Pillar 3 Disclosures
31 December 2013

Contents

1. Introduction

Effective risk management is central to Aldermore Bank PLC (the “Bank” or “Aldermore”) and in accordance with the disclosure requirements under Basel II this document provides an overview of how the Bank’s risk management framework operates and describes the key risks which the Bank faces.

This document is prepared in accordance with the BIPRU rules for capital disclosures which were in place on 31 December 2013, which is also the effective date of the document. These rules were introduced in the UK by the Financial Services Authority (FSA) to implement the European Union Capital Requirements Directive (CRD), also referred to as Basel II, from 1 January 2007.

The FSA was replaced by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) in 2013.

Basel II aimed to make the capital requirements framework more risk sensitive and representative of modern Banks' risk management practices. As part of this improved approach, the Basel II framework consists of three 'pillars':

- **Pillar 1**: defines the minimum capital requirements that banks are required to hold for credit, market and operational risks.
- **Pillar 2**: this builds on Pillar 1 and incorporates the Bank’s own assessment of additional capital resources needed in order to cover specific risks faced by the institution that are not covered by the minimum regulatory capital resources requirement set out under Pillar 1. The amount of any additional capital requirement is also assessed by the Prudential Regulatory Authority (“PRA”) during its Supervisory Review and Evaluation Process (SREP) and is used to determine the overall capital resources required by the Bank.
- **Pillar 3**: is to improve market discipline by requiring banks to publish information on their principal risks, capital structure and risk management.

In accordance with BIPRU 11, this document outlines the capital required under Pillar 1 and in accordance with Pillar 2, details specific risks which the Bank faces, and how these risks are managed.

Regulatory Developments

The disclosures in this document are based on the requirements under the Basel II rules that were in effect as at 31 December 2013.

CRD IV was approved by the European Parliament in June 2013, implementing Basel III in Europe. The Basel III legislation is effective from 1 January 2014 and replaces Basel II. The 2014 Pillar 3 disclosures will be presented taking into account the new requirements.

2. Scope

For accounting purposes the Bank has taken advantage of the exemption, allowed under section 400 of the Companies Act 2006, not to prepare group accounts as it is a wholly owned subsidiary of AC Acquisitions Limited a company incorporated in England and is included in the consolidated accounts of AC Acquisitions Limited. AC Acquisitions Limited has no commercial interests other than its holding in the Bank, via Aldermore Holdings Limited.

At the year ended 31 December 2013 the Bank has no active subsidiaries or joint ventures and all banking activities are conducted through the Bank’s balance sheet. Accordingly, the Pillar 3 disclosures represent the Bank only.

This Pillar 3 report is based upon the Bank’s Annual Report and Accounts for the year ended 31 December 2013, and is consistent with the accounting policies used to produce the Bank’s financial statements. The report is also based on the Bank’s internal structure and regulatory environment at the 2013 year-end and does not cover internal or regulatory changes since.

3. Risk Management

3.1. Risk Management Objectives

A core objective for Aldermore is the effective management of risk in order to ensure that the Bank maintains sufficient capital, liquidity and controls at all times, and to act in such a way so as to act in a reputable way, taking into account the interests of customers, regulators and shareholders.

Given the nature of the activities undertaken, the principal risks faced are strategic risk, capital risk, credit risk, liquidity risk, interest rate risk, market risk, operational risk and conduct risk. Each risk has a defined risk appetite which is controlled though documented policies and frequent reporting, and is overseen by a robust governance process.

The risk management framework is outlined below, indicating the relevant governance structure and control process.

3.2. Principle Risks

The Bank faces the following principal risks:

- **Strategic Risk** are the risks which can affect the Bank's ability to achieve its corporate and strategic objectives
- **Credit Risk** is the risk of financial loss arising from a borrower or counterparty failing to meet their financial obligations to the Bank in accordance with agreed terms.
- **Capital Risk** is the risk that the Bank has insufficient capital to cover regulatory requirements and/or growth plans.
- **Liquidity Risk** is the risk that the Bank is not able to meet its financial obligations as they fall due, or can do so only at excessive cost.
- **Interest Rate Risk** is the risk of financial loss through un-hedged or mismatched asset and liability positions sensitive to changes in interest rates.
- **Market Risk** is the financial impact from movements in market prices on the value of assets and liabilities.
- **Operational Risk** is the risk of financial loss and/or reputational damage resulting from inadequate or failed internal processes, people and systems or from external events.
- **Conduct Risk** the risk of detriment caused to the Bank`s customers due to the inappropriate execution of its business activities and processes.

The principal risks are covered in more detail below and the risk management framework is designed to ensure each risk is managed, monitored and overseen through a dedicated risk-specific committee.

The Bank has not defined regulatory risk as a single category of risk, owning to the broad nature of regulation. Prudential regulatory risks are covered as part of capital risk, liquidity risk and operational risk. Conduct regulatory risks are covered under conduct risk.

3.3. Risk Appetite

The Bank has a defined risk appetite for each of the principal risks and performance against the risk appetite statements is monitored and reported on a regular basis. The risk appetites are set by the Board and implemented by the Executive Committee. Group Risk is responsible for ensuring the Bank operates within the stated risk appetites.

The over-arching risk appetite statement of the Bank:

> ***To ensure that the Bank maintains sufficient capital, liquidity and controls at all times, and to act in a reputable way, taking into account the interests of customers, regulators and shareholders.***

A core objective for Aldermore is the effective management of risk in order to protect depositors, borrowers, shareholders and to ensure the Bank has adequate capital and liquidity at all times. The risk appetite framework is the approach through which risk appetites are established, communicated, and monitored.

The Bank's risk appetite statements are designed to be clear for all stakeholders to understand, and should be directly linked to the Bank's strategy and principal risks associated with the Bank's strategy, business model and control environment.

The risk appetite framework has the following components:

- Risk appetite statement: The articulation of the level and types of risk that the Bank is willing to accept in order to achieve its business objectives.

- Risk capacity: The maximum level of risk the Bank can assume before breaching constraints determined by regulatory capital and liquidity needs and its obligations, also from a conduct perspective to depositors, customers, and shareholders.
- Risk limits: Quantitative measures that allocate the Bank's aggregate risk appetite statement to specific activities, providing risk indicators relevant to the risk appetite.
- Risk profile: the point in time assessment of the Bank's net risk exposure.

Strategic Risk Appetite

The strategic risk appetite is measured in terms of the deviation against key performance indicators which form part of the Bank's business plan. Performance against the strategic risk appetite is measured every quarter and reported to the Audit & Risk Committee.

Credit Risk Appetite

The Bank operates a business line specific credit risk appetite, as well as an overall credit risk appetite for its lending activities. Expected losses are factored into the budgeting and forecast process and reflect Bank's expected view of lending performance, taking into account recent performance data and the prevailing economic environment.

