture the risks identified in the PRA Buffer assessment. The PRA Buffer is then set as a percentage of RWAs.

***Pillar 3: Market discipline***

The third pillar of the Basel framework requires public disclosure surrounding a firm's risk governance, risk management practices, its approach to capital management, capital resources and Pillar 1 capital requirements. These disclosures are intended to foster market discipline in relation to a firm's risk management practices.

**1.5. Notes on basis of preparation**

***Scope of consolidation***

These disclosures are comprehensive and prepared in respect of MHI.

***Basis of preparation***

These disclosures have been prepared in accordance with regulatory capital adequacy concepts and rules rather than in accordance with accounting standards. Certain information provided within these disclosures is therefore not directly comparable with financial information contained within the annual financial statements.

The table below shows the relationship between MHI's accounting balance sheet categories and the calculation of RWAs by risk driver. The table does not include all inputs included in the calculation of RWAs, but is intended to provide an overview of the link between accounting and Pillar 1 regulatory measures:

Table 2: RWA calculation drivers split by balance sheet category

Accounting balance sheet category	RWA risk type		
	Credit risk	Counterparty credit risk	Market risk
<b>Assets</b>			
Reverse repurchase agreements	-	✓	✓
Debt and equity securities	-	-	✓
Derivative assets	-	✓	✓
Loans and advances to banks	✓	-	-
Shares in group undertakings	✓	-	-
Intangible fixed assets	-	-	-
Tangible fixed assets	✓	-	-
Other assets, prepayments and accruals	✓	-	-
<b>Liabilities</b>			
Deposits by banks	-	-	-
Customer accounts	-	-	-
Repurchase agreements	-	✓	✓
Short trading positions	-	-	✓
Derivative liabilities	-	✓	✓
Debt securities in issue	-	-	-
Subordinated debt	-	-	-
Other liabilities, provisions and accruals	-	-	✓

Not all Pillar 3 disclosure requirements under CRD IV are applicable to MHI. In such instances no disclosure is presented within this document.

#### **Location and verification**

A standalone copy of these disclosures is located on the MHI's website ([www.mizuho-emea.com](http://www.mizuho-emea.com)). These disclosures should be read in conjunction with MHI's financial statements for the year ended 31 March 2017, which are also published on this website.

Whilst the disclosures presented within this document do not require validation through external audit, they have been subject to internal governance procedures, including review and approval by the Chief Financial Officer (CFO), Chief Risk Officer (CRO), and the Board of Directors of MHI (the 'Board').

#### **Frequency of disclosure and comparative balances**

Disclosures are provided in accordance with EBA guidelines, currently on an annual basis, and published as soon as practicable after the publication of the financial statements and, unless otherwise indicated, all current year figures are stated as at MHI's financial year end, 31 March 2017.

More frequent disclosures are provided in the event that a material change occurs to the MHI's business.

Comparative balances as at 31 March 2016 have generally been presented within this document. Where required, comparative prior year values have been restated to align with the 2017 presentation of disclosures.

#### **Immaterial disclosures**

In line with Article 432 of the CRR, where the information required under a particular disclosure is considered by MHI to be immaterial, such disclosures have been omitted. The determination of immateriality is based upon the guidance issued by the EBA.

#### **Other material matters**

The parent and holding company of MHI, Mizuho Securities UK Holdings Ltd (MSUKH) was placed into voluntary liquidation on 21 July 2016, and this process was completed on 5 January 2017. Following this liquidation, MHI has become a direct subsidiary of Mizuho Securities Co., Ltd.. As part of the liquidation, the

capital resources of MSUKH were materially transferred to MHI and therefore MHI is considered to be the successor entity to the MSUKH group of companies. For this reason, comparative balances as at 31 March 2016 have been provided on an MSUKH basis.



## 2. Corporate governance

### 2.1. Role of the Board

The Board has overall responsibility for the management of MHI. The role of the Board is to provide leadership of MHI within a framework of prudent and effective internal controls, in order to maintain effective operations, control of financial affairs and compliance with law and regulation. The Board is responsible for the long term success of MHI and, to this end, sets its strategy and risk appetite, whilst ensuring that an effective risk management framework is maintained.

Certain matters are reserved for approval by the Board due to their significance. These matters include decisions concerning Board membership and corporate governance, strategy, approval of risk appetite and risk management oversight, capital and liquidity matters, corporate structure, financial performance, remuneration policy, and significant legal and regulatory matters. Matters not specifically reserved to the Board are delegated to MHI's executive officers.

### 2.2. Directors' responsibilities

Under UK company law, directors must promote corporate success by exercising independent judgement with reasonable care, skill and diligence, while having regard to the long-term consequences of their decisions.

Directors of UK regulated banks are also required by the PRA and FCA to act in accordance with their principles, including requirements in relation to observing proper standards of market conduct, dealing with regulators in an open and co-operative manner, taking reasonable steps to ensure that business is organised to facilitate effective control, and ensuring compliance with the regulatory system.

The Senior Managers Regime, Certification Regime and Conduct Rules came into force on 7 March 2016. MHI has complied with all stages of adoption and now applies all conduct rules to senior managers, certified persons and all impacted staff.

The principal roles on the Board and the responsibilities attaching to those roles are summarised below:

Table 3: Roles on the Board

Role	Responsibilities
Chair	<ul style="list-style-type: none"> <li>Leads the Board and sets the Board's agenda</li> <li>Facilitates engagement and participation from all Board members</li> <li>Ensures effective communication with MHI's shareholder</li> <li>Acts as Chair of the Nomination Committee</li> </ul>
Chief Executive Officer (CEO)	<ul style="list-style-type: none"> <li>Recommends strategy to the Board</li> <li>Responsible for implementation of strategy and day-to-day management of MHI's affairs</li> </ul>
Non-executive directors	<ul style="list-style-type: none"> <li>Offers constructive challenge to management and oversees achievement of agreed objectives</li> <li>Monitors operation of effective internal control and risk management</li> </ul>
Senior independent non-executive director	<ul style="list-style-type: none"> <li>Acts as a sounding board for the Chair</li> <li>Available to act as an intermediary for other Board members and stakeholders</li> </ul>

### 2.3. Board composition

The Board is made up of a majority of non-executive directors and the importance of maintaining an appropriate balance of skills, experience, diversity and independence is recognised. The Nomination Committee will assess on an annual basis the structure, size and composition of the Board, together with the balance of knowledge, skills and experience of its members.

The Board composition at 31 March 2017 with regard to the balance of executive and non-executive membership is shown below:

Table 4: Board composition

Independence	Number of individuals
Chair and independent non-executive directors	3
Other non-executive directors	3
Executive directors	3
<b>Total</b>	<b>9</b>

MHI is committed to diversity and respects the diversity and individuality of all persons, irrespective of nationality, gender, age, career-level, or lifestyle. Board appointments will be made on merit - the Nomination Committee will identify and recommend candidates for Board appointments based on knowledge, skills and experience measured against identified objective criteria, having due regard to the benefits of diversity. The Nomination Committee has set a target for gender diversification on the Board at a minimum of ten per cent which, as of 17 May 2017, has been met.

Directorships held by Board members are reviewed to ensure compliance with the PRA's requirements regarding the total number of such positions which may be held. As at 31 March 2017, the Board contained nine members who held a total of fifteen<sup>4</sup> directorships, with no individual member holding more than four directorships in commercial or non-group enterprises, (inclusive of those held on the Board) in compliance with these requirements.

### ***Women in Finance Charter***

On 11 July 2016 MHI became one of the 72 founding signatories to the HM Treasury's Women in Finance Charter. This is a commitment by HM Treasury and signatory firms to work together to build a more balanced and fair industry and reflects the government's aspiration to see gender balance at all levels across financial services firms.

MHI's voluntary but binding commitment is backed fully by the Board which has placed diversity and inclusion, and specifically gender diversity, firmly on its agenda. The President and CEO of MHI strongly supports the business case for gender equality and values diversity as an integral part of our strategy for competing in the current and future marketplace, and for driving business performance and success.

Much progress has already been made and continues to be made through existing initiatives both in regards to gender diversity and the broader diversity agenda.

MHI's target that by 30 September 2021 30% of senior management roles will be filled by female members of staff demonstrates the Board's commitment to help build a more balanced and fair industry. As at 30 September 2016, female members of staff at MHI occupied 15.7% of senior management roles.

## **2.4. Board performance**

Arrangements for induction of new Board members and ongoing training are in place to ensure that directors are fully informed of key business, legal and regulatory matters relevant to the performance of their roles. The review of Board performance and that of individual directors plays an important role in ensuring effective ongoing governance, and MHI has made arrangements for the Nomination Committee to conduct annual performance evaluations and to make recommendations to the Board arising out of these reviews.

## **2.5. Board committees**

The Board has established a number of sub-committees to enable detailed oversight of particular areas of Board responsibility and to facilitate oversight of senior management. Board and sub-committee meetings are held on a regular basis and sufficient time is allocated to ensure that relevant business is fully considered. The sub-committees of the Board are described below, together with a summary of their respective responsibilities:

<sup>4</sup> This disclosure is given in accordance with the definition used in Article 91 of CRD IV and implemented by the PRA, whereby directorships in organisations which do not pursue predominantly commercial objectives are not counted and directorships held within the same group are counted as a single directorship.

