

NOMURA HOLDINGS INC
Form 6-K
December 19, 2014
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FORM 6-K
U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

**Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934**

Commission File Number: 1-15270

For the month of December 2014

NOMURA HOLDINGS, INC.

(Translation of registrant's name into English)

9-1, Nihonbashi 1-chome

Chuo-ku, Tokyo 103-8645

Japan

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F X Form 40-F _____

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): _____

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): _____

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Incorporation by Reference

The registrant hereby incorporates Exhibit 1 to this report on Form 6-K by reference (i) in the prospectus that is part of the Registration Statement on Form F-3 (Registration No. 333-191250) of the registrant and Nomura America Finance, LLC, filed with the Securities and Exchange Commission (SEC) on September 19, 2013 and (ii) in the prospectus that is part of the Registration Statement on Form F-3 (Registration No. 333-186755) of the registrant, filed with the SEC on February 20, 2013.

Information furnished on this form:

EXHIBITS

Exhibit Number

1.	<u>Nomura Holdings, Inc. Interim Operating and Financial Review</u>
15.	<u>Acknowledgment Letter of Ernst & Young ShinNihon LLC</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NOMURA HOLDINGS, INC.

Date: December 19, 2014

By: /s/ Hajime Ikeda
Hajime Ikeda
Managing Director

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Presentation of Financial and Other Information

As used in this Form 6-K, references to the Company, Nomura, Nomura Group, we, us and our are to Nomura Holdings, Inc. and, except context otherwise requires, its consolidated subsidiaries. As part of certain line items in Nomura's financial statements and information included in this Form 6-K, references to NHI are to Nomura Holdings, Inc.

Unless otherwise stated, references in this Form 6-K to yen and ¥ are to the lawful currency of Japan and references to U.S. dollars and \$ are to the lawful currency of the United States of America (U.S.).

All ownership data with respect to us presented in this Form 6-K is presented based on the voting interest directly or indirectly held by us. Our voting interest is presented in accordance with Japanese reporting requirements, pursuant to which the amount presented with respect to each subsidiary is the percentage of voting rights of such subsidiary held directly by us or our subsidiaries. For example, wholly-owned subsidiaries of our subsidiaries are listed as 100%, regardless of the level of our direct interest in the intermediate subsidiaries.

Amounts shown within this Form 6-K have been rounded to the nearest indicated digit unless otherwise specified. In tables and graphs with rounded figures, sums may not add up due to rounding.

Except as otherwise indicated, all financial information with respect to us presented in this Form 6-K is presented on a consolidated basis. Our fiscal year ends on March 31 of each year. We prepare interim consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP). Our interim consolidated financial statements, including the notes thereto, for the six months ended September 30, 2013 and 2014 are included elsewhere in this Form 6-K. The interim consolidated financial statements included in this Form 6-K have been reviewed in accordance with the standards of the Public Company Accounting Oversight Board (United States) by our independent auditors.

Table of Contents**Recent Developments**

Recent Developments in Capital Adequacy Regulations. In December 2010, the Basel Committee on Banking Supervision (Basel Committee) issued the overall reform package on capital adequacy ratio, liquidity and leverage ratio from Basel II (Basel III) in order to promote a more resilient banking sector. The Basel Committee has been reviewing the Basel III package and has published various proposals. After the implementation of the Capital Adequacy Notice on Final Designated Parent Company revised to be in line with Basel III, the Financial Services Agency of Japan (FSA) has been considering further revisions, taking the series of proposals published by the Basel Committee. In addition to Basel III, implementation of new regulations or strengthening of existing regulations have been determined or are under consideration by internal organizations such as the G-20, Financial Stability Board (FSB), International Organization of Securities Commissions (IOSCO) and Basel Committee, or governmental and self-regulatory organizations in Japan and in virtually all other jurisdictions in which we operate. The FSB and the Basel Committee at the Group of Twenty (G-20) summit in November 2011 identified global systemically important bank (G-SIBs) on which additional capital requirements will be imposed and update the list of G-SIBs in November of each year. We were not designated as a G-SIB in November 2013 or November 2014. The Basel Committee published updated assessment methodology and the higher loss absorbency requirement on G-SIBs, as well as disclosure requirements on G-SIBs evaluation indices, and such disclosure requirements were made effect by the FSA on March 2014. Also, the Basel Committee developed and published a set of principles on the assessment methodology and the higher loss absorbency requirement for domestic systemically important banks (D-SIBs), extending the framework for G-SIBs to D-SIBs. In addition, the FSB and the IOSCO have published assessment methodologies for identifying Non-bank Non-insurer Global Systemically Important Financial Institutions (NBNI G-SIFIs), for public consultation.

U.S. Regulatory Changes. In response to the financial markets crisis, governments and regulatory authorities in various jurisdictions have made and continue to make numerous proposals to reform the regulatory framework for, or impose a tax or levy upon, the financial services industry to enhance its resilience against future crises, contribute to the relevant economy generally or for other purposes. In July 2010, the U.S. enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) which is now the subject of a multi-agency rulemaking process. The rulemakings include provisions that (i) create a tighter regulatory framework for OTC derivatives to promote transparency and impose conduct rules in that marketplace; (ii) establish a process for designating nonbank financial firms as Systemically Important Financial Institutions (SIFIs), subject to increased (and sometimes new) prudential oversight including early remediation, capital standards, resolution authority and new regulatory fees; (iii) prohibit material conflicts of interest between firms that package and sell asset-backed securities (ABS) and firms that invest in ABS; (iv) establish risk retention requirements for ABS; and (v) a number of executive compensation mandates, including rules to curtail incentive compensation that promotes excessive risk taking. The new regulatory framework for OTC derivatives includes mandates for clearing transactions with designated clearing organizations, exchange trading, new capital requirements, bilateral and variation margin for non-cleared derivatives, reporting and recordkeeping, and internal and external business conduct rules. Some U.S. derivatives rules may be applied extraterritorially and therefore impact some non-U.S. Nomura entities.

Other aspects of the Dodd-Frank Act and related rulemakings include provisions that (i) prohibit deposit-taking banks and their affiliates from engaging in proprietary trading and limit their ability to make investments in hedge funds and private equity funds (the so-called Volcker Rule); (ii) empower regulators to liquidate failing nonbank financial companies that are systemically important; (iii) provide for new systemic risk oversight and increased capital requirements for both bank and non-bank SIFIs; (iv) provide for a broader regulatory oversight of hedge funds; and (v) new regulations regarding the role of credit rating agencies, investment advisors and others. To facilitate the transition to the requirements of the Dodd-Frank Act, the Commodity Futures Trading Commission issued an exemptive order in July 2013 (the Exemptive Order) that granted market participants temporary conditional relief from certain provisions of the Commodity Exchange Act, as amended by the Dodd-Frank Act. As the Exemptive Order expired on December 21, 2013, some U.S. derivatives rules are now being applied extraterritorially and are now therefore impacting some non-U.S. Nomura entities. In addition, Title VII of the Dodd-Frank Act gives the SEC regulatory authority over security-based swaps which are defined under the act as swaps based on a single security or loan or a narrow-based group or index of securities. Security-based swaps are included within the definition of security under the U.S. Securities and Exchange Act of 1934 and the U.S. Securities Act of 1933. On May 1, 2013, the SEC proposed rules and interpretive guidance addressing cross-border security-based swap activities. Once final, these rules will also be applied extraterritorially and impact some non-U.S. Nomura entities. The exact details of the Dodd-Frank Act implementation and ultimate impact on Nomura s operations will depend on the form and substance of the final regulations adopted by various governmental agencies and oversight boards. In addition to the rulemakings required by the Dodd-Frank Act, the SEC is considering other rulemakings that will impact Nomura s U.S. entities. While these rules have not been formally proposed, they have been publicly reported in the U.S. Office of Management and Budget s (OMB) Current Regulatory Plan and Unified Agenda of Regulatory and Deregulatory Actions. The SEC s Division of Trading and Markets is considering recommending that the SEC propose an amendment to its net capital rule that would prohibit a broker-dealer that carries customer accounts from having a ratio of total assets to regulatory capital in excess of a certain level. The Division of Trading and Markets is also considering a number of changes to equity market structure rules.

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Risk Factors

There is no significant change from the risks as previously disclosed in Part I, Item 3.D Risk Factors of our annual report on Form 20-F for the year ended March 31, 2014.

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Special Note Regarding Forward-Looking Statements

This report contains forward-looking statements that are based on our current expectations, assumptions, estimates and projections about our business, our industry and capital markets around the world. These forward-looking statements are subject to various risks and uncertainties. Generally, these forward-looking statements can be identified by the use of forward-looking terminology such as *may*, *will*, *expect*, *anticipate*, *estimate*, *plan* or similar words. These statements discuss future expectations, identify strategies, contain projections of our results of operations or financial condition, or state other forward-looking information.

Known and unknown risks, uncertainties and other factors may cause our actual results, performance, achievements or financial position to differ materially from any future results, performance, achievements or financial position expressed or implied by any forward-looking statements contained in this report. Such risks, uncertainties and other factors are set forth in *Risk Factors* above and in Item 3.D of our annual report on Form 20-F for the fiscal year ended March 31, 2014, as well as elsewhere in this Form 6-K.

Table of Contents**Operating and Financial Review and Prospects****Results of Operations Six Months Ended September 30, 2013 and 2014**

The interim consolidated financial statements included in this Form 6-K have not been audited but have been reviewed in accordance with the standards of the Public Company Accounting Oversight Board (United States) by our independent auditors. The unaudited interim consolidated financial statements are prepared on a basis substantially consistent with the audited consolidated financial statements included in our Form 20-F for the fiscal year ended March 31, 2014 filed on June 26, 2014.

Overview

The following table provides selected consolidated statements of income information for the six months ended September 30, 2013 and 2014.

	Millions of yen except percentages	
	Six months ended September 30	
	2013	2014
Non-interest revenues:		
Commissions	¥ 263,247	¥ 208,413
Fees from investment banking	48,378	40,442
Asset management and portfolio service fees	83,083	93,839
Net gain on trading	238,589	287,573
Gain on private equity investments	753	202
Gain on investments in equity securities	12,889	9,234
Other	73,294	59,579
Total non-interest revenues	720,233	699,282
Net interest revenue	67,478	45,389
Net revenue	787,711	744,671
Non-interest expenses	601,559	618,992
Income before income taxes	186,152	125,679
Income tax expense	81,505	51,291
Net income	104,647	74,388
Less: Net income attributable to noncontrolling interests	641	1,656
Net income attributable to NHI shareholders	¥ 104,006	¥ 72,732
Return on shareholders' equity (annualized) ⁽¹⁾	8.9%	5.7%

(1) Calculated as Net income attributable to NHI shareholders divided by average Total NHI shareholders' equity multiplied by two. *Net revenue* decreased by 5.5% from ¥787,711 million for the six months ended September 30, 2013 to ¥744,671 million for the six months ended September 30, 2014. *Commissions* decreased by 20.8%, primarily due to decreasing commissions received from equity and equity-related products and commissions from the distributions of investment trust certificates. *Asset management and portfolio service fees* increased by 12.9%, primarily due to an increase in assets under management driven by contribution of the new subsidiary company. *Net gain on trading* increased by 20.5%, primarily due to an increase in the results of debt trading. *Other revenue* decreased by 18.7%, primarily due to decreasing unrealized gains of the equity securities held for non-trading purposes.

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Net interest revenue was ¥67,478 million for the six months ended September 30, 2013 and ¥45,389 million for the six months ended September 30, 2014. *Net interest revenue* is a function of the level and the mix of total assets and liabilities, which includes trading assets and financing and lending transactions, and the level, term structure and volatility of interest rates. *Net interest revenue* is an integral component of our trading business. In assessing the profitability of our overall business and of our Wholesale operation in particular, we view *Net interest revenue* and *Non-interest revenues* in aggregate.

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Non-interest expenses increased by 2.9% from ¥601,559 million for the six months ended September 30, 2013 to ¥618,992 million for the six months ended September 30, 2014.

We are subject to a number of different taxes in Japan and have adopted the consolidation tax system permitted under Japanese tax law. The consolidation tax system only imposes a national tax. Between April 1, 2004 and March 31, 2012, our effective statutory tax rate was 41%. However, as a result of revisions to domestic tax laws, the effective statutory tax rates are 38% for the fiscal years beginning between April 1, 2012 and March 31, 2014, and 36% thereafter. Our foreign subsidiaries are subject to the income tax rates of the countries in which they operate, which are generally lower than those in Japan. Our effective tax rate in any one year is therefore dependent on our geographic mix of profits and losses and also on the specific tax treatment applicable in each location.

For the six months ended September 30, 2013, the difference between the effective statutory tax rate of 38% and the effective tax rate of 43.8% was mainly due to non-deductible expenses, different tax rates and changes in effective statutory tax rates applicable to income (loss) of foreign subsidiaries, whereas non-taxable revenues and a decrease in valuation allowance of foreign subsidiaries reduced the effective tax rate.

For the six months ended September 30, 2014, the difference between the effective statutory tax rate of 36% and the effective tax rate of 40.8% was mainly due to non-deductible expenses, an increase in valuation allowance of foreign subsidiaries, whereas non-taxable revenue reduced the effective tax rate.

Net income attributable to NHI shareholders was ¥104,006 million for the six months ended September 30, 2013 and ¥72,732 million for the six months ended September 30, 2014, individually. Our annualized return on shareholder's equity was 8.9% for the six months ended September 30, 2013 and 5.7% for the six months ended September 30, 2014.

Retail

In Retail, our sales activities continue to focus on providing client consultation services and investment proposals for which we receive commissions and fees from our sales activities. Additionally, we receive operational fees from asset management companies in connection with the administration services of investment trust certificates that we distribute. We also receive agent commissions from insurance companies for the insurance products we sell as an agent.

	Millions of yen	
	Six months ended September 30 2013	2014
Non-interest revenues	¥ 283,200	¥ 222,691
Net interest revenue	2,872	2,112
Net revenue	286,072	224,803
Non-interest expenses	165,011	154,332
Income before income taxes	¥ 121,061	¥ 70,471

Net revenue decreased by 21.4% from ¥286,072 million for the six months ended September 30, 2013 to ¥224,803 million for the six months ended September 30, 2014, primarily due to decreased sales performance of equities and investment trusts as a result of slow down of the equity markets.

Non-interest expenses decreased by 6.5% from ¥165,011 million for the six months ended September 30, 2013 to ¥154,332 million for the six months ended September 30, 2014.

Income before income taxes decreased by 41.8% from ¥121,061 million for the six months ended September 30, 2013 to ¥70,471 million for the six months ended September 30, 2014.

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The following graph shows revenue generated by instrument in terms of Retail non-interest revenues for the six months ended September 30, 2013 and 2014.

As shown above, the proportion of Retail non-interest revenues from equities decreased from 33% for the six months ended September 30, 2013 to 29% for the six months ended September 30, 2014, primarily due to the slowdown of Japanese equity market environment. The proportion of Retail non-interest revenues from investment trusts and asset management decreased from 48% for the six months ended September 30, 2013 to 47% for the six months ended September 30, 2014. The proportion of Retail non-interest revenues from bonds increased from 18% for the six months ended September 30, 2013 to 19% for the six months ended September 30, 2014. The proportion of Retail non-interest revenues from insurance increased from 1% for the six months ended September 30, 2013 to 5% for the six months ended September 30, 2014.

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The following graph shows amounts and details regarding the composition of retail client assets as of September 30, 2013 and 2014.

Retail Client Assets

Total retail client assets increased by ¥8.3 trillion from ¥90.9 trillion as of September 30, 2013 to ¥99.3 trillion at September 30, 2014. Retail client assets consist of clients' assets held in our custody and assets relating to insurance products.

Asset Management

Our Asset Management segment is conducted principally through Nomura Asset Management Co., Ltd. (*NAM*). We earn portfolio management fees through the development and management of investment trusts, which are distributed by Nomura Securities Co., Ltd. (*NSC*), other brokers, banks, Japan Post Bank Co., Ltd. and Japan Post Co., Ltd. We also provide investment advisory services for pension funds and other institutional clients. Net revenues generally consist of asset management and portfolio services fees that are attributable to Asset Management.

	Millions of yen	
	Six months ended September 30	
	2013	2014
Non-interest revenues	¥ 37,238	¥ 43,219
Net interest revenue	1,562	1,810
Net revenue	38,800	45,029
Non-interest expenses	25,937	28,946
Income before income taxes	¥ 12,863	¥ 16,083

Net revenue increased by 16.1% from ¥38,800 million for the six months ended September 30, 2013 to ¥45,029 million for the six months ended September 30, 2014.

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Non-interest expenses increased by 11.6% from ¥25,937 million for the six months ended September 30, 2013 to ¥28,946 million for the six months ended September 30, 2014.

Income before income taxes increased by 25.0% from ¥12,863 million for the six months ended September 30, 2013 to ¥16,083 million for the six months ended September 30, 2014.

The following table sets forth assets under management of each principal Nomura entity within Asset Management as of September 30, 2013 and 2014.

	Billions of yen September 30	
	2013	2014
Nomura Asset Management Co., Ltd.	¥ 33,107	¥ 38,347
Nomura Funds Research and Technologies Co., Ltd.	2,492	2,612
Nomura Corporate Research and Asset Management Inc.	1,565	1,590
Nomura Private Equity Capital Co., Ltd.	153	174
Combined total	37,315	42,723
Overlapping asset accounts among group companies	(7,295)	(7,873)
Total	¥ 30,021	¥ 34,850

Assets under management increased by 16.1% from ¥30.0 trillion as of September 30, 2013 to ¥34.8 trillion as of September 30, 2014, primarily due to inflows into our investment trust business and investment advisory business, and contribution of the new subsidiary company. The greatest proportion of these assets was managed by NAM with assets under management of ¥38.3 trillion as of September 30, 2014.

Domestic publicly offered investment trust assets included in the assets under management by NAM were ¥20.1 trillion as of September 30, 2014, a ¥2.7 trillion or 15% increase from September 30, 2013. We saw continuous inflows into our products during the six months ended September 30, 2014. For our investment advisory business, assets under management were ¥12.1 trillion as of September 30, 2014, a ¥0.4 trillion or 3% increase from September 30, 2013.

The following table shows NAM's share, in terms of net asset value, in the Japanese asset management market as of September 30, 2013 and 2014.

	September 30	
	2013	2014
Total of publicly offered investment trusts	23%	23%
Stock investment trusts	18%	19%
Bond investment trusts	42%	43%
<i>Wholesale</i>		

In Wholesale, we are engaged in the sales and trading of debt securities and equity securities and currencies on a global basis to various institutions, providing investment banking services such as the underwriting of bonds and equities as well as mergers and acquisitions and financial advice and investing in private equity businesses with the goal of maximizing returns on these investments by increasing the corporate value of investee companies.

Millions of yen
Six months ended September 30

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	2013	2014
Non-interest revenues	¥ 313,738	¥ 299,636
Net interest revenue	64,219	79,820
Net revenue	377,957	379,456
Non-interest expenses	327,435	351,508
Income (loss) before income taxes	¥ 50,522	¥ 27,948

Net revenue increased by 0.4% from ¥377,957 million for the six months ended September 30, 2013 to ¥379,456 million for the six months ended September 30, 2014.

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Non-interest expenses increased by 7.4% from ¥327,435 million for the six months ended September 30, 2013 to ¥351,508 million for the six months ended September 30, 2014.

Income before income taxes decreased by 44.7% from ¥50,522 million for the six months ended September 30, 2013 to ¥27,948 million for the six months ended September 30, 2014.

The breakdown of net revenue for Wholesale is as follows:

	Millions of yen	
	Six months ended 2013	September 30 2014
Fixed Income	¥ 191,312	¥ 208,610
Equities	133,615	126,020
Investment Banking (Net)	48,899	45,237
Investment Banking (Other)	4,131	(411)
Investment Banking	53,030	44,826
Net revenue	¥ 377,957	¥ 379,456
Investment Banking (Gross)	¥ 92,968	¥ 83,887

For Fixed Income, net revenue increased by 9.0% from ¥191,312 million for the six months ended September 30, 2013 to ¥208,610 million for the six months ended September 30, 2014 due to high performances of FX trading. For Equities, net revenue decreased by 5.7% from ¥133,615 million for the six months ended September 30, 2013 to ¥126,020 million for the six months ended September 30, 2014 due to the slowdown of Japanese equity market environment. For Investment Banking, net revenue decreased by 15.5% from ¥53,030 million for the six months ended September 30, 2013 to ¥44,826 million for the six months ended September 30, 2014, primarily due to a decrease in the volume of capital market transactions in Japan.

Other Operating Results

Other operating results include net gain (loss) related to economic hedging transactions, realized gain (loss) on investments in equity securities held for operating purposes, equity in earnings of affiliates, corporate items, and other financial adjustments. See Note 16 *Segment and geographic information* in our interim consolidated financial statements.

Net revenue was ¥72,681 million for the six months ended September 30, 2013 and ¥89,294 million for the six months ended September 30, 2014. Non-interest expenses were ¥83,176 million for the six months ended September 30, 2013 and ¥84,206 million for the six months ended September 30, 2014. Loss before income taxes in other operating results was ¥10,495 million for the six months ended September 30, 2013 and income before income taxes in other operating results was ¥5,088 million for the six months ended September 30, 2014.

Other operating results for the six months ended September 30, 2014 include losses from changes in the fair value of the financial liabilities, for which the fair value option was elected, attributable to the change in our creditworthiness of ¥2.2 billion; the negative impact of our own creditworthiness on derivative liabilities, which resulted in losses of ¥5.5 billion; and gains from changes in counterparty credit spreads of ¥7.0 billion.

Number of Employees

The following table shows the number of our employees as of September 30, 2013 and 2014.

September 30	
2013	2014

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Japan	16,377	16,244
Europe	3,459	3,530
Americas	2,243	2,421
Asia and Oceania	5,945	6,744
Total	28,024	28,939

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Summary of Regional Contributions

For a summary of our net revenue, income (loss) before income taxes and long-lived assets by geographic region, see Note 16 *Segment and geographic information* in our interim consolidated financial statements.

Regulatory Capital Requirements

Many of our business activities are subject to statutory capital requirements, including those of Japan, the U.S., the U.K. and certain other countries in which we operate.

Translation Exposure

A significant portion of our business is conducted in currencies other than yen most significantly, U.S. dollars, British pounds and Euros. We prepare financial statements of each of our consolidated entities in its functional currency, which is the currency of the primary economic environment in which the entity operates. Translation exposure is the risk arising from the effect of fluctuations in exchange rates on the net assets of our foreign subsidiaries. Translation exposure is not recognized in our consolidated statements of income unless and until we dispose of, or liquidate, the relevant foreign subsidiary, which historically has not occurred, and which we do not expect to occur frequently.

Critical Accounting Policies and Estimates

Use of Estimates

In preparing our interim consolidated financial statements, management makes estimates regarding certain financial instrument and investment valuations, the outcome of litigation and tax examinations, the recovery of the carrying value of goodwill, the allowance for doubtful accounts, the realization of deferred tax assets and other matters that affect the reported amounts of assets and liabilities as well as the disclosures in these interim consolidated financial statements. Estimates, by their nature, are based on judgment and available information. Therefore, actual results may differ from estimates, which could have a material impact on the interim consolidated financial statements, and it is possible that such adjustments could occur in the near term.

Fair Value for Financial Instruments

A significant amount of our financial instruments are carried at fair value, with changes in fair value recognized through the consolidated statements of income or the consolidated statements of comprehensive income on a recurring basis. Use of fair value is either specifically required under U.S. GAAP or we make an election to use fair value for certain eligible items under the fair value option.

Other financial assets and financial liabilities are carried at fair value on a nonrecurring basis, where the primary measurement basis is not fair value. Fair value is only used in specific circumstances after initial recognition, such as to measure impairment.

In accordance with Accounting Standards CodificationTM (ASC) 820 *Fair Value Measurements and Disclosures* , all financial instruments measured at fair value have been categorized into a three-level hierarchy based on the transparency of valuation inputs used to establish fair value.

Level 1:

Unadjusted quoted prices for identical financial instruments in active markets accessible by Nomura at the measurement date.

Level 2:

Quoted prices in inactive markets or prices containing other inputs which are observable, either directly or indirectly. Valuation techniques using observable inputs reflect assumptions used by market participants in pricing financial instruments and are based on data obtained from independent market sources at the measurement date.

Level 3:

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Unobservable inputs that are significant to the fair value measurement of the financial instrument. Valuation techniques using unobservable inputs reflect management's assumptions about the estimates used by other market participants in valuing similar financial instruments. These valuation techniques are developed based on the best available information at the measurement date.

The availability of inputs observable in the market varies by product and can be affected by a variety of factors. Significant factors include, but are not restricted to the prevalence of similar products in the market, especially for customized products, how established the product is in the market, for example, whether it is a new product or is relatively mature, and the reliability of information provided in the market which would depend, for example, on the frequency and volume of current data. A period of significant change in the market may reduce the availability of observable data. Under such circumstances, financial instruments may be reclassified into a lower level in the fair value hierarchy.

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Significant judgments used in determining the classification of financial instruments include the nature of the market in which the product would be traded, the underlying risks, the type and liquidity of market data inputs and the nature of observed transactions for similar instruments.

Where valuation models include the use of parameters which are less observable or unobservable in the market, significant management judgment is used in establishing fair value. The valuations for Level 3 financial instruments, therefore, involve a greater degree of judgment than those valuations for Level 1 or Level 2 financial instruments.

Certain criteria management use to determine whether a market is active or inactive include the number of transactions, the frequency that pricing is updated by other market participants, the variability of price quotes among market participants, and the amount of publicly available information.

Level 3 financial assets excluding derivatives as a proportion of total financial assets excluding derivatives, carried at fair value on a recurring basis was 2% as of September 30, 2014 as listed below:

	Billions of yen, except percentages September 30, 2014					
	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting	Total	The proportion of Level 3
Financial assets measured at fair value (Excluding derivative assets)	¥ 11,143	¥ 9,160	¥ 347	¥	¥ 20,650	2%
Derivative assets	810	31,147	193	(30,054)	2,096	
Derivative liabilities	772	30,886	247	(30,155)	1,750	

See Note 2 *Fair value measurements* in our interim consolidated financial statements.

Private equity business

All private equity investments made by investment company subsidiaries pursuant to the provisions of ASC 946 *Financial Services Investment Companies* (ASC 946) are accounted for at fair value, with changes in fair value recognized through our interim consolidated statements of income.

The valuation of unlisted private equity investments requires significant management judgment because the investments, by their nature, have little or no price transparency. Private equity investments are initially carried at cost as an approximation of fair value. Adjustments to carrying value are made if there is third-party evidence of a change in value. Adjustments are also made, in the absence of third party transactions, if it is determined that the expected exit price of the investment is different from carrying value. In reaching that determination, Nomura primarily uses either a discounted cash flow (DCF) or market multiple valuation technique. A DCF valuation technique incorporates estimated future cash flows to be generated from the underlying investee, as adjusted for an appropriate growth rate discounted at a weighted average cost of capital. Market multiple valuation techniques include comparables such as Enterprise Value/earnings before interest, taxes, depreciation and amortization ratios, Price/Earnings ratios, Price/Book ratios, Price/Embedded Value ratios and other multiples based on relationships between numbers reported in the financial statements of the investee and the price of comparable companies. A liquidity discount may also be applied to either a DCF or market multiple valuation to reflect the specific characteristics of the investee. Where possible these valuations are compared with the operating cash flows and financial performance of the companies or properties relative to budgets or projections, price/earnings data for similar quoted investee, trends within sectors and/or regions and any specific rights or terms associated with the investment, such as conversion features and liquidation preferences. Private equity investments are generally classified as Level 3 since the valuation inputs such as those mentioned above are usually unobservable.

Any changes to valuations are then stress tested to assess the impact of particular risk factors in order to establish the final estimated valuation. For more information on our private equity activities, see *Private Equity Business* below.

Assets and Liabilities Associated with Investment and Financial Services Business*Exposure to Certain Financial Instruments and Counterparties*

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Market conditions impact numerous products including securitization products and leveraged finance to which we have certain exposure. We also have exposures to Special Purpose Entities (SPEs) and others in the normal course of business.

Table of Contents*Securitization Products*

Our exposure to securitization products consists of commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS), and other securitization products. We hold these securitization products in connection with securitization, financing, trading and other activities. The following table provides a summary of our exposure to securitization products by geographic region of the underlying collateral as of September 30, 2014.

	Millions of yen September 30, 2014				Total ⁽¹⁾
	Japan	Europe	Americas	Asia and Oceania	
CMBS ⁽²⁾	¥ 2,062	¥ 24,779	¥ 69,515	¥	¥ 96,356
RMBS ⁽²⁾⁽³⁾	17,594	56,509	342,730	645	417,478
Other securitization products ⁽⁴⁾	84,078	181,997	199,433		465,508
Total	¥ 103,734	¥ 263,285	¥ 611,678	¥ 645	¥ 979,342

- (1) The balances shown exclude certain CMBS of ¥23,166 million for which we transferred financial assets to securitization vehicles where such transfers were accounted for as secured financings rather than sales under ASC 860 *Transfers and Servicing* (ASC 860), and in which we have no continuing economic exposure because the beneficial interests in the vehicles have been sold to third parties.
- (2) We have ¥33,472 million exposure, as whole loans and commitments, to U.S. CMBS and RMBS-related business as of September 30, 2014.
- (3) The RMBS balance for Americas excludes mortgage pass-through securities and U.S. government guaranteed collateralized mortgage obligations (CMOs) of ¥1,713,438 million, because their credit risks are considered minimal.
- (4) Includes collateralized loan obligations (CLOs), collateralized debt obligations (CDOs) and asset-backed securities (ABS) such as those secured on credit card loans, auto loans, student loans and home equity loans.

The following table provides our exposure to CMBS by geographic region and the external credit ratings of the underlying collateral as of September 30, 2014. Ratings are based on the lowest ratings given by Standard & Poor's Financial Services LLC, Moody's Investors Service, Inc., Fitch Ratings Ltd., Japan Credit Rating Agency, Ltd. or Rating and Investment Information, Inc. as of September 30, 2014.

	Millions of yen September 30, 2014							Total
	AAA	AA	A	BBB	BB	B and lower	Not rated	
Japan	¥	¥	¥	¥	¥ 302	¥ 1,674	¥ 86	¥ 2,062
Europe			3,846	8,173	6,191	6,487	82	24,779
Americas	24,425	3,413	12,003	7,459	5,761	15,359	1,095	69,515
Total	¥ 24,425	¥ 3,413	¥ 15,849	¥ 15,632	¥ 12,254	¥ 23,520	¥ 1,263	¥ 96,356

Leveraged Finance

We provide loans to clients in connection with leveraged buy-outs and leveraged buy-ins. As this type of finance is usually initially provided through a commitment, we have both funded and unfunded exposures on these transactions.

The following table sets forth our exposure to leveraged finance by geographic location of the target company as of September 30, 2014.

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	Millions of yen September 30, 2014		
	Funded	Unfunded	Total
Europe	¥ 7,763	¥ 11,276	¥ 19,039
Americas	15,440	128,753	144,193
Total	¥ 23,203	¥ 140,029	¥ 163,232

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Special Purpose Entities (SPEs)

Our involvement with these entities includes structuring, underwriting, as well as, subject to prevailing market conditions, distributing and selling debt instruments and beneficial interests issued by these entities. In the normal course of securitization and equity derivative activities business, we also act as a transferor of financial assets to, and underwriter, distributor and seller of repackaged financial instruments issued by these entities. We retain, purchase and sell variable interests in SPEs in connection with our market-making, investing and structuring activities. Our other types of involvement with SPEs include guarantee agreements and derivative contracts.

For further discussion on Nomura's involvement with variable interest entities (VIEs), see Note 6 *Securitized and Variable Interest Entities* in our interim consolidated financial statements.

Accounting Developments

See Note 1 *Summary of accounting policies: New accounting pronouncements recently adopted* in our interim consolidated financial statements.

Private Equity Business

Nomura makes private equity investments primarily in Japan and Europe.

Private equity investments made by certain entities which Nomura consolidates under either a voting interest or variable interest model which are investment companies pursuant to the provisions of ASC 946 are accounted for at fair value, with changes in fair value recognized through the consolidated statements of income. Investment company accounting applied by each of these investment company subsidiaries is retained in our interim consolidated financial statements.

These entities make private equity investments solely for capital appreciation, current income or both rather than to generate strategic operating benefits to Nomura. In accordance with Nomura's investment policies, non-investment companies within the group may not make investments in entities engaged in non-core businesses if such investments would result in consolidation or application of the equity method of accounting. Such investments may generally only be made by investment company subsidiaries. Non-core businesses are defined as those engaged in activities other than Nomura's business segments.

Nomura also has a subsidiary which is not an investment company but which makes investments in entities engaged in Nomura's core businesses. These investments are made for capital appreciation or current income purposes or both and are also carried at fair value, either because of election of the fair value option or other U.S. GAAP requirements.

Private Equity Business in Japan

Nomura makes private equity investments through a wholly-owned subsidiary, Nomura Financial Partners Co., Ltd. (NFP). NFP is not an investment company subsidiary as it invests in entities engaged in our core business. We elected the fair value option to account for its 37.1% investment in the common stock of Ashikaga Holdings Co., Ltd.

Private Equity Business in Europe

In Europe, Nomura's private equity investments primarily comprise legacy investments made by its former Principal Finance Group (PFG) now managed by Terra Firma (collectively referred to as the Terra Firma Investments), investments in other funds managed by Terra Firma (Other Terra Firma Funds) and through other investment company subsidiaries (Other Investments).

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Terra Firma Investments

Nomura contributed our European private equity investments to Terra Firma Capital Partners I (TFCP I), a limited partnership which is engaged in the private equity business, in exchange for a limited partnership interest. Terra Firma Investments (GP) Limited, the general partner of TFCP I, which is independent of Nomura, assumed the management and control of these investments.

The Terra Firma Investments are held by entities which are investment company subsidiaries and therefore Nomura accounted for these investments at fair value, with changes in fair value recognized through the interim consolidated statements of income.

Other Terra Firma Funds

In addition to the Terra Firma Investments, Nomura is a 10% investor in a ¥269 billion private equity fund (TFCP II) and a 2% investor in a ¥717 billion private equity fund (TFCP III), also raised and managed by Terra Firma Capital Partners Limited.

Nomura's total commitment for TFCP II was originally ¥26,919 million and reduced to ¥50 million as a result of adjustments for recyclable distributions. As of September 30, 2014, no amount had been drawn down for investments.

For TFCP III, Nomura's total commitment was ¥13,589 million and ¥13,461 million had been drawn down for investments as of September 30, 2014.

The investments in TFCP II and TFCP III are carried at fair value, with changes in fair value recognized through the interim consolidated statements of income.

Other Investments

Nomura also makes private equity investments through wholly-owned subsidiaries and other consolidated entities which have third party pooling of funds. Certain of these entities are investment company subsidiaries and therefore all of their investments are carried at fair value, with changes in fair value recognized through the interim consolidated statements of income.

Table of Contents**Deferred Tax Assets Information***Details of deferred tax assets and liabilities*

Details of deferred tax assets and liabilities reported within *Other assets*, *Other* and *Other liabilities* respectively in the consolidated balance sheets as of September 30, 2014 are as follows:

	Millions of yen
	September 30, 2014
Deferred tax assets	
Depreciation, amortization and valuation of fixed assets	¥ 14,432
Investments in subsidiaries and affiliates	34,428
Valuation of financial instruments	59,178
Accrued pension and severance costs	6,167
Other accrued expenses and provisions	98,506
Operating losses	456,521
Other	3,280
Gross deferred tax assets	672,512
Less Valuation allowance	(518,604)
Total deferred tax assets	153,908
Deferred tax liabilities	
Investments in subsidiaries and affiliates	111,310
Valuation of financial instruments	52,774
Undistributed earnings of foreign subsidiaries	736
Valuation of fixed assets	19,065
Other	5,962
Total deferred tax liabilities	189,847
Net deferred tax assets	¥ (35,939)

Calculation method of deferred tax assets

In accordance with U.S. GAAP, we recognize deferred tax assets to the extent we believe that it is more likely than not that a benefit will be realized. A valuation allowance is provided for tax benefits available to us, which are not deemed more likely than not to be realized.