The Bank recognises that actual losses may differ from forecasted or budgeted values. The credit risk appetites are set as an upper limit on losses from credit and credit related fraud and so this limit is set above the budgeted value for each business.

Capital Risk Appetite

Capital Risk is the risk that the Bank has insufficient capital to cover regulatory requirements and/or growth plans. The Bank will maintain sufficient capital to cover Pillar1 and Pillar 2 requirements, including any capital planning buffers, and maintain an operational capital buffer.

Liquidity Risk Appetite

The Board has set a liquidity risk appetite which ensures that a prudent level of liquidity is held to cover an unexpected liquidity outflow such that the Bank will be able to meet its financial commitments during an extended period of stress. Additionally, reputational risks are kept low through honouring pipeline commitments reasonably expected to complete during a three month period.

Market & Interest Rate Risk Appetite

The Bank aims to minimise interest rate risk and has a policy to ensure at least 95% of the assets are matched with liabilities of a comparable interest rate basis.

The Bank does not seek to take or expose itself to market risk, and does not carry out proprietary trading, although certain liquid asset investments which form part of the liquid asset buffer may carry a limited amount of mark to market risk which is regularly monitored.

Operational Risk Appetite

The Bank aims to maintain robust operational systems and controls and seeks to operate within a defined level of operational risk. The operational risk appetite considers risk events, the assessment of internal controls as well as holding additional capital for certain operational risks.

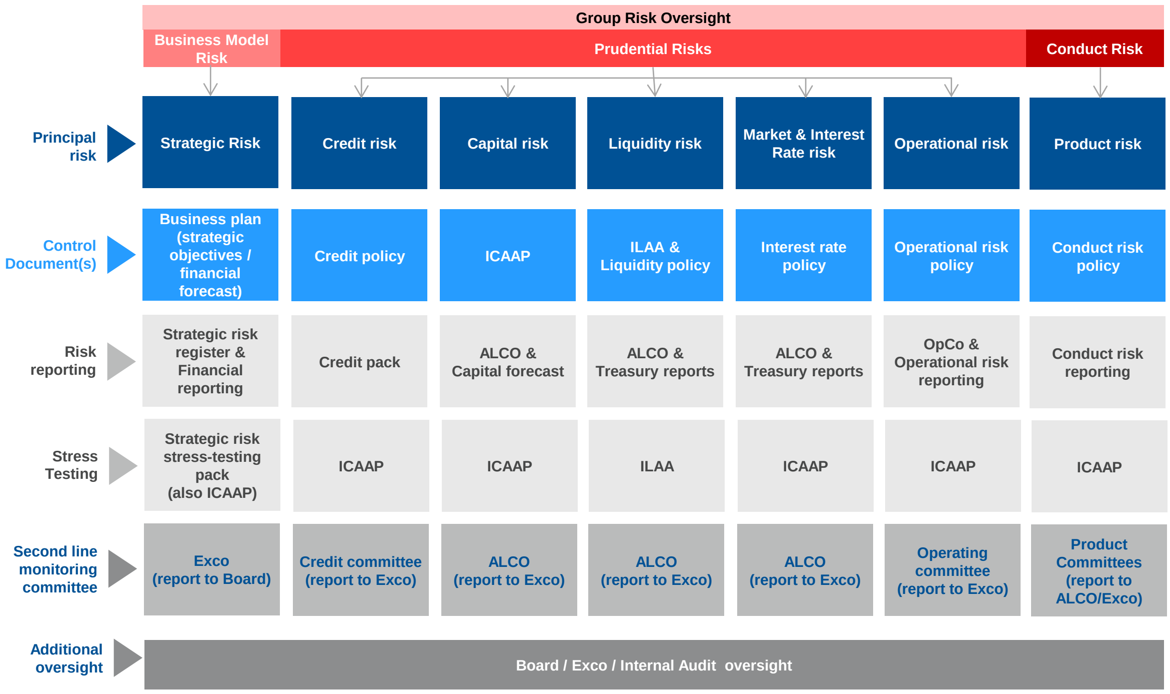
Conduct Risk Appetite

The Bank has a zero appetite for systemic unfair outcomes arising from any element of the conduct risk cycle, which includes product design, sales or after sales processes and culture. However, owing to operational processes which inadvertently have an adverse effect on customers, the Bank has set a tolerance around the detriment caused through process and/or product failings.

3.4. Risk Management Framework

The risk management framework is outlined below, indicating the relevant governance and control structure for each principal risk.

Risk Management Framework



The risk management framework includes the following components:

- Control documents – the overarching document which provides the framework and policy of how the risk is managed
- Risk Reporting – the primary reporting document relating to the risk
- Stress testing – the primary means to understand how the risk behaves under stressed conditions, and the implication for capital and liquidity resources
- Monitoring Committee – the principal committee responsible for monitoring the risk at the executive level. This is supported by further oversight by the Group Risk function, other governance committees and internal audit.

Escalation procedures exist to ensure that issues are reported and addressed at the right level.

A detailed analysis of all key risks has been considered as part of the capital adequacy assessment and is documented in the Internal Capital Adequacy Assessment Process ("ICAAP") report, which is approved by the Board. Liquidity risk is specifically assessed through the Individual Liquidity Adequacy Assessment ("ILAA"), also approved by the Board. Operational risk is managed through the Operational Risk Policy and Key Risks Registers.

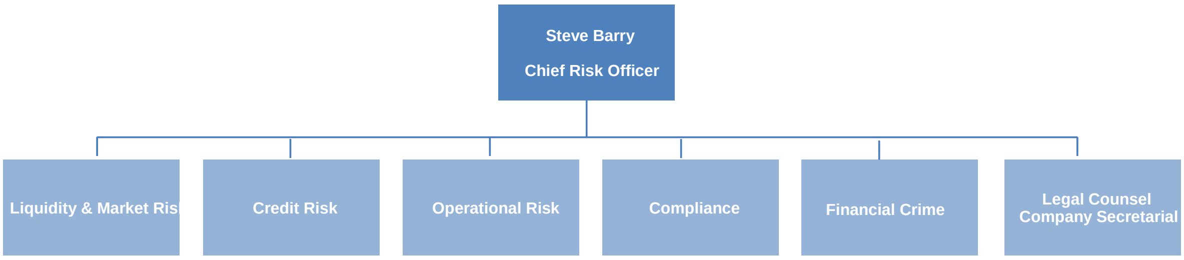
To support the risk management framework, the Bank operates a "three lines of defence" model:

- The first line of defence comes through operational management, who manage risk by maintaining appropriate systems and controls that are implemented and effective on a daily basis.
- The second line of defence comprises governance and oversight. Governance and oversight include the monitoring committees and the Group Risk function. These functions cover all significant risk areas, such as credit risk, interest rate risk, operational risk and liquidity risk. The committee structure is covered in more detail in section 3.6 below.
- The third line of defence is independent assurance checking and challenge. This is provided by Internal Audit assurance reviews. Assurance reporting is provided to the Audit & Risk Committee.