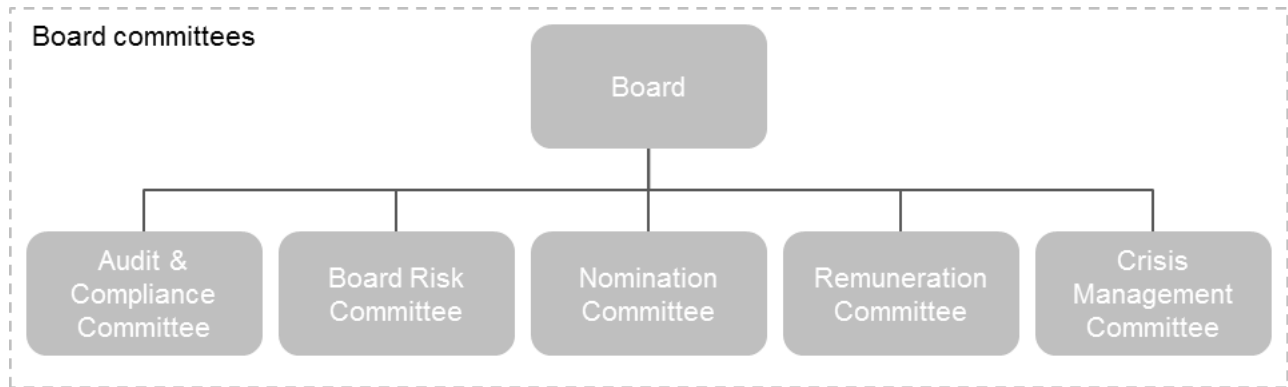


Table 5: Board committees

Committee	Role
Audit & Compliance Committee	<p>Reviews the appropriateness and completeness of the internal control framework, receives reports from internal and external auditors and monitors the progress of remedial action with regard to control weaknesses.</p> <p>Reviews arrangements established by management for compliance with regulatory requirements and reviews any matters of significance regarding MHI's relationship with its regulators.</p>
Board Risk Committee	<p>Makes recommendations to the Board concerning MHI's risk appetite, and reviews the supporting Board level limit framework and key metrics.</p> <p>Evaluates and reports to the Board on matters concerning MHI's overall risk profile and performance against risk appetite, giving consideration to key trends and concentrations, compliance with limits and significant risk issues.</p> <p>The Committee evaluates MHI's governance, risk and control framework.</p> <p>Provides input to the Remuneration Committee with regard to appropriate risk adjustments to be made to remuneration packages.</p>
Nomination Committee	<p>Reviews and makes recommendations with regard to Board composition, performance, and Board and senior management succession planning.</p> <p>Selects and recommends to the Board candidates for membership in accordance with its assessment of the balance of skills, experience, diversity and independence to be maintained on the Board.</p>
Remuneration Committee (RemCo)	<p>Sets and recommends to the Board the objectives, principles and parameters of MHI's Remuneration Policy.</p> <p>Reviews the individual remuneration arrangements of senior staff having regard to the impact on behaviour, risk appetite and risk profile of these arrangements, and the degree to which performance assessment takes account of current and potential future risks.</p>
Crisis Management Committee	<p>Convened at the request of (i) any two of the CEO, CFO, CRO and Treasurer, (ii) the Risk Management Committee, (iii) the Chair of the Board, (iv) the Chair of the Board Risk Committee, or (v) an Independent Non-Executive Director of the Board to resolve a crisis or threat situation. This includes management of MHI to the extent the Recovery Plan is initiated.</p>

### 3. Risk management framework

MHI maintains a prudent approach to risk to ensure that it can operate safely and to support sustainable business development in keeping with the Board's strategy. A culture which is supportive of strong risk management, in line with clear principles and tolerance for risk is led by the Board. MHI has a strong and independent Risk Management function responsible for the identification of MHI's principal risks, maintenance of risk control frameworks, and for keeping the Board informed of MHI's risk profile.

#### 3.1. Risk culture

MHI believes that a strong risk management culture is essential to achieve its business objectives. With ultimate responsibility for risk governance throughout MHI, the Board embeds a strong risk management culture through the establishment of an independent Risk Management function which works closely with the business and treats risk management as a shared responsibility.

#### 3.2. Risk principles

The Board has established clearly defined risk principles which describe MHI's key risk management objectives in support of its business strategy, which are summarised below:

- Maintain a predictable cautious to moderate risk profile;
- Ensure that effective control of balance sheet usage and concentration risk is exercised, without tolerating breaches of MHI's limit framework;
- Preserve strong capital and liquidity ratios and comply with all regulatory requirements;
- Maintain a diversified funding strategy with regard to both the sources and tenor of funding; and
- Ensure that remuneration arrangements are aligned to MHI's risk appetite.

#### 3.3. Risk appetite

The Board's risk appetite describes the levels and types of risk that MHI is prepared to accept in pursuit of its business strategy. The risk appetite is quantified with reference to scenario and stress testing, and is set so as to ensure that MHI is able to maintain a sound financial position throughout economic cycles.

The risk appetite is implemented through a supporting limit framework that ensures all material sources of risk are controlled in a manner consistent with the Board's overall risk tolerance. MHI has adopted a structured approach to limit management which ensures that limit reporting and oversight take place at the appropriate level within the organisation. The status of MHI's overall risk profile in relation to the risk appetite is overseen by the Board.

#### 3.4. Risk governance and assigning responsibility

##### *Three lines of defence*

In keeping with MHI's risk culture, responsibilities for risk management are assigned to multiple functions within the organisation under the three lines of defence model, to ensure that MHI's risk management framework is robust and effective.

**First line:** Business and support functions which originate or accept risk are held responsible for the management and control of that risk in line with MHI's risk appetite, supporting limit framework and other related risk policies.

**Second line:** The second line of defence is provided by risk control functions which exercise independent oversight of the management of risk by those originating functions. The principal risk control functions comprise MHI's Risk Management and Compliance functions, supported by the Finance and Legal functions.

**Third line:** Independent and post-dated assurance with regard to the effectiveness of risk management strategies, policies and processes is provided by MHI's Internal Audit function and its external auditors.

##### *Risk governance*

The Board retains responsibility for approval of risk appetite, risk management oversight and capital and liquidity matters, including compliance with applicable regulation. The heads of the principal risk control functions, being

the CRO and the Head of Compliance, are mandated through dual reporting lines to update and inform the relevant Board committees of matters relating to their functions and MHI-wide risk management.

Responsibility for the day-to-day management of the business is delegated by the Board to the CEO, who in turn mandates the heads of the principal control functions to assume responsibility for risk challenge and oversight.

### **3.5. Risk Management function and approach**

MHI maintains a strong and independent Risk Management function which is headed by the CRO. The function is mandated to oversee all material classes of risk to which MHI is exposed, other than conduct risks which are overseen by the Compliance function.

The Risk Management function is structured to facilitate oversight of these principal risk classes and incorporates separate teams with responsibility for market, credit, liquidity, regulatory governance, and operational risk oversight. A common approach to risk oversight is adopted for each principal risk class, in accordance with risk policies established for those classes.

#### ***Risk identification and assessment***

All material risk exposures are identified and recorded within MHI's risk register, whilst responsibility for the assessment of those risks resides with both the business and the risk control functions. Risks and sub-components of risk are assessed through the implementation of a variety of measures or metrics relevant to each risk class. Risk assessment measures are developed in accordance with accepted measurement methodologies for each class of risk, and the resulting assessments are classified according to severity, to provide clear identification of MHI's material exposures. Risk assessments are conducted in relation to both normal and stressed market conditions.

#### ***Control and mitigation***

Risk exposures are managed by business and support functions using a range of techniques relevant to the individual risk class. Such techniques encompass market based hedging activities, credit risk mitigation techniques, diversification of funding sources and tenor, business continuity planning and the purchase of insurance.

Risk control limits and key risk indicators are established to ensure that risk exposures remain within specified levels, and that MHI is able to operate in accordance with its overall risk appetite. A comprehensive limit framework is maintained by risk class, with defined levels of authorisation to ensure that risk exposure levels are authorised and monitored at the appropriate level within MHI's governance hierarchy.

#### ***Monitoring and reporting***

Reporting of risk exposures in relation to risk limits, and more broadly with regards to trends in MHI's risk profile and emerging risks, is performed by the Risk Management function (and by the Compliance function with regards to conduct related matters). Reporting is conducted in relation to all principal risk factors, and is designed to enable effective governance of MHI's risk profile. In particular the Board and the Board Risk Committee are regularly informed of MHI's risk exposures and compliance with risk limits.

In addition to monitoring current risk exposures, MHI also monitors potential future adverse developments by establishing early warning indicators whose breach may indicate deterioration in MHI's capital and liquidity strength. Monitoring and reporting the status of these early warning indicators forms part of MHI's contingency planning arrangements.

### **3.6. Strategy and planning**

MHI conducts formal business planning on an annual basis, through which the Board's strategic objectives are developed into detailed business plans. Commercial objectives and plans are established for all significant business lines, and from these financial projections are developed, which take account of expected macroeconomic and market conditions.

MHI's risk appetite is also formally reviewed on an annual basis as part of the business planning cycle, to ensure that business strategy and risk management activities are aligned. Business plans are also reviewed by MHI's Risk Management function to ensure that planned developments are achievable given MHI's risk management capabilities, and to form a view with regard to the balance of risk and reward attributable to planned activities.

As part of its business planning activities MHI also conducts capital planning to ensure that an appropriate balance between capital resources and capital requirements is maintained through the planning cycle. As part of its capital planning framework, MHI utilises stress tests to ensure that it is able to maintain a sound financial position in the event of severe economic stress. Stress tests are developed based upon potential future scenarios, selected in the light of MHI's risk profile and plausible future market and economic developments. Stress tests are conducted so as to apply selected scenarios in a consistent manner to the market, credit, operational and liquidity risks to which MHI is exposed and to take account of any concentrations of exposure.

### **3.7. Adequacy of risk management arrangements**

MHI assesses the adequacy of its risk management framework and of the amount of capital and liquidity that it needs to hold in respect of its risk profile on an annual basis, or more frequently if required. This assessment is formally documented within MHI's ICAAP and Internal Liquidity Adequacy Assessment Process (ILAAP), and is approved by the Board.

MHI's most recent ICAAP and ILAAP concluded that the risk management arrangements adopted by MHI were adequate in relation to its risk profile and strategy. Further, through its risk management framework, risk appetite and limit framework, independent reviews and ongoing programme of enhancements, MHI confirms that its risk management is effective.

## 4. Risk profile

### *Risk profile*

MHI's business strategy is based on the provision of intermediation services within the capital markets for MHI's international client base. In keeping with this overall strategy, MHI operates Investment Banking, and Markets and Products business lines. Investment Banking services chiefly comprise the underwriting and distribution of new debt and equity issuance on behalf of MHI's clients together with the provision of mergers & acquisition services. Within its Markets and Products division MHI acts as Mizuho Securities Co., Ltd.'s primary dealer and provider of secured financing in European debt securities, offers broking services in Japanese and Asian equities, and provides derivative risk management solutions to clients.

The Board requires that a cautious to moderate risk profile is maintained in pursuit of this strategy. MHI's Investment Banking and equity broking activities result in low levels of risk exposure as underwriting activity is predominantly conducted without accepting significant underwriting risk and equity broking activity does not expose MHI directly to equity market risk. Fixed income trading activities result in low to moderate levels of risk as MHI maintains sovereign, financial and corporate inventory, provides securities financing services, and offers predominantly vanilla and cleared derivative risk management solutions to clients.

