AllianceBernstein

'Pillar Three' Disclosure: Capital & Risk Management

JANUARY 2011

- **Pillar 1:** sets out minimum capital requirements firms are required to meet for credit, market and operational risk.
- **Pillar 2:** requires firms and their regulatory supervisors to consider whether a firm should hold additional capital against risk not covered in Pillar 1.
- **Pillar 3:** requires firms to publicly disclose certain details of their risks, capital, and risk management arrangements.

January 2011

Pillar 3 Disclosures

1. Overview

1.1 Regulatory Requirements for "Pillar 3" Disclosures

The EU Capital Requirements Directive (CRD) came into effect on 1 January 2007, introducing consistent capital adequacy standards and an associated supervisory framework in the EU based on the Basel II Accord promulgated by the Basel Committee on Banking Supervision.

The framework consists of three "pillars":

Pillar 1: sets out minimum capital requirements firms are required to meet for credit, market and operational risk.

Pillar 2: requires firms and their regulatory supervisors to consider whether a firm should hold additional capital against risk not covered in Pillar 1. In the UK, this is implemented through the Individual Capital Adequacy Assessment Process (ICAAP) undertaken by the firm and through the subsequent Supervisory Review and Evaluation Process (SREP) undertaken by the Financial Services Authority (FSA).

Pillar 3: requires firms to publicly disclose certain details of their risks, capital, and risk management arrangements. The FSA has incorporated the CRD's disclosure requirements as Chapter 11 – Disclosure (Pillar 3) of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU).

The objective of this disclosure is for AllianceBernstein Limited to meet its BIPRU Pillar 3 disclosure requirements.

1.2 Scope of Disclosures (including Significant Subsidiaries)

The disclosures included herein relate to AllianceBernstein Limited ("ABL" or the "Firm"). ABL is an indirect wholly-owned subsidiary of AllianceBernstein L.P. (the "Parent"). The Parent is a publicly reporting United States Securities and Exchange Commission-registered investment adviser. A majority of the Parent's units are indirectly owned and controlled by AXA S.A. and its group of companies (collectively, the "AXA Group") based in Paris, France.

ABL is regulated by the FSA (FRN 147956) and has two subsidiaries—AllianceBernstein Services Limited in the UK and ACM Bernstein GmbH in Germany.

ABL also maintains branches in Sweden and The Netherlands and maintains representative offices in Bahrain, Spain, Italy and Switzerland.

The disclosures included herein describe the Firm's overall risk management arrangements and its approach to assessing its capital adequacy.

1.3 Frequency of Disclosures

These disclosures will be published at least once a year and as soon as practicable following material updates to the Firm's internal capital adequacy assessments. Given its size and complexity, the Firm assesses that this annual publication should generally meet its disclosure requirements.

1.4 Verification, Media and Location

These disclosures have been prepared solely for the purpose of fulfilling the Firm's BIPRU Pillar 3 disclosure requirements and are not used by management for any other purpose. They have not been audited nor do they constitute any form of audited financial statement.

The Firm's Board of Directors is ultimately responsible for the Firm's systems and controls and for reviewing the effectiveness of those arrangements. However, such arrangements are designed to mitigate, not eliminate, risk and therefore can provide only reasonable, but not absolute, assurance against material losses or financial misstatements.

These disclosures have been reviewed by the Firm's Risk & Controls Oversight Committee (a committee of the Board of Directors) and approved by the Firm's Board of Directors.

These disclosures will be published on the website of the Firm's Parent (www.alliancebernstein.com).

2. Risk Management Objectives and Policies

The Firm's risk management objectives and policies are supported by its corporate governance arrangements, its risk management framework and its risk management processes, including its processes for mitigating and monitoring its risk.

2.1 Corporate Governance Arrangements

Board of Directors

The Firm's Board of Directors (the "Board") is expected to be aware of the major aspects of the Firm's risks, especially those risks for which it may need to set aside capital. To that end, the Board periodically reviews the effectiveness of its systems and controls, including its Risk Management Framework, which establishes the principles of how risk is to be identified, assessed, monitored and controlled/mitigated.

The Board has delegated the day-to-day executive management of the Firm to the Chief Executive Officer (the "CEO") with the exception of certain reserved matters for the Board which include but are not limited to:

- Establishing the Firm's overall strategy.
- Setting the Firm's "risk appetite".
- Assessing and approving the Firm's capital adequacy (e.g. ICAAP).

The Board has also constituted, and delegated certain responsibilities to, the following committees:

- Management Committee
- Risk & Controls Oversight Committee
- Health & Safety Committee
- Crisis Management Team

Management Committee

The Management Committee is chaired by the Firm's CEO and is comprised of members of senior management who meet regularly to support the CEO in managing the day-to-day affairs of the Firm in accordance with the powers and discretions vested in him by the Board. The Management Committee may also escalate certain matters to the Board for consideration.

