

TESCO PERSONAL FINANCE PLC

**DIRECTORS' REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 29 FEBRUARY 2012**

COMPANY NUMBER SC173199

TESCO PERSONAL FINANCE PLC

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TESCO PERSONAL FINANCE PLC

DIRECTORS AND ADVISERS

Directors:

Graham Pimlott* - Chairman
Peter Bole
Iain Clink
Shaun Doherty
Bernard Higgins
Adrian Hill*
Ricky Hunkin
Raymond Pierce*
John Reed*

*Indicates independent Non-Executive Director

Company Secretary:

Jonathan Lloyd

Registered Office:

Interpoint Building
22 Haymarket Yards
Edinburgh
EH12 5BH

Independent Auditors:

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Erskine House
68-73 Queen Street
Edinburgh
EH2 4NH

Bankers:

The Royal Bank of Scotland Public Limited Company
36 St Andrew Square
Edinburgh
EH2 2YB

HSBC Bank Plc
8 Canada Square
London
E14 5HQ

TESCO PERSONAL FINANCE PLC

DIRECTORS' REPORT

The Directors present their annual report and the audited consolidated financial statements for the year ended 29 February 2012.

In the Directors' Report and Financial Statements, unless specified otherwise, the 'Company' means Tesco Personal Finance plc and the 'Group' means the Company and its subsidiaries and associated undertaking included in the consolidated financial statements.

PRINCIPAL ACTIVITIES

The Group and Company are engaged in the provision of banking and general insurance services. The Group and Company operate using the trading name of Tesco Bank. The Group and Company are primarily focused on providing financial services and products to personal customers in the UK and the Republic of Ireland. The Company owns 49.9% of Tesco Underwriting Limited, an authorised insurance company.

FINANCIAL PERFORMANCE

Headlines:

- Profit before tax is £159.6m, up by 28.3% (2011: £124.3m).
- Underlying profit before tax¹ is up 30.7% to £227.0m (2011: £173.6m).
- Total income is up by 19.3% to £702.3m (2011: £588.4m).
 - Net interest income is down 5.1% at £259.0m (2011: £273.0m) in the year predominantly due to a 5.5% fall in loans and advances to customers to £4.4bn (2011: £4.7bn). This is primarily due to the decision to reduce marketing activity during the migration of savings and loans customers to the Group's operational platforms.
 - Non interest income is 40.5% higher at £443.2m (2011: £315.4m). This reflects continuing growth in commission generated from the Group's insurance portfolio and strong credit card fee income as spend on cards has continued to increase.
 - Non interest income includes an incremental charge of £57.4m (2011: release of £50.0m) which has been made for potential customer redress relating to payment protection insurance (PPI). Non interest income in the prior year also included a £99.3m charge in relation to legacy motor insurance claims.
- Operating expenses grew by 29.9% to £423.5m (2011: £325.9m). This is driven by the full year impact of the change to the new insurance operating model combined with the establishment of the Group's standalone platforms and processes.
- Impairment losses are down by 5.2% to £124.5m (2011: £131.4m) reflecting reduced default levels in both cards and loans.
- The share of profit of associate of £5.3m (2011: loss of £6.8m) reflects the share of the profits in Tesco Underwriting Limited following its successful first full year of trading – the loss in 2011 was due to initial start up costs.

¹ Underlying profit before tax is stated after adjusting for movements in the provision for customer redress, legacy insurance reserve movements in the prior year and a non-recurring fee payable to a supplier on the successful migration of the Motor and Home Insurance business. A full reconciliation to statutory profit before tax is provided on page 4.

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DIRECTORS' REPORT (continued)

BUSINESS OVERVIEW

Against a challenging economic backdrop, the Group has continued to make significant progress in the year to 29 February 2012 with growth in income and profit and substantial progress with the establishment of its standalone operations. Profit before tax is up to £159.6m (2011: £124.3m), a rise of 28.3%. Underlying profit is up 30.7% to £227.0m (2011: £173.6m).

The insurance business performed strongly with the customer service centres in Glasgow and Newcastle now fully established. The majority of Home and Motor Insurance business was underwritten by Tesco Underwriting Limited in the year, following the successful migration of customers from Royal Bank of Scotland (RBS) Insurance platforms which completed as planned in November 2011.

The Group's general insurance products also include Pet, Travel and Motor Rescue cover. New distribution arrangements have been put in place for these products with a variety of providers and in all cases the migration to the new arrangements has completed successfully.

In credit cards, total spend on cards regularly exceeds £1.0bn a month. Credit card balances have remained broadly stable. The number of active card holders has increased to 2.3m (2011: 2.1m). Personal loan balances fell by 11.4% to £1.9bn (2011: £2.2bn) on the back of the decision to reduce marketing activity during the loans and savings migration. In retail savings customer deposits have grown from £5.1bn to £5.4bn. Since the launch in October 2010, customers have placed £1.5bn on deposit with the Group through the Fixed Rate Saver products.

As indicated in the prior year, operationally the Group continues to see significant change as it moves towards its new operational platforms. The migration of savings and loans customers to the Group's own platform in June 2011 was successful, despite some initial technical issues where some customers were unable to access online accounts for a short period. These issues were fully resolved during the year and by the fourth quarter the platform was operating within the volumes predicted. As highlighted in August 2011, a decision was taken to defer the credit cards migration until 2012. The Group continues to make good progress towards successful migration in the first half of 2012/13.

An additional £57.4m was added to the provision in respect of PPI in August 2011 as a consequence of the Group announcing its intention to begin a programme of proactive customer contact. This programme will invite customers who think they were mis-sold PPI during a specific time period to seek reimbursement from the Group. This programme has entered an initial pilot phase to ensure that documentation and operational processes are fit for purpose. The full programme of activity is expected to commence in the first half of 2012/13.

BUSINESS DEVELOPMENT

In terms of future developments, subject to regulatory approval, Tesco Bank mortgages will be launched during 2012. The operational and commercial plans to support this launch are at an advanced stage and the Group believes it is well placed to service Tesco loyal customers attractively in this market. The Group is continuing to design and develop a current account offering however does not expect to enter this market in 2012/13. Other than these developments, the Directors do not anticipate any material change in either the type or level of activities of the Group in the next financial year.

The parent company, Tesco Personal Finance Group Limited, increased its investment in the Group by £251.5m (2011: £445.5m) during the year, of which £140.0m (2011: £nil) was subordinated debt and £111.5m (2011: £445.5m) was proceeds from an issue of share capital, increasing total equity to £1,190.0m at the balance sheet date.

Interim dividends in respect of ordinary share capital of £8.2m (2011: £12.2m) were paid to the parent company in June and September 2011, and a final dividend of £100.0m (2011: £150.0m) was paid in February 2012.

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DIRECTORS' REPORT (continued)

GOING CONCERN

The Group has strengthened its capital position during the year and has made steady growth in diversifying its funding base through the Fixed Rate Saver products. The majority of the Group's balance sheet continues to be funded by retail deposits. The Directors have made a formal assessment of going concern, taking into account both current performance and the Group's outlook, including consideration of projections for the Group's capital and funding position. As a result of this assessment the Directors consider the Group to be in a satisfactory financial position and confirm that the Group has adequate resources to continue in business in the foreseeable future. Accordingly, the Directors continue to adopt the going concern basis in preparing the financial statements.

CONSOLIDATED INCOME STATEMENT

The Group's financial performance is presented in the consolidated income statement on page 15. A summary is presented below:

	2012 £'000	2011 £'000	%
Net interest income	259,046	273,033	(5.1%)
Non interest income	443,237	315,394	40.5%
Total income	702,283	588,427	19.3%
Operating expenses	(423,490)	(325,910)	(29.9%)
Impairment	(124,511)	(131,356)	5.2%
Share of profit / (loss) of associate	5,269	(6,821)	177.2%
Profit before tax	159,551	124,340	28.3%

The Directors consider the following to be Key Performance Indicators for the Income Statement:

Net interest margin ¹	3.9%	4.6%
Cost: income ratio ²	60.3%	55.4%
Bad debt asset ratio ³	2.4%	2.7%

¹ Net interest margin is calculated by dividing net interest income by average interest bearing assets (loans and advances to customers).

² The cost: income ratio is calculated by dividing operating expenses by total income.

³ The bad debt asset ratio is calculated by dividing the impairment loss by the average balance of loans and advances to customers.

The table below reconciles statutory profit to underlying profit:

	2012 £'000	2011 £'000	%
Profit before tax	159,551	124,340	28.3%
Material adjustments:			
PPI provision	57,400	(50,000)	-
Legacy insurance reserve adjustment	-	99,347	-
Insurance migration fee	10,000	-	-
Underlying profit before tax	226,951	173,687	30.7%

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DIRECTORS' REPORT (continued)

Net Interest Income

Net interest income has fallen by 5.1% to £259.0m (2011: £273.0m). Loans fell by 11.4% to £1.9bn (2011: £2.2bn) due to the management of marketing activity during the period in which the savings and loans operation was migrated to the Group's platform. The loan interest margin has remained stable year on year. The quality of the credit cards portfolio remains high, with strong growth in both the number of active cards and the total spend on cards (refer also to non interest income below). Whilst credit card balances have remained broadly flat, a higher proportion of customers are paying in full each month resulting in a slight reduction in net interest margin. The combination of these factors, together with the higher level of liquidity held by the Group in the year, has resulted in the reported reduction in the net interest margin.

Non Interest Income

Non interest income has increased by 40.5% to £443.2m (2011: £315.4m). Active credit card numbers have grown by 8.0% in the year and spend on cards has increased by 11%. ATM transaction volumes continued to increase in the year, up by 9.4% to over 372 million.

As detailed in the Interim Report for Tesco Personal Finance plc at 31 August 2011, the Group recognised an incremental £57.4m provision to cover claims arising from potential mis-selling of PPI policies. Following a review of the provision at the year end, no further adjustment has been made.

For the year ended 29 February 2012, the results include a full year of the new insurance operating model whereby the gross commission received is booked via fees and commissions and the direct operational and marketing costs are included in operating expenses. Under the previous arrangement with RBS the operational and marketing costs were largely borne by RBS and the net fees and commissions passed across to the Group. The impact of this new model has therefore been to increase direct operating expenses by £55.0m with a related increase in the level of commission income received. Insurance performance has been strong with gross written motor premiums up by 27% and profit margins benefitting from the effect of market wide price increases on motor insurance.

Operating Expenses

Operating expenses grew by £97.6m (29.9%) to £423.5m (2011: £325.9m). Direct product costs have increased by £65.0m, largely reflecting the change in the insurance operating model. The balance of the increase in the cost base reflects the establishment of the Group's new operational platforms with depreciation and amortisation charges increasing by £25.2m in the year.

Impairment

The impairment charge for bad debts on loans and advances has fallen by 5.2% to £124.5m (2011: £131.4m). The level of customer defaults continues to reduce due to improved credit control, stricter underwriting criteria and the Group's ability to attract good quality customers. The Group's bad debt to asset ratio has marginally decreased to 2.4% (2011: 2.7%).

CONSOLIDATED BALANCE SHEET

The Group's consolidated statement of financial position is presented on page 17. A summary position is presented below:

	2012 £'000	2011 £'000
Loans and advances to customers	4,423,582	4,679,184
Total assets	7,605,143	6,991,562
Deposits from customers	5,389,787	5,077,464
Net assets	1,190,026	1,049,992

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DIRECTORS' REPORT (continued)

Loans and Advances to Customers

Loans and advances to customers have fallen by 5.5% in the year to £4.4bn (2011: £4.7bn). This is predominantly due to the decision to reduce marketing activity during the migration to the Group's savings and loans operational platform.

Deposits from Customers

Deposits from customers grew by 6.2% to £5.4bn at 29 February 2012 (2011: £5.1bn) with the Fixed Rate Saver products having attracted savings of £1.5bn (2011: £0.4bn) since launch in October 2010.

Total Assets

Total assets increased by 8.8% to £7.6bn at 29 February 2012 (2011: £7.0bn). This reflects the increase in the Group's funding with increases to both capital and customer deposits which in turn have increased the Group's liquid asset portfolio and have funded the ongoing investment in the Group's operational platforms.

Capital and Liquidity Ratios

The Directors consider the following to be Key Performance Indicators for capital and liquidity reporting:

	2012 £'000	2011 £'000
Tier 1 capital ratio ¹	15.3%	15.9%
Risk asset ratio ²	16.0%	13.6%
Net stable funding ratio ³	120.7%	112.3%

¹ The tier 1 capital ratio is calculated by dividing total tier 1 capital at the end of the year by total risk weighted assets (note 46).

² The risk asset ratio is calculated by dividing total regulatory capital by total risk weighted assets (note 46).

³ The net stable funding ratio is calculated by dividing long term funding (over one year maturity) by loans and advances to customers and other illiquid assets.

The Group's capital position has strengthened during the year. This has resulted in an improved risk asset ratio of 16.0% (2011: 13.6%). The core tier 1 ratio remains strong at 15.3% at 29 February 2012 (2011: 15.9%).

The net stable funding ratio, a key measure of the Group's liquidity position, has strengthened to 120.7% (2011: 112.3%). This is in excess of the Group's internal target and reflects the planned management of the Group's liquidity position in the run up to the Group's launch of mortgages in the next financial year.

The Group received capital injections totalling £251.5m (2011: £445.5m) from Tesco Personal Finance Group Limited during the course of the year. This funded planned expenditure on systems developments and infrastructure together with a strengthening of the Group's capital position.

The Group maintains a liquid asset portfolio of high quality investment securities of more than £1.6bn (2011: £1.2bn) which offer a high degree of liquidity.

The Group has diversified its funding base further during the year with an issue of the eight year inflation linked retail bond in December 2011 raising £60.0m, as well as continuing to grow the fixed rate savings book.

TREATING CUSTOMERS FAIRLY

Treating Customers Fairly (TCF) is central to the Financial Services Authority's (FSA's) principles for businesses and remains central to the Tesco Values which sit at the heart of the business. These values are designed to ensure that customer outcomes match their understanding and expectations.

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DIRECTORS' REPORT (continued)

DIRECTORS

The present Directors and Secretary who have served throughout the year and up to the date of signing the financial statements, except where noted below, are listed on page 1.

Since 1 March 2011 to date the following changes have taken place:

	Appointed	Resigned
John Reed	30 March 2011	
William Main		24 June 2011
Peter Bole	13 December 2011	
Andrew Higginson		26 February 2012

RISK MANAGEMENT

The management of risk is an integral part of the Group's business. The Group has established an Enterprise Wide Risk Management Framework, designed to support the identification, assessment, management and control of the material risks that threaten the achievement of the Group's strategic business objectives. The Group has developed a risk strategy which is designed to support the successful delivery of strategic business objectives through clearly defined strategic risk objectives which support risk appetite. The risk appetite reflects the level and type of risks that the Group is willing to take to deliver its strategic business objectives.

The Board has overall responsibility for the Group's business. It agrees the strategy for the Group, approves the Group's risk appetite as well as specific high level policies and the delegated authorities. The Board monitor's the risk profile of the Group.

Executive management is responsible for establishing an effective control framework and ensuring all risks are identified and controlled within the risk appetite and policy limits. The independent Risk function is responsible for developing risk appetite and the policy framework and for independently monitoring the risk profile, providing assurance where required. Risk also provides frameworks, tools and techniques to assist management in meeting their responsibilities, as well as acting as a central coordinator to ensure that enterprise wide risks are being effectively addressed. Internal Audit is responsible for the independent assessment of the effectiveness of the implementation of the risk and control measures across the business. They assess whether the internal control systems are effective both in design and practice.

The Internal Capital Adequacy Assessment Process (ICAAP) is the Group's internal assessment of capital adequacy designed to address the requirements under Pillar 2 of the Basel II framework. The ICAAP process considers all of the risks faced by the Group, the likely impact of them if they were to occur, how these risks can be mitigated and the amount of capital that it is prudent to hold against them both currently and in the future. The Group performs a full ICAAP regularly which is reviewed and approved by the Board.

The Group holds a liquid asset portfolio that the Board deem to be sufficient to cover potential future stressed cash outflows. Through its Internal Liquidity Adequacy Assessment (ILAA) process, stress events are simulated and the impact on cash flows, including any available contingency funding, is assessed and reviewed against the current and planned liquid asset portfolio. The ILAA is reviewed and approved by the Board regularly.

The Group maintains a Key Risk Register, which is subject to regular review to enable management to identify all key risks, current and emerging. As the risk profile shifts over time the potential impact on the business is considered in terms of additional management action required and/or possible additional capital or liquidity requirements. The content of the Register is developed by the Risk function through ongoing discussion with senior management and is reviewed on a regular basis.

The Group's Enterprise Wide Risk Management Framework (EWRMF) identifies the main controls and actions. Further information on the EWRMF is provided in the Notes to the Financial Statements (Note 39). There are a number of key components of the EWRMF common to all the major risk categories, including the following:

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DIRECTORS' REPORT (continued)

Component	Description of the component
Independent Risk function	Reporting to the Chief Risk Officer (CRO) and responsible for designing and implementing risk management frameworks and for independently monitoring the risk profile, providing oversight and challenge to the business.
Three Lines of Defence	Line Managers are responsible for establishing an effective control framework within their area of operations and for identifying and controlling all risks within risk appetite and policy limits. The second line of defence is the independent Risk function. Internal Audit are the third line of defence and are responsible for the independent assessment of the effectiveness of the implementation of the overall risk and control measures.
Policy framework	Risk are responsible for the policy framework, with the Group's policy documents providing the rules and guiding principles that define the approach to specific subjects and covering all aspects of risk.
Integrated Risk reporting	Reporting is provided monthly to senior governance committees. Exposures are monitored against triggers and limits on a daily, weekly or monthly frequency as required. Exceptions are reported monthly to the Asset and Liability Management Committee (ALCO), the Risk Management Committee (RMC) and to each meeting of the Board Risk Committee (BRC).
Stress Testing	Stress testing is the process under which the Group's business plans, capital and liquidity are subjected to severe adverse impacts. Stress testing is a mandatory requirement of the FSA who require that banks implement their own stress testing processes. Stress testing is essential to effective risk management and is a key component of the Group's ICAAP and ILAA processes.

The table below sets out the principal risks currently faced by the Group and provides examples of relevant key controls and mitigating factors specific to each risk type. The Board considers these to be the most significant risks although they do not comprise all risks associated with the Group. Additional risks not presently known to management, or currently deemed to be less material, may also have an adverse effect on the business.

Principal risk	Key controls and mitigating factors
Transformation Risk The Transformation Programme is a significant change programme designed to develop platforms and processes to enable the Group to conduct banking and insurance business independently of RBS. The key remaining component of the Transformation programme is the migration of the credit card portfolio. In addition, the Group has well developed plans for launching mortgages, subject to FSA approval.	• There is strong programme governance in place with a tiered committee structure headed by Executive level Project Assessment Committee. • The Group operates standard project management disciplines which are employed to deliver effective programme and risk and issue management.
Credit Risk - External environment The downside risks to the UK economy remain high, including fragile consumer confidence, a squeezing of real incomes, increasing unemployment and some consumers increasing borrowing and switching to variable rate mortgages. On the wider economic front subdued UK growth, continued fiscal austerity and the continuing Euro zone debt crisis is impacting confidence and may impact the ability to sustain debt servicing and repayment in the event of an economic shock.	• The Group's credit risk appetite is based on lending responsibly to manage the credit risk profile of its portfolio within agreed parameters. • Credit portfolios continue to be closely monitored with changes made to acquisition and limit management strategies to mitigate, as far as possible, downside economic risks. • The Group has minimal direct exposure to non-UK sovereigns and proactively monitors and manages the non-retail portfolios to reduce exposure to specific names or geographies.