Legal Proceedings

For a discussion of our litigation and related matters, see Note 15 *Commitments, contingencies and guarantees* in our interim consolidated financial statements.

Liquidity and Capital Resources**Funding and Liquidity Management***Overview*

We define liquidity risk as the risk of losses arising from difficulty in securing the necessary funding or from a significantly higher cost of funding than normal levels due to deterioration of the Nomura Group's creditworthiness or deterioration in market conditions. This risk could arise from Nomura-specific or market-wide events such as inability to access the secured or unsecured debt markets, a deterioration in our credit

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ratings, a failure to manage unplanned changes in funding requirements, a failure to liquidate assets quickly and with minimal loss in value, or changes in regulatory capital restrictions which may prevent the free flow of funds between different group entities. Our liquidity risk management policy is based on liquidity risk appetite which the Group Integrated Risk Management Committee formulates upon delegation by the Executive Management Board (EMB). Nomura s liquidity risk management, under market-wide stress and in addition, under Nomura-specific stress, seeks to ensure enough continuous liquidity to meet all funding requirements and unsecured debt obligations across one year and one month periods, respectively, without raising funds through unsecured funding or through the liquidation of assets.

We have in place a number of liquidity risk management frameworks that enable us to achieve our primary liquidity objective. These frameworks include (1) Centralized Control of Residual Cash and Maintenance of Liquidity Portfolio; (2) Appropriate Funding and Diversification of Funding Sources and Maturities Commensurate with the Composition of Assets; (3) Management of Credit Lines to Nomura Group Entities; (4) Implementation of Liquidity Stress Tests; and (5) Contingency Funding Plan.

Our EMB has the authority to make decisions concerning the group liquidity management. The Chief Financial Officer (CFO) has the operational authority and responsibility over our liquidity management based on decisions made by the EMB.

Table of Contents*1. Centralized Control of Residual Cash and Maintenance of Liquidity Portfolio.*

We centrally control residual cash held at Nomura Group entities for effective liquidity utilization purposes. As for the usage of funds, the CFO decides the maximum amount of available funds, provided without posting any collateral, for allocation within Nomura and the EMB allocates the funds to each business division. Global Treasury monitors the usage by businesses and reports to the EMB.

In order to enable us to transfer funds smoothly between group entities, we limit the issuance of securities by regulated broker-dealers or banking entities within the Nomura Group and seek to raise unsecured funding primarily through the Company or through unregulated subsidiaries. The primary benefits of this strategy include cost minimization, wider investor name recognition and greater flexibility in providing funding to various subsidiaries across the Nomura Group.

To meet any potential liquidity requirement, we maintain a liquidity portfolio in the form of cash and highly liquid, unencumbered securities that may be sold or pledged to provide liquidity. As of September 30, 2014, our liquidity portfolio was ¥5,793.1 billion which generated a liquidity surplus taking into account stress scenarios.

The following table presents a breakdown of our liquidity portfolio by type of financial assets as of March 31, 2014 and September 30, 2014 and averages maintained for the years ended March 31, 2014 and for six months ended September 30, 2014. Yearly and six months averages are calculated using month-end amounts.

	Billions of yen			
	Average for year ended March 31, 2014	March 31, 2014	Average for six months ended September 30, 2014	September 30, 2014
Cash, cash equivalents and time deposits ⁽¹⁾	¥ 1,676.6	¥ 1,497.2	¥ 1,697.7	¥ 1,311.1
Government securities	4,667.3	4,483.6	4,422.3	4,314.3
Others ⁽²⁾	214.9	146.4	216.1	167.6
Total liquidity portfolio	¥ 6,558.8	¥ 6,127.2	¥ 6,336.1	¥ 5,793.1

(1) Cash, cash equivalents, and time deposits include nostro balances and deposits with both central banks and market counterparties that are readily available to support the liquidity position of Nomura.

(2) Others include other liquid financial assets such as money market funds and U.S. agency securities.

The following table presents a breakdown of our liquidity portfolio by currency as of March 31, 2014 and September 30, 2014 and averages maintained for the years ended March 31, 2014 and for six months ended September 30, 2014. Yearly and six months averages are calculated using month-end amounts.

	Billions of yen			
	Average for year ended March 31, 2014	March 31, 2014	Average for six months ended September 30, 2014	September 30, 2014
Japanese Yen	¥ 2,463.3	¥ 2,272.3	¥ 2,406.3	¥ 1,906.7
U.S. Dollar	2,171.5	2,050.4	2,227.9	2,118.4
Euro	1,015.0	1,049.0	1,046.7	1,236.6
British Pound	662.4	568.6	565.5	425.5
Others ⁽¹⁾	246.6	186.9	89.6	105.9
Total liquidity portfolio	¥ 6,558.8	¥ 6,127.2	¥ 6,336.1	¥ 5,793.1

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(1) Includes other currencies such as the Canadian dollar, the Australian dollar and the Swiss franc.

We assess our liquidity portfolio requirements globally as well as by each major operating entity in the Nomura Group. We primarily maintain our liquidity portfolio at Nomura Holdings, Inc. (NHI) and Nomura Securities Co. Ltd (NSC), our other major broker-dealer subsidiaries, our bank subsidiaries, and other group entities. In determining the amounts and entities which hold this liquidity portfolio, we consider legal, regulatory and tax restrictions which may impact our ability to freely transfer liquidity across different entities in the Nomura Group.

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The following table presents a breakdown of our liquidity portfolio by entity as of March 31, 2014 and September 30, 2014.

	Billions of yen	
	March 31, 2014	September 30, 2014
NHI and NSC ⁽¹⁾	¥ 1,900.9	¥ 1,612.0
Major broker-dealer subsidiaries	2,815.2	2,847.1
Bank subsidiaries ⁽²⁾	1,170.5	1,081.8
Other group entities	240.6	252.1
Total liquidity portfolio	¥ 6,127.2	¥ 5,793.1

(1) NSC, a broker dealer located in Japan, holds an account with the Bank of Japan (BOJ) and has direct access to the BOJ Lombard facility through which same day funding is available for our securities pool. Any liquidity surplus at NHI is lent to NSC via short-term intercompany loans, which can be unwound immediately when needed.

(2) Includes Nomura Bank International plc (NBI), Nomura Singapore Limited and Nomura Bank Luxembourg S.A.

In addition to our liquidity portfolio, we had ¥1,923.5 billion of other unencumbered assets comprising mainly unpledged trading assets that can be used as an additional source of secured funding. The aggregate of our liquidity portfolios and other unencumbered assets as of September 30, 2014 was ¥7,716.6 billion, which represented 279.4% of our total unsecured debt maturing within one year.

	Billions of yen	
	March 31, 2014	September 30, 2014
Net liquidity value of other unencumbered assets	¥ 1,720.3	¥ 1,923.5
Liquidity portfolio	6,127.2	5,793.1
Total	¥ 7,847.5	¥ 7,716.6

2. *Appropriate Funding and Diversification of Funding Sources and Maturities Commensurate with the Composition of Assets*

We seek to maintain a surplus of long-term debt and equity above the cash capital requirements of our assets. This enables us to fund our operations for at least one year in a market-wide stress event, without needing to raise unsecured funding or force the liquidation of assets. The amount of liquidity required is based on an internal model which incorporates the following requirements:

(i) Our ability to finance assets using secured funding, including repurchase agreements and securities lending transactions. The cash capital requirements are calculated using conservative estimates of the assets secured borrowing power in stressed scenarios.

(ii) Goodwill and identifiable intangible assets, property, equipment and other illiquid assets.

(iii) Collateral requirements on derivative contracts arising as a result of a two-notch downgrade in our credit rating.

Collateral requirements to support potential increased intraday collateral requirements from our clearing and settlement agents arising as a result of a two-notch downgrade in our credit rating.

In addition, other unencumbered assets held at exchanges for other related requirements are also funded with long-term liquidity.

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(iv) Commitments to lend to external counterparties based on the probability of drawdown.

(v) Capital or other forms of financing in our regulated subsidiaries that is in excess of their long-term cash capital requirements. Our internal model takes into account legal, regulatory and tax restrictions that may impact the ability to freely transfer liquidity across the entities within the Nomura Group.

We seek to achieve diversification of our funding by market, instrument type, investors, currency, and staggered maturities in order to reduce unsecured refinancing risk.

We diversify funding by issuing various types of debt instruments these include both structured loans and notes. Structured notes are debt obligations with returns linked to interest rates, equities, indices, currencies or commodities. We issue structured notes in order to increase the diversity of our debt instruments. We typically hedge the returns we are obliged to pay with derivatives and/or the underlying assets to maintain funding consistency with our unsecured long-term debt. The proportion of our non-yen denominated long-term debt slightly increased to 34.6% of total long-term debt outstanding as of September 30, 2014 from 32.0% as of March 31, 2014.

Table of Contents**2.1 Short-Term Unsecured Debt**

Our short-term unsecured debt consists of short-term bank borrowings (including long-term bank borrowings maturing within one year), other loans, commercial paper, deposits at banking entities, certificates of deposit and debt securities maturing within one year. Deposits at banking entities and certificates of deposit comprise customer deposits and certificates of deposit held by our banking subsidiaries. Short-term unsecured debt includes the current portion of long-term unsecured debt.

The following table presents an analysis of our short-term unsecured debt by type of financial liability as of March 31, 2014 and September 30, 2014.

	Billions of yen	
	March 31, 2014	September 30, 2014
Short-term bank borrowings	¥ 722.5	¥ 673.0
Other loans	49.2	19.4
Commercial paper	246.9	271.8
Deposits at banking entities	757.7	702.1
Certificates of deposit	240.5	213.5
Debt securities maturing within one year	952.5	882.4
Total short-term unsecured debt	¥ 2,969.3	¥ 2,762.2

2.2 Long-Term Unsecured Debt

We meet our long-term capital requirements and also achieve both cost-effective funding and an appropriate maturity profile by routinely funding through long-term debt and diversifying across various maturities and currencies.

Our long-term unsecured debt includes senior and subordinated debt issued through U.S. registered shelf offerings and our U.S. registered medium-term note programs, our Euro medium-term note programs, registered shelf offerings in Japan and various other debt programs.

As a globally competitive financial services group in Japan, we have access to multiple global markets and major funding centers. The Company, NSC, Nomura Europe Finance N.V. (NEF) and NBI are the main group entities that borrow externally, issue debt instruments and engage in other funding activities. By raising funds to match the currencies and liquidities of our assets or by using foreign exchange swaps as necessary, we pursue optimization of our funding structures.

We use a wide range of products and currencies to ensure that our funding is efficient and well diversified across markets and investor types. Our unsecured senior debt is mostly issued without financial covenants, such as covenants related to adverse changes in our credit ratings, cash flows, results of operations or financial ratios, which could trigger an increase in our cost of financing or accelerate repayment of the debt.

The following table presents an analysis of our long-term unsecured debt by type of financial liability as of March 31, 2014 and September 30, 2014.

	Billions of yen	
	March 31, 2014	September 30, 2014
Long-term deposits at banking entities	¥ 116.0	¥ 140.6
Long-term bank borrowings	2,057.6	2,146.7
Other loans	129.0	171.5
Debt securities ⁽¹⁾	3,916.0	3,826.5
Total long-term unsecured debt	¥ 6,218.6	¥ 6,285.3

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- (1) Excludes long-term debt securities issued by consolidated special purpose entities and similar entities that meet the definition of variable interest entities under ASC 810, *Consolidation* and secured financing transactions recognized within long-term borrowings as a result of transfers of financial assets that are accounted for as financings rather than sales in accordance with ASC 860.

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2.3 Maturity Profile

We also seek to maintain an average maturity for plain vanilla instruments greater than or equal to three years. The average maturity for plain vanilla debt securities and borrowings with maturities longer than one year was 3.8 years as of September 30, 2014. A significant amount of our medium-term notes are structured and linked to interest rates, equities, indices, currencies or commodities. These maturities are evaluated based on our internal model and monitored by Global Treasury. Maturities for plain vanilla debt securities and borrowings are evaluated based on contractual maturities. Where there is a possibility that these may be called prior to their scheduled maturity date, maturities are based on our internal stress option adjusted model. This model values the embedded optionality under stress market conditions in order to determine when the debt securities or borrowing is likely to be called.

On this basis, the average maturity of structured notes (notes with maturities longer than one year) was 6.4 years as of September 30, 2014. The average maturity of our entire long-term debt portfolio, including plain vanilla debt securities and borrowings, was 4.8 years as of September 30, 2014. The graph below shows the distribution of maturities of our outstanding long-term debt securities and borrowings.

Redemption schedule is individually estimated by considering the probability of redemption.

2.4 Secured Borrowings

We typically fund our trading activities on a secured basis through secured borrowings, repurchase agreements and Japanese Gensaki Repo transactions. We believe these funding activities in the secured markets are more cost-efficient and less credit-rating sensitive than financing in the unsecured market. Also, repurchase agreements tend to be short-term, often overnight. We lower the liquidity risks arising from secured funding by transacting with a diverse group of global counterparties, delivering various types of securities collateral, and actively seeking long-term agreements. For more detail of secured borrowings and repurchase agreements, see Note 4 *Collateralized transactions* in our consolidated financial statements.

3. Management of Credit Lines to Nomura Group entities

We have committed facility agreements with financial institutions as part of our contingent financing sources. Total unused committed facilities stayed the same at ¥65.0 billion as of September 30, 2014 from ¥65.0 billion as of March 31, 2014. We have structured facilities to ensure that the maturity dates of these facilities are distributed evenly throughout the year in order to prevent excessive maturities of facilities in any given period. While the ability to borrow under these facilities is subject to customary lending conditions and covenants, we do not believe that any of the covenant requirements will impair our ability to draw on the facilities. We occasionally test the effectiveness of our drawdown procedures.

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4. Implementation of Liquidity Stress Tests

We maintain our liquidity portfolio and monitor the sufficiency of our liquidity based on an internal model which simulates changes in cash outflow under specified stress scenarios to comply with our above mentioned liquidity management policy.

We assess the liquidity requirements of the Nomura Group under various stress scenarios with differing levels of severity over multiple time horizons. We evaluate these requirements under Nomura-specific and broad market-wide events, including potential credit rating downgrades at our parent company and subsidiary levels that may impact us by loss of access to unsecured capital markets, additional collateral posting requirements, limited or no access to secured funding markets and other events. We call this risk analysis our Maximum Cumulative Outflow (MCO) framework.

The MCO framework is designed to incorporate the primary liquidity risks for Nomura and models the relevant cash flows in the following two primary scenarios:

Stressed scenario To maintain adequate liquidity during a severe market-wide liquidity event without raising funds through unsecured financing or the liquidation of assets for a year; and

Acute stress scenario To maintain adequate liquidity during a severe market-wide liquidity event coupled with credit concerns regarding Nomura's liquidity position, without raising funds through unsecured funding or the liquidation of assets for one month.

We assume that Nomura will not be able to liquidate assets or adjust its business model during the time horizons used in each of these scenarios. The MCO framework therefore defines the amount of liquidity required to be held in order to meet our expected liquidity needs in a stress event to a level we believe appropriate based on our liquidity risk appetite.

As of September 30, 2014, our liquidity portfolio exceeded net cash outflows under the stress scenarios described above.

We constantly evaluate and modify our liquidity risk assumptions based on regulatory and market changes. The model we use in order to simulate the impact of stress scenarios includes the following assumptions:

No liquidation of assets;

No ability to issue additional unsecured funding;

Upcoming maturities of unsecured debt (maturities less than one year);

Potential buybacks of our outstanding debt;

Loss of secured funding lines particularly for less liquid assets, over and above our cash capital estimates;

Fluctuation of funding needs under normal business circumstances;

Cash and collateral outflows in a stress event;

Widening of haircuts on outstanding repo funding;

Additional collateralization requirements of clearing banks and depositories;

Drawdown on loan commitments;

Loss of liquidity from market losses on inventory; and

Legal and regulatory requirements that can restrict the flow of funds between entities in the Nomura Group.

We recognize that liquidity standards for financial institutions continues to be the subject of further discussion among relevant supervisory bodies including the Basel Committee. The existing model and simulations upon which we currently rely may need to be reviewed depending on any new development in this area.

In 2008, the Basel Committee published *Principles for Sound Liquidity Risk Management and Supervision* (*Sound Principles*). To complement these principles, the Committee has further strengthened its liquidity framework by developing two minimum standards for funding liquidity. These standards have been developed to achieve two separate but complementary objectives.

The first objective is to promote short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high-quality liquid assets to survive a significant stress scenario lasting for one month. The Committee developed the Liquidity Coverage Ratio (the *LCR*) to achieve this objective.

The second objective is to promote resilience over a longer time horizon by creating additional incentives for banks to fund their activities with more stable sources of funding on an ongoing basis. The Net Stable Funding Ratio (the *NSFR*) has a time horizon of one year and has been developed to provide a sustainable maturity structure of assets and liabilities.

These two standards are comprised mainly of specific parameters which are internationally harmonised with prescribed values. Certain parameters, however, contain elements of national discretion to reflect jurisdiction-specific conditions.

After an observation period, the *LCR*, including any revisions, will be introduced on January 1, 2015. The *NSFR*, including any revisions, will move to a minimum standard by January 1, 2018.

5. Contingency Funding Plan

We have developed a detailed contingency funding plan to integrate liquidity risk control into our comprehensive risk management strategy and to enhance the quantitative aspects of our liquidity risk control procedures. As a part of our Contingency Funding Plan (*CFP*), we have developed an approach for analyzing and quantifying the impact of any liquidity crisis. This allows us to estimate the likely impact of both Nomura-specific and market-wide events; and specifies the immediate action to be taken to mitigate any risk. The *CFP* lists details of key internal and external parties to be contacted and the processes by which information is to be disseminated. This has been developed at a legal entity level in order to capture specific cash requirements at the local level – it assumes that our parent company does not have access to cash that may be trapped at a subsidiary level due to regulatory, legal or tax constraints. We periodically test the effectiveness of our funding plans for different Nomura-specific and market-wide events. We also have access to central banks including, but not exclusively, the BOJ, which provide financing against various types of securities. These operations are accessed in the normal course of business and are an important tool in mitigating contingent risk from market disruptions.

Table of Contents*Cash Flows*

Nomura's cash flows are primarily generated from operating activities undertaken in connection with our client flows and trading and from financing activities which are closely related to such activities. As a financial institution, growth in operations tends to result in cash outflows from operating activities as well as investing activities, as was generally the case for a number of years. For the six months ended September 30, 2014, we recorded net cash inflows from operating activities and investing activities as discussed in the comparative analysis mentioned below.

The following is the summary information on our consolidated cash flows for the six months ended September 30, 2013 and 2014:

	Billions of yen	
	Six months ended September 30	
	2013	2014
Net cash provided by operating activities	¥ 404.8	¥ 31.7
Net income	104.6	74.4
Trading assets and private equity investments	(803.5)	(775.7)
Trading liabilities	1,131.7	(395.7)
Securities purchased under agreements to resell, net of securities sold under agreements to repurchase	224.0	907.2
Securities borrowed, net of securities loaned	(232.4)	(34.8)
Other, net	(19.7)	256.3
Net cash provided by (used in) investing activities	(98.1)	23.6
Net cash provided by (used in) financing activities	169.0	(134.6)
Long-term borrowings, net	165.8	22.8
Short-term borrowings, net	59.6	(5.2)
Other, net	(56.4)	(152.2)
Effect of exchange rate changes on cash and cash equivalents	17.2	29.3
Net increase (decrease) in cash and cash equivalents	493.0	(50.0)
Cash and cash equivalents at beginning of year	805.1	1,489.8
Cash and cash equivalents at end of period	¥ 1,298.0	¥ 1,439.8

See the consolidated statements of cash flows in our interim consolidated financial statements for more detailed information.

For the six months ended September 30, 2014, our cash and cash equivalents decreased by ¥50.0 billion to ¥1,439.8 billion. Net cash of ¥134.6 billion was used in financing activities due to cash outflows of ¥1,188.5 billion by decrease in long-term borrowings, which is included in *Long-term borrowings, net*. As part of trading activities, while there were net cash outflows of ¥775.7 billion due to an increase in *Trading assets and Private equity investments*, these cash outflows were offset by net cash inflows of ¥907.2 billion from cash inflow due to an increase in *Securities purchased under agreements to resell, net of securities sold under agreements to repurchase*. As a result, net cash of ¥31.7 billion was provided by operating activities.

For the six months ended September 30, 2013, our cash and cash equivalents increased by ¥493.0 billion to ¥1,298.0 billion. Net cash of ¥169.0 billion was provided by financing activities due to cash inflows of ¥225.4 billion by net receipts of *Long-term borrowings* and *Short-term borrowings*. As part of trading activities, while there were net cash outflows of ¥803.5 billion from cash outflows due to an increase in *Trading assets and Private equity investments*, these cash outflows were offset by net cash inflows of ¥1,131.7 billion from cash inflow due to an increase in *Trading liabilities*. As a result, net cash of ¥404.8 billion was provided by operating activities.

Table of Contents*Balance Sheet and Financial Leverage*

Total assets as of September 30, 2014, were ¥43,802.1 billion, an increase of ¥281.8 billion compared with ¥43,520.3 billion as of March 31, 2014, reflecting increases in *Trading assets*. Total liabilities as of September 30, 2014, were ¥41,186.9 billion, an increase of ¥219.8 billion compared with ¥40,967.1 billion as of March 31, 2014, reflecting increases in *Securities loaned*. NHI shareholders' equity as of September 30, 2014, was ¥2,561.1 billion, an increase of ¥47.4 billion compared with ¥2,513.7 billion as of March 31, 2014.

We seek to maintain sufficient capital at all times to withstand losses due to extreme market movements. The EMB is responsible for implementing and enforcing capital policies. This includes the determination of our balance sheet size and required capital levels. We continuously review our equity capital base to ensure that it can support the economic risk inherent in our business. There are also regulatory requirements for minimum capital of entities that operate in regulated securities or banking businesses.

As leverage ratios are commonly used by other financial institutions similar to us, we voluntarily provide a Leverage ratio and Adjusted leverage ratio primarily for benchmarking purposes so that users of our annual report can compare our leverage against other financial institutions. Adjusted leverage ratio is a non-GAAP financial measure that Nomura considers to be a useful supplemental measure of leverage. There are currently no regulatory or statutory reporting requirements which require us to disclose leverage ratios.

The following table sets forth total NHI shareholders' equity, total assets, adjusted assets and leverage ratios:

	Billions of yen, except ratios	
	March 31, 2014	September 30, 2014
NHI shareholders' equity	¥ 2,513.7	¥ 2,561.1
Total assets	43,520.3	43,802.1
Adjusted assets ⁽¹⁾	26,173.3	27,421.4
Leverage ratio ⁽²⁾	17.3x	17.1x
Adjusted leverage ratio ⁽³⁾	10.4x	10.7x

- (1) Represents total assets less *Securities purchased under agreements to resell* and *Securities borrowed*. Adjusted assets is a non-GAAP financial measure and is calculated as follows:

	Billions of yen	
	March 31, 2014	September 30, 2014
Total assets	¥ 43,520.3	¥ 43,802.1
Less:		
Securities purchased under agreements to resell	9,617.7	8,299.8
Securities borrowed	7,729.3	8,080.9
Adjusted assets	¥ 26,173.3	¥ 27,421.4

- (2) Equals total assets divided by NHI shareholders' equity.

- (3) Equals adjusted assets divided by NHI shareholders' equity.

Total assets increased by 0.6% reflecting primarily increases in *Trading assets*. NHI shareholders' equity increased by 1.9%. Our leverage ratio went down from 17.3 times as of March 31, 2014 to 17.1 times as of September 30, 2014.

Adjusted assets increased due primarily to the increase in *Trading assets*. As a result, our adjusted leverage ratio went up from 10.4 times as of March 31, 2014 to 10.7 times as of September 30, 2014.

Table of Contents**Capital Management***Capital Management Policy*

We seek to enhance shareholder value and to capture growing business opportunities by maintaining sufficient levels of capital. We review levels of capital as appropriate, taking into consideration the economic risks inherent to operating our businesses, the regulatory requirements, and maintaining our ratings necessary to operate businesses globally.

Dividends

Nomura believes that pursuing a sustainable increase in shareholder value and paying dividends are essential to generating returns to our shareholders. Nomura will strive to pay stable dividends using a consolidated payout ratio of 30 percent as a key indicator.

Dividend payments will be determined taking into account a comprehensive range of factors such as the tightening of Basel regulations and other changes to the regulatory environment, as well as the Company's consolidated financial performance.

Nomura paid dividend of ¥6.0 per share for the first half in line with its dividend policy for the fiscal year ended March 31, 2015.

With respect to the retained earnings, in order to implement measures to adapt to regulatory changes and to increase shareholder value, we seek to efficiently invest in business areas where high profitability and growth may reasonably be expected, including the development and expansion of infrastructure.

The following table sets forth the amounts of dividends per share paid by us in respect of the periods indicated:

Fiscal year ended or ending March 31,	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
2010	¥	¥	4.00	¥	¥ 8.00
2011			4.00		8.00
2012			4.00	2.00	6.00
2013			2.00	6.00	8.00
2014			8.00	9.00	17.00
2015			6.00		

Stock Repurchases

We consider repurchase of treasury stock as an option in our financial strategy to respond quickly to changes in the business environment and to increase shareholder value. We make announcements immediately after any decision to set up a share buyback program and conduct such programs in accordance with internal guidelines.

On October 28, 2014, we announced a resolution of the Board of Directors to establish a share buyback program in accordance with Article 459-1 of the Companies Act of Japan. The period of repurchase under the program was from November 13, 2014 to January 16, 2015, and we were authorized to purchase up to 40,000,000 shares of our common stock or to a maximum of ¥28 billion.

Table of Contents**Consolidated Regulatory Capital Requirements**

The FSA established the Guideline for Financial Conglomerates Supervision (Financial Conglomerates Guideline) in June 2005 and set out the rules on consolidated regulatory capital. We started monitoring our consolidated capital adequacy ratio in accordance with the Financial Conglomerates Guideline from April 2005.

The Company has been assigned as a Final Designated Parent Company who must calculate a consolidated capital adequacy ratio according to the Capital Adequacy Notice on Final Designated Parent Company in April 2011. Since then, we have been calculating our consolidated capital adequacy ratio according to the Capital Adequacy Notice on Final Designated Parent Company. Note that the Capital Adequacy Notice on Final Designated Parent Company has been revised to be in line with Basel 2.5 and Basel III, and we have calculated a Basel III-based consolidated capital adequacy ratio from the end of March 2013. Basel 2.5 includes significant change in calculation method of market risk and Basel III includes redefinition of capital items for the purpose of requiring higher quality of capital and expansion of the scope of credit risk-weighted assets calculation.

In accordance with Article 2 of the Capital Adequacy Notice on Final Designated Parent Company, our consolidated capital adequacy ratio is currently calculated based on the amounts of common equity Tier 1 capital, Tier 1 capital (sum of common equity Tier 1 capital and additional Tier 1 capital), total capital (sum of Tier 1 capital and Tier 2 capital), credit risk-weighted assets, market risk and operational risk. As of September 30, 2014, our common equity Tier 1 capital ratio (common equity Tier 1 capital divided by risk-weighted assets) is 12.7%, Tier 1 capital ratio (Tier 1 capital divided by risk-weighted assets) is 12.7% and consolidated capital adequacy ratio (total capital divided by risk-weighted assets) is 14.7% and we were in compliance with the requirement for each ratio set out in the Capital Adequacy Notice on Final Designated Parent Company (required level as of September 30, 2014 is 4.0% for common equity Tier 1 capital ratio, 5.5% for Tier 1 capital ratio and 8.0% for consolidated capital adequacy ratio).

The following table presents the Company's consolidated capital adequacy ratio as of March 31, 2014 and September 30, 2014.

	Billions of yen, except ratios	
	March 31, 2014	September 30, 2014
Common equity Tier 1 capital	¥ 2,314.2	¥ 2,351.9
Tier 1 capital	2,314.2	2,351.9
Total capital	2,715.7	2,723.4
Risk-Weighted Assets		
Credit risk-weighted assets	8,034.8	8,209.4
Market risk equivalent assets	6,999.7	7,656.6
Operational risk equivalent assets	2,391.5	2,567.8
Total risk-weighted assets	¥ 17,425.9	¥ 18,433.8

Consolidated Capital Adequacy Ratios

Common equity Tier 1 capital ratio	13.2%	12.7%
Tier 1 capital ratio	13.2%	12.7%
Consolidated capital adequacy ratio	15.5%	14.7%

Common equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital are calculated by deducting regulatory adjustment item from basic item for each capital class, respectively. If the amount of basic item is less than the amount of adjustment item, we need to deduct deficit amount from upper capital class. Each capital item and regulatory adjustment is defined in the Capital Adequacy Notice on Final Designated Parent Company and these new definitions of capital will come into effect gradually by transitional measures.

As of September 30, 2014, capital items for our common equity Tier 1 capital mainly consists of shareholder's equity relating to the common stock and all or part of subordinated debt which satisfies the requirements under Capital Adequacy Notice on Final Designated Parent Company (such as maturity) is included into capital items for Tier 2 capital. We have not issued any capital instruments which can be included into additional Tier 1 capital.

Regulatory adjustment for our common equity Tier 1 capital mainly consists of a part of intangible assets and expected losses and regulatory adjustment for our Tier 2 capital includes investments in additional Tier 1 capital instruments of other financial institutions and a part of expected losses (Note both items are transitional treatment.). Regulatory adjustment for our additional Tier 1 capital will be included into

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regulatory adjustment for common equity Tier 1 capital, as we don't have any outstanding additional Tier 1 capital instruments.

Market risk equivalent assets are calculated by using The Internal Models Approach for market risk. Since the end of December, 2011, we have been required to calculate market risk equivalent assets under the Basel 2.5 rule, which is significantly larger than market risk equivalent assets under the Basel II rule. Also, since the end of March 2013, a part of securitization products is added to the scope of market risk calculation.

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On the end of March, 2011, we have been calculating credit risk-weighted assets and operational risk equivalent assets by using the foundation Internal Ratings-Based Approach and The Standardized Approach, respectively, with the approval of the FSA. Furthermore, since the end of December, 2012, we started using the Internal Model Method for the exposure calculation of majority of derivative and repurchase transactions instead of the Current Exposure Method or the Comprehensive Method upon approval from the FSA. Since the end of March 2013, the scope of credit risk-weighted assets calculation has been widened following the implementation of Basel III (e.g., credit risk for credit value adjustment (CVA) on derivative exposures, credit risk for central counterparties (CCPs) exposures, etc.).

We provide consolidated capital adequacy ratios not only to demonstrate that we are in compliance with the requirements set out in the Capital Adequacy Notice on Final Designated Parent Company but also for benchmarking purposes so that users of our report can compare our capital position against those of other financial groups to which Basel III is applied. Management receives and reviews these capital ratios on a regular basis.

The Basel Committee has issued a series of announcements regarding a Basel III program designed to strengthen the regulatory capital framework in light of weaknesses revealed by the financial crises. The following is a summary of the proposals which are most relevant to us.

On July 13, 2009, the Basel Committee announced its approval of a package of measures designed to strengthen its rules governing trading book capital and to enhance the three pillars of the Basel II framework, which was called Basel 2.5 . This announcement stated that the Basel Committee's trading book rules, effective at the end of 2011, would introduce higher capital requirements to capture the credit risk of complex trading activities, which became effective as the end of 2011. Such trading book rules also included a stressed VaR requirement.

On December 16, 2010, in an effort to promote a more resilient banking sector, the Basel Committee issued Basel III, that is, International framework for liquidity risk measurement, standards and monitoring and A global regulatory framework for more resilient banks and banking systems . The proposals include raising the quality, consistency and transparency of the capital base; strengthening the risk coverage of the capital framework such as the implementation of a CVA charge for over-the-counter derivative trades; introducing a leverage ratio requirement as a supplemental measure to the risk-based framework; and introducing a series of measures to address concerns over the procyclicality of the current framework. The proposals also introduce a minimum liquidity standard including a 30-day liquidity coverage ratio as well as a longer-term structural liquidity ratio. Additional capital, liquidity or other supervisory measures to reduce the externalities created by systemically important institutions are also under review. These standards were implemented from 2013, which includes transitional treatment (i.e. they are phased in gradually from 2013). In addition, after two rounds of public consultation and discussions with the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO), the Basel Committee has issued interim rules for the capitalization of bank exposures to CCPs on July 25, 2012, which were intended to come into effect as of January 2013 as part of Basel III.

At the G-20 summit in November 2011, the Financial Stability Board (FSB) and the Basel Committee announced the list of global systemically important banks (G-SIBs) and the additional requirements to the G-SIBs including the recovery and resolution plan. The FSB also announced the group of G-SIBs will be updated annually and published by the FSB each November. In November 2013, the FSB and the Basel Committee have updated the list of G-SIBs. We were not designated as a G-SIBs in November 2012 and November 2013. On the other hand, the FSB and the Basel Committee were asked to work on extending the framework for G-SIBs to domestic systemically important financial institutions (D-SIBs) and the Basel Committee developed and published a set of principles on the assessment methodology and the higher loss absorbency requirement for D-SIBs. In addition to the above, the FSB and the IOSCO have published assessment methodologies for identifying Non-bank Non-insurer Global Systemically Important Financial Institutions (NBNI G-SIFIs), for public consultation.

Following the change in international regulatory environment, the FSA introduced rules and notices such as the Capital Adequacy Notice on Final Designated Parent Company on consolidated regulation and supervision of securities companies on a consolidated basis on April 1, 2011 to improve the stability and transparency of Japan's financial system and ensure the protection of investors. It is expected that such regulation and notice will be revised further to be in line with a series of rules and standards proposed by the Basel Committee, FSB or IOSCO.

Table of Contents**Credit Ratings**

The cost and availability of unsecured funding are generally dependent on credit ratings. Our long-term and short-term debt is rated by several recognized credit rating agencies. We believe that our credit ratings include the credit ratings agencies' assessment of the general operating environment, our positions in the markets in which we operate, reputation, earnings structure, trend and volatility of our earnings, risk management framework, liquidity and capital management. An adverse change in any of these factors could result in a downgrade of our credit ratings, and that could, in turn, increase our borrowing costs and limit our access to the capital markets or require us to post additional collateral and permit counterparties to terminate transactions pursuant to certain contractual obligations. In addition, our credit ratings can have a significant impact on certain of our trading revenues, particularly in those businesses where longer term counterparty performance is critical, such as OTC derivative transactions.

On October 9, 2014, Moody's upgraded the long-term issuer and senior unsecured debt ratings of the Company to Baa1 from Baa3. Moody's also upgraded the long-term issuer rating of Nomura Securities Co., Ltd. (NSC) to A3 from Baa2.

As of November 30, 2014, the credit ratings of the Company and NSC were as follows:

Nomura Holdings, Inc.	Short-term Debt	Long-term Debt
Standard & Poor's	A-2	BBB+
Moody's Investors Service		Baa1
Fitch Ratings	F1	A-
Rating and Investment Information, Inc.	a-1	A+
Japan Credit Rating Agency, Ltd.		AA-

Nomura Securities Co., Ltd.	Short-term Debt	Long-term Debt
Standard & Poor's	A-2	A-
Moody's Investors Service	P-2	A3
Fitch Ratings	F1	A-
Rating and Investment Information, Inc.	a-1	A+
Japan Credit Rating Agency, Ltd.		AA-

Both Rating and Investment Information, Inc. and Japan Credit Rating Agency, Ltd. are credit rating agencies nationally recognized in Japan. We rely on, or utilize, credit ratings on our long-term and short-term debt provided by these Japanese credit rating agencies, as well as Standard & Poor's and Moody's Investors Service, for unsecured funding and other financing purposes and also for our trading and other business activities.

There has been no change to the ratings in the above table since the date indicated.