3.5. Risk Oversight, Monitoring and Reporting

Aldermore has a Chief Risk Officer ("CRO") who is responsible for ensuring each risk is adequately monitored, managed and mitigated. Through the Group Risk function, the CRO is responsible for providing assurance to the Board and the Directors that the principal risks are adequately managed and that the Bank is operating within its risk appetites.

Group Risk



Group Risk is an independent risk management function, and is separate from the operational and sales side of the Bank. Group Risk is responsible for ensuring that appropriate risk management processes, techniques and controls are in place, and that they are sufficiently robust.

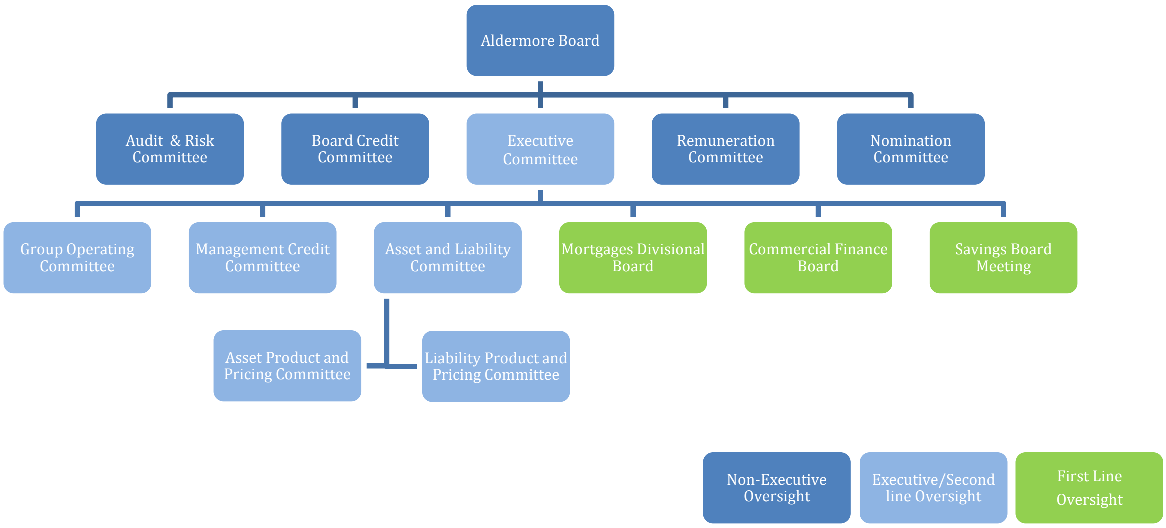
The Group Risk function provides periodic independent reports on risk positions, risk management and performance against the risk appetite statements. Risk reports are provided to the Operating Committee, Management and Board Credit Committees, the Board and the Audit & Risk Committee.

The reporting and oversight process is designed to ensure the committees which form the governance structure are informed and aware of the key risks and that there are adequate controls in place for these risks. Reports are produced on each key risk and the frequency ranges from daily to monthly, according to what is appropriate for the risk.

3.6. Risk Governance Structure

The responsibility for managing the principal risks ultimately rests with the Bank's Board of Directors. The Bank's governance structure is outlined below.

Aldermore Governance Structure (December 2013)



3.7. Committee Structure

This section outlines the details of the Board and principal committees which enable high-level controls to be exercised over the Bank's activities. The frequency of meetings is detailed below, although it is expected that these committees will meet more frequently as circumstances require.

Board

The Board is the primary governing body and has ultimate responsibility for setting the Bank's strategy, corporate objectives and risk appetite. The strategy and risk appetites take into consideration the interests of depositors, borrowers and shareholders.

The Board approves the level of risk which the Bank is willing to accept and is responsible for maintaining a sufficient control environment to manage the principal risks. The Board is also responsible for ensuring the capital and liquidity resources are adequate to achieve the Bank's objectives without taking undue risk. The Board also maintains a close oversight of current and future activities, through a combination of monthly board reports including financial results, operational reports, budgets and forecasts and reviews of the main risks set out in the ICAAP and ILAA reports.

The Board is comprised of five non-executive directors and five executive directors. The Board meets at least six times a year.

Audit & Risk Committee

The Board has delegated responsibility for reviewing the effectiveness of the Bank's internal controls to the Audit & Risk Committee. This Committee meets quarterly and monitors and considers the internal control environment focusing on operational risks, internal and external audits and compliance matters.

The Internal Audit function reports directly to the Audit & Risk Committee under the terms of reference for the committee. The Audit & Risk Committee approves the terms of appointment and receives reports from the external auditors independently from the Board.

Board Credit Committee

The Board has delegated responsibility for overseeing the performance of credit risk to the Board Credit Committee.

This committee meets on a quarterly basis to review provisioning, lending policies, new products and monitors portfolio performance and the lending environment. The committee may also consider individual transactions which are referred up from the Management Credit Committee.

This committee will specifically consider whether the Bank is operating within its credit risk appetite and whether any product or criteria changes would impact this. The Bank's aggregated credit risk exposures and concentration risk report are also reviewed.

Management Credit Committee

This Committee meets monthly and is responsible for monitoring portfolio performance and reviewing policy issues, such as provisioning and lending policies and recommending these to the Board or Board Credit Committee. It is also responsible for approving credit proposals that have been presented to it by the business lines pursuant to its delegated authority.

Detailed credit reports are produced covering each specific business line. These are reviewed in detail by this committee and Group Risk. The credit packs report on the quality of new lending, credit performance, arrears and non-performing loans and also provides a significant level of detail on the composition of the credit portfolios.

Board Remuneration Committee

This Committee reviews remuneration matters, employee benefits and performance related pay structures for the Bank. It is also responsible for considering and determining the Bank's remuneration policy and reviewing its adequacy and effectiveness.

This Committee is also responsible for ensuring that the remuneration policy and process complies with the Remuneration Code which came into effect from 1st January 2011.

This Committee is comprised of Non-Executive Directors with the Chief Executive Officer and Group HR Director in attendance. The Remuneration Committee meets four times a year.

Board Nomination Committee

This Committee reviews the structure and composition of the Board, succession planning and material appointments, in particular Board appointments.

This Committee is comprised of Non-Executive Directors with the Chief Executive Officer and Group HR Director in attendance. The Nomination Committee meets twice a year.

Executive Committee

The Executive Committee takes day-to-day responsibility for the running of the business. The Executive Committee implements the strategy which is approved at the Board and ensures the performance of the business is conducted in accordance with the Board's instructions.

This committee meets twice a month and reviews all aspects of business performance, including reviewing management of the principal risks.

