Pillar 3 Disclosures 2008

Virgin Money Personal Financial Service Ltd

1. Overview

1.1. Background

The original Basel Accord was agreed in 1988 by the Basel Committee on Banking Supervision. The 1988 Accord, now referred to as Basel 1, helped to strengthen the soundness and stability of the international banking system as a result of the higher capital ratios that it required.

Basel 2 is a revision of the existing framework, which aims to make the framework more risk sensitive and representative of modern banks' risk management practices.

It is more sensitive to the risks that firms face: the new framework includes an explicit measure for operational risk and includes more risk sensitive risk weightings against credit risk.

It reflects improvements in firms' risk management practices and allows firms to rely to a certain extent on their own estimates of risk.

It provides incentives for firms to improve their risk management practices, with more risk sensitive risk weights as firms adopt more sophisticated approaches to risk management.

The new framework aims to leave the overall level of capital held by financial firms collectively broadly unchanged.

The new Basel Accord has been implemented in the European Union via the Capital Requirements Directive (CRD). It affects banks and building societies and certain types of investment firms, like Virgin Money Personal Financial Service Ltd.

The new framework consists of three 'pillars'.

- Pillar 1 sets out the minimum capital requirements firms will be required to meet for credit, market and operational risk.

- Under Pillar 2, firms and supervisors have to take a view on whether a firm should hold additional capital against risks not covered in Pillar 1 and must take action accordingly.

- The aim of Pillar 3 is to improve market discipline by requiring firms to publish certain details of their risks, capital and risk management.

1.2. Basis of Disclosure

This document has been prepared by Virgin Money Personal Financial Service (VMPFS) in line with its internal policy for Pillar 3 disclosure and FSA requirements.

The effective date of these disclosures is as at 31 December 2007. Values are generally based on year end values or 12 month accounting periods observed from VMPFS's statutory account and management accounting reports.

Disclosures will be made on an annual basis and made available shortly after filing of the firm's statutory accounts has been completed.

1.3. Scope

VMPFS, together with the other FSA regulated entity in the Virgin Money UK group, Virgin Money Personal Financial Service Ltd, (VMPFS) currently holds an waiver granted by the FSA exempting it from the full scope of FSA consolidated supervision requirements.

Pillar 3 disclosures are therefore produced on a solo rather than a consolidated basis. In addition to these Pillar 3 disclosures for VMPFS, disclosures have been produced for VMUTM.

Given this is the first year of disclosures required under the CRD, it is not possible or appropriate to make disclosure of the quantitative data required under FSA BIPRU rules. We intend to make those disclosures that are based on or related to year end accounting data as at 31 December 2008 when we publish the 2009 Pillar 3 documentation.

Accordingly, the 2008 disclosures relate only to the qualitative information required under the FSA rules.

1.4. Approval and publication

These Pillar 3 disclosures were approved by the Board of VMPFS on 30 October 2008 and published on the firm's website (www.virginmoney.com). The disclosures have not been subject to external audit.

2. Risk Management Objectives and Policies

2.1. Risk appetite of VMPFS

VMPFS's aim is to successfully sell ISA unit trust based products and GI and life insurance products to the mass retail market meeting its customers' requirement for good value, straightforward design and good investment performance. However VMPFS seeks to do this whilst minimising its risk exposure as follows:

- VMPFS (via its interest in the ISA investment share of VMUTM's unit trusts) has no direct market/investment performance risk and outsources the investment adviser role to a very experienced specialist passive management house, SSgA and an active fund manager with a proven track record, GLG.

- Market/investment performance risk indirectly impacts the business's income and is mitigated through a VM Group strategy of hedging stock market performance to protect this income stream (to the extent that it is economically viable).

- Operational risk is carried primarily through our outsourcing of transfer agency functions to IFDS, one of the largest unit trust TPA providers in the UK currently handling over 40% of the UK ISA market.

- VMPFS also has a low risk approach to selling practices, does not offer advice to customers and deals only on an execution only basis.

- Insurance risk is held by the third parties who provide the insurance products for which VMPFS acts as introducer.

In essence, the firm aims to minimise its risks through a combination of the structure and design of its products, its strategy of appointing business partners with world class expertise and the embedding of Virgin's brand values in its marketing approach.

The firm aims to operate its business so that it does not allow its capital resource requirement to fall below our regulatory capital requirement at any point in the economic cycle (including a severely stressed scenario modelling a one in twenty five year adverse business downturn) plus an appropriate level of headroom to allow for the normal variability in timings of cashflows.

At the same time, the firm manages those risks within its aim to achieve its shareholder's expected return of capital hurdle.