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Off-Balance Sheet Arrangements

Off-Balance Sheet Entities

In the normal course of business, we engage in a variety of off-balance sheet arrangements with off-balance sheet entities which may have an impact on Nomura's future financial position and performance.

Off-balance sheet arrangements with off-balance sheet entities include the following where Nomura has:

an obligation under a guarantee contract;

a retained or contingent interest in assets transferred to an off-balance sheet entity or similar arrangement that serves to provide credit, liquidity or market risk support to such entity;

any obligation, including a contingent obligation, under a contract that would be accounted for as a derivative instrument; or

any obligation, including contingent obligation, arising out of a variable interest in an off-balance sheet entity that is held by, and material to us, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with us.

Off-balance sheet entities may take the form of a corporation, partnership, fund, trust or other legal vehicle which is designed to fulfill a limited, specific purpose by its sponsor. We both create or sponsor these entities and also enter into arrangements with entities created or sponsored by others.

Our involvement with these entities includes structuring, underwriting, distributing and selling debt instruments and beneficial interests issued by these entities, subject to prevailing market conditions. In connection with our securitization and equity derivative activities, we also act as a transferor of financial assets to these entities, as well as, underwriter, distributor and seller of asset-repackaged financial instruments issued by these entities. We retain, purchase and sell variable interests in SPEs in connection with our market-making, investing and structuring activities. Our other types of off-balance sheet arrangements include guarantee agreements and derivative contracts. Significant involvement is assessed based on all of our arrangements with these entities, even if the probability of loss, as assessed at the balance sheet date, is remote.

For further information about transactions with VIEs, see Note 6 *Securitizations and Variable Interest Entities* in our interim consolidated financial statements.

Contractual Obligations

Since March 31, 2014, there have been no other material changes outside our ordinary course of business in connection with our standby letters of credit and other guarantees, long-term borrowings and contractual interest payments, operating lease commitments, capital lease commitments, purchase obligations, commitments to extend credit, commitments to invest in partnerships, commitments to purchase aircraft and commitments to purchase real estate.

For further details on our commitments, contingencies and guarantees, see Note 15 *Commitments, contingencies and guarantees* in our interim consolidated financial statements.

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Quantitative and Qualitative Disclosures about Market Risk

Risk Management

Nomura defines risks as (i) the potential erosion of Nomura's capital base due to unexpected losses arising from risks to which its business operations are exposed, such as market risk, credit risk, operational risk and model risk, (ii) liquidity risk, the potential lack of access to funds or higher cost of funding than normal levels due to a deterioration in Nomura's creditworthiness or deterioration in market conditions, and (iii) business risk, the potential failure of revenues to cover costs due to a deterioration in the earnings environment or a deterioration in the efficiency or effectiveness of its business operations.

A fundamental principle established by Nomura is that all employees shall regard themselves as principals of risk management and appropriately manage these risks. Nomura seeks to promote a culture of proactive risk management throughout all levels of the organization and to limit risks to the confines of its risk appetite. The risk management framework that Nomura uses to manage these risks consists of its risk appetite, risk management governance and oversight, the management of financial resources, the management of all risk classes, and processes to measure and control risks. Each of these key components is explained in further detail below.

Risk Appetite

Nomura's risk appetite defines the type and quantum of risk that Nomura is willing to accept in pursuit of its business objectives. The Risk Management Division and the Finance Division are jointly responsible for developing and proposing risk appetite to the Group Integrated Risk Management Committee (GIRMC) for their input and final approval.

Nomura's risk appetite includes both quantitative measures and qualitative statements of appetite, covering Nomura's risk classes. It provides an aggregated view of risk and is subject to regular monitoring and breach escalation as appropriate by the owner of the relevant risk appetite statement.

Nomura's risk appetite is required to be reviewed annually by the GIRMC but may be reviewed on an ad hoc basis, and must specifically be reviewed following any significant changes in Nomura's strategy. Risk appetite underpins all additional aspects of Nomura's risk management framework.

Risk Management Governance and Oversight

Committee Governance

Nomura has established a committee structure to facilitate effective business operations and management of Nomura's risks. The formal governance structure for risk management within Nomura is as follows:

Board of Directors (BoD)

The BoD determines the policy for the execution of the business of Nomura and other matters prescribed in laws and regulations, supervises Directors and Executive Officers' execution of their duties and has authority to adopt, alter or abolish the regulations of the Executive Management Board.

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Executive Management Board (EMB)

The EMB deliberates on and determines management strategy, the allocation of management resources and important management matters of Nomura, and seeks to increase shareholder value by promoting effective use of management resources and unified decision-making with regard to the execution of business. The EMB delegates responsibility for deliberation of matters concerning risk management to the GIRMC. Key responsibilities of the EMB include the following:

Resource Allocation At the beginning of each financial year, the EMB determines the allocation of management resources and financial resources such as economic capital and unsecured funding to business units and establishes usage limits for these resources;

Business Plan At the beginning of each financial year, the EMB approves the business plan and budget of Nomura. Introduction of significant new businesses, changes to business plans, the budget and the allocation of management resources during the year are also approved by the EMB; and

Reporting The EMB reports the status of its deliberations to the BoD.

Group Integrated Risk Management Committee (GIRMC)

Upon delegation from the EMB, the GIRMC deliberates on or determines important matters concerning integrated risk management of Nomura to assure the sound and effective management of its businesses. The GIRMC establishes Nomura's risk appetite and a framework of integrated risk management consistent with Nomura's risk appetite. The GIRMC supervises Nomura's risk management by establishing and operating its risk management framework. The GIRMC reports the status of key risk management issues and any other matters deemed necessary by the committee chairman to the BoD and the EMB.

In addition, the GIRMC, upon delegation from the EMB, has established the Risk Management Policy, describing Nomura's overall risk management framework including the fundamental risk management principles followed by Nomura.

Global Risk Management Committee (GRMC)

Upon delegation from the GIRMC, the GRMC deliberates on or determines, based on strategic risk allocation and risk appetite determined by the GIRMC, important matters concerning market, credit or reputational risk management of Nomura in order to assure the sound and effective management of Nomura's businesses. The GRMC reports to the GIRMC the status of discussions at its meetings and any other matters as deemed necessary by the committee chairman.

Asset Liability Committee (ALCO)

Upon delegation from the GIRMC, the ALCO deliberates on, based on Nomura's risk appetite determined by the GIRMC, balance sheet management, financial resource allocation, liquidity management and related matters. The ALCO reports to the GIRMC the status of discussions at its meetings and any other matters as deemed necessary by the committee chairman.

Global Risk Analytics Committee (GRAC) and Model Risk Analytics Committee (MRAC)

Upon delegation from the GRMC, the GRAC and the MRAC deliberate on or determine matters concerning the development, management and strategy of risk models and valuation models, respectively. The committees' primary responsibility is to govern and provide oversight of model management, including the approval of new models and significant model changes. Both committees report all significant matters and material decisions taken to the GRMC, on a regular basis.

GRMC Transaction Committee

Upon delegation from the GRMC, the GRMC Transaction Committee deliberates on or approves individual transactions in line with Nomura's risk appetite in order to assure the sound and effective management of Nomura's businesses.

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Collateral Steering Committee (CSC)

Upon delegation from the GRMC, the CSC deliberates on or determines Nomura's collateral risk management, including concentrations, liquidity, collateral re-use, limits and stress tests, provides direction on Nomura's collateral strategy and ensures compliance with regulatory collateral requirements.

Chief Risk Officer (CRO)

The CRO is responsible for setting the overall strategy and direction of the Risk Management Division. The CRO is responsible for supervising the Risk Management Division and maintaining the effectiveness of the risk management framework independently from the business units within Nomura. The CRO regularly reports on the status of Nomura's risk management to the GIRMC, and reports to and seeks the approval of the GIRMC on measures required for risk management.

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Chief Financial Officer (CFO)

The CFO is responsible for overall financial strategy of Nomura, and has operational authority and responsibility over Nomura's liquidity management based on decisions made by the EMB.

Risk Management Division

The Risk Management Division comprises various departments or units in charge of risk management established independently from Nomura's business units. The Risk Management Division is responsible for establishing and operating risk management processes, establishing and enforcing risk management policies and regulations, verifying the effectiveness of risk management methods, gathering reports from Nomura Group entities, reporting to Executive Officers/Senior Managing Directors and the GIRMC and others, as well as reporting to regulatory bodies and handling regulatory applications concerning risk management methods and other items as necessary. Important risk management issues are closely communicated between members of the Risk Management departments and the CRO. The CRO and/or Deputy CRO regularly attend the EMB and GIRMC meetings to report specific risk issues.

Risk Policy Framework

Policies and procedures are essential tools of governance used by the Risk Management Division. They define principles, rules and standards, and the specific processes that must be adhered to in order to effectively manage risk at Nomura. The Risk Management Division has established a risk policy framework to promote appropriate standards and consistency for risk policies and procedures and to articulate the principles and procedures conducive to effective risk management. All risk management policies and procedures are developed in line with this policy framework and a defined process is followed for any exceptions.

Monitoring, Reporting and Data Integrity

Development, consolidation, monitoring and reporting of risk management information (risk MI) are fundamental to the appropriate management of risk. The aim of all risk MI is to provide a basis for sound decision-making, action and escalation as required. The Risk Management Division and the Finance Division are responsible for producing regular risk MI, which reflects the position of Nomura relative to stated risk appetite. Risk MI includes information from across the risk classes defined in the risk management framework and reflect the use of the various risk tools used to identify and assess those risks. The Risk Management Division is responsible for implementing appropriate controls over data integrity for risk MI.

Management of Financial Resources

Nomura has established a framework for management of financial resources in order to adequately manage utilization of these resources. The EMB allocates financial resources to business units at the beginning of each financial year. These allocations are used to set revenue forecasts for each business units. Key components are set out below:

Risk-weighted Assets

The EMB determines a minimum target Tier 1 capital ratio on an annual basis. A key component used in the calculation of the ratio is consolidated risk-weighted assets which are allocated by the EMB to each division and to additional lower levels of the organization. See Item 4.B. Business Overview Regulatory Capital Rules of our annual report on Form 20-F for the fiscal year ended March 31, 2014 and Consolidated Regulatory Capital Requirements of this report for further information on our consolidated capital adequacy ratios and risk-weighted assets.

Economic Capital

Nomura's internal measure of the capital required to support its business is the Nomura Capital Allocation Target (NCAT), which is measured as the amount of capital required to absorb unexpected losses over a one-year time horizon under a severely adverse scenario. For quantification purposes, a severely adverse scenario is defined as the unexpected loss computed by risk models at the 99.95th percentile. NCAT consists of i) portfolio NCAT, which captures the risks directly impacting the value of specific positions such as market risk, credit risk, asset liquidity risk and other risks such as event risk to account for portfolio risks not easily covered in a historically calibrated model, and ii) non-portfolio NCAT, which captures the risks not directly affecting the value of specific positions, such as operational risk and business risk. Nomura's NCAT limit is initially set by the EMB, and the EMB subsequently allocates it to each business division and additional lower levels of the organization.

Available Funds

The CFO decides the maximum amount of available funds, provided without posting of any collateral, for allocation within Nomura and the EMB approves the allocation of the funds to each business division. Global Treasury monitors the usage by businesses and reports to the EMB.

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Classification and Definition of Risk

Nomura classifies and defines risks as follows and has established departments or units to manage each risk type.

Risk Category	Definition
Market risk	Risk of loss arising from fluctuations in the value of financial assets and liabilities (including off-balance sheet items) due to fluctuations in market risk factors (interest rates, foreign exchange rates, prices of securities and others).
Credit risk	Risk of loss arising from an obligor or counterparty's default, insolvency or administrative proceeding which results in the obligor's failure to meet its contractual obligations in accordance with agreed terms. This includes both on and off-balance sheet exposures. It is also the risk of loss arising through a credit valuation adjustment (CVA) associated with deterioration in the creditworthiness of a counterparty.
Operational risk	Risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It excludes strategic risk (the risk of loss as a result of poor strategic business decisions), but includes the risk of breach of legal and regulatory requirements, and the risk of damage to Nomura's reputation if caused by an operational risk.
Model risk	Risk arising from model errors or incorrect or inappropriate model application, which can lead to financial loss, poor business and strategic decision-making, restatement of external and internal reports, regulatory penalties and damage to Nomura's reputation.
Funding and Liquidity risk	Risk of loss arising from difficulty in securing necessary funding or from a significantly higher cost of funding than normal levels due to a deterioration in Nomura's creditworthiness or a deterioration in market conditions.
Business risk	Risk of failure of revenues to cover costs due to a deterioration in the earnings environment or a deterioration in the efficiency or effectiveness of Nomura's business operations. Managing business risk is the responsibility of Nomura's Executive Managing Directors and Senior Managing Directors.

Market Risk Management

Market risk is the risk of loss arising from fluctuations in the value of financial assets and liabilities (including off-balance sheet items) due to fluctuations in market risk factors (interest rates, foreign exchange rates, prices of securities and others).

Market Risk Management Process

Effective management of market risk requires the ability to analyze a complex and constantly changing global market environment, identify problematic trends and ensure that appropriate action is taken in a timely manner.

Nomura uses a variety of complementary tools to measure, model and aggregate market risk. Nomura's principal statistical measurement tool to assess and monitor market risk on an ongoing basis is Value at Risk (VaR). Limits on VaR are set in line with Nomura's risk appetite as expressed through economic capital. In addition to VaR, Nomura uses sensitivity analysis and stress testing to measure and analyze its market risk. Sensitivities are measures used to show the potential changes to a portfolio due to standard moves in market risk factors. They are specific to each asset class and cannot usually be aggregated across risk factors. Stress testing enables the analysis of portfolio risks or tail risks, including non-linear behaviors and can be aggregated across risk factors at any level of the group hierarchy, from firmwide level to business division, units or desk levels. Market risk is monitored against a set of approved limits, with daily reports and other management information provided to the business units and senior management.

Value at Risk

VaR is a measure of the potential loss in the value of Nomura's trading positions due to adverse movements in markets over a defined time horizon with a specified confidence level. Market risks that are incorporated in the VaR model include equity prices, interest rates, credit, foreign exchange rates, and commodities with associated volatilities and correlations.

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VaR Methodology Assumptions

Nomura uses a single VaR model which has been implemented globally in order to determine the total trading VaR for Nomura. Nomura's VaR methodology uses historical simulation to estimate potential profit or loss. Historical market moves are repeatedly applied to current exposure, forming a distribution of simulated portfolio returns. From this distribution, potential losses can be estimated at required confidence levels or probabilities.

Nomura uses the same VaR model for both internal risk management purposes and for regulatory reporting of consolidated VaR to the FSA. For internal risk management purposes, VaR is calculated across Nomura at a 99% confidence level and using a 1-day time horizon. For regulatory reporting purposes, Nomura uses the same confidence level but a 10-day time horizon, calculated using actual 10-day historical market moves.

The VaR model uses a default historical time window of two years (520 business days). Nomura uses a weighted VaR, whereby for the calculation of VaR, the probability weight assigned to each measure of estimated profit or loss in the historical simulation scenarios depends on when it occurred. The older the observation, the lower the weight.

In addition, Nomura calculates other measures used to complement VaR under Basel 2.5 regulations. One of these, Stressed-VaR (SVaR) is calibrated using a one-year window during a period of financial stress. The SVaR calculation uses one year of market data from that period of financial stress. The one-year window is calibrated to be the one with the largest SVaR, given Nomura's current portfolio. The historical data used for SVaR is not weighted. All VaR and SVaR numbers are calculated within the same system using equivalent model assumptions.

Nomura's VaR model uses time series for each individual underlying, whenever available. Whenever a time series cannot be found for a specific underlying, the VaR model will follow a proxy logic to map the exposure to an appropriate time series (for example, this would be the case for an option on a recently issued stock). The level of proxying taking place in the VaR model is carefully monitored through internal risk management processes and there is a continual effort to source new time series to use in the VaR calculation.

VaR Backtesting

The performance of Nomura's VaR model is constantly monitored to ensure that it remains fit for purpose. The main approach for validating VaR is to compare actual 1-day trading losses with the corresponding VaR estimate. Using a 99% VaR measure, 2 or 3 exceptions (i.e., loss is larger than VaR) may be expected to occur each year. Nomura's VaR model is backtested at a Nomura group level as well as at a number of lower levels, and backtesting results are reviewed on a monthly basis by Nomura's Risk Management Division.

1-day trading losses did not exceed the 99% VaR estimate at a Nomura group level for the six month ended September 30, 2014.

Limitations and Advantages of VaR

The main advantage of VaR as a risk measure is that it is able to aggregate risk from different asset classes in contrast with other risk measures sensitivities that cannot be easily aggregated directly. The risk from different divisions of Nomura can therefore easily be compared and aggregated using VaR.

As a risk measure, however, VaR has certain limitations. One of the main disadvantages with VaR is that it is a backward-looking risk measure. Using historical market moves to estimate future profits or losses assumes that only events that have actually happened in the past are relevant to analyze the risk of a portfolio.

In addition, VaR only gives an estimate of the loss at a stated 99% confidence level (i.e., in one out of 100 days the loss will be greater than 1-day VaR), but not what the magnitude of loss could be whenever the loss does exceed VaR.

VaR as a risk measure is most appropriate for liquid markets and may understate the financial impact of severe events for which there is no historical precedent or where market liquidity may not be reliable. In particular, historical correlations can break down in extreme markets leading to unexpected relative market moves. This may make positions that offset each other in VaR modeling move in the same direction thus increasing losses.

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Given the limitations of the VaR model, Nomura uses VaR only as one component of a diverse market risk management process. Other metrics to supplement VaR include stress testing and sensitivity analysis.

VaR metrics

The following graph shows the daily VaR over the last six quarters for substantially all of Nomura's trading positions:

The following tables show the VaR as of each of the dates indicated for substantially all of Nomura's trading positions:

	Billions of yen		
	Mar. 29, 2013	Mar. 31, 2014	Sep. 30, 2014
Equity	¥ 1.26	¥ 1.28	¥ 1.50
Interest rate	5.00	3.95	4.25
Foreign exchange	1.87	2.79	2.70
Subtotal	8.14	8.02	8.45
Less: Diversification Benefit	(3.05)	(2.86)	(1.62)
VaR	¥ 5.09	¥ 5.16	¥ 6.83

	Billions of yen		
	For the twelve months ended Mar. 29, 2013	Mar. 31, 2014	For the six months ended Sep. 30, 2014
Maximum daily VaR ⁽¹⁾	¥ 8.66	¥ 9.90	¥ 9.84
Average daily VaR ⁽¹⁾	6.11	6.67	6.92
Minimum daily VaR ⁽¹⁾	4.33	4.45	4.47

(1) Represents the maximum, average and minimum VaR based on all daily calculations for the twelve months ended March 29, 2013 and March 31, 2014, and for the six months ended September 30, 2014.

Total VaR increased to ¥6.83 billion as of September 30, 2014 from ¥5.16 billion as of March 31, 2014. VaR relating to interest rate risk increased to ¥4.25 billion as of September 30, 2014, compared to ¥3.95 billion as of March 31, 2014. VaR relating to equity risk increased to ¥1.50 billion as of September 30, 2014, compared to ¥1.28 billion as of March 31, 2014. VaR relating to foreign exchange risk remained relatively unchanged at ¥2.70 billion as of September 30, 2014, compared to ¥2.79 billion as of March 31, 2014.

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Total VaR remained relatively unchanged at ¥5.16 billion as of March 31, 2014 compared to total VaR as of March 29, 2013. VaR relating to interest rate risk decreased to ¥3.95 billion as of March 31, 2014, compared to ¥5.00 billion as of March 29, 2013 due to lower outright interest risk being taken. VaR relating to foreign exchange risk increased to ¥2.79 billion as of March 31, 2014 from ¥1.87 billion as of March 29, 2013, driven by changes in the outright foreign exchange risk being taken. VaR relating to equity risk remained relatively unchanged at ¥1.28 billion as of March 31, 2014 compared to ¥1.26 billion as of March 29, 2013.

Stress Testing

Nomura conducts market risk stress testing since VaR and sensitivity analysis have limited ability to capture all portfolio risks or tail risks. Stress testing for market risk is conducted daily and weekly, using various scenarios based upon features of trading strategies. Nomura conducts stress testing not only at each desk level, but also at a Nomura group level with a set of common global scenarios in order to capture the impact of market fluctuations on the entire Nomura group.

Non-Trading Risk

A major market risk in Nomura's non-trading portfolio relates to equity investments held for operating purposes and on a long-term basis. This non-trading portfolio is exposed mainly to volatility in the Japanese stock market. One method that can estimate the market risk in this portfolio is to analyze market sensitivity based on changes in the TOPIX, which is a leading index of prices of stocks on the First Section of the Tokyo Stock Exchange.

Nomura uses regression analysis covering the previous 90 days which tracks and compares fluctuations in the TOPIX and the market value of Nomura's equity investments held for operating purposes. This analysis indicates that for each 10% change in the TOPIX, the market value of Nomura's operating equity investments held for operating purposes can be expected to change by ¥19,721 million at the end of March 2014 and ¥19,760 million at the end of September 2014. The TOPIX closed at 1,202.89 points at the end of March 2014 and at 1,326.29 points at the end of September 2014. This simulation analyzes data for the entire portfolio of equity investments held for operating purposes at Nomura and therefore actual results may differ from Nomura's expectations because of price fluctuations of individual equities.

Credit Risk Management

Credit risk is the risk of loss arising from an obligor or counterparty's default, insolvency or administrative proceeding which results in the obligor's failure to meet its contractual obligations in accordance with agreed terms. This includes both on and off-balance sheet exposures. It is also the risk of loss arising through a CVA associated with deterioration in the creditworthiness of a counterparty.

Nomura manages credit risk on a global basis and on an individual Nomura legal entity basis.

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Credit Risk Management Framework

The measurement, monitoring and management of credit risk at Nomura is governed by a set of global policies and procedures. Credit Risk Management (CRM), a global function within the Risk Management Division, is responsible for the implementation and maintenance of these policies and procedures. These policies are authorized by the GIRMC and/or Global Risk Strategic Committee (GRSC), prescribe the basic principles of credit risk management and set credit limits to counterparties that are formally approved by CRM personnel with the appropriate level of credit authority.

Credit risk is managed by CRM together with various global and regional risk committees. This ensures transparency of material credit risks and compliance with established credit limits, the approval of material extensions of credit and the escalation of risk concentrations to appropriate senior management.

Credit Risk Management Process

CRM operates as a credit risk control function within the Risk Management Division, reporting to the CRO. The process for managing credit risk at Nomura includes:

Evaluation of likelihood that a counterparty defaults on its payments and obligations;

Assignment of internal ratings to all active counterparties;

Approval of extensions of credit and establishment of credit limits;

Measurement, monitoring and management of Nomura's current and potential future credit exposures;

Setting credit terms in legal documentation including margin terms; and

Use of appropriate credit risk mitigants including netting, collateral and hedging.

The scope of credit risk management includes counterparty trading and various debt or equity instruments including loans, private equity investments, fund investments, investment securities and any other as deemed necessary from a credit risk management perspective. The evaluation of counterparties' creditworthiness involves a thorough due diligence and analysis of the business environments in which they operate, their competitive positions, management and financial strength and flexibility. Credit analysts also take into account the corporate structure and any explicit or implicit credit support. CRM evaluates credit risk not only by counterparty, but also by counterparty group.

Following the credit analysis, CRM estimates the probability of default of a given counterparty or obligor through an alphanumeric ratings scale similar to that used by rating agencies and a corresponding numeric scale. Credit analysts are responsible for assigning and maintaining the internal ratings, ensuring that each rating is reviewed and approved at least annually.

Nomura's internal rating system employs a range of ratings models to ensure global consistency and accuracy. These models are developed and maintained by the Risk Methodology Group. Internal ratings represent a critical component of Nomura's approach to managing counterparty credit risk. They are used as key factors in:

Establishing the amount of counterparty credit risk that Nomura is willing to take to an individual counterparty or counterparty group (setting of credit limits);

Determining the level of delegated authority for setting credit limits (including tenor);

The frequency of credit reviews (renewal of credit limits);

Reporting counterparty credit risk to senior management within Nomura; and

Reporting counterparty credit risk to stakeholders outside of Nomura.

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The Credit Risk Control Unit (CRCU) is a function that is independent of CRM. It ensures that Nomura's internal rating system is properly reviewed and validated, reporting any breaks or issues to senior management for timely resolution. The unit is responsible for ensuring that the system remains accurate and predictive of risk and provides periodic reporting on the system to senior management.

Nomura has established an Internal Rating System to be a unified, exhaustive and objective framework to evaluate credit risk. Internal ratings are typically classified into obligor, facility and specialized lending ratings. Each rating classification serves to properly express the credit risk either in terms of probability of default, the level of potential recovery given its position in a capital structure or the probability of repayment under the terms of a specialized lending facility.

For regulatory capital calculation purposes, Nomura has been applying the Foundation Internal Rating Based Approach (FIRB) in calculating credit risk weighted assets since the end of March 2011. The Standardized Approach is applied to certain business units or asset types, which are considered immaterial to the calculation of credit risk-weighted assets.

Credit Limits and Risk Measures

Internal ratings form an integral part in the assignment of credit limits to counterparties. Nomura's credit limit framework is designed to ensure that Nomura takes appropriate credit risk in a manner that is consistent with its overall risk appetite. Global Credit policies define the delegated authority matrices that establish the maximum aggregated limit amounts and tenors that may be set for any single counterparty group based on their internal rating.

Nomura's main type of counterparty credit risk exposures arise from derivatives transactions or securities financing transactions. Credit exposures against counterparties are managed by means of setting credit limits based upon credit analysis of individual counterparty. Credit risk is managed daily through the monitoring of credit exposure against approved credit limits and the ongoing monitoring of the creditworthiness of Nomura's counterparties. Any change in circumstance that alters Nomura's risk appetite for any particular counterparty, sector, industry or country is reflected in changes to the internal rating and credit limit as appropriate.

Nomura's global credit risk management systems record all credit limits and capture credit exposures to the Nomura's counterparties allowing CRM to measure, monitor and manage utilization of credit limits, ensure appropriate reporting and escalation of any limit breaches.

For derivatives and securities financing transactions, Nomura measures credit risk primarily by way of a Monte Carlo-based simulation model that determines a Potential Exposure (PE) profile at a specified confidence level. The exposure calculation model used for counterparty credit risk management has also been used for the Internal Model Method (IMM) based exposure calculation for regulatory capital reporting purposes since the end of December 2012.

Loans and lending commitments are measured and monitored on both a funded and unfunded basis.

Wrong Way Risk

Wrong Way Risk (WWR) occurs when exposure to a counterparty is highly correlated with the deterioration of creditworthiness of that counterparty. Nomura has established global policies that govern the management of any WWR exposures. Stress testing is used to support the assessment of any WWR embedded within existing portfolios and adjustments are made to credit exposures and regulatory capital, as appropriate.

Stress Testing

Stress Testing is an integral part of Nomura's management of credit risk. Regular stress tests are used to support the assessment of credit risks by counterparties, sectors and regions. The stress tests include potential concentrations that are highlighted as a result of applying shocks to risk factors, probabilities of default or rating migrations.

Risk Mitigation

Nomura utilizes financial instruments, agreements and practices to assist in the management of credit risk. Nomura enters into legal agreements, such as the International Swap and Derivatives Association, Inc. (ISDA) agreements or equivalent (referred to as Master Netting Agreements), with many of its counterparties. Master Netting Agreements allow netting of receivables and payables and reduce losses potentially incurred as a result of a counterparty default. Further reduction in credit risk is achieved through entering into collateral agreements that allow Nomura to

obtain collateral from counterparties either upfront or contingent on exposure levels, changes in credit rating or other factors.

Table of Contents**Credit Risk to Counterparties in Derivatives Transaction**

The credit exposures arising from Nomura's trading-related derivatives as of March 31, 2014 are summarized in the table below, showing the positive fair value of derivative assets by counterparty credit rating and by remaining contractual maturity. The credit ratings are internally determined by Nomura's CRM.

Credit Rating	Billions of yen									
	Years to Maturity					Cross-Maturity Netting ⁽¹⁾	Total Fair Value (a)	Collateral obtained (b)	Replacement cost ⁽³⁾ (a)-(b)	
	Less than 1 year	1 to 3 years	3 to 5 years	5 to 7 years	More than 7 years					
AAA	¥ 13	¥ 32	¥ 69	¥ 23	¥ 66	¥ (57)	¥ 146	¥ 48	¥ 98	
AA	125	286	375	323	675	(1,342)	442	27	415	
A	512	452	548	397	949	(2,205)	653	142	511	
BBB	165	155	164	120	408	(629)	383	136	247	
BB and lower	21	41	38	76	299	(255)	220	279	0	
Other ⁽²⁾	28	16	31	11	77	(160)	3	23	0	
Sub-total	864	982	1,225	950	2,474	(4,648)	1,847	655	1,271	
Listed	525	160	30	1		(258)	458	1	457	
Total	¥ 1,389	¥ 1,142	¥ 1,255	¥ 951	¥ 2,474	¥ (4,906)	¥ 2,305	¥ 656	¥ 1,728	

(1) Represents netting of derivative liabilities against derivatives assets entered into with the same counterparty across different maturity bands. Derivative assets and derivative liabilities with the same counterparty in the same maturity band are net within the relevant maturity band. Cash collateral netting against net derivative assets in accordance with ASC 210-20 *Balance Sheet Offsetting* and ASC 815 *Derivatives and Hedging* is also included.

(2) Other comprises unrated counterparties and certain portfolio level valuation adjustments not allocated to specific counterparties

(3) Zero balances represent where total collateral received is in excess of the total fair value therefore Nomura's credit exposure is zero.

Exposure to certain European peripheral countries

Nomura manages country risk arising from inventory positions, trades with counterparties and any other businesses or products as deemed necessary. A number of European countries have experienced a higher degree of financial stress over the last few years. While this stress has the potential to impact both European and global markets, its impact has been more pronounced in several peripheral countries within the Euro-zone, such as Greece, Ireland, Italy, Portugal and Spain (the GIIPS countries) due, primarily, to their economic and fiscal weaknesses.

Financial, economic and structural issues in the GIIPS countries have adversely influenced major global financial markets. Further stress in these countries combined with a sustained market or economic downturn could adversely affect Nomura's business and could result in substantial future losses.

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The table below presents information regarding Nomura's exposure to the GIIPS countries as of September 30, 2014. Country risk exposure is reported based on the location of the counterparty, issuer or underlier's assets.

	Billions of yen September 30, 2014											
	Net inventory exposures			Net counterparty exposures								
	Debt securities	Equity securities	Equity and credit derivatives referencing GIIPS underlyings	Derivative contracts with GIIPS counterparties				Total gross funded exposure	Unfunded exposure	Total gross exposure	Less: Hedges	Total net exposure
				Loans	Securities financing	Swaps	Options					
¥	¥	¥	¥	¥	¥	¥	¥	¥	¥	¥	¥	
Greece	9	0	(6)	8	1	13	13	3	13	4	8	
Sovereign	(0)		(3)	6		3	3		3	4	(1)	
Non-sovereign ⁽⁹⁾	10	0	(3)	2	1	9	9		9	0	9	
Ireland	40	0	10	0	0	51	51	1	52	0	51	
Sovereign	13		6	0	0	20	20		20	0	19	
Non-sovereign ⁽⁹⁾	27	0	4	0	0	31	31	1	32	0	32	
Italy	99	13	(123)	40	3	33	33		33	31	2	
Sovereign	84		(146)	26		(36)	(36)		(36)	30	(66)	
Non-sovereign ⁽⁹⁾	15	13	23	14	3	69	69		69	1	68	
Portugal	27	(0)	(4)	0	0	22	22		22	1	21	
Sovereign	15		(9)			7	7		7	1	6	
Non-sovereign ⁽⁹⁾	11	(0)	5	0	0	15	15		15	1	15	
Spain	176	(2)	(136)	2	16	62	62		62	13	50	
Sovereign	78		(56)	7		29	29		29	8	20	
Non-sovereign ⁽⁹⁾	98	(2)	(80)	2	9	34	34		34	4	30	
Total	¥ 351	¥ 12	¥ (259)	¥ 2	¥ 64	¥ 181	¥ 181	¥ 1	¥ 182	¥ 50	¥ 132	
Sovereign	191		(208)	39	0	22	22		22	44	(22)	
Non-sovereign ⁽⁹⁾	161	12	(51)	2	25	159	159	1	160	6	154	

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- (1) Fair value amounts of long and short debt securities by GIIPS issuers. No GIIPS collateral has been used in repurchase-to-maturity transactions outstanding as of September 30, 2014.
- (2) Fair value amounts of long and short equity securities by GIIPS issuers.
- (3) Net derivatives entered into for market-making and trading purposes which reference GIIPS underlyings and includes both single-name credit default swaps (CDS) and other credit derivatives referencing baskets of reference assets, indices or other multiple underlyings. Amounts disclosed are calculated based on notional amounts of the derivatives assuming zero recovery as adjusted for fair value movements.

Where derivative contracts cover multiple underlyings, including one or more GIIPS countries or both sovereign and non-sovereign underlyings in these countries, the relevant derivatives are disaggregated into their constituent single names for reporting in the table. Exposure for each single name is calculated as the change in mark to market of the product, based on an internally developed model, given the instantaneous default of the relevant reference credit and assuming zero recovery. No specific assumptions are made regarding the order of defaults or collateral coverage.

- (4) Fair value amounts of loans to GIIPS counterparties.
- (5) Derivatives with GIIPS counterparties which are shown net by counterparty and after deduction of cash collateral received of ¥455.8 billion.
- (6) Fair value amounts of reverse repurchase agreements, repurchase agreements, securities borrowing and lending transactions, which are shown net by counterparty and after deduction of securities collateral and cash margin received of ¥424.9 billion.
- (7) Notional amount of unfunded loan commitments with GIIPS borrowers.
- (8) Hedges consist primarily of single-name CDS where Nomura has purchased net protection against GIIPS net counterparty credit exposures. Amounts disclosed are calculated based on notional amounts assuming zero recovery as adjusted for fair value movements.
- (9) Non-sovereign counterparties are primarily financial institutions located in these countries.

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Amounts reported in net inventory exposures and hedges include single-name CDS where Nomura has either purchased or sold credit protection on a single name GIIPS underlying. The following table presents the gross notional value and fair value of these derivatives by relevant GIIPS country and by type of underlying.

	Billions of yen September 30, 2014			
	Purchased protection		Sold protection	
	Notional value	Fair value	Notional value	Fair value
Greece				
Sovereign	¥	¥	¥	¥
Non-sovereign	35	(2)	36	2
	35	(2)	36	2
Ireland				
Sovereign	170	(3)	180	3
Non-sovereign	81	(5)	86	6
	252	(9)	266	9
Italy				
Sovereign	2,330	35	2,290	(28)
Non-sovereign	575	(23)	586	26
	2,905	12	2,877	(2)
Portugal				
Sovereign	244	2	234	(2)
Non-sovereign	146	(5)	149	6
	390	(4)	383	4
Spain				
Sovereign	1,109	(14)	1,291	19
Non-sovereign	378	(17)	411	18
	1,488	(31)	1,702	37
Total				
Sovereign	3,853	19	3,995	(8)
Non-sovereign	1,215	(53)	1,269	58
	¥ 5,068	¥ (33)	¥ 5,264	¥ 50

These notional and fair value amounts are not representative of Nomura's overall exposure as they exclude the impact of master netting agreements and collateralization arrangements in place with the counterparties to these transactions. See Note 3 *Derivative instruments and hedging activities* in our interim consolidated financial statements for more information around the nature of Nomura's credit derivative activities, including the nature of payout or trigger events under these contracts.

In addition to the above direct exposures to these countries, Nomura also has indirect exposures to these countries as follows:

Exposure to other European sovereign and non-sovereign counterparties such as counterparties in France, Germany and the UK who themselves may have exposures to these countries. These exposures are monitored and mitigated when necessary as part of Nomura's Credit Risk Management procedures.

Exposure to redenomination risk if the Euro is no longer used as the currency unit in one or more GIIPS or other Eurozone countries. Nomura monitors and manages redenomination risk through scenario analyses which quantify the potential impact on its GIIPS exposures.

