

Pillar 3 Disclosures 2010

1. Overview

1.1 Background

The Capital Requirements Directive (Basel II), has been implemented in the UK by the Financial Services Authority (FSA) and enforced through the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU). The rules consist of three 'pillars'.

- › **Pillar 1** Sets out the minimum capital requirements firms are required to meet for credit, market and operational risk.
- › **Pillar 2** Describes the supervisory review process and the assessment of additional capital resources required to cover specific risks faced by the Group that have not been covered by the minimum regulatory requirements as set out in Pillar 1.
- › **Pillar 3** Aims to encourage market discipline by developing a set of disclosure requirements which allow market participants to assess key pieces of information on a firm's capital, risk exposures and risk assessment processes.

These Pillar 3 Disclosures seek to outline, for each separate category of risk relevant to VM, the risk appetite policy, strategies and processes in place to manage that category of risk.

The information has been provided for the purpose of explaining the basis on which the Bank has prepared and disclosed certain capital requirements and information about the management of risks relating to those requirements, and for no other purpose. It therefore does not constitute any form of financial statement of the Bank nor does it constitute any form of contemporary or forward-looking record or opinion of the Bank.

1.2 Scope of Application

This disclosure report is based on the consolidated corporate Group referred to and described as "VM" (Virgin Money Regulated Group or simply "VM").

The Bank has complied with the FSA's prudential capital regulations, including BIPRU 11, throughout the year. This Disclosure is presented in respect of the year to 31 December 2010.

1.3 Frequency & Location

VM's Pillar 3 disclosure is published on an annual basis. The Pillar 3 disclosure document is published on the Virgin Money website, <http://uk.virginmoney.com/virgin/>

The frequency of disclosure will be reviewed should there be a material change in any approach used for the calculation of capital, business structure or regulatory requirements.

1.4 Verification

These disclosures are not subject to external audit, except where they are equivalent to those prepared under accounting requirements for inclusion in the Group's audited Annual Report and Accounts dated 31 December 2010. These disclosures are approved by the Board.

2. Risk Management Objectives and Policies

2.1 Risk Appetite

The VM Board sets the Group’s risk appetite and reviews it at least annually. The Group risk appetite covers four primary areas, each supported by detailed underlying metrics and thresholds:

- › **Depositor Protection** – As an authorised deposit taker, our primary obligations are to ensure that our depositors are repaid in accordance with the terms and conditions governing their deposit and that those depositors’ financial assets and personal data are protected.
- › **Liquidity, Capital & Profitability** – VM maintains a high quality capital base, targeting a capital adequacy ratio in excess of FSA regulatory minima.

VM operates an investment strategy for our treasury assets which prioritises liquidity and ensures that we hold a liquid assets buffer above FSA minimum requirements.

Achieving target profitability across all business lines is essential to the sustainability of the VM customer proposition.

- › **Mature Control Environment** – Ensuring that our control environment is fit for purpose, supporting the business as it grows in terms of people, processes and systems. A robust control environment provides the discipline and structure to achieve our business objectives.
- › **Minimise Unrewarded Risks** – Unrewarded risks only expose us to downside risk, unrewarded risks are avoided if possible or controlled as far as is economically feasible.

2.2 Risk Management Controls

Identification, measurement and monitoring of risks that VM is exposed to is a priority for the company. Responsibility for management of risk lies with the Board. Responsibility for managing the Bank’s exposure to risk has been delegated to the Risk Management Committee.

VM has a comprehensive Risk Management Framework that clearly articulates the internal controls and governance structures that have been established for the management and control of risk.

Virgin Money has adopted the ‘three lines of defence’ model of governance with clearly defined roles and responsibilities.