2.2. Virgin Money Group Governance and Risk Management Processes

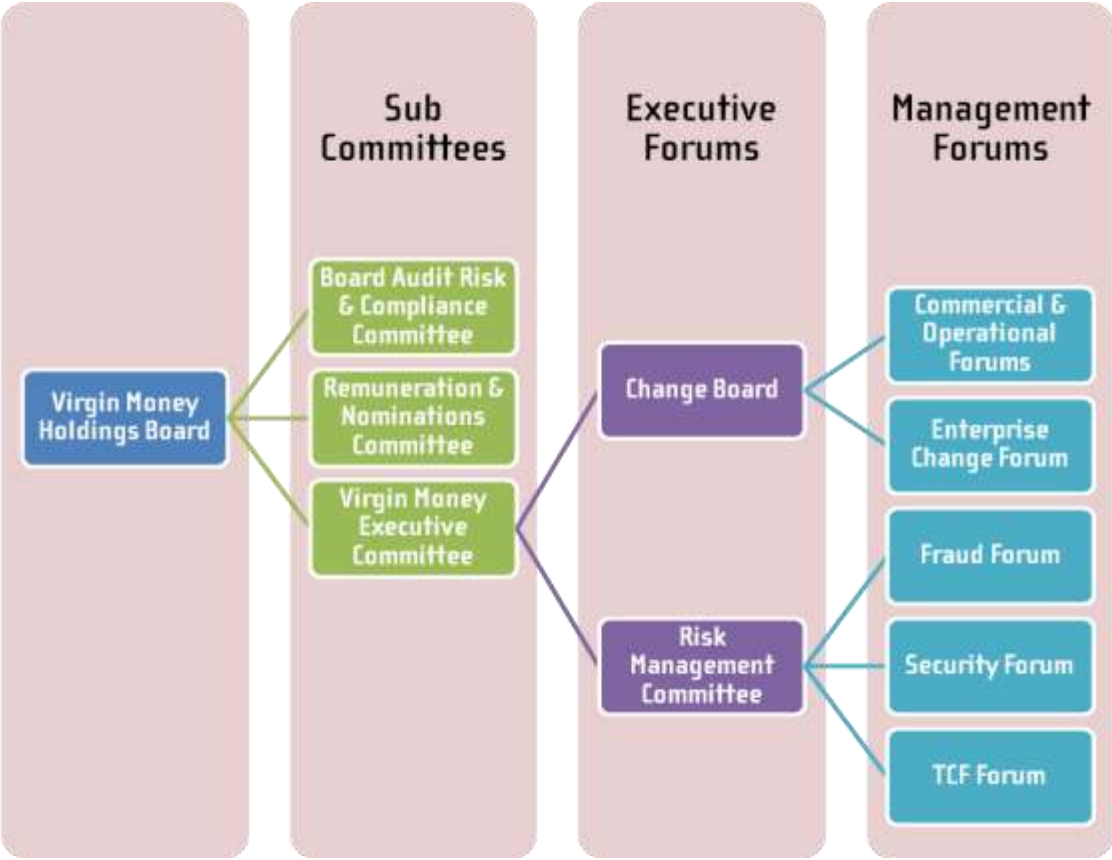
The risk management framework is part of the Corporate Governance arrangements operated by VMPFS and the VM Group.

Virgin Money group companies operate within a well defined governance framework which meets current best practice in a manner appropriate to our scale and scope of operations. The framework demonstrates control of the business, whilst facilitating transparency for all stakeholders and supporting the business to move rapidly in a changing market.

2.3. Governance Framework

The diagram below outlines the bodies through which Virgin Money undertakes governance, from the Board level through to Executive level.

The three Executive level committees have members selected from the Executive Team and all have Terms of Reference outlining their authority. Broadly speaking the decision making powers of these committees is limited to the authority granted to the executive through the Standing Authorities.



2.4. Risk Management Processes

The risk management process is defined as below and is given context in the risk appetite which is set by the Board (see section 2.1). Risks and their management are reported every month through the risk management committee and ultimately to the Board Audit Risk and Compliance Committee. The basic framework which Virgin Money group and its senior management follows to manage risks is:

- Board Level (Top-Down) Risk Assessment covering corporate level risks that threaten the achievement of corporate and strategic goals, and how they are mitigated.

- Internal Capital Adequacy Assessment Process (ICAAP) covering the management of capital including allocations to cover operational risk, using an FSA defined process.

- Risk Appetite providing a benchmark level of acceptable risk against which residual risk levels should be compared.

- Process Level (Bottom Up) Risk and Control Assessment covering risks that threaten the achievement of functional or departmental objectives and how they are mitigated.

