eToro (Europe) Ltd.

Risk Management Disclosure Report 2016

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1. SCOPE OF THE RISK MANAGEMENT REPORT

The report presents the evaluation and management of the various risks faced by the Company during the period from the 1st of January 2016 to the 31st of December 2016.

The report was approved by the Board of Directors, approving the adequacy of risk management arrangements of the Company providing assurance that the risk management systems put in place are adequate with regard to the Company's profile and strategy.

The Report has been prepared with accordance to the disclosures required under Part 8, Articles 431-455 (the "Disclosures") of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (the "CRR") for the year ended 31 December 2016.

As part of this disclosure, details of the capital structure and regulatory capital requirements are required.

The CRD IV framework in respect of capital consists of three 'pillars':

- Pillar 1 requires the Company to establish minimum capital requirements
- Pillar 2 requires the Company to assess whether its Pillar 1 capital is adequate to meet risk exposures and to calculate the amount of capital that should be held against those exposures. This process forms the basis of the Internal Capital Adequacy Assessment Process ("ICAAP") required by the CYSEC.
- Pillar 3 requires eToro EU to publicly disclose specific information about the underlying risk management controls and capital position.

The Company's policy is to publish the Pillar III disclosures on an annual basis on the website. The report can be found at: https://www.etoro.com/en/customer-service/regulation-license/

2. LICENSE INFORMATION

The Company obtained a licence as an investment firm, able to trade on its own account, from the Cyprus Securities and Exchange Commission (hereinafter, the "CySEC"), CIF 109/10 on 14 January 2010. The CIF Licence was further amended on 31st March 2017.

The Company's business involves the offering of investment services in trading contracts for differences especially in foreign exchange and also in stocks, indices, commodities, and digital currencies, mainly to Retail Clients. The table below, illustrates the Cyprus Investment Firm license information of the Company (please refer to link below):

Investment Services	Explanations of Financial Instruments: 1 2 3 4 5 6 7 8 9 10
Reception and transmission of orders in relation to one or more financial instruments:	1-10
Execution of Orders on Behalf of Clients:	1-10
Dealing on Own Account:	1-10
Portfolio Management:	1-10
Investment Advice:	1-10

Ancillary Services	Explanations of Financial Instruments: 1 2 3 4 5 6 7 8 9 10
Safekeeping and administration of financial instruments, including custodianship and related services:	1-10
Granting credits or loans to one or more financial instruments, where the firm granting the credit or loan is involved in the transaction:	1-10
Foreign exchange services where these are connected to the provision of investment services:	✓
Investment research and financial analysis or other forms :	1-10

http://www.cysec.gov.cy/en-GB/entities/investment-firms/cypriot/37683/

3. EXECUTIVE SUMMARY

The work of the Risk Manager during the period under review was to ensure that the Company's policies and procedures in place, relating to the management of the various risks faced by the Company, were followed, as well as to assess and update the said policies and procedures, when and as it was deemed necessary.
To this end, the Risk Manager's work during this period was focused on the following areas:

- reporting risk management issues to the Company's Senior Management, Risk Committee and the Board of Directors (hereinafter, the "Board")
- monitoring of the risks faced by the Company
- compliance with any new legislation from a risk management point of view
- examination of the capital adequacy and the financial results of the Company

- provision to the Company's personnel with the appropriate advice/support and training
- identification of any problematic areas.

An assessment of the key risks faced by the company was undertaken in 2016 as part of the annual risk assessment process, which are described in more detail in the next section, together with mitigating controls.

During 2016, The Company was operating under CRR/CRD IV (Basel III Framework) Legislation:

From 1 January 2016, as per DI144-2014-14 of the Cyprus Securities and Exchange Commission for the prudential supervision of investment firms (the 'Directive'), paragraph 66 (transitional provisions for capital buffers), CIFs that are authorised to provide a) dealing on own account and b) underwriting of financial instruments and/or placing of financial instruments on firm commitment basis (Paragraph 51 of the Directive), will be required to maintain the following capital buffers in addition to the own funds requirements:

Capital conservation buffer (Paragraph 52 of the Directive)
As of 1.1.16, the Company is obliged to maintain additional capital buffer of Common Equity Tier 1 capital equal to 0.625% of the total of the risk-weighted exposure amounts (gradually up to 2,5 % in 2019, as per the table in section 6.4).
The Company has met its capital requirement throughout FY 2016, taking into consideration the above new legislation. The Company also took into account the abovementioned capital buffers in its ICAAP capital planning for the projected period that ranges between 31 December 2016 and 31 December 2019.

The leverage ratio requirement is a supplemental 3% non-risk based ratio – i.e. all of the Company's assets (both off and on balance sheet) should not be more than 33 times the Company's capital. As of Dec. 31, 2016 the Company meets the LR requirement.

Based on the new legislation, the following capital requirements were identified as of 31.12.16:

		31/12/2016
		USD '000
Original Own Funds		
Paid up capital		4
Share Premium		7,778
Reserves		(631)
Investment Compensation Fund deduction		(77)
Total Eligible Own Funds		**7,074**

	Capital required – 8% from Risk weighted exposure	Risk weighted exposure
Credit Risk	1,472	18,397
Position, Foreign Exchange and Commodities Risk	3,313	41,412
Operational Risk	596	7,451
Credit Valuation Adjustment Risk	61	763
Other Capital Requirements	35	436
Total	**5,477**	**68,458**
Capital Adequacy Ratio (Own Funds/Total Risk Weighted Exposure)		**10.33%**
Minimum Capital Adequacy Ratio (including buffers)		**8,625%**

The Company additionally has an ICAAP process for calculating its capital requirements under Pillar 2.

Within its ICAAP the Company has performed sensitivity analyses and stress testing that considered material risks. Refer to section 6.3 for further detail.