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DIRECTORS' REPORT (continued)

Principal risk	Key controls and mitigating factors
Legal and Regulatory Compliance Risk Legal and Regulatory Compliance Risk is the risk of consequences arising as a result of non-compliance with the laws and regulations affecting the Group's governance, prudential arrangements, business activities, risk management and its conduct with customers. There remains significant regulatory focus in relation to "Conduct Risk" and "Treating Customers Fairly". Specifically there has been continued industry-wide focus on provision of redress in relation to past sales of Payment Protection Insurance (PPI).	• The Group's aim is to meet all legal and regulatory requirements by maintaining an effective control framework. • A dedicated risk team is responsible for the identification of regulatory risks, the management and oversight of policies and processes and the provision of assurance in relation to regulatory risk and compliance. • The Treating Customers Fairly Board and the Board reviews and challenges delivery of fair outcomes for customers. • A programme to proactively remediate disadvantaged PPI customers has commenced.
Insurance risk The Group defines insurance risk as the risk we accept through our insurance products in return for a premium. These risks may or may not occur as expected and the amount and timing of these risks are uncertain and determined by events outside of our control. The Group is exposed to insurance risks through its historic distribution arrangement with RBS, which is expected to terminate in quarter four of 2012, and through its ownership of 49.9% of Tesco Underwriting Limited (TU).	• The Group's aim is to actively manage insurance risk exposure with particular focus on those risks that impact profit volatility. • Regular, independent reviews of reserves are undertaken with reporting to RMC, Audit Committee, BRC and the Board. • The Group uses reinsurance to limit exposure above pre-determined limits. • Risk Appetite and a suite of risk policies are in place to manage risk in TU. • The Group's Insurance Risk function provides independent oversight of TU which is appropriate to the Group's role as key shareholder.
Liquidity and Funding Risk Liquidity risk is the risk that the Group has insufficient cash resources to meet its obligations as they fall due or can do so only at excessive cost. Funding risk is the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient. External market conditions continue to exhibit signs of stress (with wholesale funding markets constrained) and significant competition for retail deposits. The Group relies upon significant amounts of on demand retail funding.	• The Group aims to have a conservative Balance Sheet structure with prudent risk appetite supported by explicit targets and metrics which enable it to meet its financial obligations, including under stressed conditions. • The Group holds a significant and diversified stock of highly marketable liquid assets, in excess of internal and regulatory requirements. • The Group's significant retail deposit base means that there is currently less reliance on wholesale markets as a source of funding and historic practice indicates that such deposits tend to be relatively stable.

TESCO PERSONAL FINANCE PLC

DIRECTORS' REPORT (continued)

Principal risk	Key controls and mitigating factors
Operational Risk Operational Risk is the potential error, loss, harm or failure caused by ineffective or inadequately defined processes, system failure, improper conduct, human error or from external events. Outsourcing Risk A significant number of services and processes are provided by third party service providers and a key operational risk is the failure of an outsourced service provider. People Risk Increased market demand for specialist personnel could result in increased costs of recruitment and retention or reduced organisational effectiveness if a sufficient number of skilled staff cannot be employed.	• The Group's aim is to minimise all operational risks and reputational impacts. • A Risk and Control Self Assessment (RCSA) process is used by the business to identify, assess, quantify, monitor and report its operational risks and management's effectiveness in mitigating them. Regular reporting is provided to RMC and remedial actions taken as required. • The Procurement policy provides consistent and robust standards for supplier sourcing and selection. • The Group's Strategic Relationship Management process enables the monitoring of the performance of third party outsourcers and suppliers against agreed service level agreements, the management of the relationships and the improvement of supply or termination of contract where appropriate. • The People Matters Group (PMG), an Executive committee, oversees key aspects of people risk, including talent management, performance management, retention and succession planning.
Market Risk Market risk is defined as the risk that the value of the Group's assets, liabilities, income or costs might vary due to changes in the value of financial market prices; this includes interest rates, foreign exchange rates, credit spreads and equities.	• The Group has no trading book. • There is low appetite for exposure to interest rate risk in the banking book (IRRBB) and other market risks, such as credit spreads, which are monitored and reported through ALCO and RMC.

PILLAR 3

The Company's Pillar 3 disclosures are published in the Investors Centre section of the Tesco plc corporate website: www.tescopl.com/investors/results.

DIRECTORS' INDEMNITIES

In terms of Section 236 of the Companies Act 2006: Graham Pimlott, Adrian Hill, Raymond Pierce and John Reed have been issued a Qualifying Third Party Indemnity Provision by Tesco Personal Finance Group Limited. All qualifying third party indemnities were in force during the financial year and at the date of approval of the financial statements.

SUPPLIER PAYMENT POLICY

During the year ended 29 February 2012, the Group continued to adhere to its procurement policy in respect to payment of its suppliers. The Group is committed to maintaining a sound commercial relationship with its suppliers in line with the Business Code of Conduct. Consequently, it is the Group's policy to negotiate and agree terms and conditions with its suppliers. The standard payment terms to suppliers of goods and services will be 34 days from the receipt of a correctly submitted invoice for goods or services that have been ordered and received in accordance with the terms of the contract.

Trade payables of the Group and Company for the year ended 29 February 2012 were equivalent to 17 days (2011: 42 days), based on the ratio of the Group and Company trade payables at the end of the year to the amounts invoiced during the year.

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DIRECTORS' REPORT (continued)

OUR PEOPLE

The Group depends on the skills and commitment of its employees in order to achieve its objectives. There are processes for understanding and responding to employees' needs through the PMG, staff surveys and regular performance reviews. Business developments are communicated frequently to ensure that employees are well informed about the business of the Group. Ongoing training programmes also seek to ensure that employees understand the Group's objectives and the regulatory environment in which it operates.

Employees are encouraged to become involved in the financial performance of the wider Tesco plc Group through a variety of schemes, principally the Tesco employee profit-sharing scheme (Shares in Success), the savings related share option scheme (Save As You Earn) and the partnership share plan (Buy As You Earn).

The Group's selection, training, development and promotion policies are designed to ensure equal opportunities for all employees regardless of factors such as gender, marital status, race, age, sexual preference and orientation, colour, creed, ethnic origin, disability, religion or belief.

INDEPENDENT AUDITORS

The auditors, PricewaterhouseCoopers LLP, who are considered to be independent by the Audit Committee, have indicated their willingness to continue in office.

STATEMENT OF DISCLOSURE TO AUDITORS

So far as each Director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditors in connection with preparing their report, of which the auditors are unaware. All of the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

TESCO PERSONAL FINANCE PLC

DIRECTORS' REPORT (continued)

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and parent Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that year. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Approved by the Board of Directors and signed by order of the Board



Jonathan Lloyd
Company Secretary
27 April 2012

TESCO PERSONAL FINANCE PLC

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF TESCO PERSONAL FINANCE PLC

We have audited the Group and parent Company financial statements (the "financial statements") of Tesco Personal Finance plc for the year ended 29 February 2012 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Parent Company Statement of Financial Position, the Consolidated and Parent Company Cash Flow Statements, the Consolidated and Parent Company Statement of Changes in Equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the Statement of Directors' Responsibilities (set out on page 12), the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Directors' Report and Financial Statements to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

OPINION ON FINANCIAL STATEMENTS

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 29 February 2012 and of the Group's profit and Group's and parent Company's cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

TESCO PERSONAL FINANCE PLC

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF TESCO PERSONAL FINANCE PLC (continued)

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Catrin Thomas (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
27 April 2012

TESCO PERSONAL FINANCE PLC

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 29 FEBRUARY 2012

	Note	2012 £'000	2011 £'000
Interest and similar income	4	425,647	420,161
Interest expense and similar charges	4	(166,601)	(147,128)
Net interest income		259,046	273,033
Fees and commissions income	5	517,920	285,731
Fees and commissions expense	5	(22,530)	(20,291)
Provision for customer redress	31	(57,400)	50,000
Net fees and commissions income		437,990	315,440
Gains/(losses) on financial assets	6	498	(610)
Realised gain on investment securities	7	4,749	564
		5,247	(46)
Total income		702,283	588,427
Administrative expenses	8	(378,945)	(306,519)
Depreciation and amortisation	9	(44,545)	(19,391)
Operating expenses		(423,490)	(325,910)
Impairment	10	(124,511)	(131,356)
Share of profit/(loss) of associate	24	5,269	(6,821)
		(119,242)	(138,177)
Profit before tax		159,551	124,340
Income tax expense	12	(39,561)	(37,794)
Profit for the year attributable to owners of the parent		119,990	86,546

TESCO PERSONAL FINANCE PLC

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 29 FEBRUARY 2012

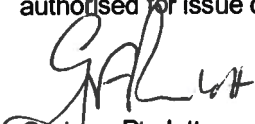
	Note	2012 £'000	2011 £'000
Profit for the year		119,990	86,546
Net gains on available for sale investment securities			
Unrealised net gains during year, before tax		9,473	2,243
Cash flow hedges			
Net gains arising on hedges recognised in other comprehensive income, before tax		276	1,099
Income tax relating to components of other comprehensive income	15	(2,495)	(938)
Share of other comprehensive income of associate	24	3,205	-
Total comprehensive income for the year attributable to owners of the parent		130,449	88,950

TESCO PERSONAL FINANCE PLC

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 29 FEBRUARY 2012

	Note	2012 £'000	2011 £'000
Assets			
Cash and balances with central banks	16	455,809	136,848
Loans and advances to banks	17	93,132	403,598
Loans and advances to customers.	18	4,423,582	4,679,184
Derivative financial instruments	19	19,522	16,378
Investment securities:			
- Available for sale	20	1,302,731	849,831
- Loans and receivables	20	292,931	292,931
Prepayments and accrued income	21	43,360	79,491
Other assets	22	454,815	142,668
Investment in associate	24	72,459	63,985
Intangible assets	26	336,995	215,275
Property, plant and equipment	27	109,807	111,373
Total assets		7,605,143	6,991,562
Liabilities			
Deposits from banks	28	77,706	36,200
Deposits from customers	29	5,389,787	5,077,464
Debt securities in issue	30	197,849	350,031
Derivative financial instruments	19	71,186	37,369
Provisions for liabilities and charges	31	78,341	39,477
Accruals and deferred income	32	132,370	185,151
Current income tax liability		2,969	2,789
Other liabilities	33	106,139	18,067
Deferred income tax liability	25	28,770	5,022
Subordinated liabilities	34	330,000	190,000
Total liabilities		6,415,117	5,941,570
Equity			
Shareholders' funds:			
- Share capital	35	103,490	92,340
- Share premium account	35	931,410	831,060
- Retained earnings		90,244	79,341
- Other reserves	36	19,882	2,251
Subordinated notes	37	45,000	45,000
Total equity		1,190,026	1,049,992
Total liabilities and equity		7,605,143	6,991,562

The consolidated financial statements on pages 15 – 105 were approved by the Board of Directors and authorised for issue on 27 April 2012 and were signed on its behalf by:


Graham Pimlott
Chairman

TESCO PERSONAL FINANCE PLC

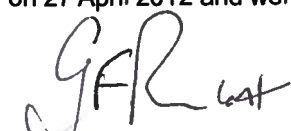
COMPANY STATEMENT OF FINANCIAL POSITION

AS AT 29 FEBRUARY 2012

Company number SC173199

	Note	2012 £'000	2011 £'000
Assets			
Cash and balances with central banks	16	455,766	136,808
Loans and advances to banks	17	93,132	323,136
Loans and advances to customers	18	4,423,582	4,679,184
Derivative financial instruments	19	19,522	16,378
Investment securities:			
- Available for sale	20	1,302,731	849,831
- Loans and receivables	20	292,931	292,931
Prepayments and accrued income	21	43,356	111,676
Other assets	22	454,906	200,891
Investment in group undertakings	23	-	-
Investment in associate	24	71,708	71,708
Intangible assets	26	336,995	215,275
Property, plant and equipment	27	109,807	111,373
Total assets		7,604,436	7,009,191
Liabilities			
Deposits from banks	28	77,706	36,200
Deposits from customers	29	5,389,787	5,077,464
Debt securities in issue	30	197,849	350,255
Derivative financial instruments	19	71,186	37,369
Provisions for liabilities and charges	31	78,341	39,477
Accruals and deferred income	32	132,370	185,151
Current income tax liability		2,969	3,366
Other liabilities	33	106,138	24,919
Deferred income tax liability	25	28,787	5,022
Subordinated liabilities	34	330,000	190,000
Total liabilities		6,415,133	5,949,223
Equity			
Shareholders' funds:			
- Share capital	35	103,490	92,340
- Share premium account	35	931,410	831,060
- Retained earnings		92,726	89,317
- Other reserves	36	16,677	2,251
Subordinated notes	37	45,000	45,000
Total equity		1,189,303	1,059,968
Total liabilities and equity		7,604,436	7,009,191

The financial statements on pages 15 – 105 were approved by the Board of Directors and authorised for issue on 27 April 2012 and were signed on its behalf by:


Graham Pimlott
Chairman

TESCO PERSONAL FINANCE PLC

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 29 FEBRUARY 2012

	Share capital	Share premium account	Retained earnings	Sub- ordinated notes	Other reserves	Total	Non- controll ing interest	Total equity
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Balance at 1 March 2011	92,340	831,060	79,341	45,000	2,251	1,049,992	-	1,049,992
Comprehensive income								
Profit for the year	-	-	119,990	-	-	119,990	-	119,990
Net gains on available for sale investment securities	-	-	-	-	7,053	7,053	-	7,053
Net gains on cash flow hedges	-	-	-	-	201	201	-	201
Share of other comprehensive income of associate	-	-	-	-	3,205	3,205	-	3,205
Total comprehensive income	-	-	119,990	-	10,459	130,449	-	130,449
Transactions with owners								
Shares issued in the year	11,150	100,350	-	-	-	111,500	-	111,500
Dividends to ordinary shareholders	-	-	(108,150)	-	-	(108,150)	-	(108,150)
Dividends to holders of other equity	-	-	(937)	-	-	(937)	-	(937)
Share based payments	-	-	-	-	7,172	7,172	-	7,172
Total transactions with owners	11,150	100,350	(109,087)	-	7,172	9,585	-	9,585
Balance at 29 February 2012	103,490	931,410	90,244	45,000	19,882	1,190,026	-	1,190,026

	Share capital	Share premium account	Retained earnings	Sub- ordinated notes	Other reserves	Total	Non- controll ing interest	Total equity
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Balance at 1 March 2010	47,790	430,110	155,799	45,000	(153)	678,546	2,005	680,551
Comprehensive income								
Profit for the year	-	-	86,546	-	-	86,546	-	86,546
Net gains on available for sale investment securities	-	-	-	-	1,615	1,615	-	1,615
Net gains on cash flow hedges	-	-	-	-	789	789	-	789
Total comprehensive income	-	-	86,546	-	2,404	88,950	-	88,950
Transactions with owners								
Shares issued in the year	44,550	400,950	-	-	-	445,500	-	445,500
Dividends to ordinary shareholders	-	-	(162,150)	-	-	(162,150)	-	(162,150)
Dividends to holders of other equity	-	-	(854)	-	-	(854)	(2,005)	(2,859)
Total transactions with owners	44,550	400,950	(163,004)	-	-	282,496	(2,005)	280,491
Balance at 28 February 2011	92,340	831,060	79,341	45,000	2,251	1,049,992	-	1,049,992

TESCO PERSONAL FINANCE PLC

COMPANY STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 29 FEBRUARY 2012

	Share capital £'000	Share premium account £'000	Retained earnings £'000	Subordinated notes £'000	Other reserves £'000	Total equity £'000
Balance at 1 March 2011	92,340	831,060	89,317	45,000	2,251	1,059,968
Comprehensive income						
Profit for the year	-	-	112,496	-	-	112,496
Net gains on available for sale investment securities	-	-	-	-	7,053	7,053
Net gains on cash flow hedges	-	-	-	-	201	201
Total comprehensive income	-	-	112,496	-	7,254	119,750
Transactions with owners						
Shares issued in the year	11,150	100,350	-	-	-	111,500
Dividends to ordinary shareholders	-	-	(108,150)	-	-	(108,150)
Dividends to holders of other equity	-	-	(937)	-	-	(937)
Share based payments	-	-	-	-	7,172	7,172
Total transactions with owners	11,150	100,350	(109,087)	-	7,172	9,585
Balance at 29 February 2012	103,490	931,410	92,726	45,000	16,677	1,189,303

	Share capital £'000	Share premium account £'000	Retained earnings £'000	Subordinated notes £'000	Other reserves £'000	Total equity £'000
Balance at 1 March 2010	47,790	430,110	152,952	45,000	(153)	675,699
Comprehensive income						
Profit for the year	-	-	99,369	-	-	99,369
Net gains on available for sale investment securities	-	-	-	-	1,615	1,615
Net gains on cash flow hedges	-	-	-	-	789	789
Total comprehensive income	-	-	99,369	-	2,404	101,773
Transactions with owners						
Shares issued in the year	44,550	400,950	-	-	-	445,500
Dividends to ordinary shareholders	-	-	(162,150)	-	-	(162,150)
Dividends to holders of other equity	-	-	(854)	-	-	(854)
Total transactions with owners	44,550	400,950	(163,004)	-	-	282,496
Balance at 28 February 2011	92,340	831,060	89,317	45,000	2,251	1,059,968

TESCO PERSONAL FINANCE PLC

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 29 FEBRUARY 2012

	Note	2012 £'000	2011 £'000
Operating activities			
Profit before taxation		159,551	124,340
Adjusted for:			
Non cash items included in operating profit before taxation	45	239,036	100,981
Changes in operating assets and liabilities	45	230,329	163,781
Income tax paid		(18,128)	(5,275)
Cash flows generated from operating activities		610,788	383,827
Investing activities			
Purchase of non-current assets		(165,431)	(206,586)
Purchase of available for sale investment securities		(729,368)	(424,357)
Sale of available for sale investment securities		183,072	165,756
Loan to associate		-	(34,431)
Investment in associate	24	-	(68,851)
Cash flows used in investing activities		(711,727)	(568,469)
Financing activities			
Proceeds from issue of debt securities		59,587	125,559
Proceeds from issue of subordinated liabilities		140,000	-
Redemption of own debt securities		(225,000)	-
Proceeds from issue of share capital	35	111,500	445,500
Dividends paid to ordinary shareholders		(108,150)	(162,150)
Dividends paid to non controlling interest		-	(2,005)
Dividends paid to holders of other equity		(673)	(714)
Interest paid on subordinated liabilities		(3,712)	(2,783)
Cash flows (used in)/generated from financing activities		(26,448)	403,407
Net (decrease)/increase in cash and cash equivalents		(127,387)	218,765
Cash and cash equivalents at the beginning of the year		706,263	487,498
Cash and cash equivalents at the end of the year	44	578,876	706,263

TESCO PERSONAL FINANCE PLC

COMPANY CASH FLOW STATEMENT FOR THE YEAR ENDED 29 FEBRUARY 2012

	Note	2012 £'000	2011 £'000
Operating activities			
Profit before taxation		154,367	134,872
Adjusted for:			
Non cash items included in operating profit before taxation	45	244,081	94,385
Changes in operating assets and liabilities	45	310,927	157,827
Income taxes paid		(18,128)	(3,734)
Cash flows generated from operating activities		691,247	383,350
Investing activities			
Purchase of non-current assets		(165,431)	(206,586)
Purchase of available for sale investment securities		(729,368)	(424,357)
Sale of available for sale investment securities		183,072	165,756
Loan to associate		-	(34,431)
Investment in associate	24	-	(68,851)
Cash flows used in investing activities		(711,727)	(568,469)
Financing activities			
Proceeds from issue of debt securities		59,587	125,559
Proceeds from issue of subordinated liabilities		140,000	-
Redemption of own debt securities		(225,000)	-
Proceeds from issue of share capital	35	111,500	445,500
Dividends paid to ordinary shareholders		(108,150)	(162,150)
Dividends paid to holders of other equity		(673)	(714)
Interest paid on subordinated liabilities		(3,712)	(2,783)
Cash flows (used in)/generated from financing activities		(26,448)	405,412
Net (decrease)/increase in cash and cash equivalents		(46,928)	220,293
Cash and cash equivalents at the beginning of the year		625,761	405,468
Cash and cash equivalents at the end of the year	44	578,833	625,761

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

BASIS OF PREPARATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB, as endorsed by the European Union (EU), and those parts of the Companies Act applicable to companies reporting under IFRS.