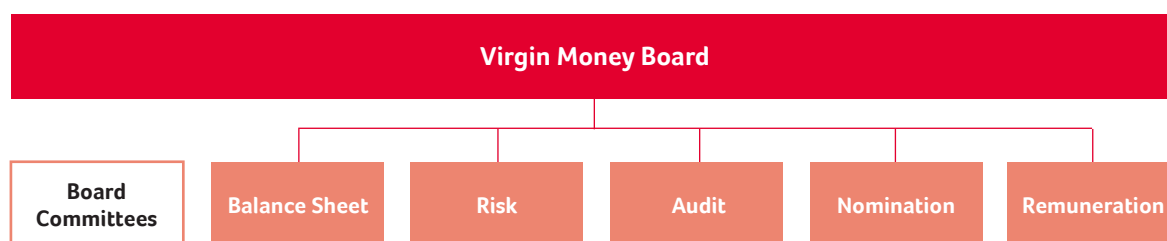
The **first line of defence** is front-line management and staff – people at the heart of the business who manage its risks. They understand their risk exposures in light of the business risk appetite and put in place appropriate risk mitigants. The first line of defence oversee key partners and outsourcers.

The **second line of defence** encompasses people undertaking risk and control functions. The Risk Management function encompasses Financial Risk Management, Enterprise Risk Management and Regulatory Risk Management. These Risk Management functions facilitate the risk appetite dialogue, designs and operate the frameworks within which key risk classes are managed. They interpret the risk appetite of the Board into practical policies, procedures and limits. Risk Management support the first line of defence, monitor the performance of the business and provide early warning of adverse trends.

The **third line of defence** is external and internal Audit, including other third party assurance providers. They provide assurance to the Board and senior management on the adequacy of design and operational effectiveness of the system of internal controls.

2.3 Group Oversight and Governance

Committee Structure



The Board

VM's Board has overall responsibility for setting the Company's strategic aims and risk appetite, reviewing management performance and maintaining company standards. In addition it is responsible for reviewing key financial objectives and providing entrepreneurial leadership within a framework of controls. The Board is also responsible for Depositor Protection and Treating Customers Fairly (TCF).

Balance Sheet Committee

The Balance Sheet Committee has responsibility for capital, funding and liquidity risk, and interest rate risk in the banking book. In addition it owns the Strategic Funding and Liquidity Plan and approves and recommends the use of the contingency funding plan. The Committee oversees the work of the Asset & Liability Committee.

Risk Committee

The Risk Committee has responsibility for Credit, Market, Operational and Pillar 2 risks. For all risks the Committee advises the board on risk appetite and tolerance. In addition it is responsible for overseeing within an agreed policy framework the key risk exposures. The Risk Committee considers the adequacy of the company's internal control and risk management systems. The Committee oversees the work of the Risk Management Committee (RMC).

Audit Committee

The Audit Committee oversees the integrity of the financial statements and reviews the over-arching system of internal control and risk management. The Committee monitors and reviews the effectiveness of the company's internal audit function, recommending appointment, re-appointment and approval of the remuneration of the external auditors. It also reviews and monitors the independence, objectivity and effectiveness of the audit process.

Nomination Committee

The Nomination Committee has responsibility for developing and maintaining a formal, rigorous and transparent process for making appointments and re-appointments to the Board.

Remuneration Committee

The Remuneration Committee has responsibility for developing and maintaining a formal and transparent procedure for a company-wide remuneration framework, including the implementation and overview of the bonus and other reward programmes. Further discussion in respect to remuneration is detailed in section 7.

2.4 Risk Exposures

2.4.1 Retail credit risk

Retail credit risk is the risk of loss due to a customer's non re-payment (default) on a secured or unsecured consumer credit product.

VM is exposed to retail credit risk from its mortgage portfolio. VM's risk appetite for customer lending is defined in the lending policy, which defines:

- › The target market for its lending
- › Exposure limits for mortgages
- › The policies in respect of affordability and indebtedness

VM monitors external economic indicators to identify changes to the external economic environment which are likely to impact portfolio performance.

Comprehensive Management Information on the economy, portfolio limits, quality of new business, stock performance, and collections and recoveries performance is presented in detail to the RMC each month.

All changes to lending policy and operational strategies are presented to the Credit Committee then to the RMC for approval.

Responsible lending is key to Virgin Money's lending policies and practices and we always seek to ensure that we understand our customer's ability to repay and the affordability of any borrowing. TCF is core in everything we do and a full TCF analysis is undertaken for any new product launch, routinely as part of the commercial and operational management of our portfolios and annually as part of the product renewal cycle.