Additional exposure to replacement risk arising from financial instruments entered into with GIIPS counterparties. Nomura manages and mitigates replacement risk relating to GIIPS counterparties by monitoring exposures on selected counterparties believed to represent the most significant risk, identifying major concentration of risks in order to reduce exposures when possible and being prepared to put in place a pre-emptive plan of action if such an event occurs.

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Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. It excludes strategic risk (the risk of loss as a result of poor strategic business decisions), but includes the risk of breach of legal and regulatory requirements, and the risk of damage to Nomura's reputation if caused by an operational risk.

The Three Lines of Defence

Nomura adopts the industry standard "Three Lines of Defence" for the management of operational risk, comprising the following elements:

- 1) 1st Line of Defence: The business which owns and manages its risks
- 2) 2nd Line of Defence: The Operational Risk Management (ORM) function, which defines and co-ordinates Nomura's operational risk strategy and framework and provides challenge to the 1st Line of Defence
- 3) 3rd Line of Defence: Internal and External Audit, who provide independent assurance

Operational Risk Management Framework

An Operational Risk Management Framework has been established in order to allow Nomura to identify, assess, manage, monitor and report on operational risk. The GIRMC, with delegated authority from the EMB has formal oversight over the management of operational risk. Operational risk appetite is defined through a mixture of qualitative appetite statements and quantitative measures utilizing key components of the Operational Risk Management Framework.

This framework is set out below:

Infrastructure of the framework

Policy framework: Sets standards for managing operational risk and details how to monitor adherence to these standards.

Training and awareness: Action taken by ORM to improve business understanding of operational risk.

Products and Services

Risk and Control Self-Assessment (RCSA): The process used by business units to identify and assess the operational risks to which they are exposed, the controls in place to mitigate risks, and action plans to further reduce risk.

Scenario Analysis: Process to identify and assess high impact, low probability "tail events" .

Event Reporting: Process to obtain information on and learn from actual events impacting Nomura and relevant external events. A key step is to identify appropriate action plans to prevent or mitigate future occurrence of events.

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Key Risk Indicators (KRI): Metrics which allow monitoring of certain key operational risks and trigger appropriate responses as thresholds are breached.

Outputs

Analysis and reporting: A key aspect of ORM s role is to analyze, report, and challenge operational risk information provided by business units, and work with business units to develop action plans to mitigate risks.

Operational risk capital calculation: Calculate operational risk capital for regulatory reporting purposes and allocate to business units to improve the efficiency on profit versus risks.

Table of Contents**Regulatory capital calculation for operational risk**

Nomura uses The Standardized Approach for calculating regulatory capital for operational risk. This involves using a three-year average of gross income allocated to business lines, which is multiplied by a fixed percentage (Beta Factor) determined by the FSA, to establish the amount of required operational risk capital.

Nomura uses consolidated net revenue as gross income, however for certain consolidated subsidiaries, gross operating profit is used as gross income. Gross income allocation is performed by mapping the net revenue of each business segment as defined in Nomura's management accounting data to each Basel business line as follows:

Business Line	Description	Beta Factor
Retail Banking	Retail deposit and loan-related services	12%
Commercial Banking	Deposit and loan-related services except for Retail Banking business	15%
Payment and Settlement	Payment and settlement services for clients' transactions	18%
Retail Brokerage	Securities-related services mainly for individuals	12%
Trading and Sales	Market-related business	18%
Corporate Finance	M&A, underwriting, secondary and private offerings, and other funding services for clients	18%
Agency Services	Agency services for clients such as custody	15%
Asset Management	Fund management services for clients	12%

Nomura calculates the required amount of operational risk capital for each business line by multiplying the allocated annual gross income amount by the appropriate Beta Factor defined above. The operational risk capital for any gross income amount not allocated to a specific business line is determined by multiplying such unallocated gross income amount by a fixed percentage of 18%.

The total operational risk capital for Nomura is calculated by aggregating the total amount of operational risk capital required for each business line and unallocated amount and by determining a three-year average. Where the aggregated amount for a given year is negative, then the total operational risk capital amount for that year will be calculated as zero.

In any given year, negative amounts in any business line are offset against positive amounts in other business lines. However, negative unallocated amounts are not offset against positive amounts in other business lines and are calculated as zero.

Operational risk capital is calculated at the end of September and March each year.

Model Risk Management

Model risk is the risk arising from model errors or incorrect or inappropriate model application, which can lead to financial loss, poor business and strategic decision-making, restatement of external and internal reports, regulatory penalties and damage to Nomura's reputation.

Errors can occur at any point from model assumptions through to implementation. In addition, the quality of model outputs depends on the quality of model parameters and any input data. Even a fundamentally sound model producing accurate outputs consistent with the design objective of the model may exhibit high model risk if it is misapplied or misused.

Model Management Framework

The models within the model management framework are defined as either:

valuation models, used for calculating prices and risk sensitivities of Nomura's positions; or,

risk models, used by the Risk Management Division for quantifying the risk of a portfolio by calculating the potential losses incurred from a specific type of risk, and used for regulatory or economic capital calculations, limit monitoring, trade approval and management reporting.

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Before models are put into official use, the Model Validation Group (MVG) is responsible for validating their integrity and comprehensiveness independently from those who design and build them. As part of this validation process, the MVG analyzes a number of factors to assess a model's suitability, to quantify model risk which is then mitigated by applying model reserves and capital adjustments. Valuation models are developed and maintained by the business units and risk models by the Risk Methodology Group (RMG) within the Risk Management Division. Certain models may also be developed by third party providers. The RMG has primary responsibility for the ongoing refinement and improvement of risk models and methodologies within Nomura.

All models are also subject to an annual re-approval process by MVG to ensure they remain suitable. Upon delegation from the GRMC, the MRAC's and GRAC's primary responsibility is to govern and provide oversight of model management for valuation and risk models, respectively.

Changes to valuation and risk models

Nomura has documented policies and procedures in place, approved by the GIRMC and/or GRSC, which define the process and validation requirements for implementing changes to valuation and risk models. For changes with an impact above certain materiality thresholds, model approval is required. These materiality thresholds are defined through procedures owned by MVG and reflect Nomura's model risk appetite. For certain material changes to risk models, backtesting of the new model, parallel running of both models and stress-testing of the new model are required prior to the model being approved.

Funding and Liquidity Risk Management

For further information on funding and liquidity risk management, see *Liquidity and Capital Resources Funding and Liquidity Management* in this report.

Risk Measures and Controls

Limit Frameworks

The establishment of robust limit monitoring and management is central to appropriate monitoring and management of risk. The limit management frameworks incorporate clear escalation policies to ensure approval of limits at appropriate levels of seniority. The Risk Management Division is responsible for day-to-day operation of these limit frameworks including approval, monitoring, and reporting as required. Business units are responsible for complying with the agreed limits. Limits apply across a range of quantitative measures of risk and across market and credit risks.

New Business Risk Management

The new business approval process represents the starting point for new business in Nomura and exists to support management decision-making and ensure that risks associated with new products and new businesses are identified and managed appropriately. The new business approval process consists of two components:

- 1) Transaction committees are in place to provide formal governance over the review and decision-making process for individual transactions. Clear responsibilities are documented for cases of non-adherence.
- 2) The new product approval process allows business unit sponsors to submit applications for new products and obtain input from relevant departments prior to approval of the application. The process is designed to capture and assess risks across all risk classes as a result of the new product or business.

Stress Testing

Stress testing is a process of assessing the stability or business continuity of Nomura from the view point of capital adequacy, profit and loss impact or liquidity adequacy using plausible scenarios at various levels of the hierarchy from firmwide level to division or desk levels, including those based on sensitivity analysis.

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Nomura conducts a rigorous programme of stress testing through a comprehensive suite of top-down and bottom-up scenarios, covering different time horizons, severities, scope and methodologies and these are reviewed, run and presented on a regular basis to senior management, who can then take appropriate actions.

Stress testing is categorised either as sensitivity analysis, scenario analysis, firmwide stress testing or reverse stress testing.

Sensitivity analysis is used to quantify the impact of a market move in one or two associated risk factors across all positions (e.g., equity prices or equity prices/equity volatility) using a variety of defined market shocks in order to assess specific risks or potential concentrations;

Scenario analysis is used to quantify the impact of a specified event on Nomura's portfolio, combining simultaneous cross-asset market shocks;

Firmwide stress testing is applied consistently across risk classes, such as market, credit, operational, business and liquidity risks. It is used to assess Nomura's capital adequacy under severe market scenarios; and

Reverse stress testing is designed to identify a range of adverse circumstances which could cause Nomura's business plan to become unviable. Such tests would stress Nomura's exposures or business models in an extreme fashion until the point of capital failure, liquidity failure or business closure.

Stress tests are run on a regular basis as part of Nomura's routine risk management process and on an ad hoc basis in response to market events or concerns. Stress testing is regarded as an integral part of Nomura's risk management governance and used as a tool for forward-looking risk management and decision-making.

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Table of Contents**Interim Consolidated Financial Statements****Consolidated Balance Sheets (UNAUDITED)**

	Millions of yen	
	March 31, 2014	September 30, 2014
ASSETS		
Cash and cash deposits:		
Cash and cash equivalents	¥ 1,489,792	¥ 1,439,786
Time deposits	363,682	224,992
Deposits with stock exchanges and other segregated cash	335,836	405,134
Total cash and cash deposits	2,189,310	2,069,912
Loans and receivables:		
Loans receivable (including ¥303,956 million and ¥282,822 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	1,327,875	1,357,346
Receivables from customers (including ¥2,180 million and ¥2,248 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	64,070	67,002
Receivables from other than customers	1,181,742	1,266,421
Allowance for doubtful accounts	(3,009)	(2,754)
Total loans and receivables	2,570,678	2,688,015
Collateralized agreements:		
Securities purchased under agreements to resell (including ¥1,087,138 million and ¥984,385 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	9,617,675	8,299,801
Securities borrowed	7,729,326	8,080,883
Total collateralized agreements	17,347,001	16,380,684
Trading assets and private equity investments:		
Trading assets (including securities pledged as collateral of ¥9,266,192 million and ¥10,673,083 million as of March 31, 2014 and September 30, 2014, respectively; including ¥9,156 million and ¥11,684 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	18,672,318	20,009,976
Private equity investments (including ¥3,476 million and ¥5,716 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	41,996	44,723
Total trading assets and private equity investments	18,714,314	20,054,699
Other assets:		
Office buildings, land, equipment and facilities (net of accumulated depreciation and amortization of ¥350,820 million as of March 31, 2014 and ¥369,320 million as of September 30, 2014)	408,917	413,385
Non-trading debt securities	1,023,746	967,293
Investments in equity securities	136,740	141,508
Investments in and advances to affiliated companies	345,434	349,528
Other (including ¥56,976 million and ¥67,644 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	784,174	737,070
Total other assets	2,699,011	2,608,784

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Total assets	¥ 43,520,314	¥	43,802,094
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Table of Contents**Consolidated Balance Sheets (Continued) (UNAUDITED)**

	Millions of yen	
	March 31, 2014	September 30, 2014
LIABILITIES AND EQUITY		
Short-term borrowings (including ¥49,279 million and ¥39,638 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	¥ 602,131	¥ 609,481
Payables and deposits:		
Payables to customers	492,516	651,914
Payables to other than customers	1,230,176	1,246,609
Deposits received at banks	1,114,181	1,056,216
Total payables and deposits	2,836,873	2,954,739
Collateralized financing:		
Securities sold under agreements to repurchase (including ¥530,397 million and ¥535,816 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	13,937,690	13,878,397
Securities loaned	2,359,809	2,629,628
Other secured borrowings	814,500	739,014
Total collateralized financing	17,111,999	17,247,039
Trading liabilities	11,047,285	10,882,727
Other liabilities (including ¥1,123 million and ¥17,377 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	1,141,750	1,080,878
Long-term borrowings (including ¥1,984,986 million and ¥2,378,535 million measured at fair value by applying the fair value option as of March 31, 2014 and September 30, 2014, respectively)	8,227,063	8,412,012
Total liabilities	40,967,101	41,186,876
Commitments and contingencies (Note 15)		
Equity:		
Nomura Holdings, Inc. (NHI) shareholders' equity:		
Common stock		
No par value share;		
Authorized 6,000,000,000 shares as of March 31, 2014 and September 30, 2014		
Issued 3,822,562,601 shares as of March 31, 2014 and September 30, 2014		
Outstanding 3,717,630,462 shares as of March 31, 2014 and 3,640,236,853 shares as of September 30, 2014	594,493	594,493
Additional paid-in capital	683,638	683,112
Retained earnings	1,287,003	1,335,236
Accumulated other comprehensive income	20,636	70,533
Total NHI shareholders' equity before treasury stock	2,585,770	2,683,374
Common stock held in treasury, at cost 104,932,139 shares as of March 31, 2014 and 182,325,748 shares as of September 30, 2014	(72,090)	(122,286)
Total NHI shareholders' equity	2,513,680	2,561,088
Noncontrolling interests	39,533	54,130
Total equity	2,553,213	2,615,218
Total liabilities and equity	¥ 43,520,314	¥ 43,802,094

Table of Contents**Consolidated Balance Sheets (Continued) (UNAUDITED)**

The following table presents the classification of consolidated variable interest entities (VIEs) assets and liabilities included in the consolidated balance sheets above. The assets of a consolidated VIE may only be used to settle obligations of that VIE. Creditors do not have any recourse to Nomura beyond the assets held in the VIEs. See Note 6 *Securitizations and Variable Interest Entities* for further information.

	Billions of yen	
	March 31, 2014	September 30, 2014
Cash and cash deposits	¥ 18	¥ 21
Trading assets and private equity investments	751	897
Other assets	114	64
 Total assets	 ¥ 883	 ¥ 982
 Trading liabilities	 ¥ 42	 ¥ 27
Other liabilities	27	15
Borrowings	424	640
 Total liabilities	 ¥ 493	 ¥ 682

The accompanying notes are an integral part of these interim consolidated financial statements.

Table of Contents**Consolidated Statements of Income (UNAUDITED)**

	Millions of yen	
	Six months ended September 30 2013	2014
Revenue:		
Commissions	¥ 263,247	¥ 208,413
Fees from investment banking	48,378	40,442
Asset management and portfolio service fees	83,083	93,839
Net gain on trading	238,589	287,573
Gain on private equity investments	753	202
Interest and dividends	213,416	213,692
Gain on investments in equity securities	12,889	9,234
Other	73,294	59,579
Total revenue	933,649	912,974
Interest expense	145,938	168,303
Net revenue	787,711	744,671
Non-interest expenses:		
Compensation and benefits	298,596	309,590
Commissions and floor brokerage	55,180	61,189
Information processing and communications	94,473	90,857
Occupancy and related depreciation	40,614	36,777
Business development expenses	17,332	16,998
Other	95,364	103,581
Total non-interest expenses	601,559	618,992
Income before income taxes	186,152	125,679
Income tax expense	81,505	51,291
Net income	¥ 104,647	¥ 74,388
Less: Net income attributable to noncontrolling interests	641	1,656
Net income attributable to NHI shareholders	¥ 104,006	¥ 72,732
Yen		
Six months ended September 30		
2013 2014		
Per share of common stock:		
Basic		
Net income attributable to NHI shareholders per share	¥ 28.07	¥ 19.87
Diluted		
Net income attributable to NHI shareholders per share	¥ 27.20	¥ 19.34

The accompanying notes are an integral part of these interim consolidated financial statements.

Table of Contents**Consolidated Statements of Income (Continued) (UNAUDITED)**

	Millions of yen	
	Three months ended September 30 2013	September 30 2014
Revenue:		
Commissions	¥ 105,613	¥ 112,132
Fees from investment banking	22,984	20,620
Asset management and portfolio service fees	40,702	48,395
Net gain on trading	110,180	129,011
Gain on private equity investments	703	489
Interest and dividends	98,091	108,775
Gain on investments in equity securities	5,037	2,884
Other	45,069	28,514
Total revenue	428,379	450,820
Interest expense	71,989	76,987
Net revenue	356,390	373,833
Non-interest expenses:		
Compensation and benefits	135,391	140,823
Commissions and floor brokerage	26,134	33,599
Information processing and communications	46,240	45,961
Occupancy and related depreciation	20,830	18,224
Business development expenses	9,473	9,071
Other	45,389	52,150
Total non-interest expenses	283,457	299,828
Income before income taxes	72,933	74,005
Income tax expense	34,549	20,894
Net income	¥ 38,384	¥ 53,111
Less: Net income attributable to noncontrolling interests	272	239
Net income attributable to NHI shareholders	¥ 38,112	¥ 52,872
	Yen	
	Three months ended September 30 2013	September 30 2014
Per share of common stock:		
Basic		
Net income attributable to NHI shareholders per share	¥ 10.29	¥ 14.53
Diluted		
Net income attributable to NHI shareholders per share	¥ 9.99	¥ 14.15

The accompanying notes are an integral part of these interim consolidated financial statements.

Table of Contents**Consolidated Statements of Comprehensive Income (UNAUDITED)**

	Millions of yen	
	Six months ended 2013	September 30 2014
Net income	¥ 104,647	¥ 74,388
Other comprehensive income:		
Change in cumulative translation adjustments, net of tax	27,431	46,285
Defined benefit pension plans:		
Pension liability adjustment	2,005	374
Deferred income taxes	(703)	(211)
Total	1,302	163
Non-trading securities:		
Net unrealized gain on non-trading securities	1,469	9,712
Deferred income taxes	(645)	(2,539)
Total	824	7,173
Total other comprehensive income	29,557	53,621
Comprehensive income	¥ 134,204	¥ 128,009
Less: Comprehensive income attributable to noncontrolling interests	1,382	5,380
Comprehensive income attributable to NHI shareholders	¥ 132,822	¥ 122,629

	Millions of yen	
	Three months ended 2013	September 30 2014
Net income	¥ 38,384	¥ 53,111
Other comprehensive income (loss):		
Change in cumulative translation adjustments, net of tax	(5,542)	58,079
Defined benefit pension plans:		
Pension liability adjustment	449	14
Deferred income taxes	(171)	(69)
Total	278	(55)
Non-trading securities:		
Net unrealized gain on non-trading securities	4,471	6,312
Deferred income taxes	(1,286)	(2,017)
Total	3,185	4,295
Total other comprehensive income (loss)	(2,079)	62,319
Comprehensive income	¥ 36,305	¥ 115,430
Less: Comprehensive income attributable to noncontrolling interests	962	3,574
Comprehensive income attributable to NHI shareholders	¥ 35,343	¥ 111,856

The accompanying notes are an integral part of these interim consolidated financial statements.

Table of Contents**Consolidated Statements of Changes in Equity (UNAUDITED)**

	Millions of yen	
	Six months ended September 30 2013	2014
Common stock		
Balance at beginning of year	¥ 594,493	¥ 594,493
Balance at end of period	594,493	594,493
Additional paid-in capital		
Balance at beginning of year	691,264	683,638
Gain (loss) on sales of treasury stock	(5,439)	(2,417)
Issuance and exercise of common stock options	(3,777)	1,891
Balance at end of period	682,048	683,112
Retained earnings		
Balance at beginning of year	1,136,523	1,287,003
Net income attributable to NHI shareholders	104,006	72,732
Cash dividends ⁽¹⁾	(29,652)	(21,841)
Gain (loss) on sales of treasury stock		(2,658)
Balance at end of period	1,210,877	1,335,236
Accumulated other comprehensive income (loss)		
Cumulative translation adjustments		
Balance at beginning of year	(38,875)	27,704
Net change during the period	26,902	44,378
Balance at end of period	(11,973)	72,082
Defined benefit pension plans		
Balance at beginning of year	(28,518)	(18,809)
Pension liability adjustment	1,302	163
Balance at end of period	(27,216)	(18,646)
Non-trading securities		
Balance at beginning of year	9,998	11,741
Net unrealized gain on non-trading securities	612	5,356
Balance at end of period	10,610	17,097
Balance at end of period	(28,579)	70,533
Common stock held in treasury		
Balance at beginning of year	(70,514)	(72,090)
Repurchases of common stock	(32,493)	(65,199)
Sales of common stock	8	4
Common stock issued to employees	22,662	14,999
Other net change in treasury stock	683	

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Balance at end of period	(79,654)	(122,286)
Total NHI shareholders' equity		
Balance at end of period	2,379,185	2,561,088
Noncontrolling interests		
Balance at beginning of year	24,612	39,533
Cash dividends	(19)	(19)
Net income attributable to noncontrolling interests	641	1,656
Accumulated other comprehensive income attributable to noncontrolling interests	741	3,724
Purchase / sale of subsidiary shares, net		5,072
Other net change in noncontrolling interests	6,142	4,164
Balance at end of period	32,117	54,130
Total equity		
Balance at end of period	¥ 2,411,302	¥ 2,615,218

(1) Dividends per share		Three months ended September 30,
	Six months ended September 30, 2013	2013
		¥ 8.00
	Six months ended September 30, 2014	Three months ended September 30,
		2014
		¥ 6.00

The accompanying notes are an integral part of these interim consolidated financial statements.

Table of Contents**Consolidated Statements of Cash Flows (UNAUDITED)**

	Millions of yen	
	Six months ended September 30 2013	2014
Cash flows from operating activities:		
Net income	¥ 104,647	¥ 74,388
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	39,853	37,566
Gain on investments in equity securities	(12,889)	(9,234)
Deferred income taxes	9,523	19,918
Changes in operating assets and liabilities:		
Time deposits	141,920	143,036
Deposits with stock exchanges and other segregated cash	(106,007)	(49,499)
Trading assets and private equity investments	(803,462)	(775,733)
Trading liabilities	1,131,663	(395,689)
Securities purchased under agreements to resell, net of securities sold under agreements to repurchase	224,006	907,217
Securities borrowed, net of securities loaned	(232,396)	(34,750)
Other secured borrowings	11,732	(75,485)
Loans and receivables, net of allowance for doubtful accounts	(161,064)	9,322
Payables	347,701	150,424
Bonus accrual	(37,128)	(53,295)
Accrued income taxes, net	(16,873)	16,987
Other, net	(236,432)	66,521
Net cash provided by operating activities	404,794	31,694
Cash flows from investing activities:		
Payments for purchases of office buildings, land, equipment and facilities	(114,549)	(72,612)
Proceeds from sales of office buildings, land, equipment and facilities	94,214	41,768
Payments for purchases of investments in equity securities	(100)	(102)
Proceeds from sales of investments in equity securities	2,304	4,735
Decrease (increase) in loans receivable at banks, net	3,918	(12,464)
Decrease (increase) in non-trading debt securities, net	(88,042)	68,663
Other, net	4,146	(6,411)
Net cash provided by (used in) investing activities	(98,109)	23,577
Cash flows from financing activities:		
Increase in long-term borrowings	1,112,884	1,211,301
Decrease in long-term borrowings	(947,062)	(1,188,488)
Increase (decrease) in short-term borrowings, net	59,590	(5,168)
Decrease in deposits received at banks, net	(1,891)	(53,645)
Proceeds from sales of common stock held in treasury	288	78
Payments for repurchases of common stock held in treasury	(32,493)	(65,199)
Payments for cash dividends	(22,285)	(33,469)
Net cash provided by (used in) financing activities	169,031	(134,590)
Effect of exchange rate changes on cash and cash equivalents	17,240	29,313
Net increase (decrease) in cash and cash equivalents	492,956	(50,006)
Cash and cash equivalents at beginning of year	805,087	1,489,792

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Cash and cash equivalents at end of period	¥ 1,298,043	¥ 1,439,786
Supplemental information:		
Cash paid during the period for		
Interest	¥ 154,025	¥ 170,522
Income tax payments, net	¥ 88,855	¥ 14,386

The accompanying notes are an integral part of these interim consolidated financial statements.

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Notes to the Interim Consolidated Financial Statements (UNAUDITED)

1. Summary of accounting policies:

Description of business

Nomura Holdings, Inc. (the Company) and its broker-dealer, banking and other financial services subsidiaries provide investment, financing and related services to individual, institutional and government clients on a global basis. The Company and other entities in which it has a controlling financial interest are collectively referred to as Nomura within these interim consolidated financial statements.

Nomura operates its business through various divisions based upon the nature of specific products and services, its main client base and its management structure. Nomura reports operating results through three business segments: Retail, Asset Management and Wholesale.

In its Retail segment, Nomura provides investment consultation services mainly to individual clients in Japan. In its Asset Management segment, Nomura develops and manages investment trusts, and provides investment advisory services. In its Wholesale segment, Nomura is engaged in the sales and trading of debt and equity securities and currencies on a global basis to various institutions, provides investment banking services such as the underwriting of bonds and equities as well as mergers and acquisitions and financial advice and invests in private equity businesses and seeks to maximize returns on the investments by increasing the corporate value of investee companies.

The accounting and financial reporting policies of Nomura conform to U.S. generally accepted accounting principles (U.S. GAAP) as applicable to broker dealers. A summary of the significant accounting policies applied by Nomura within these interim consolidated financial statements is provided within in the notes to the consolidated financial statements of Nomura's annual report on Form 20-F for the year ended March 31, 2014 as filed on June 26, 2014.

New accounting pronouncements recently adopted

No new accounting pronouncements relevant to Nomura were adopted during the three months ended September 30, 2014.

The following new accounting pronouncements relevant to Nomura were adopted during the three months ended June 30, 2014:

Release of cumulative translation adjustment amounts

In March 2013, the FASB issued amendments to ASC 810-10 *Consolidation Overall* (ASC 810-10) and ASC 830-30 *Foreign Currency Matters Translation of Financial Statements* (ASC 830-30) through issuance of ASU 2013-05 *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity* (ASU 2013-05). The amendments resolve diversity in practice about whether guidance in ASC 810-10 or ASC 830-30 applies to the release of cumulative translation adjustment (CTA) amounts into earnings when a parent sells part or all of its investment in a foreign entity (or no longer holds a controlling financial interest in a subsidiary).

ASU 2013-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 with early adoption permitted.

Nomura adopted ASU 2013-05 from April 1, 2014 and these amendments did not have a material impact on these consolidated financial statements.

Investment companies

In June 2013, the FASB issued amendments to ASC 946 *Financial Services Investment Companies* (ASC 946) through issuance of ASU 2013-08 *Amendments to the Scope, Measurement, and Disclosure Requirements* (ASU 2013-08). ASU 2013-08 modifies the guidance under ASC 946 for determining whether an entity is an investment company, which is an entity that is required to measure its investments at fair value, including controlling financial interests in investees that are not investment companies. ASU 2013-08 also requires an investment company to measure noncontrolling ownership interests in other investment companies at fair value rather than using the equity method of accounting, and requires certain additional disclosures including information about financial support provided, or contractually required to be provided, by an investment company to any of its investees.

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ASU 2013-08 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013 with early adoption prohibited.

Nomura adopted ASU 2013-08 from April 1, 2014 and these amendments did not have a material impact on these consolidated financial statements.

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Notes to the Interim Consolidated Financial Statements (Continued) (UNAUDITED)

Future accounting developments

The following new accounting pronouncements relevant to Nomura will be adopted in future periods:

Reporting Discontinued Operations

In April 2014, the FASB issued amendments to ASC 205, *Presentation of Financial Statements* (ASC 205) and ASC 360 *Property, Plant and Equipment* (ASC 360) through issuance of ASU 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*, (ASU 2014-08). ASU 2014-08 changes the criteria for discontinued operations reporting with the intention of less disposals qualifying and also introduces new presentation and disclosure requirements.

ASU 2014-08 is effective prospectively for all disposals or expected disposals classified as held for sale that occur within annual periods beginning on or after December 15, 2014 and interim periods within those years. Early adoption is permitted, but only for disposals or expected disposals classified as held for sale that have not been reported in financial statements previously issued or available for issue.

Nomura currently plans to adopt ASU 2014-08 from April 1, 2015 and does not expect these amendments to have a material impact on these consolidated financial statements.

Revenue Recognition

In May 2014, the FASB issued ASC 606 *Revenue from Contracts with Customers* (ASC 606) as well as amendments to other pronouncements, including ASC 350 *Intangibles Goodwill and Other* , ASC 360 *Property, Plant, and Equipment* , and ASC 605-35 *Revenue Recognition Construction-Type and Production-Type Contracts* through issuance of ASU 2014-09 *Revenue from Contracts with Customers* (ASU 2014-09). ASU 2014-09 replaces existing revenue recognition guidance in ASC 605 *Revenue Recognition* , replaces certain other industry-specific revenue recognition guidance, specifies the accounting for certain costs to obtain or fulfill a contract with a customer and provides recognition and measurement guidance in relation to sales of non-financial assets. The core principle of ASU 2014-09 is to depict the transfer of goods or services to customers at an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. It provides guidance on how to achieve this core principle, including how to identify contracts with customers and separate performance obligations in the contract, how to determine and allocate the transaction price to such performance obligations and how to recognize revenue when a performance obligation has been satisfied.

ASU 2014-09 is effective for annual reporting periods, and interim periods within those reporting periods, beginning after December 15, 2016 with early adoption prohibited.

Nomura will adopt ASU 2014-09 from April 1, 2017 and is currently evaluating the potential impact it may have on these consolidated financial statements.

Repurchase agreements and similar transactions

In June 2014, the FASB issued amendments to ASC 860 *Transfers and Servicing* (ASC 860) through issuance of ASU 2014-11 *Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures* (ASU 2014-11). These amendments change the accounting for repurchase-to-maturity transactions which are repurchase agreements where the maturity of the security transferred as collateral matches the maturity of the repurchase agreement. Under ASU 2014-11, all repurchase-to-maturity transactions will be accounted for as secured borrowing transactions in the same way as other repurchase agreements rather than as sales of a financial asset and forward commitment to repurchase. The amendments also change the accounting for repurchase financing arrangements which are transactions involving the transfer of a financial asset to a counterparty executed contemporaneously with a reverse repurchase agreement with the same counterparty. Under ASU 2014-11, all repurchase financings will now be accounted for separately, which will result in secured lending accounting for the reverse repurchase agreement. ASU 2014-11 also introduces new disclosure requirements regarding repurchase agreements and securities lending transactions as well as certain other transactions which involve the transfer of financial assets accounted for as sales and where the transferor retains substantially all of the exposure to the economic return on the transferred assets.

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ASU 2014-11 is effective for interim or annual periods beginning after December 15, 2014 with early adoption prohibited. As of adoption date, the accounting for all outstanding repurchase-to-maturity transactions and repurchase financing arrangements is adjusted by means of a cumulative-effect adjustment to the balance sheet and retained earnings.

Nomura will adopt ASU 2014-11 from January 1, 2015 and is currently evaluating the potential impact it may have on these consolidated financial statements.

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Notes to the Interim Consolidated Financial Statements (Continued) (UNAUDITED)

Stock compensation

In June 2014, the FASB issued amendments to ASC 718 *Compensation - Stock Compensation* (ASC 718) through issuance of ASU 2014-12 *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period* (ASU 2014-12). ASU 2014-12 requires a performance target that affects vesting and that could be achieved after the requisite service period be accounted for as a performance condition based on the existing guidance in ASC 718 rather than as a nonvesting condition that affects the grant-date fair value of the award.

ASU 2014-12 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015 with early adoption permitted. ASU 2014-12 may be applied either by prospectively or retrospectively.

Nomura currently plans to adopt ASU 2014-12 from April 1, 2016 and does not expect these amendments to have a material impact on these consolidated financial statements.

Measurement of the financial assets and the financial liabilities of collateralized financing entities

In August 2014, the FASB issued amendments to ASC 810 *Consolidation* (ASC 810) through issuance of ASU 2014-13 *Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity* (ASU 2014-13). ASU 2014-13 provides an alternative to ASC 820 *Fair Value Measurements and disclosures* (ASC 820) for measuring the fair value of financial assets and the financial liabilities of a consolidated collateralized financing entity. When the measurement alternative is elected, either the fair value of the financial assets or the fair value of the financial liabilities is measured, depending upon which is more observable, with the value of the other side imputed, thus eliminating differences that can arise when each is measured separately.

ASU 2014-13 is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015 with early adoption permitted.

Nomura currently plans to adopt ASU 2014-13 from April 1, 2016 and is currently evaluating the potential impact it may have on these consolidated financial statements.

Table of Contents**Notes to the Interim Consolidated Financial Statements (Continued) (UNAUDITED)****2. Fair value measurements:****The fair value of financial instruments**

A significant amount of Nomura's financial instruments are carried at fair value. Financial assets carried at fair value on a recurring basis are reported in the consolidated balance sheets within *Trading assets and private equity investments, Loans and receivables, Collateralized agreements* and *Other assets*. Financial liabilities carried at fair value on a recurring basis are reported within *Trading liabilities, Short-term borrowings, Payables and deposits, Collateralized financing, Long-term borrowings* and *Other liabilities*.

Other financial assets and financial liabilities are measured at fair value on a nonrecurring basis, where the primary measurement basis is not fair value but where fair value is used in specific circumstances after initial recognition, such as to measure impairment.

In all cases, fair value is determined in accordance with ASC 820 which defines fair value as the amount that would be exchanged to sell a financial asset or transfer a financial liability in an orderly transaction between market participants at the measurement date. It assumes that the transaction occurs in Nomura's principal market, or in the absence of the principal market, the most advantageous market for the relevant financial assets or financial liabilities.

Fair value is usually determined on an individual financial instrument basis consistent with the unit of account of the financial instrument. However, certain financial instruments managed on a portfolio basis are valued as a portfolio, namely based on the price that would be received to sell a net long position (i.e. a net financial asset) or transfer a net short position (i.e. a net financial liability) consistent with how market participants would price the net risk exposure at the measurement date.

Financial assets carried at fair value also include investments in certain funds where, as a practical expedient, fair value is determined on the basis of net asset value per share (NAV per share) if the NAV per share is calculated in accordance with certain industry standard principles.

Increases and decreases in the fair value of assets and liabilities will significantly impact Nomura's position, performance, liquidity and capital resources. As explained below, valuation techniques applied contain inherent uncertainties and Nomura is unable to predict the accurate impact of future developments in the market. Where appropriate, Nomura uses economic hedging strategies to mitigate its risk, although these hedges are also subject to unpredictable movements in the market.

Valuation methodology for financial instruments carried at fair value on a recurring basis

The fair value of financial instruments is based on quoted market prices including market indices, broker or dealer quotations or an estimation by management of the expected exit price under current market conditions. Various financial instruments, including cash instruments and over-the-counter (OTC) contracts, have bid and offer prices that are observable in the market. These are measured at the point within the bid-offer range which best represents Nomura's estimate of fair value. Where quoted market prices or broker or dealer quotations are not available, prices for similar instruments or valuation pricing models are considered in the determination of fair value.

Where quoted prices are available in active markets, no valuation adjustments are taken to modify the fair value of assets or liabilities marked using such prices. Other instruments may be measured using valuation techniques, such as valuation pricing models incorporating observable parameters, unobservable parameters or a combination of both. Valuation pricing models use parameters which would be considered by market participants in valuing similar financial instruments.

Valuation pricing models and their underlying assumptions impact the amount and timing of unrealized and realized gains and losses recognized, and the use of different valuation pricing models or underlying assumptions could produce different financial results. Valuation uncertainty results from a variety of factors, including the valuation technique or model selected, the quantitative assumptions used within the valuation model, the inputs into the model, as well as other factors. Valuation adjustments are used to reflect the assessment of this uncertainty. Common valuation adjustments include model reserves, credit adjustments, close-out adjustments, and other appropriate instrument-specific adjustments, such as those to reflect transfer or sale restrictions.

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The level of adjustments is largely judgmental and is based on an assessment of the factors that management believe other market participants would use in determining the fair value of similar financial instruments. The type of adjustments taken, the methodology for the calculation of these adjustments, and the inputs for these calculations are reassessed periodically to reflect current market practice and the availability of new information.

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For example, the fair value of certain financial instruments includes adjustments for credit risk; both with regards to counterparty credit risk on positions held and Nomura's own creditworthiness on positions issued. Credit risk on financial assets is significantly mitigated by credit enhancements such as collateral and netting arrangements. Any net credit exposure is measured using available and applicable inputs for the relevant counterparty. The same approach is used to measure the credit exposure on Nomura's financial liabilities as is used to measure counterparty credit risk on Nomura's financial assets.

