

# Alliance Trust PLC Pillar 3 Disclosures

## Background

The 2006 Capital Requirements Directive ('the Directive') of the European Union created a revised regulatory capital framework for financial services companies and groups.

This consists of three 'pillars':

- Pillar 1 sets out the minimum capital requirements that we are required to meet for credit, market and operational risk;
- Pillar 2 requires us, and the FSA, to consider whether additional capital should be held against risks not covered by Pillar 1; and
- Pillar 3 requires us to disclose capital requirements and policies for managing our risks.

In this document we set out:

- How the directive applies to us;
- Our risk management objectives and policies;
- Our capital resources and resource requirements; and
- How we comply with the rules on Pillar 2 requirements.

## Scope and Application of Directive Requirements

### Scope

These disclosures have been prepared for the Alliance Trust PLC Group ('the Group').

The principal business within the Group is Alliance Trust PLC which is a self managed investment company with investment trust status ('the Trust'). The Trust is not a regulated entity under the Financial Services and Markets Act 2000.

The Group includes a number of wholly owned regulated subsidiaries: Alliance Trust Savings Limited ('ATS'), Alliance Trust Asset Management Limited ('Asset Management') and Alliance Trust Equity Partners Limited ('ATEP'), an Article 2 MiFID exempt firm.

## Application

### Pillar 1

The Group's pillar 1 capital has been calculated on the basis of BIPRU 8.6.7R which requires that the consolidated capital resources for the Group be determined using the capital resources calculation for a bank, being the sum of operational risk, credit risk and market risk.

Credit risk has been calculated on the basis of the standardised approach.

Operational risk has been calculated based upon the basic indicator approach.

Market risk has been calculated based on foreign exchange movements within the portfolio.

### Pillar 2

The Board of Alliance Trust PLC considers the key risks to which the Group is exposed to determine the assessment of capital requirements under Pillar 2. Our process involves:

- Identification of risks by senior managers across each company within the Group;
- Prioritisation of risks and measurement of their significance and probability both before and after considering controls in place;
- Stress testing using scenario analysis to determine the impact of significant risks and managements' response;
- The role of risk appetite statements and tolerance levels; and
- Assessment of recent loss events.

Processes and procedures are in place to monitor the capital requirement over the three year planning horizon. This is updated monthly using actual outturn and projected forward as part of our reforecasting.

### ICAAP

Our overall approach to assessing the adequacy of our internal capital is set out in our Internal Capital Adequacy Assessment Process (ICAAP). The Group undertakes the ICAAP at least annually.

## Risk Management Objectives and Policies

### Risk management objectives

The Trust invests in equities, investment property, private equity, financial instruments and its subsidiary businesses in order to achieve its investment objectives as published in the 2009 Report & Accounts. In pursuing these objectives the Group is exposed to a variety of risks that could result in a reduction in the Group's net assets and/or a reduction in the profits available for payment as dividends.

### Risk management framework

The Group has in place a risk management framework designed to ensure that the risks inherent within the business are adequately identified, assessed, monitored and controlled. No business is without risk. The following sections explain our risk management structure and highlight the main risks that we believe could impact on the performance of the business.

### Control environment

The Group has an organisational structure with established lines of accountability as well as defined levels of authority for matters such as approval of capital.

The organisational model is consistent with industry standard 'three lines of defence': 1. line management; 2. control functions and 3. internal audit. In addition each subsidiary is required to operate in accordance with established Group specific policies and procedures.

The key Boards and Committees of the Trust include:

- Board: Reviews and approves the consolidated risk summary and ICAAP report.
- Audit Committee: Reviews the effectiveness of the system of internal controls, including the process for assessing risk factors and managing key risks identified.
- Executive Committee: Responsible for the management of group-wide strategic risks and the oversight of group-wide technical and operational risks.
- Operating Committee: Responsible for the management of operational risks for the Group

- Risk Committee: Approves and maintains the framework for the identification and management of risks by the Group.
- Asset Allocation Committee: Responsible for the management of investments and market risk for the Trust

Each subsidiary has an organisational structure with established lines of accountability as well as defined levels of authority for matters such as approval of capital expenditure.