4. THE COMPANY'S APPROACH TO RISK MANAGEMENT

Managing risk effectively in a multifaceted organisation, operating in a continuously changing risk environment, requires a strong risk management culture. To this end, the Company has established an effective risk oversight structure and the necessary internal organisational controls to ensure that the Company identifies and manages its risks adequately, establishes the necessary policies and procedures, sets and monitors relevant limits and complies with the relevant legislation.

The principal responsibilities of the Board, the Senior Management, the Internal Auditor, the Risk Management Committee and the Risk Management function in relation to the management of the Company's risks include the following:

- The Board reviews and discusses, during its meetings, the written reports prepared by the Risk Manager and identifies the risks faced by the Company. The Board sets the risk appetite (through limits) and approves the risk policy of the Company. Risk is considered as part of the strategy of the company and new products/ strategic initiatives are analyzed for the risks they bear.

- the Company's Senior Management also reviews the written reports prepared by the Risk Manager, applies the decisions of the Board with respect to risk management and monitors whether all the Company's risk management procedures are followed
- the Internal Auditor evaluates the adequacy and effectiveness of the Company's internal control systems, policies and procedures with respect to risk management
- The Risk Committee ensures efficient management of the Company's risks in the provision of the investment and ancillary services to Clients, as well as the risks underlying the operation of the Company. Furthermore, the Risk Committee bears the responsibility to monitor the adequacy and effectiveness of the risk management policies and procedures that are in place, the level of compliance by the Company and its relevant persons with the policies and procedures adopted, in addition to the Company's obligations stemming from the relevant laws, as well as the adequacy and effectiveness of measures taken to address any deficiencies with respect to those policies and procedures that are in place, including failures by the Company's relevant persons to comply with those policies and procedures.

  During 2016, the Risk Committee has met 4 times.

  The Risk Manager ensures that all the different types of risks taken by the Company are in compliance with the obligations stemming from the relevant laws, and that all necessary procedures, relating to risk management are in place. Moreover, the Risk Manager is responsible for making recommendations and indicating in particular whether the appropriate remedial measures have been taken in the event of any deficiencies identified.

5. ANALYSIS OF THE RISKS FACED BY THE COMPANY

The Company is exposed to Credit Risk, Counterparty Credit Risk, Operational Risk (including online fraud risk, information and technology risk), Market Risk (including open positions risk, foreign exchange risk and interest rate risk), Liquidity risk, Regulatory Risk (including compliance risk, money laundering and terrorist financing risk), Business Risk, Group Risk, Reputation Risk and Political Risk. The analysis of the risks included in this Section of the Report describes each type of risk, the measures and policies taken by the Company to manage these risks and the standing of the Company with respect to each risk, as applicable.

5.1 Credit Risk

Credit Risk arises when failures by clients and counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date.

Cash balances are held with highly rated financial institutions and the Company has policies in accordance with the relevant legislation, to limit the amount of credit exposure to any financial institution. The company also reviews and examines on quarterly basis the credit ratings of the financial institutions and limits its assets according to the risk rate of the institutions. The probability of material credit loss due to a default of these credit institutions is quite low, based on the relevant calculations in the Company's capital requirements. However, in case such default shall occur, the impact on the company could be material (see also 5.2- Counterparty Credit Risk).

The Company acts in a fiduciary capacity for clients executing trades on its platform. Clients funds are held by the company as an agent in segregated clients' accounts with highly rated banks. The title of the abovementioned accounts sufficiently distinguishes these accounts from any account containing funds belonging to the company. These funds are recorded off-balance sheet.

Further to the above the Company has policies to diversify risks and to limit the amount of credit exposure to any particular counterparty in compliance with the requirements of the CySEC Directive DI144-2007-06.

The Company uses the Standardized Approach to Credit Requirements for the calculation of its credit risk.

The table below shows the credit risk and Counterparty Credit risk total amount of exposures and the capital requirement (8 per cent of the risk-weighted exposure amounts) as at 31 December 2016 as well as the average amount of the exposures over the period, for each exposure class:

	USD K				
Asset Class	**Total Exposure Amount**		**Capital Requirement**		**Average Exposure**
Institutions	31,802		523		28,684
Corporate	5,857		240		3,635
Other Assets	3,963		300		2,649
Retail	27,597		409		22,104
Public Sector Entities	-		0		41
Total	**69,219**		**1,472**		**57,112**

The table below shows the exposure values as at December 31, 2016 before and after credit risk mitigation associated with each asset class:

	USD K				
Asset Class	Total Exposure Amount Pre Credit Risk Mitigation		Net Effect of Credit Risk Mitigation		Total Exposure Amount After Credit Risk Mitigation
Institutions	31,802		-		31,802
Corporate	5,857		1,767		4,090
Other Assets	3,963		-		3,963
Retail	27,597		20,783		6,814
Public Sector Entities	-		-		-
Total	**69,219**		**22,550**		**46,669**

The table below shows the geographic distribution of the exposures, broken down in significant areas by material exposure classes, as at 31 December 2016:

	USD K					
	Geographic Area					
Asset Class	EU		USA		Other	Total
Institutions	27,170		4,631		1	**31,802**
Corporate	-		44		5,813	**5,857**
Other Assets	928		-		3,036	**3,963**
Retail	16,683		-		10,914	**27,597**
Public Sector Entities	-		-		-	-
Total	**44,781**		**4,675**		**19,764**	**69,219**

As at 31 December 2016, most of the firms' exposures had residual maturity of less than 3 months:

	USD K				
Asset Class	Residual Maturity <3 Months		Residual Maturity >3 Months		Total
Institutions	31,623		179		**31,802**
Corporate	5,857		-		**5,857**
Other Assets	3,305		658		**3,963**
Retail	27,597		-		**27,597**
Public Sector Entities	-		-		-
Total	**68,382**		**837**		**69,219**

The great majority of credit risk exposures are attributable to companies of the financial services industry.