- Control Risk Self Assessment (CRSA) providing quarterly positive assurance to senior management on the adequacy of design and operating effectiveness of controls.

- JAWS system which immediately escalates significant risk events to senior management.

- Key Risk Indicator (KRI) reporting which provides managers with information on the trends around certain key risks, enabling timely management and prevention or rectification of emerging risk issues.

- Loss Event reporting which helps inform the ICAAP capital planning process outlined above, through centralised reporting of losses incurred through operational risk issues.

- Change Risk Assessment which enables all business change to be risk assessed to ensure it is within VM's risk appetite and to ensure the ICAAP reflects any new risk levels appropriately.

- A dedicated Risk Team which includes Operational Risk, Regulatory Advice, Legal and Internal Audit/Compliance Monitoring.

2.5. Risk Management by category of risk

2.5.1. Credit risk

VMPFS has relatively few exposures to sources of credit risk and would not generally expect to have a material exposure to credit risk (that is, the risk of that a party will default on a financial agreement). Its exposures are to its key debtors, being:

- UK authorised banks in relation to cash reserves.

- Income due from its share of funds under management from the Trustees of the Virgin Money authorised unit trusts.

- Income due from UKI and Scottish Widows in respect of commission for the sale of their General Insurance and Life Insurance products.

- Income due for its share of deposit account margin interest on Cash ISA and deposit account balances.

It mitigates the risk of these assets failing to be delivered by:

- Performing credit checks and completing due diligence checks at the outset of entering into material contracts with counterparties.

- Monitoring on an ongoing basis the financial strength of the credit institutions with whom it banks.

- Establishing a contractual timetable in relation to the payment of income amounts and monitoring the payment of those amounts against agreed service level agreements.

2.5.2. Market risk

VMPFS has no exposure to market risk in relation to stock market investments (market risk being the risks that arise from fluctuations in values of, or income from, assets or in interest or exchange rates) as the assets it controls are held independently of the company by the Trustees of its authorised unit trusts, for the benefit of the unitholders of those funds.

As such, it has no requirement for risk mitigation processes in relation to market risk.

2.5.3. Operational risk

As a limited licence firm, VMPFS is not required to hold capital at Pillar 1 under the FSA's standardised approach to operational risk and has not done so. Operational risk is defined by the FSAO as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.

VMPFS controls these risks through the maintenance of an Operational Risk Framework comprising policy, principles and procedures that provides for consistent identification, assessment, mitigation, monitoring and reporting of operational risk exposures across the VM group.

This enables VMPFS to be protected from losses of a financial and reputational nature, in turn protecting shareholders, customers and staff. The Framework also assists the company in meeting its regulatory requirements as outlined in the FSA's High Level Standards, in particular SYSC (Senior Management Arrangements, Systems and Controls).

Operational risks are recorded on a Risk Database and reviewed by management on a quarterly basis. The controls used to mitigate those risks are also reviewed quarterly to ensure they remain adequate and effective. Formal confirmation in the form of the Control Risk Self Assessment is provided to the Operational Risk Team, on a quarterly basis, using the prescribed certification method. Operational Risk collate the reporting for the business and provide this to the RMC to support the annual director's sign-off for internal controls as required by the FSA.

Action plans are required when the residual risks for an area are in excess of the VM risk appetite. This occurs if any risk sits in the red area of the firm's assessment matrix for risk or if more 20% of the residual risks sit in the amber section of the assessment matrix.

In both cases action plans are submitted with the CRSA either to address specific red risks or more generally to reduce the number of amber risks to within the desired risk appetite level.

2.6. Securitisation risk

VMPFS makes no use of securitisation techniques and consequently has no exposures to securitisation risk.

3. Capital Resources

3.1. Regulatory capital as at 31 December 2007

	£000
Core tier 1 capital before deductions	9,296
Innovative tier 1 capital*	-
Tier 2 capital*	-
Tier 3 capital*	-
Deductions from tier 1 capital	(4,827)
Total capital after deductions	4,469

* VMPFS has no innovative Tier 1 capital instruments and no Tier 2 or Tier 3 capital instruments or deductions.

3.2. Tier 1 Capital

Tier 1 capital represents Ordinary Share Capital, Distributable Capital Reserves and Profit & Loss Account balances as at 31 December 2007.

Deductions from Tier 1 represent inter-group debtors (loans to other group companies) which are treated as fully illiquid for the purposes of available capital resources in line with FSA rules.

3.3. Transferability of capital

The Virgin Money group is reliant, in part, on a loan facility offered by Lloyds TSB. The Facilities are subject to two financial covenants, which are tested quarterly. The two covenants are in respect of leverage and interest cover.

