



Your Social Investment Network

eToro (UK) Limited

Pillar 3

Disclosures in accordance with

**Capital Requirements Regulation (EU) No
575/2013 on prudential requirements for
credit institutions and investment firms**

As at 31 December 2017



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1. INTRODUCTION

This document provides a description of the key regulatory information that eToro (UK) Limited (“eToro UK”) provides to interested parties. This report has been prepared with accordance with the EU Capital Requirements Directive (“CRD IV”) and in particular to the disclosures required under Part 8, Articles 431-455 of Regulation (EU) No 575/2013, for the year ended 31 December 2017.

eToro UK is authorised and regulated by the Financial Conduct Authority (“FCA”) and is categorised as a limited licence firm by the FCA for capital purposes. The CRD IV created a revised regulatory capital framework across Europe, based on the provisions of the Basel III Capital Accord.

As a regulated company, eToro UK is required to disclose certain aspects of regulatory information and certain details of internal processes relating to the structure and operations in place to measure and report risks. 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 eToro UK to establish minimum capital requirements
- Pillar 2 requires eToro UK 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 FCA.
- Pillar 3 requires eToro UK to publicly disclose specific information about the underlying risk management controls and capital position.

The Supervisory Review Process (“SREP”) 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 2 covers any risk not fully addressed in Pillar 1, 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 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.

The Company held an internal risk assessment exercise in 2017 in respect to the year ended 31 December 2016, which was approved by the Board in July 2017. Within its ICAAP the Company performed sensitivity analyses and stress testing scenarios, considering all material risks.

The ICAAP is reviewed and updated each year.

The Company publishes the Pillar III disclosures on an annual basis on its website. The Disclosures report can be found at: <https://www.etoro.com/en/customer-service/regulation-license/>.

2. OVERVIEW OF THE BUSINESS

eToro UK was incorporated on March 2, 2012, was granted authorization on May 9, 2013, and commenced trading on 23 November 2015.

The Company presents an online social trading platform to customers who have deposited at least \$5,000 to trade contracts for differences (CFDs) in currencies, commodities, indices, ETFs, stocks and cryptocurrencies online in a simple, transparent way. Customers are able to follow other customers using the platform and automatically copy their investments. During 2017 the Company commenced offering clients the ability to buy the underlying crypto currencies. This applies to non-leveraged buy transactions in crypto currencies which are unregulated assets. All other transactions in crypto currencies are CFDs, which with all other CFDs, are regulated products

The Company connects the traditional investing world with the new world of social networks. Customers buy and sell financial products on the platform whilst exchanging information with other customers. A customer's portfolio, risk score, and trading performance are visible to other customers on the platform. By following a financial instrument or another customer, a feed of information and trading activity is received into a customers' own feed. By copy trading, a customer can allocate a sum of money that will be invested to copy proportionally the amount invested in either another customer's existing portfolio or any new trades made by that



customer, and automatically execute the same transaction, in proportion to the amount invested.

The Company executes trades in an agency capacity, and uses an associate company, eToro (Europe) Limited, to execute its clients' trades, including to provide the automated execution of copy trades. eToro (Europe) Limited is incorporated in Cyprus and authorised and regulated by the Cyprus Securities and Exchange Commission (CySEC).

The Company's revenues are generated primarily from commission earned from buying and selling contracts for differences, net of execution costs paid to the executing broker, and revenues received from parent company eToro Group Ltd ("eToro Group"), in respect of intermediary services and the recharge of marketing costs.

3. RISK MANAGEMENT OBJECTIVES & POLICIES

3.1 Governance

Risk management in eToro UK during 2017 was overseen directly by the Board of Directors. This included approval of the company's risk-taking philosophy, risk appetite and risk tolerance, approval of the Individual Capital Adequacy Policy ("ICAAP"), and reviewing the effectiveness of the risk and compliance frameworks.

The Board of Directors of eToro UK have approved 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.

3.2 Risk Statement

The Board's approach to risk management is to have a comprehensive and robust risk management framework to ensure risks are identified, measured, decided upon and monitored. The Board also sets its Risk Appetite Statement, which defines the amount of risk that it is prepared to accept. The Board has given consideration to the following risks:

3.2.1 Credit Risk

Credit risk is the risk that a counterparty fails to perform its obligations, resulting in a financial loss. The principal sources of credit risk to eToro UK are from financial institutions and individual clients.



Financial institution credit risk

Financial institutions with which the company has an exposure are subject to a due diligence review, and exposures are monitored on a regular basis.

eToro UK is exposed to banks with respect to the company's own deposits.

eToro UK also 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 Company monitors its exposure to banks.