- ***'Past due' and 'Impaired' Receivables***
  A provision for impairment of trade and other current receivables is established when there's objective evidence that the firm will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or delinquency in payments are considered indicators that the trade receivables are impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of loss is recognised in the profit and loss. When a trade or other current receivable is uncollectible, it is written off against the allowance account for trade and other current receivables.

  A financial asset is 'past due' when a counterparty fails to make a payment that is contractually due.

The firm has booked a provision for doubtful debt in the amount of 16k$ at 31 December 2016, in its trade receivables other assets category.

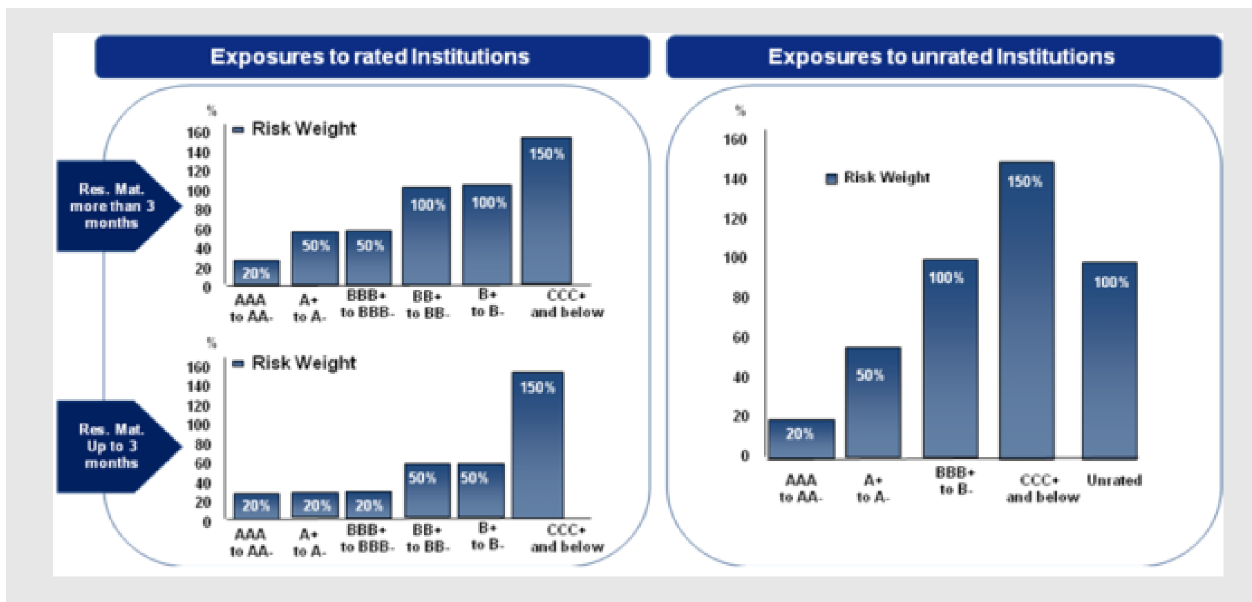
- ***Use of External Credit Assessment Institutions (ECAIs) and Expert Credit Agencies (ECAs)***
  The firm obtains information on credit ratings of counterparties from the following agencies, if available:
  - Moody's Investor Services
  - Standard & Poor's Rating Services
  - Fitch Ratings

Risk Weighted Assets and Credit Quality Steps

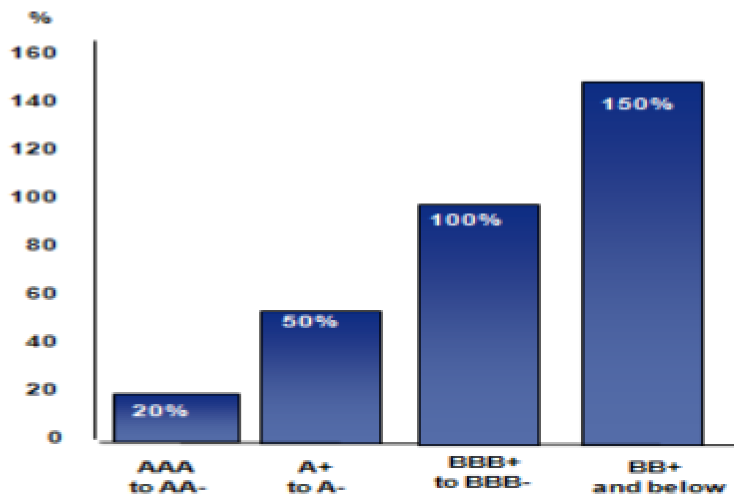
Institutions

As per the CRR/CRD, for exposures to Institutions, the Company applies the "Institution Based Approach" instead of the "Government Based Approach", for determining its capital requirements. That means that in order to determine the risk weight that applies for exposures to Institutions (corresponding Credit Quality Step ("CQS")), the Company uses the specific credit rating of the Institutions itself instead of the credit rating of the Central Bank of the jurisdiction in which the Institutions is incorporated. Only where the Institutions is unrated does the Company use the credit Rating of the Central Government of the Country in which the institution is incorporated.

See table below:



For short term exposures to Institutions with a short term credit rating, the following risk weights are applied:



Note: Ratings are based on the rating agency Fitch

As at 31 December 2016, all exposures to Institutions had a residual maturity of less than 3 months. All exposures except of two were also rated at least A- (whether the Institution itself or the corresponding central bank of the jurisdiction in which it was Incorporated). As a result, a 20% risk weight was used for all such exposures (CQ1+CQ2), 20% was also used for 1 exposure that although rated B1 (CQ5) - using the preferable approach since regulated in CY with EUR currency allowed to apply only 20%, and applying a 150% risk weight to one exposure rated CCC (CQ6).