A condition of the loan facilities restricts the amount of cash that can be held by VMPFS and VMUTM to a required limit above that which is required to satisfy FSA or other regulatory capital requirements.

Under the Facilities, each VM group company is subject to general undertakings not to pay dividends, make other distributions or redeem or repurchase shares and not to issue shares (subject to certain exceptions stipulated - the effect of which are generally to require the consent of Lloyds TSB prior to any capital event occurring).

Subject to the above, there are no current or foreseen impediments to the prompt transfer of capital within the group or repayment of group liabilities.

4. Capital Adequacy

4.1. Internal Capital Adequacy Assessment Process

The FSA set regulatory obligations under Pillar 2 of the Capital Requirements Directive which require all firms within the scope of CRD to have an Internal Capital Adequacy Process (ICAAP).

This includes requirements on VMPFS to:

- carry out regularly assessments of the amounts, types and distribution of financial resources, capital resources and internal capital that it considers adequate to cover the nature and level of the risks to which it is or might be exposed.
- identify the major sources of risk to its ability to meet its liabilities as they fall due.
- conduct stress and scenario tests.
- ensure that the processes, strategies and systems required by the overall Pillar 2 rule and used in its ICAAP, are both comprehensive and proportionate to the nature, scale and complexity of VMPFS's activities.
- document its ICAAP.

The VMPFS ICAAP forms part of the VMPFS formal planning cycle with:

- strategic targets fully informing the risks provided for in the ICAAP.
- a quarterly ICAAP review and update alongside the normal cycle of FSA capital reporting.
- Board consideration of the updated ICAAP as a standing agenda item.
- annual update of the ICAAP within the annual strategy and budget process, including a fundamental review of risk assumptions and revised strategic targets.
- consideration of individual ICAAP guidance from the FSA.
- consideration of updated ICAAP guidance from industry bodies.
- review of the annual ICAAP by the Board and its shareholders.
- immediate update of the ICAAP if there are material changes to VMPFS's risks.

4.2. Minimum Capital Requirement – Pillar 1

In line with most investment management firms which are limited licence BIPRU firms, VMPFS's Pillar 1 requirement is determined by its Fixed Overhead Requirement (FOR) rather than the sum of its market and credit risk as these values are far less than the FOR.

For 2008, VMPFS's minimum capital requirement under Pillar 1 was a Fixed Overhead Requirement of £1,796k.

4.3. Pillar 2 Assessment

As required under the ICAAP process, VMPFS has carried out a detailed internal assessment of the risks and capital that it believes it should hold. The risks considered can be classified under the headings of credit risk and operational risks. The firm has no material exposure to market risks as investment assets belong to the unitholders, rather than VMPFS.

For 2008, our assessment of capital required at Pillar 2 was £742k, comprising £60k in relation to credit risk and £682k for operational risk.

Credit risk has been appraised using the FSA standardised approach for credit risk.

As a limited licence BIPRU investment firm, VMPFS is exempt from Operational Risk requirements at Pillar 1.

The operational risks provided at Pillar 2 for have been identified by Virgin Money based on its business activities, sales and marketing approach and following current FSA and industry ICAAP guidance for small investment firms.

The evaluation of those risks has been carried out by using internal models rather than using the FSA's standardised approach.

These risks have also been subject to stress testing against a range of economic models from a mild stress scenario to a severe stressed scenario.

4.4. Comparison between Pillar 1 and Pillar 2 forecasts

Based on our assessment of pillar 2 risks, there is no additional capital required to be held over and above the minimum regulatory capital at pillar as the pillar 2 requirement is £1,054k lower.

5. Glossary of abbreviations and terms used

BARCC	Board Audit Risk & Compliance Committee
BIPRU	FSA Prudential Sourcebook for Banks, Building Societies and Investment Firms
CRD	Capital Requirements Directive
CRSA	Control Risk Self Assessment
FSA	Financial Services Authority
ICAAP	Internal Capital Adequacy Assessment Process
IFDS	International Financial Data Service Ltd
ISA	Individual Savings Accounts
JAWS	Virgin Money's Early Warning Risk System
KRI	Key Risk Indicator
MI	Management Information
RMC	Risk Management Committee
SLA	Service Level Agreement
SYSC	FSA Senior Management Arrangements, Systems and Controls Sourcebook
TCF	Treating Customers Fairly
TPA	Third Party Administrator
UKI	UK Insurance Ltd
VM	Virgin Money
VMPFS	Virgin Money Personal Financial Service Ltd
VMUTM	Virgin Money Unit Trust Managers Ltd