At a Group level the Chief Executive's Group (CEG) was dissolved post 31 January 2009 year end and has been replaced by the Executive Committee and Operating Committee.

### Risk management policies

The Group manages a number of different categories of risk, with those relevant to this disclosure described below.

#### Business risk

This risk category includes external factors such as changes in the political, economic and regulatory environment as well as the risks arising from our businesses and products, strategic acquisitions or business diversification.

We have a number of specialist staff to ensure compliance with the legal and regulatory strictures affecting our operations.

#### Credit risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Group.

This risk is managed as follows:

- Investment transactions are carried out with a number of well established, approved brokers.
- Investment transactions are done on a cash against receipt or cash against delivery basis.

The Group minimises credit risk through banking policies which restrict banking deposits to highly rated financial institutions (Moody's Aa3 or above). The policies also set maximum exposure to individual banks.

None of the Group's financial assets are secured by collateral or other credit enhancements. The carrying amounts of financial assets best represent the maximum credit risk exposure at the reporting date.

#### Investment risk

Investment risk covers market risk and embodies the potential for both losses and gains and includes currency risk, interest rate risk and price risk. The Trust's strategy on investment risk is outlined in our statement of investment objectives and policy in the 2009 Report & Accounts. The Trust's portfolios are held with investment intent, rather than trading intent.

Investment risk concerns mainly the decisions being taken over the investment of funds in different asset classes, and within the different portfolios. It is managed on a regular basis by the Asset Allocation Committee which manages the allocation of the capital of the Trust between and among the asset classes approved by the Board and within the risk parameters, policies and other limits and guidelines set by the Board and with a view to the income derived from the Trust's assets.

The Asset Allocation Committee's responsibilities include: asset allocation, cash and currency management, risk management and allocation of the capital of the Trust to ensure adherence to the dividend policy set by the Board. Individual managers are responsible for assessing the risks associated with each investment that they make.

A Board approved derivatives policy is in place which formulates the basis under which these financial instruments can be used. Derivatives may be used by the Trust to reduce the potential of loss or to enhance our ability to change investments quickly. The use of such investments is centrally controlled.

Interest rates may affect the fair value of investments in fixed interest rate securities, income receivable on cash deposits and interest payable on variable rate borrowings. The possible effects on fair value and cash flows as a result of an interest rate change are taken into account when making investment or borrowing decisions.

Alliance Trust Savings holds client deposits and pays interest on these. This subsidiary has detailed risk management policies, with treasury and cash management undertaken within a framework of banking policies. These banking policies cover credit risk, counterparty exposure, capital adequacy and liquidity.

#### Liquidity risk

This risk category relates to the level of liquid funds, whether in cash or easily realisable assets that we keep to satisfy obligations for payments that may arise. Our cash position is monitored daily across the organisation with surplus funds invested to earn interest. The current economic turbulence has exposed a number of weaknesses in the market which impacted on the ability of some companies to obtain credit.

The Group continues to be able to secure funding when required from major banks at competitive rates.

#### Gearing risk

This is the risk that the value of investments made with money which is borrowed does not increase sufficiently to cover the borrowing and interest costs resulting in a loss. The Trust intends only to use gearing tactically where it identifies opportunities which will provide a return, whilst at the same time managing the risk. The level of gearing which may be used is set by the Board and the use of gearing is decided by the Asset Allocation Committee.

#### Operational risk

This is the risk of inadequate or failed processes or systems. The main potential risk here is a failure of our systems for holding or administering investments.

We have introduced enhanced management and oversight within the investment department, including updates to the investment management process and associated standards and procedures. Our project framework ensures that we focus activity on those areas identified as presenting our greatest potential risk exposure.