Corporates

Exposures to Corporates were not included in “member state” nor in “equivalent 3rd country” list. As a result, a 100% risk weight was used for unrated exposures (government based approach not Applicable).

Other Items

The Other Items category includes Bitcoin cold storage wallet and plant, property and equipment. As a result, a risk weight of 100% was applied to all exposures to Other Items.

A breakdown of the Company’s exposures to Institutions by CQS is provided in the table below:

	USD K					
Asset Class	**CQS 1**		**CQS 2**	**CQS 5**	**CQS 6**	**Total**
Institutions	4,350		1,924	59	202	**6,535**

5.2 Counterparty Credit Risk

Counterparty credit risk can arise from the followings:

- Customer or counterparty failure to meet contract terms

  Specific risk to the company- The Company holds large amounts with counterparties, which might default and result in loss of some/ all of the balances, with no securities against these balances. The firm has several brokers who act as the liquidity providers (LPs) while others are kept as a redundancy.

  There is also counterparty risk on customers (which is more diversified risk). Customers may have negative balances which the Company can't recover, as this amount could be significant if there is a major market movement or gap when liquidity disappears (refer to section 9).

  Controls in place/ mitigation- The Company performs due diligence and risk checks before engaging with counterparties and sets limits for the exposure to each counterparty. Brokers used as liquidity providers are monitored on a continuous basis.
  For customers, there is a mandatory stop loss limits & daily margin call process that is being performed by back office department. When possible, negative balances will be recovered from other open positions.

- Failure to monitor customers or counterparties and failure to make an adequate assessment of the correlation between the financial condition of the customer and the price changes and liquidity of the market for the financial instrument.

  Specific risk to the company- The Company identifies this risk arising mainly from liquidity providers and customers.

  Controls in place/ mitigation- The company performs the due diligence and credit checks on its' counterparties on at least an annual basis and updates its' records accordingly. The Finance Controller reviews and approves the results and (when required) updates the exposures to the counterparty accordingly.

- Subjective decision-making by senior management of the company. This includes trading with or extending credit to companies they own or with which they are affiliated, to personal friends, to persons with a reputation for financial acumen or to meet a personal agenda.

  Specific risk to the company- The Company identifies this risk arising mainly from choice of liquidity providers or other large counterparties.

<u>Controls in place/ mitigation</u>- All financial decisions are made in line with the company Internal Operating Manual , internal policies and the signatory rights. All financial transactions require the approval of at least two signatories.

The firm uses the Mark-To-Market methodology in order to calculate its Counterparty Credit Risk. The table below shows the results of Mark-To-Market calculations for Counterparty Credit Risk:

	USD K						
Exposure Type	**Market Value LP's**	**Market Value Clients**	**Add-on Mark to Market LP's**	**Add-on Mark to Market clients**	**PFCE %**	**Final Exposure LP's**	**Final Exposure Clients**
Short term FX CFDs	227	6,682	940	3,020	1	1,167	9,702
Short term Equity CFDs	358	5,447	2,023	11,048	6	2,381	16,495
Short term Debt CFDs	-	2	-	-	0	-	2
Short term Commodity CFDs	2	453	333	3,664	10	335	4,117
Short term Precious Metals CFDs	0	449	53	585	7	53	1,034
Short term CFDs	587	13,033	3,349	18,317		3,936	31,350

As at December 31, 2016 the risk weighted exposure to LP's and to clients (after mitigation) counterparty credit risk summed to:

		31/12/2016
	Capital Requirement	**Risk Weighted Exposure**
	USD '000	**USD '000**
Credit Risk	841	10,514
LP's Counterparty Credit Risk	63	787
Client Counterparty Credit Risk	568	7,096
Total Credit and Counterparty Credit Risk	**1,472**	**18,397**

Credit Valuation Adjustment Risk (CRDIV)

Institutions should hold additional own funds due to credit valuation adjustment risk arising from OTC derivatives.

“Credit Valuation adjustment” (“CVA”) is the risk of loss caused by changes in the credit spread to a counterparty due to changes in its credit quality (also referred to as market value of counterparty credit risk).

An Institution shall calculate the capital requirements for CVA risk for all OTC derivative instruments is respect of all of its business activities, other than credit derivatives recognized to reduce risk-weighted exposure amounts for credit risk (mitigation factors).

As at December 31, 2016 the CVA weighted risk exposure amounted to 763k$, and the capital requirement (8% from risk weighted exposure) was 61k$.

5.3 Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk includes legal risk but excludes strategic and reputational risk.
The following list presents some event types, included in operational risk, with some examples for each category:

- Internal Fraud - misappropriation of assets, intentional mismarking of positions, bribery.
- External Fraud - theft of information, hacking damage, third-party theft and forgery.
- Employment Practices and Workplace Safety - discrimination, workers compensation, employee health and safety.
- Clients, Products, & Business Practice - market manipulation, antitrust, improper trade, product defects, fiduciary breaches, account churning.
- Business Disruption & Systems Failures - utility disruptions, software failures, hardware failures.
- Execution, Delivery, & Process Management - data entry errors, accounting errors, failed mandatory reporting, negligent loss of Client assets.

The Company manages operational risk through a control-based environment in which processes are documented and transactions are reconciled and monitored. This is supported by continuous monitoring of operational risk incidents to ensure that past failures are not repeated.
For the calculation of operational risk in relation to the capital adequacy returns, the Company uses the Basic Indicator Approach. Based on the relevant calculations in the Company’s capital requirements, the figure calculated shows that the Company’s minimum capital requirement due to operational risk, as at 31 December 2015,was $596K.

5.4 Market Risk

Market risk is the potential for loss resulting from unfavourable market movements.

- ***Foreign Exchange Risk***
  Foreign exchange risk is the effect that unanticipated exchange rate changes have, on the Company.
  In the ordinary course of business, the Company is exposed to foreign exchange risk, which is monitored through various control mechanisms.