Asset & Liability Committee ("ALCO")

The Exco has delegated responsibility for managing the Bank's exposure to capital, liquidity, interest rate and market risk to the ALCO.

The ALCO meets monthly and ensures that the firm adheres to the market risk, interest rate risk and liquidity policies and objectives set down by the Board. It also has responsibility for ensuring that the policies that are implemented are adequate to meet prudential and regulatory targets. The committee is also responsible for the effective management of the Bank's assets and liabilities and the impact on capital and liquidity of future business activity and management actions.

Group Operating Committee

This committee reviews IT, operational and compliance matters to ensure appropriate systems and controls exist which are able to support the needs of the Bank including any projects and change programmes.

This committee monitors operational risk, including regulatory and compliance risk, implements the operational risk management policy and reviews operational performance, including key risk indicator reports. The Group Operating Committee meets monthly.

Asset Product and Liability Product and Pricing Committees

These committees meet monthly to review, approve and set the pricing for new products proposals introduced by Aldermore, and reviews product performance as well as on-going pricing initiatives. The Committees are also responsible for the effective oversight of the Bank`s conduct risk processes in terms of product governance, design and on-going performance.

The product and pricing committees report into ALCo and ExCo.

Divisional Boards (Mortgages, Commercial Finance and Savings)

The purpose of the Divisional Boards is to meet on a monthly basis and provide a forum for open discussion and decisions on key issues; specific responsibilities includes the delivery of strategic objectives, budget formulation and financial delivery; recruitment, training, implementing and maintaining effective controls, product review and performance and management of conduct risk.

4. Capital Resources

As at 31 December 2013, the Bank's capital base was made up of £250.4 million of Tier 1 capital and £39.3 million of Tier 2 capital. Tier 1 capital consisted of fully issued ordinary shares, satisfying all the criteria for a Tier 1 instrument as outlined in the PRA's regulatory document GENPRU 2.2.83 R and audited reserves. Tier 2 capital relates to issued subordinated loan notes and general provisions. The Bank does not hold any Tier 3 capital.

Total capital based on the 31 December 2013 & restated 2012 audited accounts is as follows:

	2013	2012
	£'000	£'000
Share capital	3,300	3,300
Share premium	233,380	171,823
Profit and loss reserve	20,719	(4,192)
Total Core Tier 1 capital	257,399	170,931
Intangible Assets	(7,017)	(7,467)
Total Tier 1 capital	250,382	163,464
Total Tier 2 capital	39,273	36,207
Total capital	**289,655**	**199,671**

The Bank's capital base was made up of £250.4 million of Tier 1 capital and £39.3 million of Tier 2 capital.

The Bank has elected to use the standardised approach for credit risk. Under Basel II, the Bank must set aside capital equal to 8% of its total risk weighted assets to cover its 'Pillar 1' capital requirements. 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 Individual Capital Guidance ("ICG") ratio.

The ICG ratio is based on the various risks which the Bank faces and is agreed by the PRA. The Bank's capital base was significantly in excess of the minimum required under the ICG.

4.1. Capital Risk and Capital Adequacy

As part of the Pillar 2 approach to capital adequacy, the Board is required to consider all material risks which the Bank faces and determines whether additional capital is required in order to provide additional protection to depositors and borrowers and to ensure the Bank is sufficiently well capitalised to withstand a severe economic downturn.

The Bank is required to maintain a certain level of capital to meet several requirements:

- To meet minimum regulatory capital requirements
- To ensure the Bank can meet its objectives, including growth objectives
- To ensure the Bank can withstand future uncertainty, such as a severe economic downturn
- To provide assurance to depositors, borrowers, shareholders and other third parties

The Board manages its internal capital levels for both current and future activities and documents its risk appetite and capital requirements during stress scenarios as part of the ICAAP. The ICAAP represents the aggregated view on risk for the Bank and is used by the Board, management and shareholders to understand the levels of capital required to be held over the near and medium term.

The Bank produces regular reports on the current and forecasted level of capital, as well as the results of stress scenarios, to the Board and to the Audit & Risk Committee.

The key assumptions and risk drivers used to create the ICAAP are regularly monitored and reported and any material deviation from the forecast and risk profile of the Bank will mean the ICAAP will need to be up-dated.

The principal risks which are considered as part of the ICAAP are detailed below.

5. Principle Risks: Credit Risk

Credit risk is the risk of financial loss arising from a Bank borrower or counterparty failing to meet their financial obligations to the Bank in accordance with agreed terms. This risk arises from the Bank's lending activities as a result of defaulting mortgage, lease and loan contracts and is the most significant risk incurred by the Bank.

Although credit risk arises from the Bank's loan book it can also arise from other off balance sheet activities. The Bank does not actively trade in financial instruments, other than for liquidity management purposes.

Credit risks associated with lending are managed through the use of detailed lending policies which outline the approach to lending, underwriting criteria, credit mandates, concentration limits and product terms. The Bank maintains a dynamic approach to credit management and will take necessary steps if credit performance deteriorates, or is expected to deteriorate, due to economic or sector-specific weaknesses.

The Bank also seeks to mitigate credit risk by focusing on business sectors where it has specific expertise and through limiting concentrated exposures on larger loans, certain sectors and other factors which can represent higher risk. The Bank also seeks to obtain security cover and where appropriate personal guarantees from borrowers.

Due to the retail and SME markets the Bank operates in, external rating agency ratings for borrowers are not typically available. Credit risk is however assessed through applying a combination of due diligence, reviewing credit reference agency reports, reviewing financial information, credit scores and the use of experienced underwriters.

Each business area has its own lending policy and dedicated credit team which assesses credit risk, supported by a divisional Risk Director who has oversight of lending activities.

Group Risk, the Management Credit Committee and Board Credit Committee have oversight responsibility for credit risk.

5.1. Credit Risk Exposure

The Bank uses the standardised approach in determining the appropriate level of capital to be held for regulatory purposes.