The Board's risk appetite with respect to capital is quantified with reference to minimum capital requirements and stress testing, and ensures an appropriate surplus is maintained over MHI's assessed capital requirements; this includes regulatory ICG, ensuring that MHI meets the PRA's capital requirements on an ongoing basis. The capital surplus ratio associated with MHI's risk appetite at 31 March 2017 is shown below:

Table 6: Key risk profile metrics

<b>Capital risk metrics</b>	<b>Actual exposure 2017</b>
Capital surplus ratio	135.9%

This aggregate risk appetite measure is supported by a range of supporting limits and metrics which facilitate the control of individual risk factors at a detailed operational level.

## 5. Capital resources

### 5.1. Capital ratio

MHI has continued to maintain capital resources significantly above the minimum requirements established by the Basel Committee on Banking Standards' Pillar 1 framework. MHI's ratio of tier 1 common equity to Pillar 1 RWAs is given below:

Table 7: Tier 1 capital ratio

	2017	2016
Tier 1 capital ratio	32.9%	36.4%

### 5.2. Capital resources

As at 31 March 2017, MHI's total capital resources consisted of £658.3 m common equity tier 1, which comprised equity share capital, audited profit and loss and other reserves, and £45m of tier 2 capital.

The difference between total equity on an accounting basis and regulatory capital arises from the different treatment of adjustments for own credit, prudent valuation and intangible assets, as shown below:

Table 8: Capital resources reconciliation

Capital resources composition	2017	2016
	Capital resources	Capital resources
	£m	£m
<b>Total equity</b>	<b>736.4</b>	<b>476.9</b>
Own credit adjustments in respect of fair value financial liabilities	-	(0.9)
Prudent valuation adjustment	(6.6)	(6.3)
Intangible asset adjustment	(71.5)	(61.3)
<b>Total common equity tier 1 capital</b>	<b>658.3</b>	<b>408.3</b>
Total tier 2 capital	45.0	45.0
<b>Total capital resources</b>	<b>703.3</b>	<b>453.3</b>

MHI's share capital was increased by 1,790,000 shares at a total value of £17,900,000 on 25 August 2016, and by a further 25,000,000 shares at a total value of £250,000,000 on 30 September 2016.

On 15 March 2017, a share capital reduction was undertaken to cancel the cumulative loss on MHI's balance sheet. On this date, 135,000,000 JPY ordinary shares and £111,534,584 ordinary shares were cancelled. The overall value of the reduction was £2,433,323,794.

Further detail on MHI's own funds, provided in accordance with EBA guidelines, is set out in the table below:



Table 9: Own funds disclosure

<b>Common Equity Tier 1 (CET1) capital: instruments and reserves</b>		<b>2017</b>	<b>2016</b>
		<b>£m</b>	<b>£m</b>
1	Capital instruments and the related share premium accounts of which: Instrument type 1	725.5	2,900.3
2	Retained earnings	12.2	(2,404.7)
3	Accumulated other comprehensive income (and other reserves)	(1.3)	(18.8)
<b>6</b>	<b>Common Equity Tier 1 (CET1) capital before regulatory adjustments</b>	<b>736.4</b>	<b>476.9</b>
<b>Common Equity Tier 1 (CET1) capital: regulatory adjustments</b>			
7	Additional value adjustments (incl Prudent valuation adjustments)	(6.6)	(7.2)
8	Intangible assets (net of related tax liability) (negative amount)	(71.5)	(61.3)
<b>28</b>	<b>Total regulatory adjustments to Common Equity Tier 1 (CET1)</b>	<b>(78.1)</b>	<b>(68.6)</b>
<b>29</b>	<b>Common Equity Tier 1 (CET1) capital</b>	<b>658.3</b>	<b>408.3</b>
<b>58</b>	<b>Tier 2 (T2) capital</b>	<b>45.0</b>	<b>45.0</b>
<b>59</b>	<b>Total capital (TC = T1 + T2)</b>	<b>703.3</b>	<b>453.3</b>
<b>60</b>	<b>Total risk weighted assets</b>	<b>2,002.2</b>	<b>1,122.4</b>
<b>Capital ratios and buffers</b>			
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	32.9%	36.4%
62	Tier 1 (as a percentage of total risk exposure amount)	32.9%	36.4%
63	Total capital (as a percentage of total risk exposure amount)	35.1%	40.4%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	1.33%	0.629%
65	of which: capital conservation buffer requirement	1.25%	0.625%
66	of which: countercyclical buffer requirement	0.08%	0.004%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	25.6%	29.7%

## 6. Capital requirements

### 6.1. RWAs and Pillar 1 capital requirements

MHI's Pillar 1 capital requirements and RWAs as at 31 March 2017 are set out below by risk class. These requirements are further analysed in the following sections as referenced below:

Table 10: RWAs and Pillar 1 capital requirements

	Section	2017 RWAs £m	2017 Pillar 1 capital requirements £m	2016 RWAs £m	2016 Pillar 1 capital requirements £m
Interest rate position risk	7	1,380.5	110.4	649.6	52.0
Equity position risk	7	-	-	3.6	0.2
Foreign currency position risk	7	12.9	1.0	6.5	0.5
<b>Market risk total</b>		<b>1,393.4</b>	<b>111.4</b>	<b>659.7</b>	<b>52.7</b>
Counterparty credit risk	9	184.5	14.8	134.0	10.7
Concentration risk	8	-	-	-	-
Credit risk	8	117.7	9.5	101.1	8.1
<b>Credit risk total</b>		<b>302.1</b>	<b>24.2</b>	<b>235.1</b>	<b>18.8</b>
<b>Operational risk</b>	10	<b>306.7</b>	<b>24.5</b>	<b>227.5</b>	<b>18.2</b>
<b>Total Pillar 1 capital requirement</b>		<b>2,002.2</b>	<b>160.1</b>	<b>1,122.3</b>	<b>89.7</b>

### 6.2. Leverage ratio

The proposed leverage ratio requirement, relevant to institutions which are not major UK banks and building societies, will vary between 3% and 3.9%. This proposed requirement comprises a minimum ratio of 3% together with a countercyclical leverage ratio buffer of between 0% and 0.9%, which is designed to restrict leverage during periods of excess credit growth and systemic risk.

The management of exposure to leverage forms part of MHI's business planning process and risk appetite framework. MHI's leverage ratio as at 31 March 2017 meets the expected future requirements set out above. MHI is committed to ensuring that full compliance with all relevant regulatory requirements is maintained.

MHI's leverage ratio calculation as at 31 March 2017, which details the reconciliation of the leverage ratio exposure measure to total assets recorded within MHI's financial statements, is given below:

Table 11: Leverage ratio calculation

Leverage ratio calculation	2017 £m	2016 £m
<b>Accounting assets</b>		
Derivatives	1,498.4	424.0
Securities financing transactions (SFTs)	9,198.2	6,445.4
Other assets	4,698.6	5,735.7
<b>Total assets</b>	<b>15,395.2</b>	<b>12,605.1</b>
<b>Derivative adjustments</b>		
Adjustment for regulatory netting	(1,158.2)	(172.0)
Eligible cash variation margin received offset against derivatives market value	(289.1)	-
Net written credit protection	106.9	29.1
Regulatory potential future exposure	912.1	124.9
<b>Total derivative adjustments</b>	<b>(428.3)</b>	<b>(18.0)</b>
<b>SFT adjustments</b>		
Regulatory adjustments for SFTs	(10.4)	(258.9)
Counterparty credit risk add-on for SFTs	224.0	180.7
<b>Total SFT adjustments</b>	<b>213.6</b>	<b>(78.2)</b>
Off-balance sheet items	5.9	4.6
Other regulatory adjustments	(78.1)	(68.6)
<b>Total leverage ratio exposure measure</b>	<b>15,108.3</b>	<b>12,444.9</b>
<b>Tier 1 capital</b>	<b>658.3</b>	<b>408.3</b>
<b>Leverage ratio</b>	<b>4.36%</b>	<b>3.28%</b>

### 6.3. Pillar 2 capital requirements

The PRA prescribes ICG to firms as part of its supervision of the banking sector. MHI has been issued with an ICG by the PRA and maintains capital that exceeds this requirement.

MHI's ICAAP provides an assessment of risks not covered or not fully captured through Pillar 1 capital requirements together with MHI's own quantification of those risks. MHI ensures that it maintains capital which also exceeds this internal assessment of risk exposures (to the extent that this assessment exceeds ICG requirements). Some of the key risks assessed within the ICAAP under Pillar 2A include:

#### *Risks not fully captured under Pillar 1*

- Operational risk: operational risk losses measured using MHI's stress testing approach to potential operational risk scenarios.
- Concentration risk: the risk of additional losses arising due to a higher level of default correlation than is assumed in Pillar 1 approaches; for example, due to sectoral concentrations.
- Counterparty risk: additional counterparty risk exposure measured using MHI's credit portfolio model (CVaR).
- Market risk: additional market risk exposure calculated using market stress and issuer default scenarios measured at the 99<sup>th</sup> percentile.

#### *Risks not included under Pillar 1*

- Pension risk: the risk of additional defined benefit pension contributions arising due to adverse movements in market rates or increases in longevity.

- Structural foreign exchange risk: the risk of deterioration of MHI's capital surplus due to the revaluation of non-sterling risk assets with regard to foreign exchange rates.
- Interest rate risk in the banking book: the risk of losses due to adverse interest rate movements which impact non-trading assets and liabilities.

MHI has also been set capital buffer requirements by the PRA. The ICAAP forecasts capital requirements and capital resources under stressed scenarios, which enables MHI to make an internal assessment of the capital buffer required to ensure that it will continue to meet the PRA's ICG throughout the economic cycle. MHI maintains capital which exceeds the higher of the PRA's ICG and buffer requirements and its internal assessment of potential future capital needs.

## 6.4. CRD IV capital buffers

### Introduction

Alongside the minimum capital requirements, CRD IV requires institutions to hold capital buffers that can be drawn down in times of economic stress to absorb losses. Specific capital buffers that MHI is required to hold include:

#### Capital conservation buffer (CCoB)

The CCoB is designed to ensure that institutions build up capital buffers outside of times of stress that can be drawn upon if required. The requirement is 2.5% of RWAs but will be phased in from 2016 in steps of 0.625% per annum to the full value in 2019. The CCoB for 2017 is 1.25%.