The 'Company' means Tesco Personal Finance plc and the 'Group' means the Company and its subsidiaries and associated undertaking included in the consolidated financial statements.

During the financial year ended 29 February 2012 the Company concluded that it was no longer appropriate to take the exemption available under IAS 27 'Consolidated and separate financial statements' and the Companies Act 2006 from preparing group accounts. Accordingly, these financial statements have been prepared on a consolidated basis for the Group.

The consolidated financial statements are presented in Sterling, which is the functional currency of the Group. The figures shown in the financial statements are rounded to the nearest thousand unless otherwise stated.

GOING CONCERN

The Group has strengthened its capital position during the year and has made steady growth in diversifying its funding base through the Fixed Rate Saver products. The majority of the Group's balance sheet continues to be funded by retail deposits. The Directors have made a formal assessment of going concern, taking into account both current performance and the Group's outlook, including consideration of projections for the Group's capital and funding position. As a result of this assessment the Directors consider the Group to be in a satisfactory financial position and confirm that the Group has adequate resources to continue in business in the foreseeable future. Accordingly, the Directors continue to adopt the going concern basis in preparing the financial statements.

PRINCIPAL ACCOUNTING POLICIES

a) ACCOUNTING CONVENTION

The Company is incorporated and domiciled in the UK and registered in Scotland. The financial statements have been prepared on the historical cost basis as modified by the revaluation of certain financial assets and liabilities (including derivative instruments) at fair value. A summary of the Group's accounting policies is set out below. These policies have been consistently applied to all of the years presented, unless otherwise stated.

b) BASIS OF CONSOLIDATION

The consolidated financial statements of the Group comprise the financial statements of the Company and all consolidated subsidiaries, including certain securitisation special purpose entities, and the Group's share of its interests in associates as at 29 February 2012.

Investment in group undertakings

A subsidiary is an entity in which the Group directly or indirectly holds the majority of the voting rights and where it determines its financial and business policies and is able to exercise control over it in order to benefit from its activities.

The results of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intragroup balances, and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

The Company's investments in its subsidiaries are stated at cost less any impairment.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES (continued)

Interests in the equity of subsidiaries not attributable to the parent are reported in consolidated equity as non-controlling interests.

Investment in associate

An associate is an entity over which the Group has significant influence and can participate in the financial and operating policy decisions of the entity.

The Group's share of the results of associates is included in the consolidated income statement using the equity method of accounting. Investments in associates are carried in the statement of financial position at cost plus post-acquisition changes in the Group's share of the net assets of the entity, less any impairment.

If the Group's share of losses in an associate equals or exceeds its investment in the associate, the Group does not recognise further losses, unless it has incurred obligations to do so or made payments on behalf of the associate.

The Company's investment in its associate is stated at cost less any impairment.

c) NET INTEREST INCOME RECOGNITION

Interest income on financial assets that are classified as loans and receivables or available for sale, and interest expense on financial liabilities are determined using the effective interest rate method. The effective interest rate method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees receivable, that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual and behavioural terms of a financial instrument are considered when estimating future cash flows.

d) NON INTEREST INCOME RECOGNITION

Fees in respect of services (primarily credit card interchange fees and ATM revenue) are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable.

The Group generates commission from the sale and service of Motor and Home insurance policies underwritten by Tesco Underwriting Limited, or in a minority of cases by a third party underwriter. This is based on commission rates which are independent of the profitability of underlying insurance policies. Similar commission income is also generated from the sale of white label insurance products underwritten by other third party providers. This commission income is recognised as such policies are sold.

The Group continues to receive insurance commission arising from the sale of insurance policies sold under the Tesco brand through the legacy arrangement with The Royal Bank of Scotland Public Limited Company (RBS). This commission income is variable and dependant upon the profitability of the underlying insurance policies. This commission income is recognised over the life of the policies.

Revenue recognition – customer loyalty programmes

The Group participates in the customer loyalty programme operated by Tesco Stores Limited. The programme operates by allowing customers to accumulate Clubcard points on purchases for future redemption against a range of Tesco products. The cost of providing Clubcard points to customers is recharged by Tesco Stores Limited to the Group and is treated as a deduction from non interest income in the financial statements of the Group in the period the costs are incurred.

The Group has no obligation to customers in respect of Clubcard points once the obligation with Tesco Stores Limited is settled.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES (continued)

e) GOVERNMENT GRANTS

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to property, plant and equipment are included in deferred income as deferred government grants and are credited to the income statement on a straight-line basis over the expected lives of the related assets.

Where a government grant relates to both costs and expenditure on property, plant and equipment it may be appropriate to allocate part of the grant on one basis and part on another.

f) DIVIDEND INCOME

Dividends are recognised in the consolidated income statement when the entity's right to receive payment is established.

g) TAXATION

The tax expense included in the consolidated income statement consists of current and deferred tax.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted by the balance sheet date. Tax is recognised in the consolidated income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in other comprehensive income or equity, respectively.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is calculated at the tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited in the consolidated income statement, except when it relates to items charged or credited directly to equity or other comprehensive income, in which case the deferred tax is also recognised in equity, or other comprehensive income, respectively.

Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are offset against each other when there is a legally enforceable right to set-off current taxation assets against current taxation liabilities and it is the intention to settle these on a net basis.

h) FOREIGN CURRENCIES

Foreign currency transactions that are transaction denominated, or that require settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions.

Monetary items denominated in foreign currency are translated with the closing rate as at the reporting date. Non-monetary items measured at historical cost denominated in a foreign currency are translated with the exchange rate as at the date of initial recognition; non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rates at the date when the fair value was determined.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES (continued)

translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated income statement, except when deferred in equity as gains or losses from qualifying cash flow hedging instruments.

All foreign exchange gains and losses recognised in the consolidated income statement are presented net in the consolidated income statement within the corresponding item. Foreign exchange gains and losses on other comprehensive income items are presented in other comprehensive income within the corresponding item.

In the case of changes in the fair value of monetary assets denominated in foreign currency classified as available for sale, a distinction is made between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in the consolidated income statement, and other changes in the carrying amount, except impairment, are recognised in equity.

i) CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand and demand deposits with banks together with short-term highly liquid investments of less than 3 months maturity, that are readily convertible to known amounts of cash and subject to insignificant risk of changes in value.

j) FINANCIAL ASSETS

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss, loans and receivables and available for sale. Management determines this classification at initial recognition.

i) Financial assets at fair value through profit and loss – This can be classified into the following two categories; assets designated at fair value through profit and loss at inception and financial assets held for trading.

The Group does not currently hold any financial assets designated at fair value through profit and loss at inception. Where the Group holds derivatives that are unable to be designated as hedging instruments these are classified as held for trading.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to the consolidated income statement. Gains and losses arising from changes in fair value are included directly in the consolidated income statement and reported separately.

ii) Loans and receivables – The Group's loans and advances to banks, customers and other entities with fixed or determinable repayments that are not quoted in an active market, are classified as loans and receivables. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method less any impairment losses.

iii) Available for sale – Available for sale investments are those intended to be held for an indefinite period of time, which may be sold in response to the need for liquidity or changes in interest rates, exchange rates or other market prices.

Available for sale financial assets are initially recognised at fair value plus transaction costs and measured subsequently at fair value with gains and losses being recognised in the statement of comprehensive income (except for impairment losses and foreign exchange gains and losses which are immediately recognised through the income statement) until the financial asset is derecognised.

If an available for sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in the statement of comprehensive income is recognised in the income statement. Interest on available for sale assets is calculated using the effective interest method.

The Group records contracts that take place on the date at which the contract has been entered into.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES (continued)

k) FINANCIAL LIABILITIES

The Group classifies its financial liabilities into two categories as below. Management determines this classification at initial recognition.

i) Financial liabilities held at fair value through profit and loss or other financial liabilities which are measured at amortised cost – This includes the following balance sheet categories; deposits from banks or customers, debt securities in issue for which the fair value option is not applied, and subordinated debt.

ii) Derivative financial liabilities – This includes derivatives which are held at fair value through the income statement.

l) DERECOGNITION OF FINANCIAL ASSETS AND LIABILITIES

Financial assets and liabilities are derecognised when the rights to receive cash flows have expired or where substantially all of the risks and rewards of ownership have been transferred and the transfer qualifies for derecognition.

Collateral furnished by the Group under standard repurchase agreements is not derecognised because the Group retains substantially all the risks and rewards on the basis of the predetermined repurchase price, therefore the criteria for derecognition are not met. This also applies to certain securitisation transactions in which the Group retains a portion of the risks. There are no securitisation notes in issue as at 29 February 2012.

m) OFFSETTING OF FINANCIAL INSTRUMENTS

Financial assets and liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a current enforceable legal right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise an asset and settle the liability simultaneously.

n) IMPAIRMENT OF FINANCIAL ASSETS

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

i) Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition. Impairment losses are assessed individually for financial assets that are individually significant and collectively for assets that are not individually significant. In making the collective assessment of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of currently observable data, to reflect the effects of current conditions that did not affect the historical period.

Impairment losses are recognised in the consolidated income statement and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If in a subsequent year the amount of the impairment loss reduces and the reduction can be related objectively to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

ii) Financial assets classified as available for sale – in the case of investment securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for available for sale financial assets, the cumulative loss – measured as the difference between the acquisition

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES (continued)

cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the consolidated income statement. Impairment losses recognised in the income statement on investment securities are not reversed through the consolidated income statement. If, in a subsequent year, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the consolidated income statement.

o) DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

The Group uses derivative financial instruments to hedge its exposure to interest rate and foreign exchange risks arising from operating, financing and investment activities. The Group does not hold or issue derivative financial instruments for trading purposes.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from valuation techniques (for example for swaps and currency transactions) including discounted cash flow models using solely observable market data. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated and qualifies as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either:

- i) Hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedges); or
- ii) Hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges).

The Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the consolidated income statement.

Amounts accumulated in equity are recycled to the consolidated income statement in the years when the hedged item affects profit or loss. They are recorded in the revenue or expense lines in which the related hedged item is reported.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the consolidated income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the consolidated income statement.

Fair value hedges

The Group currently applies fair value hedge accounting for hedging fixed interest rate risk which is inherent in the writing of fixed rate loans business and the holding of fixed rate investment securities. The hedge protects against fluctuations in the fair value of the fixed rate loans as interest rates move. The hedge achieves the desired risk management objective of a floating rate LIBOR based return by swapping the fixed rates receivable on loans and investment securities for floating rates.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES (continued)

the consolidated income statement, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The net result is included as ineffectiveness within net interest income.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to profit or loss over the period to maturity and recorded as net interest income.

Derivatives not in hedge accounting relationships

The gain or loss relating to derivatives classified as trading is recognised in the consolidated income statement within gains/(losses) on financial assets.

p) IMPAIRMENT OF INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES

At each reporting date, the Group assesses whether there is any indication that its investments held in subsidiaries and associates are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset. If the carrying value exceeds the recoverable amount then a provision for impairment is made to reduce the carrying value to the recoverable amount. No investments in subsidiaries or associates were impaired as at 29 February 2012 (2011: nil).

q) PROPERTY, PLANT AND EQUIPMENT

Items of plant, property and equipment are stated at historical cost less accumulated depreciation (refer below) and any impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Where an item of plant and equipment comprises major components having different useful lives, they are accounted for separately.

Depreciation is charged to the consolidated income statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Depreciation commences on the date that the asset is brought into use. Work In Progress assets are not depreciated until they are brought into use and transferred to the appropriate category of property, plant and equipment. Estimated useful lives for property, plant and equipment are:

• Plant and Equipment	2 to 8 years
• Fixture and Fittings	4 to 14 years
• Computer Hardware	3 to 7 years
• Leasehold Improvements	15 to 20 years
• Freehold buildings	40 years

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in administrative expenses in the consolidated income statement.

Property, plant and equipment are reviewed for impairment in accordance with International Accounting Standard (IAS) 36 'Impairment of Assets' annually or when there are indications that the carrying value may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use. No property, plant and equipment were impaired as at 29 February 2012 (2011: nil).

r) INTANGIBLE ASSETS

Acquired intangible assets

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the consolidated income statement on a straight-line basis over their estimated useful lives. The estimated useful lives are as follows:

• Computer software	3 to 10 years
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Internally generated intangible assets – research and development expenditure

Research costs are expensed as incurred.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES (continued)

Development expenditure incurred on an individual project is capitalised only if the following criteria are met:

- An asset is created that can be identified (such as software);
- It is probable that the asset created will generate future economic benefits; and
- The development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the estimated useful lives of the assets created. Amortisation commences on the date that the asset is brought into use. As assets categorised as Work In Progress are brought into use the assets are transferred to the appropriate classification within intangible assets.

Intangible assets are reviewed for impairment in accordance with IAS 36 'Impairment of Assets' annually or when there are indications that the carrying value may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use. No intangible assets were impaired as at 29 February 2012 (2011: nil).

s) LEASES

If the lease does not transfer the risks and rewards of ownership of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to the consolidated income statement on a straight line basis over the period of the lease. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to the consolidated income statement in the period in which the termination is made. The Group has entered into a number of operating leases for office buildings.

t) EMPLOYEE BENEFITS

The Group accounts for pension costs on a contributions basis in line with the requirements of IAS 19. The Group makes contributions to the Tesco plc scheme.

IAS 19 requires that where there is no policy or agreement for sharing the cost of the IAS 19 charge across the subsidiaries that the Sponsoring employer recognises the net defined benefit cost of a defined benefit scheme. The Sponsoring employer is Tesco plc and the principal pension plan is the Tesco plc pension scheme. The scheme is a funded defined benefit scheme in the UK, the assets of which are administered by trustees. Tesco plc has recognised the appropriate net liability of the scheme.

u) SHARE BASED PAYMENTS

Employees of the Group receive part of their remuneration in the form of share-based payment transactions, whereby employees render services in exchange for Tesco plc shares or rights over shares (equity-settled transactions) or in exchange for entitlements to cash based payments based on the value of the shares (cash-settled transactions).

The fair value of employee share option plans is calculated at the grant date using the Black-Scholes model. In accordance with IFRS 2 'Share-based payment', the resulting cost is charged to the consolidated income statement over the vesting period. The value of the charge is adjusted to reflect expected and actual levels of vesting.

The grant by Tesco plc of options over its equity instruments to the employees of the Group is treated as a capital contribution in equity. The social security contribution payable in connection with the grant of the share options is considered an integral part of the grant itself, and the charge is treated as a cash-settled transaction.

v) PROVISIONS FOR LIABILITIES AND CHARGES AND CONTINGENT LIABILITIES

A provision is recognised where there is a present legal or constructive obligation as a result of a past event, it is probable that the obligation will be settled and the amount of the obligation can be reliably estimated.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES (continued)

w) CAPITAL INSTRUMENTS

The Group classifies a financial instrument that it issues as a financial asset, financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms.

An instrument is classified as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities.

x) SHARE CAPITAL

i) Share issue costs – Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

ii) Dividends on shares – Dividends on shares are recognised in equity in the period they are approved by the Group's Board.

y) SECURITISATION TRANSACTIONS

The Group enters into securitisation transactions in which it sells Medium Term Notes to a Special Purpose Entity (SPE) and issues securities backed by the cash flows from the securitised credit card receivables. Although none of the equity of the SPE is owned by the Group, the nature of these entities, which are in substance controlled by the Group, mean that the Group retains substantially all the risks and rewards of ownership of the securitised credit card receivables. As such the SPEs are consolidated on a line by line basis in the Group consolidated financial statements.

As at 29 February 2012 there were no securitisation notes in issue in relation to securitisation transactions.

z) SEGMENT REPORTING

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. The Group has determined the Board of Directors as its chief operating decision-maker.

Income and expenses directly associated with each segment are included in determining business segment performance.

In accordance with IFRS 8, the Group has the following business segments: retail banking and insurance.

aa) STANDARDS, AMENDMENTS AND INTERPRETATIONS, WHICH BECAME EFFECTIVE IN 2011 AND ARE RELEVANT TO THE GROUP

The following standards, amendments and interpretations, which became effective in 2011, are relevant to the Group:

- i) Amendment to IAS 24, 'Related Party Transactions'. The amendment changes the definition of a related party and modifies certain related-party disclosure requirements for government-related entities. This has no impact on the Group.
- ii) Improvements to IFRSs (2010) – These improvements contain numerous amendments to IFRS that the IASB consider non-urgent but necessary. This has no material impact on the Group's accounting policies.

ab) STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

The following standards and interpretations have been issued and are mandatory for the Group's accounting periods beginning on or after 1 March 2012 or later periods and are expected to be relevant to the Group. The impact of these new standards and interpretations is still being assessed:

- IAS 1, 'Financial statement presentation' regarding other comprehensive income (effective annual periods beginning on or after 1 July 2012)

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES (continued)

- IAS 12, 'Income taxes' on deferred tax (effective annual periods beginning on or after 1 January 2012)
- IAS 19, 'Employee benefits' (effective annual periods beginning on or after 1 January 2013)
- IFRS 7, 'Financial instruments: Disclosures' on derecognition (effective annual periods beginning on or after 1 July 2011)
- IFRS 9, 'Financial instruments' (effective annual periods beginning on or after 1 January 2015)
- IFRS 10, 'Consolidated financial statements' (effective annual periods beginning on or after 1 January 2013)
- IFRS 11, 'Joint arrangements' (effective annual periods beginning on or after 1 January 2013)
- IFRS 12, 'Disclosures of interests in other entities' (effective annual periods beginning on or after 1 January 2013)
- IFRS 13, 'Fair value measurement' (effective annual periods beginning on or after 1 January 2013)
- IAS 27 (revised 2011), 'Separate financial statements' (effective annual periods beginning on or after 1 January 2013)
- IAS 28 (revised 2011), 'Associates and joint ventures' (effective annual periods beginning on or after 1 January 2013)

ac) EARLY ADOPTION STANDARDS

The Group did not early-adopt any new or amended standards in the year ended 29 February 2012.

2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. The Group's principal accounting policies are set out above. United Kingdom company law and IFRS require the Directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. Where accounting standards are not specific and management have to choose a policy, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' requires them to adopt policies that will result in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB Framework for the Preparation and Presentation of Financial Statements.

The judgements and assumptions involved in the Group's accounting policies that are considered to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

a) LOAN IMPAIRMENT PROVISIONS

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of customer loans classified as loans and receivables and carried at amortised cost. A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

At 29 February 2012, gross loans and receivables totalled £4,608,213,000 (2011: £4,861,005,000) and loan impairment provisions amounted to £184,631,000 (2011: £181,821,000).

The Group's loan impairment provisions are established on a portfolio basis taking into account the level of arrears, security, past loss experience and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates. These portfolios include credit card receivables and other personal advances. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, unemployment levels, payment behaviour and bankruptcy trends.

b) PROVISION FOR CUSTOMER REDRESS

The Group has a provision for potential customer redress. In the prior year, the Financial Services Authority (FSA) formally issued Policy Statement 10/12 (PS 10/12), which introduced new guidance in respect of Payment Protection Insurance (PPI) customer redress and evidential provisions to the FSA Handbook with

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

an implementation date of 1 December 2010. The Group continues to handle complaints and redress customers in accordance with PS 10/12. This will include ongoing analysis of historical claims experience in accordance with the guidance.