  The foreign exchange risk in the Company is effectively managed by setting and controlling foreign exchange risk limits, such as through the establishment of maximum value of exposure to a particular currency pair as well as through the utilization of sensitivity analysis.

  The Company is mainly exposed to the fluctuation of the Euro versus the United States Dollar (USD), due to the fact that after its denominated USD assets, a big portion of the Company's assets are denominated in Euro whereas the reporting currency is the USD. The Company's foreign exchange risk exposure is $1,378K capital requirement emanating from a net foreign exchange position of $17,231K, based on the latest relevant calculations in the Company's capital requirements, as at 31 December 2016.

  The Risk Manager monitors these risks with the assistance of the accounting function and undertakes daily hedging of the Company's FX exposures.

- ***Market Commodity Risk***
  Market Commodity Risk arises from the positions of the Company in derivative contracts for which the underlying instruments are commodities. The capital requirement for Commodity risk is calculated using the Simplified Approach.

  The Company's Market Commodity risk exposure is $549K capital requirement emanating from total position of $6,864K, based on the latest relevant calculations in the Company's capital requirements, as at 31 December 2016.

- ***Market Equity Risk***
  Market Equity Risk is the risk of loss resulting from fluctuations in the price of stocks or changes that relate to the issuer of a share or the stock market in general. The Company uses the Standardised Approach to calculate its capital requirement against equity risk.

  The Company's Market Equity risk exposure is $1,383K capital requirement emanating from total position of $17,284K, based on the latest relevant calculations in the Company's capital requirements, as at 31 December 2016.

CRDIV introduced a new categorization to be used for the calculation of market risk related to equities. The various categories are defined by the below national markets:

Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Egypt, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Lithuania, Liechtenstein, Luxembourg, Malta, Netherland, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, UK, Albania, Japan, Republic of Macedonia, Russia, Serbia, Switzerland, Turkey, Ukraine, USA, Other (rest of the world).

In CRDIV, market risk result of the calculation of the overall gross position specific risk is 8% from gross position per instrument/per national market. The market risk result of the calculation of the overall net position general risk allows offsetting of short and long positions only inside the national market where the instruments are traded..

The following table presents the breakdown of equities exposures per relevant national markets, as of December 31, 2016:

EQUITY PORTFOLIO	LONG Positions per National Market (USD)	SHORT Positions per National Market (USD)
USA Total	-	2,784
UK Total	1,834	379
FRA Total	97	216
Other Total	199	243
Spain Total	-	597
Switzerland Total	-	-
Japan Total	352	-
Italy Total	-	76
Germany Total	-	2,541
TOTAL	2,483	6,835

TOTAL	129,111	133,464	2,483	6,835
	Final Exposures		Capital Requirement	
Overall gross position	9,318	8%	745	Specific Risk
Overall net position	7,966	8%	637	General Risk
Total capital requirements (USD)	1,383			
Risk Weighted Assets (USD)	17,284			

5.5 Interest Rate Risk

Interest rate risk is the risk that the value of financial instruments (including currencies) will fluctuate due to changes in the market interest rates.

The Company's income and operating cash flows are substantially independent from changes in market interest rates due to the fact that the Company, other than cash at bank which attracts interest at normal commercial rates, has no other significant interest bearing financial assets or liabilities. Given that current interest rates are low, interest rate risk is currently an insignificant risk to the Company. Nevertheless, the Risk Manager monitors these risks on a regular basis

5.6 Funding Liquidity Risk

Funding liquidity risk is the possibility that, over a specific horizon, the Company will be unable to meet its demands/needs for cash and other highly liquid assets through mismatch of assets and liabilities. During the period under review, the Company had sufficient liquid assets to meet its liabilities, and monitors its liquidity requirements on a regular basis.

There is a risk that liquidity providers may increase their margin requirements, especially during periods of high market volatility, requiring additional liquidity.

CySEC issued in October 2016 a consultation paper on "Safeguarding of client funds". The Company has reviewed the paper, and is ready to implement the changes when this becomes CySEC policy.
The Company is also reviewing MIFID II requirements that may have any liquidity implications.

5.7 Money Laundering and Terrorist Financing Risk

Money laundering is the process of taking the proceeds of criminal activity and making them appear legal. Terrorist financing involves using the funds obtained from various businesses, including non-profit organizations or unregistered money services businesses, to fund terrorist activities. As an internet-based financial services provider, eToro is continuously exposed to the risk that a customer's trading account may be used as a mean to launder money and/or finance terrorism. The Company has established extensive policies, procedures and controls in order to mitigate the money laundering and terrorist financing risks.

5.8 Compliance Risk

Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or non-conformance with, laws, bylaws, regulations, prescribed practices, internal policies, and procedures, or ethical standards. This risk exposes the Company to financial loss, fines, civil money penalties, payment of damages, and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced Company value, limited business opportunities, reduced expansion potential, and an inability to enforce contracts.

The Compliance Monitoring Program of eToro (Europe) Ltd (CMP) covers on the following business departments and their various functions: Operations, Dealing, Compliance, Finance, MIMO/Customer Service, IT, Marketing and Financial Promotions. It employs various monitoring techniques. Upon the performance of those monitoring techniques, the Compliance Officer assesses the risk level of the finding and provides the recommendations on the areas that need improvements. The recommendations are first submitted to the management of the respective departments and, upon the receipt of feedback, to the Board of Directors.

Compliance risk is limited to a significant extent due to the supervision applied by the Compliance Officer, as well as the monitoring controls and systems applied by the Company

5.9 Reputation Risk

Reputation risk is the current or prospective risk to earnings and capital arising from an adverse perception of the image of the Company by Clients, counterparties, shareholders, investors or regulators. Reputation risk could be triggered by poor performance, the loss of one or more of the Company's key directors, the loss of large Clients, poor Client service, fraud or theft, Client claims, legal action, regulatory fines and from negative publicity relating to the Company's operations whether such fact is true or false.

