

Aldermore Bank Plc

Pillar 3 Disclosures

1. Consolidation Group

For accounting purposes the Bank has taken advantage of the exemption, allowed under section 228 of the Companies Act 1985, not to prepare group accounts as it is a wholly owned subsidiary of Aldermore Holdings Limited, a company incorporated in England and Wales. Aldermore Holdings Limited has no commercial interests other than its holding in Aldermore Bank Plc.

Accordingly the financial statements represent the Bank only.

2. Risk Management

2.1 Introduction

The Bank's risk management focuses on the four major areas of risk incurred by the Bank: credit risk, liquidity risk, interest rate risk and operating risk.

Authority for managing these risks ultimately rests with the Bank's Board of Directors. The Board currently comprises four Executive Directors, three non-Executive Directors and a non-Executive Chairman.

The main elements of risk governance are as follows:

2.2 Board

This is the primary governing body. It approves the level of risk which the Bank is exposed to and the framework for reporting and mitigating those risks. The Board manages risks and internal capital requirements, for both current and future activities, through a combination of monthly board reports including financial results, periodic reports, budgets & forecasts and periodic reviews of the main risks set out in the ICAAP report (see section 3 below).

2.3 Credit Underwriting

Credit proposals are submitted for underwriting to a central underwriting function via electronic processing systems which records the progress of transactions. This establishes an auditable trail of the credit process and payout authorisations. Appropriate authority levels are set according to the facility value, and are periodically reviewed.

2.4 Audit Committee

The audit committee's key role in risk management is the assessment of controls that are in place to mitigate risks. The Audit Committee, chaired by a non executive director, comprises the non executive chairman, the chief executive and two non executive directors. It considers the risks that management have assessed and provides a timetable to the internal audit function. The internal audit function reports directly to the audit committee under the terms

of reference for the committee. The Audit Committee approves the terms of appointment and receives reports from the external auditors independently from the Board.

2.5 Compliance

The Head of Compliance is an experienced executive who is responsible for compliance and acts as the MLRO. Board responsibility rests with the finance & risk director.

3. Internal Capital Adequacy

The Board manages its internal capital levels for both current and future activities. Under the Basel 2 regulatory requirement, the Bank undertakes its own assessment of its internal capital needs, known as the Internal Capital Adequacy Assessment Process (ICAAP). The Bank submitted its ICAAP to the Financial Services Authority in January 2008 and awaits confirmation of its Individual Capital Guidance (ICG). Until this is received, the Bank operates under an interim capital regime (Interim ICG). The disclosures in this document refer to the Bank's internal assessment unless there is a specific reference to the Interim ICG. The FSA has indicated that following change of control in May 2009 it will review an updated ICAAP report towards the end of 2009.

4. Capital Resources

As at 31 March 2009, the Bank's entire capital base was Tier 1 Capital which consisted of fully issued ordinary shares, satisfying all the criteria for a tier 1 instrument as outlined in the FSA's regulatory document GENPRU 2.2.83 R and audited reserves.

Tier 1 capital based on our 31 March 2009 audited accounts is as follows:

	£'000
Share capital	2,500
Profit and loss reserve	<u>15,386</u>
Total tier 1 capital	<u>17,886</u>

The Bank has elected to use the standardised approach for credit risk. Under Basel 2, the Bank must set aside capital equal to 8% of its total risk weighted assets to cover its 'Pillar 1' capital requirement. The Bank must also set aside additional 'Pillar 2' capital to provide for additional risks. This is calculated by multiplying the Pillar 1 capital by the ICG ratio. The ICG ratio will be based on the various risks the Bank faces.

The Bank's capital base was significantly in excess of the minimum required under the Interim ICG regime.

Following the change of control additional capital has been raised by the Bank as disclosed in paragraph 9 below.

5. Credit Risk

Credit risk is the risk that companies, financial institutions and other counterparties will be unable to meet their obligations to the Bank which may result in financial losses. This is the most significant risk incurred by the Bank. Credit risk arises principally from the Bank's loan book but can also arise from other on and off balance sheet activities, the most material of which is the issue of guarantees. The Bank does not trade in financial instruments.

The Bank mitigates credit risk by:

- Focusing on business sectors it knows well or has an established connection.
- Limiting the size of exposures to any particular entity / group.
- Limiting the aggregate size of exposures to any particular sector or subsector.
- Obtaining security cover and where appropriate personal guarantees for the exposure.
- Regularly reviewing the credit risk grading of each exposure.

Due to the markets the Bank operates in, none of our credit risk categories are calculated using external credit agencies.

5.1 Credit Risk Analysis

The numerical disclosure below show the total amount of exposures at 31 March 2009, including undrawn commitments and guarantees, after accounting offsets analysed by different type of exposure classes, as follows:

Credit risk exposure	Carrying value £'000	8% risk weighted £'000
Government or banks	23,367	374
Corporates	33,905	2,590
Retail *	14,421	865
Past due items **	14,130	1,541

* Retail are exposures to a person or persons or to a small or medium sized entity (SME).

** See 5.5 below

The numerical disclosure below show the total amount of exposures at 31 March 2009, including undrawn commitments and guarantees, after accounting offsets analysed by sector, as follows:

Credit risk exposure	Carrying value £'000	Provision £'000
Property	37,747	2,837
Asset Finance	17,898	292
Banks	23,245	-
Other	6,933	466

The average exposures in the year were not materially different to the above.