The calculation of this provision involves estimating a number of variables, principally the level of customer complaints which may be received and the level of any compensation which may be payable to customers. The number of cases on which compensation is ultimately payable may also be influenced by the outcome of the analysis of historical claims referred to above. A change in the estimate of any of the key variable in this calculation could have the potential to significantly impact the provision recognised. The carrying amount of this provision at 29 February 2012 is £74,546,000 (2011: £39,477,000).

c) INSURANCE RESERVES

Until October 2010 all Tesco Bank branded insurance products were sold through the RBS Insurance partner. From November 2011, therefore, all general insurance policies sold through the arrangement with RBS Insurance had expired. There are however a number of outstanding claims which have yet to be settled. RBS holds insurance reserves against those unsettled claims. In addition, there remains £255,000,000 of loan capital provided to RBS Insurance to support these claims over and above the reserves held. Due to the nature of the insurance claims, uncertainty exists around the ultimate cost of settling these. Commission receivable from RBS Insurance is also dependent on the estimated cost of settling these claims.

Under the terms of the arrangement with RBS Insurance it is likely that a claims reserve will be determined by the end of the next financial year (February 2013) to cover all unsettled claims at that date. This reserve (the Termination Reserve) will drive a final commission settlement resulting in either a final payment of commission from RBS Insurance or a rebate of previously paid commission by the Group. The loan capital provided to RBS Insurance would also become due for repayment at this point. The Termination Reserve will be agreed by both the Group and RBS Insurance or, in the eventuality of material disagreement, set by an independent arbiter. The reserve determined is dependent therefore on the combined impact of the actual claims run-off until October 2012 and on the assumptions underpinning the estimate of the quantum of unpaid claims. Since the number of new claim notifications is expected to be insignificant now that the exposure has run-off, the key uncertainty in determining the Termination Reserve will therefore be the assessment of the cost of settling existing claims. This cost is dependent on a number of factors including court/legal rulings on individual large losses, the extent to which claims developments impact the reinsurance protection in place and the proportion of claims settling with periodic payment orders (PPOs). The nature of these factors (together with the lack of relevant data on PPOs and the potential for disagreement with RBS Insurance) is such that it is not possible at this time to quantify the uncertainty around the eventual cost as at 29 February 2012.

d) EFFECTIVE INTEREST RATE

In calculating the effective interest rate of a financial instrument the Group takes into account all amounts that are integral to the yield. In the case of loans and advances to customers judgement is applied in estimating future cash flows. Judgement is also required in estimating the expected average life of customer debt balances. A change in the estimate of any of the key variables in this calculation could have the potential to significantly impact income recognised in the consolidated income statement.

3 SEGMENTAL REPORTING

Following the management approach of IFRS 8, operating segments are reported in accordance with the internal reporting provided to the Chief Executive and the Board of Directors, who are responsible for allocating resources to the reporting segments and assessing their performance. All operating segments used by the Group meet the definition of a reportable segment under IFRS 8.

The Group has two main operating segments:

- Retail banking - incorporating loans, credit cards, savings accounts, ATMs and transactional services; and
- Insurance - incorporating motor, home, pet, travel and other insurance products.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

3 SEGMENTAL REPORTING (continued)

There are no transactions between the operating segments.

Segment assets and liabilities comprise operating assets and liabilities, being the majority of the statement of financial position, but exclude items such as taxation. Tax balances are reflected in the adjustments column in part b) of this note.

a) Segment results of operations

Group	Retail banking £'000	Insurance £'000	Central costs £'000	Total £'000
2012				
Interest and similar income	424,132	1,515	-	425,647
Interest expense and similar charges	(166,596)	(5)	-	(166,601)
Fees and commissions income	285,447	232,473	-	517,920
Fees and commissions expense	(22,530)	-	-	(22,530)
Provision for customer redress	(57,400)	-	-	(57,400)
Gains on financial assets	498	-	-	498
Realised gain on investment securities	4,749	-	-	4,749
Administrative expenses*	(184,335)	(72,665)	(121,945)	(378,945)
Depreciation and amortisation	-	-	(44,545)	(44,545)
Impairment	(119,028)	(5,483)	-	(124,511)
Share of profit of associate	-	5,269	-	5,269
Profit/(loss) before tax	164,937	161,104	(166,490)	159,551
Total assets**	6,887,607	717,536	-	7,605,143
Total liabilities	6,354,316	29,062	-	6,383,378

* The Retail banking and Insurance segments include only directly attributable administrative costs such as marketing and operational costs. Central overhead costs which reflect the overhead of operating both the insurance and banking businesses are not allocated against an operating segment for internal reporting purposes.

** The investment of £72,459,000 (2011: £63,985,000) in Tesco Underwriting Limited, an associate company accounted for using the equity method, is shown within the total assets of the Insurance segment.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

3 SEGMENTAL REPORTING (continued)

Group	Retail banking £'000	Insurance £'000	Central costs £'000	Total £'000
2011				
Interest and similar income	420,161	-	-	420,161
Interest expense and similar charges	(147,128)	-	-	(147,128)
Fees and commissions income***	270,556	15,175	-	285,731
Fees and commissions expense	(20,291)	-	-	(20,291)
Provision for customer redress	50,000	-	-	50,000
Losses on financial assets	(610)	-	-	(610)
Realised gain on investment securities	564	-	-	564
Administrative expenses*	(155,125)	(31,978)	(119,416)	(306,519)
Depreciation and amortisation	-	-	(19,391)	(19,391)
Impairment	(130,942)	(414)	-	(131,356)
Share of loss of associate	-	(6,821)	-	(6,821)
Profit/(loss) before tax	287,185	(24,038)	(138,807)	124,340
Total assets **	6,517,636	473,926	-	6,991,562
Total liabilities	5,916,799	16,960	-	5,933,759

*** The insurance commission income included within total income for the prior year is stated after a fourth quarter reduction of £99,347,000 in relation to legacy Motor Insurance claims.

b) Reconciliation of segment results of operations to results of operations

Group	Total management reporting £'000	Consolidation and adjustments £'000	Total consolidated £'000
2012			
Interest and similar income	425,647	-	425,647
Interest expense and similar charges	(166,601)	-	(166,601)
Fees and commissions income	517,920	-	517,920
Fees and commissions expense	(22,530)	-	(22,530)
Provision for customer redress	(57,400)	-	(57,400)
Gains on financial assets	498	-	498
Realised gain on investment securities	4,749	-	4,749
Administrative expenses	(378,945)	-	(378,945)
Depreciation and amortisation	(44,545)	-	(44,545)
Impairment	(124,511)	-	(124,511)
Share of profit of associate	5,269	-	5,269
Profit before tax	159,551	-	159,551
Total assets	7,605,143	-	7,605,143
Total liabilities	6,383,378	31,739	6,415,117

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

3 SEGMENTAL REPORTING (continued)

Group	Total management reporting £'000	Consolidation and adjustments £'000	Total consolidated £'000
2011			
Interest and similar income	420,161	-	420,161
Interest expense and similar charges	(147,128)	-	(147,128)
Fees and commissions income	285,731	-	285,731
Fees and commissions expense	(20,291)	-	(20,291)
Provision for customer redress	50,000	-	50,000
Losses on financial assets	(610)	-	(610)
Realised gain on investment securities	564	-	564
Administrative expenses	(306,519)	-	(306,519)
Depreciation and amortisation	(19,391)	-	(19,391)
Impairment	(131,356)	-	(131,356)
Share of loss of associate	(6,821)	-	(6,821)
Profit before tax	124,340	-	124,340
Total assets	6,991,562	-	6,991,562
Total liabilities	5,933,759	7,811	5,941,570

4 NET INTEREST INCOME

	2012 £'000	2011 £'000
Interest and similar income		
Loans and advances to customers	392,805	386,318
Loans and advances to banks	4,090	9,835
Fair value hedge ineffectiveness	4,825	11,359
Interest on investment securities	23,773	11,983
Other income	154	666
	425,647	420,161
Interest expense and similar charges		
Deposits from customers	(112,536)	(99,849)
Deposits from banks	(28,650)	(32,727)
Interest rate swap expenses	(20,954)	(11,359)
Subordinated liabilities	(4,461)	(3,193)
	(166,601)	(147,128)

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

5 NET FEES AND COMMISSIONS INCOME

	2012 £'000	2011 £'000
Fees and commissions income		
Banking fees and commission	279,850	259,784
Insurance income *	232,473	15,175
Other income	5,597	10,772
	517,920	285,731
Fees and commissions expense		
Banking expenses	(20,770)	(17,230)
Other expenses	(1,760)	(3,061)
	(22,530)	(20,291)

* The Insurance commission income included within Total Income for the prior year is stated after a fourth quarter reduction of £99,347,000 in relation to legacy Motor Insurance claims.

6 GAINS/(LOSSES) ON FINANCIAL ASSETS

	2012 £'000	2011 £'000
Foreign exchange loss on financial assets	(2,299)	(7,923)
Net gains arising on derivatives not designated as hedging instruments under the terms of IAS 39	2,797	7,313
	498	(610)

7 REALISED GAIN ON INVESTMENT SECURITIES

	2012 £'000	2011 £'000
<i>Financial assets classified as available for sale</i>		
Realised gain on disposals	4,749	564

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

8 ADMINISTRATIVE EXPENSES

	2012 £'000	2011 £'000
Staff costs (refer below)	117,040	77,572
Premises and equipment	63,111	61,620
Operating leases	5,239	6,047
Marketing	57,224	35,034
Auditors' remuneration (refer below)	572	387
Outsourcing and professional fees	106,386	95,057
Other administrative expenses	29,373	30,802
	378,945	306,519

The average monthly number of persons (including executive Directors) employed by the Group during the year was 2,818 (2011: 1,274), of which 18 (2011: 22) were seconded to another Group company, Tesco Personal Finance Compare Limited, during the year.

Staff costs (including executive Directors) for the year are as follows:

	2012 £'000	2011 £'000
Wages and salaries	74,796	47,304
Social security costs	6,566	3,888
Pension costs	6,002	3,161
Share based payments	2,944	6,162
Other costs including temporary staff	26,732	17,057
	117,040	77,572

Remuneration paid to the auditors for the year was as follows:

	2012 £'000	2011 £'000
Fees payable to the Company's auditors for the audit of the Company and consolidated annual financial statements	423	280
Fees payable for the audit of the Company's subsidiaries pursuant to legislation	39	37
	462	317
Fees payable to the Company's auditors for other assurance services	70	70
Fees payable to the Company's auditors for other services pursuant to legislation	40	-
	110	70

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

9 DEPRECIATION AND AMORTISATION

	2012 £'000	2011 £'000
Depreciation of property, plant and equipment (refer note 27)	15,857	11,458
Amortisation of intangible assets (refer note 26)	28,688	7,933
	44,545	19,391

10 IMPAIRMENT

	2012 £'000	2011 £'000
Impairment loss on loans and advances (refer note 18)	119,028	130,942
Impairment loss on amounts due in respect of insurance premiums and commissions receivable	5,483	414
	124,511	131,356

11 DIRECTORS' EMOLUMENTS

The remuneration of the Directors paid by the Group during the year was as follows:

	2012 £'000	2011 £'000
Aggregate emoluments	3,390	3,338
Aggregate amounts receivable under long-term incentive schemes	-	-
Company contributions to pension scheme	-	-
Total emoluments	3,390	3,338

	2012 Number	2011 Number
Number of directors to whom retirement benefits are accruing under defined benefit schemes	-	-
Number of directors in respect of whose qualifying services shares were received or receivable under long term incentive schemes	5	4
Number of directors who exercised share options in the year	-	-

The total emoluments of the highest paid Director were £1,077,000 (2011: £1,326,000). During the year the highest paid director did not exercise any share options.

At 29 February 2012 the accrued pension and lump sum under a defined benefit scheme for the highest paid Director was £nil (2011: £nil).

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

12 INCOME TAX EXPENSE

	2012 £'000	2011 £'000
Current tax charge for the year	39,485	25,865
Current tax (over)/under provided on profits for prior years	(23,550)	2,287
Total current tax	15,935	28,152
Deferred tax charge for the year	2,832	11,308
Impact of tax rate change	(1,422)	(189)
Deferred tax under/(over) provided on profits for prior years	22,216	(1,477)
Total deferred tax (refer note 25)	23,626	9,642
Income tax expense	39,561	37,794

The standard rate of corporation tax in the UK was changed from 28% to 26% with effect from 1 April 2011. This gives an overall blended Corporation Tax rate for the Group for the full year of 26.2 %.

The tax assessed for the year is lower (2011: higher) than the blended rate of corporation tax in the UK of 26.2% (2011: 28%). The differences are explained below:

	2012 £'000	2011 £'000
Profit before taxation	159,551	124,340
Profit on ordinary activities multiplied by blended rate in the UK 26.2% (2011: 28%)	41,802	34,815
Factors affecting charge for the year:		
Group relief surrendered without payment	(165)	(108)
Difference between local and group tax rate	5	-
Expenses not deductible for tax purposes	2,031	38
Adjustment to prior years – current tax	(23,550)	2,287
Adjustment to prior years – deferred tax	22,216	(1,477)
Share based payments	92	1,055
Other tax adjustments	(68)	(537)
Tax rate change	(1,422)	(189)
Share of (profit)/loss of associate	(1,380)	1,910
Income tax expense	39,561	37,794

A number of changes to the UK Corporation tax system were announced in the March 2011 UK Budget Statement. The Finance Act 2011 included legislation to reduce the main rate of corporation tax from 27% to 26% from 1 April 2011 and to 25% from 1 April 2012. The proposed reduction from 27% to 25% was substantively enacted at the balance sheet date. In the March 2012 UK Budget Statement it was announced that the rate would be reduced further from 25% to 24% from 1 April 2012 and proposals to reduce the rate by 1% per annum to 22% by 1 April 2014. These further changes had not been enacted at the balance sheet date and therefore, are not reflected in these consolidated financial statements.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

13 PROFIT OF THE COMPANY

Profit after tax for the year of £112,496,000 (2011: £99,369,000) is attributable to the operations of the Company. The income statement and statement of comprehensive income of the Company are not presented by virtue of the exemption contained within section 408 (3) of the Companies Act 2006.

14 DISTRIBUTIONS TO EQUITY HOLDERS

	2012 £'000	2011 £'000
Ordinary dividend paid	108,150	162,150
Interest paid on subordinated notes included within equity	937	854
	109,087	163,004

On 30 June 2011 an interim dividend of £0.0036 per ordinary share was paid. On 30 September 2011 a further interim dividend of £0.0045 per ordinary share was paid. On 28 February 2012 a final dividend of £0.0966 per ordinary share was paid, resulting in a total dividend payment for the year of £108,150,000.

In the prior year, an interim dividend of £0.0172 per ordinary share was paid on 30 September 2010, followed by a further dividend of £0.1624 per ordinary share paid on 25 February 2011. This resulted in a total dividend payment for the prior year of £162,150,000.

Interest payable on the subordinated notes included within equity is based on three month LIBOR plus 120 basis points.

15 INCOME TAX RELATING TO COMPONENTS OF OTHER COMPREHENSIVE INCOME

	Before tax amount £'000	Tax expense £'000	Net of tax amount £'000
2012			
Net gains on available for sale investment securities	9,473	(2,420)	7,053
Cash flow hedges	276	(75)	201
Other comprehensive income for the year	9,749	(2,495)	7,254
2011			
Net gains on available for sale investment securities	2,243	(628)	1,615
Cash flow hedges	1,099	(310)	789
Other comprehensive income for the year	3,342	(938)	2,404

Current tax on items charged to equity is £2,420,000 for the year (2011: £628,000) and deferred tax for the year is £75,000 (2011: £310,000)

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

16 CASH AND BALANCES WITH CENTRAL BANKS

Group	2012 £'000	2011 £'000
Cash at bank	26,620	11,754
Mandatory reserve deposits held with the Bank of England	5,088	4,240
Other balances held with the Bank of England	424,101	120,854
	455,809	136,848
Company	2012 £'000	2011 £'000
Cash at bank	26,577	11,714
Mandatory reserve deposits held with the Bank of England	5,088	4,240
Other balances held with the Bank of England	424,101	120,854
	455,766	136,808

Mandatory reserve deposits are not available for use in the Group's day to day operations and are non interest bearing. Other balances are subject to variable interest rates based on the Bank of England base rates.

17 LOANS AND ADVANCES TO BANKS

Group	2012 £'000	2011 £'000
Loans and advances to banks	93,132	403,598
Company	2012 £'000	2011 £'000
Loans and advances to banks	93,132	323,136

Loans and advances to banks represent cash and cash equivalents which had a maturity on original acquisition of less than three months.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

18 LOANS AND ADVANCES TO CUSTOMERS

Group and Company	2012 £'000	2011 £'000
Unsecured lending	4,583,113	4,845,499
Fair value hedge adjustment	25,100	15,506
Gross loans and advances to customers	<u>4,608,213</u>	<u>4,861,005</u>
Less: allowance for impairment	<u>(184,631)</u>	<u>(181,821)</u>
Net loans and advances to customers	<u>4,423,582</u>	<u>4,679,184</u>
Current	2,513,782	2,535,140
Non-current	1,909,800	2,144,044

As at the year end, £1,224,655,000 of the credit card portfolio has had legal interest assigned to a special purpose entity for use as collateral in securitisation transactions (2011: £1,355,995,000). As a result of the early repayment in May 2011 there are no securitisation notes in issue as at 29 February 2012 (2011: £1,165,500,000).

Fair value hedge adjustments amounting to £25,100,000 (2011: £15,506,000) are in respect of fixed rate loans. These adjustments reflect movements in interest rates from the date the loans were issued to the balance sheet date. These adjustments are largely offset by derivatives, which are used to manage interest rate risk and are designated as fair value hedges within loans and advances to customers.

The following table shows impairment provisions for loans and advances:

Group and Company	2012 £'000	2011 £'000
At beginning of year	181,821	313,991
Amounts written off	(120,187)	(268,252)
Recoveries of amounts previously written off	7,811	8,636
Charged to the income statement (refer note 10)	119,028	130,942
Unwind of discount	(3,842)	(3,496)
At end of year	<u>184,631</u>	<u>181,821</u>

19 DERIVATIVE FINANCIAL INSTRUMENTS

Strategy in using derivative financial instruments

The objective when using a derivative instrument is to ensure that the risk to reward profile of a transaction is optimised allowing the Group to manage its exposure to interest rate and foreign exchange rate risk. The intention is to only use derivatives to create economically effective hedges. There are specific requirements stipulated under IAS 39 which are necessary for a hedge to qualify for hedge accounting. As a result not all economic hedges are designated as accounting hedges, either because natural accounting offsets are expected or because obtaining hedge accounting would be especially onerous.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

19 DERIVATIVE FINANCIAL INSTRUMENTS (continued)

For those hedges where hedge accounting is applied, gains and losses on these hedging instruments and the hedged items are offset in the consolidated income statement. The Group does not intentionally hold trading positions in derivatives; however where a derivative held for economic hedging purposes does not qualify for hedge accounting, or if it has not specifically been designated as a hedge, these derivatives are categorised as held for trading in the statement of financial position.

a) Fair value hedges

At 29 February 2012 the Group had a portfolio of micro hedge relationships in place with an aggregate notional principal of £2,716,695,000 (2011: £2,188,582,000).

The Group's risk management objective to create economically effective hedges is to use interest rate contracts to swap fixed rate exposures back to a floating rate LIBOR basis. This includes the hedging of fixed rate customer loans, holdings of fixed rate investment securities and issuances of fixed rate debt, which protects the Group against the fair value volatility of these financial assets and liabilities due to movements in interest rates. Each swap is defined as hedging one or more fixed rate assets or liabilities.

The total fair value of derivatives held within fair value hedges at 29 February 2012 was a net liability of £53,085,000 (2011: £22,470,000). Included in the statement of comprehensive income is £28,625,000 of fair value losses on interest rate swaps in designated fair value hedges (2011: gains of £35,966,000), offset by fair value hedge adjustments on hedged items of £33,450,000 (2011: (£24,607,000)). The net balance of £4,825,000 (2011: £11,359,000) represents ineffectiveness in the fair value hedge relationships.

b) Cash flow hedges

The Group designated no interest rate swaps (2011: two) as cash flow hedges. In the prior year these swaps were used to hedge the variability in cash flows associated with floating rate borrowings.

The total fair value of derivatives included within cash flow hedges as at 29 February 2012 was a net liability of £nil (2011: £278,000).