Such valuation pricing models are calibrated to the market on a regular basis and inputs used are adjusted for current market conditions and risks. The Global Model Validation Group (MVG) within Nomura's Risk Management Department reviews pricing models and assesses model appropriateness and consistency independently of the front office. The model reviews consider a number of factors about a model's suitability for valuation and sensitivity of a particular product. Valuation models are calibrated to the market on a periodic basis by comparison to observable market pricing, comparison with alternative models and analysis of risk profiles.

As explained above, any changes in fixed income, equity, foreign exchange and commodity markets can impact Nomura's estimates of fair value in the future, potentially affecting trading gains and losses. Where financial contracts have longer maturity dates, Nomura's estimates of fair value may involve greater subjectivity due to the lack of transparent market data.

Fair value hierarchy

All financial instruments measured at fair value, including those carried at fair value using the fair value option, have been categorized into a three-level hierarchy (fair value hierarchy) based on the transparency of valuation inputs used by Nomura to estimate fair value. A financial instrument is classified in the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement of the financial instrument. The three levels of the fair value hierarchy are defined as follows, with Level 1 representing the most transparent inputs and Level 3 representing the least transparent inputs:

Level 1:

Unadjusted quoted prices for identical financial instruments in active markets accessible by Nomura at the measurement date.

Level 2:

Quoted prices in inactive markets or prices containing other inputs which are observable, either directly or indirectly. Valuation techniques using observable inputs reflect assumptions used by market participants in pricing financial instruments and are based on data obtained from independent market sources at the measurement date.

Level 3:

Unobservable inputs that are significant to the fair value measurement of the financial instrument. Valuation techniques using unobservable inputs reflect management's assumptions about the estimates used by other market participants in valuing similar financial instruments. These valuation techniques are developed based on the best available information at the measurement date.

The availability of inputs observable in the market varies by product and can be affected by a variety of factors. Significant factors include, but are not restricted to the prevalence of similar products in the market, especially for customized products, how established the product is in the market, for example, whether it is a new product or is relatively mature, and the reliability of information provided in the market which would depend, for example, on the frequency and volume of current data. A period of significant change in the market may reduce the availability of observable data. Under such circumstances, financial instruments may be reclassified into a lower level in the fair value hierarchy.

Significant judgments used in determining the classification of financial instruments include the nature of the market in which the product would be traded, the underlying risks, the type and liquidity of market data inputs and the nature of observed transactions for similar instruments.

Where valuation models include the use of parameters which are less observable or unobservable in the market, significant management judgment is used in establishing fair value. The valuations for Level 3 financial instruments, therefore, involve a greater degree of judgment than

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those valuations for Level 1 or Level 2 financial instruments.

Certain criteria management use to determine whether a market is active or inactive include the number of transactions, the frequency that pricing is updated by other market participants, the variability of price quotes among market participants, and the amount of publicly available information.

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The following tables present the amounts of Nomura's financial instruments measured at fair value on a recurring basis as of March 31, 2014 and September 30, 2014 within the fair value hierarchy.

	Billions of yen March 31, 2014				
	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting ⁽¹⁾	Balance as of March 31, 2014
Assets:					
Trading assets and private equity investments ⁽²⁾					
Equities ⁽³⁾	¥ 2,176	¥ 655	¥ 68	¥	¥ 2,899
Private equity investments ⁽³⁾			42		42
Japanese government securities	2,587				2,587
Japanese agency and municipal securities		192			192
Foreign government, agency and municipal securities	4,615	1,378	26		6,019
Bank and corporate debt securities and loans for trading purposes		1,735	116		1,851
Commercial mortgage-backed securities (CMBS)		156	3		159
Residential mortgage-backed securities (RMBS)		2,221	3		2,224
Real estate-backed securities			0		0
Collateralized debt obligations (CDOs) and other		170	13		183
Investment trust funds and other	136	87	30		253
Total trading assets and private equity investments	9,514	6,594	301		16,409
Derivative assets⁽⁵⁾					
Equity contracts	750	1,102	70		1,922
Interest rate contracts	11	19,398	112		19,521
Credit contracts	4	1,268	42		1,314
Foreign exchange contracts		3,293	19		3,312
Commodity contracts	0	0	0		0
Netting				(23,764)	(23,764)
Total derivative assets	765	25,061	243	(23,764)	2,305
Subtotal	¥ 10,279	¥ 31,655	¥ 544	¥ (23,764)	¥ 18,714
Loans and receivables ⁽⁶⁾		280	26		306
Collateralized agreements ⁽⁷⁾		1,087			1,087
Other assets					
Non-trading debt securities	406	615	3		1,024
Other ⁽³⁾	358	94	56		508
Total	¥ 11,043	¥ 33,731	¥ 629	¥ (23,764)	¥ 21,639
Liabilities:					
Trading liabilities					
Equities	¥ 774	¥ 132	¥ 1	¥	¥ 907
Japanese government securities	3,046				3,046
Foreign government, agency and municipal securities	3,831	688			4,519
Bank and corporate debt securities		396	0		396
Residential mortgage-backed securities (RMBS)		1			1
Collateralized debt obligations (CDOs) and other		0			0
Investment trust funds and other	76	12			88

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Total trading liabilities	7,727	1,229	1		8,957
Derivative liabilities ⁽⁵⁾					
Equity contracts	827	1,368	59		2,254
Interest rate contracts	10	19,142	151		19,303
Credit contracts	4	1,582	37		1,623
Foreign exchange contracts		2,926	14		2,940
Commodity contracts	0	0	0		0
Netting				(24,030)	(24,030)
Total derivative liabilities	841	25,018	261	(24,030)	2,090
Subtotal	¥ 8,568	¥ 26,247	¥ 262	¥ (24,030)	¥ 11,047
Short-term borrowings ⁽⁸⁾		46	3		49
Payables and deposits ⁽⁹⁾		0	0		0
Collateralized financing ⁽⁷⁾		530			530
Long-term borrowings ⁽⁸⁾⁽¹⁰⁾⁽¹¹⁾	134	1,439	394		1,967
Other liabilities ⁽¹²⁾	152	86			238
Total	¥ 8,854	¥ 28,348	¥ 659	¥ (24,030)	¥ 13,831

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	Billions of yen September 30, 2014				Balance as of September 30, 2014
	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting ⁽¹⁾	
Assets:					
Trading assets and private equity investments ⁽²⁾					
Equities ⁽³⁾	¥ 1,794	¥ 912	¥ 42	¥	¥ 2,748
Private equity investments ⁽³⁾			45		45
Japanese government securities	3,241				3,241
Japanese agency and municipal securities		168	0		168
Foreign government, agency and municipal securities	4,920	1,502	11		6,433
Bank and corporate debt securities and loans for trading purposes		2,116	115		2,231
Commercial mortgage-backed securities (CMBS)		143	3		146
Residential mortgage-backed securities (RMBS)		2,130	1		2,131
Real estate-backed securities		29	0		29
Collateralized debt obligations (CDO) and other		194	29		223
Investment trust funds and other	475	71	18		564
Total trading assets and private equity investments	10,430	7,265	264		17,959
Derivative assets⁽⁵⁾					
Equity contracts	784	1,212	53		2,049
Interest rate contracts	21	24,023	87		24,131
Credit contracts	5	1,069	35		1,109
Foreign exchange contracts	0	4,843	18		4,861
Commodity contracts	0	0	0		0
Netting				(30,054)	(30,054)
Total derivative assets	810	31,147	193	(30,054)	2,096
Subtotal	¥ 11,240	¥ 38,412	¥ 457	¥ (30,054)	¥ 20,055
Loans and receivables ⁽⁶⁾		258	27		285
Collateralized agreements ⁽⁷⁾		984			984
Other assets					
Non-trading debt securities	366	601	0		967
Other ⁽³⁾	347	52	56		455
Total	¥ 11,953	¥ 40,307	¥ 540	¥ (30,054)	¥ 22,746
Liabilities:					
Trading liabilities					
Equities	¥ 870	¥ 195	¥ 1	¥	¥ 1,066
Japanese government securities	2,894				2,894
Foreign government, agency and municipal securities	3,873	771			4,644
Bank and corporate debt securities		432	0		432
Residential mortgage-backed securities (RMBS)		3			3
Collateralized debt obligations (CDO) and other		1	1		2
Investment trust funds and other	79	12			91
Total trading liabilities	7,716	1,414	2		9,132
Derivative liabilities⁽⁵⁾					
Equity contracts	759	1,348	61		2,168
Interest rate contracts	9	23,696	139		23,844

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Credit contracts	4	1,417	31		1,452
Foreign exchange contracts	0	4,425	16		4,441
Commodity contracts	0	0	0		0
Netting				(30,155)	(30,155)
Total derivative liabilities	772	30,886	247	(30,155)	1,750
Subtotal	¥ 8,488	¥ 32,300	¥ 249	¥ (30,155)	¥ 10,882
Short-term borrowings ⁽⁸⁾		35	2		37
Payables and deposits ⁽⁹⁾		0	0		0
Collateralized financing ⁽⁷⁾		536			536
Long-term borrowings ⁽⁸⁾⁽¹⁰⁾⁽¹¹⁾	113	1,835	439		2,387
Other liabilities ⁽¹²⁾	142	43			185
Total	¥ 8,743	¥ 34,749	¥ 690	¥ (30,155)	¥ 14,027

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- (1) Represents the amount offset under counterparty netting of derivative assets and liabilities as well as cash collateral netting against net derivatives.
- (2) Includes investments in certain funds measured at fair value on the basis of NAV per share as a practical expedient.
- (3) Includes equity investments that would have been accounted for under the equity method had Nomura not chosen to elect the fair value option.
- (4) Includes collateralized loan obligations (CLOs) and asset-backed securities (ABS) such as those secured on credit card loans, auto loans and student loans.
- (5) Each derivative classification includes derivatives referencing multiple risk components. For example, interest rate contracts include complex derivatives referencing interest rate risk as well as foreign exchange risk or other factors such as prepayment rates. Credit contracts include credit default swaps as well as derivatives referencing corporate and government debt securities.
- (6) Includes loans for which the fair value option is elected.
- (7) Includes collateralized agreements or collateralized financing for which the fair value option is elected.
- (8) Includes structured notes for which the fair value option is elected.
- (9) Includes embedded derivatives bifurcated from deposits received at banks. If unrealized gains are greater than unrealized losses, deposits are reduced by the excess amount.
- (10) Includes embedded derivatives bifurcated from issued structured notes. If unrealized gains are greater than unrealized losses, borrowings are reduced by the excess amount.
- (11) Includes liabilities recognized from secured financing transactions that are accounted for as financings rather than sales. Nomura elected the fair value option for these liabilities.
- (12) Includes loan commitments for which the fair value option is elected.

Valuation techniques by major class of financial instrument

The valuation techniques used by Nomura to estimate fair value for major classes of financial instruments, together with the significant inputs which determine classification in the fair value hierarchy, are as follows.

Equities and equity securities reported within Other assets Equities and equity securities reported within *Other assets* include direct holdings of both listed and unlisted equity securities, and fund investments. Listed equity securities are valued using quoted prices for identical securities from active markets where available. These valuations should be in line with market practice and therefore can be based on bid/offer prices as applicable or mid-market prices. Nomura determines whether the market is active depending on the sufficiency and frequency of trading activity. Where these securities are classified in Level 1 of the fair value hierarchy, no valuation adjustments are made to fair value. Listed equity securities traded in inactive markets are also generally valued using the exchange price and are classified in Level 2. Whilst rare in practice, Nomura may apply a discount or liquidity adjustment to the exchange price of a listed equity security traded in an inactive market if the exchange price is not considered to be an appropriate representation of fair value. These adjustments are determined by individual security and are not determined or influenced by the size of holding. The amount of such adjustments made to listed equity securities traded in inactive markets was ¥nil as of March 31, 2014 and September 30, 2014, respectively. Unlisted equity securities are valued using the same methodology as private equity investments described below and are usually classified in Level 3 because significant valuation inputs such as yields and liquidity discounts are unobservable. As a practical expedient, fund investments are generally valued using NAV per share where available. Publicly traded mutual funds which are valued using a daily NAV per share are classified in Level 1. Investments in funds where Nomura has the ability to redeem its investment with the investee at NAV per share as of the balance sheet date or within the near term are classified in Level 2. Investments in funds where Nomura does not have the ability to redeem in the near term or does not know when it can redeem are classified in Level 3. The Direct Capitalization Method (DCM) is used as a valuation technique for certain equity investments in real estate funds, with net operating income used as a measure of financial performance which is then applied to a capitalization rate dependent on the characteristics of the underlying real estate. Equity investments which are valued using DCM valuation techniques are generally classified in Level 3 since observable market capitalization rates are usually not available for identical or sufficiently similar real estate to that held within the real estate funds being valued.

Private equity investments The valuation of unlisted private equity investments requires significant management judgment because the investments, by their nature, have little or no price transparency. Private equity investments are initially carried at cost as an approximation of fair value. Adjustments to carrying value are made if there is third-party evidence of a change in value. Adjustments are also made, in the absence of third-party transactions, if it is determined that the expected exit price of the investment is different from carrying value. In reaching that determination, Nomura primarily uses either a discounted cash flow (DCF) or market multiple valuation technique. A DCF valuation technique incorporates estimated future cash flows to be generated from the underlying investee, as adjusted for an appropriate growth rate discounted at a weighted average cost of capital (WACC). Market multiple valuation techniques include comparables such as Enterprise

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Value/earnings before interest, taxes, depreciation and amortization (EV/EBITDA) ratios, Price/Earnings (PE) ratios, Price/Book ratios, Price/Embedded Value ratios and other multiples based on relationships between numbers reported in the financial statements of the investee and the price of comparable companies. A liquidity discount may also be applied to either a DCF or market multiple valuation to reflect the specific characteristics of the investee. Where possible these valuations are compared with the operating cash flows and financial performance of the investee or properties relative to budgets or projections, price/earnings data for similar quoted companies, trends within sectors and/or regions and any specific rights or terms associated with the investment, such as conversion features and liquidation preferences. Private equity investments are generally classified in Level 3 since the valuation inputs such as those mentioned above are usually unobservable.

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Government, agency and municipal securities Japanese and other G7 government securities are valued using quoted market prices, executable broker or dealer quotations, or alternative pricing sources. These securities are traded in active markets and therefore are classified within Level 1 of the fair value hierarchy. Non-G7 government securities, agency securities and municipal securities are valued using similar pricing sources but are generally classified in Level 2 as they are traded in inactive markets. Certain non-G7 securities may be classified in Level 1 because they are traded in active markets. Certain securities may be classified in Level 3 because they are traded infrequently and there is not sufficient information from comparable securities to classify them in Level 2. These are valued using DCF valuation techniques which include significant unobservable inputs such as credit spreads of the issuer.

Bank and corporate debt securities The fair value of bank and corporate debt securities is primarily determined using DCF valuation techniques but also using broker or dealer quotations and recent market transactions of identical or similar debt securities, if available. Consideration is given to the nature of the broker and dealer quotations, namely whether these are indicative or executable, the number of available quotations and how these quotations compare to any available recent market activity or alternative pricing sources. The significant valuation inputs used for DCF valuations are yield curves, asset swap spreads, recovery rates and credit spreads of the issuer. Bank and corporate debt securities are generally classified in Level 2 of the fair value hierarchy because these valuation inputs are usually observable or market-corroborated. Certain bank and corporate debt securities will be classified in Level 3 because they are traded infrequently and there is insufficient information from comparable securities to classify them in Level 2, or credit spreads or recovery rates of the issuer used in DCF valuations are unobservable.

Commercial mortgage-backed securities (CMBS) and Residential mortgage-backed securities (RMBS) The fair value of CMBS and RMBS is primarily determined using DCF valuation techniques but also using broker or dealer quotations and recent market transactions of identical or similar securities, if available. Consideration is given to the nature of the broker and dealer quotations, namely whether these are indicative or executable, the number of available quotations and how these quotations compare to any available recent market activity or alternative pricing sources. The significant valuation inputs include yields, prepayment rates, default probabilities and loss severities. CMBS and RMBS securities are generally classified in Level 2 because these valuation inputs are observable or market-corroborated. Certain CMBS and RMBS positions will be classified in Level 3 because they are traded infrequently and there is insufficient information from comparable securities to classify them in Level 2, or one or more of the significant valuation inputs used in DCF valuations are unobservable.

Real estate-backed securities The fair value of real estate-backed securities is estimated using broker or dealer quotations, recent market transactions or by reference to a comparable market index. Consideration is given to the nature of the broker and dealer quotations, namely whether these are indicative or executable, the number of available quotations and how these quotations compare to any available recent market activity or alternative pricing sources. Where all significant inputs are observable, the securities will be classified in Level 2. For certain securities, no direct pricing sources or comparable securities or indices may be available. These securities are valued using DCF or DCM valuation techniques and are classified in Level 3 as the valuation includes significant unobservable valuation inputs such as yields, prepayment rates, default probabilities, loss severities and capitalization rates.

Collateralized debt obligations (CDOs) and other The fair value of CDOs is primarily determined using DCF valuation techniques but also using broker or dealer quotations and recent market transactions of identical or similar securities, if available. Consideration is given to the nature of the broker and dealer quotations, namely whether these are indicative or executable, the number of available quotations and how these quotations compare to any available recent market activity or alternative pricing sources. The significant valuation inputs used include market spread data for each credit rating, yields, prepayment rates, default probabilities and loss severities. CDOs are generally classified in Level 2 of the fair value hierarchy because these valuation inputs are observable or market-corroborated. CDOs will be classified in Level 3 where one or more of the significant valuation inputs used in the DCF valuations are unobservable.

Investment trust funds and other Investment trust funds are generally valued using NAV per share. Publicly traded funds which are valued using a daily NAV per share are classified in Level 1. For funds that are not publicly traded but Nomura has the ability to redeem its investment with the investee at NAV per share on the balance sheet date or within the near term, the investments are classified in Level 2. Investments where Nomura does not have the ability to redeem in the near term or does not know when it can redeem are classified in Level 3. The fair value of certain other investments reported within *Investment trust funds and other* is determined using DCF valuation techniques. These investments are classified in Level 3 as the valuation includes significant unobservable valuation inputs such as credit spreads of issuer and correlation.

Derivatives Equity contracts Nomura enters into both exchange-traded and OTC equity derivative transactions such as index and equity options, equity basket options and index and equity swaps. The fair value of exchange-traded equity derivatives is primarily determined using an unadjusted exchange price. These derivatives are generally traded in active markets and therefore are classified in Level 1 of the fair value hierarchy. Where these derivatives are not valued at the exchange price due to timing differences, these are classified in Level 2. The fair value

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of OTC equity derivatives is determined through option models such as Black-Scholes and Monte Carlo simulation. The significant valuation inputs used include equity prices, dividend yields, volatilities and correlations. Valuation adjustments are also made to model valuations in order to reflect counterparty credit risk on derivative assets and Nomura's own creditworthiness on derivative liabilities. OTC equity derivatives are generally classified in Level 2 because all significant valuation inputs and adjustments are observable or market-corroborated. Certain longer-dated or more complex equity derivatives are classified in Level 3 where dividend yield, volatility or correlation valuation inputs are significant and unobservable.

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Derivatives Interest rate contracts Nomura enters into both exchange-traded and OTC interest rate derivative transactions such as interest rate swaps, currency swaps, interest rate options, forward rate agreements, swaptions, caps and floors. The fair value of exchange-traded interest rate derivatives is primarily determined using an unadjusted exchange price. These derivatives are traded in active markets and therefore are classified in Level 1 of the fair value hierarchy. Where these derivatives are not valued at the exchange price due to timing differences, they are classified in Level 2. The fair value of OTC interest rate derivatives is determined through DCF valuation techniques as well as option models such as Black-Scholes and Monte Carlo simulation. The significant valuation inputs used include interest rates, forward foreign exchange (FX) rates, volatilities and correlations. Valuation adjustments are also made to model valuations in order to reflect counterparty credit risk on derivative assets and Nomura's own creditworthiness on derivative liabilities. OTC interest rate derivatives are generally classified in Level 2 because all significant valuation inputs and adjustments are observable or market-corroborated. Certain longer-dated or more complex OTC interest rate derivatives are classified in Level 3 where forward FX rate, interest rate, volatility or correlation valuation inputs are significant and unobservable.

Derivatives Credit contracts Nomura enters into OTC credit derivative transactions such as credit default swaps and credit options on single names, indices or baskets of assets. The fair value of OTC credit derivatives is determined through DCF valuation techniques as well as option models such as Black-Scholes and Monte Carlo simulation. The significant valuation inputs used include interest rates, credit spreads, recovery rates, default probabilities, volatilities and correlations. Valuation adjustments are also made to model valuations in order to reflect counterparty credit risk on derivative assets and Nomura's own creditworthiness on derivative liabilities. OTC credit derivatives are generally classified in Level 2 of the fair value hierarchy because all significant valuation inputs and adjustments are observable or market-corroborated. Certain longer-dated or more complex OTC credit derivatives are classified in Level 3 where credit spread, recovery rate, volatility or correlation valuation inputs are significant and unobservable.

Derivatives Foreign exchange contracts Nomura enters into both exchange-traded and OTC foreign exchange derivative transactions such as foreign exchange forwards and currency options. The fair value of exchange-traded foreign exchange derivatives is primarily determined using an unadjusted exchange price. These derivatives are traded in active markets and therefore are classified in Level 1 of the fair value hierarchy. Where these derivatives are not valued at the exchange price due to timing differences, they are classified in Level 2. The fair value of OTC foreign exchange derivatives is determined through DCF valuation techniques as well as option models such as Black-Scholes and Monte Carlo simulation. The significant valuation inputs used include interest rates, forward FX rates, spot FX rates and volatilities. Valuation adjustments are also made to model valuations in order to reflect counterparty credit risk on derivative assets and Nomura's own creditworthiness on derivative liabilities. OTC foreign exchange derivatives are generally classified in Level 2 because all significant valuation inputs and adjustments are observable or market-corroborated. Certain longer-dated foreign exchange derivatives are classified in Level 3 where forward FX rate or volatility valuation inputs are significant and unobservable.

Derivatives Commodity contracts Nomura enters into OTC commodity derivative transactions such as commodity swaps, commodity forwards and commodity options. The fair value of OTC commodity derivatives is determined through DCF valuation techniques as well as option models such as Black-Scholes and Monte Carlo simulation. The significant valuation inputs used include commodity prices, interest rates, volatilities and correlations. Valuation adjustments are also made to model valuations in order to reflect counterparty credit risk on derivative assets and Nomura's own creditworthiness on derivative liabilities. OTC commodity derivatives are generally classified in Level 2 of the fair value hierarchy because these valuation inputs and adjustments are observable or market-corroborated.

Loans The fair value of loans carried at fair value either as trading assets or through election of the fair value option is primarily determined using DCF valuation techniques as quoted prices are typically not available. The significant valuation inputs used are similar to those used in the valuation of corporate debt securities described above. Loans are generally classified in Level 2 of the fair value hierarchy because all significant valuation inputs are observable. Certain loans, however, are classified in Level 3 because they are traded infrequently and there is not sufficient information from comparable securities to classify them in Level 2 or credit spreads of the issuer used in DCF valuations are significant and unobservable.

Collateralized agreements and Collateralized financing The primary types of collateralized agreement and financing transactions carried at fair value are reverse repurchase and repurchase agreements elected for the fair value option. The fair value of these financial instruments is primarily determined using DCF valuation techniques. The significant valuation inputs used include interest rates and collateral funding spreads such as general collateral or special rates. Reverse repurchase and repurchase agreements are generally classified in Level 2 of the fair value hierarchy because these valuation inputs are usually observable.

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Non-trading debt securities These are debt securities held by certain non-trading subsidiaries in the group and are valued and classified in the fair value hierarchy using the same valuation techniques used for other debt securities classified as *Government, agency and municipal securities* and *Bank and corporate debt securities* described above.

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Notes to the Interim Consolidated Financial Statements (Continued) (UNAUDITED)

Short-term and long-term borrowings (Structured notes) Structured notes are debt securities issued by Nomura or by consolidated variable interest entities (VIEs) which contain embedded features that alter the return to the investor from simply receiving a fixed or floating rate of interest to a return that depends upon some other variables, such as an equity or equity index, commodity price, foreign exchange rate, credit rating of a third party or a more complex interest rate (i.e., an embedded derivative).

The fair value of structured notes is estimated using a quoted price in an active market for the identical liability if available, and where not available, using a mixture of valuation techniques that use the quoted price of the identical liability when traded as an asset, quoted prices for similar liabilities, similar liabilities when traded as assets, or an internal model which combines DCF valuation techniques and option pricing models, depending on the nature of the embedded features within the structured note. Where an internal model is used, Nomura estimates the fair value of both the underlying debt instrument and the embedded derivative components. The significant valuation inputs used to estimate the fair value of the debt instrument component include yield curves and prepayment rates. The significant valuation inputs used to estimate the fair value of the embedded derivative component are the same as those used for the relevant type of freestanding OTC derivative discussed above. A valuation adjustment is also made to the entire structured note in order to reflect Nomura's own creditworthiness. To reflect Nomura's own creditworthiness, the fair value of structured notes includes a credit adjustment of ¥1 billion as of March 31, 2014 and ¥3 billion as of September 30, 2014. This adjustment is determined as follows:

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Lothar F. P. Freund

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Melinda S. Conley

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31,160

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5,940

98,663

(1)

All options granted prior to our initial public offering in December 2009 were granted pursuant to the TJ Chemical Holdings LLC 2004 Option Plan. Options granted from January 2010 forward were granted pursuant to the Kraton Performance Polymers, Inc. 2009 Equity Incentive Plan, as amended and restated. Options granted in March 2013 and 2014 vest over three years. The vesting of the option grants set forth above is as follows:

With respect to Mr. Fogarty's unvested options granted on March 4, 2013, 21,698 vested on March 4, 2016. With respect to Mr. Fogarty's unvested options granted on March 3, 2014, 24,350 vested on March 3, 2016 and 24,351 will vest on March 3, 2017, subject to Mr. Fogarty remaining continuously employed by us through the vesting date. With respect to Mr. Tremblay's unvested options granted on March 4, 2013, 4,882 vested on March 4, 2016. With respect to Mr. Tremblay's unvested options granted on March 3, 2014, 7,197 vested on March 3, 2016 and 7,197 will vest on March 3, 2017, subject to Mr. Tremblay remaining continuously employed by us through the vesting date.

With respect to Dr. Jung's unvested options granted on March 4, 2013, 3,173 vested on March 4, 2016. With respect to Dr. Jung's unvested options granted on March 3, 2014, 5,411 vested on March 3, 2016 and 5,411 will vest on March 3, 2017, subject to Dr. Jung remaining continuously employed by us through the vesting date.

With respect to Dr. Freund's unvested options granted on March 4, 2013, 3,173 vested on March 4, 2016. With respect to Dr. Freund's unvested options granted on March 3, 2014, 4,951 vested on March 3, 2016 and 4,951 will vest on March 3, 2017, subject to Dr. Freund remaining continuously employed by us through the vesting date.

With respect to Ms. Conley's unvested options granted on March 4, 2013, 2,712 vested on March 4, 2016. With respect to Ms. Conley's unvested options granted on March 3, 2014, 2,705 vested on March 3, 2016 and 2,705 will vest on March 3, 2017, subject to Ms. Conley remaining continuously employed by us through the vesting date.

(2) Each of our named executive officers has received restricted stock grants having a three-year cliff vest. The vesting of the restricted stock grants set forth in the table above is as follows:

Mr. Fogarty received a grant 33,564 restricted shares on March 4, 2013, which vested on March 4, 2016, a grant of 32,166 restricted shares on March 3, 2014, which will vest on March 3, 2017, and a grant of 45,825 restricted shares on February 27, 2015, which will vest on February 27, 2018, subject in each case to Mr. Fogarty remaining continuously employed by us through the vesting date.

Mr. Tremblay received a grant of 7,551 restricted shares on March 4, 2013, which vested on March 4, 2016, a grant of 9,543 restricted shares on March 3, 2014, which will vest on March 3, 2017, and a grant of 13,578 restricted shares on February 27, 2015, which will vest on February 27, 2018, subject in each case to Mr. Tremblay remaining continuously employed by us through the vesting date.

Dr. Jung received a grant of 4,908 restricted shares on March 4, 2013, which vested on March 4, 2016, a grant of 7,148 restricted shares on March 3, 2014, which will vest on March 3, 2017, and a grant of 10,183 restricted shares on February 27, 2015, which will vest on February 27, 2018, subject in each case to Dr. Jung remaining continuously employed by us through the vesting date.

Dr. Freund received a grant of 4,908 restricted shares on March 4, 2013, which vested on March 4, 2016, a grant of 6,576 restricted shares on March 3, 2014, which will vest on March 3, 2017, and a grant of 9,335 restricted shares on February 27, 2015, which will vest on February 27, 2018, subject in each case to Dr. Freund remaining continuously employed by us through the vesting date.

Ms. Conley received a grant of 4,195 restricted shares on March 4, 2013, which vested on March 4, 2016, a grant of 3,574 restricted shares on March 3, 2014, which will vest on March 3, 2017, and a grant of 5,940 restricted shares on February 27, 2015, which will vest on February 27, 2018, subject in each case to Ms. Conley remaining continuously employed by us through the vesting date.

(3) The market value of shares that have not yet vested and of equity incentive plan awards that have not been earned is calculated based on the closing price of our common stock on December 31, 2015, the last trading day of the year, which was \$16.61.

(4) The number of shares reported in this column (i) and the payout value in column (j) is based on the achievement of threshold performance levels of Adjusted EBITDA, provided that for the March 3, 2014 grants of performance restricted stock units for which the performance period for determining the number of performance units concluded on December 31, 2014, the actual performance factor (0.525) that was certified by the Compensation Committee on February 11, 2015 was used.

Option Exercises and Stock Vested Table

The following table sets forth information regarding equity awards held by our named executive officers exercised or vested during fiscal year 2015.

Name	Stock Awards	
	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$) (1)
Kevin M. Fogarty	15,517	315,461
Stephen E. Tremblay	4,170	84,776
Holger R. Jung	3,695	75,119
Lothar F. P. Freund	3,431	69,752

Melinda S. Conley

3,418

76,768

(1) The value realized on vesting is calculated by multiplying the number of shares of stock by the fair market value of the underlying shares on the vesting date.

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Pension Benefits

The following table sets forth information regarding participation of our named executive officers in our U.S. Pension Plan during fiscal year 2015.

Name (1)	Plan Name	Number of Years Credited Services (#)	Present Value of Accumulated Benefit (\$)	Payments During Last Fiscal Year (\$)
(a)	(b)	(c)	(d)	(e)
Kevin M. Fogarty	Pension Plan	0.60	12,165	—
Lothar F. P. Freund	Pension Plan	0.34	8,556	—

(1) Mr. Tremblay, Mr. Jung, and Ms. Conley are not eligible to participate in our pension plan.

We maintain a tax-qualified noncontributory defined benefit pension plan that covers our U.S. eligible employees hired prior to October 15, 2005, our former employees and our retirees. See Note 13, Employee Benefits, in the Notes to Consolidated Financial Statements contained in our Annual Report on Form 10-K for the year ended December 31, 2015. We make contributions to the plan on behalf of our eligible employees. Employees do not make contributions to the plan. The pension plan is intended to qualify under Section 401 of the Internal Revenue Code.

The normal retirement benefit formula for participants is approximately 1.6% of the participant's average final compensation multiplied by his years of accredited service, minus a percentage of benefits received under social security. The company does not have a policy of granting extra years of service. The primary elements of compensation that are included in applying the payment and benefit formulae are (i) base salary, including salary deferrals, and (ii) non-deferred payments under incentive compensation plans prior to a participant's separation from service, provided that no more than three consecutive payments of incentive compensation are taken into account. Participants become eligible to begin receiving payments when they reach the "normal" retirement age of 65. Under certain circumstances participants are eligible to receive payments at early retirement; however, under no circumstances can a participant be qualified for early retirement before the age of 45. None of our named executive officers is currently eligible for early retirement under the terms of the pension plan. Benefits under the pension plan for Messrs. Fogarty and Freund were frozen as of December 31, 2005; however, they continue to accumulate years of credited service for purposes of vesting under the plan. The other named executive officers do not participate in the pension plan.

Non-qualified Deferred Compensation

The following table sets forth information regarding participation of our named executive officers in our non-qualified deferred compensation plans for fiscal year 2015. Amounts set forth in the table are under our Benefits Restoration Plan.

Name	Executive Contributions in 2015 (\$)	Company Contributions in 2015 (\$) (1)	Aggregate Earnings in 2015 (\$) (2)	Aggregate Withdrawals/ Distributions (\$)	Aggregate Balance at 12/31/2015 (\$)
(a)	(b)	(c)	(d)	(e)	(f)
Kevin M. Fogarty	57,495	84,267	38,413	—	1,089,944
Stephen E. Tremblay	18,085	30,142	13,723	—	325,413
Holger R. Jung	11,973	11,973	4,595	—	111,653
Lothar F. P. Freund	10,115	16,858	8,825	—	232,856
Melinda S. Conley	6,672	6,672	1,996	—	43,550

(1) Amounts set forth in this column were reported in "All Other Compensation" for 2015 in our "Summary of Cash and Certain Other Compensation" table.

These amounts were not reported for 2015 in our “Summary of Cash and Certain Other Compensation” table because our named executive officers do not earn above-market or preferential earnings on contributions under this plan. In 2015, our named executive officers invested in these funds with gross one-year average annual total returns reflected as of December 31, 2015: Baron Growth Fund Retail Shares (-4.31%); Baron Small Cap Fund Retail Class (-5.24%); Deutsche CROCI Equity Dividend A (-7.16%); Fidelity Blue Chip Growth (6.28%); Fidelity Blue Chip Value (-1.96%); Fidelity Contrafund (6.46%); Fidelity Freedom 2020 (-0.23%); Fidelity Freedom 2025 (-0.16%); Fidelity Freedom 2035 (-0.21%); Fidelity Freedom Income (-0.38%); Fidelity Growth and Income Portfolio (-2.28%); Fidelity Large Cap Stock (-3.17%); Fidelity OTC Portfolio (10.92%); Fidelity Real Estate Investment Portfolio (5.95%); Fidelity Worldwide (3.51%); Fidelity Total Bond (-0.42%); Fidelity Nasdaq Composite Index (6.82%).

Benefits Restoration Plan

Our Benefits Restoration Plan is intended to restore certain benefits that may not be provided under our tax-qualified savings plan due to limitations under the Internal Revenue Code on tax-qualified plans. Our Benefits Restoration Plan offers participants the opportunity to defer a portion of their base compensation in excess of the compensation limit under the Internal Revenue Code (“compensation limit”) that applies to our tax-qualified 401(k) plan (“deferral contributions”). Deferral contributions are limited to the matched contribution percentage of the participant’s base compensation under our 401(k) plan. Participants receive employer matching contributions under our Benefits Restoration Plan on their deferral contributions based on the employer matching contribution formula under our 401(k) plan. Also, participants have the opportunity to receive non-elective employer contributions under our Benefits Restoration Plan based on the enhanced employer contribution formula under our 401(k) plan based on their base compensation in excess of the compensation limit. To make deferral contributions, a participant must complete a deferral election prior to January 1st of the plan year during which the deferrals will be made. Deferrals and employer contributions are credited to a bookkeeping account and notionally invested in accordance with the participant’s investment elections in the investment options selected for the plan.

A participant’s deferral contributions (and earnings thereon) made under the Benefits Restoration Plan on and after January 1, 2013 will be paid to the participant in a lump sum cash payment 183 days after the participant’s separation from service date. Deferral contributions (and earnings thereon) made prior to 2013 are subject to the terms and conditions of the plan and the participant’s deferral elections in effect at the time the amounts were contributed to the plan, including with respect to the form of payment of the participant’s pre-2013 benefits.