The numerical disclosure below show the total amount of exposures at 31 March 2009, including undrawn commitments and guarantees, after accounting offsets analysed by maturity, as follows:

Credit risk exposure	Carrying value £'000
Loans & advances to Banks	
- Repayable in not more than 3 months	23,245
Loans & advances to Customers	
- Repayable in not more than 3 months	30,309
- More than 3 months but not more than 6 months	7,151
- More than 6 months but not more than 1 year	13,859
- More than 1 year but not more than 5 years	9,096
- Commitments & Guarantees	2,163

5.2 Property

The Bank provides finance to property developers for residential bridging, refurbishment and development. Therefore, the Bank is exposed to a reduction of the Loan to Value (LTV) cover should the UK property market decline. The Bank believes that the following partially mitigate the above risks:

- We seek personal guarantees of directors.
- Our LTV ratios on advances have typically been 65% to 75%.
- Typically we provide facilities with a term of less than 18 months. At the time of lending, we should have a reasonable view of the market for the next twelve months.
- We rarely finance development sites, as these are typically subject to greatest price movements.
- All properties are visited by a senior executive prior to a credit proposal being written.

5.3 Asset Finance

This portfolio is primarily made up of fairground rides, coin operated machines, leisure equipment and printing equipment. The portfolio responds to the economic cycle in varying degrees depending on the type of equipment, the business ability of the owner and the maturity profile of the exposure. However the results to date show that the portfolio has performed relatively well during the recession.

5.4 Other

Corporate: This is typically the provision of finance to businesses to fund acquisitions, capital expenditure or temporary working capital requirements. These are usually secured by a debenture or a combination of property, stock, receivables or specific assets. This is not a core business line and is gradually reducing.

Personal: These are small facilities to individuals known to the Bank. Facilities will usually be secured on property.

5.5 Past due and provisions

A financial asset is treated as past due when it has failed to make a payment within three months from when contractually due. For prudential reporting purposes, when an individual exposure falls into the past due category, then the entire amount of the facility exposure and all exposures in this 'customer group' are treated as past due even if they are not individually in arrears. This can result in the reported past due figure being significantly in excess of the actual amount overdue.

Past due does not mean that a counterparty will never pay and we do not tend to reschedule overdue amounts on our asset finance agreements. Failure to make payments when due can trigger various actions such as renegotiation, enforcement of covenants, or legal proceedings.

On a quarterly basis, the requirement for specific bad debt provisions is considered. This is completed in conjunction with the review of credit risk gradings. Exposures that attract a grading of 7 are given a specific provision and interest is no longer accrued. Should any event occur between these reviews which indicates a provision is clearly needed then a provision will be made in advance of the quarterly review process. At 31 March 2009, provisions for bad debts amounted to £3.59m (2008: £1.05m). The charge against profit for the year ended 31 March 2009 for bad and doubtful debts was £2.88m of which £2.6m related to property finance.

6. Liquidity Risk

Liquidity risk is the risk that the Bank encounters difficulty in realising assets or otherwise raising funds to meet commitments associated with liabilities or financial obligations.

There is a requirement to keep a balance between the funding maturity profile and the funding requirement derived from the run-off of our loan receivables. While the Bank is significantly funded from shareholders funds, there is still a need to keep a balance between the deposit maturity profile and the loanbook maturity profile such that we always have at least a 3 month window in which new funds could be sourced.

We believe that additional funding deposits and, at a price, bank funding could be obtained within 3 months. This period has been chosen as it would allow reasonable time to put a facility in place, at a time of limited availability of funding. The Bank has no wholesale funding other than a standby bank facility, which is provided on a committed basis.

We monitor closely the activity levels of our deposits and have the flexibility to quickly amend the amount and structure of interest rates on offer if necessary to obtain the required profile of deposits.

We have always met our liquidity requirements with a degree of comfort. At 31 March 2009, we had significantly higher cash balances than in previous years and this has continued beyond the year end.

7. Interest Rate Risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in the market interest rate.

The Bank provides finance and obtains its funding on a fixed and variable rate basis. This creates an exposure to movements in interest rates. We undertake financial modeling in order to be able to monitor the level of exposure and to estimate the impact that this would have for a given future movement in interest rates. Based on the prevailing loan and deposit structure, the Bank forecast that a 2% increase in rates would reduce the net present value of the financial assets by £53k. A 2% decrease in rates would increase the net present value of those financial assets by £55k.

8. Operating Risk

Operating risk is the risk of loss resulting from weaknesses in systems, procedures and people, or from external events such as regulation or economic events. These risks are mitigated by the Bank operating from two sites where directors are in close proximity to the daily transactions and therefore have visibility to ensure that appropriate controls are being operated. The Bank has assessed a regulatory capital amount of £419k for operating risk, against £708k required under the Interim ICG regime based on the basic indicator approach.

9. Post Balance Sheet Events

On 9 January 2009 the shareholders of Aldermore Holdings Limited agreed to sell all their shares to Anacap Financial Partners LP and Anacap Financial Partners II LP, subject to certain conditions including approval by the FSA. On 20 May 2009 that sale was completed. On the same day, the Bank issued shares valued at £48.2 million, for cash of £12.5 million and a 100% interest in Base Commercial Mortgages Holdings Limited (BCMHL), valued at £35.7 million. The Bank subsequently acquired all the assets and liabilities of BCMHL. BCMHL was previously owned by Anacap Financial Partners LP.

On 20 May 2009 the Bank sold the freehold land and buildings, investments and certain loan assets, valued at £12 million, to Mr WR Ruffler, a director of the Bank.