#### Countercyclical capital buffer (CCyB)

The CCyB is designed to require financial institutions to hold additional capital to reduce the build-up of systemic risk in a credit boom by providing additional loss absorbing capacity and acting as an incentive to limit further credit growth.

Each institution's specific countercyclical buffer rate is a weighted average of the countercyclical capital buffers that apply in the jurisdictions where the institution's relevant credit exposures are located. The Financial Policy Committee (FPC) is responsible for setting the UK CCyB rate (for credit exposures located in the UK), and has indicated that this will be set at 1% in normal economic conditions. As of 31 March 2017, the FPC maintained the UK CCyB rate at 0%. Since the reporting date of 31 March 2017, the CCyB rate has been increased to 0.5% by the FPC (effective from June 2018), with a further plan to increase it to 1% in November 2017 (effective from November 2018). MHI continues to adhere to these buffer requirements.

Table 12 shows MHI's specific CCyB rate and requirement. The table is split down into:

- The total risk exposure amount, for exposures in all countries;
- The institution specific CCyB rate, which is MHI's weighted-average CCyB rate, calculated by multiplying the total exposure to each geographical area by the CCyB rate set for that region (including those countries with a CCyB rate set to zero); and
- The institution specific CCyB requirement, which is calculated by multiplying the above two figures together.

Table 12: Amount of institution specific countercyclical capital buffer

CCyB metric	2017
Total risk exposure amount	£2,002.2m
Institution specific CCyB rate	0.08%
Institution specific CCyB requirement	£1.6m

As at 31 March 2017, MHI's only exposures in countries with a CCyB rate greater than 0% were in Hong Kong, Norway and Sweden. These countries currently have the following CCyB rates:

Table 13: Countries with CCyB greater than 0% to which MHI has exposure

<b>Country</b>	<b>Current CCyB</b>	<b>Implementation date</b>
Hong Kong	1.25%	1 January 2016
Norway	1.5%	30 June 2016
Sweden	2.0%	19 March 2017

Table 14 shows the breakdown of exposures for all countries, including those which currently have a countercyclical buffer rate set to 0%.

Table 14: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

Breakdown by country	General credit exposures	Trading book exposures	Own funds requirements			Own funds requirements weights	Countercyclical capital buffer rate
	Exposure value for SA	Sum of long and short positions of trading book exposures for SA	of which: General credit exposures	of which: General trading book	Total		
Row	£m	£m	£m	£m	£m		
<b>010</b>	<b>010</b>	<b>030</b>	<b>080</b>	<b>090</b>	<b>070</b>	<b>110</b>	<b>120</b>
010 United Arab Emirates	0.00	10.72	0.00	0.25	0.25	0.01	
010 Austria	0.00	3.03	0.00	0.24	0.24	0.01	
010 Australia	0.00	7.95	0.00	0.32	0.32	0.01	
010 Belgium	0.00	12.54	0.00	0.45	0.45	0.01	
010 Brazil	0.00	3.58	0.00	0.29	0.29	0.01	
010 Canada	0.00	1.72	0.00	0.11	0.11	0.00	
010 Switzerland	0.00	26.21	0.00	0.69	0.69	0.01	
010 China	0.00	1.03	0.00	0.03	0.03	0.00	
010 Germany	0.00	78.99	0.00	4.19	4.19	0.09	
010 Denmark	0.00	7.61	0.00	0.61	0.61	0.01	
010 Spain	0.00	28.46	0.00	2.19	2.19	0.05	
010 Finland	0.00	12.22	0.00	0.98	0.98	0.02	
010 France	0.00	126.66	0.00	6.49	6.49	0.13	
010 United Kingdom	85.80	102.29	6.90	7.19	14.09	0.29	
010 Greece	0.00	0.12	0.00	0.01	0.01	0.00	
010 Hong Kong	0.00	0.92	0.00	0.01	0.01	0.00	1.25%
010 Ireland	0.00	14.84	0.00	1.02	1.02	0.02	
010 Israel	0.00	1.83	0.00	0.15	0.15	0.00	
010 Italy	0.01	30.88	0.00	2.62	2.62	0.05	
010 Japan	5.76	0.11	0.46	0.01	0.47	0.01	
010 Korea, Republic of	0.03	16.28	0.00	0.20	0.20	0.00	
010 Kuwait	0.00	2.66	0.00	0.13	0.13	0.00	
010 Cayman Islands	0.26	0.00	0.02	0.00	0.02	0.00	
010 Luxembourg	0.00	1.27	0.00	0.12	0.12	0.00	
010 Mexico	0.00	9.54	0.00	0.74	0.74	0.02	
010 Netherlands	0.00	28.39	0.00	1.44	1.44	0.03	
010 Norway	0.00	12.33	0.00	0.29	0.29	0.01	1.5%
010 New Zealand	0.00	0.00	0.00	0.00	0.00	0.00	
010 Portugal	0.00	6.82	0.00	0.55	0.55	0.01	
010 Qatar	0.00	10.95	0.00	0.26	0.26	0.01	
010 Russian Federation	0.00	0.40	0.00	0.03	0.03	0.00	
010 Saudi Arabia	0.00	1.02	0.00	0.02	0.02	0.00	
010 Sweden	0.00	22.60	0.00	1.72	1.72	0.04	2.0%
010 Singapore	0.00	0.00	0.00	0.00	0.00	0.00	
010 United States	0.05	170.28	0.00	7.43	7.44	0.15	
<b>020 Total</b>	<b>91.90</b>	<b>754.27</b>	<b>7.38</b>	<b>40.76</b>	<b>48.14</b>	<b>1.00</b>	

## 7. Market risk

### 7.1. Risk management

Market risk is the risk of realised financial loss or reduced valuation arising from adverse market movements (including changes in interest rates, foreign exchange rates, credit spreads and bond prices, equity prices and their associated volatilities). Credit valuation adjustments are considered within section 9 of this disclosure.

Market risk appetite is a component of MHI's overall risk appetite and is approved by the Board. MHI provides liquidity to customers of the wider Mizuho Financial Group, Inc. group of companies in debt and equity products, and holds inventory in its core product classes. MHI's market risk appetite is to maintain a cautious to moderate risk profile, whilst focusing upon client transaction flows in actively traded vanilla products.

MHI's market risk exposures arise principally from its trading operations in government, supranational, sub-sovereign and agency, and corporate debt instruments, and through the provision of derivatives for client risk management solutions. Exposures are partially mitigated through the execution of offsetting transactions in other debt instruments or through the use of hedging derivative contracts.

Market risk is managed in accordance with a variety of risk measures including sensitivity based measures (e.g. sensitivity to a basis point move in interest rates or credit spreads), VaR, and stress testing. Market risk limits are set and monitored using these measures as appropriate on a business line basis. Key risk exposures, which incorporate the effect of hedging activity, are monitored by MHI's Risk Management function on a daily basis.

Market risk exposure is routinely monitored by the Risk Management Committee, and is overseen by the Board Risk Committee and the Board. Significant exposures are escalated in accordance with market risk policy.

### 7.2. Balance sheet split of trading and banking books

Trading books comprise those positions that are held with trading intent or to hedge elements of the trading book. Trading intent must be evidenced through strategies, policies and procedures established by firms to manage positions or portfolios. In addition to these positions, the trading books also contain assets held as part of the high quality liquid asset portfolio; these positions are held principally to mitigate liquidity risk in stressed conditions and not with trading intent.

MHI's balance sheet is split between trading and non-trading or 'banking' books as shown below:

Table 15: Balance sheet split by trading and banking books

Balance sheet category	2017	2017	2017
	Trading book	Banking book	Total
	£m	£m	£m
Reverse repurchase agreements	9,198.2	-	9,198.2
Debt and equity securities	4,055.1	1.0	4,056.1
Derivative assets	1,481.8	16.6	1,498.4
Loans and advances to banks	-	278.9	278.9
Shares in group undertakings	-	5.8	5.8
Intangible fixed assets	-	71.5	71.5
Tangible fixed assets	-	33.2	33.2
Other assets, prepayments and accruals	222.6	30.5	253.1
<b>Total assets</b>	<b>14,957.7</b>	<b>437.5</b>	<b>15,395.2</b>
Deposits by banks	-	318.9	318.9
Customer accounts	-	432.0	432.0
Repurchase agreements	6,227.8	-	6,227.8
Short trading positions	4,297.7	-	4,297.7
Derivative liabilities	1,429.3	3.8	1,433.1
Debt securities in issue	-	1,387.9	1,387.9
Subordinated debt	-	45.2	45.2
Other liabilities, provisions and accruals	387.4	128.8	516.2
<b>Total liabilities</b>	<b>12,342.2</b>	<b>2,316.6</b>	<b>14,658.8</b>

### 7.3. Internal risk measures

MHI has continued to manage its market risk at low levels over the past year, with average VaR of £1.5m (2016: £1.3m). The table below shows MHI's internal VaR measurement, determined using a 99<sup>th</sup> percentile confidence level over a one day time horizon, by risk factor:

Table 16: VaR by risk factor

VaR by risk factor	2017				2016			
	Close £m	Average £m	High £m	Low £m	Close £m	Average £m	High £m	Low £m
Interest rate risk	0.9	0.8	2.1	0.4	1.0	0.9	1.5	0.4
Credit spread risk	1.4	1.1	2.0	0.4	0.7	0.6	1.7	0.4
Equity risk	-	-	0.3	-	0.1	-	0.6	-
Foreign exchange risk	0.4	0.2	0.5	-	0.1	0.1	0.2	-
<b>Total VaR<sup>(1)</sup></b>	<b>1.8</b>	<b>1.5</b>	<b>2.1</b>	<b>0.8</b>	<b>1.2</b>	<b>1.3</b>	<b>2.2</b>	<b>0.7</b>

<sup>(1)</sup>Total VaR assumes some diversification across risk types and therefore does not represent the simple sum of component risk factors.

### 7.4. Pillar 1 requirements by risk category

MHI's largest sources of market risk derive from general debt instrument risk within its trading inventory of flow derivative instruments, and specific debt instrument risk from the trading inventory of fixed income securities. Specific debt instrument risk arising from the trading of fixed income securities represents exposure to risk factors related to the issuer relevant to the pricing of individual debt securities. During the year ended 31 March 2017, MHI has seen a significant increase in market risk Pillar 1 capital requirements as a result of the growth in its flow derivatives business and the associated integration of Mizuho Capital Markets (UK) Limited.