The numerical disclosure below shows the total amount of exposures net of provisions at 31 December 2013, including off balance sheet items, after accounting offsets analysed by different type of exposure classes, as follows:

As at 31 December 2013

Credit risk exposure	Exposure value £'000	Pillar 1 Capital (8% x Risk Weight) £'000
Government or central banks	802,878	0
Regional governments or local authorities	4,497	72
Multilateral Development Banks	137,897	0
Institutions	223,864	3,582
Corporates	111,339	8,907
Retail*	830,198	50,354
Secured by mortgages on residential property	1,990,462	56,083
Secured by mortgages on commercial real estate	479,207	38,322
Past due items	23,825	2,490
Securitisation positions	76,514	1,224
Other items	65,938	3,997
	4,746,619	**165,031**

* Retail exposures include individual and small and medium sized enterprises (SMEs)

The numerical disclosure below shows the total amount of exposures net of provisions at 31 December 2013, including off balance sheet items, after accounting offsets analysed by sector, as follows:

As at 31 December 2013 Credit risk exposure	Exposure value £'000	Provision £'000
Banks	223,864	
Property	2,494,084	(5,826)
Asset Finance	733,416	(3,942)
Invoice Financing	212,028	(9,576)
Asset Backed Securities	76,514	
UK Government Gilts and Treasury Bills (incl BOE)	802,878	
Supranational Bonds	137,897	
Other items	60,370	
Derivatives	5,568	
	4,746,619	**(19,344)**

The numerical disclosure below shows the main line exposures at 31 December 2013, including off balance sheet items, after accounting offsets analysed by maturity, as follows:

As at 31 December Credit risk exposure	2013 £'000
Loans and advances to Banks	
-Repayable on demand	223,864
-Repayable in not more than 3 months	-
-Derivatives	5,568
Asset Backed Securities	
-Marketable	76,632
Loans and advances to Customers	
-Repayable in not more than 3 months	293,182
-More than 3 months but not more than 1 year	200,095
-More than 1 year but not more than 5 years	607,288
-More than 5 years	2,289,577
-Specific and General Provisions	(19,344)
-Commitments and Guarantees	343,652
Total	**4,020,514**

Regional Exposures

Below is a table outlining the Bank's credit exposures for loans on a regional basis and includes the proportion of loans and agreements which are not performing.

As at 31 December 2013

Region	Gross Loan Balances £'000	Past Due Balances £'000
East Anglia	298,291	609
East Midlands	201,542	1,589
Greater London	658,104	1,024
North East	102,704	512
North West	413,534	3,892
Northern Ireland	2,562	31
Scotland	134,767	531
South East	617,212	4,729
South West	326,405	1,317
Wales	106,605	1,320
West Midlands	268,693	3,231
Yorkshire and Humberside	259,723	3,222
Others	-	-
Total	3,390,142	22,007

Gross Loan Balances include all accrued interest and fees and are gross of any suspended income and impairment charges. Past due balances include any account three or more months in arrears, and includes expired, non-performing and terminated facilities.

The Bank has a regionally diversified lending portfolio, with a larger proportion of balances in the more significant regional economies such as Manchester, London and the South East.

5.2. Credit Risk – Lending

The Bank targets SME and retail mortgage customers. Credit risk is managed in accordance with lending policies, the risk appetite and the risk management framework. Lending policies and performance against risk appetites are reviewed regularly. This section provides further detail on the specific areas which the Bank is exposed to credit risk.

Residential Mortgages

The Bank's residential mortgage lending focusses on owner occupied residential and buy-to-let mortgage loans.

All applications are reviewed by an experienced team of underwriters who manually assess each application. Applications are underwritten in accordance with a residential mortgage lending policy and each loan has to undergo an affordability assessment, which takes into account the specific circumstances of each borrower. Information is obtained on all loan applications from credit reference agencies which provide a detailed insight on the applicant's credit history and indebtedness which is carefully reviewed by the underwriters.

The Bank has a conservative approach to lending, lending up to a maximum of 85% loan-to-value ("LTV") on a single dwelling without further guarantees and undertakes a full valuation on all properties which act as security. Valuation reports are produced by an experienced panel of qualified external valuers.

The Bank does offer limited advice to mortgage borrowers but does not sell payment protection insurance policies.

Commercial Mortgages

Aldermore provides commercial mortgages to businesses who own their own property and to commercial and residential property investors. Loans are typically to SMEs and secured on smaller properties, with limits in place for larger loans. A team of experienced underwriters carefully review all applications.

Properties are individually valued and a detailed report produced to ensure the property represents suitable security. Consideration is given to whether the property has alternate use or has an identifiable market in the event of default, where the asset acting as security has to be recovered and sold. Valuations are performed by highly experienced and qualified external surveyors. The valuation reports also provide commentary on the tenancy/letting of properties where the commercial mortgages are connected to an investment property transaction.

Affordability assessments are performed on all loans and other forms of security are often obtained, such as a personal guarantee.

Loans to commercial mortgage customers are secured on properties solely located in the UK, although there are various sectors within the UK to which the Bank is not currently lending. Concentration risks are closely monitored and credit exposures are well diversified by sector and geography. Regular reviews are performed on loans in the portfolio, with particular attention paid to larger exposures.

Property Development

The Bank has a small portfolio of property development loans, which are predominantly for the purpose of building and developing residential property.

Although the UK property sector is showing signs of recovery, Aldermore continues to be cautious about property development financing. The Bank uses a conservative approach for lending since re-entering the market in 2009 and all live facilities are regularly inspected by the Bank and quantity surveyors.

Invoice Finance

The invoice financing activity provides working capital finance for SME clients with a turnover typically ranging from £0.1m to £25m. This activity may also include credit control and collection services for clients.

The approval process includes a detailed review of the management, financial and operational strength of the client's business and careful consideration is given to the quality and contractual collectability of the underlying receivables which act as security. Information on the business and the individuals behind the business are carefully reviewed and financial and credit information is obtained from external credit reference agencies.

During the term of the facility, audits and reconciliations are performed to ensure the risk of fraud and default risks associated with client failure are carefully managed. There is significant diversification at the invoice level which heavily mitigates concentration risk.

Asset Finance

The asset finance business line originates loan and lease contracts to a diversified range of end users and finances a range of assets. Credit risks range from public sector organisations to corporate, SMEs and sole traders. Asset finance and leasing to smaller businesses can represent a higher risk, although the majority of contracts will have tangible assets acting as security which can be recovered and sold in the event of default. Asset financing includes vendor, wholesale and block discounting facilities.

A team of experienced underwriters carefully review all applications. Information on the business and the individuals behind the business are considered and financial and credit information is obtained from external credit reference agencies. Assets which act as security are valued and the future resale value of assets is also considered where appropriate.

Where appropriate, audits and site visits are used to ensure the Bank maintains oversight of certain facilities as well as an awareness of the location, use and condition of assets being financed.

At the balance sheet date the Bank does not have any direct residual value risk.

5.3. Credit Risk – Treasury

Credit risk exists with treasury assets where the Bank has acquired securities or placed cash deposits with other financial institutions. The credit risk of treasury assets is considered to be low. No assets are held for speculative purposes nor are actively traded for profit. Certain liquid assets are held as part of the Bank's liquidity buffer.

Cash Placements

Credit risk of Bank and treasury counterparties is controlled through a policy which limits the maximum exposure by entity where the Bank can place cash deposits. All institutions need to meet long term and short term rating requirements, pursuant to the Counterparty Placements Policy. Cash placements with other banks have a 20% risk-weighting using the standardised approach to risk weighting assets.

Gilts, Treasury Bills and Supranational Bonds

As part of the liquidity buffer (see section 6), the Bank holds a portfolio of Gilts, Treasury Bills and Supranational Bonds. These instruments are AAA or AA rated and typically represent sovereign risk. The amount held in these securities at 31 December 2013 was £376 million. These instruments have a 0% risk-weighting.