2.4.2 Counterparty Credit Risk

Counterparty credit risk is the risk that counterparties fail to meet their contractual obligations in a timely manner, resulting in a cash loss to the group or a strain on the group's liquidity position.

Counterparty credit risk is managed on an aggregate basis by including all existing exposures and connected exposures with related entities of the same organisation. VM has a strict policy of assessment of credit risk before new wholesale counterparties are accepted and on an ongoing basis to ensure any exposures are within agreed limits. In addition, new non-wholesale counterparties are subject to a strict policy of due diligence and assessment of credit risk before being accepted. All counterparties are monitored for changes in their credit quality and reported to the Risk Management Committee.

2.4.3 Operational Risk

Operational risk is the risk of loss caused by human error, ineffective or inadequately designed processes, system failure, improper conduct, fraud and external events.

Sound management of operational risk helps to create and preserve value for stakeholders, enabling us to deal effectively with events that create uncertainty and to respond to them in a manner that reduces both their impact and probability.

The Operational Risk Management Framework (ORMF) has been built around the principles of the Turnbull and COSO¹ frameworks. We have adapted the principles in these frameworks to both the size and nature of the VM business.

The ORMF outlines the governance processes through which operational risk is managed and the tools that are used to achieve this. This enables a consistent approach to be applied across all areas of the business through the standardisation of risk and control policies and processes.

All employees of the Virgin Money Group have an obligation to manage risk in accordance with the ORMF.

The major sources of operational risk in the business are:

- › Financial Crime
- › Business Disruption
- › Partnership Risk
- › Outsourcing Risk
- › Information Security

2.4.4 Liquidity Risk

Liquidity risk is the risk that the firm will not be able to efficiently meet both the expected and unexpected current and future cash flows without affecting daily operations or the financial conditions of the firm.

VM operates under the FSA's Simplified Liquidity Regime and as such must ensure that its balance sheet is invested in a sufficient quantity of liquid assets. The appropriate parameters and limits for day to day business management are considered in this context. Liquidity risk is controlled through monthly stress testing of liquidity and the reporting of the results to the Board.

¹Committee of Sponsoring Organisations of the Treadway Commission

2.4.5 Reputational Risk

Reputational risk is the risk that the business can be adversely affected by events impacting the strength of the brand and financial conditions of the business.

Managing risk to reputation requires an awareness of how our corporate behaviour affects the perception of suppliers, employees, customers and regulators as well as many other secondary stakeholders. We actively manage and monitor our reputational exposures and any impact they may have on the business.

2.4.6 Interest Rate Risk in the Banking Book

Interest rate risk in the Banking Book is the risk that adverse movements in interest rates cause a current or prospective reduction in earnings and capital. Principal sources of interest rate risk are; re-pricing risk, yield curve risk, basis risk, and optionality.

Interest rate risk is assessed based on the sensitivity of net interest income to interest rate shocks over the next 12 months (or planning horizon) and the impact on the economic value of the balance sheet. VM's interest rate risk arises from the provision of financial products to retail customers and through exposure to wholesale assets and liabilities.

Sensitivity to parallel rate shocks

Parallel Rate Movement	Dec 2010 12 month earnings sensitivity	Aug 2010 12 month earnings sensitivity
+ 0.5%	+£21,000	+£16,000
- 0.5%	-£21,000	-£16,000

3. Capital Resources

VM has gone through a period of significant change during the year end to which this report relates. At 31 December 2009 VM had two regulated entities, Virgin Money Unit Trust Managers Ltd (VMUTM) and Virgin Money Personal Financial Service Ltd (VMPFS). The parent holding company held a waiver, granted by the FSA, exempting the group from the full scope of FSA consolidated supervision requirements. Capital Resources disclosures for these entities were therefore produced on a solo rather than a consolidated basis.