Termination and Change in Control Payments

The following tables set forth the estimated value of payments and benefits that our named executive officers would be entitled to receive assuming certain terminations of employment and/or assuming a change in control of Kraton, in each case occurring on December 31, 2015, in addition to the amounts they would be entitled to receive pursuant to the pension plan and the Benefits Restoration Plan, each as described above, as well as benefits available generally to salaried employees. Excluded from the tables below are payouts under the Executive Deferred Compensation Plan, a plan formerly available to our executives, now frozen, under which they were allowed to defer a portion of their annual cash bonus, which was invested in phantom shares of Kraton common stock that are to be issued six months after the executive’s separation from service.

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The following table reflects amounts that would be due to our named executive officers under the Kraton Performance Polymers, Inc. Executive Severance Program as it existed on December 31, 2015.

Name and Triggering Event	Severance Payment(\$)	Accelerated Vesting of Equity Awards (\$)(4)	Continuation of Medical Benefits (\$)	Total (\$)
Kevin M. Fogarty (7)				
Termination of Employment:				
By us for cause or resignation by executive without good reason	—	—	—	—
By us without cause or by executive for good reason (1)	2,007,611	—	28,891	2,036,502
By us without cause or by executive for good reason within one year after a change in control (2)	5,250,000	3,655,731	57,782	8,963,513
Upon Disability or Death (3)	463,407	2,547,361	—	3,010,768
Upon a Change in Control	—	—	—	—
Stephen E. Tremblay				
Termination of Employment:				
By us for cause or resignation by executive without good reason	—	—	—	—
By us without cause or by executive for good reason (5)	599,719	—	6,858	606,577
By us without cause or by executive for good reason within one year after a change in control (6)	1,485,000	1,043,410	13,715	2,542,125
Upon Disability or Death (3)	149,719	715,079	—	864,798
Upon a Change in Control	—	—	—	—
Holger R. Jung				
Termination of Employment:				
By us for cause or resignation by executive without good reason	—	—	—	—
By us without cause or by executive for good reason (5)	478,976	—	19,261	498,237
By us without cause or by executive for good reason within one year after a change in control (6)	1,200,000	770,018	38,521	2,008,539
Upon Disability or Death (3)	103,976	523,710	—	627,686
Upon a Change in Control	—	—	—	—
Lothar F. P. Freund				
Termination of Employment:				
By us for cause or resignation by executive without good reason	—	—	—	—
By us without cause or by executive for good reason (5)	460,389	—	26,052	486,441
By us without cause or by executive for good reason within one year after a change in control (6)	1,120,000	712,926	52,103	1,885,029
Upon Disability or Death (3)	110,389	487,188	—	597,577
Upon a Change in Control	—	—	—	—
Melinda S. Conley				
Termination of Employment:				
By us for cause or resignation by executive without good reason	—	—	—	—
By us without cause or by executive for good reason (5)	422,917	—	19,261	442,178
By us without cause or by executive for good reason within one year after a change in control (6)	975,000	456,199	38,521	1,469,720

Upon Disability or Death (3)	97,917	314,260	—	412,177
Upon a Change in Control	—	—	—	—

- Upon termination of Mr. Fogarty’s employment by us without cause or by Mr. Fogarty for “good reason,” Mr. Fogarty is entitled to (i) continuation of base salary for 18 months, (ii) a lump sum cash payment equal to 1.5 times Mr. Fogarty’s average annual bonus paid over the prior three years and (iii) continuation of medical benefits for up to 18 months (such benefits cease when Mr. Fogarty becomes entitled to benefits from a new employer, if any; however, for the purposes of this table, we have assumed such benefits shall continue for 18 months).
- Upon termination of Mr. Fogarty’s employment by us without cause or by Mr. Fogarty for “good reason” within one year after a change in control, Mr. Fogarty is entitled to (i) continuation of base salary for 36 months, (ii) a lump sum cash payment equal to three times Mr. Fogarty’s target annual bonus and (iii) continuation of medical benefits for up to 36 months (such benefits cease when Mr. Fogarty becomes entitled to benefits from a new employer, if any; however, for the purposes of this table, we have assumed such benefits shall continue for 36 months).
- Upon termination of the executive officer’s employment due to Disability or Death, such executive officer, or his or her estate, is entitled to a lump sum cash payment equal to the product of such executive officer’s average annual bonus paid over the prior three years, times a fraction, the numerator of which is the number of days such executive officer worked in the year in which the termination event occurred and the denominator of which is 365.
- Equity awards vest in accordance with the terms of the individual grant agreements with respect to each award. Options, restricted shares and restricted stock performance units (which vest at the Target amount) held by the executive officer vest immediately in the event of termination of such executive officer’s employment by us without “cause” within one year following a change in control. Option and restricted share awards also vest in full upon the termination of the grantee’s employment due to Disability or death, and restricted stock performance units will vest at one-third of Target (if termination occurs prior to the first anniversary of grant), two-thirds of Target (after the first anniversary, but prior to the second) or in full (after the second anniversary of grant). For the 2014 grants of performance restricted stock units for which the performance period for determining the number of performance units concluded on December 31, 2014, our Compensation Committee certified an actual performance factor of 0.525x target, which was used to calculate the “Target” for these awards. For the 2013 grants of performance restricted stock units for which the performance period for determining the number of performance units concluded on December 31, 2015, our Compensation Committee certified an actual performance factor of 0x target, therefore no amounts are included for those grants in the table. The value in this column represents an amount equal to the number of shares underlying the executive officer’s unvested restricted stock, restricted stock performance units and stock options as of December 31, 2015 multiplied by (i) in the case of restricted stock and restricted stock performance units, the closing market price of our common stock on December 31, 2015 (\$16.61), which was the last trading day of fiscal 2015, and (ii) in the case of stock options, the spread between the closing market price of our common stock on December 31, 2015 (\$16.61) and the applicable exercise price of each stock option.
- Upon termination of the executive officer’s employment by us without cause or by such executive officer for “good reason,” such executive officer is entitled to (i) continuation of base salary for 12 months, (ii) a lump sum cash payment equal to one times such executive officer’s average annual bonus paid over the prior three years and (iii) continuation of medical benefits for up to 12 months (such benefits cease when such executive officer becomes entitled to benefits from a new employer, if any; however, for the purposes of this table, we have assumed such benefits shall continue for 12 months).
- Upon termination of the executive officer’s employment by us without cause or by such executive officer for “good reason” within one year after a change in control, such executive officer is entitled to (i) continuation of base salary for 24 months, (ii) a lump sum cash payment equal to two times such executive officer’s target annual bonus and (iii) continuation of medical benefits for up to 24 months (such benefits cease when such executive officer becomes entitled to benefits from a new employer, if any; however, for the purposes of this table, we have assumed such benefits shall continue for 24 months).
- In addition to the amounts set forth in the table for Mr. Fogarty, on the first day of the seventh month from his date of separation, Mr. Fogarty would be entitled to the issuance of 5,607 shares of Kraton common stock based on phantom shares of Kraton common stock Mr. Fogarty holds as a result of deferrals of bonus compensation he had previously made under the terms of the Executive Deferred Compensation Plan and as a result of a grant of phantom stock prior to our initial public offering.

Severance Arrangements under Executive Severance Program

The executive severance program generally sets forth the severance, if any, a named executive officer is entitled to receive under specified circumstances. Any executive who is not party to an employment agreement with us is eligible to be named as a participant in the severance program. Participants are designated by the Compensation Committee each calendar year and are subject to removal from the program upon written notice from the committee. The severance program provides for the payment of severance benefits upon the occurrence of certain termination events. The provisions of the severance program that are related to payments on termination of employment or a change in control of Kraton are set forth in the tabular disclosure directly above under the heading “Termination and Change in Control Payments.”

Generally, the severance program defines “Cause” to mean (A) the executive’s continued failure substantially to perform the executive’s duties, provided that we cannot terminate the executive’s

employment for Cause because of dissatisfaction with the quality of services provided by or disagreement with the actions taken by him or her in the good faith performance of his or her duties to our company; (B) failure to maintain his or her principal residence in the same metropolitan area as our principal headquarters, or elsewhere as mutually agreed; (C) theft or embezzlement of our company's property; (D) executive's conviction of or plea of guilty or no contest to (i) a felony or (ii) a crime involving moral turpitude; (E) the executive's willful malfeasance or willful misconduct in connection with his or her duties or any act or omission which is materially injurious to the financial condition or business reputation of our company or any of its subsidiaries or affiliates; or (F) the executive's breach of the restrictive covenants in any confidentiality, non-compete or non-solicitation agreement.

Generally, the severance program defines "Good Reason" to mean (A) our failure to pay the executive's Base Salary or Annual Bonus (if any) when due; (B) a material reduction in the executive's Base Salary, the Target Annual Bonus opportunity, or Employee Benefits, other than an across-the-board reduction; (C) a relocation of the executive's primary work location more than 50 miles from Houston, Texas, without written consent; or (D) a material reduction in the executive's duties and responsibilities, provided that none of these events shall constitute Good Reason if it was an isolated and inadvertent action not taken in bad faith and if it is remedied by us within 30 days after receipt of written notice (or, if the matter is not capable of remedy within 30 days, then within a reasonable period of time following such 30-day period, provided that we have commenced remedy within said 30-day period).

Employee Confidentiality and Non-competition Agreements

Each of our named executive officers has entered into an Employee Confidentiality and Non-competition Agreement containing confidentiality provisions and providing for customary restrictive covenants, including non-competition and non-solicitation provisions for a period of 12 months following termination of employment.

DIRECTOR COMPENSATION

In making its recommendation to the board on independent director compensation, the Compensation Committee considers peer and general industry data, including an analysis of director compensation provided by an independent consultant. To further align the financial interests of our directors with those of our stockholders, our board has adopted stock ownership guidelines whereby each covered director should own shares of our stock valued at five times the annual cash retainer for service on our board. As of December 31, 2015, it was determined that all directors subject to the guidelines were making reasonable progress toward their respective ownership targets. Our President and Chief Executive Officer does not receive compensation for his services as a director.

Components of Non-Employee Director Compensation

Our compensation program for non-management directors consists of a combination of cash retainers and equity grants of shares of our fully-vested common stock. We also reimburse our directors for travel, lodging and related expenses incurred in attending board or committee meetings and for directors' education programs and seminars. The following table details our 2015 director compensation structure:

Component	Type	Annual Amount
Base Compensation all non-employee directors	for Equity Grant	\$ 80,000
	Cash Retainer	\$ 80,000
	Chairman of the Board	\$ 130,000
Additional Cash Fees Board and Committee Chairs	for Audit Committee Chair	\$ 17,500
	Compensation Committee Chair	\$ 12,500
	NCGC Chair	\$ 10,000

Director Compensation for Fiscal 2015

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)(1)	Total (\$)
Anna C. Catalano	80,000	79,994	159,994
Steven J. Demetriou (2)	92,500	79,994	172,494
Dominique Fournier	90,000	79,994	169,994
John J. Gallagher, III	97,500	79,994	177,494
Barry J. Goldstein (3)	80,000	79,994	159,994
Francis S. Kalman	80,000	79,994	159,994
Dan F. Smith (4)	210,000	79,994	289,994
Karen A. Twitchell	80,000	79,994	159,994

Amounts set forth in the Stock Awards column represent the aggregate grant date fair value with respect to grants of fully vested common stock in accordance with the Financial Accounting Standards Board ASC Topic 718 (disregarding the estimate of forfeitures related to service-based vesting conditions). For a discussion of the assumptions used in calculating the fair value of our stock-based compensation, refer to Note 4, Share-Based Compensation, in the Notes to Consolidated Financial Statements contained in our Annual Report on Form 10-K for the year ended December 31, 2015.

(2) At December 31, 2015, Mr. Demetriou had 7,400 options outstanding, all of which were exercisable.

(3) At December 31, 2015, Mr. Goldstein had 16,651 options outstanding, all of which were exercisable.

(4) At December 31, 2015, Mr. Smith had 14,801 options outstanding, all of which were exercisable.

PROPOSAL 2

ADVISORY VOTE ON THE COMPENSATION OF THE NAMED EXECUTIVE OFFICERS

The Dodd-Frank Wall Street Reform and Consumer Protection Act added Section 14A to the Exchange Act which requires that we provide our stockholders with the opportunity to vote to approve, on a nonbinding, advisory basis, the compensation of our named executive officers as disclosed in this proxy statement in accordance with the compensation disclosure rules of the Securities and Exchange Commission.

As discussed in the “Compensation Discussion and Analysis” section of this proxy statement, we seek to align the interests of our named executive officers with the interests of our stockholders. Our compensation programs are designed to reward our named executive officers for the achievement of short-term and long-term strategic and operational goals, while at the same time avoiding encouragement of unnecessary or excessive risk-taking. Elements of compensation paid to our named executive officers in 2015 included base salary, annual cash incentive compensation, long-term equity incentive compensation and other compensation. Our board invites you to review carefully the Compensation Discussion and Analysis and the tabular and other disclosures on executive compensation contained herein.

The board recommends that stockholders vote “FOR” the following resolution:

“RESOLVED, that the Company’s stockholders approve, on an advisory basis, the compensation paid to its named executive officers, as disclosed in this proxy statement pursuant to the compensation rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, the Summary of Cash and Certain Other Compensation table and the other related tables and disclosure.”

This proposal allows our stockholders to express their opinions regarding the decisions of the Compensation Committee on the prior year’s compensation paid to our named executive officers. Your vote on this resolution is not intended to address any specific element of compensation; rather, the vote relates to the overall compensation of our named executive officers as described in this proxy statement. The vote is advisory, which means that it is not binding on the company, the board or the Compensation Committee. Your advisory vote will serve as an additional tool to guide the board and the Compensation Committee in continuing to maintain the appropriate compensation programs to align executive compensation with the interests of Kraton and its stockholders. Accordingly, we and the board welcome our stockholders’ views on this subject and will consider the outcome of this vote when making future decisions regarding executive compensation. The board has adopted a policy that provides for annual “say on pay” advisory votes.

REPORT OF THE AUDIT COMMITTEE

The Audit Committee operates under a written charter, adopted by the board, that outlines its responsibilities and practices. The written charter can be found in the “Investor Relations” section of our website located at www.kraton.com. The Audit Committee reviews and assesses the adequacy of its charter at least annually and, when appropriate, recommends changes to the board to reflect the evolving role of the Audit Committee. The Audit Committee consists of non-management directors who meet the definition of “independent director” for purposes of serving on an audit committee under applicable SEC rules and NYSE listing standards. The board has determined that each of Messrs. Gallagher, Goldstein and Kalman and Ms. Twitchell qualifies as an “audit committee financial expert.”

Primary Responsibilities

In 2015, the Audit Committee held nine meetings. During 2015, the Audit Committee, on behalf of the board, represented and assisted the board in fulfilling its oversight responsibility relating to, among other things: the integrity of the company’s financial statements and financial reporting process and the company’s systems of internal accounting and financial controls;

- the performance of the internal audit services function;
- the annual independent audit of the company’s financial statements, the engagement of the independent auditors and the evaluation of the independent auditors’ qualifications, independence and performance;
- the compliance by the company with legal and regulatory requirements, including the company’s disclosure controls and procedures;
- the evaluation of enterprise risk issues; and
- the fulfillment of the other responsibilities set out in its charter.

The Audit Committee has the sole responsibility for the engagement and retention of the company’s independent registered public accounting firm and the approval of all audit and other engagement fees.

In discharging its responsibilities, the Audit Committee is not itself responsible for the planning or conducting of audits or for any determination that the company’s financial statements are complete and accurate or in accordance with generally accepted accounting principles. The company’s management is primarily responsible for the company’s financial statements and the quality and integrity of the reporting process. The independent registered public accounting firm KPMG LLP is responsible for auditing those financial statements and for expressing an opinion on the conformity of the consolidated financial statements with accounting principles generally accepted in the United States of America. KPMG LLP, which has served as our independent registered public accounting firm since 2001, audited the financial records of the company and its subsidiaries for the fiscal year ended December 31, 2015.

Oversight of Independent Registered Public Accounting Firm

In fulfilling its oversight responsibilities, the Audit Committee has reviewed and discussed the company’s audited consolidated financial statements for the year ended December 31, 2015 and management’s report of the effectiveness of the company’s system of internal control over financial reporting with the company’s management and representatives of the independent registered public accounting firm. The Audit Committee discussed with the independent registered public accounting firm the matters required to be discussed by the statement on Auditing Standards No. 61, Communication with Audit Committees, as amended (AICPA, Professional Standards, Vol. 1, AU section 380), as adopted by the Public Company Accounting Oversight Board in Rule 3200T. In addition, the Audit Committee has received the written disclosures and the letter from the independent registered public accounting firm required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent registered

public accounting firm's communications with the Audit Committee concerning independence and has discussed with the independent registered public accounting firm its independence.

The Audit Committee recognizes the importance of maintaining the independence of the company's independent registered public accounting firm, both in fact and appearance. Each year, the committee evaluates the qualifications, performance, and independence of the company's independent registered public accounting firm and determines whether to reengage the current independent registered public accounting firm. In doing so, the Audit Committee considers the quality and efficiency of the services provided by the independent registered public accounting firm, the independent registered public accounting firm's global capabilities, and the independent registered public accounting firm's technical expertise and knowledge of the Company's operations and industry. Based on this evaluation, the Audit Committee has retained KPMG, LLP as the Company's independent registered public accounting firm for 2016. The members of the Audit Committee and the Board believe that, due to KPMG LLP's knowledge of the company and the industries in which the company operates, it is in the best interests of the company and its stockholders to continue the retention of KPMG, LLP to serve as the company's independent registered public accounting firm. Although the Audit Committee has the sole authority to retain the independent registered public accounting firm, the Audit Committee will recommend that the Board ask the stockholders to ratify the appointment of the independent registered public accounting firm at the Annual Meeting.

2015 Audited Financial Statements

In its oversight role, the Audit Committee relies on the work and assurances of Kraton's management, which has the responsibility for establishing and maintaining adequate internal control over financial reporting and for preparing the financial statements and other reports, and of the independent auditors, who are engaged to audit and report on the consolidated financial statements of Kraton and subsidiaries and the effectiveness of Kraton's internal control over financial reporting.

The Audit Committee has reviewed and discussed with management and the independent auditors the audited financial statements in Kraton's Annual Report on Form 10-K for the fiscal year ended December 31, 2015 (the "2015 Annual Report"). As part of its review and discussion, the Audit Committee asked for management's representations and reviewed certifications prepared by the President and Chief Executive Officer and the Chief Financial Officer that Kraton's unaudited quarterly and audited consolidated financial statements fairly present, in all material respects, the financial condition, results of operations and cash flows of the company.

In reliance on its review of the audited consolidated financial statements, the review of the report of management on the effectiveness of Kraton's internal control over financial reporting, the discussions referred to above and the receipt of the written disclosures referred to above, the Audit Committee has recommended to the board that the audited consolidated financial statements be included in the 2015 Annual Report, for filing with the SEC.

Submitted by the Audit Committee:

John J. Gallagher, III, Chairman
Barry J. Goldstein
Francis S. Kalman
Karen A. Twitchell

PROPOSAL 3

RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Our Audit Committee has selected KPMG LLP to serve as our independent registered public accounting firm for the fiscal year ending December 31, 2016. While the Audit Committee is responsible for the appointment, compensation, retention, termination and oversight of the independent auditor, we are requesting, as a matter of good corporate governance, that the stockholders ratify the appointment of KPMG LLP as our independent registered public accounting firm. If the stockholders fail to ratify the selection, the Audit Committee will reconsider whether to retain KPMG LLP and may retain that firm or another without re-submitting the matter to our stockholders. Even if the appointment is ratified, the Audit Committee may, in its discretion, direct the appointment of a different independent registered public accounting firm at any time during the year.

KPMG LLP's representatives are expected to be present at the Annual Meeting and will have an opportunity to make a statement, if they so desire, as well as to respond to appropriate questions asked by our stockholders.

The board recommends that stockholders vote "FOR" the ratification of the appointment of KPMG LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2016.

Fees Paid to Independent Registered Public Accounting Firm

The following table presents fees billed for professional audit services rendered by KPMG LLP for the audit of our annual financial statements for 2014 and 2015, as well as other services rendered by KPMG LLP during those periods:

Description of Services	Amount Billed (\$ millions)	
	2015	2014
Audit Fees - the audit of our consolidated financial statements, review of our interim financial statements, review of our systems of internal control over financial reporting, services in connection with statutory and regulatory filings and performance of work in connection with the acquisition of Arizona Chemical and related financings.	\$1.8	\$1.9
Audit-Related Fees - performance of the audit or review of our financial statements and other professional services, but that are not reportable as Audit Fees.	0.02	0.0
Tax Fees - tax compliance, tax advice and tax planning services, primarily related to consultations for certain tax matters with respect to our international operations.	0.2	0.6
All Other Fees - performance of work in connection with the acquisition of Arizona Chemical	0.5	—
Total	\$2.5	\$2.5

The services provided by KPMG LLP described in "Audit-Related Fees," "Tax Fees" and "All Other Fees" above, if any, were approved by the Audit Committee according to applicable SEC rules. The Audit Committee has considered whether the provision of the above-noted non-audit services is compatible with maintaining the independence of the independent registered public accounting firm and has determined, based on advice from KPMG LLP, that the provision of such services has not adversely affected KPMG LLP's independence.

Audit Committee Pre-Approval Policies and Procedures

The Audit Committee's policy is that the committee shall pre-approve the audit and non-audit services performed by our independent registered public accounting firm to assure that the provision of such services does not impair our auditor's independence. Toward this end, our Audit Committee has identified certain services that will always require separate pre-approval on a case-by-case basis and has also provided for policy-based approvals by describing particular types of services that may be provided by our independent registered public accounting firm without consideration by the Audit Committee on a case-by-case basis. Unless a service is of a type that has received policy-based approval, as specifically identified in our pre-approval policy, the service will require separate approval by the Audit Committee.

Under our policy, the terms and fees for the annual financial statement audit and for the annual audit of our internal control over financial reporting always require separate approval on a case-by-case basis by the Audit Committee. The Audit Committee has granted policy-based pre-approval for other specified Audit Services, Audit-Related Services, Tax Services and All Other Services as scheduled in our pre-approval policy provided that in each case, such pre-approval is limited to \$100,000 per engagement with an annual calendar-year aggregate limit on all pre-approved engagements of \$500,000. All services to be provided by our independent registered public accounting firm are reviewed by the Audit Committee with the independent registered public accounting firm on a quarterly basis. The Audit Committee may delegate pre-approval authority from time to time to one or more of its members in its discretion. Any committee member to whom pre-approval authority is delegated is required to report any pre-approval decisions to the full Audit Committee at its next meeting. The Audit Committee may not delegate its responsibilities to pre-approve services performed by the independent registered public accounting firm to any member of our management.

PROPOSAL 4

APPROVAL OF THE ADOPTION OF THE KRATON PERFORMANCE POLYMERS, INC. 2016 EQUITY AND CASH INCENTIVE PLAN

On April 4, 2016, upon recommendation of the Compensation Committee, the Board approved the adoption of the Kraton Performance Polymers, Inc. 2016 Equity and Cash Incentive Plan (the “2016 Plan”), subject to stockholder approval.

The purpose of the 2016 Plan is to promote the interests of the Company and its stockholders by providing the employees, consultants, and non-employee directors of the Company, who are largely responsible for the management, growth, and protection of the business of the Company, with incentives and rewards to encourage them to continue in the service of the Company. The 2016 Plan is designed to meet this purpose by providing such employees, consultants, and non-employee directors with a proprietary interest in pursuing the long-term growth, profitability, and financial success of the Company and by creating long-term stockholder value.

Highlights of the 2016 Plan

The Board believes that the 2016 Plan will promote the interests of our stockholders, reflects our commitment to effective management of incentive compensation and is consistent with principles of good corporate governance, including the following features:

Clawback Provisions	Awards will be subject to potential reduction, cancellation, forfeiture or other clawback pursuant to the Company’s clawback policy.
Minimum Vesting Periods	Awards will be subject to a minimum vesting period of one year, subject to an exclusion of 5% of the plan reserve.
Limited Discretion to Accelerate Vesting	The Compensation Committee will not have the discretion to accelerate equity vesting absent specific circumstances, including a change in control or death, disability or retirement.
Double Trigger Change in Control	Awards will not automatically vest and pay out solely as a result of a change in control.
No Liberal Share Recycling	The 2016 Plan will prohibit the reuse of shares withheld or delivered to satisfy the exercise price of stock options or to satisfy tax withholding requirements of any award.
Participant Caps	The 2016 Plan will impose annual grant limits for all participants.
Limitations on Options and SARs	For Options and SARs, the 2016 Plan will require stockholder approval for repricing; preclude the payment of dividends or dividend equivalents; and require that the exercise price may not be lower than the fair market value of the underlying shares on the grant date.
Fungible Share Design	The 2016 Plan will use a fungible share pool model in which full value awards count as two shares against the plan reserve.
Independent Committee	The Compensation Committee, consisting solely of independent directors, will administer the 2016 Plan.
No Evergreen Provision	Shares authorized for issuance under the 2016 Plan will not be automatically replenished.

Stockholder Approval of the 2016 Plan

We are seeking stockholder approval of the 2016 Plan in accordance with the NYSE Listed Company Rules which, with limited exceptions, require stockholder approval for all equity compensation plans.

If approved by our stockholders at the Annual Meeting, the 2016 Plan would be a successor to both our 2013 Cash Incentive Plan and our 2009 Equity Incentive Plan. If our stockholders approve the 2016 Plan at the Annual Meeting, the Committee would cease to grant (1) annual cash performance awards under the 2013 Cash Incentive Plan as of December 31, 2016 and would grant future cash awards under the 2016 Plan on and after January 1, 2017 and (2) further awards under the 2009 Equity Incentive Plan after the date of approval of the 2016 Plan by our stockholders, the 2016 Plan's effective date.

If the 2016 Plan is not approved by our stockholders, it will not become effective and the 2009 Equity Incentive Plan and 2013 Cash Incentive Plan will continue in effect in their current form. The 2009 Equity Incentive Plan is the only plan under which equity-based compensation may currently be awarded to our employees and directors. As of March 25, 2016, there were 347,236 shares of common stock remaining available for the grant of equity awards under the 2009 Equity Incentive Plan. In order to enable the company to continue offering meaningful cash-based and equity-based incentives to key employees and non-employee directors, particularly in light of our acquisition of Arizona Chemical, our board believes that it is both necessary and appropriate to increase the number of shares of our common stock available for these purposes. At the same time, our board believes that this provides a good opportunity to modernize the plan design by incorporating current compensation best practices in a replacement plan. As a result, on April 4, 2016, upon recommendation of the Compensation Committee, the board approved the adoption of the 2016 Plan, subject to stockholder approval.

If this proposal is approved, the maximum number of shares reserved for issuance under the 2016 Plan will be (i) 1,550,000 shares plus (ii) the shares of common stock remaining available for awards under the 2009 Equity Incentive Plan as of the date the 2016 Plan is approved by the stockholders. As of March 25, 2016, there were 347,236 authorized shares remaining for issuance under the 2009 Equity Incentive Plan.

This proposal is separate from Proposal 5 to approve the material terms of the performance goals for purposes of Section 162(m) of the Internal Revenue Code (the "Code"), beginning on page 74.

Summary of the Material Terms of the 2016 Plan

A summary of the 2016 Plan is set forth below. This summary is qualified by and subject to the full text of the 2016 Plan, as proposed, which is attached as Annex A. Capitalized terms used in this summary that are not otherwise defined have the respective meanings given such terms in the 2016 Plan.

Number of Authorized Shares

The maximum number of shares of common stock reserved for issuance under the 2016 Plan (the "Maximum Limitation") will be 1,550,000 shares, plus the shares of common stock remaining available for awards under the 2009 Equity Incentive Plan as of the date the 2016 Plan is approved by the stockholders. As of March 25, 2016, there were 347,236 authorized shares remaining for issuance under the 2009 Equity Incentive Plan. The closing price of a share of our common stock on the NYSE on March 31, 2016 was \$17.30.

Shares of common stock issued under the 2016 Plan may be authorized and unissued shares or treasury shares, or both, at the sole discretion of the Compensation Committee. In addition, the 2016 Plan includes the following features:

No Liberal Share Recycling. Shares of common stock tendered, surrendered or withheld for the payment of the exercise price or purchase price of an award, or for tax withholding obligations, will not again be available for issuance under the 2016 Plan.

Fungible Shares. All "full-value awards," meaning all awards other than Options and stock appreciation rights ("SARs"), would be counted against the Maximum Limitation in a 2-to-1 ratio.

For example, if we granted 100 restricted stock units, we would reduce the Maximum Limitation by 200 shares of common stock. Options and SARs would be counted against the Maximum Limitation in a 1-to-1 ratio.

Incentive Option Shares. All shares of common stock available for awards will be available for grant as incentive options (“ISOs”).

Limits on Shares

Under the 2016 Plan, for any given calendar year, the Committee may not grant:

- Options or SARs exercisable for more than (1) 1,000,000 shares of common stock to any employee or consultant, or (2) 100,000 shares of common stock to any non-employee director;
- Stock Awards covering or relating to more than (1) 1,000,000 shares of common stock to any employee or consultant, or (2) 50,000 shares of common stock to any non-employee director; and
- Cash Awards in excess of \$5,000,000 based on the grant date value to any participant.

Administration of the Plan

Unless otherwise determined by the Board, the Compensation Committee will administer the 2016 Plan. Our Compensation Committee will have broad discretionary authority and responsibility for administering and making decisions under the 2016 Plan including, but not limited to:

- selecting eligible employees and consultants to receive awards (our Board retains discretion for selecting non-employee directors);
- determining the limitations and other terms and conditions applicable to each award;
- determining the type and size of award, and whether, to what extent, and under what circumstances, awards may be settled in cash, shares, or other property;
- determining the treatment of an award upon termination of a participant’s employment for cause or for good reason, a change in control, or a participant’s death, disability or retirement; and
- delegating its authority to grant awards to consultants and certain employees to a subcommittee or any other committee of our Board.

Eligibility

Eligibility to participate in the 2016 Plan will be limited to (1) employees and consultants of the Company and its subsidiaries, as the Compensation Committee selects from time to time and (2) non-employee directors of the Board, as the Board selects from time to time. In the last fiscal grant cycle, a total of 148 employees and eight non-employee directors received awards under the 2009 Equity Incentive Plan and 479 employees received awards under the 2013 Cash Incentive Plan.

Types of Awards

The 2016 Plan provides for the issuance of Options, SARs, Stock Awards and Cash Awards. Additionally, an award may be granted in the form of a performance award, as discussed under “—Performance Awards” below. Subject to accelerated vesting in certain situations, generally all awards will have a minimum vesting period of one year from the date of grant. Unless otherwise provided in the participant’s award agreement, no award under the 2016 Plan will be assignable or otherwise transferable.

Options. ISOs, which meet the requirements of Section 422 of the Code, and non-qualified stock options (“NSOs”), which are not intended to comply with Section 422 of the Code, each entitle the recipient to receive a number of shares of common stock upon exercise of the Option and payment of the Option’s exercise price, which shall be no less than 100% of the fair market value of the

common stock on the grant date. The term of an Option may not exceed ten years. ISOs may only be granted to employees.

SARs. A SAR entitles the participant to receive payment, in cash, shares of common stock or other property, equal to the excess of the fair market value of a share of common stock on the exercise date over the fair market value of a share of common stock on the grant date. The strike price for a SAR may not be less than the fair market value of the common stock on the grant date. The term of a SAR may not exceed ten years.

Stock Awards. The 2016 Plan permits the grant of (1) unrestricted shares of common stock, (2) restricted stock and (3) restricted stock units. Restricted stock is common stock that we grant subject to transfer restrictions and forfeiture provisions. A restricted stock unit is a right, subject to transfer restrictions and forfeiture provisions, to receive shares of common stock or cash equal to the fair market value of a share of common stock at the end of a specified period. These applicable restrictions may be time-based, performance-based, or both. Rights to dividends or dividend equivalents may be extended to and made part of any Stock Award; provided, however, that no such dividends or dividend equivalent shall be paid on an unvested performance award.

Cash Awards. The 2016 Plan permits the grant of awards in cash denominations.

Performance Awards. The 2016 Plan is designed to comply with Section 162(m) of the Code so that, subject to shareholder approval of the material terms of the performance goals described under “Proposal 5: Approval of the material terms of the performance metrics for purposes of Section 162(m) of the Code”, grants of Stock Awards and Cash Awards under the 2016 Plan that are performance-based may qualify as performance-based compensation not subject to Section 162(m)’s \$1 million deductibility cap.

Prohibition on Repricing

Except in connection with a corporate transaction involving the Company, the terms of outstanding Options and SARs may not be amended to (1) reduce the exercise price of outstanding Options or SARs or (2) cancel outstanding Options or SARs in exchange for cash, other Awards or Options or SARs with an exercise price that is less than the exercise price of the original Options or SARs without stockholder approval.

Adjustments

In the event of any subdivision or consolidation of outstanding shares of common stock, declaration of a dividend payable in shares of common stock or other stock split (collectively a “Stock Event”) then the Compensation Committee may adjust the number of shares of common stock reserved under the 2016 Plan. In the event of a Stock Event or any other recapitalization or capital reorganization of the Company, any consolidation or merger of the Company with another corporation or entity, the adoption by the Company of any plan of exchange affecting the common stock or any distribution to holders of common stock of securities or property (other than normal cash dividends or dividends payable in common stock) then the Compensation Committee may make necessary adjustments including, but not limited to, the number of shares of common stock available for ISOs and Stock Awards, award limitations, price determinations and fair market value calculations. No adjustment shall be made that would result in the 2016 Plan or benefits payable thereunder failing to comply with or to be exempt from Section 409A of the Code.

Corporate Transactions

In the event of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation, the Compensation Committee may provide for the continuation or assumption of outstanding awards, for new grants in substitution of outstanding awards, for the accelerated vesting or delivery of shares of common stock under awards or for a cash out of outstanding awards, in each case on such terms and with such restrictions as it deems appropriate. The Compensation Committee may only accelerate exercisability, nonforfeitability and transferability of Performance Awards upon a change in control: (1) to the extent of actual achievement of the applicable performance conditions or (2) on a prorated basis for time elapsed in ongoing performance period(s).

Amendment and Termination

Our Board may amend, modify, suspend or terminate the 2016 Plan at any time and the Compensation Committee can amend outstanding awards issued under the 2016 Plan at any time, except that (1) the Compensation Committee will not be able alter the terms of an award if it would affect materially and adversely a participant's rights under the award without the participant's consent and (2) stockholder approval will be required for any amendment to the extent such approval is required by law, including the Code or applicable stock exchange requirements.

New Plan Benefits

The amount of any future benefits that may be received by any one individual or group of individuals under the 2016 Plan is subject to the discretion of the Compensation Committee and, therefore, is not determinable at this time. The following table presents the long-term equity incentive and cash compensation granted during 2015 to our named executive officers, the current executive officers as a group, all non-executive officers and employees as a group and all non-employee directors as a group, as well as the aggregate grant date fair value of such awards:

NEO/Group	Restricted Stock ⁽¹⁾	Performance Units	Options	Cash Incentive ⁽²⁾ (\$)	Aggregate Grant Date Fair Value ⁽³⁾
Kevin M. Fogarty	45,825	91,650	–	1,420,794	2,885,261
Stephen E. Tremblay	13,578	27,155	–	494,676	854,885
Holger R. Jung	10,183	20,367	–	358,515	641,170
Lothar F. P. Freund	9,335	18,669	–	341,460	587,735
Melinda S. Conley	5,940	11,880	–	258,928	373,998
All executive officers, as a group	113,954	199,247	–	3,602,946	5,955,464
All other employees, as a group	219,244	41,289	–	9,819,318	5,764,688
All non-employee directors, as a group	32,584	–	–	–	659,337
TOTAL	365,782	240,536	–	13,422,264	12,379,489

(1)Includes restricted stock awards and restricted stock units.

(2)Cash Incentive compensation paid pursuant to the 2013 Cash Incentive Plan.