ABS

Aldermore has a small portfolio of asset backed securities (“ABS”). These investments are in AAA or AA rated bonds secured on UK originated assets. All investments are in Sterling; no foreign currency bonds were bought. As at 31 December 2013 the value of these investments was £78 million. The portfolio has a significant level of credit enhancement, providing substantial principal protection against losses.

Credit risk mitigation

The Bank undertakes a modest number of interest rate swap transactions primarily to hedge interest rate risk. The swaps are booked with a handful of large Financial Institutions. The Bank has entered into a legal netting agreement with each counterparty to off-set positive mark-to-markets against negative mark-to-markets. In addition cash collateral is then posted to cover residual exposure. As at 31 December 2013 mark-to-market netting amounted to £6.09m and we held a further £1.68m as cash collateral against the residual positive mark-to-market at that date.

5.4. Non-performing Loans and Provisioning

Aldermore maintains a provisioning policy which applies to all lending activities within the Bank. A collective provision is raised against performing balances and specific provisions are raised against agreements showing signs of impairment, are non-performing or in default.

Defaulted agreements are considered to be loans three or more months in arrears, where there is an event of agreement default or where the debtor is insolvent. Invoice finance will raise a full specific provision for any current account balance remaining outstanding on expiry of six months following commencement of a collect out. A specific provision will be raised earlier if there is an immediate anticipation of loss.

When specific provisions are made for defaulted agreements a loan-by-loan analysis is undertaken to understand the probability of recovery, whether the agreement can be restored to order or, if not, what the recovery is likely to be. The majority of loans have good security, such as property, and this will lead in most cases to a full or high level of recovery. Any potential shortfall is calculated and this value forms the basis of the specific provision, taking into account the costs of recovery.

There is regular monitoring of the performance of loan assets, especially where there is any sign of potential or actual impairment. Late payments and arrears cases are reported in detail and reviewed on a regular basis and detailed credit reports are submitted for review to the monthly Management Credit Committee and to the Board Credit Committee on a quarterly basis.

The opening and closing position for provisions at the year-end is outlined below:

2013	Specific £'000	General £'000	Total £'000
1 January	9,441	2,059	11,500
Write off in year net of recoveries	(1,933)	-	(1,933)
Charge to profit and loss account	7,682	2,095	9,777
31 December	15,190	4,154	19,344

A table of provisions by assets class is shown above in section 5.1.

Specific and general doubtful debts for the year ended 31st December 2013 performed within the stated risk appetite of the Bank.

A proportion of written-off balances relates to historic lending terms which are different to the Bank's current, and more prudent terms.

6. Principal Risks: Liquidity Risk

Liquidity risk is the risk that Aldermore is not able to meet its financial obligations as they fall due, or can do so only at excessive cost.

To protect the Bank and its depositors against liquidity risks the Bank maintains a liquidity buffer, which is based on the Bank's liquidity needs under stressed conditions. The liquidity buffer is monitored on a daily basis to ensure there are sufficient liquid assets at all times to cover cash flow movements and fluctuations in funding and to enable the Bank to meet all financial obligations and to support anticipated asset growth.

Through the ILAA process, the Bank has assessed the level of liquidity necessary to prudently cover systemic and idiosyncratic risks and the ILAA process determines the appropriate liquidity buffer, taking into account the specific nature of the deposit base.

The ILAA requires the Bank to consider all material liquidity risks in detail and the ILAA has documented the Bank's analysis of each key liquidity risk driver and set a liquidity risk appetite against each key liquidity risk. Liquidity risks are specifically considered by the ALCO each month.

Based on the business model of funding via retail and SME deposits, the liquidity risk appetite as set by the Bank is considered appropriate, and provides assurance to the Board that the relevant liquidity risk drivers have been considered and appropriately stressed and that the Bank is able to meet liabilities beyond the targeted survival period.

6.1. Liquidity Risk Drivers

This section provides an overview of the Bank's key liquidity risk drivers.

Deposit Funding Risk

The deposit funding risk is the primary liquidity risk driver for Aldermore and this could occur if there was a concern by depositors over the current or future creditworthiness of the Bank. Although the Bank seeks to operate in such a way as to protect depositors, an extremely high proportion of deposits are protected by the government Financial Services Compensation Scheme ("FSCS"). The insured amount currently provided by the FSCS is £85,000 for each depositor.

Wholesale Funding

The Bank has participated in the Funding for Lending Scheme (FLS) launched by the Bank of England and HM Treasury. The Bank pre-positioned certain lending assets at the Bank of England in exchange for UK government treasury bills ("FLS T-bills") which are then converted to cash via repurchase agreements with other counterparties. The FLS T-bills have a fixed maturity of four years from drawdown.

Other than drawings under the FLS and repo facilities to help manage liquid assets, the Bank does not currently have or use any wholesale funding and primarily finances its operations through retail and SME deposit taking. The Bank does have relationship banking facilities in place which are used to hedge against currency and interest rate exposures as well as repo facilities for short term liquidity management.

Payments Systems

The Bank does not form part of the UK payment system. However, in the event there are problems with one of the payment systems, the Bank has access to other bank payment facilities with which to make payments if needed.

Pipeline Loan Commitments

The Bank needs to maintain liquidity to cover the outstanding pipeline of loan offers. Although certain pipeline offers may not be legally binding, the failure to adhere to an expression of intent to finance a loan contract brings reputational risk, therefore liquidity is held for such pipeline offers.

Cash Collateral Requirements

The swap Credit Support Annex ("CSA") agreement requires the Bank or a swap counterparty to hold cash in a deposit account, depending on whether the swap is in or out of the money. As Aldermore is un-rated, the swap agreements are not credit rating sensitive, which removes the impact from a Bank down-grade risk.

Contingency Funding Plan

As a regulated firm, the Bank is required to maintain a Contingency Funding Plan ("CFP"). The plan involves a two stage process, covering preventative measures and curative measures to be invoked when there is a potential or actual risk to the Bank's liquidity position. The CFP provides a plan for managing a liquidity situation or crisis within the Bank, caused by internal events, external events or a combination thereof. The plan outlines what actions the Bank could take to ensure it complies with the liquidity adequacy rule and operates within its risk appetite and limits, as set and approved by the Board. The CFP form's part of the Bank's Recovery and Resolution Plan.

7. Principal Risks: Interest Rate Risk

Interest rate risk is the risk of loss through un-hedged or mismatched asset and liability positions sensitive to changes in interest rates. Where possible the Bank seeks to match the interest rate structure of assets with liabilities, or deposits, creating a natural hedge. Where this is not possible the Bank will enter into swap agreements to convert fixed interest rate liabilities into variable rate liabilities, which are then matched with variable interest rate assets. Interest rate risk is monitored by the ALM function and reported to ALCO on a monthly basis.