Client Credit Risk

Client credit risk principally arises when a client's equity is insufficient to cover any trading losses incurred. This can arise where there are significant major market movements or gaps when liquidity disappears. As eToro UK traded as agent during 2017, it was not exposed to such risk.

Intercompany Credit Risk

eToro UK is also exposed to its affiliate companies with respect to intercompany balances that are not cleared. The Company monitors this exposure as well.

3.2.2 Market Risk & Foreign Exchange Risk

. Market risk is the potential for loss resulting from unfavourable market movements, which can arise from changes in exchange rates or other market factors. The Company executes trades in an agency capacity, thus is not exposed to market risk in the instruments in which its customers trade.

eToro UK is exposed in the normal course of business to market risk which can arise from changes in exchange rates. Transactional foreign currency exposures represent financial assets or liabilities denominated in currencies other than the functional currency of the transacting entity.

eToro presents its financial statements in U.S. Dollars, which is the company's functional currency. The functional currency is the currency that best reflects the economic environment in which the Company operates and conducts its transactions and is used to measure its financial position and operating results.



Foreign currency risk is managed on a Group-wide basis. The Group monitors and hedges transactional foreign currency risks including currency statement of financial position and future expected exposures.

3.2.3 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 is not exposed directly to any interest rate bearing instruments, other than cash at bank which attract interest at normal commercial rates. Given that current interest rates are low, interest rate risk is currently an insignificant risk to the Company.

3.2.4 Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations arising from its financial liabilities that are settled by delivering cash or other financial assets.

The Company's approach to managing liquidity is to ensure it will have sufficient liquidity to meet its financial liabilities when they fall due.

Given the short-term nature of the Company's financial assets and liabilities, eToro UK has sufficient liquid assets available to meet its liabilities.

3.2.5 Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, human behaviour and systems or from external events. Operational risk includes legal risk but excludes strategic and reputational risk

The following list presents some event types of 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 maintains appropriate systems and controls, as well as commissioning external reviews, to minimize the risk of loss from operational risk.

The Company is highly dependent on outsourced services to its affiliate companies, and has systems and controls in place to supervise the outsourced units

3.2.6 Regulatory Risk

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, the Company 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.

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.



eToro UK takes its regulatory obligations very seriously, strives to ensure compliance at all times, and believes in an open and transparent dialogue with regulatory authorities

3.2.7 Business Risk

Business Risk is the risk that may cause inadequate profits or result in losses to the Company. However, this risk 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. The company has quantified the financial impact of this risk in the stress test results per its ICAAP process.

Business risk is influenced by numerous factors, including volume of trades, high costs, competition, and overall economic climate and government regulations.

The Company is exposed to Business Risk mainly due to a potential decrease in the number of active investors and volume they trade that may lead to a reduction in the Company'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. Additionally, the company acknowledges that business risks could be triggered by numerous factors which may also be correlated with both regulatory and political risks as well as reputational risks.

3.2.8 Group Risk

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

The Company is highly dependent on outsourced services to its affiliate companies, and has systems and controls in place to supervise the outsourced units

4. CAPITAL ADEQUACY & OWN FUNDS

4.1 Capital Adequacy

eToro UK is required by the European Capital Requirements Regulation at all times to satisfy the following own funds requirements.



Common Equity Tier 1 Capital Ratio	4.5%
Tier 1 Capital Ratio	6.0%
Total Capital Ratio	8.0%

eToro UK's Pillar 1 Capital Adequacy as at 31 December 2017 was as follows:

	USD
Own Funds	940,220
Total Risk Exposure	5,404,118
Total Capital Ratio	17.40%

The Company is also required to assess its risks and any additional capital required to cover these risks (Pillar 2 capital requirement).

eToro UK has met its regulatory capital obligations throughout 2017.

4.2 Own Funds

eToro UK's regulatory capital is comprised entirely of Common Equity Tier 1:



	USD
Ordinary share capital	2,600,002
Capital Reserve for share-based payments	205,831
Retained earnings (deficit)	(1,659,782)
Total Equity	1,146,051
Less: not recognised as regulatory capital	
Capital Reserve for share-based payments	(205,831)
Regulatory Capital Own Funds	940,220

5. CAPITAL REQUIREMENTS

5.1 Pillar 1 Capital Requirement

As a limited license firm, eToro UK's Pillar 1 capital requirement is calculated as the higher of the Fixed Overhead Requirement and the sum of credit and market risk capital requirements.

As at 31 December 2017, eToro UK's capital requirement was calculated as follows:

	USD	USD
	Risk Weighted Exposure	Capital required – 8% of Risk weighted exposure
Credit Risk	825,221	66,018
Market Risk	287,231	22,978
Credit + Market Risk	1,112,451	88,996
Fixed Overhead Requirement	5,404,118	432,329
Capital Requirement	5,404,118	432,329



5.2 Credit & Counterparty Exposure

eToro UK uses the Standardized Approach to Credit Requirements for the calculation of its credit risk.