The table below shows MHI's Pillar 1 market risk capital requirements, calculated using the standardised approach by risk factor:

Table 17: Pillar 1 market risk under standardised approach

Market risk under standardised approach	2017 £m	2016 £m
General debt instrument risk	56.8	11.5
Specific debt instrument risk	53.6	40.4
General equity instrument risk	-	0.1
Specific equity instrument risk	-	0.1
Foreign exchange risk	1.0	0.5
<b>Total market risk</b>	<b>111.4</b>	<b>52.7</b>

### 7.5. Non-traded market risk

Market risk exposures which arise from non-trading activities are not captured or fully captured through Pillar 1 capital requirements, and thus attract Pillar 2 charges. The market risk exposures which arise in respect of non-trading activities are summarised below:

Table 18: Summary of non-traded market risk

	Principal risk factors			
	Interest rate	Inflation	Credit spread	Equity
Banking book	●	○	○	●
Pension scheme	●	●	●	●

#### Equity risk in the banking book

Banking book equity investments, being those which are not held for trading intent, attract credit risk capital requirements under the standardised approach.



MHI's most significant non-trading equity asset constitutes a carried interest entitlement in a private equity healthcare fund, representing a contractual interest in the fund's performance in excess of predefined thresholds. This interest had a fair value of £0.8m as at 31 March 2017.

MHI maintains holdings of Mizuho Financial Group, Inc. shares in connection with share based remuneration arrangements as discussed in section 12.

The balance sheet value of non-trading equity investments is shown below by investment category. These holdings are recorded on the balance sheet at fair value, with revaluation gains taken through profit and loss:

Table 19: Banking book equity by category

<b>Banking book equity</b>	<b>2017</b>	<b>2016</b>
	<b>Balance sheet value £m</b>	<b>Balance sheet value £m</b>
Private equity	0.8	0.6
Exchange traded	6.0	3.8
Other	-	-
<b>Total banking book equity</b>	<b>6.8</b>	<b>4.4</b>

### ***Interest rate risk in the banking book***

The non-trading book principally comprises net balances of unsecured funding raised and managed by MHI's Treasury & Funding function in support of trading activities. Funding is raised across a range of maturities to ensure diversification of repayment risk and is issued on both a fixed and floating rate basis. MHI's policy is to minimise interest rate risk in the banking book through the use of derivative interest rate hedges, which leaves MHI exposed to falling short term interest rates.

### ***Pension scheme market risk***

MHI sponsors one defined benefit pension plan, the Mizuho International plc Retirement Benefits Scheme (the 'Scheme'). The Scheme closed to new members in 1996. Accrual of further liabilities ceased on the retirement of the last active member, prior to the 31 March 2009 actuarial valuation of the Scheme. The requirement to fund the Scheme is borne jointly by MHI and DIAM International Ltd. in proportion to the historical association of Scheme members to those employers.

The Scheme's investment strategy is set by the Trustees, in consultation with MHI and recorded in the Scheme's Statement of Investment Principles. The strategy involves retaining longevity risk within the Scheme and holding a proportion of return seeking assets.

With regard to market risks, the Scheme's assets give rise to long-term interest rate, credit spread and equity risk and the Scheme's liabilities give rise to interest rate, credit spread and inflation risk.

## 8. Credit risk

### 8.1. Risk management

Credit risk is the risk of financial loss arising from the failure of a customer, client, issuer, or counterparty to meet its contractual obligations. MHI's activities that give rise to counterparty credit risk, such as securities financing, derivatives and securities trading which supports MHI's market-making, are discussed in section 9 and the credit risk arising from exposure to issuers of traded debt is discussed within section 7.

Credit risk appetite forms a key component of MHI's overall risk appetite statement and is approved by the Board. MHI employs a number of metrics in support of this, which are used to limit and monitor the credit risk exposures in accordance with credit risk management policies.

Aside from the credit risks discussed in sections 7 and 9, the principal sources of non-trading credit risk exposures arise from funding operations through the placement of cash resources and deposits with third parties. Credit exposures also arise in the ordinary course of business through short term receivables and, in addition, Pillar 1 credit risk charges also apply to investments in fixed assets. MHI does not undertake commercial or retail lending activity and does not extend credit through the provision of guarantees.

Non-trading credit risk exposures are measured in accordance with balance sheet carrying amounts, after taking account of any applicable credit risk mitigation arrangements and adjustments for credit impairment.

### 8.2. Pillar 1 requirements

RWAs and Pillar 1 credit risk capital requirements calculated under the standardised approach are set out below:

Table 20: Credit risk RWAs and Pillar 1 capital requirements by exposure class

	2017		2016	
	RWAs £m	Pillar 1 capital requirements £m	RWAs £m	Pillar 1 capital requirements £m
Financial institutions	25.7	2.1	10.9	0.9
Corporates	-	-	0.1	-
Fixed assets and other assets	92.0	7.4	90.2	7.2
<b>Total</b>	<b>117.7</b>	<b>9.5</b>	<b>101.1</b>	<b>8.1</b>

### 8.3. Analysis of credit risk exposures

#### *Credit risk exposures by credit quality*

Credit risk exposures before and after credit risk mitigation (CRM) and RWAs by credit quality, in accordance with the credit quality steps used within the standardised approach, are given below:

Table 21: Credit risk exposures and RWAs by credit quality step

	2017			
	Gross credit exposure	CRM	Net credit exposure	RWAs
	£m	£m	£m	£m
Credit quality step 1	114.1	-	114.1	-
Credit quality step 2	196.0	67.6	128.4	25.7
Credit quality step 3	-	-	-	-
Credit quality step 6	0.8	-	0.8	1.2
Uniform regulatory treatment	90.7	-	90.7	90.7
<b>Total</b>	<b>401.6</b>	<b>67.6</b>	<b>334.0</b>	<b>117.7</b>

	2016			
	Gross credit exposure	CRM	Net credit exposure	RWAs
	£m	£m	£m	£m
Credit quality step 1	31.7	-	31.7	-
Credit quality step 2	107.0	52.7	54.3	10.9
Credit quality step 3	0.1	-	0.1	0.1
Credit quality step 6	0.6	-	0.6	0.9
Uniform regulatory treatment	89.3	-	89.3	89.3
<b>Total</b>	<b>228.7</b>	<b>52.7</b>	<b>175.9</b>	<b>101.1</b>

**Gross credit exposures by exposure class**

Gross credit risk exposures, before the impact of credit risk mitigation, as at year end and averaged over the financial year are summarised below:

Table 22: Gross credit risk exposures by exposure class

	2017		2016	
	Average gross exposure	Year End gross exposure	Average gross exposure	Year End gross exposure
	£m	£m	£m	£m
Government, central banks & international organisations	106.2	114.1	50.3	31.7
Financial institutions	123.5	195.9	100.7	107.0
Corporates	-	-	-	0.1
Fixed assets and other assets	91.6	91.6	79.9	89.9
<b>Total</b>	<b>321.3</b>	<b>401.6</b>	<b>230.9</b>	<b>228.7</b>

**Geographic distribution of gross credit exposures**

The geographic distribution of gross credit exposures as at 31 March 2017 is given below:

Table 23: Geographic distribution of gross credit risk exposures

	2017					
	UK £m	Japan £m	US £m	Europe £m	Other £m	Total £m
Government, central banks & international organisations	114.1	-	-	-	-	114.1
Financial institutions	30.5	67.6	84.7	13.1	0.0	196.0
Corporates	-	-	-	-	0.0	0.0
Fixed assets and other assets	85.8	5.8	-	-	-	91.6
<b>Total credit risk exposure</b>	<b>230.4</b>	<b>73.4</b>	<b>84.7</b>	<b>13.1</b>	<b>0.1</b>	<b>401.6</b>

	2016					
	UK £m	Japan £m	US £m	Europe £m	Other £m	Total £m
Government, central banks & international organisations	31.7	-	-	-	-	31.7
Financial institutions	4.1	52.7	42.7	7.5	-	107.0
Corporates	-	0.1	-	-	-	0.1
Fixed assets and other assets	86.1	3.8	-	-	-	89.9
<b>Total credit risk exposure</b>	<b>121.9</b>	<b>56.6</b>	<b>42.7</b>	<b>7.5</b>	<b>-</b>	<b>228.7</b>

**Residual maturity of gross credit exposures**

The residual maturity of gross credit exposures as at 31 March 2017 is given below:

Table 24: Residual maturity of gross credit risk exposures

	2017					Total £m
	Less than 1 year £m	1 to 5 years £m	5 to 10 years £m	Over 10 years £m		
Government, central banks & international organisations	114.1	-	-	-	-	114.1
Financial institutions	196.0	-	-	-	-	196.0
Fixed assets and other assets	85.0	-	-	6.6	-	91.6
<b>Total credit risk exposure</b>	<b>395.0</b>	<b>-</b>	<b>-</b>	<b>6.6</b>	<b>-</b>	<b>401.6</b>

	2016					Total £m
	Less than 1 year £m	1 to 5 years £m	5 to 10 years £m	Over 10 years £m		
Government, central banks & international organisations	31.7	-	-	-	-	31.7
Financial institutions	107.0	-	-	-	-	107.0
Fixed assets and other assets	85.5	-	-	4.4	-	89.9
<b>Total credit risk exposure</b>	<b>224.2</b>	<b>-</b>	<b>-</b>	<b>4.4</b>	<b>-</b>	<b>228.7</b>

**Single issuer exposures**

Single issuer concentration risk is the risk associated with significant issuer, credit and counterparty risk exposures to a single entity or group of connected entities. If firms hold exposures to single entities or groups in

excess of 25% of their own capital resources<sup>5</sup>, they are required to hold additional Pillar 1 capital in respect of concentration risk.

As at 31 March 2017, MHI had no Pillar 1 concentration risk capital requirement.

#### **8.4. Impairment adjustments**

At each balance sheet date, MHI assesses whether those financial and other assets which are not accounted for at fair value through profit and loss, are impaired. As at 31 March 2017, no adjustments in respect of asset impairment were made (31 March 2016: no impairment adjustments were made).

MHI's accounting policies concerning the treatment of impaired financial and non-financial assets are set out in its financial statements.

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<sup>5</sup> Or in excess of €150m where exposures are incurred towards financial institutions.