Interest rate risk in the banking book consists of asset-liability interest rate gap risk and basis risk.

7.1. Asset-liability Gap Risk

Where possible the Bank seeks to match the interest rate structure of assets with liabilities, or deposits, creating a natural hedge. Where this is not possible the Bank will enter into swap agreements to convert fixed interest rate liabilities into variable rate liabilities, which are then matched with variable interest rate assets. The swap agreements transform fixed interest rate liabilities into three month LIBOR liabilities.

Given timing differences and the price of hedging small gaps, it is not cost effective to have an absolute match of variable rate assets and liabilities. The risk impact of an imperfectly hedged asset-liability interest rate profile is captured through calculating the impact of a 2.00% immediate rise or fall in interest rates and the potential impact on the Bank's profitability. Each month the ALM function produces an interest rate gap report to determine the effect of a 2.00% shift of the yield curve.

7.2. Basis Risk

Basis risk is where there is a mismatch in the interest rate reference base for assets and liabilities. When the Bank enters into derivative contracts to swap fixed rate deposit liabilities into variable rate liabilities, the reference base is usually three month LIBOR. Certain lending products have interest rates which are based on the prevailing Bank of England Base Rate and this different basis reference can lead to basis risk.

The Bank has a basis risk policy in place which limits the basis risk exposure by entering into basis swap agreements to reduce this risk.

8. Principal Risks: Market Risk

The Bank does not carry out proprietary trading or hold any positions in assets or equity which are actively traded.

The Bank does however hold a small portfolio of ABS and a portfolio of liquid assets (Gilts, Treasury bills and supranational bonds) which are used for liquidity buffer purposes. These securities are exposed to market price movements should any of the securities be sold. Monthly prices are obtained to ensure the Bank is aware of any material diminution in value. The Bank has repo facilities in place which will be used in the first instance to obtain liquidity when necessary, which will avoid the need to sell the liquidity buffer assets and so crystallise any price gain or loss due to market price movements.

9. Principal Risks: Operational Risk

Operational risk is the risk of financial loss or reputational damage resulting from inadequate or failed internal processes, people and systems or from external events.

Operational risk management includes the impact of IT, data security, project, outsourcing, tax, legal, internal and third party fraud and compliance risks. Aldermore has a defined risk appetite for operational risk which considers profitability, balance sheet and reputational aspects of operational risk.

Through the establishment and investment in sound systems, controls and audit functions, the Bank seeks to minimise operational failures and as part of the operational risk management process, Aldermore has an Operational Risk Policy, maintains a key risks register and has business continuity plans in place. During 2013 further development of the Enterprise Risk Management system helped the Bank support the recognition, controls and monitoring of operational risks.

The Operating Committee meets monthly to ensure that a quality and robust IT, operations and compliance service are delivered at all times and is capable of supporting the changing business requirements of the Bank. It has responsibility for monitoring all the key operational risks facing the organisation, including compliance and operational risks. Key Risk Indicators are used to provide an overview of the control environment and acts as a means to practically assess performance against the Bank's operational risk appetite.

The Bank has continued to grow and develop during 2013 and this has required a number of projects to be completed. All projects are carefully managed by dedicated project managers, who facilitate projects which are overseen by project sponsors. During 2013, many projects were successfully completed which has enabled the Bank to achieve growth objectives without running unacceptable operational risks.

The operational risk charge for Aldermore under Pillar 1 is calculated using the basic indicator approach, whereby a 15% multiplier is applied to the 3 year historical average net interest and fee income. The amount calculated under this approach was £6.5m for 2013.

Key Risk Registers

Each functional area is required to maintain a risk register which identifies and analyses the core risks facing their business. These are maintained in conjunction with the support from the second line operational risk function, which provides challenge and oversight of the registers.

The business line risks are also considered as part of the Bank's risk register. The Bank risk register is maintained by Group Risk and owned by the Executive Committee. As part of the ICAAP, the key operational risks from the Bank risk register are considered.

The Bank risk register is published to the Operating Committee and is formally reviewed by the Executive Committee and the Audit & Risk Committee.

Business Continuity Plans ("BCP") and Disaster Recovery ("DR") Plans

BCP and DR plans are in place for all operational locations and core systems and are regularly updated. These plans are tested to ensure that they are robust and fit for purpose and the Bank uses external continuity and disaster recovery sites as back up locations for both IT servers and staff. The integrated IT system has enhanced the Bank's ability to operate from various locations utilising the network of offices and contingency sites across the country should the need arise.

10. Principal Risks: Conduct risk

Conduct risk is defined as the risk of detriment caused to the Bank`s customers due to the inappropriate execution of its business activities and processes. The Bank extends the definition of "customer" to include both retail and business customers (excluding intermediaries/third parties) across all business lines, including both regulated and non-regulated activities.

The Bank has a zero appetite for systemic unfair outcomes arising from any element of the conduct risk cycle, which includes product design, sales or after sales processes and culture. However, where the Bank identifies potential conduct risks for customers, it will be proactive in agreeing appropriate actions and where necessary communicating clearly with its customers to ensure a fair outcome is achieved.

Conduct risk metrics include the number of complaints, satisfactory actions and replies, referrals to Ombudsman, etc. The conduct risk metrics vary across the business lines and consist of individual business line conduct risk KPIs; the sum of which is measured against the risk appetite.

Conduct risk metrics and KPIs are in place to evidence fair outcomes, identify any emerging issues and document remedial actions. Each customer facing area is responsible for implementing controls designed to manage and reporting on conduct risk, which includes understanding how customer detriment may occur, how it is identified and how it is prevented going forward.

11. Other Risks

11.1. Concentration Risks

Concentration risk exists through having high or excessive exposures to certain counterparties, regions or sectors which can lead to a concentration of loss in the event of an adverse movement in the strength or creditworthiness of the borrower or security.

The Bank actively assesses and monitors its exposure to a range of characteristics and concentration risks from lending activities are managed and controlled through the adoption of a concentration risk policy. Reported exposures against policy limits are reviewed and discussed on a monthly basis.

Although there is diversification within the Bank's portfolios and operations, there are certain features of the Bank's activity which contains an element of concentration:

- Geography: although there are no excessive regional concentrations, the Bank only operates within the UK.
- Asset class: notwithstanding the range of products and customer types, Aldermore has a sector focus on SME and residential property investment products
- Funding: the Bank has one primary source of liquidity which are retail and SME deposits

Although the Bank only operates within the UK and limits its focus on certain sectors, these sectors have been targeted due to the Bank's expertise and/or the security and other risk mitigants available. For instance, the Bank rarely offers unsecured lending and only does so for very short periods to high quality borrowers (e.g. financially strong professional practices).

Concentration risk of treasury assets is managed and controlled through a counterparty placements policy.