On 26 January 2010 the acquisition of Church House Trust Plc (CHT) by Virgin Money was declared unconditional, so bringing a banking entity into the Group. CHT has subsequently been renamed Virgin Bank Ltd. In August 2010 WL Ross & Co. LLC invested £97 million in the Virgin Money Group. These events are material to the VM Group and as such the Capital Resources disclosure has been restated at a VM Group level based on 31 December 2010 financial information with comparatives as at 30 August 2010.

3.1 Total Capital Resources

	Dec 2010	Aug 2010
Capital Resources	£000	£000
Total Tier 1	169,362	143,587
Deduction for intangible assets	(10,229)	(9,951)
Deduction for investments	0	(9,656)
Deductions for illiquid assets	(228)	0
Total Capital	158,905	123,980

3.2 Tier 1 Capital

	Dec 2010	Aug 2010
Tier 1 Capital	£000	£000
Share Capital	1	1
Share Premium	49,600	49,600
Minority Interests	35,209	31,747
Retained Earnings	84,551	62,239
Total Tier 1 Capital	169,362	143,587

4. Compliance with BIPRU and the overall Pillar 2 Rule

4.1 Assessment of the adequacy of internal capital

Maintenance of adequate capital resources is fundamental to sound prudential management. The key internal and regulatory requirement is for the Bank and the consolidated group to hold adequate capital at all times, in terms of both quantum and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. Capital is held to absorb losses that unexpectedly materialise and is therefore a mitigant to the risks encountered by the Group.

The Group has in place sound, effective and complete processes, strategies and systems to:

- › Identify and quantify the major sources of risk to which it is exposed.
- › Calculate the quantum of capital resources deemed to be adequate, both in terms of the Group's own assessment and regulatory requirements.
- › Ensure that the Group holds adequate capital resources, both in terms of amount and quality at the current time, and
- › Analyse the risk that the Group will fail to hold sufficient capital at any future time.

The minimum capital ratio is conservatively set in line with a prudent business strategy and is based on our financial and capital planning horizon with an expectation that this is in excess of the minimum regulatory requirements.

VM has no market risk and therefore no Pillar 1 market risk capital requirement. VM has no foreign exchange exposure of any kind.

4.2 Credit Risk Standardised Risk Weighted Exposure Amounts

Exposure Class	Dec 2010 £000 Pillar 1 Credit Risk Capital Requirement	Dec 2010 £000 Risk Weighted Assets
Financial Institutions	2,977	37,212
Secured Real Estate Property	609	7,617
Past Due	126	1,575
Unsecured Retail	0	0
Other ²	4,357	54,459
Total Risk Capital Requirement	8,069	100,864

² Consists of tangible fixed assets, petty cash and debtors.

Exposure Class	Aug 2010 £000 Pillar 1 Credit Risk Capital Requirement	Aug 2010 £000 Risk Weighted Assets
Financial Institutions	3,055	38,182
Secured Real Estate Property	627	7,836
Past Due	175	2,185
Unsecured Retail	0	3
Other	1,622	20,280
Total Risk Capital Requirement	5,479	68,486

4.3 Operational Risk Capital Requirements

VM uses the 'basic indicator approach' to calculating the operational risk capital requirement.

	Dec 2010 £000	Aug 2010 £000
Pillar 1 Operational Risk Capital Requirement	12,199	5,920

5. Credit and Dilution Risk

5.1 Definition of Past Due and Impaired

VM considers its assets as being past due when a customer does not make their contractual monthly payment. For accounting purposes, an asset is considered impaired when it is 90 days past due or where we have earlier objective evidence of impairment (for example insolvency or a declaration of financial hardship).

5.2 Credit Quality Analysed by Impairment and Past Due

	Dec 2010	Aug 2010
Impaired	£000	£000
Less than 3 months past due	511	1,870
Past due 3 to 6 months	495	1,370
Past due 6+ months	569	1,180
Total Impaired Mortgage Assets	1,575	4,420

5.3 Exposure to Credit Risk (by Class)

	Dec 2010	Aug 2010
Credit Exposure	£000	£000
Financial Institutions	185,306	189,424
Secured on real estate property ³	21,326	22,299
Unsecured retail	0	159
Sovereign	74,930	40,969
Total	281,561	252,851