## 9. Counterparty credit risk

### 9.1. Risk management

Counterparty credit risk forms part of MHI's overall credit risk but is differentiated from that discussed in section 8 in that it arises where the failure of a counterparty to meet its contractual obligations may lead to losses of an uncertain nature, driven by fluctuations in market valuations.

Counterparty credit risk forms a key component of MHI's overall risk appetite, and is approved by the Board. MHI employs a number of metrics in support of this which are used to limit and monitor the credit risk exposures in accordance with credit risk management policies.

MHI is exposed to counterparty credit risk principally through derivative and repurchase agreement contracts arising from its trading activities, and to a lesser extent from securities trading which supports MHI's market-making activities.

#### **Counterparty credit risk methodology**

Counterparty credit risk is assessed and limits are set in accordance with MHI's methodology. Exposure is evaluated by determining the potential size of counterparty exposures which may arise from transactions together with an assessment of the creditworthiness of the obligor.

The potential size of counterparty credit risk is a function of both current and potential future exposures. Potential future exposures to a counterparty default, which may arise through securities trading, derivatives, and repurchase agreement contracts, are estimated using historical volatilities of key pricing variables to those contracts over their remaining life.

Counterparty credit quality is assessed using external credit ratings where available, or alternatively an internal rating is assigned in accordance with internal credit rating methodology.

Counterparty credit limits are established in accordance with MHI's methodology for measuring counterparty credit risk, taking into account executed documentation with permissible netting and collateral management arrangements, and consistent with the overall credit risk appetite.

#### **Counterparty credit risk mitigation**

Risk mitigation techniques are used to reduce counterparty credit risks arising from MHI's activities. These techniques include the use of netting agreements, acceptance of collateral, application of haircuts, and execution of transactions with central counterparties, whereby credit risk to individual counterparties is replaced by exposure to a central counterparty.

Derivative and repurchase agreement trading activity is undertaken using netting agreements on a collateralised basis, unless exceptions are approved in accordance with credit risk policies. Collateral arrangements are governed by standard agreements (such as Credit Support Annexes to International Swaps and Derivatives Association (ISDA) Master Agreements and Global Master Repurchase Agreements). The forms of collateral which may be accepted are subject to MHI's internal credit risk policy, which seeks to ensure that in the event of counterparty default the value of collateral held is sufficient to compensate for losses arising from such default.

Repurchase agreement trading activity is principally conducted using high-quality government securities as collateral, and minimal use is made of sub-investment grade corporate securities as collateral. This is in line with MHI's requirement to only accept high quality collateral for margining purposes, which must be of at least of equivalent quality to the collateral of the underlying transaction. Collateral is revalued on a daily basis in accordance with collateral management procedures.

In order to recognise the effects of credit risk mitigation, a number of conditions must be met, and in particular agreements must be legally enforceable and legal title to collateral must be passed to MHI. Once these conditions are satisfied the effect of collateral is reflected through the reduction in the measure of credit exposure.

Credit valuation adjustments are established in accordance with valuation policies for derivative and repurchase agreement transactions. Credit valuation adjustments concerning individual counterparties are based upon the potential size of exposures to those counterparties, taking account of legally enforceable netting and collateral agreements, together with market pricing of the creditworthiness of those counterparties.

#### **Correlated risk**

Correlated or *wrong way* risk arises where the probability of counterparty default is positively correlated to the risk of the underlying transaction. MHI adopts an integrated market risk and credit risk stress testing methodology which highlights correlated exposures across a range of scenarios.

Credit risk policies have been implemented to mitigate *wrong way* risk which, for example, prohibit the acceptance of collateral issued by a connected entity to the transaction counterparty, and over-collateralisation. *Wrong way* risk is further controlled through the operation of a credit limit framework in respect of specific counterparties, groups of counterparties and countries.

## 9.2. Pillar 1 requirements

MHI's RWAs and Pillar 1 counterparty risk requirements, in respect of counterparty risk arising within trading and non-trading books, are set out below as calculated under the standardised approach:

Table 25: Counterparty credit RWAs and Pillar 1 capital requirements

	2017		2016	
	RWAs	Pillar 1 capital requirements	RWAs	Pillar 1 capital requirements
	£m	£m	£m	£m
Counterparty credit risk	184.5	14.8	134.0	10.7

The total counterparty credit risk RWA and Pillar 1 capital requirement includes default fund contributions, settlement risk and CVA capital requirements.

## 9.3. Analysis of counterparty risk exposures

### *RWAs and exposures by product type*

An analysis of counterparty credit risk RWAs and exposures as at 31 March 2017 by product type is given below:

Table 26: Counterparty credit RWAs and exposures by product type

	2017		2016	
	RWAs	Counterparty Credit risk exposure <sup>1</sup>	RWAs	Counterparty Credit risk exposure <sup>1</sup>
	£m	£m	£m	£m
Derivative contracts	69.1	910.4	33.5	140.7
Securities financing contracts	45.0	471.0	57.6	302.9
Other	70.4 <sup>2</sup>	5.9 <sup>3</sup>	42.9 <sup>2</sup>	4.6 <sup>3</sup>
<b>Total</b>	<b>184.5</b>	<b>1,387.3</b>	<b>134.0</b>	<b>448.2</b>

<sup>(1)</sup>Counterparty credit risk exposure is shown as the credit exposure, calculated in accordance with Pillar 1 standard rules using the mark to market approach, less deductions in respect of credit risk mitigation.

<sup>(2)</sup>Includes a credit valuation adjustment charge, settlement and delivery risk charges, default fund and Treasury Default Loss Allocation Regime contribution.

<sup>(3)</sup>Includes Treasury Default Loss Allocation Regime contribution.

Further analysis of credit risk exposure in respect of derivative contracts is given below, and shows the impact of netting benefits from legally enforceable netting agreements and collateral arrangements:

Table 27: Derivative counterparty credit risk exposures

	2017	2016
	<b>Counterparty Credit risk exposure £m</b>	<b>Counterparty Credit risk exposure £m</b>
Gross positive fair value of derivative contracts	2,798.0	499.8
Potential future credit exposure	954.2	129.8
Netting benefits	(2,457.3)	(255.0)
Netted credit exposure on derivative contracts	1,294.9	374.6
Collateral (held) / placed	(387.5)	(255.6)
Long settlement	3.0	21.7
<b>Total net derivatives credit risk exposure</b>	<b>910.4</b>	<b>140.7</b>

**Counterparty credit risk exposures by exposure class**

An analysis of counterparty credit risk exposures as at 31 March 2017 by principal exposure class is given below:

Table 28: Counterparty credit risk exposures by exposure class

	2017	2016
	<b>Counterparty Credit risk exposure £m</b>	<b>Counterparty Credit risk exposure £m</b>
Governments, central banks and international organisations	89.3	41.5
Central counterparties	1,068.4	271.8
Financial institutions	223.4	130.3
Corporates	0.3	-
<b>Total<sup>(1)</sup></b>	<b>1,381.4</b>	<b>443.6</b>

<sup>1</sup>Excludes Treasury Default Loss Allocation Regime contribution.

**Counterparty credit risk exposures by credit quality**

MHI has maintained a cautious approach with regard to the credit standing of its counterparties. An analysis of counterparty credit risk exposures as at 31 March 2017 by credit quality, in accordance with the credit quality steps used within the Pillar 1 standardised approach, is given below:



Table 29: Counterparty credit risk exposures by credit quality step

2017						
	Credit quality steps					Total £m
	1 £m	2 £m	3 £m	4 £m	N/a <sup>(1)</sup> £m	
Government, central banks and international organisations	89.2	-	0.1	-	-	89.3
Central counterparties <sup>(2)</sup>	-	-	-	-	1,068.4	1,068.4
Financial institutions	-	223.4	-	-	-	223.4
Corporates	-	-	0.3	-	-	0.3
<b>Total credit risk exposure</b>	<b>89.2</b>	<b>223.4</b>	<b>0.4</b>	<b>-</b>	<b>1,068.4</b>	<b>1,381.4</b>

2016						
	Credit quality steps					Total £m
	1 £m	2 £m	3 £m	4 £m	N/a <sup>(1)</sup> £m	
Government, central banks and international organisations	41.5	-	-	-	-	41.5
Central counterparties <sup>(2)</sup>	-	-	-	-	271.8	271.8
Financial institutions	-	129.3	-	1.0	-	130.3
Corporates	-	-	-	-	-	-
<b>Total credit risk exposure</b>	<b>41.5</b>	<b>129.3</b>	<b>-</b>	<b>1.0</b>	<b>271.8</b>	<b>443.6</b>

<sup>(1)</sup>Uniform regulatory treatment applied.

<sup>(2)</sup>Qualifying central counterparties attract a uniform 2% risk weighting irrespective of credit quality.

Under the standardised approach, credit ratings assigned by credit rating agencies are used in the calculation of RWAs. The PRA determines which rating agencies may be used in the calculation of risk weights, of which MHI uses ratings assigned by Standard & Poor's Financial Services LLC (S&P), Moody's Investor Service, Inc. (Moody's) and Fitch Ratings, Inc. (Fitch). Credit exposures must be assigned to one of six credit quality steps if a rating is available. Risk weight percentages are assigned based upon the credit quality step, exposure class and maturity of each credit exposure. Where an external credit rating is not available or where exposures exist to central counterparties, a default treatment is applied as specified by regulatory guidance.

Exposures are assigned to credit quality steps based upon external ratings as illustrated below:

Table 30: Assignment of ratings to credit quality steps

	S&P	Moody's	Fitch
Credit quality step 1	AAA to AA-	Aaa to Aa3	AAA to AA-
Credit quality step 2	A+ to A-	A1 to A3	A+ to A-
Credit quality step 3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB
Credit quality step 4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-
Credit quality step 5	B+ to B-	B1 to B3	B+ to B-
Credit quality step 6	CCC+ and below	Caa1 and below	CCC+ and below

The counterparty credit risk exposures described in the analysis above include credit derivative contracts which give rise to counterparty credit risk exposure to the counterparty to the contract.

#### 9.4. Notional value of credit derivative transactions

The following table shows the notional value of the credit derivative transactions outstanding as at 31 March 2017, arising in respect of MHI's own credit portfolio or through intermediation activities. Transactions in respect of MHI's own credit portfolio comprise both hedges of market risk associated with trading inventory and hedges used in connection with the issuance of structured notes:

Table 31: Notional value of credit derivative transactions

Notional value of outstanding transactions	2017		2016	
	Own credit portfolio		Own credit portfolio	
	Protection purchased £m	Protection sold £m	Protection purchased £m	Protection sold £m
Credit default swaps	597.6	559.7	27.7	46.2

## **10. Operational risk**

### **10.1. Risk management**

Operational risk is the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events.