The Company has policies and procedures in place when dealing with possible Client complaints in order to provide the best possible assistance and service under such circumstances. The possibility of having to deal with Client complaints is low, compared to the high amount of the Company's Clients, as the Company does its best to provide high quality services to its Clients and has the appropriate procedures in place. In addition, the Company's Board members and *Senior Management* is comprised of experienced professionals who are recognized in the industry for their integrity and ethos, and, as such, add value to the Company.
Where the relatively few client complaints have been received, these have been successfully resolved.

5.10 Online Fraud

Online fraud could occur when Clients illegally use the credit cards or other online payment methods of others in order to fund their accounts with the Company. This risk exposes the Company to monetary loss and to potential implications with the credit cards' issuers.

To prevent and identify online fraud, the Company has developed robust risk management technology to identify fraudulent transactions. To this end, the Company employs the Risk Rule Engine (an automated alert and flagging system), as well as a semi-automated scoring system, whereby each deposit is scored according to internal fraud triggers. All flagged accounts are reviewed daily by a dedicated Risk Analyst.

Following an alert/flag by the Company's Risk Rule Engine Alerting and Flagging System, the Company investigates the relevant account(s) to establish whether the transaction(s) in question are indeed fraudulent. In case the Company establishes that fraud activity has been performed, the Company then refunds the funds to the original mean of payment (i.e. to the real payment account holder).

In addition, Credit card issuers have adopted credit card security guidelines as part of their on-going efforts to prevent identity theft and credit card fraud. The Company continues to work with credit card issuers to ensure that its services, including customer account maintenance, comply with these rules. There can be no assurances, however, that the Company's services are fully protected from unauthorized access or hacking. When there is unauthorized access to credit card data that results in financial loss, there is the potential that the Company could experience reputational damage and parties could seek damages from the Company.

5.11 Information Technology Risk

Information Technology (hereinafter, "IT") risk could occur as a result of inadequate information technology and processing, or arise from an inadequate IT strategy and policy or inadequate use of the Company's IT. Given the company's high reliance on IT systems and procedures, this security & systems failure risk (before mitigation factors) is deemed to be a high risk by the company. However, due to the many controls that are in place, the risk after mitigation factors is deemed to be medium.

Specifically, monitoring abilities with automatic escalation, including integration to advanced alerting system, that is consolidating all alerts to one center place, policies have been implemented regarding improved backup procedures, these now include 3 levels of backup, full site replication of trading systems, replication of core systems to all sites, software maintenance, full redundancy in all site connections to internet, by use of multiple internet connections via multiple internet

providers (ISPs), hardware maintenance, improved security policies and training, use of the internet, anti-virus procedures and monitoring systems.

The Company understands that there are new attack vectors that are directed towards internal employees, therefore security awareness is in the highest importance, all employees are being educated to mitigate, detect and alert on such scenarios, and detection systems were added in order to be able to detect a potential infection. Once such infection was detected, it can be contained and problem can be mitigated.

The Company pays particular attention to its data retention. To this end, the Company conducts frequent backups (See also Section 5.11 above) with respect to all the Company's IT systems for all types of data and information and stores these backups at multiple safe remote locations outside the Company's head offices and in different countries. All data is stored for at least 5 years.

5.12 Business Risk

Definition

- Business Risk is the risk that may cause inadequate profits or even losses to the firm. However, this is mitigated because, the inter-company agreements between the Company and its parent leave a risk-based level of profitability within the company, even if losses are incurred (ie with losses, the parent will inject funds into the company through this agreement). The company has quantified the financial impact of this risk in the stress test results per its ICAAP process (refer to section 6.3).
- Business risk is influenced by numerous factors, including volume of trades, high costs, competition, overall economic climate and government regulations

Measurement and Management

- eToro is exposed to Business Risk mainly due to a possible decrease in the number of active investors and volume they trade leading to a reduction in eToro's profits. Another business risk is the introduction of new products which on the one hand, can create opportunities, whereas on the other hand can result in negative returns on the investment.
- Also, eToro acknowledges that their business risk could be triggered by numerous factors which may also be correlated with both regulatory and political risks (already described above) as well as reputational risks

- The firm acknowledges that Business Risk is very critical and monitors it very closely having in place policies and procedures
- These include the regular monitoring of eToro's Budgets (considering the overall Economic conditions) and continuous support upon additional capital requirement by the parent company. In addition, every introduction of a new product is subjected to a detailed risk analysis and approval by the risk committee and Board of directors.
- Despite the fact that eToro belongs in a high competitive Investment firm's environment, the firm's unique platform that offers social networking to its client, gives eToro the step ahead in the market from other IF's.

5.13 Group Risk

Group Risk could occur as adverse impact due to relationships (financial or non-financial) of the Company with other entities in the group is being generated,s or by risks which may affect the financial position of the whole group (e.g, reputational contagion).

Mitigation:

- eToro Group Ltd (and other related entitites) to be well capitalized & funded - Risk Manager monitors financial strength of eToro Group.
- Ensure independence of entities to minimize impact of any regulatory or reputational events in other group operations.
- Include provision in inter-company agreements that allow set-off of liabilities against debts.

In any event of group structure change (i.e. new companies added to the Group, the Board of Directors, Risk Committee and Risk Manager consider and analyze the risks under such a structure – such as regulatory risk, reputational risk, credit risk and operational risk.

5.14 Political Risk

Political risk is considered to be low, however eToro considers that a political issue (such as Brexit, Euro crisis, Russia's sanctions) might impact the company and banks holding clients and corporate funds and therefore is monitored on a continuous basis.