Risk & Controls Oversight Committee

The Risk & Controls Oversight Committee is chaired by the Firm's Director of Risk Management and is comprised of members of senior management, including the CEO. The role of the committee is to ensure that the control functions operate effectively and independently from operational areas and to advise the Board on the establishment, implementation, and maintenance of adequate risk management policies and procedures. In particular, the committee advises the Board on:

- Identifying risks relating to all of the activities, systems and processes of the Firm;
- Setting the level of risk tolerated by the Firm;
- Managing the risks identified (within any risk tolerance); and
- Monitoring the effectiveness of risk management policies and procedures, including compliance with such policies and remedial actions.

Health & Safety Committee

The Health & Safety Committee is chaired by a member of the Board and is responsible for the general oversight of safety arrangements at the Firm's premises, for advising all managers and employees of their respective health and safety obligations and responsibilities, and for proposing Firm policy on health and safety related matters.

Crisis Management Team

Inasmuch as the Firm shares physical premises, technological infrastructure, and certain support resources with its London-based sister company Sanford C. Bernstein Limited ("SCBL"), the Boards of Directors of each of the Firm and SCBL have resolved to delegate responsibility for crisis management to a joint committee of those Boards known as the Crisis Management Team ("the CMT"). The CMT is empowered to exercise, in accordance with its terms of reference, all of the rights, powers and discretions available to the Directors in the event of a crisis.

2.2 Risk Management Framework: Three Lines of Defence

The Firm has adopted a "three lines of defence" model which can be summarised as follows:

First Line of Defence

The first line of defence is comprised of the senior managers responsible for the Firm's business units and departments who are primarily responsible for identifying and managing risks in their area and for developing and communicating policies, guidance, and procedures necessary to manage those risks.

Second Line of Defence

The second line of defence is comprised of the Risk and Compliance functions.

The Risk function is responsible for facilitating the development, implementation and embedding of processes whereby management identifies assesses, monitors, controls and mitigates the risks in their areas.

The Compliance function is responsible for monitoring adherence to regulatory standards and for reporting its findings to relevant senior management and to the Board. The Compliance function is also responsible for the provision of technical regulatory/compliance advice and support.

Third Line of Defence

The third line of defence is comprised of the Internal Audit function.

Internal Audit provides independent assurance of the suitability and effectiveness of the Firm's risk management framework, including management's execution of its responsibilities to ensure an effective system of internal controls, risk management, and compliance is embedded in throughout the Firm.

2.3 Risk Appetite

The Firm's approach to setting risk appetite first considers the risks inherent in each of its strategies and objectives and then evaluates the most effective way to provide for these risks. For the key risks which cannot be perfectly controlled, the residual risks are quantified and a determination is made whether to provide for each risk with financial planning buffers or with capital (or a combination of both). Generally, expected losses are provided for with financial planning and P&L buffers and unexpected or extreme losses are provided for with capital. These quantifications of risk appetite are the basis on which the Firm's individual capital adequacy assessment (ICAAP) is developed.

3. Risk Management by Category of Risks

As for other asset managers, risk is inherent in the nature of the Firm's business and activities. Generally, the Firm's main areas of risk exposures can be categorized as: business risk, operational risk, market risk and credit risk.

The key risks to which the Firm is exposed are:

- operational risks in relation to how it conducts its business activities; and
- market risk in relation to the value of assets under management that underpin revenue streams.

The Firm has clear risk management policies and practices in place to manage each category of risk which are described in further detail below.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Firm has a dedicated Risk Management function which facilitates the ongoing identification, assessment, monitoring, controlling and mitigation of risks. The Risk & Controls Oversight Committee escalates key risks to the Board for consideration as "Top Risks", which are in turn developed into scenarios for capital modelling purposes at a 99.5% (1 in 200) confidence level.

Market Risk

Market risk arises in relation to the value of assets under management that underpin revenue streams. The Firm's balance sheet is not directly impacted by market risk as it does not hold any material proprietary positions (except for certain seed capital investments). The management of market risk is considered within business risk and is managed similarly to operational risks.

Credit Risk

The Firm's credit risk arises from its cash deposits with banks and financial institutions, investments in low risk UK government securities (gilts), seed capital, as well as credit exposures to debtors in respect of outstanding receivables. Cash deposits are diversified among several high quality institutions which are regularly monitored and there is an active credit control monitoring process whereby aged receivables are reviewed on a regular business and where appropriate, an amount set aside as provision for debts that are not expected to be collected in full.

Interest Rate Risk

Interest rate risk is the exposure of a firm's financial condition to adverse movements in interest rates. Changes in interest rates do not affect the Firm's earnings by materially changing its net interest income nor the level of other interest-sensitive income and operating expenses. Such a movement in interest rates does not affect the underlying value of the Firm's assets and liabilities nor materially change the present value of future cash flows.