Operational risk tolerance forms a component of MHI's overall risk appetite and is approved by the Board. MHI has no tolerance for inappropriate staff behaviour which may result in damage to its reputation or to the interests of its clients.

The principal operational risks to which MHI is exposed include technology failures (including cyber-attack), fraud, human error, the creation of unauthorised credit or market risks, regulatory breaches, and litigation.

Operational risk exposures are assessed and measured using a framework which includes: risk and control self-assessments, key risk indicators, internal loss event reporting, external loss event capture, and scenario stress testing.

MHI mitigates such risks through the maintenance of a comprehensive system of internal controls, which incorporates a strict segregation of duties between front and back office functions, the purchase of external insurance, and business continuity planning. Root cause analysis is undertaken to investigate internal instances of operational loss or near miss incidents. In cases where internal controls cannot be implemented to reduce operational risk to an acceptable level, consideration is given to avoiding or transferring the risk altogether.

Operational risk reporting is undertaken routinely to the Risk Management Committee and to the Operational Risk Committee. Significant matters are escalated to the Board Risk Committee and to the Board.

### **10.2. Pillar 1 requirements**

As at 31 March 2017, the Pillar 1 capital requirement in respect of operational risk was £24.5m (2016: £18.2m) as calculated under the basic indicator approach.

## 11. Liquidity risk

### 11.1. Risk management

Liquidity risk is the risk that MHI does not have sufficient capital and funding resources to meet its financial contractual obligations as they fall due. Liquidity risk can result from a lack of availability of external funding and the inability to convert securities into cash to meet near-term funding demands.

MHI's management of liquidity risk aims to ensure that there are sufficient liquid resources, both in amount and quality, to enable MHI to meet its financial contractual obligations as they fall due, even during times of idiosyncratic and / or market stress. MHI maintains liquidity in excess of its regulatory and internal risk appetite requirements.

Liquidity risk appetite is a component of MHI's overall risk appetite and is approved by the Board. MHI's business model is simple, largely cash-based with derivatives predominantly being of a vanilla and cleared nature, has access to diverse funding sources, allocates funding costs to businesses in a transparent and effective way, and has a robust limit and control framework to protect against liquidity risks in excess of appetite.

MHI further mitigates liquidity risks through maintenance of high quality liquid assets (HQLAs) in a segregated portfolio under the control of its Treasury & Funding function, as well as holding additional HQLA-eligible unencumbered assets elsewhere across the firm.

MHI performs stress testing of its liquidity risk position; a dynamic and forward looking approach is taken for MHI's internal liquidity stress scenarios and their underlying assumptions. Reporting of liquidity risks and associated stress testing is undertaken routinely by the Stress Testing Committee and the Risk Management Committee. Significant matters are escalated to the Board Risk Committee and the Board.

#### **ILAAP**

MHI has produced and maintains an ILAAP document detailing how it assesses, quantifies, and manages the principal liquidity risks to which it is exposed. Further, it highlights MHI's approach to determining the minimum level of internal liquidity resources required to be maintained to mitigate those risks in line with its overall liquidity risk management and liquidity risk appetite approved by the Board.

The approval and overall ownership of the ILAAP is the responsibility of the Board of MHI. The leadership for preparation of the ILAAP document has been delegated to the CRO with support from the Risk Management Department, Finance, Regulatory Reporting, Treasury & Funding, Compliance, and impacted business areas. The document has been discussed and challenged by senior management, including the CEO, the CFO, the Head of Compliance and the Treasurer.

The ILAAP document is an integral part of MHI's liquidity management framework and informs the Board of the ongoing assessment and quantification of liquidity risks, how these are mitigated, and required liquidity resources. The CRO; through the Head of Regulatory & Liquidity Risk Management and supporting functions; is responsible for maintaining and updating the ILAAP document, monitoring MHI's liquidity adequacy, and ensuring that the ILAAP document is reflective of MHI's liquidity risk management at all times.

The ILAAP document is dynamic and updated at least annually, but also in line with changes in regulations, risk appetite, business model, and market conditions.

#### ***Collateral requirements in the event of a rating downgrade***

MHI also considers the effects of a downgrade in the rating of Mizuho Bank, Ltd., whose rating is referenced within the CSAs under which MHI may be required to pay collateral to its counterparties. Stress testing is conducted which incorporates the impact of a three notch downgrade in the rating of Mizuho Bank, Ltd., and this modelling indicates that MHI has sufficient available liquidity resources to manage the cash requirements which may arise in such a situation.

### 11.2. Asset encumbrance

Encumbered and unencumbered assets for MHI as at 31 March 2017 are disclosed using median values. These median values are the rolling quarterly medians for June 2016, September 2016, December 2016 and March 2017 and are based on the requirements in Part Eight of the CRR and other guidelines issued by the EBA in June 2014 and March 2017.

Table 32: Encumbered and unencumbered assets

<b>2017</b>				
	<b>Carrying amount of encumbered assets £m</b>	<b>Fair value of encumbered assets £m</b>	<b>Carrying amount of unencumbered assets £m</b>	<b>Fair value of unencumbered assets £m</b>
Assets of the reporting institution	2,734.5 <sup>1</sup>	<i>'not applicable'</i>	12,868.6 <sup>1,2</sup>	<i>'not applicable'</i>
Equity instruments	-	-	8.0	8.0
Debt securities	2,664.7	2,684.9	2,214.0	2,268.0
Other assets	-	<i>'not applicable'</i>	1,101.5	<i>'not applicable'</i>
<b>2016</b>				
	<b>Carrying amount of encumbered assets £m</b>	<b>Fair value of encumbered assets £m</b>	<b>Carrying amount of unencumbered assets £m</b>	<b>Fair value of unencumbered assets £m</b>
Assets of the reporting institution	3,212 <sup>1</sup>	<i>'not applicable'</i>	19,001 <sup>1,2</sup>	<i>'not applicable'</i>
Equity instruments	-	-	10	9
Debt securities	3,132	3,155	1,759	1,770
Other assets	-	<i>'not applicable'</i>	548	<i>'not applicable'</i>

<sup>(1)</sup> 'Assets of the reporting institution' will not reconcile to total assets balances reported in the financial statement for 31 March 2017 as the treatment of financial instrument netting differs. 'Assets of the reporting institution' also includes other asset items (e.g. loans and advances other than loans on demand) which are not required to be separately disclosed.

<sup>(2)</sup> This amount predominantly relates to the balance sheet value of cash placed under reverse repurchase agreements; it should be read in conjunction with Table 33 as the (majority of the) collateral received through reverse repurchase agreements has been used in matching repurchase agreements.

Table 33: Encumbered assets / collateral received and associated liabilities

<b>2017</b>		
	<b>Matching liabilities, contingent liabilities or securities lent £m</b>	<b>Assets, collateral received and own debt securities issued other than covered bonds and encumbered ABS £m</b>
Carrying amount	13,322.6	13,771.6
<b>2016</b>		
	<b>Matching liabilities, contingent liabilities or securities lent £m</b>	<b>Assets, collateral received and own debt securities issued other than covered bonds and encumbered ABS £m</b>
Carrying amount	14,715	14,943

The secured and unsecured wholesale market, together with the debt issuance programme, is the prime funding source for MHI. MHI provides securities financing transactions and collateralised borrowing as part of its repurchase agreement business and these result in off-balance sheet encumbrance. Another form of encumbrance is pledging securities with central counterparties to facilitate trading activities and meet initial margin requirements. Assets on the balance sheet are considered encumbered when they have been pledged or used to secure or collateralise a transaction that impacts their transferability.

## 12. Remuneration

### 12.1. The Remuneration Committee (RemCo)

As part of MHI's corporate governance arrangements the Board has established a RemCo to approve remuneration policy and set specific remuneration at certain levels. RemCo members are appointed by the Board and solely comprise Non-Executive Directors; the committee reports to the Board through its Chair. The remuneration of MHI's Executive Directors is approved by the RemCo. The RemCo also approves the remuneration of Managing Directors and above and of Material Risk Takers (MRTs), a definition of which is set out below. Between 1 April 2016 and 31 March 2017, the RemCo held ten meetings.

### 12.2. Remuneration policy

MHI maintains a remuneration policy which applies to all employees together with staff seconded from affiliates within the Mizuho Financial Group, Inc. of companies. The policy takes into account the PRA and FCA's Remuneration Codes and related guidance, and is intended to promote effective risk management whilst retaining the flexibility to make changes dependent upon external factors including, but not limited to, future legislative or regulatory changes. The policy also provides a market based remuneration framework, which enables the Group to recruit and retain high calibre staff and promote fairness and consistency throughout the employment relationship whilst not compromising the Group's high standards of control and risk management.

The remuneration policy and its implementation are reviewed and approved by the RemCo from time to time and at least annually. Any changes to the policy will only take effect upon approval by the RemCo and will be subject to ratification by the Board. RemCo approved a revised remuneration policy during the meeting of 16 March 2017.

### 12.3. MRTs

MRTs are defined as staff whose professional activities can have a material impact on MHI's risk profile, taking into account the criteria set out in the European Banking Authority's Regulatory Technical Standard *CDR (EU) No 604/2014*. This includes senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers.

A list of MRTs is held by MHI's Human Resources (HR) department. Employees that appear on this list are notified by HR of their status and of the implications of being defined as an MRT.

As at 31 March 2017 for the fiscal year 2016/17, 73 active members of staff were identified as MRTs.

### 12.4. Control functions

The compensation of employees engaged in control functions is based principally on the achievement of objectives linked to those functions and MHI performance. Compensation for the heads of those control functions is approved by the RemCo.

### 12.5. The link between pay and performance

The remuneration policy is designed to align employee rewards with performance and aims to protect and promote shareholder interests by incentivising staff to deliver sustained performance and create long-term value through delivery of MHI's goals. The policy also provides a market-competitive remuneration structure to attract and retain high calibre staff. The policy is reviewed at least annually and approved by the RemCo and the Board. The policy is made available to all employees on MHI's intranet site and when updated it is mandatory that all employees attest that they have read and understood the policy.