In 2012, there is no ineffectiveness recognised in the consolidated income statement in respect of cash flow hedges (2011: nil).

There were no transactions for which cash flow hedge accounting had to be ceased in the current or prior year as a result of the highly probable cash flows no longer being expected to occur.

c) Derivatives not in hedge relationships

All derivative financial instruments are held for economic hedging purposes, although not all derivatives are designated as hedging instruments under the terms of IAS 39. The Group has the following derivative contracts in economic hedge relationships but not in accounting hedge relationships.

- Forward foreign exchange contracts to hedge the exchange rate risk of the initial funding of the euro credit card business and eventual repayments by customers.
- Forward foreign exchange contracts and cross currency swaps to hedge the exchange rate risk inherent in the investment securities denominated in foreign currencies.
- Forward foreign exchange contracts to hedge the exchange rate risk inherent in holding stock denominated in foreign currencies in travel money bureaux.
- Interest rate swaps which have never been in hedge accounting relationships and are viewed as trading derivatives under IAS 39.

The total fair value of derivatives not in hedge relationships as at 29 February 2012 was a net asset of £1,421,000 (2011: net asset of £1,757,000).

The analysis below splits derivatives between those classified in hedge accounting relationships and those not in hedge accounting relationships.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

19 DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Group and Company	Notional 2012 £'000	Asset fair value 2012 £'000	Liability fair value 2012 £'000
Derivatives in accounting hedge relationships			
<i>Derivatives designated as fair value hedges</i>			
Interest rate swaps	2,716,695	15,399	(68,484)
<i>Derivatives designated as cash flow hedges</i>			
Interest rate swaps	-	-	-
	2,716,695	15,399	(68,484)
Derivatives not in hedge accounting relationships			
<i>Interest rate derivatives</i>			
RPI basis swaps	60,000	360	(313)
Interest rate swaps	50,000	521	(521)
<i>Currency derivatives</i>			
Forward foreign exchange contracts	94,541	200	(1,018)
Cross currency Swaps	181,900	3,042	(850)
	386,441	4,123	(2,702)
	3,103,136	19,522	(71,186)
Group and Company			
	Notional 2011 £'000	Asset fair value 2011 £'000	Liability fair value 2011 £'000
Derivatives in accounting hedge relationships			
<i>Derivatives designated as fair value hedges</i>			
Interest rate swaps	2,188,582	13,492	(35,962)
<i>Derivatives designated as cash flow hedges</i>			
Interest rate swaps	55,000	-	(278)
	2,243,582	13,492	(36,240)
Derivatives not in hedge accounting relationships			
<i>Interest rate derivatives</i>			
RPI basis swaps	-	-	-
Interest rate swaps	50,000	821	(821)
<i>Currency derivatives</i>			
Forward foreign exchange contracts	63,769	117	(242)
Cross currency swaps	86,155	1,948	(66)
	199,924	2,886	(1,129)
	2,443,506	16,378	(37,369)

Derivatives, whether designated in hedge accounting relationships or not, are regarded as current where they are expected to mature within one year. All other derivatives are regarded as non-current.

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NOTES TO THE FINANCIAL STATEMENTS

19 DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Group and Company	Assets 2012 £'000	Assets 2011 £'000	Liabilities 2012 £'000	Liabilities 2011 £'000
Current	1,146	117	(7,940)	(6,723)
Non-current	18,376	16,261	(63,246)	(30,646)
	19,522	16,378	(71,186)	(37,369)

20 INVESTMENT SECURITIES

Group and Company	2012 £'000	2011 £'000
<i>Available for sale:</i>		
Government-backed investment securities	73,035	80,223
Gilts	541,354	188,059
Supranational investment securities	406,755	225,535
Other investment securities	201,348	112,696
Certificates of deposit	35,023	170,057
Asset-backed securities	45,216	73,261
	1,302,731	849,831
<i>Loans and receivables:</i>		
Loan to Direct Line Insurance Group Plc	258,500	258,500
Loan to Tesco Underwriting Limited	34,431	34,431
	292,931	292,931
Current	192,992	202,346
Non-current	1,402,670	940,416

There were no impairment charges within the year (2011: £nil).

Available for sale

Included in investment securities are fixed-interest investment securities totalling £1,111,982,000 (2011: £666,065,000) and variable-interest investment securities amounting to £190,749,000 (2011: £183,766,000).

Loans and receivables

The loan to Direct Line Insurance Group Plc (formerly the Royal Bank of Scotland Insurance Group Limited), a wholly owned subsidiary of The Royal Bank of Scotland Public Limited Company, comprises an undated interest free subordinated loan of £258,500,000. During the year impairment charges of £nil (2011: £nil) were recognised on the loan.

The loan to Tesco Underwriting Limited comprises a LIBOR +3.5% subordinated loan of £34,431,000. During the year impairment charges of £nil (2011: £nil) were recognised on the loan.

Assets pledged as collateral

Available for sale investment securities with a market value of £41,000,000 (2011: £44,554,000) are pledged as collateral under repurchase agreements with other banks. All collateral agreements mature within 12 months.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

21 PREPAYMENTS AND ACCRUED INCOME

Group	2012 £'000	2011 £'000
Prepayments	8,787	9,142
Accrued income	34,573	70,349
	43,360	79,491

Company	2012 £'000	2011 £'000
Prepayments	8,787	9,142
Accrued income	34,569	102,534
	43,356	111,676

All amounts are receivable within one year.

22 OTHER ASSETS

Group	2012 £'000	2011 £'000
Amounts due from Tesco Group subsidiaries	805	393
Amount due from insurance premiums and commissions receivable	352,146	117,010
Other assets	101,864	25,265
	454,815	142,668

Company	2012 £'000	2011 £'000
Amounts due from Tesco Group subsidiaries	805	393
Amount due from insurance premiums and commissions receivable	352,146	117,010
Other assets	101,955	83,488
	454,906	200,891

All amounts are receivable within one year.

23 INVESTMENT IN GROUP UNDERTAKINGS

The Company's investment in group undertakings in the prior year related to a 100% shareholding of the ordinary share capital in TPF ATM Services Limited which was incorporated in Scotland, and amounted to £2. This entity was dormant during both current and prior reporting periods and was liquidated on 16th December 2011.

Shares in group undertakings in the current year relates to a 100% shareholding of the ordinary share capital in Tesco CTF Nominees Limited which was incorporated in Scotland on 28 February 2012, and amounted to £1. This company was dormant in the current reporting period.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

24 INVESTMENT IN ASSOCIATE

Details of the Group's associate are as follows:

Name of company	Nature of business	Place of incorporation	Ownership interest	
			29 February 2012	28 February 2011
Tesco Underwriting Limited	Insurance	England	49.9%	49.9%

Tesco Underwriting Limited has a financial year end of 31 December 2011. The management accounts of Tesco Underwriting Limited are used to consolidate the results to 29 February 2012 within these financial statements.

The Group uses the equity method of accounting for associates. The following table shows the aggregate movement in the Group's investment in the associate in the year:

Group	2012 £'000	2011 £'000
At beginning of year	63,985	1,955
Acquisition of ordinary share capital	-	68,851
Share of profit/(loss) of associate	5,269	(6,821)
Share of available for sale reserve of associate	3,205	-
At end of year	<u>72,459</u>	<u>63,985</u>

The share of the assets, liabilities and profits/(losses) of the associate which are included in the consolidated financial statements are as follows:

Group	2012 £'000	2011 £'000
Non-current assets	360,963	162,758
Current assets	9,383	10,744
Current liabilities	(47,985)	(42,131)
Non-current liabilities	(252,748)	(70,232)
Net assets *	<u>69,613</u>	<u>61,139</u>
Revenue	230,466	13,302
Expenses including claims costs	(225,197)	(20,123)
Profit/(loss) for the year	<u>5,269</u>	<u>(6,821)</u>

*The share of net assets differs from the investment in associate balance at year end due to the capitalisation of legal costs associated with the set up of Tesco Underwriting Limited in 2010.

There are no contingent liabilities in respect of the associate.

The investment in associate is non-current.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

24 INVESTMENT IN ASSOCIATE (continued)

The Company carries the investment in associate at cost. The following table shows the aggregate movement in the Company's investment in the associate in the year:

Company	2012 £'000	2011 £'000
At beginning of year	71,708	2,857
Acquisition of ordinary share capital	-	68,851
At end of year	71,708	71,708

25 DEFERRED INCOME TAX ASSET/(LIABILITY)

The deferred tax asset/(liability) can be analysed as follows:

2012	Accelerated capital allowances £'000	Other £'000	Total £'000
Group			
At beginning of year	(12,807)	7,785	(5,022)
Charged to the consolidated income statement	(21,677)	(1,949)	(23,626)
Charged to equity	-	(122)	(122)
At end of year	(34,484)	5,714	(28,770)
2011	Accelerated capital allowances £'000	Other £'000	Total £'000
Group			
At beginning of year	(4,813)	9,743	4,930
Charged to the consolidated income statement	(7,994)	(1,648)	(9,642)
Charged to equity	-	(310)	(310)
At end of year	(12,807)	7,785	(5,022)
2012	Accelerated capital allowances £'000	Other £'000	Total £'000
Company			
At beginning of year	(12,807)	7,785	(5,022)
Charged to the income statement	(21,677)	(1,966)	(23,643)
Charged to equity	-	(122)	(122)
At end of year	(34,484)	5,697	(28,787)

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

25 DEFERRED INCOME TAX ASSET/(LIABILITY) (continued)

2011	Accelerated capital allowances £'000	Other £'000	Total £'000
Company			
At beginning of year	(4,813)	9,743	4,930
Charged to the income statement	(7,994)	(1,648)	(9,642)
Charged to equity	-	(310)	(310)
At end of year	<u>(12,807)</u>	<u>7,785</u>	<u>(5,022)</u>

The other deferred tax asset primarily relates to an asset created on transition to IFRS due to a change in accounting policy for loan relationship fees and bad debt provisions under IFRS. This deferred tax asset is being unwound over a period of 10 years.

26 INTANGIBLE ASSETS

Group and Company	Work in Progress £'000	Computer Software £'000	Total £'000
At 28 February 2010			
Cost	59,875	558	60,433
Accumulated depreciation	-	(105)	(105)
Net book value	<u>59,875</u>	<u>453</u>	<u>60,328</u>
Year ended 28 February 2011			
Opening net book value	59,875	453	60,328
Additions	138,847	24,033	162,880
Transfers	(120,901)	120,901	-
Amortisation	-	(7,933)	(7,933)
Closing net book value	<u>77,821</u>	<u>137,454</u>	<u>215,275</u>
At 28 February 2011			
Cost	77,821	145,492	223,313
Accumulated amortisation	-	(8,038)	(8,038)
Net book value	<u>77,821</u>	<u>137,454</u>	<u>215,275</u>
Year ended 29 February 2012			
Opening net book value	77,821	137,454	215,275
Additions	117,535	19,802	137,337
Transfers	(67,893)	80,964	13,071
Amortisation	-	(28,688)	(28,688)
Closing net book value	<u>127,463</u>	<u>209,532</u>	<u>336,995</u>
At 29 February 2012			
Cost	127,463	245,981	373,444
Accumulated amortisation	-	(36,449)	(36,449)
Net book value	<u>127,463</u>	<u>209,532</u>	<u>336,995</u>

Work in progress relates primarily to the internal development of IT software assets as part of the migration to a new infrastructure for the Group.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

26 INTANGIBLE ASSETS (continued)

Intangible asset balances are non-current.

27 PROPERTY, PLANT AND EQUIPMENT

Group and Company	Work in Progress £'000	Plant and Equipment £'000	Fixtures and Fittings £'000	Computer Hardware £'000	Freehold Building £'000	Leasehold Improvements £'000	Total £'000
At 28 February 2010							
Cost	33,643	4,040	5,387	62,916	-	3,250	109,236
Accumulated depreciation	-	(1,998)	(3,611)	(42,340)	-	(162)	(48,111)
Net book value	33,643	2,042	1,776	20,576	-	3,088	61,125
Year ended 28 February 2011							
Opening net book value	33,643	2,042	1,776	20,576	-	3,088	61,125
Additions	29,691	757	3,134	8,703	18,710	711	61,706
Transfers	(37,602)	(413)	663	21,790	-	15,562	-
Depreciation charge	-	(622)	(639)	(9,347)	-	(850)	(11,458)
Closing net book value	25,732	1,764	4,934	41,722	18,710	18,511	111,373
At 28 February 2011							
Cost	25,732	3,189	6,176	90,182	18,710	19,523	163,512
Accumulated depreciation	-	(1,425)	(1,242)	(48,460)	-	(1,012)	(52,139)
Net book value	25,732	1,764	4,934	41,722	18,710	18,511	111,373
Year ended 29 February 2012							
Opening net book value	25,732	1,764	4,934	41,722	18,710	18,511	111,373
Additions	4,492	90	3,090	11,234	8,582	51	27,539
Transfers	(16,244)	-	151	3,007	-	15	(13,071)
Disposals	-	(177)	-	-	-	-	(177)
Depreciation charge	-	(635)	(979)	(12,650)	(286)	(1,307)	(15,857)
Closing net book value	13,980	1,042	7,196	43,313	27,006	17,270	109,807
At 29 February 2012							
Cost	13,980	3,012	8,625	103,314	27,292	19,589	175,812
Accumulated depreciation	-	(1,970)	(1,429)	(60,001)	(286)	(2,319)	(66,005)
Net book value	13,980	1,042	7,196	43,313	27,006	17,270	109,807

Work in progress at 29 February 2012 relates predominantly to the development of IT infrastructure assets and, in addition, ATMs and travel money fixtures.

Property, plant and equipment balances are non-current.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

28 DEPOSITS FROM BANKS

Group and Company	2012 £'000	2011 £'000
Deposits from banks	<u>77,706</u>	<u>36,200</u>

All amounts owed are repayable within one year.

29 DEPOSITS FROM CUSTOMERS

Group and Company	2012 £'000	2011 £'000
Deposits from Tesco Personal Finance Group companies	2,660	3,090
Retail deposits	<u>5,387,127</u>	<u>5,074,374</u>
	<u>5,389,787</u>	<u>5,077,464</u>
Current	5,089,409	4,900,842
Non-current	300,378	176,622

30 DEBT SECURITIES IN ISSUE

Group	2012 £'000	2011 £'000
Floating rate bond maturing in 2012	-	224,472
Fixed rate retail bond maturing in 2018	138,412	125,559
RPI bond maturing in 2019	<u>59,437</u>	<u>-</u>
	<u>197,849</u>	<u>350,031</u>
Current	-	224,472
Non-current	197,849	125,559
Company	2012 £'000	2011 £'000
Floating rate bond maturing in 2012	-	224,696
Fixed rate retail bond maturing in 2018	138,412	125,559
RPI bond maturing in 2019	<u>59,437</u>	<u>-</u>
	<u>197,849</u>	<u>350,255</u>
Current	-	224,696
Non-current	197,849	125,559

On 27 February 2009 the Group issued a nominal £225,000,000 3 year floating rate bond guaranteed by the Commissioners of Her Majesty's Treasury. Interest payable was based on three month LIBOR plus 50 basis points. The full amount of this bond was repaid on 27 February 2012.

On 24 February 2011 the Group issued a nominal £125,000,000 7.5 year fixed rate retail bond which is listed on the London Stock Exchange. Interest is payable at a fixed rate of 5.2%.

On 16 December 2011 the Group issued a nominal £60,000,000 8 year inflation linked retail bond which is listed on the London Stock Exchange. Interest is payable at a fixed rate of 1.0%, with the principal adjusted for RPI inflation every six months.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

31 PROVISIONS FOR LIABILITIES AND CHARGES

Group and Company	PPI Provision £'000	Insurance Provision £'000	Total £'000
2012			
At beginning of year	39,477	-	39,477
Charged to the income statement	57,400	3,795	61,195
Utilised during the year	(22,331)	-	(22,331)
At end of year	74,546	3,795	78,341

Group and Company	PPI Provision £'000	Insurance Provision £'000	Total £'000
2011			
At beginning of year	100,000	-	100,000
Utilised during the year	(10,523)	-	(10,523)
Unused amounts released to the income statement	(50,000)	-	(50,000)
At end of year	39,477	-	39,477

PPI PROVISION

Of the total provision balance at 29 February 2012, £74,546,000 (2011: £39,477,000) relates to a provision for customer redress in respect of potential customer complaints arising from historic sales of PPI. The provision is likely to be utilised over several years, although the timing of utilisation is uncertain. Hence the balance is classified as current at year end.

The British Bankers Association initiated a judicial review on 24 January 2011 in relation to the regulation of PPI sales practices. The Group did not participate in this action and continued to deal with customer complaints in line with the FSA requirements throughout the duration of the legal proceedings undertaken by the other banks involved. The Group will continue to handle claims and redress customers in accordance with PS 10/12. This will include ongoing analysis of historical claims experience in accordance with the guidance.

During the first half of the year, the Group undertook a review of historic sales practices in place over the period in which PPI was sold to customers. During the year, the Group announced its intention to begin a programme of proactive customer contact, inviting customers who think they were mis-sold PPI during a specific time period to seek reimbursement from the Group. This programme has entered an initial pilot phase. The principal purpose of the pilot was to test operational processes in order to ensure that they were fit for purpose and could cope with the volume associated with a full programme of customer contact. Following the decision to proactively contact customers the provision was increased by £57,400,000 in the first half of the year.

INSURANCE PROVISION

The insurance provision of £3,795,000 at 29 February 2012 (2011: £nil) relates to a provision for insurance policy cancellation by customers. This balance is classified as current at year end as all insurance policies expire in a maximum of one year.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

32 ACCRUALS AND DEFERRED INCOME

Group and Company	2012 £'000	2011 £'000
Amounts accrued to Tesco Personal Finance Group companies	1,779	590
Amounts accrued to Tesco Group subsidiaries	6,914	2,651
Other accruals	111,004	172,844
Deferred income	12,673	9,066
	132,370	185,151

All amounts accrued are repayable within one year.

33 OTHER LIABILITIES

Group	2012 £'000	2011 £'000
Amounts owed to Tesco Group subsidiaries	16,366	6,836
Other liabilities	89,773	11,231
	106,139	18,067

Company	2012 £'000	2011 £'000
Amounts owed to Tesco Group subsidiaries	16,366	6,835
Other liabilities	89,772	18,084
	106,138	24,919

All amounts owed are repayable within one year.

34 SUBORDINATED LIABILITIES

Group and Company	2012 £'000	2011 £'000
Floating rate subordinated loan maturing 2017	30,000	30,000
Floating rate subordinated loan maturing 2018	35,000	35,000
Floating rate subordinated loan maturing 2020	30,000	30,000
Floating rate subordinated loan maturing 2021	140,000	-
Floating rate subordinated loan maturing 2022	95,000	95,000
	330,000	190,000
Current	-	-
Non-current	330,000	190,000

Subordinated liabilities comprise loan capital issued to Tesco Personal Finance Group Limited. All amounts are non-current.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

34 SUBORDINATED LIABILITIES (continued)

Subordinated liabilities are included in the Group's qualifying subordinated debt for regulatory capital reporting (refer note 46).

The floating rate subordinated loans are repayable, in whole or in part, at the option of the issuer, prior to maturity, on conditions governing the debt obligation. Interest payable is based on three month LIBOR plus a spread ranging from 60 to 225 points.

35 SHARE CAPITAL AND SHARE PREMIUM

During the year the Company issued 111,500,000 (2011: 445,500,000) ordinary shares to the parent company, Tesco Personal Finance Group Limited, for total consideration of £111,500,000 (2011: £445,500,000).