³ Includes past due items

5.4 Residual Maturity of Exposures

Dec 2010	Up to 12 months	1-5 years	More than 5 years	Total
Credit Exposure	£000	£000	£000	£000
Financial Institutions	185,306	0	0	185,306
Secured on real estate property	1,180	3,210	16,936	21,326
Unsecured retail	0	0	0	0
Sovereign	74,930	0	0	74,930
Total	261,415	3,210	16,936	281,561

Aug 2010	Up to 12 months	1-5 years	More than 5 years	Total
Credit Exposure	£000	£000	£000	£000
Financial Institutions	187,074	2,350	0	189,424
Secured on real estate property	1,612	3,297	17,390	22,299
Unsecured retail	156	3	0	159
Sovereign	40,969	0	0	40,969
Total	229,811	5,650	17,390	252,851

All retail credit exposures are to the UK and are sterling denominated

5.5 Provisions for Impaired Exposures and Credit Risk Mitigation

	£000
Provisions at 1 January 2010	659
Amounts written off	(366)
Recoveries of amounts previously written off	100
Charged to income statement	78
Provisions at 31 December 2010	471

The acquisition by VM of CHT was structured with a Deferred Consideration of £2.1m issued via Contingent Loan Notes to provide protection in the event that the required bad debt provision against CHT's loan book increased from that required at the date of acquisition. The loan notes expire on 31 December 2011.

5.6 Exposure by Credit Quality Step

Dec 2010	1	2	3	4	5	6	Unrated Exposure	Total
Credit Quality Step	£000	£000	£000	£000	£000	£000	£000	£000
S&P Assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	CCC+ and below		
Secured on real estate property	-	-	-	-	-	-	21,326	21,326
Unsecured lending	-	-	-	-	-	-	-	-
Sovereign	74,930	-	-	-	-	-	-	74,930
Financial institutions	37,432	147,874	-	-	-	-	-	185,306
Total exposure pre mitigation	112,361	147,874	-	-	-	-	21,326	281,561
Total exposure post mitigation	112,361	147,874	-	-	-	-	20,855	281,090

Aug 2010	1	2	3	4	5	6	Unrated Exposure	Total
Credit Quality Step	£000	£000	£000	£000	£000	£000	£000	£000
S&P Assessment	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	B+ to B-	CCC+ and below		
Secured on real estate property	-	-	-	-	-	-	22,299	22,299
Unsecured lending	-	-	-	-	-	-	159	159
Sovereign	40,969	-	-	-	-	-	-	40,969
Financial institutions	51,908	137,516	-	-	-	-	-	189,424
Total exposure pre mitigation	92,877	137,516	-	-	-	-	22,458	252,851
Total exposure post mitigation	92,877	137,516	-	-	-	-	20,358	250,751

6 Securitisation

The Group has not securitised any assets that it has originated.

7. Remuneration Disclosure

Decisions around the determination of remuneration policy are made at the Remuneration Committees of the Virgin Money Holdings (UK) Limited and Virgin Bank Limited Boards. The Committees are chaired by an independent non-executive director and are comprised solely of independent non-executive directors. In addition to matters relating to the determination of policy, the Remuneration Committees approve the individual remuneration of all Directors, Executives and variable pay for other staff falling within the scope of the FSA's Remuneration Code ('Code Staff'). The Remuneration Committees approve the quantum of variable remuneration available for distribution in any given year and will ensure that it takes adequate account of current year performance and revised expectations of previous years' performance considering as appropriate ex ante risk adjustment and relevant risk factors. The Committees also consider individual performance and appropriate risk adjustment before approving the level of variable pay awarded to each Code Staff member.

The FSA's Remuneration Code only applies to Virgin Money from 2011 onwards. The following quantitative disclosures are made based upon 2010 remuneration and are presented as if the current members of Virgin Money Code Staff had been deemed Code Staff during 2010.

Total 2010 Virgin Money Staff 2010 Remuneration	£16,690,517
2010 Fixed Remuneration of Current Code Staff	£2,043,573
2010 Variable Remuneration of Current Code Staff	£641,674
Total number of Code Staff	15



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