MHI policy states that variable remuneration awards are conditional, discretionary and contingent upon a sustainable and risk-adjusted performance, in excess of that required to fulfil the employee's job description as part of the employee's terms of employment. In particular, Front Office staff performance is assessed on a range of both quantitative and qualitative measures. Awards of variable remuneration are capable of forfeiture or reduction at MHI's discretion, including down to zero.

Variable remuneration will be paid only if it is sustainable in the context of MHI's financial situation and is justified on the basis of individual, departmental, MHI or wider Mizuho Financial Group, Inc. performance.

A remuneration sub-group consisting of the Head of HR, the Head of Compliance, the CFO, the CRO and a representative from Internal Audit, meets regularly (generally before each RemCo meeting) to discuss a number

of remuneration related matters including behaviour and conduct. The sub-group is involved in the process to review and set remuneration. Concerns regarding an individual's activities and / or conduct can be raised at any stage and are taken into account by management through the Balanced Scorecard Appraisal process; this is described in further detail below.

An evaluation committee, comprising Executive Committee members, meets on an annual basis to assess individual staff behaviours, the results of which form part of the appraisal and remuneration process. This is in addition to the specific involvement of the remuneration sub-group.

The RemCo will use information in respect of corporate performance and risk management to make informed decisions when reviewing the appropriateness of discretionary reward and specifically the remuneration of MRTs. The level of discretionary remuneration is agreed with MHI's parent company, Mizuho Securities Co., Ltd., with final approval by RemCo.

The staff appraisal system ensures that an individual's behaviour and their adherence to control and compliance requirements is taken into account, and that sole reliance is not placed on an individual's financial performance. The assessment is in the form of a Balanced Scorecard Appraisal. The Balanced Scorecard Appraisal consists of the following:

- (1) Financial, Strategic & Operational: this measures employees' performance against *SMART* objectives set at the beginning of the financial year; and
- (2) Culture, Conduct & Values: this comprises inputs from the remuneration sub-group, Internal Audit, and Front Office Supervisory Reporting, and is strongly linked to MHI's values (Speed, Innovative Spirit, Team Spirit, Passion and Customer First) through a competency framework.

The Balanced Scorecard Appraisal is used to determine the overall performance ratings and as a basis for determining any adjustments to individual discretionary remuneration awards, including malus and clawback. All permanent employees qualify for consideration of discretionary remuneration; no formulaic discretionary remuneration is awarded by MHI.

An employee's individual performance is measured on a rating scale of 1 (Poor) to 5 (Outstanding). An employee will not be assigned a rating higher than a 3 if they have not met their objectives including any financial targets. Where an appraisal rating is a 2 or lower then malus will be applied to any discretionary remuneration awarded to the employee.

## **12.6. The design characteristics of the remuneration scheme**

During the period in question variable remuneration for MRTs (who were not subject to the *de minimis* concession) was paid in cash and shares, with elements subject to deferral. MRTs that fell under the *de minimis* concession were paid in cash only. Variable remuneration is subject to the following design characteristics:

### ***Risk adjustment***

The level of discretionary remuneration is determined from performance figures which inherently factor in risk adjusted accounting measures; the level of discretionary remuneration is further adjusted for risk by the RemCo. The CRO attends RemCo and contributes to discussions on the size of overall discretionary remuneration relative to risk by reference to a number of metrics including adherence to MHI's risk appetite. The CRO and CFO (who also attends the RemCo on a frequent basis) can recommend discretionary or formulaic adjustments to accrued discretionary remuneration at any point throughout the year via the RemCo or the Board Risk Committee where relevant performance metrics are discussed.

The Board and RemCo are of the view that a purely formulaic approach to discretionary remuneration adjustment is not suitable in any circumstances. In addition, MHI has been in an evolving process of revising its budget and strategy for future years, this means that a more flexible discretionary approach to adjusting discretionary remuneration is required e.g. for retaining and attracting key staff. Current potential discretionary adjustments include, but are not limited to, the cost of capital, cost of funding and potential long tail risks.

### ***Deferral policy***

During the financial year April 2016 to March 2017 variable pay for MRTs and certain other staff was subject to a deferral plan. The deferral plan for MRTs (who were not subject to the *de minimis* concession) provided for deferral of between 40% and 60% of variable pay for a period of between three and seven years in line with the Remuneration Codes and subject to an MRTs categorisation (Senior Manager, Risk Manager or Other MRT). For all other staff subject to the deferral plan (and MRTs who fell under the *de minimis* concession), the deferral plan provided for cash deferrals of between 20% and 40% of variable pay over a prescribed threshold for a period of three years.

### ***Malus: performance adjustment***

A deferred award may be subject to adjustment (including forfeiture) as set out below and will only vest to the extent determined by the RemCo at its discretion, giving regard to such matters as it considers appropriate, including, but not limited to:

- 1) In the case of all staff including MRTs, any restatement or recalculation of individual and / or departmental and / or MHI and / or Mizuho Financial Group, Inc. company financial performance (including but not limited to following the discovery of incorrect or false accounting); and / or
- 2) In the case of MRTs only:
  - whether vesting is (a) sustainable according to the financial situation of MHI, and / or (b) justified on the basis of individual and / or departmental and / or MHI and / or Mizuho Financial Group, Inc. company performance; and / or
  - (a) any assessment or reassessment of individual and / or departmental and / or MHI and / or Mizuho Financial Group, Inc. company performance, (b) any evidence of an individual's misbehaviour and / or material error, (c) any material downturn in departmental and / or MHI and / or Mizuho Financial Group, Inc. company financial performance, and / or (d) any material failure of risk management suffered by MHI and / or any Mizuho Financial Group, Inc. company and / or the individual's department; and / or
  - (a) any conduct which the individual participated in and / or was responsible for and which resulted in significant losses to MHI and / or any Mizuho Financial Group, Inc. company and / or the individual's department, and / or (b) any failure of the individual to meet appropriate standards of fitness and / or propriety (including, without limitation, any such standards set by a regulator and / or MHI and / or any Mizuho Financial Group, Inc. company) and / or to comply with MHI and / or Mizuho Financial Group, Inc. company policies; and / or
  - any misconduct and / or material failure of risk management which the individual could (a) reasonably be expected to be aware of but failed to take adequate steps to promptly identify, assess, report, escalate or address, and / or (b) by virtue of the individual's role or seniority, be deemed indirectly responsible and / or accountable for, including, without limitation, by virtue of being senior staff in charge of setting MHI and / or Mizuho Financial Group, Inc. company culture and / or strategy; and/or
- 3) In the case of all staff including MRTs, any other circumstance as required by law and / or any regulator.

### **Clawback**

The Remuneration Codes require MHI to apply clawback to the variable remuneration of MRTs. The following provisions apply in respect of payments of all discretionary remuneration awards for a period of seven years after the date the award is made (which can be extended from seven to ten years for *Senior Managers* in certain circumstances where at the end of the normal seven year clawback period (i) MHI has commenced an internal inquiry into a possible material failure which could lead to clawback or (ii) a regulatory authority has notified MHI that it has commenced an investigation which could lead to clawback):

- An employee who is or becomes an MRT may be required to repay to MHI up to 100% of the gross amount of any non-deferred cash award, deferred cash award, non-deferred share award and / or deferred share award paid pursuant to a discretionary remuneration award in the event that the employee is involved in or is responsible for:
  - a. any misconduct and / or material failure of risk management suffered by MHI and / or the employee's department, including any misconduct and / or material failure of risk management which the employee could (i) reasonably be expected to have been aware of but failed to take adequate steps to promptly identify, assess, report, escalate or address, and / or (ii) by virtue of the employee's role or seniority, be deemed indirectly responsible or accountable for; and / or
  - b. conduct which results in significant losses to MHI and / or the employee's department; and / or
  - c. any restatement or recalculation of individual and / or departmental and MHI financial performance (including but not limited to following the discovery of incorrect or false accounting); and / or
  - d. any material error and / or any failure to meet appropriate standards of fitness and / or propriety (including, without limitation, any such standards set by a regulator and MHI) and / or to comply with MHI policies which apply to an employee; and / or
  - e. any other circumstance as required by law and / or any regulator.
- The RemCo in its sole discretion shall determine whether and the extent to which some or all of any part of the discretionary remuneration award that has previously been paid must be repaid pursuant to these clawback provisions.



- An employee who accepts an award and is or becomes an MRT agrees that MHI shall be entitled to withhold or collect any repayment required pursuant to the clawback provisions (i) by deduction from any salary or other earnings or payments due to the employee at any time, (ii) directly from the employee by immediate payment in cleared funds or (iii) by selling some or all of any shares held on the employee's behalf.

## 12.7. Remuneration leverage

Remuneration leverage is the ratio of fixed to variable components of remuneration. MHI ensures that fixed and variable components of total remuneration are appropriately balanced and sets fixed remuneration at a level which permits a fully flexible discretionary remuneration policy (including the award of no variable remuneration in appropriate circumstances). For 2016/17, the maximum leverage ratio for all Front Office staff has been set as 1:2 (Fixed : Variable) and for all support and control functions staff this has been set at 1:1 (Fixed : Variable). In accordance with the Remuneration Codes, approval for the aforementioned ratios has been obtained from the shareholders.

## 12.8. Remuneration awards and expenditure

### Aggregate MRT total remuneration by business area

Aggregate remuneration awards to MRTs by business area are shown below:

Table 34: Aggregate MRT remuneration by business area

	2017	2016
MRT aggregate remuneration	Aggregate Remuneration awards £m	Aggregate Remuneration awards £m
Investment Banking	5.8	3.9
Markets and Products	18.6	12
Central functions	12.5	10.5
<b>Total</b>	<b>36.9</b>	<b>26.4</b>

### Aggregate remuneration of MRT by type of award

Aggregate remuneration awards in respect of MRT by type of award, split between senior management and other staff, are set out below:

Table 35: Aggregate MRT remuneration by type of award

	2017		2016	
MRT aggregate remuneration	Senior management £m	Other MRTs £m	Senior management £m	Other MRTs £m
Fixed remuneration	7.6	13.6	6.5	9.3
Variable remuneration	4.6	11.1	4.5	6.1
<b>Total remuneration</b>	<b>12.2</b>	<b>24.7</b>	<b>11.0</b>	<b>15.4</b>

The number of MRTs in respect of whom remuneration awards were made during the year is as follows:

Table 36: Number of MRTs subject to awards

	2017		2016	
MRT staff numbers	Senior management	Other MRTs	Senior management	Other MRTs
Number of staff	21	52	21	38