6. CAPITAL MANAGEMENT AND LEVERAGE RATIO

6.1 Capital Management

This is the risk that the Company will not comply with capital adequacy requirements or may not be able to continue as a going concern. The primary objective of the Company with respect to capital management is to ensure that the Company complies with the imposed capital requirements of Section 67 of the Law with respect to its own funds and that the Company maintains strong capital ratios in order to support its business, to maximize shareholders' value and to optimise its debt and equity balance. The Company must have own funds which are at all times more than or equal to the sum of its capital requirements. In addition, the Company must not fall below the level of its initial capital in any case.

Furthermore, CySEC requires every Cyprus Investment Firm to maintain a minimum ratio of capital to risk weighted assets of 8%, plus capital buffers (0.625% in 2016, 1.25% in 2017, 1.75% in 2018 and 2.5% in 2019). The capital adequacy ratio expresses the capital base of the Company as a proportion of the total risk weighted assets. CySEC may impose additional capital requirements for risks which are not covered by Pillar I of Basel III. The Company was further required by the Law to report on its capital adequacy on a quarterly basis during 2016. The Senior Management as well as the Risk Manager monitor such reporting and have policies and procedures in place to help meet the specific regulatory requirements. This is achieved through the preparation (on a monthly basis) of accounts to monitor the financial and capital position of the Company.

The Company manages its capital structure and makes adjustments to it in light of the changes in the economic and business conditions and the risk characteristics of its activities.
The Company's Own Funds, Capital Requirements and Capital Adequacy Ratio as reported at 31 December 2016, were the following:

		31/12/2016
		USD '000
Original Own Funds		
Paid up capital		4
Share Premium		7,778
Reserves		(631)
Investment Compensation Fund deduction		(77)
Total Eligible Own Funds		**7,074**
	Capital required – 8% from Risk	Risk weighted exposure

	weighted exposure	
Credit Risk	1,472	18,397
Position, Foreign Exchange and Commodities Risk	3,313	41,412
Operational Risk	596	7,451
Credit Valuation Adjustment Risk	61	763
Other Capital Requirements	35	436
Total	**5,477**	**68,458**
Capital Adequacy Ratio (Own Funds/Total Risk Weighted Exposure)		**10.33%**
Minimum Capital Adequacy Ratio (including buffers)		**8.625%**

6.2 Leverage Ratio

An underlying feature of the financial crisis was the build up of excessive on and off balance sheet leverage in the banking system. In many cases, institutions built up excessive leverage while maintaining strong risk-based capital ratios. At the height of the crisis, the market forced the banking sector to reduce its leverage in a manner that amplified downward pressure on asset prices. This deleveraging process exacerbated the feedback loop between losses, falling Institutions' capital and shrinking credit availability.

The Basel III reforms introduced a non-risk based leverage ratio to act as a supplementary measure to the risk-based capital requirements.

The Company has policies and processes in place for identification, management and monitoring of the risk of excessive leverage.

A minimum ratio of Tier 1 capital to total assets of 3% is tested. The basis of calculation is the average of the three month-end leverage ratios over a quarter:

Leverage ratio: = (1) Capital Measure (Tier 1 Capital) / (2) Exposure Measure (Total Assets) >= 3%

As of December 31, 2016 the leverage ratio was calculated as follows:

Capital Measure	**7,074**
• **Derivatives: Market Value (Client & LP's, refer to section 5.2)**	**13,620**
• **Derivatives: Add-on Mark to Market Method (Client & LP's, refer to section 5.2)**	**21,666**

• **Off-Balance sheet undrawn credit facilities**	**109**
• **Other Balance sheet items**	**32,847**
Exposure Measure (1+2+3+4)	**68,242**
Leverage Ratio	**10.37%**

6.3 Pillar II – The ICAAP and the SREP

The Supervisory Review Process provides rules to ensure that adequate capital is in place to support any risk exposures of the Company in addition to requiring appropriate risk management, reporting and governance structures. Pillar II covers any risk not fully addressed in Pillar I, such as concentration risk, reputation risk, business and strategic risk and any external factors affecting the Company.

Pillar II connects the regulatory capital requirements to the Company's internal capital adequacy assessment procedures (ICAAP) and to the reliability of its internal control structures. The function of Pillar II is to provide communication between supervisors and investment firms on a continuous basis and to evaluate how well the investment firms are assessing their capital needs relative to their risks. If a deficiency arises, prompt and decisive action is taken to restore the appropriate relationship of capital to risk.

The Company has an ICAAP process for calculating its capital requirements under Pillar 2
In respect of 2016 and using forecasts for subsequent periods, the Company assessed the adequacy of its internal capital, and the Board of Directors has approved in the ICAAP additional Pillar II capital.

Within its ICAAP the Company has performed sensitivity analyses and stress testing that considered material risks.

STRESS TESTING

- As part of its risk assessment and measurement process, eToro has performed a number of stress tests to evaluate the impact of extreme but plausible events on its financial position, performance and capital adequacy
- All the stress tests performed are forward-looking and relate to the projected period that ranges between 31 December 2016 and 31 December 2019. The Company has used the Static Balance Sheet assumption in performing the stress tests.

The results of the above stress tests are included in the Pillar II capital requirement.