The table below shows the credit risk exposures as at 31 December 2017 for each exposure class. The company had no counterparty risk exposure at that date.

The company estimated that the credit exposure as at December 31, 2017 is equal to the carrying value or related assets, and no impairment has been identified.

	Exposure	Risk Weighted Exposure
	USD	USD
Credit Risk		
Institutions	3,129,033	625,807
Corporates	131,650	131,650
Retail	0	0
Other	67,764	67,764
	3,328,447	825,221

Capital requirements are calculated at 8% of the risk weighted exposure. In calculating the risk weighted exposure, the following methodology is used:

Institutions

Where available, the company obtains information on credit ratings of counterparties from the following agencies:

- o Moody's Investor Services
- o Standard & Poor's Rating Services
- o Fitch Ratings

eToro UK applies the "Institution Based Approach" for determining its capital requirements. That means that in order to determine the risk weight that applies for exposures to Institutions, the Company uses the specific credit rating of the Institution itself. Where the Institution is unrated, the Company use the credit rating of the Central Government of the Country in which the institution is incorporated.



As at 31 December 2017, all exposures to Institutions had a residual maturity of less than 3 months, and were also rated at least AA- (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.

Corporates

Exposures to Corporates were unrated. As a result, a 100% risk weight was used.

Retail

As eToro UK traded as agent during 2017, there was no retail counterparty credit exposure.

Other Items

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

5.3 Other Risk Exposures

Market Risk

Market risk at 31 December 2017 relates entirely to exposures arising from foreign currencies, other than those in the company's functional currency of USD. The risk exposure is calculated as the higher of the overall net long and net short of exposures denominated in currencies other than USD, and converted into USD. The capital requirement is calculated as 8% of the risk exposure.

Interest Rate Risk

eToro UK had no interest rate risk exposure at 31 December 2017

5.4 Pillar 2 - ICAAP

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 2 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 2 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 2 is to provide communication between supervisors and firms on a continuous basis and to evaluate how well the 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.

eToro UK has an ICAAP process for calculating its capital requirements under Pillar 2. Within its ICAAP eToro UK has performed sensitivity analyses and stress testing that considered material risks.

6. REMUNERATION POLICY

6.1 Introduction

All firms within the scope of the FCA's Remuneration Code (the "Code") are expected to ensure that their remuneration policies, practices and procedures are clear and documented. To record those policies, practices and procedures, and assess their compliance with the Code, firms should complete a Remuneration Policy Statement (RPS). The level of detail within the RPS may vary depending on a firm's size, internal organisation, and the nature, the scope and the complexity of its activities.

As a limited license firm, eToro UK is designated as a Proportionality Level 3 firm for the purposes of complying with the requirements of the FCA Remuneration Code, which means it is not required to expected to comply with some of the more prescriptive rules. eToro UK adheres to the principles of the FCA Remuneration Code.

6.2 eToro UK Remuneration Policy

The following is applicable with regards to eToro UK's remuneration policy.

eToro UK's remuneration policy is concerned in particular with the practices of 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.

Taking into account its size, internal organization and the nature, the scope and the complexity of its activities, eToro UK does not deem it necessary to establish a specific remuneration committee. There is significant interaction with the eToro Group in respect to remuneration policies and decisions on these matters are taken by the Board of Directors and/or the eToro Group Board.

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 a variable remuneration component of sales commission, bonuses, employee option plan, and employees investment accounts.

6.3 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 is being performed as follows:

- Objectives are set in the beginning of each year defining what the Company functions, departments and individuals are expected to achieve over an upcoming period of time.
- 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.
- Annual performance evaluation: takes place annually, usually at the end of each year.



6.4 Remuneration Data

Details of remuneration paid to eToro UK senior management and key staff members during 2017 is as follows:

	Fixed USD'000	Variable (all cash) USD'000	Total Number of Staff
Senior Management	470	184	4
Other Key Members of Staff	239	64	3

7. 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:

- Integrity, morality, and reliability (character) of the person
- academic qualifications
- professional experience
- possession of certificates of professional competence, where applicable
- his/her potential to contribute to the business development of the Company

Qualifications for Managerial or Key Control Positions

When recruiting an individual to an FCA controlled function, the company will in particular consider:

- honesty, integrity and reputation;
- competence and capability; and
- financial soundness.

8. 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 four directors of the Company held the following directorships:

- 1 director held 4 directorships
- 2 directors held 3 directorships
- 2 directors held 2 directorships

Directorships held in companies within the same group are considered as one directorship.