11.2. Insurance Risk

The Bank does not directly insure commercial risks such as credit, market or residual value exposures, although certain invoice finance customers have credit insurance in place.

Aldermore does have insurance protection for standard business risks. These include professional indemnity, directors and officers insurance, insurance for buildings and equipment.

11.3. Pension Risk

The Bank only has a defined contribution scheme, which is expensed through the profit and loss account. The Bank has no exposure to defined benefit pension schemes.

11.4. Residual Value Risk

At the 2013 year-end the Bank does not have any residual value risk exposure. Certain agreements originated by the Asset Finance business line are leases where an agreement has an option to return the asset, this option must be matched by an agreement for the Bank to sell the asset back to a third party. This third party will typically be the original manufacturer or a dealer. Any third party obliged to buy the asset from Aldermore as part of a buy-back at the end of the lease term will be underwritten to ensure the party is creditworthy and able to meet the obligation.

12. Remuneration

The PRA/FCA has defined certain requirements relating to remuneration for banks, referred to as the Remuneration Code. In accordance the Remuneration Code, a firm must establish, implement and maintain remuneration policies, procedures and practices that are consistent with and promote sound and effective risk management. Policies and procedures must be comprehensive and proportionate to the nature, scale and complexity of the firm's activities.

A firm must maintain a record of its remuneration code staff (staff whose activities may have a material impact on the firms risk profile) and take reasonable steps to ensure they understand the implications of the code.

The disclosure requirements of Pillar 3 as defined by the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU) 11 as at December 31st 2013. Data is provided for remuneration received for the 2012 financial year. Aldermore Bank Plc (Aldermore) currently employs 28 individuals (excluding non-executive directors) who are classed as Coded staff and is committed to adherence to the remuneration code practices and guidelines in respect of these employees.

12.1. Overview of approach to remuneration

The key principles behind Aldermore's remuneration policy are those that we believe are critical to the business and reflect our values.

- It is fair and equitable, reflecting Aldermore's commitment to diversity and equality of opportunity.
- It makes good commercial sense for our business, being affordable and proportionate, and sustainable over the long term
- It represents an attractive reward proposition for our people and potential recruits, and is benchmarked against appropriate external markets
- It rewards success, with the performance management framework focusing on objective measurement of outputs along with behavioural measures which assess the way in which work is done and derive from the DNA values which articulate how Aldermore deliver the vision and strategic objectives.

12.2. Governance and decision making

In line with regulatory guidance remuneration is overseen by the Board's Remuneration Committee. This Committee is made up of at least 3 members, all of whom are independent non-executive directors able to contribute an oversight of best practice externally and who are appointed by the Board, on the recommendation of the Nomination Committee in consultation with the Chairman of the Remuneration Committee. The Remuneration Committee meets at least four times a year and otherwise as required.

The members of the Remuneration Committee are:

- John Callender Chairman Non-Executive Director
- Chris Stamper Non-Executive Director
- Peter Cartwright Non-Executive Director

This committee is responsible for determining, on behalf of the board, the overall remuneration policy for all staff and, in particular, the policy and the level of remuneration of Code staff. The Committee also reviews and provides feedback on Executive Directors.

Within its terms of reference the Committee is obliged to review its own performance, constitution and terms of reference at least annually to ensure it is operating at maximum effectiveness and in line with regulatory requirements, and recommend any changes it considers necessary to the Board for approval.

The committee takes independent external professional advice as appropriate, and monitors comparative remuneration packages within the financial sector.

12.3. Code Staff Criteria

Coded staff have been identified within the Company in accordance with the criteria for Code Staff.

Link between Pay and Performance - Remuneration policy for executive directors and other senior managers with a material impact on the Bank's risk profile ('Code Staff')

Performance-based remuneration is awarded by the Remuneration Committee in a manner which promotes sound risk management (within the Bank's stated risk appetite and ICAAP measures) and does not induce excessive risk-taking.

The Bank's remuneration policy focuses on ensuring sound and effective risk management through:

- a stringent governance structure for setting goals and communicating these to employees
- performance assessment metrics for executive and other coded staff are reviewed and agreed by the chief risk officer and include both financial and non-financial goals
- making all variable remuneration awards at the discretion of the Committee and subject to individual, business unit, overall bank performance, stated risk appetite and ICAAP measures

In practice all remuneration decisions would be approved by relevant Executive Committee member and relevant HR Business Partner before implementation, and as part of this be reviewed from a risk perspective. For coded staff the remuneration decisions are reviewed and approved by the Remuneration Committee. Risk/Compliance would also be involved as appropriate to provide input around Risk.

12.4. Composition of Remuneration for Code Staff

The policy in relation to the various elements of remuneration structures for executive directors and other Code Staff is set out below.

(a) Basic salary

Basic pay for executive directors (as for all employees) will be market related. Individual development and progression is reflected through the annual salary and personal review processes.

(b) Variable Pay

In 2013, the executive directors and other Code staff participated in a non-pensionable performance incentive scheme, the metrics of which were based on the elements of which reflected the Bank's key objectives. These measures were all set to provide challenging objectives, giving the executive directors an incentive to perform at the highest level. The financial outcomes also were moderated by the extent to which personal objectives had been achieved.

(c) Long Term Incentive Plan

Executive Directors and some code staff participate in a Long Term Incentive Plan. The LTIP is designed to reward participants for enhancing value for shareholders which is determined by using an internal rate of return (IRR) approach.

This plan consists of the issue of a specified class of shares redeemable only in relation to particular company outcomes. The restriction period adds a longer term element to focus behaviour and decision-making activity beyond the current year.

(d) Benefits

Each executive director is provided with benefits which comprise a company car (or an equivalent allowance), pension arrangements, private medical insurance, critical illness cover, life assurance and group income protection insurance. The executive directors are invited to participate in the relevant Group pension Plan.

Other Code staff have similar car, pension, life assurance and private medical insurance arrangements.

12.5. Service contracts

All the current executive directors have entered into contracts that can be terminated by either party on six months' notice or by the payment by the Bank of an amount equivalent to six months remuneration.

Service contracts for other Code staff have notice periods which vary depending on the particular role.

Non-executive directors are appointed by letter for an initial term of three years and will generally be expected to serve a second three year term.

12.6. Aggregate remuneration data

The Prudential Sourcebook for Banks, Building Societies and Investment Firms (Remuneration Disclosures) Instrument 2010 now requires the publication of aggregate remuneration data for senior managers and members of staff whose actions have a material impact on the risk profile of the firm (Code staff). These figures are indicated in the table below. Disclosure Table Breakdown of remuneration of staff in respect of whom disclosure is required by business area.

Total remuneration for the year ended December 2013 (£/000)

Business Area A – Chief Operating Office	£ 2,037
Business Area B – Commercial Finance	£ 775
Business Area C – Central Functions	£ 2,082
Business Area D – Mortgages	£ 1,306