All business areas are subject to at least a bi-annual risk review facilitated by our Head of Risk. The risk management process consists of a cycle of risk identification and assessment, control evaluation, measurement and reporting, monitoring and assurance and Group and subsidiary board level review. While the Risk function's role is to facilitate this process, the process is embedded in existing governance structures and does not operate in isolation.

#### Concentration risk

The majority of equity investments by value are in UK companies, with significant amounts also in Europe and North America. As at 31 January 2009, no individual investment exceeded 3% of net assets attributable to equity holders of the Trust.

The Company's UK listed equities are held in CREST, and its overseas listed equities are held by Bank of New York as custodian. Bankruptcy or insolvency of the custodian may cause the Group's rights with respect to securities held by the custodian to be delayed or limited.

The banking policies also set maximum exposure to individual banks.

Other than outlined above there was no significant concentrations of credit risk to counterparties at the reporting date.

#### Pension obligation risk

The Group sponsors two pension arrangements. The Alliance Trust Companies' Pension fund (the 'Scheme') is a funded defined benefit pension scheme which is now closed to new entrants. Members continue to accrue benefits under the Scheme. Employees who joined the Group pursuant to an offer made after 1 March 2005 are not entitled to join the scheme but are entitled to receive contributions into their own Self Invested Personal Pension provided by Alliance Trust Savings.

The risk is that funds held by the Scheme are insufficient to meet its obligations to members. This risk is managed by the triennial valuations to review the current level of funding, the results of which are reviewed by the Trustees of the Scheme and the Company and a payment schedule agreed. There is also a bi-annual review of the Scheme's assets and liabilities for inclusion in the Annual Report and Interim Report.

## Capital Resources

### Total capital resources

Table 1 sets out the total capital resources of the Group at 31 January 2009.

Tier 1 capital comprises permanent share capital, profit and loss and other reserves and the share premium account. The deductions from Tier 1 capital comprise intangible assets being capitalised projects and goodwill. There are no innovative Tier 1 capital resources.

Tier 2 capital comprises revaluation reserves. There are no Tier 3 capital resources.

Table 2 sets out the minimum capital resources requirements of the Group as at 31 January 2009, together with its capital adequacy position.

As an investment company the Trust does not have a trading book as its main activity is buying, holding and selling securities for its portfolio: portfolios are held with investment intent, rather than trading intent. Therefore the market risk capital charge is the sum of the foreign exchange (Fx) and commodities position risk requirements (PRR).

Moody's is used as the External Credit Assessment Institution (ECAI) in order to determine the credit quality of our assets.

The Board has determined that no additional capital is required to be held in excess of Pillar 1. Therefore the Pillar 2 capital requirement has been assessed as being no more than that as calculated under Pillar 1 (£307.9 million), which is our own assessment of the minimum amount of capital that we believe is adequate against the risks identified.

### Table 1

Capital Resources	£000
Tier 1 capital	2,121,789
Deductions from Tier 1 capital	(5,251)
Total Tier 1 capital	2,116,538
Total Tier 2 capital	183
Total Capital Resources	2,116,721

### Table 2

Pillar 1	Capital £000	Capital £000
<b>Operational Risk</b>		<b>51,762</b>
Credit Risk: Exposure Class	Credit Quality Step	
Investments: Equity	1	24,244
	2	44,937
	3	31,341
	4	6,258
	5	-
	6	-
	Unrated	55,458
Investments: Real Estate		4,507
Cash and Cash equivalents	Gilts	-
	Treasury Bills	-
	Cash at minimum Aa3	6,152
Other	Fixed Assets	511
	Other debtors	1,403
		174,811
<b>Market Risk</b>		
Fx PRR:	Cash positions	980
	Equity positions	76,800
Commodities PRR:	Mineral rights	3,570
		81,350
<b>Pillar 1</b>		<b>307,923</b>
<b>Pillar 2</b>		<b>-</b>
<b>Total Capital Requirement</b>		<b>307,923</b>
<b>Current Total Capital</b>		<b>2,116,721</b>
<b>Capital Surplus</b>		<b>1,808,798</b>