These amounts represent the full fair value of restricted stock awards, restricted stock units and restricted stock performance units as calculated under ASC Topic 718. For a discussion of the assumptions used in calculating the (3) fair value of our stock-based compensation, refer to Note 4, Share-Based Compensation, in the Notes to Consolidated Financial Statements contained in our Annual Report on Form 10-K for the year ended December 31, 2015.

Historical Equity Award Data

Our Compensation Committee granted restricted stock performance units (“PSUs”) in fiscal 2013, subject to a three-year performance and vesting period, all of which were forfeited because threshold performance goals were not achieved. Our Compensation Committee also granted PSUs in fiscal 2014, subject to a one-year performance period with an additional two-year vesting period, 33,070 of which were forfeited based on our Compensation Committee's certificate of a payout at 0.525x target. Burn rate from vested PSUs is calculated as (i) the number of non-qualified stock options (“Options”) and time-based restricted stock units and restricted stock awards (together, “RSAs”) granted, plus (ii) the number of PSUs vested, divided by (iii) the weighted average basic common shares outstanding in the year indicated.

The following table shows our three-year average burn rate from vested PSUs:

Fiscal Year	Options Granted	RSAs Granted	PSUs Vested	Total Granted /Vested	Weighted Average Basic # Common Units Outstanding	Burn Rate
2015	—	365,782	—	(1) 365,782	30,574,000	1.20 %
2014	158,118	254,248	—	(2) 412,366	32,163,000	1.28 %
2013	131,321	258,427	—	(3) 389,748	32,096,000	1.21 %
Three Year Average						1.23 %

No PSUs were earned from the 2013 fiscal grants which had a three-year performance period because threshold (1) performance goals were not achieved. For reference, 67,585 PSUs were granted in fiscal 2013. During fiscal 2015, 240,536 PSUs were granted, with a three-year performance and vesting period ending December 31, 2017.

During fiscal 2014, 36,551 PSUs were earned following the one-year performance period and the certification by (2) our Compensation Committee of a payout at 0.525x target. The PSUs will vest in 2016. For reference, 69,621 PSUs were granted in fiscal 2014, excluding an additional 7,148 special PSUs and 13,417 PSUs which never vested due to our proposed combination with LCY not closing.

(3) PSUs were first granted in 2013 and, therefore, no PSUs vested in 2014.

Federal Income Tax Consequences of Awards

This summary is based on U.S. federal income tax laws in effect on March 31, 2016. This summary is not intended to be exhaustive, does not constitute tax advice and, among other things, does not describe state, local or foreign tax consequences, which may be substantially different.

Incentive Stock Options

In general, a participant realizes no taxable income upon the grant or exercise of an ISO. However, the exercise of an ISO may result in an alternative minimum tax liability to the participant. With some exceptions, a disposition of shares purchased under an ISO within two years from the date of grant or within one year after exercise produces ordinary income to the participant (and generally a deduction to the Company) equal to the value of the shares at the time of exercise less the exercise price. Any additional gain recognized in the disposition is treated as a capital gain for which the Company is not entitled to a deduction. If the participant does not dispose of the shares until after the expiration of these one and two-year holding periods, any gain or loss recognized upon a subsequent sale is treated as a long-term capital gain or loss for which the Company is not entitled to a deduction.

Non-Qualified Stock Options

In general, a participant has no taxable income upon the grant of an NSO but realizes ordinary income in connection with exercise of the option in an amount equal to the excess (at time of exercise) of the fair market value of the shares acquired upon exercise over the exercise price. A corresponding deduction is generally available to the Company. Upon a subsequent sale or exchange of the shares, any recognized gain or loss is treated as a capital gain or loss for which the Company is not entitled to a deduction.

Stock Appreciation Rights

The grant of a SAR does not itself result in taxable income, nor does taxable income result merely because a SAR becomes exercisable. In general, a participant who exercises a SAR for shares of stock or receives payment in cancellation of a SAR will have ordinary income equal to the amount of any cash and the fair market value of any stock received. A corresponding deduction is generally available to the Company.

Restricted Stock Awards and Restricted Stock Unit Awards

A recipient of restricted stock or restricted stock units will not have taxable income upon the grant unless, in the case of restricted stock, a participant elects pursuant to Section 83(b) of the Code to be taxed

at that time. In the case of restricted stock, a participant will have ordinary income at the time of vesting equal to the fair market value on the vesting date of the shares (or cash) received minus any amount paid for the shares and a corresponding deduction is generally available to the Company in the same year that the participant recognizes income. In the case of restricted stock units, a participant will have ordinary income on the payment date (and a corresponding deduction is generally available to the Company) equal to the amount paid in cash or the fair market value of shares distributed to the participant.

Certain Tax Code Limitations on Deductibility

In order for us to deduct the amounts described above, such amounts must constitute reasonable compensation for services rendered or to be rendered and must be ordinary and necessary business expenses. The ability to obtain a deduction for awards under the incentive plan could also be limited by Section 280G of the Code, as discussed below. Subject to shareholder approval of the material terms of the performance goals described under “Proposal 5: Approval of the material terms of the performance metrics for purposes of Section 162(m) of the Code,” the ability to obtain a deduction for amounts paid under the 2016 Plan could also be affected by Section 162(m) of the Code, which limits the deductibility, for U.S. federal income tax purposes, of compensation paid to certain employees to \$1 million during any taxable year. However, certain exceptions apply to this limitation in the case of qualified performance-based compensation. However, the Compensation Committee may award compensation that is or may become non-deductible, and expects to consider whether it believes such grants are in our best interest, balancing tax efficiency with long-term strategic objectives.

Section 409A of the Code

If an award is subject to Section 409A of the Code (which relates to nonqualified deferred compensation plans), and if the requirements of Section 409A of the Code are not met, the taxable events as described above could apply earlier than described, and could result in the imposition a 20% penalty. All awards under the 2016 Plan are intended to be exempt from or comply with Section 409A of the Code.

Certain Change in Control Payments

Under Section 280G of the Code, the vesting or accelerated exercisability of options or the vesting and payments of other awards in connection with a change in control of a corporation may result in an “excess parachute payment”. A “parachute payment” occurs when an employee receives payments contingent upon a change in control that exceed an amount equal to three times his or her “base amount.” The term “base amount” generally means the average annual compensation paid to such employee during the five-year period preceding the change in control. An “excess parachute payment” is the excess of all parachute payments made to the employee on account of a change in control over the employee’s base amount. If any amount received by an employee is characterized as an excess parachute payment, the employee is subject to a 20% excise tax on the amount of the excess, and we are denied a deduction with respect to such excess payment.

Tax Withholding

To the extent required by law, the Company will withhold from any amount paid in settlement of an award amounts of withholding and other taxes due or take other action as it deems advisable to enable the Company and the participant to satisfy withholding and tax obligations related to any awards.

The board recommends that stockholders vote “FOR” the approval of the 2016 Plan.

PROPOSAL 5

APPROVAL OF THE MATERIAL TERMS OF THE PERFORMANCE METRICS FOR PURPOSES OF SECTION 162(M) OF THE INTERNAL REVENUE CODE

On April 4, 2016, upon recommendation of the Compensation Committee, the Board approved the material terms of the performance goals described herein, subject to stockholder approval. The performance goals would enable the company to have a shareholder-approved arrangement under which certain cash and equity-based compensation awarded to executive officers under any of the 2009 Equity Incentive Plan, the 2013 Cash Incentive Plan or the 2016 Plan may qualify, until the date of the 2021 annual meeting, as performance-based compensation for purposes of Section 162(m) of the Code.

If both this Proposal 5 and Proposal 4 are approved by our stockholders at the Annual Meeting, the Compensation Committee would cease to grant (1) annual cash performance awards under the 2013 Cash Incentive Plan as of December 31, 2016 and would grant future cash awards under the 2016 Plan on and after January 1, 2017 and (2) further awards under the 2009 Equity Incentive Plan after the effective date of the 2016 Plan, being the date that our stockholders approve the 2016 Plan.

If this Proposal 5 is approved but Proposal 4 to approve the 2016 Plan is not approved, the 2009 Equity Incentive Plan and the 2013 Cash Incentive Plan (plus the performance goals approved in this Proposal 5) will continue until the date of the 2021 annual meeting.

If neither Proposal 4 nor this Proposal 5 is approved, performance awards may still be granted under the 2009 Equity Incentive Plan and the 2013 Cash Incentive Plan, but certain awards to executive officers made after the date of the 2016 Annual Meeting may no longer be fully tax deductible to the company.

Section 162(m) of the Code (“Section 162(m)”) imposes a \$1 million limit on the amount that a public company may deduct for compensation paid to the company’s chief executive officer or any of the company’s three other most highly compensated executive officers (other than the chief financial officer) who are employed as of the end of the year. This limitation does not apply to compensation that meets the requirements under Section 162(m) for “qualified performance-based” compensation (i.e., compensation paid only if the individual’s performance meets pre-established objective goals based on criteria approved by shareholders). One of the requirements for compensation to qualify as performance-based under Section 162(m) is that the material terms of the performance goals for such compensation be disclosed to and approved by shareholders every five years. In accordance with Section 162(m), the material terms that the shareholders approve constitute the framework for the Compensation Committee to establish programs and awards under which compensation provided by the company may qualify as performance-based compensation for purposes of Section 162(m). However, there can be no guarantee that amounts payable under these programs and awards will be treated as qualified performance-based compensation under Section 162(m).

The performance goals pertain to the following forms of compensation that may be awarded to the senior officers of the company during the next five years under the 2009 Equity Incentive Plan and the 2013 Cash Incentive Plan or, if approved under Proposal 4, the 2016 Plan (1) performance-based awards payable in cash (2) performance-based awards payable in common stock, including for example performance-based restricted stock or restricted stock units and (3) dividends or dividend equivalents earned on performance-based awards that are contingent on the achievement of performance goals relating to the underlying award to which such dividends or dividend equivalents relate.

For a description of the material terms of the 2016 Plan, see “Proposal 4—Approval of the adoption of the Kraton Performance Polymers, Inc. 2016 Equity and Cash Incentive Plan.”

Material Terms of the Performance Goals

For purposes of Section 162(m), the material terms of the performance goals include: (i) the employees eligible to receive compensation (ii) the description of the business measures on which the performance goals may be based and (iii) the maximum amount, or the formula used to calculate the maximum amount, of compensation that can be paid to an employee under the arrangement. Each of these aspects is discussed below, and shareholder approval of this Proposal 5 constitutes approval of each of these aspects for purposes of the Section 162(m) shareholder approval requirements.

Performance Measure and Goals

A performance goal may be based on one or more business criteria that apply to the participant, one or more business units, divisions or sectors of the Company, or the Company as a whole, and by comparison with a peer group of companies. A performance goal may include one or more of the following: (1) EBITDA; (2) profit; (3) corporate value measures (including, but not limited to, ethics, compliance, environmental and safety performance); (4) innovation as a percent of total revenue; (5) cost out and pricing initiatives before or after tax net income; (6) earnings per share; (7) book value per share; (8) stock price; (9) return on stockholder's equity; (10) expense measures (including, but not limited to, overhead cost and general and administrative expense); (11) improvements in capital structure (including, but not limited to, debt to equity ratios, net debt and other leverage measures); (12) profitability of an identifiable business unit or product (including return on investment on new business acquisitions or growth and expansion activities for the year); (13) measures relating to acquisitions, dispositions or customer satisfaction; (14) business growth (percent increase in revenue from year to year); (15) before or after tax profit margins; (16) budget comparisons; (17) total return to stockholders or other shareholder variability metric; (18) market share (percent shares the Company has captured in the market); (19) cash flow measures (including, but not limited to, net cash flow from operating activities and working capital); (20) return measures (including, but not limited to, return on equity, return on assets and return on invested capital); (21) increase in sales volumes; (22) increase in production volume (percent of increase from year to year); (23) increase in productivity yield per acreage; (24) percent of decrease in production costs; (25) customer satisfaction based on a third party survey; (26) decrease costs of delivery of service (e.g. freight costs, costs of loans, reduction of inventory); (27) decrease turnaround time for servicing requests or processing information (e.g. number of days closing, numbers of days accounts payables turnaround time); (28) identification of ways to cut down costs on a long term basis; (29) implementation of new systems, processes, procedures to accomplish better efficiency, reduce current costs, or provide better management information reports; and (30) implementation of improvements in area of accountability and responsibility that has great impact on the management of the business. The Compensation Committee will also have discretion to reduce (but not to increase) the value of a qualified performance award.

Awards may be granted in the form of a performance award, subject to certain limitations. The amount payable with respect to an award that is intended to qualify as "qualified performance-based compensation" under Section 162(m) will be paid, vested or otherwise deliverable solely on account of the attainment of one or more pre-established objective performance goals, and such performance goals will be established by the Compensation Committee (1) no later than 90 days after the commencement of service to which the performance goal relates and (2) prior to the completion of 25% of the performance period. Prior to the payment of any qualified performance awards, the Compensation Committee must certify in writing that applicable performance goals and any of the material terms thereof were, in fact, satisfied, and in its sole discretion may adjustment the payment of such awards downward. Subject to limited exceptions, the Compensation Committee is authorized to make adjustments in the terms and conditions of, and the criteria included in Performance Awards and performance goals and any hypothetical funding pool relating thereto in recognition of unusual or nonrecurring events (including, without limitation, acquisitions and dispositions of businesses and assets) affecting the Company, any subsidiary or other business unit, or the financial statements of the Company or any subsidiary, or in response to changes in applicable laws, regulations, accounting principles, tax rates and regulations or business conditions or in view of the Compensation Committee's assessment of the business strategy of the Company, any subsidiary or business unit thereof,

performance of comparable organizations, economic and business conditions, personal performance of a participant, and any other circumstances deemed relevant.

Eligibility

Eligibility to participate in the 2009 Equity Incentive Plan is, and the 2016 Plan will be, limited to (1) employees and consultants of the company and its subsidiaries, as the Compensation Committee selects from time to time and (2) non-employee directors of the board, as the board selects from time to time. Eligibility to participate in the 2013 Cash Incentive Plan is limited to employees of the company who (i) are regular or part-time employees and (ii) regularly work at least 20 hours per week are eligible for the payment of an award under the plan.

In the last fiscal grant cycle, a total of 148 employees and eight non-employee directors received awards under the 2009 Equity Incentive Plan and 479 employees received awards under the 2013 Cash Incentive Plan. The group of employees whose compensation would be subject to the performance goals described in this Proposal 5 would include the company's senior officers, including the executive officers required to file reports under Section 16 of the Exchange Act . Although Section 162(m) only limits deductibility for compensation paid to the chief executive officer or any of the company's three other most highly compensated executive officers (other than the chief financial officer) who are employed as of the end of the year, the Compensation Committee may apply the performance goals to all senior officers in the event that any of them becomes a covered employee under Section 162(m) during the time that they hold an award described in this proposal.

Limitations of Individual Awards

Under the 2016 Plan, if approved, for any given calendar year, the Committee may not grant:

- Options or SARs exercisable for more than (1) 1,000,000 shares of common stock to employees or consultants, or (2) 100,000 shares of common stock to non-employee directors;
- Stock Awards covering or relating to more than (1) 1,000,000 shares of common stock to employees or consultants, or (2) 50,000 shares of common stock to non-employee directors; and
- Cash Awards in excess of \$5,000,000 based on the grant date value to any participant.

Under the 2013 Cash Incentive Plan, no participant may be granted performance awards that would result in the payment of more than \$3,000,000 per plan year. Under the 2009 Equity Incentive Plan, no participant may be granted more than 400,000 shares in any calendar year and the aggregate annual share limit under the plan in any calendar year is 750,000 shares.

The board recommends that stockholders vote "FOR" the approval of the material terms of the performance goals for purposes of Section 162(m) of the Code.

STOCKHOLDER PROPOSALS AND NOMINATIONS FOR 2017 ANNUAL MEETING

Inclusion of Proposals in Our Proxy Statement and Proxy Card under the SEC's Rules

The board is not aware of any other matter to be submitted at the Annual Meeting. If any other matter properly comes before the Annual Meeting, the persons named in the enclosed form of proxy generally will have discretionary authority to vote the shares thereby represented in accordance with their judgment.

Any proposal of a stockholder intended to be included in our proxy statement and form of proxy/voting instruction card for the 2017 annual meeting of stockholders pursuant to Rule 14a-8 of the SEC's rules must be received by us no later than January 18, 2017, unless the date of our 2017 annual meeting is more than 30 days before or after May 18, 2017, in which case the proposal must be received a reasonable time before we begin to print and mail our proxy materials. All proposals should be addressed to Corporate Secretary, Kraton Performance Polymers, Inc., 15710 John F. Kennedy Boulevard, Suite 300, Houston, Texas 77032.

Bylaw Requirements for Stockholder Submission of Nominations and Proposals

A stockholder recommendation for nomination of a person for election to our board or a proposal for consideration at our 2017 annual meeting must be submitted in accordance with the advance notice procedures and other requirements set forth in our bylaws. These requirements are separate from, and in addition to, the requirements discussed above to have the stockholder nomination or other proposal included in our proxy statement and form of proxy/voting instruction card pursuant to the SEC's rules. The item to be brought before the meeting must be a proper subject for stockholder action. Our bylaws require that the proposal or recommendation for nomination must be received by our Corporate Secretary at the above address not later than February 17, 2017, nor earlier than January 18, 2017, unless the date of our 2017 annual meeting is more than 30 days before or more than 60 days after May 18, 2017, the anniversary of our 2016 annual meeting, in which case notice by the stockholder to be timely must be so delivered not earlier than 120 days prior to such annual meeting and not later than the close of business on the later of the ninetieth day prior to such annual meeting or, if the first public announcement of the date of the annual meeting is less than 100 days prior to the date of the meeting, the tenth day following the day on which public announcement of the date of such meeting is first made. Stockholder proposals or nominations must include specified information concerning the stockholder and the proposal or nominee as provided in our bylaws.

ADDITIONAL INFORMATION

Incorporation by Reference

Notwithstanding anything to the contrary set forth in any of our previous filings under the Securities Act of 1933, as amended, or the Exchange Act, that might incorporate future filings including this proxy statement, in whole or in part, the report of the Compensation Committee and the report of the Audit Committee included in this proxy statement shall not be incorporated by reference to any such filings.

Annual Report on Form 10-K

We will furnish without charge to each person whose proxy is being solicited, upon request of any such person, a copy of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, as

filed with the SEC, including the consolidated financial statements and schedules thereto, but not the exhibits. Requests for copies of such report should be directed to Director of Investor Relations, Kraton Performance Polymers, Inc., 15710 John F. Kennedy Boulevard, Suite 300, Houston, Texas 77032. Copies of any exhibit to the Form 10-K will be forwarded upon receipt of a written request addressed to our Director of Investor Relations. Important Notice Regarding Internet Availability of Proxy Materials for the 2016 Annual Meeting of Stockholders to be held on May 18, 2016: Our proxy material relating to our 2016 Annual Meeting of Stockholders (notice, proxy statement, proxy and 2015 Annual Report) will be available at "Investor Relations" on our website at www.kraton.com.
Delivery of Documents to Stockholders Sharing an Address

No more than one Notice of Internet Availability of Proxy Materials are being sent to multiple stockholders sharing an address unless we have received contrary instructions from one or more of the stockholders at that address.

Stockholders may request a separate copy of the Notice of Internet Availability of Proxy Materials or proxy materials by writing to The Director of Investor Relations, Kraton Performance Polymers, Inc., 15710 John F. Kennedy Boulevard, Suite 300, Houston, Texas 77032, or by calling Investor Relations at 281-504-4700. Requests will be responded to promptly. Stockholders sharing an address who desire to receive multiple copies, or who wish to receive only a single copy, of the Notice of Internet Availability of Proxy Materials may write to the above address to request a change.

WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, WE URGE YOU TO VOTE BY TELEPHONE, OVER THE INTERNET OR BY MARKING, SIGNING AND RETURNING YOUR PROXY OR VOTING INSTRUCTION CARD AS SOON AS POSSIBLE. NO POSTAGE IS NECESSARY IF MAILED IN THE UNITED STATES.

By Order of the Board of Directors of Kraton
Performance Polymers, Inc.,

JAMES L. SIMMONS,
Vice President, General Counsel and Corporate
Secretary

HOUSTON, TEXAS
April 8, 2016

Kraton Performance Polymers, Inc.
2016 Annual Meeting of Stockholders
The Board of Directors Solicits this Proxy
PROXY

The undersigned hereby appoints Stephen E. Tremblay, Executive Vice President and Chief Financial Officer of Kraton Performance Polymers, Inc., and James L. Simmons, Vice President, General Counsel and Corporate Secretary of Kraton Performance Polymers, Inc., and each of them, acting in the absence of others, as proxies of the undersigned, with full power of substitution in the premises and with discretionary authority to each of them, to appear and vote, as designated herein, all shares of the common stock of Kraton Performance Polymers, Inc. held of record by the undersigned on March 21, 2016 at the Annual Meeting of Stockholders scheduled to be held at The Sheraton North Houston, 15700 John F. Kennedy Boulevard, Houston, Texas 77032 on May 18, 2016 at 1:00 p.m., central time, and at any and all postponements or adjournments thereof. The undersigned acknowledges receipt of the notice of and proxy statement for such annual meeting.

PROXY VOTING INSTRUCTIONS

Mail - Mark, sign and date your proxy card and return it in the postage-paid envelope provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

-or-

Telephone - Call toll-free 1-800-690-6903 from any touch-tone telephone to transmit your voting instructions. Have your proxy card in hand when you call and then follow the instructions.

-or-

Internet - Access “www.proxyvote.com” and follow the on-screen instructions. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

You may enter your voting instructions at 1-800-690-6903 or www.proxyvote.com until 11:59 p.m. eastern time on May 17, 2016.

The Board of Directors recommends a vote “FOR” each of the nominees listed in Proposal 1, “FOR” Proposal 2, “FOR” Proposal 3, “FOR” Proposal 4 and “FOR” Proposal 5.

Please sign, date and return promptly in the enclosed envelope. Please mark your vote in blue or black ink.

ANNEX A

KRATON PERFORMANCE POLYMERS, INC. 2016 EQUITY AND CASH INCENTIVE PLAN

KRATON PERFORMANCE POLYMERS, INC.
2016 EQUITY AND CASH INCENTIVE PLAN

Plan. This Kraton Performance Polymers, Inc. 2016 Equity and Cash Incentive Plan (this “Plan”) was adopted by the Company to reward certain corporate officers, directors, independent contractors and key employees of the Company and its Subsidiaries by enabling them to acquire shares of common stock of the Company and/or through the provision of cash payments.

Objectives. This Plan is designed to promote the interests of the Company and its stockholders by providing the (i) employees and consultants of the Company and its Subsidiaries and (ii) non-employee directors of the Company, who are largely responsible for the management, growth, and protection of the business of the Company, with equity and cash incentives and rewards to encourage them to continue in the service of the Company. This Plan is designed to meet this intent by providing such employees, independent contractors, and non-employee directors with a proprietary interest in pursuing the long-term and short-term growth, profitability, and financial success of the Company. Annual cash performance awards under the Kraton Performance Polymers, Inc. 2013 Cash Incentive Plan, as effective January 1, 2013, shall cease to be made under that plan as of December 31, 2016 and future annual cash performance awards shall be granted under this Plan on and after January 1, 2017.

3. Definitions. As used herein, the terms set forth below shall have the following respective meanings:

“Award” means the grant, by the Company pursuant to this Plan, of any Option, SAR, Stock Award or Cash Award, whether granted singly, in combination or in tandem, to a Participant pursuant to such applicable terms, conditions and limitations as the Committee (or the Board, in the case of Awards to Directors) may establish in order to fulfill the objectives of this Plan.

“Award Agreement” means any agreement (in writing or electronic) issued for and on behalf of the Company setting forth, in writing, the terms, conditions and limitations applicable to an Award.

“Board” means the Board of Directors of the Company.

“Cash Award” means an Award, granted by the Company pursuant to this Plan, denominated in cash.

“Change in Control” means the occurrence of any of the following:

(i)Change in the Ownership of the Company. Any Person, acquires ownership of securities of the Company that, together with securities held by such Person, constitutes more than 50% of the total fair market value or total voting power of the securities of the Company.

(ii)Change in the Effective Control of the Company. The date any Person acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such Person) ownership of securities of the Company possessing 30% or more of the total voting power of the securities of the Company; or the date a majority of members of the Board is replaced during any 12-month period by directors whose appointment or election is not endorsed by a majority of the members of the Board before the date of the appointment or election.

(iii)Change in the Ownership of a Substantial Portion of the Company's Assets. A change in the ownership of a substantial portion of the Company's assets occurs on the date that any Person acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such Person) assets from the Company that have a total gross fair market value equal to or more than 40% of the total gross fair market value of all of the assets of the Company immediately before such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of such corporation, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

Notwithstanding the foregoing, no Change in Control shall be deemed to have occurred with respect to an Award that is subject to Code Section 409A unless such event constitutes an event specified in Code Section 409A(a)(2)(A)(v) and the Treasury regulations promulgated thereunder.

“Code” means the Internal Revenue Code of 1986, as amended from time to time.

“Committee” means the Compensation Committee of the Board or such other committee of the Board as is designated by the Board to administer this Plan.

“Common Stock” means the common stock, par value \$0.01 per share, of the Company.

“Company” means Kraton Performance Polymers, Inc., a Delaware corporation, and any successor thereto.

“Consultant” means an individual providing services to the Company or any of its Subsidiaries, other than an Employee or a Director.

“Director” means an individual serving as a member of the Board who is not an Employee or a Consultant.

“Dividend Equivalents” means an amount equal to dividends and other distributions (or the economic equivalent thereof) that are payable to stockholders of record on a like number of shares of Common Stock.

“Effective Date” means [•], 2016, the date this Plan was approved by the Company’s stockholders.

“Employee” means an employee of the Company or any of its Subsidiaries or an individual who has agreed to become an employee of the Company or any of its Subsidiaries and actually becomes such an employee within the six months immediately following the making of an Award to such individual.

“Exchange Act” means the Securities Exchange Act of 1934, as amended from time to time.

“Fair Market Value” of a share of Common Stock means, as of a particular date:

- (i) if shares of Common Stock are listed on a national securities exchange, the average of the high and low sales prices per share of Common Stock on the consolidated transaction reporting system for the principal national securities exchange on which shares of Common Stock are listed on that date, or, if there shall have been no such sale so reported on that date, on the last preceding date on which such a sale was so reported;
- (ii) if the Common Stock is not so listed, the average of the closing bid and asked price on that date, or, if there are no quotations available for such date, on the last preceding date on which such quotations shall be available, as reported by an inter-dealer quotation system;
- (iii) if shares of Common Stock are not publicly traded, the most recent value determined by an independent appraiser appointed by the Committee for such purpose; or
- (iv) if none of the above are applicable, the Fair Market Value of a share of Common Stock as determined in good faith by the Committee.

“Incentive Option” means an Option that is intended to comply with the requirements set forth in Code Section 422.

“Maximum Share Limitation” shall have the meaning ascribed to such term in Section 5(a) hereof.

“Nonqualified Option” means an Option that is not intended to comply with the requirements set forth in Code Section 422.

“Nonqualified Performance Award” means an Award as described in Section 8(e)(i) hereof.

“Option” means a right, granted by the Company pursuant to this Plan, to purchase a specified number of shares of Common Stock at a specified price.

“Participant” means an Employee, Consultant or Director to whom an Award has been made under this Plan.

“Performance Award” means a Stock Award or a Cash Award to a Participant which Award is subject to the attainment of one or more Performance Goals, including both long-term and annual Performance Awards.

“Performance Goal” means a standard established by the Committee, the satisfaction of which shall determine in whole or in part whether a Performance Award shall be earned.

“Person” means any individual, corporation, partnership, “group” (as such term is used in Rule 13d-5 under the Exchange Act), association or other “person,” as such term is used in Sections 13(d) and 14(d) of the Exchange Act, and the related rules and regulations promulgated thereunder.

“Plan” means this Kraton Performance Polymers, Inc. 2016 Equity and Cash Incentive Plan, as it may be amended from time to time.

“Prior Plan” means the Kraton Performance Polymers, Inc. 2009 Equity Incentive Plan, originally effective as of November 30, 2009 and as amended and restated effective as of February 16, 2012.

“Qualified Performance Award” means an Award as described in Section 8(e)(ii) hereof.

“Restricted Stock” means any Common Stock that is restricted or subject to forfeiture provisions.

“Restricted Stock Unit” means a unit that is restricted or subject to forfeiture provisions evidencing the right to receive one share of Common Stock or cash equal to the Fair Market Value of one share of Common Stock.

“Restriction Period” means a period of time beginning as of the date upon which an Award of Restricted Stock or Restricted Stock Units is made pursuant to this Plan and ending as of the date upon which such Award is issued (if not previously issued), no longer restricted or no longer subject to forfeiture provisions.

“SAR” means a right, granted by the Company pursuant to this Plan, to receive a payment, in cash or Common Stock, equal to the excess of the Fair Market Value of a share of Common Stock on the date the right is exercised over the Fair Market Value of a share of Common Stock on the date of grant.

“Section 409A” means Code Section 409A, and related regulations and Treasury pronouncements.

“Stock Award” means an Award, granted by the Company pursuant to this Plan, in the form of shares of Common Stock or units denominated in shares of Common Stock, and includes Restricted Stock and Restricted Stock Units, but does not include Options or SARs.

“Stock Based Award Limitations” is as defined in Section 5(d) hereof.

“Subsidiary” means (i) in the case of a corporation, any corporation of which the Company directly or indirectly owns shares representing 50% or more of the combined voting power of the shares of all classes or series of capital stock of such corporation which have the right to vote generally on matters submitted to a vote of the stockholders of such corporation, and (ii) in the case of a partnership or other business entity not organized as a corporation, any such business entity of which the Company directly or indirectly owns 50% or more of the voting, capital or profits interests (whether in the form of partnership interests, membership interests or otherwise).

Eligibility. The persons who shall be eligible to receive Awards pursuant to this Plan shall be (a) those Employees 4. and Consultants whom the Committee shall select from time to time and (b) Directors whom the Board shall select from time to time.

5. Common Stock Available for Awards; Plan and Award Limitations.

Common Stock Available Under this Plan. Subject to the provisions of the immediately following subsection (b), (a) the maximum number of shares of Common Stock that may be subject to Awards under this Plan is 1,550,000 shares plus the shares remaining available for awards under the Prior Plan as of the Effective Date (the “Maximum Share Limitation”). From and after the Effective Date, no further awards may be made under the Prior Plan.

Share Counting. Each Stock Award shall be counted against the Maximum Share Limitation as two shares of Common Stock; each Option and SAR shall be counted against the Maximum Share Limitation as one share of Common Stock. The number of shares of Common Stock that are the subject of Awards under this (b) Plan or the Prior Plan that are canceled, terminated, forfeited or expire unexercised shall again immediately become available for Awards hereunder as if such shares had never been the subject of an Award, and the Maximum Share Limitation shall be increased by the same amount as such Shares were counted against the Maximum Share Limitation (or with respect to Awards granted under

the Prior Plan, as one share of Common Stock per share of Common Stock subject to the Award). The number of shares of Common Stock that are the subject of Awards under this Plan or the Prior Plan that are tendered, surrendered or withheld in connection with the exercise or settlement of an Award or the Company's tax withholding obligations shall not again be available for Awards under this Plan. Notwithstanding the foregoing, Awards granted pursuant to an Award Agreement specifying that such Award will be settled in cash shall not be counted against the limit set forth in Section 5(a).

(c) Incentive Option Shares. All of the shares of Common Stock that are available for Awards under this Plan are available for grant as Incentive Options.

(d) Award Limitations. The following limitations shall apply to any Awards made hereunder:

(i) No Employee or Consultant may be granted, during any calendar year, Awards consisting of Options or SARs that are exercisable for more than 1,000,000 shares of Common Stock, and no Director may be granted, during any calendar year, Awards consisting of Options or SARs that are exercisable for more than 100,000 shares of Common Stock;

(ii) No Employee or Consultant may be granted, during any calendar year, Stock Awards covering or relating to more than 1,000,000 shares of Common Stock, and no Director may be granted, during any calendar year, Stock Awards covering or relating to more than 50,000 shares of Common Stock (the limitations set forth in this clause (ii), together with the limitations set forth in clause (i) above, being hereinafter collectively referred to as the "Stock Based Award Limitations"); and

(iii) No Employee or Consultant may be granted Cash Awards in respect of any calendar year having a value determined on the date of grant in excess of \$5,000,000.

(e) Adjustments. The limitations set forth in this Section 4 are subject to adjustment in accordance with Section 15 hereof.

(f) Other Actions. The Committee may from time to time adopt and observe such procedures concerning the counting of shares against this Plan maximum as it may deem appropriate. The Board, the Committee and the officers of the Company shall from time to time take whatever actions are necessary to file any required documents with governmental authorities, stock exchanges and transaction reporting systems to ensure that shares of Common Stock are available for issuance pursuant to Awards.

6. Administration.

Authority of the Committee. Except as otherwise provided in this Plan with respect to actions or determinations by the Board, this Plan shall be administered by the Committee. Subject to the provisions hereof, the Committee shall have full and exclusive power and authority to administer this Plan and to take all actions that are specifically contemplated hereby or are necessary or appropriate in connection with the administration hereof. The Committee shall also have full and exclusive power to interpret this Plan and to adopt such rules, regulations and guidelines for carrying out this Plan as it may deem necessary or proper, all of which powers shall be exercised in the best interests of the Company and in keeping with the objectives of this Plan. Subject to Section 6(c) and Section 18 hereof, the Committee may, in its discretion, provide for (i) the extension of the exercisability of an Award, (ii) in the event of a Participant's death, disability or retirement (in the case of disability and retirement, unless otherwise specified in the relevant grant agreement, as determined in accordance with the applicable policies and procedures of the Company as in effect from time to time) or in the event of a termination of employment by the Company without "Cause" or by the Participant with "Good Reason" (as such terms are defined in an Award Agreement, employment agreement or the Company's Executive Severance Plan): (A) the acceleration of the date on which any such Award becomes vested or exercisable, as the case may be, (B) the elimination of (or lesser restrictions on) any restrictions contained in an Award, (C) the waiver of any restriction or other provision of this Plan or an Award or (iii) amendment or modification of an Award in any manner that is (A) not materially adverse to the Participant to whom such Award was granted, (B) consented to by such Participant or (C) authorized by Section 15(c) hereof; provided, however, that no such action shall permit the term of any Option or SAR to be greater than ten years from the applicable grant date. For avoidance of doubt, in the event of Change in Control without a subsequent termination of employment, the Committee's discretion with respect to Awards shall be subject to Section 15(c), rather than this Section 6(a). The Committee may make an Award to an individual who it expects to become an Employee of the Company or any of its Subsidiaries within the six months following the date the Award is made, with such Award being subject to the individual's actually becoming an Employee within such time period, and subject to such other terms and conditions as may be established by the Committee. The Committee may correct any defect or supply any omission or reconcile any inconsistency in this Plan or in any Award in the manner and to the extent the Committee deems necessary or desirable to further the purposes of this Plan. Any decision of the Committee in the interpretation and administration of this Plan shall lie within its sole and absolute discretion and shall be final, conclusive and binding on all parties concerned.

Indemnity. No member of the Board or the Committee or officer of the Company to whom the Committee has (b) delegated authority in accordance with the provisions of Section 7 of this Plan shall be liable for anything done or omitted to be done by him or her, by any member of the Board or the Committee or by any officer of the

Company in connection with the performance of any duties under this Plan, except for his or her own willful misconduct or as expressly provided by statute.

Prohibition on Repricing of Options and Stock Appreciation Rights. Except in connection with a corporate transaction involving the Company (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split up, spin off, combination, or exchange of (c) shares), the terms of outstanding Options and SARs may not be amended to (i) reduce the exercise price of outstanding Options or SARs or (ii) cancel outstanding Options or SARs in exchange for cash, other Awards or Options or SARs with an exercise price that is less than the exercise price of the original Options or SARs without stockholder approval.