Group and Company	2012 Number	2011 Number
Authorised		
Ordinary shares of 10p each	<u>Unlimited</u>	<u>Unlimited</u>

Group and Company	2012 £'000	2011 £'000
Allotted, called up and fully paid		
1,034,900,000 (2011: 923,400,000) Ordinary shares of 10p each	<u>103,490</u>	<u>92,340</u>

Group and Company	2012 £'000	2011 £'000
Share Premium Account	<u>931,410</u>	<u>831,060</u>

36 OTHER RESERVES

Group	2012 £'000	2011 £'000
Cash flow hedge reserve	-	(201)
Available for sale reserve	12,710	2,452
Share based payment reserve	7,172	-
	<u>19,882</u>	<u>2,251</u>

Company	2012 £'000	2011 £'000
Cash flow hedge reserve	-	(201)
Available for sale reserve	9,505	2,452
Share based payment reserve	7,172	-
	<u>16,677</u>	<u>2,251</u>

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

36 OTHER RESERVES (continued)

Cash flow hedge reserve

The effective portion of changes in the fair value derivatives that are designated and qualify as cash flow hedges are included in the cash flow hedge reserve. The gain or loss relating to the ineffective portion is recognised immediately in the consolidated income statement.

Available for sale reserve

Available for sale financial assets are initially recognised at fair value and measured subsequently at fair value with gains and losses being recognised in the statement of other comprehensive income (except for impairment losses and foreign exchange gains and losses which are immediately recognised in the income statement) until the financial asset is derecognised.

The consolidated available for sale reserve at 29 February 2012 of £12,710,000 also includes the Group's share of the available for sale reserve of its associate, Tesco Underwriting Limited.

Share based payment reserve

The fair value of Tesco Plc equity-settled share options granted to employees of the Group is included in the share based payment reserve.

37 SUBORDINATED NOTES

Group and Company	2012 £'000	2011 £'000
Undated floating rate notes	<u>45,000</u>	<u>45,000</u>

The undated floating rate notes have no fixed maturity date and may not be repaid except under certain conditions such as the winding up of the Group.

Undated floating rate notes are included in the Group's qualifying subordinated debt for regulatory capital reporting (refer note 46).

38 EMPLOYEE BENEFIT LIABILITY

The Group accounts for pension costs on a contributions basis in line with the requirements of IAS 19 and these contributions are made to the Tesco plc scheme by the Company.

IAS 19 requires that where there is no policy or agreement of sharing the cost of the IAS 19 charge across the subsidiaries that the Sponsoring employer recognises the net defined benefit cost of a defined benefit scheme. The Sponsoring employer is Tesco plc and the principal pension plan is the Tesco plc pension scheme. The scheme is a funded defined benefit scheme in the UK, the assets of which are held as a segregated fund and administered by trustees. Tesco plc has recognised the appropriate net liability of the scheme. Towers Watson Limited, an independent actuary, carried out the latest triennial actuarial assessment of the scheme as at 31 March 2008 using the projected unit method. The actuarial assessment as at 31 March 2011 has started and the results will be finalised by June 2012. The Tesco plc group is currently in consultation with staff and Trustees regarding proposed changes to the scheme.

The following disclosures relate to the Tesco plc pension scheme.

Principal assumptions

The valuations used for IAS 19 have been based on the most recent actuarial valuations and updated by Towers Watson Limited to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes as at 29 February 2012. The major assumptions, on a weighted average basis, used by the actuaries were as follows:

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

38 EMPLOYEE BENEFIT LIABILITY (continued)

	2012 %	2011 %
Rate of increase in salaries	3.2	3.6
Rate of increase in pensions in payment*	2.9	3.3
Rate of increase in deferred pensions*	2.1	2.8
Rate of increase in career average benefits	3.1	3.5
Discount rate	5.2	5.9
Price inflation	3.1	3.5

*In excess of any Guaranteed Minimum Pension (GMP) element.

The main financial assumption is the real discount rate (i.e. the excess of the discount rate over the rate of price inflation). If this assumption increased/decreased by 0.1%, the UK defined benefit obligation would decrease/increase by approximately £170,000,000 and the annual UK current service cost would decrease/increase by approximately £14,000,000.

Rates of return on scheme assets

The assets in the Tesco plc defined benefit pension schemes and the expected rates of return were:

	2012		2011	
	Long term rate of return %	Market value £'000	Long term rate of return %	Market value £'000
Equities	8.1	3,377,000	8.5	3,032,000
Bonds	4.9	1,365,000	5.0	1,116,000
Property	6.5	577,000	6.8	511,000
Other (alternative assets)	8.1	741,000	8.5	564,000
Cash	3.6	109,000	4.0	385,000
Total market value of assets		6,169,000		5,608,000

The expected rate of return on assets is a weighted average based on the actual plan assets held and the respective returns expected on the separate asset classes. The expected rates of return on equities and cash have both been set with reference to the expected medium term, as calculated by Tesco plc's independent actuary. The expected rate of return on bonds was measured directly from actual yields for gilts and corporate bond stocks. The rate above takes into account the actual mixture of UK gilts, UK corporate bonds and overseas bonds held at the balance sheet date.

Movements in pension deficit during the year

Changes in the fair value of the Tesco plc defined benefit pension plan assets are as follows:

	2012 £'000	2011 £'000
Opening fair value of plan assets	5,608,000	4,696,000
Expected return	422,000	363,000
Actuarial (losses)/gains	(168,000)	278,000
Contributions by employer	457,000	433,000
Actual member contributions	11,000	10,000
Foreign currency translation differences	(1,000)	(9,000)
Benefits paid	(160,000)	(163,000)
Closing fair value of plan assets	6,169,000	5,608,000

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

38 EMPLOYEE BENEFIT LIABILITY (continued)

Changes in the present value of defined benefit obligations are as follows:

	2012 £'000	2011 £'000
Opening defined benefit obligation	(6,964,000)	(6,536,000)
Current service cost	(495,000)	(499,000)
Past service gain/(cost)	3,000	(29,000)
Interest cost	(404,000)	(381,000)
(Loss)/gain on change of assumptions	(373,000)	342,000
Experience gains/(losses)	43,000	(25,000)
Foreign currency translations differences	-	11,000
Benefits paid	160,000	163,000
Actual member contributions	(11,000)	(10,000)
Closing defined benefit obligation	(8,041,000)	(6,964,000)

Post-retirement benefits other than pensions

Tesco plc operates a scheme offering post-retirement healthcare benefits. The cost of providing these benefits has been accounted for on a similar basis to that used for defined benefit pension schemes.

The liability in Tesco plc as at 29 February 2012 was £11,000,000 (2011: £12,000,000), which was determined in accordance with the advice of independent actuaries. £800,000 (2011: £800,000) has been charged to the Tesco plc consolidated income statement in the year and £600,000 (2011: £600,000) of benefits were paid.

A change of 1.0% in assumed healthcare cost trend rates would have the following effect:

	2012 £'000	2011 £'000
Effect of 1.0% increase in assumed medical cost rate on		
Service and interest cost	100	100
Defined benefit obligation	1,600	1,800
Effect of 1.0% decrease in assumed medical cost rate on		
Service and interest cost	(100)	(100)
Defined benefit obligation	(1,300)	(1,400)

39 RISK MANAGEMENT

APPROACH TO RISK MANAGEMENT

The Board has overall responsibility for the business. It agrees the strategy for the business, approves the Group's risk appetite as well as specific high level policies and the delegated authorities. Board approval is also required for the Group's business plans, budget, Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment (ILAA) and new material product lines. The Board monitors the Group's risk management profile and capital adequacy position.

Management of profit volatility and development of a stable and prudent business compliant with regulations are amongst the key strategic business objectives. The Group is focussed on developing a strong savings franchise with reliable sources of funding within an overall culture of treating customers fairly.

The Group seeks to ensure that it has an integrated approach to Risk Management so that all areas of direction setting, organisation and control, decision making, risk appetite, risk identification, risk assessment and business operations are aligned. The risk management framework is described below and further detail on the framework can be obtained from the Tesco Personal Finance plc Basel II Pillar 3 Disclosures document.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

RISK MANAGEMENT FRAMEWORK

During the year the Group has worked on the further development of its Risk Management Framework. The principal means by which the Group seeks to deliver effective risk management are contained in the Enterprise Wide Risk Management Framework (EWRMF). The EWRMF is designed to support the identification, assessment, management and control of the material risks that threaten the achievement of the Group's strategic business objectives.

The EWRMF can be broken down into the following five key elements:

- i. Risk management strategy and appetite
- ii. EWRMF components
- iii. Integrated risk processes
- iv. Embedding risk within the organisation
- v. Major specific risk categories

These are described in further detail below:

i. RISK MANAGEMENT STRATEGY AND APPETITE

The Group has developed a risk strategy which is designed to support the successful delivery of strategic business objectives through defined strategic risk objectives which support risk appetite. The risk appetite reflects the level and type of risks that the Group is willing to take to deliver its strategic business objectives. The refinement and exposition of the Group's risk appetite communicates the Board's view on the type and quantum of risks that should be acquired, avoided, retained or removed and provides direction to be taken into account when making key decisions.

The Group measures risk appetite in both quantitative and qualitative terms with performance against these measures reported to the Asset and Liability Management Committee (ALCO), Risk Management Committee (RMC), the Board Risk Committee (BRC) and to the Board as appropriate. Committee reporting includes stress testing and scenario analysis which is designed to inform senior management of required levels of capital and other financial resources, including liquidity, under various stressed economic and business scenarios.

ii. EWRMF COMPONENTS

The scope of the EWRMF extends to all major specific risk categories faced by the Group and is underpinned by governance, controls, processes, systems and policies within the second-line Risk function and those of the first-line business areas (see section below for further details about the three lines of defence model). The key components which collectively ensure that risks are managed and key control activities conducted are outlined below:

a) Governance

The Board has ultimate responsibility for all material risk matters, but has delegated to the Chief Executive the responsibility to manage the business and deliver against the strategy in an effective and controlled way. The Chief Executive has ultimate executive responsibility for acts and omissions of the Group and acts in accordance with the authority delegated from the Board. The Chief Executive is responsible for delivery of the overall strategy and the management of risks in so doing. The Chief Executive manages the business through an Executive Committee (ExCo). The ExCo has further established its own sub-committees which manage specific areas of the business.

Formal arrangements for the management and control of the business of the Group have been defined, with delegated authorities, approval bodies and roles and responsibilities documented.

A committee structure including BRC, Audit Committee, Remuneration Committee, ExCo, RMC, ALCO and Treating Customers Fairly Board (TCF Board) operated throughout the year as described below.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

- **The Board**

Membership of the Board comprises the Chairman, every non-executive and every executive director. The Board has overall responsibility for the business. It sets the strategic aims for the business, in line with delegated authority from the shareholder and in some circumstances subject to shareholder approval, within a framework of prudent controls, which are designed to enable risk to be assessed and managed. The Board satisfies itself that financial controls and systems of risk management are robust.

- **Board Risk Committee**

The BRC is comprised of all of the non-executive directors. The role of the BRC includes considering and recommending to the Board any changes to the Group's risk appetite and risk strategy.

- **Audit Committee**

The Audit Committee is comprised of all of the non-executive directors. The role of the Audit Committee includes: reviewing and recommending to the Board for approval the financial statements; monitoring accounting policies and practices for compliance with relevant standards; reviewing the scope and results of the annual external audit; maintaining a professional relationship with and recommending the appointment, re-appointment and removal of the external auditors; examining arrangements in place to enable management to ensure compliance with requirements and standards under the regulatory system; overseeing the internal audit function and the internal audit programme and expressing an opinion on the effectiveness of internal controls.

- **Remuneration Committee**

The Remuneration Committee is comprised of all of the non-executive directors. The role of the Remuneration Committee is: to determine and approve remuneration arrangements for Remuneration Code staff¹ within the Group; to approve a remuneration framework for employees of the Group below the leadership level; to ensure that, where appropriate, remuneration is aligned with Tesco PLC Group Reward Policy; to ensure the levels and structure of remuneration are designed to attract, retain, and motivate the management talent needed to run the Group's business in a way which is consistent with the risk appetite and ongoing sustainability of the business and to be compliant with all applicable legislation, regulation and guidelines.

- **Executive Committee**

The ExCo is comprised of the Chief Executive, Chief Commercial Officer, Chief Financial Officer, Chief Operating Officer and the Chief Risk Officer (CRO). The ExCo provides general executive management of the business and facilitates cross-functional communication and liaison. The relevant ExCo member is responsible to the Chief Executive and through him to the Board, for managing performance in line with the Group's long term plan, the strategy, the annual budget and the risk appetite.

- **Risk Management Committee**

The principal role of RMC is to ensure that there is effective management and control of all key risks and issues facing the Group.

Two sub-committees, the Fraud, Operational & Regulatory Risk Committee (FORRC) and the Credit Risk Management Committee (CRMC), support the RMC in discharging its duties.

- **Asset and Liability Management Committee**

The principal role of the ALCO is to optimise the Group's balance sheet structure and to identify, manage and control the Group's balance sheet risks in the execution of its chosen business strategy.

¹ Remuneration Code staff comprises categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm's risk profile.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

The ALCO has two sub-committees, the Liquidity Management Forum (LMF) and the Contingency Funding Committee.

- **Treating Customers Fairly Board**

The principal role of the TCF Board is to provide review and challenge relating to the delivery of fair outcomes for customers by each business area.

b) Three Lines of Defence

The Group's risk management follows the 'Three Lines of Defence' model where:

- **First line of defence** - Line Managers are responsible for establishing an effective control framework within their area of operations and identifying and controlling all risks so that they are within the organisational risk appetite and policy limits. They also devise appropriate key risk indicators, management information and assurance processes to render effective the control framework they operate.
- **Second line of defence** - the Risk Management function is responsible for proposing to the Board appropriate objectives and measures to define the Group's risk appetite and for devising the suite of policies necessary to control the business including the overarching framework and for independently monitoring the risk profile, providing additional assurance where required. With additional expertise in risk management, Risk will also provide frameworks, tools and techniques which will assist management in meeting their responsibilities, as well as acting as a central coordinator to identify enterprise wide risks and make recommendations to address them.
- **Third line of defence** - the Internal Audit function is responsible for independent assessment of the effectiveness of the implementation of the risk and control measures across the business both in design and practice. They undertake specific reviews of business areas and functions.

c) Risk Identification

The risk identification process sets out to identify and define risk. It provides guidance in relation to the ways in which risks can be identified, the sources to investigate and research in order to identify new and emerging risks and sets out consistent principles which should be applied wherever the Group needs to identify risks.

d) Risk Assessment

The risk assessment process is the means through which the Group understands and estimates the effect of risk on the business and the processes, systems and controls that mitigate those risks to an acceptable level. The risk assessment process is the formal method undertaken to determine the potential impact that identified risks or events could have on the Group.

e) Policies

The Group's policy documents provide the rules and guiding principles that define its approach to control identified risks and are provided as a suite covering all aspects of risk within the EWRMF. The policy framework and accountabilities are the foundations that determine the way the Group has regard to risk when it carries out its business. Detailed accountabilities turn policies and appetite limits into individual limits and responsibilities.

f) Risk Management Function

The Risk Management Function operates under the leadership of the CRO who reports directly to the Chief Executive and is a member of ExCo and the Board. The Risk Teams reporting to the CRO have been staffed by people with specific expertise and structured to provide analysis, understanding and oversight of each of the major risks faced by the Group.

g) Stress Testing

Stress testing is the process under which the Group's business plans are subjected to severe adverse impacts and that the implication of those stresses on the Group's business including projected capital and liquidity positions are understood. Stress testing is a mandatory requirement of the FSA who require that banks implement their own stress testing processes.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

h) Monitoring and Reporting

The Risk Management function is the focus and centralised location for integrated risk reporting across the Group. The Enterprise Wide Risk Management team act as risk integrators to ensure that risk reporting and communications form a total risk perspective; aggregation and correlation issues are addressed; and risk coverage is viewed holistically so that issues do not fall between other functions.

The Group monitors and tracks current exposures against limits defined in the risk appetite and reports exceptions on a monthly basis to the ALCO and RMC and to each meeting of the BRC. Adherence to these limits is independently monitored, measured and reported using a suite of key indicators defined by each risk team responsible for managing the major specific risk categories faced by the Group. Decisions made at subordinate risk committees and forums are reported up to senior committees as appropriate.

iii. INTEGRATED RISK PROCESSES

The Group's integrated risk processes include the linking of risk appetite to business plans and associated capital and liquidity requirements.

The Group is required to submit periodic ICAAP reports to the FSA which set out future plans, their impact on capital availability and requirements and the risks to capital adequacy under potential stress scenarios.

The Group is also required to submit to the FSA an ILAA which provides an ongoing assessment and quantification of the Group's liquidity risks, how the Group mitigates those risks and how much current and future liquidity is required based on business plans and under stress scenarios. The Group must demonstrate that it has sufficient liquidity and contingency plans to manage unexpected cash outflows.

Risk appetite helps to limit the risks which the business can accept in pursuit of its strategic objectives. Risk appetite is reviewed annually. The Group's strategy, business plan and capital and liquidity plans are set with reference to risk appetite.

The integrated risk process documents define regulatory guidance and requirements, set out expectations and define the processes that are followed in the Group.

iv. EMBEDDING RISK WITHIN THE ORGANISATION

Where risk management is effectively embedded, it becomes an intrinsic part of business planning and decision making ensuring that there is no direction taken without considering potential risks and comparing them against the Group's risk appetite.

a) Risk Culture

A strong group-wide risk culture is an important element of effective risk management. The Group aims to create a culture of risk awareness, openness and incentivisation of correct behaviours. A number of activities are undertaken to ensure consistency of message and appropriate cultural reinforcement. These activities include: non-executive education, briefings by the risk function, modular risk training and reviews of incentive schemes.

b) Risk Assurance

Risk assurance is undertaken in a number of places within the Group, reflecting the three lines of defence risk management approach. Independent oversight and assurance is intended to provide comfort that the Group's risks are being effectively monitored and managed across all areas of the business in line with the risk framework and the Group's risk appetite.

More information on the activities to embed risk in the organisation is available in the Tesco Personal Finance plc Basel II Pillar 3 Disclosures document.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

v. INFORMATION IN RELATION TO THE GROUP'S MAJOR SPECIFIC RISK CATEGORIES

a) Legal and Regulatory Risk

Legal and regulatory compliance risk is the risk of consequences arising as a result of non-compliance with the laws and regulations affecting the Group's governance, prudential arrangements, business activities, risk management and its conduct with customers. The Group's aim is to meet all legal and regulatory requirements and minimise any reputational impact by maintaining an effective control framework. Where legal or regulatory requirements are not met effective remediation plans will be put in place.

The CRO, and his direct report, the Director of Compliance and Regulatory Risk, together with a dedicated regulatory risk team are responsible for: regulatory risk management policies and processes; ensuring that regulatory risks are identified and managed appropriately; monitoring, challenge and oversight of regulatory risk and compliance across the Group's business; and providing guidance and advice to enable the business to operate in a compliant manner. Regulatory risk's scope includes FSA regulations and the Office of the Information Commissioner requirements (for Data Protection Act) as well as internal regulatory risk management policies.

As part of the Group's Policy Framework, regulatory risk is responsible for a number of policies and the compliance manual which sets out the scope of the Group's regulatory responsibilities and its approach to managing regulatory risk across the business. The compliance manual is approved through RMC.

The Group's Legal function provides advice and support on all aspects of law and associated policies, including Statutory Compliance Policy, Competition Policy, Bribery and Corruption and Information Retention.

b) Operational risk

Operational Risk is the potential error, loss, harm or failure caused by ineffective or inadequately defined processes, system failure, improper conduct, human error or from external events. The Group aims to minimise all operational risks and reputational impacts.

The CRO, and his direct report, the Head of Operational Risk, are responsible for: developing and maintaining the operational risk framework; working with the business to ensure they understand their first line responsibilities and how they must execute them within the framework; embedding policies, tools and frameworks across the business and instilling a positive risk management culture; and independently monitoring, assessing and reporting on operational risk profiles and losses. In addition, the Head of Operational Risk also has responsibility for fraud risk management (internal and external to the business) and anti-money laundering (AML).