The Firm does not rely on interest income to fund its operations and has no debt and as result would not be materially affected by a 200 basis point movement in interest rates. Therefore, the Firm considers that interest rate risk is not material.

Foreign Exchange Risk

Foreign Exchange Risk (FER) is the exposure of the Firm's financial condition to adverse movements in exchange rates. The Firm is primarily exposed to FER from its non-sterling revenue streams and from its non-sterling assets and liabilities such as cash and net counterparty trade debtors and creditors. The Firm actively manages its cash balances and converts surplus foreign currency balances to sterling as soon as practicable.

Liquidity Risk

Liquidity risk is the risk that current assets are not readily convertible to cash, that funds are either not available to service day-to-day funding requirements or are only available at a high cost, or need to be arranged at a time when market conditions are unfavourable and consequently the terms are onerous.

The liquidity requirements for the Firm arise from day-to-day routine financial activities including the settlement of non-trading book creditors, accounts payable and payroll, offset by the receipt of non-trading book receivables, particularly non-trading accounts receivable.

Whilst a certain amount of cash volatility is an inevitable consequence of general business activities, the Firm maintains controls to reduce this volatility through cash forecasting. The Firm retains a mixture of substantial cash balances and is confident of being able to settle transactions and continue operations even in the most difficult foreseeable circumstances. Cash requirements are monitored and forecast on a regular basis.

The Firm is not exposed to any significant liquidity risk as it funds its business from its internal resources, does not have client money and does not have trading book positions. Therefore, the Firm considers that liquidity risk is not material.

Pension Risks

The Firm does not offer a defined benefit pension scheme and therefore does not consider pension risk material.

Other Risks

Insurance risk, concentration risk, residual risk and securitisation risk have also been considered. These risks are not deemed to be material.

4. Internal Capital Adequacy Assessment and Capital Resources

The Firm undertakes its Internal Capital Adequacy Assessment Process (ICAAP) at least once annually (or as material changes in conditions warrant) in fulfilment of its Pillar 2 requirements. The Firm's most recent ICAAP document was approved by the Board on 13 December 2010.

4.1 Internal Capital Adequacy Assessment Process (ICAAP)

- The ICAAP document describes the framework under which the Board of Directors carries out its assessment of the adequacy of the Firm's capital resources. In particular the document sets out:
- The Firm's internal governance structure and assurance framework.
- The risk management framework.
- The key risk areas relevant to the Firm's capital.
- Financial and capital projections.
- The adequacy of capital resources in relation to the overall risk profile and certain stress and scenario events, and hence the Firm's overall ability to meet its liabilities as they fall due.
- An orderly wind-down scenario
- The way in which the ICAAP is used in the business.

The ICAAP is undertaken on a proportionate basis, taking into account the Firm's size, and the nature and complexity of its activities.

4.2 Capital Requirements and Resources

The Firm is a limited licence firm, and as such its BIPRU Pillar 1 capital requirements are the greater of:

- Its base capital requirement of EUR 50,000;
- The sum of its market and credit risk requirements; or
- Its fixed overhead requirement.

The Firm also assesses its Pillar 2 capital requirements as compared to the Pillar 1 capital requirements, with the final capital requirement equalling the higher of the Pillar 1 or Pillar 2 amounts (or such other amount as may be recommended to the Board by the FSA in accordance with its Individual Capital Guidance (ICG) for the Firm).

The Firm is also subject to the FSA's MIPRU rulebook as it has permission for insurance mediation. This requires it to hold Personal Indemnity Insurance (PII). There is sufficient cover at AllianceBernstein Group level to satisfy the insurance limits and £59,000 of additional capital has been set aside to satisfy MIPRU's insurance excess requirements.

While the Firm maintains various insurance arrangements which could potentially mitigate certain risks, the Firm capital calculations do not take such potential benefits into consideration.

The Firm has a simple capital structure and does not use any exotic capital instruments. A summary of the Firm's capital requirements and resources appear in the tables below:

Pillar 1 and Pillar 2 Comparison (£'000)	**Pillar 1**	**Pillar 2**
Credit risk capital requirement (CR)	8040	417
Market risk capital requirement (MR)	394	25,722
Operational risk capital requirement (OR)	n/a	17,740
Fixed overhead requirement (FOR)	21,099	n/a
Pillar 1 Capital Resource Requirement (Pillar 1 CRR)	21,099	
Pillar 2 Capital Resource Requirement (Pillar 2 CRR)		43,878
Total BIPRU C**apital** R**esources** R**equirement** (Higher of Pillar 1 and Pillar 2 CRR)		43,878

Capital Summary as at November 30, 2010	**£'000**
Current total capital	88,708
Additional capital required under MIPRU 3.2.14	59
Total BIPRU capital requirement (higher of Pillar 1 and Pillar 2)	43,878
Surplus capital	44,771