Delegation. The Committee may delegate any of its authority to grant Awards to Employees who are not subject to Section 16(b) of the Exchange Act and Consultants, subject to Section 6(a) above, to a subcommittee of the 7. Committee or to any other committee of the Board, provided such delegation is made in writing and specifically sets forth such delegated authority. Any such delegation hereunder shall only be made to the extent permitted by applicable law.

Awards. Except as otherwise provided in Section 9 hereof pertaining to Awards to Directors, the Committee shall determine the type or types of Awards to be made under this Plan and shall designate from time to time the Participants who are to be the recipients of such Awards. Each Award shall be embodied in an Award Agreement in such form as the Committee determines, which shall contain such terms, conditions and limitations as shall be determined by the Committee in its sole discretion, including any treatment upon a Change in Control, and shall be issued for and on behalf of the Company. Awards may consist of those listed in this Section 8 and may be granted singly, in combination or in tandem. Awards may also be made in combination or in tandem with, in replacement of, or as alternatives to, grants or rights under this Plan or any other plan of the Company or any of its Subsidiaries, including this Plan of any acquired entity; provided that, except as contemplated in Section 15 hereof, no Option or 8. SAR may be issued in exchange for the cancellation of an Option or SAR, respectively, with a higher exercise price nor may the exercise price of any Option or SAR be reduced. Subject to accelerated vesting in the event of a Participant's termination of employment due to death, disability or retirement as provided in Section 6(a) or following a Change in Control as provided in Section 15(c), all Awards shall have a minimum vesting period of one year from the date of grant; provided, however, that Awards with respect to up to five percent of the shares of Common Stock authorized for grant pursuant to this Plan may have a vesting period of less than one year. All or part of an Award may be subject to conditions established by the Committee, which may include, but are not limited to, continuous service with the Company and its Subsidiaries, achievement of specific business objectives, increases in specified indices, attainment of specified growth rates and other measurements of performance. Upon the termination of employment by a Participant who is an Employee or termination of service by a Participant who is a

Consultant, any unexercised, deferred, unvested or unpaid Awards shall be treated as set forth in the applicable Award Agreement.

Option. An Award may be in the form of an Option. An Option awarded pursuant to this Plan may consist of an Incentive Option or a Nonqualified Option. The price at which shares of Common Stock may be purchased upon the exercise of an Option shall be not less than the Fair Market Value of the Common Stock on the date of grant. The term of an Option shall not exceed ten years from the date of grant. Subject to the foregoing provisions, the terms, conditions and limitations applicable to any Options awarded pursuant to this Plan, including the term of any (a) Options and the date or dates upon which such Options become exercisable, shall be determined by the Committee. Options may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of a Participant, only by the Participant; provided, however, that the Committee may permit Nonqualified Options to be sold, pledged, assigned, hypothecated, transferred, or disposed of, on a general or specific basis, subject to such conditions and limitations as the Committee may determine.

Stock Appreciation Right. An Award may be in the form of a SAR. The strike price for a SAR shall not be less than the Fair Market Value of the Common Stock on the date on which the SAR is granted. The term of a SAR shall not exceed ten years from the date of grant. Subject to the foregoing limitations, the terms, conditions and (b) limitations applicable to any SARs awarded pursuant to this Plan, including the term of any SARs and the date or dates upon which such SARs become exercisable, shall be determined by the Committee. As of the date of grant of a SAR, the Committee may specifically designate that the Award will be paid (i) only in cash, (ii) only in Common Stock, or (iii) in such other form or combination of forms as the Committee may elect or permit at the time of exercise.

Stock Award. An Award may be in the form of a Stock Award. The terms, conditions and limitations applicable to (c) any Stock Awards granted pursuant to this Plan shall be determined by the Committee, subject to the limitations specified below.

(d) Cash Award. An Award may be in the form of a Cash Award. The terms, conditions and limitations applicable to any Cash Awards granted pursuant to this Plan shall be determined by the Committee.

(e) Performance Award. Without limiting the type or number of Awards that may be made under the other provisions of this Plan, an Award may be in the form of a Performance Award. The terms, conditions and limitations applicable to any Performance Awards granted to Participants pursuant to this Plan shall be determined by the Committee, subject to the limitations specified in this Plan.

The Committee shall set Performance Goals in its discretion which, depending on the extent to which such Performance Goals are met, will determine the value and/or amount of Performance Awards that will be paid out to the Participant and/or the portion of an Award that may be exercised.

(i) Nonqualified Performance Awards. Performance Awards granted to Employees, Consultants or Directors that are not intended to qualify as qualified performance based compensation under Code Section 162(m) shall be based on achievement of such Performance Goals and be subject to such terms, conditions and restrictions as the Committee or its delegate shall determine.

(ii) Qualified Performance Awards. Performance Awards granted to Employees under this Plan that are intended to qualify as qualified performance based compensation under Code Section 162(m) shall be paid, vested or otherwise deliverable solely on account of the attainment of one or more pre established, objective Performance Goals established by the Committee prior to the earlier to occur of (1) 90 days after the commencement of the period of service to which the Performance Goal relates and (2) the lapse of 25% of the period of service (as scheduled in good faith at the time the goal is established), and in any event while the outcome is substantially uncertain. A Performance Goal is objective if a third party having knowledge of the relevant facts could determine whether the goal is met. Such a Performance Goal may be based on one or more business criteria that apply to the Employee, one or more business units, divisions or sectors of the Company, or the Company as a whole, and if so desired by the Committee, by comparison with a peer group of companies. A Performance Goal may include one or more of the following: EBITDA; profit; corporate value measures (including, but not limited to, ethics, compliance, environmental and safety performance); innovation as a percent of total revenue; cost out and pricing initiatives before or after tax net income; earnings per share; book value per share; stock price; return on stockholder's equity; expense measures (including, but not limited to, overhead cost and general and administrative expense); improvements in capital structure (including, but not limited to, debt to equity ratios, net debt and other leverage measures); profitability of an identifiable business unit or product (including return on investment on new business acquisitions or growth and expansion activities for the year); measures relating to acquisitions, dispositions or customer satisfaction; business growth (percent increase in revenue from year to year); before or after tax profit margins; budget comparisons; total return to stockholders or other shareholder variability metric; market share (percent shares the Company has captured in the market); cash flow measures (including, but not limited to, net cash flow from operating activities and working capital); return measures (including, but not limited to, return on equity,

return on assets and return on invested capital); increase in sales volumes; increase in production volume (percent of increase from year to year); increase in productivity yield per acreage; percent of decrease in production costs; customer satisfaction based on a third party survey; decrease costs of delivery of service (e.g. freight costs, costs of loans, reduction of inventory); decrease turnaround time for servicing requests or processing information (e.g. number of days closing, numbers of days accounts payables turnaround time); identification of ways to cut down costs on a long term basis; implementation of new systems, processes, procedures to accomplish better efficiency, reduce current costs, or provide better management information reports; and implementation of improvements in area of accountability and responsibility that has great impact on the management of the business. In interpreting Plan provisions applicable to Qualified Performance Awards, it is the intent of this Plan to conform with the standards of Code Section 162(m) and Treasury Regulation Section 1.162-27(e)(2)(i), as to grants to those Employees whose compensation is, or is likely to be, subject to Code Section 162(m), and the Committee in establishing such goals and interpreting this Plan shall be guided by such provisions. Prior to the payment of any compensation based on the achievement of Performance Goals applicable to Qualified Performance Awards, the Committee must certify in writing that applicable Performance Goals and any of the material terms thereof were, in fact, satisfied. Subject to the foregoing provisions, the terms, conditions and limitations applicable to any Qualified Performance Awards made pursuant to this Plan shall be determined by the Committee. Notwithstanding the foregoing, the Committee is authorized to make adjustments in the terms and conditions of, and the criteria included in, Awards (including Performance Awards and performance goals and any hypothetical funding pool relating thereto) in recognition of unusual or nonrecurring events (including, without limitation, acquisitions and dispositions of businesses and assets) affecting the Company, any subsidiary or other business unit, or the financial statements of the Company or any subsidiary, or in response to changes in applicable laws, regulations, accounting principles, tax rates and regulations or business conditions or in view of the Committee's assessment of the business strategy of the Company, any subsidiary or business unit thereof, performance of comparable organizations, economic and business conditions, personal performance of a Participant, and any other circumstances deemed relevant; provided that no such adjustment shall be authorized or made if and to the extent such adjustment causes any Awards intended to qualify as Qualified Performance Awards to cease to be so qualified.

⁹ Awards to Directors. Subject to the limitations set forth in Section 5(d) hereof, the Board may grant a Director of the Company one or more Awards and establish the terms thereof

in accordance with Section 8 and consistent with the provisions therein for the granting of Awards to Employees and Consultants by the Committee. Any such Award shall be subject to the applicable terms, conditions and limitations set forth in this Plan and the applicable Award Agreement. If the Board grants an Award to an individual whom it expects to become a Director within six months following the date of such Award is made, then such Award shall be subject to (among other terms and conditions) the individual actually becoming a Director. Upon the termination of service by a Participant who is a Director, any unexercised, deferred, unvested or unpaid Awards shall be treated as set forth in the applicable Award Agreement.

10. Award Payment; Dividends and Dividend Equivalents.

General. Payment of Awards may be made in the form of cash or Common Stock, or a combination thereof, and may include such restrictions as the Committee shall determine, including, in the case of Common Stock, restrictions on transfer and forfeiture provisions. If payment of an Award is made in the form of Restricted Stock, the applicable Award Agreement relating to such shares shall specify whether such shares are to be issued at the beginning or end of the Restriction Period. In the event that shares of Restricted Stock are to be issued at the beginning of the Restriction Period, the certificates evidencing such shares (to the extent that such shares are so evidenced) shall contain appropriate legends and restrictions that describe the terms and conditions of the restrictions applicable thereto. In the event that shares of Restricted Stock are to be issued at the end of the Restriction Period, the right to receive such shares shall be evidenced by book entry registration or in such other manner as the Committee may determine.

Dividends, Dividend Equivalents and Interest. Rights to dividends or Dividend Equivalents may be extended to and made part of any Award (other than Options and SARs) consisting of shares of Common Stock or units denominated in shares of Common Stock, subject to such terms, conditions and restrictions as the Committee may establish; provided that no such dividends or Dividend Equivalents shall be paid with respect to unvested Performance Awards. Dividends and/or Dividend Equivalents shall not be made part of any Options or SARs. The Committee may also establish rules and procedures for the crediting of interest on deferred cash payments, dividends or Dividend Equivalents.

Deferrals. Amounts payable in respect of Cash Awards to be deferred and paid in accordance with the terms of the Company's deferred compensation plan that may permit such deferrals (if any), subject to the terms and conditions of such plan as it may be amended from time to time, and provided the Participant is eligible to defer Cash Awards under such plan and such deferrals comply with Section 409A.

Stock Option Exercise. The price at which shares of Common Stock may be purchased under an Option shall be paid in full at the time of exercise in cash or, if permitted by the Committee and elected by the Participant, the Participant may purchase such shares by

means of the Company withholding shares of Common Stock otherwise deliverable on exercise of the Award or tendering Common Stock or surrendering another Award, including Restricted Stock, valued at Fair Market Value on the date of exercise, or any combination thereof. The Committee, in its sole discretion, shall determine acceptable methods for Participants to tender Common Stock or other Awards. The Committee may provide for procedures to permit the exercise or purchase of such Awards by use of the proceeds to be received from the sale of Common Stock issuable pursuant to an Award (including cashless exercise involving a broker or dealer approved by the Committee or net-exercise both pursuant to procedures approved by the Committee). Unless otherwise provided in the applicable Award Agreement, in the event shares of Restricted Stock are tendered as consideration for the exercise of an Option, a number of the shares issued upon the exercise of the Option, equal to the number of shares of Restricted Stock used as consideration therefore, shall be subject to the same restrictions as the Restricted Stock so submitted as well as any additional restrictions that may be imposed by the Committee. The Committee may adopt additional rules and procedures regarding the exercise of Options from time to time, provided that such rules and procedures are not inconsistent with the provisions of this Section 11.

Taxes. The Company shall have the right to deduct applicable taxes from any Award payment and withhold an appropriate amount of cash or number of shares of Common Stock or a combination thereof for payment of taxes required by law or to take such other action as may be necessary in the opinion of the Company to satisfy all 12. obligations for withholding of such taxes. The Committee may also permit withholding to be satisfied by the transfer to the Company of shares of Common Stock theretofore owned by the holder of the Award with respect to which withholding is required. If shares of Common Stock are used to satisfy tax withholding, such shares shall be valued based on the Fair Market Value when the tax withholding is required to be made.

Amendment, Modification, Suspension or Termination. The Board may amend, modify, suspend or terminate this Plan (and the Committee may amend or modify an Award Agreement) for the purpose of meeting or addressing any changes in legal requirements or for any other purpose permitted by applicable law, except that (i) no amendment or alteration that would materially adversely affect the rights of any Participant under any Award previously granted to such Participant shall be made without the consent of such Participant and (ii) no amendment or alteration shall be effective prior to its approval by the stockholders of the Company to the extent stockholder approval is otherwise required by applicable legal requirements or the requirements of the securities exchange on 13. which the Company's stock is listed, including any amendment that expands the types of Awards available under this Plan, materially increases the number of shares of Common Stock available for Awards under this Plan, materially expands the classes of persons eligible for Awards under this Plan, materially extends the term of this Plan, materially changes the method of determining the Exercise Price of Options or strike price of SARs, deletes or limits any provisions of this Plan that prohibit the repricing of Options or SARs or materially modifies the restrictions on the Committee's authority pursuant to Section 6(a) and 15(c) hereof. Notwithstanding any provision in this Plan to the contrary, this Plan

shall not be amended or terminated in such manner that would cause this Plan or any amounts or benefits payable hereunder to fail to comply with or be exempt from Section 409A, and any such amendment or termination that may reasonably be expected to result in such failure shall be of no force or effect.

Assignability. Unless otherwise determined by the Committee and provided in the Award Agreement, no Award or 14. any other benefit under this Plan shall be assignable or otherwise transferable. Any attempted assignment of an Award or any other benefit under this Plan in violation of this Section 14 shall be null and void.

15. Adjustments.

The existence of outstanding Awards shall not affect in any manner the right or power of the Company or its stockholders to make or authorize any or all adjustments, recapitalizations, reorganizations or other changes in the capital stock of the Company or its business or any merger or consolidation of the Company, or any issue of bonds, (a) debentures, preferred or prior preference stock (whether or not such issue is prior to, on a parity with or junior to the Common Stock) or the dissolution or liquidation of the Company, or any sale or transfer of all or any part of its assets or business, or any other corporate act or proceeding of any kind, whether or not of a character similar to that of the acts or proceedings enumerated above.

In the event of any subdivision or consolidation of outstanding shares of Common Stock, declaration of a dividend payable in shares of Common Stock or other stock split, then (i) the number of shares of Common Stock reserved under this Plan, (ii) the number of shares of Common Stock available under this Plan for Incentive Options and Stock Awards, (iii) the number of shares of Common Stock covered by outstanding Awards in the form of Common Stock or units denominated in Common Stock, (iv) the exercise or other price in respect of such Awards, (v) the Stock Based Award Limitations, and (vi) the appropriate Fair Market Value and other price determinations for such Awards shall each be proportionately adjusted by the Committee to reflect such transaction. In the event of any other recapitalization or capital reorganization of the Company, any consolidation or merger of the (b) Company with another corporation or entity, the adoption by the Company of any plan of exchange affecting the Common Stock or any distribution to holders of Common Stock of securities or property (other than normal cash dividends or dividends payable in Common Stock), the Committee shall make appropriate adjustments to (1) the number of shares of Common Stock covered by Awards in the form of Common Stock or units denominated in Common Stock, (2) the exercise or other price in respect of such Awards, (3) the appropriate Fair Market Value and other price determinations for such Awards, (4) the number of shares of Common Stock available under this Plan for Incentive Options and Stock Awards, and (5) the Stock Based Award Limitations to give effect to such transaction; provided that such adjustments shall

only be such as are necessary to maintain the proportionate interest of the holders of the Awards and preserve, without exceeding, the value of such Awards.

In the event of a corporate merger, consolidation, acquisition of property or stock, separation, reorganization or liquidation, the Committee may make such adjustments to Awards or other provisions for the disposition of Awards as it deems equitable, and shall (i) if available pursuant to the terms of the transaction, provide for the substitution of a new Award or other arrangement (which, if applicable, may be exercisable for such property or stock as the Committee determines) for an Award or the assumption of the Award (and for awards not granted under this Plan), regardless of whether in a transaction to which Code Section 424(a) applies, or (ii), to the extent that Awards cannot be substituted or assumed pursuant to subsection (i) above: (A) provide, prior to the transaction, for the acceleration of the vesting and exercisability of, or lapse of restrictions with respect to, the Award and, if the transaction is a cash merger, provide for the termination of any portion of the Award that remains unexercised at the time of such transaction, (B) provide for the acceleration of the vesting and exercisability of an Award and the cancellation thereof in exchange for such payment as the Committee, in its sole discretion, (c) determines is a reasonable approximation of the value thereof, (C) cancel any Awards and direct the Company to deliver to the Participants who are the holders of such Awards cash in an amount that the Committee shall determine in its sole discretion is equal to the Fair Market Value of such Awards as of the date of such event, which, in the case of any Option, shall be the amount equal to the excess of the Fair Market Value of a share as of such date over the per share exercise price for such Option (for the avoidance of doubt, if such exercise price is less than such Fair Market Value, the Option may be canceled for no consideration), or (D) cancel Awards that are Options and give the Participants who are the holders of such Awards notice and opportunity to exercise prior to such cancellation. Notwithstanding anything to the contrary in the above, with respect to Performance Awards, the Committee shall only accelerate exercisability, nonforfeitability and transferability of such Awards upon the Change in Control: (x) to the extent of actual achievement of the applicable performance conditions or (y) on a prorated basis for time elapsed in ongoing performance period(s).

No adjustment authorized by this Section 15 shall be made in such manner that would result in this Plan or any (d) amounts or benefits payable hereunder to fail to comply with or be exempt from Section 409A, and any such adjustment that may reasonably be expected to result in such failure shall be of no force or effect.

16. Restrictions. No Common Stock or other form of payment shall be issued or made with respect to any Award unless the Company shall be satisfied based on the advice of its counsel that such issuance or other payment will be in compliance with all applicable federal and state securities laws. Certificates evidencing shares of Common Stock delivered under this Plan (to the extent that such shares are so evidenced) may be subject

to such stop transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations and other requirements of the Securities and Exchange Commission, any securities exchange or transaction reporting system upon which the Common Stock is then listed or to which it is admitted for quotation and any applicable federal or state securities law. The Committee may cause a legend or legends to be placed upon such certificates (if any) to make appropriate reference to such restrictions.

Unfunded Plan. This Plan is unfunded. Although bookkeeping accounts may be established with respect to Participants who are entitled to cash, Common Stock or rights thereto under this Plan, any such accounts shall be used merely as a bookkeeping convenience. The Company shall not be required to segregate any assets that may at any time be represented by cash, Common Stock or rights thereto, nor shall this Plan be construed as providing for such segregation, nor shall the Company, the Board or the Committee be deemed to be a trustee of any cash, 17. Common Stock or rights thereto to be granted under this Plan. Any liability or obligation of the Company to any Participant with respect to an Award of cash, Common Stock or rights thereto under this Plan shall be based solely upon any contractual obligations that may be created by this Plan and any Award Agreement, and no such liability or obligation of the Company shall be deemed to be secured by any pledge or other encumbrance on any property of the Company. None of the Company, the Board or the Committee shall be required to give any security or bond for the performance of any obligation that may be created by this Plan.

18. Section 409A.

Notwithstanding anything in this Plan to the contrary, if any Plan provision or Award under this Plan would result in the imposition of an additional tax under Section 409A, that Plan provision or Award will be reformed to avoid imposition of the additional tax, including that any Award subject to 409A held by a specified employee that is settled upon termination of employment (for reasons other than death) shall be delayed in payment until the (a) expiration of six months, and no action taken to comply with Section 409A shall be deemed to adversely affect the Participant's rights to an Award. Awards made under this Plan are intended to comply with or be exempt from Section 409A, and ambiguous provisions hereof, if any, shall be construed and interpreted in a manner consistent with such intent. No payment, benefit or consideration shall be substituted for an Award if such action would result in the imposition of taxes under Section 409A.

Unless the Committee provides otherwise in an Award Agreement, each Restricted Stock Unit Award or Cash Award (or portion thereof if the Award is subject to a vesting schedule) shall be settled no later than the 15th day (b) of the third month after the end of the first calendar year in which the Award (or such portion thereof) is no longer subject to a "substantial risk of forfeiture" within the meaning of Section 409A. If the Committee determines that a Restricted Stock Unit Award or Cash Award is intended to be subject to Section 409A, the

applicable Award Agreement shall include terms that are designed to satisfy the requirements of Section 409A.

(c) If the Participant is identified by the Company as a “specified employee” within the meaning of Code Section 409A(a)(2)(B)(i) on the date on which the Participant has a “separation from service” (other than due to death) within the meaning of Treasury Regulation Section 1.409A-1(h), any Award payable or settled on account of a separation from service that is deferred compensation subject to Section 409A shall be paid or settled on the earliest of (1) the first business day following the expiration of six months from the Participant’s separation from service, (2) the date of the Participant’s death, or (3) such earlier date as complies with the requirements of Section 409A.

19. **Governing Law.** This Plan and all determinations made and actions taken pursuant hereto, to the extent not otherwise governed by mandatory provisions of the Code or the securities laws of the United States, shall be governed by and construed in accordance with the laws of the State of Texas.

20. **Right to Continued Service or Employment.** Nothing in this Plan or an Award Agreement shall interfere with or limit in any way the right of the Company or any of its Subsidiaries to terminate any Participant’s employment or other service relationship with the Company or its Subsidiaries at any time, nor confer upon any Participant any right to continue in the capacity in which he is employed or otherwise serves the Company or its Subsidiaries.

21. **Clawback Right.** Notwithstanding any other provisions in this Plan, any Award shall be subject to recovery or clawback by the Company under any clawback policy adopted by the Company whether before or after the date of grant of the Award.

22. **Usage.** Words used in this Plan in the singular shall include the plural and vice versa, and words of one gender shall be construed to include the other gender and the neuter, in each case as the context requires.

23. **Headings.** The headings in this Plan are inserted for convenience of reference only and shall not affect the meaning or interpretation of this Plan.

24. **No Fractional Shares.** No fractional shares of Common Stock shall be issued or delivered pursuant to this Plan or any Award. The Committee shall determine whether cash, Awards, or other property shall be issued or paid in lieu of fractional shares of Common Stock or whether such fractional shares of Common Stock or any rights thereto shall be forfeited or otherwise eliminated.

25. **Participants Based Outside of the United States.** Notwithstanding any provision of this Plan to the contrary, in order to comply with the laws in other countries in which the

Company operates or has Employees, Directors or Consultants, the Committee, in its sole discretion, shall have the power and authority to:

- (i) Determine which affiliates and Subsidiaries shall be covered by this Plan;
- (ii) Determine which Employees, Directors, and/or Consultants outside the United States are eligible to participate in this Plan;
- (iii) Modify the terms and conditions of any Award granted to Employees, Directors, and/or Consultants outside the United States to comply with applicable foreign laws;
- (iv) Establish subplans and modify exercise procedures and other terms and procedures, to the extent such actions may be necessary or advisable. Any subplans and modifications to Plan terms and procedures established under this Section 25 by the Committee shall be attached to the Plan document as appendices; and
- (v) Take any action, before or after an Award is made, that it deems advisable to obtain approval or comply with any necessary local government regulatory exemptions or approvals.

Notwithstanding the above, the Committee may not take any actions hereunder, and no Awards shall be granted, that would violate applicable law.

Effective Date. This Plan, as approved by the Board on February 11, 2016, shall be effective as of the Effective Date. This Plan shall continue in effect for a term of 10 years commencing on the Effective Date, unless earlier terminated by action of the Board, and no further Awards may be granted under this Plan after the tenth anniversary of the Effective Date or, if earlier, termination by action of the Board, except as to Awards then outstanding under this Plan. Such outstanding Awards shall remain in effect until they have been exercised or terminated, or have expired.

Notwithstanding the foregoing, the adoption of this Plan is expressly conditioned upon the approval by the holders of a majority of shares of Common Stock present, or represented, and entitled to vote at a meeting of the Company's stockholders at the Company's 2016 annual stockholders meeting to be held on May 18, 2016, or any adjournment or postponement thereof. If the stockholders of the Company should fail to so approve this Plan on such date, this Plan shall not be of any force or effect and the Prior Plan shall continue in force and effect.

ANNEX B
RECONCILIATION OF NON-GAAP MEASURES

Adjusted Gross Profit and Adjusted EBITDA

We consider Adjusted Gross Profit, Adjusted EBITDA and Adjusted Diluted Earnings Per Share to be important supplemental measures of our performance and believe they are frequently used by investors, securities analysts, and other interested parties in the evaluation of our performance and/or that of other companies in our industry, including period-to-period comparisons. In addition, management uses these measures to evaluate operating performance, and our incentive compensation plan bases incentive compensation payments on our Adjusted EBITDA performance, along with other factors. Adjusted Gross Profit, Adjusted EBITDA and Adjusted Diluted Earnings Per Share have limitations as analytical tools and in some cases can vary substantially from other measures of our performance. You should not consider any of them in isolation, or as substitutes for analysis of our results under U.S. generally accepted accounting principles (“GAAP”).

	Years ended December 31,		
	2015	2014	2013
	(in thousands, except per share data)		
Adjusted Gross Profit (1) (2)	\$279,540	\$257,936	\$260,625
Adjusted EBITDA (1) (3)	\$166,817	\$147,194	\$140,906
Adjusted Diluted Earnings Per Share (1) (2)	\$2.02	\$1.16	\$1.20

Although we report our financial results using the FIFO basis of accounting, as part of our pricing strategy, we measure our business performance using the estimated current replacement cost (“ECRC”) of our inventory and cost of goods sold. We maintain our perpetual inventory in our global enterprise resource planning system, where the carrying value of our inventory is determined using FIFO. At the beginning of each month, we determine the ECRC of our raw materials for that particular month, and using the same perpetual inventory system that we use to manage inventory and therefore costs of goods sold under FIFO, we revalue our ending inventory to reflect the total cost of such inventory as if it was valued using the ECRC. The result of this revaluation from FIFO creates the spread between FIFO and ECRC. With inventory valued under FIFO and ECRC, we then have the ability to report cost of goods sold and therefore Adjusted Gross Profit, Adjusted EBITDA and Adjusted Diluted Earnings Per Share under both our FIFO convention and ECRC.

Adjusted Gross Profit is gross profit net of the impact of the spread between the FIFO basis of accounting and ECRC and net of the impact of items we do not consider indicative of our ongoing operating performance. We explain how each adjustment is derived and why we believe it is helpful and appropriate in the reconciliation below. You are encouraged to evaluate each adjustment and the reasons we consider it appropriate for supplemental analysis. As a measure of our performance, Adjusted Gross Profit and Adjusted Diluted Earnings Per Share are limited because they often vary substantially from gross profit and diluted earnings per share calculated in accordance with US GAAP.

EBITDA represents net income before interest, taxes, depreciation and amortization. Limitations for EBITDA as an analytical tool include the following:

- EBITDA does not reflect the significant interest expense on our debt;

EBITDA does not reflect the significant depreciation and amortization expense associated with our long-lived assets;

EBITDA included herein should not be used for purposes of assessing compliance or non-compliance with financial covenants under our debt agreements. The calculation of EBITDA in the debt agreements includes adjustments, such as extraordinary, non-recurring or one-time charges, proforma cost savings, certain non-cash items, turnaround costs, and other items included in the definition of EBITDA in the debt agreements; and other companies in our industry may calculate EBITDA differently than we do, limiting its usefulness as a comparative measure.

Adjusted EBITDA is EBITDA net of the impact of the spread between the FIFO basis of accounting and ECRC and net of the impact of items we do not consider indicative of our ongoing operating performance. We explain how each adjustment is derived and why we believe it is helpful and appropriate in the reconciliation below. You are encouraged to evaluate each adjustment and the reasons we consider it appropriate for supplemental analysis. As an analytical tool, Adjusted EBITDA is subject to the limitations applicable to EBITDA described above, as well as the following limitations:

due to volatility in raw material price, Adjusted EBITDA may, and often does, vary substantially from EBITDA, net income and other performance measures, including net income calculated in accordance with US GAAP; and Adjusted EBITDA may, and often will, vary significantly from EBITDA calculations under the terms of our debt agreements and should not be used for assessing compliance or non-compliance with financial covenants under our debt agreements.

Because of these and other limitations, EBITDA and Adjusted EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business.

Our presentation of non-GAAP financial measures and the adjustments made therein should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items, and in the future we may incur expenses or charges similar to the adjustments made in the presentation of our non-GAAP financial measures. We compensate for the above limitations by relying primarily on our GAAP results and using Adjusted Gross Profit, Adjusted EBITDA and Adjusted Diluted Earnings Per Share only as supplemental measures.

We reconcile Gross Profit to Adjusted Gross Profit as follows:

	Years ended December 31,		
	2015	2014	2013
	(in thousands)		
Gross profit	\$228,656	\$237,067	\$225,832
Add (deduct):			
Restructuring and other charges (a)	159	651	218
Production downtime (b)	(474) 9,905	3,506
Impairment of spare parts inventory (c)	—	430	—
Non-cash compensation expense (d)	541	628	332
Spread between FIFO and ECRC	50,658	9,255	30,737
Adjusted gross profit	\$279,540	\$257,936	\$260,625

(a) Employee severance costs and other restructuring related charges.

In 2015, the reduction in costs is due to insurance recoveries related to the Belpre production downtime. In 2014,

(b) weather-related production downtime at our Belpre, Ohio, facility and an operating disruption from a small fire at our Berre, France, facility. In 2013, production downtime at our Belpre, Ohio facility,

in preparation for the installation of natural gas boilers to replace the coal-burning boilers required by the MACT legislation.

- (c) Impairment of spare parts inventory associated with the coal-burning boilers which were decommissioned in 2015.
 (d) Represents non-cash expense related to equity compensation plans.

We reconcile consolidated net income (loss) to EBITDA, and Adjusted EBITDA as follows:

	Years ended December 31,		
	2015	2014	2013
	(in thousands)		
Net income (loss) attributable to Kraton	\$(10,535)	\$2,419	\$(618)
Net loss attributable to noncontrolling interest	(1,994)	(1,209)	(357)
Consolidated net income (loss)	(12,529)	1,210	(975)
Add (deduct):			
Interest expense, net	24,223	24,594	30,470
Income tax expense (benefit)	6,943	5,118	(3,887)
Depreciation and amortization	62,093	66,242	63,182
EBITDA	\$80,730	\$97,164	\$88,790
Add (deduct):			
Retirement plan charges (a)	792	399	—
Restructuring and other charges (b)	1,729	2,953	815
Transaction and acquisition related costs (c)	20,846	9,585	9,164
Impairment of long-lived assets (d)	—	4,731	—
Impairment of spare parts inventory (e)	—	430	—
Production downtime (f)	(593)	10,291	3,506
KFPC startup costs (g)	3,640	1,911	—
Non-cash compensation expense (h)	9,015	10,475	7,894
Spread between FIFO and ECRC	50,658	9,255	30,737
Adjusted EBITDA	\$166,817	\$147,194	\$140,906

(a) Charges associated with the termination of the defined benefit restoration pension plan, which are primarily recorded in selling, general, and administrative expenses.

(b) Employee severance, professional fees, and other restructuring related charges which are primarily recorded in selling, general, and administrative expenses.

Charges related to the evaluation of acquisition transactions which are recorded in selling, general, and administrative expenses. In 2015, charges are primarily related to the acquisition of Arizona Chemical. In 2014 and 2013, charges are primarily related to the terminated Combination Agreement with LCY.

The charge recognized in 2014 includes \$2.4 million related to engineering and design assets for projects we determined were no longer economically viable, \$1.4 million related to information technology and office assets associated with fourth quarter restructuring activities, and \$0.9 million related to other long-lived assets.

(e) Impairment of spare parts inventory associated with the coal-burning boilers which were decommissioned in 2015 which is recorded in cost of goods sold.

(f) In 2015, the reduction in costs is due to insurance recoveries related to the Belpre production downtime, which are primarily recorded in cost of goods sold. In 2014, weather-related production downtime at our Belpre, Ohio, facility and an operating disruption from a small fire at our Berre, France, facility, of which

\$9.9 million is recorded in cost of goods sold and \$0.4 million is recorded in selling, general, and administrative expenses. In 2013, production downtime at our Belpre, Ohio, facility, in preparation for the installation of natural gas boilers to replace the coal-burning boilers required by the MACT legislation, which is recorded in cost of goods sold.

(g) Startup costs related to the joint venture company, KFPC, which are recorded in selling, general, and administrative expenses.

Represents non-cash expense related to equity compensation plans. We had historically recorded these costs in selling, general and administrative expenses; however, beginning in the second quarter of 2013, a portion of these costs were recorded in cost of goods sold and research and development expenses. In 2015, \$7.8 million, \$0.7 million and \$0.5 million, in 2014, \$9.0 million, \$0.9 million and \$0.6 million, and in 2013, \$7.1 million, \$0.5 million, and \$0.3 million were recorded in selling, general, and administrative expenses, research and development expenses, and cost of goods sold, respectively.

We reconcile GAAP Diluted Earnings (Loss) Per Share to Adjusted Diluted Earnings Per Share as follows:

	Years ended December 31,		
	2015	2014	2013
	(in thousands)		
GAAP earnings (loss)	\$(0.34)	\$0.07	\$(0.02)
Retirement plan charges (a)	0.03	0.01	—
Restructuring and other charges (b)	0.05	0.08	0.02
Transaction and acquisition related costs (c)	0.67	0.29	0.28
Impairment of long-lived assets (d)	—	0.14	—
Impairment of spare parts inventory (e)	—	0.01	—
Production downtime (f)	(0.02)	0.31	0.11
KFPC startup costs (g)	0.05	0.02	—
Change in valuation allowance (h)	—	(0.05)	(0.31)
Settlement of interest rate swap (i)	—	—	0.02
Write-off of debt issuance cost (j)	—	—	0.16
Spread between FIFO and ECRC	1.58	0.28	0.94
Adjusted Earnings	\$2.02	\$1.16	\$1.20

(a) Charges associated with the termination of the defined benefit restoration pension plan, which are primarily recorded in selling, general and administrative expenses.

(b) Employee severance, professional fees and other restructuring related charges which are primarily recorded in selling, general and administrative expenses.

Charges related to the evaluation of acquisition transactions which are recorded in selling, general and administrative expenses. In 2015, charges are primarily related to the Arizona Chemical Acquisition. In 2014 and 2013, charges are primarily related to the terminated Combination Agreement with LCY.

The charge recognized in 2014 includes \$2.4 million related to engineering and design assets for projects we determined were no longer economically viable, \$1.4 million related to information technology and office assets associated with fourth quarter restructuring activities, and \$0.9 million related to other long-lived assets.

(e) Impairment of spare parts inventory associated with the coal-burning boilers which were decommissioned in 2015 which is recorded in cost of goods sold.

In 2015, the reduction in costs is due to insurance recoveries related to the Belpre production downtime, which are primarily recorded in cost of goods sold. In 2014, weather-related production downtime at our Belpre, Ohio, facility and an operating disruption from a small fire at our Berre, France, facility, of which

\$9.9 million is recorded in cost of goods sold and \$0.4 million is recorded in selling, general and administrative expenses. In 2013, production downtime at our Belpre, Ohio, facility, in preparation for the installation of natural gas boilers to replace the coal-burning boilers required by the MACT legislation, which is recorded in cost of goods sold.

- (g) Startup costs related to the joint venture company, KFPC, which are recorded in selling, general and administrative expenses.
- (h) Income tax benefit related to a portion of the change in our valuation allowance for deferred tax assets.
- (i) Interest expense related to the termination and settlement of an interest rate swap agreement in connection with the refinancing of our credit facility.
- (j) Interest expense related to the write-off of unamortized debt issuance costs in connection with the refinancing of our credit facility.