One of the biggest operational risks run by the Group over the past three years has been the Transformation programme under which the Group has set up a banking and insurance infrastructure and processes separate from RBS. The Group migrated its savings and loans business and its insurance business from RBS during 2010 and 2011. The last remaining element of the Transformation programme is to build systems and capability to run the Group's credit card business. This migration is planned to complete during the first half of the 2012/13 financial year. In the short term the Transformation programme generates an elevated level of risk. Given the profile of Transformation Risk, a separate Risk team, reporting directly to the CRO, provides added second line assurance and risk coverage

c) Credit Risk

Credit risk is the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The Group's aim in relation to credit risk is to seek to lend responsibly, ensuring that the credit risk profile remains within agreed volatility parameters.

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39 RISK MANAGEMENT (continued)

Credit risk arises principally from the Group's retail lending activities but also from placement of surplus funds with other banks and money market funds, investments in transferable securities and interest rate and foreign exchange derivatives. In addition, credit risk arises from contractual arrangements with third parties where payments and commissions are owed to the Group for short periods of time. Credit risk may also arise when an adverse change in an entity's credit rating causes a fall in the fair value of the Group's investment in that entity's financial instrument.

The CRO and his direct report, the Director of Credit Risk, are responsible for: the development and oversight of the credit risk management framework; developing credit risk policies, tools and frameworks across the business and instilling a positive risk management culture; managing effective credit risk strategies; providing oversight of credit risk activities undertaken by the first line; and credit performance monitoring.

The Credit Risk function maintains a suite of policies defining the minimum requirements for the management of credit activities across the lifecycle. Credit risk policies include Credit Risk Policy and Minimum Standards, Wholesale Credit Risk Policy, Model Development, Collections and Recoveries and Provisioning. All credit risk policies are subject to annual review by the RMC.

Credit Risk policies are supported by a range of process and procedures manuals that cover the activities undertaken through the credit lifecycle that require manual intervention. Good management information is critical for the effective management of credit risk. A suite of management information is produced for different audiences within the governance framework. Crucial within this suite are Key Risk Indicators, with supporting limits and tolerances, that allow the Group to track performance against appetite and identify any trends that could act as an early warning that performance may move outside risk appetite in the future.

- **Retail Credit Risk**

The Group's credit policy is defined via the credit risk policy framework. Through this, standards and limits are defined at all stages of the customer lifecycle, including new account sanctioning, customer management and collections and recoveries activity. Customer credit decisions are managed principally through the deployment of bespoke credit scorecard models and credit policy rules, which exclude specific areas of lending, and an affordability assessment which determines a customer's ability to repay an outstanding credit amount.

A dedicated credit risk management team have the day to day responsibility for managing the credit quality of the lending portfolio. As at 29 February 2012, the deployment and execution of credit strategies for the credit card portfolios sat within the RBS infrastructure, managed through the relevant Commercial Services Agreement. During the year the personal loan portfolios were migrated from RBS to the Group's infrastructure. The Group has full ownership of its credit risk appetite and its credit policy. Responsibility for setting scorecard parameters, and the process for dealing with exceptions, lies with the Director of Credit Risk, reporting to the CRO. Regular reporting to the RMC, ExCo, BRC and the Board provides oversight of this activity and insight to the performance of the portfolio.

- **Wholesale Credit Risk**

The Group maintains a limits-based framework for managing exposure to counterparty credit risk. These limits and the framework are set out in the Wholesale Credit Risk Policy which is approved by the RMC. The Treasurer is responsible for ensuring that Treasury complies with counterparty credit risk limits, with the Counterparty Credit Risk Manager and the Insurance and Market Risk Director providing independent oversight that these limits are adhered to.

The control framework defines approved country, counterparty and instrument types and maturity profiles. The Group's risk appetite focuses on counterparties with strong capacity to meet financial commitments and requires approved counterparties to have upper investment grade ratings. Counterparty types include financial institutions, sovereigns and supranationals with approved instrument types including cash, certificates of deposit, bonds, treasury bills, gilts, repurchase agreements, money market funds and asset backed securities / covered bonds. Country limits are derived using External Credit Assessment Institutions (ECAI) ratings and economy size. Interest

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39 RISK MANAGEMENT (continued)

rate and foreign exchange derivatives are also used to hedge exposures.

The framework sets limits on the amounts that can be lent based on counterparty credit-worthiness, instrument type and remaining tenor. As part of the credit assessment process for wholesale credit risk exposures, the Group continues to use Fitch, Moody's and Standard & Poor's as ECAs. All material limits are approved via the RMC and any exceptions or overrides to the Group's policy must be explicitly agreed by the RMC.

Daily monitoring of exposures is undertaken by the Counterparty Credit Risk Manager with monthly reporting of Key Risk Indicators provided to RMC.

- Third Party Credit Exposures**

The Group has a number of contracts with third parties that involve the payment of fees or commissions to TPF plc. Credit exposure arises through the risk that these payments may not be made. The requirements for management of these exposures are detailed in the Wholesale Credit Risk Policy with a limits framework in place to manage these exposures. The Counterparty Credit Risk Manager is responsible for reporting these exposures and any limit breaches to RMC.

- Credit Risk Exposures**

Credit risk exposures relating to on-balance sheet assets are as follows:

Group	Maximum exposure	
	2012 £'000	2011 £'000
Cash and balances with central banks	455,809	136,848
Loans and advances to banks	93,132	403,598
Loans and advances to customers	4,423,582	4,679,184
Derivative financial instruments	19,522	16,378
Investment securities:		
- Available for sale	1,302,731	849,831
- Loans and receivables	292,931	292,931
Other assets	454,815	142,668
	7,042,522	6,521,438

Company	Maximum exposure	
	2012 £'000	2011 £'000
Cash and balances with central banks	455,766	136,808
Loans and advances to banks	93,132	323,136
Loans and advances to customers	4,423,582	4,679,184
Derivative financial instruments	19,522	16,378
Investment securities:		
- Available for sale	1,302,731	849,831
- Loans and receivables	292,931	292,931
Other assets	454,906	200,891
	7,042,570	6,499,159

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39 RISK MANAGEMENT (continued)

Credit risk exposures relating to undrawn credit card commitments are as follows:

Group and Company	Maximum exposure	
	2012 £'000	2011 £'000
Undrawn credit card commitments	<u>7,422,554</u>	<u>7,127,334</u>

The above table represents a worse-case scenario of credit risk exposure to the Group at 29 February 2012. For on-balance-sheet assets, the balances set out above are based on net carrying amounts as reported in the statement of financial position.

As shown above, 63% of the total maximum exposure for the Group is derived from loans and advances to customers (2011: 72%); 18% represents investments in financial assets classified as available for sale (2011: 13%); and 1% (2011: 5%) represents loans and advances to banks.

- Credit Risk: Analysis by Geography**

The table detailed below provides the geographic distribution of the Group's exposures by material asset class. The Group is primarily focused on providing financial services and products to UK personal customers although there is limited exposure in the Republic of Ireland.

The Group sells credit cards in the Republic of Ireland where it is an authorised 'credit institution' under Irish law and is directly regulated by the Irish Financial Regulator in respect of this activity.

Group 2012	UK £'000	Europe (ex. UK) £'000	Other £'000	Total £'000
<i>On balance sheet</i>				
Cash and balances with central banks	455,809	-	-	455,809
Loans and advances to banks	50,000	43,132	-	93,132
Loans and advances to customers	4,391,472	32,110	-	4,423,582
Derivative financial instruments	19,522	-	-	19,522
Investment securities:				
- Available for sale	694,629	520,554	87,548	1,302,731
- Loans and receivables	292,931	-	-	292,931
Other assets	454,056	375	384	454,815
	<u>6,358,419</u>	<u>596,171</u>	<u>87,932</u>	<u>7,042,522</u>
Undrawn loan commitments	7,387,629	34,925	-	7,422,554
	<u>13,746,048</u>	<u>631,096</u>	<u>87,932</u>	<u>14,465,076</u>

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39 RISK MANAGEMENT (continued)

Group 2011	UK £'000	Europe (ex. UK) £'000	Other £'000	Total £'000
<i>On balance sheet</i>				
Cash and balances with central banks	136,848	-	-	136,848
Loans and advances to banks	403,598	-	-	403,598
Loans and advances to customers	4,646,501	32,683	-	4,679,184
Derivative financial instruments	16,378	-	-	16,378
Investment securities:				
- Available for sale	511,600	338,231	-	849,831
- Loans and receivables	292,931	-	-	292,931
Other assets	140,896	1,772	-	142,668
	6,148,752	372,686	-	6,521,438
Undrawn loan commitments	7,084,999	42,335	-	7,127,334
	13,233,751	415,021	-	13,648,772

Company 2012	UK £'000	Europe (ex. UK) £'000	Other £'000	Total £'000
<i>On balance sheet</i>				
Cash and balances with central banks	455,766	-	-	455,766
Loans and advances to banks	50,000	43,132	-	93,132
Loans and advances to customers	4,391,472	32,110	-	4,423,582
Derivative financial instruments	19,522	-	-	19,522
Investment securities:				
- Available for sale	694,629	520,554	87,548	1,302,731
- Loans and receivables	292,931	-	-	292,931
Other assets	453,933	973	-	454,906
	6,358,253	596,769	87,548	7,042,570
Undrawn loan commitments	7,387,629	34,925	-	7,422,554
	13,745,882	631,694	87,548	14,465,124

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39 RISK MANAGEMENT (continued)

Company 2011	UK £'000	Europe (ex. UK) £'000	Other £'000	Total £'000
<i>On balance sheet</i>				
Cash and balances with central banks	136,808	-	-	136,808
Loans and advances to banks	323,136	-	-	323,136
Loans and advances to customers	4,646,501	32,683	-	4,679,184
Derivative financial instruments	16,378	-	-	16,378
Investment securities:				
- Available for sale	511,600	338,231	-	849,831
- Loans and receivables	292,931	-	-	292,931
Other assets	199,119	1,772	-	200,891
	6,126,473	372,686	-	6,499,159
Undrawn loan commitments	7,084,999	42,335	-	7,127,334
	13,211,472	415,021	-	13,626,493

- **Credit Risk: Analysis by Industry type**

The distribution of exposures by industry type is provided below. The Group is primarily focused on providing financial services and products to UK personal customers although it also has exposure to wholesale counterparties as detailed below.

Group 2012	Financial institutions £'000	Government £'000	Individuals £'000	Wholesale and retail trade £'000	Total £'000
<i>On balance sheet</i>					
Cash and balances with central banks	26,620	429,189	-	-	455,809
Loans and advances to banks	93,132	-	-	-	93,132
Loans and advances to customers	-	-	4,420,422	3,160	4,423,582
Derivative financial instruments	19,522	-	-	-	19,522
Investment securities:					
- Available for sale	500,592	802,139	-	-	1,302,731
- Loans and receivables	292,931	-	-	-	292,931
Other assets	394,604	-	60,211	-	454,815
	1,327,401	1,231,328	4,480,633	3,160	7,042,522
Undrawn loan commitments	-	-	7,406,796	15,758	7,422,554
	1,327,401	1,231,328	11,887,429	18,918	14,465,076

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39 RISK MANAGEMENT (continued)

Group
2011

	Financial institutions £'000	Government £'000	Individuals £'000	Wholesale and retail trade £'000	Total £'000
<i>On balance sheet</i>					
Cash and balances with central banks	7,909	124,777	-	4,162	136,848
Loans and advances to banks	403,598	-	-	-	403,598
Loans and advances to customers	-	-	4,674,813	4,371	4,679,184
Derivative financial instruments	16,378	-	-	-	16,378
Investment securities:					
- Available for sale	468,854	380,977	-	-	849,831
- Loans and receivables	292,931	-	-	-	292,931
Other assets	27,272	-	99,737	15,659	142,668
	1,216,942	505,754	4,774,550	24,192	6,521,438
Undrawn loan commitments	-	-	7,111,892	15,442	7,127,334
	1,216,942	505,754	11,886,442	39,634	13,648,772

Company 2012	Financial institutions £'000	Government £'000	Individuals £'000	Wholesale and retail trade £'000	Total £'000
<i>On balance sheet</i>					
Cash and balances with central banks	26,577	429,189	-	-	455,766
Loans and advances to banks	93,132	-	-	-	93,132
Loans and advances to customers	-	-	4,420,422	3,160	4,423,582
Derivative financial instruments	19,522	-	-	-	19,522
Investment securities:					
- Available for sale	500,592	802,139	-	-	1,302,731
- Loans and receivables	292,931	-	-	-	292,931
Other assets	394,695	-	60,211	-	454,906
	1,327,449	1,231,328	4,480,633	3,160	7,042,570
Undrawn loan commitments	-	-	7,406,796	15,758	7,422,554
	1,327,449	1,231,328	11,887,429	18,918	14,465,124

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39 RISK MANAGEMENT (continued)

Company 2011	Financial institutions	Government	Individuals	Wholesale and retail trade	Total
	£'000	£'000	£'000	£'000	£'000
<i>On balance sheet</i>					
Cash and balances with central banks	7,869	124,777	-	4,162	136,808
Loans and advances to banks	323,136	-	-	-	323,136
Loans and advances to customers	-	-	4,674,813	4,371	4,679,184
Derivative financial instruments	16,378	-	-	-	16,378
Investment securities:					
- Available for sale	468,854	380,977	-	-	849,831
- Loans and receivables	292,931	-	-	-	292,931
Other assets	96,368	-	99,737	4,786	200,891
	1,205,536	505,754	4,774,550	13,319	6,499,159
Undrawn loan commitments	-	-	7,111,892	15,442	7,127,334
	1,205,536	505,754	11,886,442	28,761	13,626,493

d) Insurance Risk

The Group defines insurance risk as the risk accepted through insurance products in return for a premium. These risks may or may not occur and the amount and timing of these risks are uncertain and determined by events outside of our control (e.g. flood or car crash). The Group's aim is to actively manage insurance risk exposure with particular focus on those risks that impact profit volatility.

Insurance risk is typically categorised in the following way:

- Underwriting risk – Related to the selection and pricing (or quantification) of the risk currently being transferred from customers to an insurer; and
- Reserving risk – Related to valuation and management of financial resources sufficient to pay claims for the risk already transferred from customers to an insurer.

The Group is exposed to insurance risks through its ownership of 49.9% of TU, an authorised insurance company, and through its historic distribution arrangement with RBS insurance.

Since late 2010 the majority of new and renewal business policies for Home and Motor Insurance products sold by the Group have been underwritten by TU. The Group provides marketing, sales and distribution of these products with TU providing underwriting, reserving and claims management. The key insurance risks within TU relate to Underwriting Risk and specifically the potential for a major weather event to generate significant claims on Home insurance or the cost of settling bodily injury claims on Motor Insurance. Exposure to these risks, and pricing risks, are actively managed within TU with close monitoring of performance metrics and the use of reinsurance to limit TU's exposure above pre-determined limits. The Group conducts oversight of these exposures as a significant shareholder in TU.

Additional capacity is provided by a panel of third party providers for those Motor and Home customers who fall outside the desired TU underwriting footprint. The Group has also distributed Pet, Travel, Life, Health, Dental and Breakdown insurance on a 'white label' basis for other providers. The Group does not carry the insurance risk associated with these products.

The primary risk that the Group remains exposed to through its previous relationship with RBS insurance is Reserving Risk – the risk that claims reserves are insufficient to cover the ultimate cost of those insurance claims that have not yet been settled. This is particularly relevant to Motor Insurance claims where the ultimate cost of large bodily injury claims is uncertain and the time taken to settle such claims can vary significantly depending on the severity of the injury. This risk is, in part, mitigated by the use of reinsurance

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39 RISK MANAGEMENT (continued)

to limit the Group's exposure to the cost of individual claims above certain pre determined limits. However, the nature of this exposure results in the process of estimating the ultimate cost of these claims carrying a degree of uncertainty.

The Group stopped selling PPI from 1 October 2011 (product underwritten by RBS Insurance). However, while the Motor and Home back books have migrated from RBS Insurance to TU, legacy PPI policies currently remain with RBS insurance.

The insurance risk team is responsible for designing and implementing the insurance risk framework which seeks to: provide an effective and consistent approach to insurance risk management and to the management of counterparties, including TU, RBS insurance and white label providers; understand and manage the potential volatility of the insurance results; measure the extent to which the insurance business within the Group is being conducted in accordance with the risk appetite and policies; to provide subject matter expert support to the business in identifying, assessing and managing risk in accordance with the Group's EWRMF; and to monitor the performance of TU and the effectiveness of insurance risk management.

TU operates a separate risk framework with dedicated risk and compliance teams and a suite of TU risk policies. TU is working to implement Solvency II in accordance with regulatory timelines. Solvency II aims to establish an enhanced set of capital and risk management standards across the European insurance industry.

e) Market Risk

Market risk is defined as the risk that the value of the Group's income, liabilities, assets or costs might vary due to changes in the value of financial market prices; this includes interest rates, foreign exchange rates, credit spreads and equities. The Group has no Trading Book. Market risk arises in the following ways in the Group:

- Interest rate risk in the Group's retail portfolios, its ATM income and in its funding activities arises from the different repricing characteristics of non trading assets and liabilities, hereafter referred to as interest rate risk in the banking book (IRRBB);
- Foreign exchange exposures that arise from foreign currency investments, foreign currency loans, deposits, income and other foreign currency contracts;
- Interest rate and credit spread risk in the investment portfolios of the Group's insurance companies TU and RBS insurance; and
- Investment risk relating to the Group's pension obligations.

Control of market risk exposure is managed by ALCO, which makes regular reports to the RMC and Board. The Market and Liquidity Risk team provides review and challenge of policies and procedures relating to market risk across the Group. Market and Liquidity Risk are responsible for oversight and monitoring of the Asset & Liability Management (ALM) and Market Execution teams within Treasury.

- **Interest Rate Risk in the Banking Book**

IRRBB is the main market risk that could affect the Group's net interest income and arises where there is potential for changes in benchmark interest rates (that embed little or no credit risk) which results in a movement in the Banking Book net interest income.

IRRBB may arise for a number of reasons, for example:

- Repricing Risk – related to the timing differences in the maturity (for fixed rate) and repricing (for floating rate) of the Group's assets, liabilities and off balance sheet positions;
- Yield Curve Risk - risk that earnings from banking book products are adversely affected by movement in the yield curve due to the timing mismatch in the repricing of assets, liabilities and off balance sheet positions;
- Basis Risk - risk arising from the imperfect correlation between changes in interest rate indices, such as between LIBOR and Base rate or between Base rate and Administered rates;

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39 RISK MANAGEMENT (continued)

- Customer Optionality – risk that a loss in value arises because the take up of a fixed rate product, e.g. personal fixed rate loans, are different from expectations (recruitment risk) or the repayment behaviour of customers differs from expectations (prepayment risk), due to, or combined with, a movement in interest rates.

The Group has established limits that describe its risk appetite in this area and stress tests are performed using sensitivity to fluctuations in underlying interest rates in order to monitor this risk. The Board have delegated authority for detailed approval of IRRBB to the ALCO. High level risk appetite and policies are recommended for approval by the ALCO to the Board. The ALCO have delegated responsibility to the ALM team to ensure that the Group's IRRBB Risk Appetite is effectively managed. The IRRBB policy is owned and monitored by Treasury and approved by the ALCO. The main policy objectives are to:

- Manage the overall IRRBB of the Group by:
 - Identifying, assessing, controlling and reporting the Group's interest rate risk exposure within risk appetite parameters;
 - Minimising the sensitivity at product, balance or business level of net interest income to changes in benchmark interest rates; and
 - Ensuring that IRRBB arising in the Group is transferred to the market or managed efficiently by Treasury within approved limits.
- Ensure that compliance with evolving regulatory IRRBB requirements is maintained within each jurisdiction in which the Group operates, including requirements set out as part of the ICAAP process.

Non traded interest rate risk primarily arises from the consumer lending portfolios and retail deposits. Hedging strategies are implemented as required to ensure that the Group remains within stated risk appetite.

