

## OVERVIEW

The European Union (EU) Capital requirements Directive (CRD) was adopted by the EU on 14 June 2006 and became effective in Ireland on 1 January 2007. The CRD applies to all investment firms authorised under the Investment Intermediaries Act, 1995 and, Statutory Instrument No. 375/2017 European Union (Markets in Financial Instruments) Regulations 2017.

In Ireland, the implementation of the CRD required regulated firms to make significant changes to the way they calculate their capital requirements including the application of the concepts of minimum capital requirements (Pillar 1) and the internal capital adequacy assessment process (Pillar 2) in the determination of those requirements.

Pillar 1 sets out the methodology for calculating a firm's minimum regulatory capital. Pillar 2 requires a firm to assess their own risks and determine if sufficient capital is in place to cover these risks including specific risks not captured under Pillar 1. This process is known as the internal capital adequacy assessment process (ICAAP) and its purpose is to ensure that the appropriately identified and measured risk profile of a firm is adequately covered by the capital it holds against its risks.

The disclosure requirements of Pillar 3 complement the capital requirements described in Pillar 1 and Pillar 2 and seek to promote greater market discipline and transparency through the disclosure of key information about risk exposures and risk management processes.

The Capital Requirements Directive (CRD) introduced a new capital adequacy framework for banks and investment firms across Europe. The CRD is made up of three components called Pillar1, Pillar 2 and Pillar 3 which jointly form the prudential framework.

Pillar 1 is the minimum capital requirement set out by the Directive and instructed in the national discretions. The minimum capital requirement has three main components;

- a. Market Risk
- b. Operational Risk
- c. Credit Risk

The Capital Requirements Directive (CRD) permits firm to omit one or more of the required disclosures where it believes that the information is regarded as proprietary or confidential. Proprietary and confidential information includes non-public information that is confidential and/or proprietary belonging to the firm and/or parties with whom the firm does business or if the disclosure of such information may undermine the firm's competitive advantage. This document relates to Pillar 3 disclosures only.

## SCOPE OF APPLICATION

Ava Trade EU Limited ("AVA or firm") trading as AVATRADE is regulated by the Central Bank of Ireland.

The Capital Requirements Directive, and the Pillar 3 disclosure requirement, applies to Ava Trade EU Limited only

## FREQUENCY OF DISCLOSURE

These disclosures are based on the financial statement prepared to 31 December 2019. The next report is to be issued in conjunction with the 31 December 2019 financial statements.

## LOCATION

This disclosure is published on the AVATRADE website, <https://www.avatrade.com/about-avatrade/legal-documentation>

## RISK MANAGEMENT OBJECTIVES AND POLICES

Under Statutory Instrument No. 375 of 2017, investment Firms are required to establish, implement and maintain adequate risk management policies and procedures which identify the Firm's risks, adopt arrangements to manage the Firm's risks and address any deficiencies in the Firm's risk management arrangements.

The Board of Directors of AVA are ultimately responsible for the management of the firm including the setting of risk management policies. The Board, the membership of which includes Non-Executive Directors, meets on a quarterly basis and more frequently should the need arise.

AVA has dedicated Compliance & Risk Management Functions, which have direct access to the Board of Directors.

The risk management framework is part of the well-defined governance framework which meets best practice in a manner appropriate to the firms scale and scope of operations. The framework demonstrates control of the business, whilst facilitating transparency for all stakeholders and supporting the business to move rapidly in a changing market.

# Ava Trade EU Limited Pillar 3 Disclosure 2019

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AVA's risk management policies and main risk mitigations and controls have been documented in the firm's ICAAP and in the Compliance Manual and Risk Policies. The firm's systems of internal control include appropriate levels of authorisation and segregation of duties. Financial reports are presented to management monthly and the Board quarterly, detailing the results, variances against forecast and other Key Performance Indicators.

For the purposes of Pillar 3 disclosures, the material areas of risk identified are;

- Market risk
- Operational risk
- Credit Risk

## Market risk

This is the risk that the fair value of equity or commodity related financial instrument will fluctuate due to changes in market prices other than due to currency or interest rate risk.

Market price risk arises from AVA's clients trading contracts for difference (CFDs) which are based on underlying equities and indices on world stock markets, foreign currencies, commodities and interest rates and the derivative (OTC and exchange-traded) or physical positions AVA takes to hedge these client positions. All derivatives used to hedge client positions are margin-traded so the profit or loss arising on the position is settled on a daily basis. The use of derivative financial instruments is governed by AVA policies approved by the Board, which provide written principles on their use consistent with the AVA's risk management strategy.

AVA monitors its market price risk on these client positions against internally approved limits as defined in the company's risk appetite and hedges these client positions based on a number of internally agreed metrics to manage its net exposure.

These positions are monitored on a real-time basis on all open positions held by AVA's clients to calculate AVA's total net client exposure to ensure optimal hedging decisions are made.

The diversity of the product range and global distribution of client base significantly reduces AVA's revenue sensitivity to individual asset classes and instruments. The direct result is consistent historical revenue performance throughout periods of varying market movements and volatility levels.

## Operational risk

AVA has adopted the Basic Indicator Approach to calculate the Pillar 1 capital requirements for operational risk. This produces an operational risk capital requirement equivalent to 15% of the three-year average of AVA's net income.

Operational risk is the risk of loss or negative impact to AVA resulting from inadequate or failed internal process, people and systems or from external factors such as new regulation and key supplier failure.