6.4 Additional Capital Buffers

from 1 January 2016, as per DI144-2014-14 of the Cyprus Securities and Exchange Commission for the prudential supervision of investment firms (the 'Directive'), paragraph 66 (transitional provisions for capital buffers), CIFs that are authorised to provide a) dealing on own account and

b) underwriting of financial instruments and/or placing of financial instruments on firm commitment basis (Paragraph 51 of the Directive), will be required to maintain the following capital buffers in addition to the own funds requirements:

Year	2015	2016	2017	2018	2019
Minimum CET1 capital ratio	4,5%	4,5%	4,5%	4,5%	4,5%
CET1 capital conservation buffer	N/A	0,625%	1,25%	1,875%	2,5%
Minimum CET1 capital ratio plus capital conservation buffer	4,5%	5,125%	5,75%	6,375%	7,0%
Minimum Tier 1 capital ratio	6,0%	6,0%	6,0%	6,0%	6,0%
Minimum Tier 1 capital ratio plus capital conservation buffer	N/A	6,625%	7,25%	7,875%	8,5%
Minimum total capital ratio	8,0%	8,0%	8,0%	8,0%	8,0%
Minimum total capital ratio plus conservation buffer	N/A	8,625%	9,25%	9,875%	10,5%
Countercyclical Buffer	N/A	≤0,625%	≤1,25%	≤1,875%	≤2,5%
Systemic Risk Buffer	Possibility of add-on for systemically important firms				

Capital conservation buffer (Paragraph 52 of the Directive):
As of 1.1.16, the Company is obliged to maintain additional capital buffer of Common Equity Tier 1 capital equal to 0.625% of the total of the risk-weighted exposure amounts (gradually up to 2,5 % in 2019, as per the table above).

The objective is to conserve the CIF's capital. When a CIF breaches the buffer, automatic safeguards kick in and limit the amount of dividend and bonus payments a CIF can make. The further the CIF 'eats' into the buffer, the stricter the limits become.

Form-144-14-06-1 (Calculation of own funds and capital ratio) is expected to be amended by CySEC as applicable.

The Company has met its capital requirement as of 1.1.16, taking into consideration the above new legislation.

The Company took into account the abovementioned capital buffers in its ICAAP capital planning for the projected period that ranges between 31 December 2016 and 31 December 2019.

7. REMUNERATION POLICY

The principles employed within the Company's Remuneration Policy shall be appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities whilst adhering to the provisions of the Directive DI144-2007-05 of 2012 of the Cyprus Securities and

Exchange Commission for the Capital Requirements of Financial Firms which was introduced with effect from November 26, 2012.

7.1 Remuneration System

The following is applicable with regards to the Company's remuneration system:

The Company's remuneration system and policy is concerned with practices of the Company for those categories of staff whose professional activities have a material impact on its risk profile, i.e. the Senior Management, members of the Board of Directors and the Heads of the departments; the said practices are established to ensure that the rewards for the 'executive management' are linked to the Company's performance, to provide an incentive to achieve the key business aims and deliver an appropriate link between reward and performance whilst ensuring base salary levels are not set at artificially low levels. The Company uses remuneration as a significant method of attracting and retaining key employees whose talent can contribute to the Company's short and long term success.

The remuneration mechanisms employed are well known management and human resources tools that take into account the staff's skills, experience and performance, whilst supporting at the same time the long-term business objectives.

The Company's remuneration system takes into account the highly competitive sector in which the Company operates, and the considerable amount of resources the Company invests in each member of the staff.

The total remuneration of staff currently consists of primarily a fixed component. The remuneration varies for different positions/roles depending on each position's actual functional requirements, and it is set at levels which reflect the educational level, experience, accountability, and responsibility needed for an employee to perform each position/role. The remuneration is also set in comparison with standard market practices employed by the other market participants/ competitors.

In addition there is variable remuneration component of sales commissions, bonuses, employee option plan and employees investment accounts. There were no severance payments during the current year.

Until the last quarter of 2016, the Company has taken into account its size, internal organization and the nature, the scope and the complexity of its activities and did not deem necessary the establishment of a specific remuneration committee. Decisions on these matters were taken on a

Board of Directors level. However, during the last quarter of 2016, the Company met the annual turnover criteria of becoming a significant CIF with accordance to Directive DI144-2014-14 for the prudential Supervision of Investment Firms. As a result, the Company has established a combined nomination and remuneration committee which is composed of non-executives members of the board in 1.17.

7.2 Performance Appraisal

The Company implements a performance appraisal method, which is based on a set of Key Performance Indicators, developed for each business unit and for the company as a whole. The appraisal process during 2016 was performed as follows:

a. Objectives are set in the beginning of each quarter defining what the Company functions, departments and individuals are expected to achieve over an upcoming period of time.
b. Performance checks and feedbacks: managers provide support and feedback to the concerned staff during the time periods decided, during the daily activities or during formal or informal performance reviews; the aim is to assist the staff to develop their skills and competencies.
c. Annual performance evaluation: takes place annually, usually at the end of each year.

	Fixed	**Variable**	
	K EUR		**Total number of staff**
Senior Management	62	5	5
Other Key Management Personnel	448	117	10

8. RECRUITMENT POLICY

- Hiring Criteria

All organizational units of the Company shall be staffed by competent people. During the executive hiring process, special attention shall be given to the following:
(a) morality and reliability (character) of the person
(b) academic qualifications
(c) professional experience
(d) possession of certificates of professional competence, where applicable.

(e) his/her potential to contribute to the business development of the Company's

- Qualifications for Managerial or Key Control Positions

In accordance with the requirements set by the Guidelines GD-IF-01 ("Guidelines for compliance with the authorization and operating conditions of CIF – Persons employed by CIF"), key persons employed by a CIF must meet the following criteria:

a. Good repute
b. Skills, knowledge and expertise
c. Relevant academic title or degree or professional qualification and relevant experience.

9. OTHER DIRECTORSHIPS

According to article 435 part 2 of Regulation (EU) No 575/2013, Companies shall disclose, at least on an annual basis, the number of directorships held by the members of the management body.

During the period under review, the five directors of the Company held the following directorships :

- 1 directors held 1 directorship.
- 1 directors held 2 directorships.
- 1 director held 3 directorships.
- 1 director held 4 directorships.
- 1 director held 5 directorships.

10. TRAINING

During the period under review, a number of the Company's employees and directors, including the Risk Manager, have attended courses on the applicable Compliance legislation and its relevant procedures. The Board is updated on a regular basis on changes to CySEC regulations.

During the period under review, all of the company employees completed training designed by reputable providers, in accordance with the CySec training requirements.