The following scenarios are considered by AVA's Board to be key risk themes and therefore risk treatment measures have been put in place to reduce the risks to an acceptable level:

- Inadequate business continuity planning or execution;
- Risk connected with a key counterparty failure;
- Risk connected with a key banking institution failure;
- A malicious act by an internal or external party;
- A significant reduction in the existing or potential customer base driven by regulatory changes;
- Human error or non-adherence to process;
- Inadequate change control; and
- Litigation risk.

### **Business Continuity Failure**

There are a number of sudden events (such as fires and floods) that may result in the invocation of the AVA's Business Continuity Plan (BCP).

To ensure the impact to 'business as usual' is kept to a minimum, AVA regularly tests the BCP and IT recovery plans, ensures up to date training is provided and business interruption insurances are in place.

### **Key Counterparty / Banking Institution Failure**

AVA mitigates the risk of disruption caused by a key counterparty or banking institution failure by ensuring extensive due diligence on counterparties is undertaken. In addition to the Credit and Counterparty Risk arising from this, AVA's also faces business disruption and reputational risk.

## **Malicious Act**

The controls that AVA has in relation to controlling internal and external fraud or other malicious acts include daily cash reconciliations, authorisation procedures and segregation of duties, front office monitoring and restriction of access to internal systems. Insurance provision has also been made in relation to residual risk exposure.

## **Regulatory action**

AVA endeavours to maintain good working relations with regulators in each jurisdiction where it operates. This is achieved via a compliance function that ensures AVA has experienced compliance professionals in place to ensure timely compliance with regulatory requirements.

## **Human Error or Non-Adherence to Process**

Although administration errors and dealing errors are inherent in the scale of AVA's operations, a number of automated controls and review procedures are also in place to reduce the level of error in key processes. The level of client complaints arising due to errors by the business is considered very low.

## **Inadequate Change Control**

Effective implementation of new systems, products and procedures is ensured through the New Product Process, due diligence activities and dedicated project management resources for major change programs.

## **Litigation Risk**

The risk of litigation arising from internal adverse employee relations has been reduced by the implementation of a comprehensive disciplinary procedure, an equal opportunities policy and an employee code of conduct.

## **Credit risk**

AVA does not offer credit facilities to clients and funds must be deposited in order to open a position. AVA operates a real-time marked-to-market trading platform with client profits and losses being credited and debited automatically to their account.

Credit risk occurs where a client's funds held by AVA are insufficient to cover losses incurred by the client upon liquidation. In particular, client credit risk can arise where there are significant, sudden movements in the market i.e. due to high general market volatility or specific volatility relating to an individual underlying financial instrument.

Client credit risk is therefore monitored daily with reference to the market price movement of the underlying instrument in which the client holds a position and the equity the client holds in relation to the margining requirement calculated for their position.

Credit risk is also the risk that AVA's counterparties may fail to pay amounts owed to the AVA as they become due.

It is AVA's policy to manage credit risk by only placing funds with financial institutions with a credit rating in line with AVA's Credit risk assessment limits matrix.

Limits are regularly reviewed and divergence from this policy is measured with a level of risk appetite. Limits are in place to monitor exposure to individual counterparties or connected counterparties. Funds deposited with various financial institutions are subject to internal concentration risk limits and these are reported regularly to the Board.

Credit risk also arises from deposits and excess funds placed with brokers that AVA uses to hedge its net client positions.

Counterparty credit risk arises principally from exposures arising in the trading book due to financial derivative instruments as well as unsettled non-trading book transactions and is calculated as % of the total risk-weighted exposure amounts.

AVA's calculates counterparty credit risk (CCR) on client margin balances which are greater than their total equity. Although the risk is significantly reduced by the automatic liquidation on AVA's trading platform which will liquidate the clients' positions before they become a debtor.

## CAPITAL ADEQUACY

AVA's objectives for managing capital are as follows:

- To comply with the capital requirements set by the Central Bank of Ireland
- To ensure that AVA is able to operate as a going concern and satisfy any minimum externally imposed capital requirements; and
- To ensure that AVA maintains a strong capital base to support the development of its business.

## Internal Capital Adequacy Assessment Process

AVA's Internal Capital Adequacy Assessment Process (ICAAP), prepared under the requirements of the Central Bank of Ireland and the Capital Requirements Directive, is an on-going assessment of AVA's risks and risk mitigation strategies, to ensure that adequate capital is maintained against risks that the firm wishes to take to achieve its business objectives.

The outcome of the ICAAP is presented as an Internal Capital Assessment (ICA) document. The ICA covers all material risks to determine the capital requirement over a one-year horizon and includes stressed scenarios to satisfy regulatory requirements. The ICA is reviewed and approved by the Board.

## CAPITAL RESOURCES

At the 31st December 2019, and throughout the year, AVA has complied with the capital requirements set out by the Central Bank of Ireland. The following table provides a breakdown of the capital resources available to meet these requirements:

	December-19 €'000
Called Up Share Capital	2,262
Revenue Reserves	1,480
<b>Tier 1 Capital</b>	<b>3,742</b>
<b>Tier 2 Capital</b>	<b>0</b>
<b>Total Capital Resources</b>	<b>3,742</b>
<b>Capital Requirement</b>	<b>2,671</b>
<b>Total Capital Excess</b>	<b>1,071</b>