The main hedging instruments used are interest rate swaps and the residual exposure is reported to the ALCO monthly using two key risk measures:

- Economic value of equity sensitivity to 200 basis point movements across the yield curve. This is then expressed as a percentage change from the base present value of equity; and
- Net interest income sensitivity to an instantaneous 1% parallel movement in interest rates.

The different methodologies can be summarised as:

Economic Value of Equity (EVE) – the EVE approach focuses on the value of the Group in today's interest rate environment and its sensitivity to changes in interest rates. This is done by scheduling the cash flows of all assets and liabilities and applying a set of discount rates to develop the present values. The present value of equity is derived by calculating the difference between the present value of assets and liabilities (Equity = Assets - Liabilities). The EVE calculation for the Group is subject to sensitivity analysis comprising +200 and -200 basis point movements across the yield curve. This is then expressed as a percentage change from the base present value of equity.

Net Interest Income (NII) Sensitivity – This measures the effect of a 100 basis point interest rate shock on the next 12 months NII, based on the re-pricing gaps in the existing portfolio.

	2012	2011
Measure		
Economic Value of Equity (EVE)	(7.84%)	(8.47)%
NII Sensitivity	(1.26%)	(0.62)%

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39 RISK MANAGEMENT (continued)

The following table summarises the contractual interest rate sensitivity gap for the Group as at 29 February 2012. It is not necessarily indicative of the positions at other times. A liability (or negative) gap position exists when liabilities reprice more quickly or in greater proportion than assets during a given period and tends to benefit net interest income in a declining interest rate environment. An asset (or positive) gap position exists when assets reprice more quickly or in greater proportion than liabilities during a given period and tends to benefit net interest income in a rising interest rate environment.

Group 2012	Within 3 months £'000	After 3 months, but within 6 months £'000	After 6 months, but within 1 year £'000	After 1 year, but within 5 years £'000	After 5 years £'000	Non – interest bearing funds £'000	Total £'000
Assets:							
Cash and balances with central banks	455,809	-	-	-	-	-	455,809
Loans and advances to banks	93,132	-	-	-	-	-	93,132
Loans and advances to customers	1,641,770	329,235	520,615	1,107,456	87,941	736,565	4,423,582
Investment securities	239,283	90,311	24,715	526,641	421,758	292,954	1,595,662
Other assets	-	-	-	-	-	1,036,958	1,036,958
Total assets	2,429,994	419,546	545,330	1,634,097	509,699	2,066,477	7,605,143
Liabilities and equity:							
Deposits from banks	64,606	10,000	3,100	-	-	-	77,706
Deposits from customers	4,108,319	195,950	766,482	319,036	-	-	5,389,787
Debt securities in issue	-	-	-	-	197,849	-	197,849
Other liabilities	22,216	19,556	27,919	9,219	-	340,865	419,775
Subordinated liabilities	330,000	-	-	-	-	-	330,000
Shareholders' equity	-	-	-	-	-	1,190,026	1,190,026
Total liabilities and equity	4,525,141	225,506	797,501	328,255	197,849	1,530,891	7,605,143
On Balance Sheet Interest rate sensitivity gap	(2,095,147)	194,040	(252,171)	1,305,842	311,850	535,586	-
Notional value of derivatives	1,814,331	(192,995)	(69,000)	(1,294,386)	(257,950)	-	-
Cumulative Interest rate sensitivity gap	(280,816)	(279,771)	(600,942)	(589,486)	(535,586)	-	-

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39 RISK MANAGEMENT (continued)

Group 2011	Within 3 months £'000	After 3 months, but within 6 months £'000	After 6 months, but within 1 year £'000	After 1 year, but within 5 years £'000	After 5 years £'000	Non – interest bearing funds £'000	Total £'000
Assets:							
Cash and balances at central banks	136,848	-	-	-	-	-	136,848
Loans and advances to banks	403,598	-	-	-	-	-	403,598
Loans and advances to customers	1,687,300	308,470	586,926	1,245,672	101,979	748,837	4,679,184
Investment securities	188,680	165,000	-	294,083	202,068	292,931	1,142,762
Other assets	-	-	-	-	-	629,170	629,170
Total assets	2,416,426	473,470	586,926	1,539,755	304,047	1,670,938	6,991,562
Liabilities and equity:							
Deposits from banks	26,200	10,000	-	-	-	-	36,200
Deposits from customers	4,655,010	2,266	225,442	194,746	-	-	5,077,464
Other liabilities	42,566	-	-	-	-	245,309	287,875
Debt securities in issue	224,472	-	-	-	125,559	-	350,031
Subordinated liabilities	190,000	-	-	-	-	-	190,000
Shareholders' equity	-	-	-	-	-	1,049,992	1,049,992
Total liabilities and equity	5,138,248	12,266	225,442	194,746	125,559	1,295,301	6,991,562
On Balance Sheet							
Interest rate sensitivity gap	(2,721,822)	461,204	361,484	1,345,009	178,488	375,637	-
Notional value of derivatives	1,579,725	149,000	(280,000)	(1,339,477)	(109,248)	-	-
Cumulative Interest rate sensitivity gap	(1,142,097)	(531,893)	(450,409)	(444,877)	(375,637)	-	-

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

Company 2012	Within 3 months £'000	After 3 months, but within 6 months £'000	After 6 months, but within 1 year £'000	After 1 year, but within 5 years £'000	After 5 years £'000	Non – interest bearing funds £'000	Total £'000
Assets:							
Cash and balances with central banks	455,766	-	-	-	-	-	455,766
Loans and advances to banks	93,132	-	-	-	-	-	93,132
Loans and advances to customers	1,641,770	329,235	520,615	1,107,456	87,941	736,565	4,423,582
Investment securities	239,283	90,311	24,715	526,641	421,758	292,954	1,595,662
Other assets	-	-	-	-	-	1,036,294	1,036,294
Total assets	2,429,951	419,546	545,330	1,634,097	509,699	2,065,813	7,604,436
Liabilities and equity:							
Deposits from banks	64,606	10,000	3,100	-	-	-	77,706
Deposits from customers	4,108,319	195,950	766,482	319,036	-	-	5,389,787
Debt securities in issue	-	-	-	-	197,849	-	197,849
Other liabilities	22,216	19,556	27,919	9,220	-	340,880	419,791
Subordinated liabilities	330,000	-	-	-	-	-	330,000
Shareholders' equity	-	-	-	-	-	1,189,303	1,189,303
Total liabilities and equity	4,525,141	225,506	797,501	328,256	197,849	1,530,183	7,604,436
On Balance Sheet Interest rate sensitivity gap	(2,095,190)	194,040	(252,171)	1,305,841	311,850	535,630	-
Notional value of derivatives	1,814,331	(192,995)	(69,000)	(1,294,386)	(257,950)	-	-
Cumulative Interest rate sensitivity gap	(280,859)	(279,814)	(600,985)	(589,530)	(535,630)	-	-

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

Company 2011	Within 3 months £'000	After 3 months, but within 6 months £'000	After 6 months, but within 1 year £'000	After 1 year, but within 5 years £'000	After 5 years £'000	Non – interest bearing funds £'000	Total £'000
Assets:							
Cash and balances at central banks	136,808	-	-	-	-	-	136,808
Loans and advances to banks	323,136	-	-	-	-	-	323,136
Loans and advances to customers	1,687,300	308,470	586,926	1,245,672	101,979	748,837	4,679,184
Investment securities	188,680	165,000	-	294,083	202,068	292,931	1,142,762
Other assets	-	-	-	-	-	727,301	727,301
Total assets	2,335,924	473,470	586,926	1,539,755	304,047	1,769,069	7,009,191
Liabilities and equity:							
Deposits from banks	26,200	10,000	-	-	-	-	36,200
Deposits from customers	4,655,009	2,266	225,442	194,747	-	-	5,077,464
Other liabilities	42,567	-	-	-	-	252,737	295,304
Debt securities in issue	224,696	-	-	-	125,559	-	350,255
Subordinated liabilities	190,000	-	-	-	-	-	190,000
Shareholders' equity	-	-	-	-	-	1,059,968	1,059,968
Total liabilities and equity	5,138,472	12,266	225,442	194,747	125,559	1,312,705	7,009,191
On Balance Sheet							
Interest rate sensitivity gap	(2,802,548)	461,204	361,484	1,345,008	178,488	456,364	-
Notional value of derivatives	1,579,725	149,000	(280,000)	(1,339,477)	(109,248)	-	-
Cumulative Interest rate sensitivity gap	(1,222,823)	(612,619)	(531,135)	(525,604)	(456,364)	-	-

- Foreign Exchange Risk**

The Group invests in non-GBP denominated bonds, and may raise funding from the wholesale markets in currencies other than GBP. Foreign exchange (FX) exposure arises if these exposures are not hedged. FX exposure may also arise through the Group's EUR-denominated Irish credit card exposure, through the cash held in tills and in transit from the Travel Money business and through invoices received which are denominated in foreign currencies.

All foreign currency exposure is hedged such that no material net exposure results.

The table below summarises the Group's exposure to foreign currency exchange rate risk at 29 February 2012. Included in the table are the Group's financial instruments at carrying amounts, categorised by currency.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

Group Maximum exposure 2012

	EUR £'000	USD £'000	GBP £'000	Other £'000	Total £'000
Assets:					
Cash and balances with central banks	(39)	(29)	455,877	-	455,809
Loans and advances to banks	-	-	93,132	-	93,132
Loans and advances to customers	32,110	-	4,391,472	-	4,423,582
Derivative financial instruments	1,942	1,358	16,221	1	19,522
Investment securities:					
- Available for sale	131,087	55,938	1,115,706	-	1,302,731
- Loans and receivables	-	-	292,931	-	292,931
Other assets	973	-	453,842	-	454,815
Investment in associate	-	-	72,459	-	72,459
Total assets	166,073	57,267	6,891,640	1	7,114,981
Liabilities:					
Deposits by banks	-	-	77,706	-	77,706
Deposits by customers	-	-	5,389,787	-	5,389,787
Debt securities in issue	-	-	197,849	-	197,849
Derivative financial instruments	3,280	291	67,615	-	71,186
Provisions for liabilities and charges	-	-	78,341	-	78,341
Accruals and deferred income	432	61	131,605	272	132,370
Current income tax liability	-	-	2,969	-	2,969
Deferred income tax liability	-	-	28,770	-	28,770
Other liabilities	800	27	105,312	-	106,139
Subordinated liabilities	-	-	330,000	-	330,000
Total liabilities	4,512	379	6,409,954	272	6,415,117

Group Maximum exposure 2011

	EUR £'000	USD £'000	GBP £'000	Other £'000	Total £'000
Assets:					
Cash and balances with central banks	1,540	1,023	133,529	756	136,848
Loans and advances to banks	-	-	403,598	-	403,598
Loans and advances to customers	32,683	-	4,646,501	-	4,679,184
Derivative financial instruments	-	-	16,378	-	16,378
Investment securities:					
- Available for sale	101,050	7,068	741,713	-	849,831
- Loans and receivables	-	-	292,931	-	292,931
Other assets	1,772	-	140,896	-	142,668
Investment in associate	-	-	63,985	-	63,985
Total assets	137,045	8,091	6,439,531	756	6,585,423
Liabilities:					
Deposits by banks	-	-	36,200	-	36,200
Deposits by customers	77	-	5,077,387	-	5,077,464
Debt securities in issue	-	-	350,031	-	350,031
Derivative financial instruments	-	-	37,369	-	37,369
Provisions for liabilities and charges	-	-	39,477	-	39,477
Accruals and deferred income	6,430	1,058	176,902	761	185,151
Current income tax liability	-	-	2,789	-	2,789
Deferred income tax liability	-	-	5,022	-	5,022
Other liabilities	659	-	17,284	124	18,067
Subordinated liabilities	-	-	190,000	-	190,000
Total liabilities	7,166	1,058	5,932,461	885	5,941,570

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

Company Maximum exposure 2012	EUR £'000	USD £'000	GBP £'000	Other £'000	Total £'000
Assets:					
Cash and balances with central banks	(39)	(29)	455,834	-	455,766
Loans and advances to banks	-	-	93,132	-	93,132
Loans and advances to customers	32,110	-	4,391,472	-	4,423,582
Derivative financial instruments	1,942	1,358	16,221	1	19,522
Investment securities					
- Available for sale	131,087	55,938	1,115,706	-	1,302,731
- Loans and receivables	-	-	292,931	-	292,931
Other assets	973	-	453,933	-	454,906
Investment in associate	-	-	71,708	-	71,708
Total assets	166,073	57,267	6,890,937	1	7,114,278
Liabilities:					
Deposits by banks	-	-	77,706	-	77,706
Deposits by customers	-	-	5,389,787	-	5,389,787
Debt securities in issue	-	-	197,849	-	197,849
Derivative financial instruments	3,280	291	67,615	-	71,186
Provisions for liabilities and charges	-	-	78,341	-	78,341
Accruals and deferred income	432	61	131,605	272	132,370
Current income tax liability	-	-	2,969	-	2,969
Deferred income tax liability	-	-	28,787	-	28,787
Other liabilities	800	27	105,310	1	106,138
Subordinated liabilities	-	-	330,000	-	330,000
Total liabilities	4,512	379	6,409,969	273	6,415,133

Company Maximum exposure 2011	EUR £'000	USD £'000	GBP £'000	Other £'000	Total £'000
Assets:					
Cash and balances with central banks	1,540	1,023	133,489	756	136,808
Loans and advances to banks	-	-	323,136	-	323,136
Loans and advances to customers	32,683	-	4,646,501	-	4,679,184
Derivative financial instruments	-	-	16,378	-	16,378
Investment securities:					
- Available for sale	101,050	7,068	741,713	-	849,831
- Loans and receivables	-	-	292,931	-	292,931
Other assets	1,772	-	199,119	-	200,891
Investment in associate	-	-	71,708	-	71,708
Total assets	137,045	8,091	6,424,975	756	6,570,867
Liabilities:					
Deposits by banks	-	-	36,200	-	36,200
Deposits by customers	78	-	5,077,386	-	5,077,464
Debt securities in issue	-	-	350,255	-	350,255
Derivative financial instruments	-	-	37,369	-	37,369
Provisions for liabilities and charges	-	-	39,477	-	39,477
Accruals and deferred income	6,430	1,058	176,902	761	185,151
Current income tax liability	-	-	3,366	-	3,366
Deferred income tax liability	-	-	5,022	-	5,022
Other liabilities	659	-	24,137	123	24,919
Subordinated liabilities	-	-	190,000	-	190,000
Total liabilities	7,167	1,058	5,940,114	884	5,949,223

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

- **RBS Insurance and TU Investment Portfolios**

The RBS insurance portfolio is part of Direct Line Insurance Group Plc (formerly RBS Insurance Group Limited) although any fluctuation in the value of the portfolio resides with the Group. Both the TU and the RBS insurance portfolios are predominantly comprised of Bonds and short term cash investments.

The main risks in the two portfolios relate to changes in: (i) interest rates affecting fair value arising as a proportion of the bonds are fixed rate in nature, (ii) credit quality, as the range of assets held are issued by a variety of institutions with different credit characteristics.

Portfolio management is undertaken by the RBS insurance and TU investment committees. The Group's ALM team monitors high-level risk information and the performance of the portfolios and reports this to the ALCO on a monthly basis. Risk provides oversight and challenge.

- **Pension Risk**

Pension Risk may be defined as: the risk to a firm caused by its contractual or other liabilities to or with respect to a pension scheme (whether established for its employees or those of a related company or otherwise). It also means the risk that the firm will make payments or other contribution to or with respect to a pension scheme because of a moral obligation or because the firm considers that it needs to do so for some other reason.

The Group is a participating employer in the Tesco PLC Pension Scheme (the Scheme) which is accounted for on a contributions only basis as described in Note 38 above.

f) Liquidity and Funding Risk

Liquidity risk is the risk that the Group has insufficient cash resources to meet its obligations as they fall due or can do so only at excessive cost. Liquidity is the on-going ability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet contractual obligations through unconstrained access to funding at reasonable market rates. The Group seeks to maintain a conservative liquidity and funding profile ensuring that it is able to meet its financial obligations under stressed conditions.

The Board approves the Liquidity Risk Management Policy framework (LRMP) and delegates to the CEO and thence, through ExCo and the ALCO, the day to day responsibility for complying with the framework which is in turn delegated to the Treasurer. The LRMP provides a framework to enable the Group to manage liquidity risk in a structured and prudent manner, as approved by the Board.

The Group sets limits to maintain liquidity risk exposures within its Liquidity Risk Appetite. These limits are a core component of the LRMP. The key liquidity measures monitored on a daily basis are the Individual Liquidity Guidance (ILG) ratio, the Net Stable Funding Ratio (NSFR) and the Net Wholesale Funding Outflow. The ILG ratio requires the Group to maintain sufficient high quality liquid assets to meet liquidity requirements during periods of market dislocation and stress. The NSFR measure is designed to enable the Group to fully fund long term and illiquid assets by an appropriate combination (size and maturity) of stable liabilities. The ratio does not give any credit for short-term wholesale funding thereby lessening refinancing risk. Management of the Net Wholesale Funding Outflow is designed to restrict high concentrations of wholesale cash outflows and to spread wholesale funding maturities.

The Treasurer is responsible for ensuring that all liquidity and funding measures are managed within policy and appetite. Liquidity management information is provided on a regular basis to the Liquidity Management Forum, the ALCO and the Board, with any exceptions highlighted. The Market and Liquidity Risk team provides review and challenge of policies and procedures relating to funding and liquidity risk.

Stress testing and reverse stress testing of current and forecast Balance Sheets is conducted to inform the Group of required liquidity resources and the circumstances that would result in liquidity resources being exhausted.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

As part of the FSA's liquidity framework the Group is required to complete an ILAA submission to the FSA. The ILAA is approved by the ALCO and Board before submission.

The following table shows cash flows payable up to a period of 20 years on an undiscounted basis. These differ from the statement of financial position values due to the effects of discounting on certain statement of financial position items and due to the inclusion of contractual future interest flows.

Derivatives designated in a hedging relationship are included according to their contractual maturity.

Group 2012	Within 1 year £'000	Between 1 and 2 years £'000	Between 2 and 3 years £'000	Between 3 and 4 years £'000	Between 4 and 5 years £'000	Beyond 5 years £'000	Total £'000
Financial assets:							
Cash and balances at central banks	455,935	-	-	-	-	-	455,935
Loans and advances to banks	93,209	-	-	-	-	-	93,209
Loans and advances to customers	3,120,708	484,171	370,435	227,073	129,711	127,503	4,459,601
Investment securities – available for sale	271,814	127,778	249,111	252,633	134,879	409,720	1,445,935
Investment in and loan to associate	1,531	1,559	1,360	1,866	1,961	81,388	89,665
Other loans and receivables	-	258,500	-	-	-	-	258,500
Other assets	454,815	-	-	-	-	-	454,815
	4,398,012	872,008	620,906	481,572	266,551	618,611	7,257,660
Financial liabilities:							
Deposits from banks	77,706	-	-	-	-	-	77,706
Deposits from customers	5,089,409	249,180	51,198	-	-	-	5,389,787
Debt securities in issue	-	-	-	-	-	185,000	185,000
Net settled derivative contracts	6,794	11,345	9,341	12,213	4,068	7,903	51,664
Interest payment on borrowings	5,141	5,108	5,048	4,976	4,895	8,127	33,295
Other liabilities	106,139	-	-	-	-	-	106,139
Subordinated liabilities	-	-	-	-	-	330,000	330,000
	5,285,189	265,633	65,587	17,189	8,963	531,030	6,173,591
Gap analysis	(887,177)	606,375	555,319	464,383	257,588	87,581	1,084,069

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

Group 2011	Within 1 year £'000	Between 1 and 2 years £'000	Between 2 and 3 years £'000	Between 3 and 4 years £'000	Between 4 and 5 years £'000	Beyond 5 years £'000	Total £'000
Financial assets:							
Cash and balances at central banks	136,848	-	-	-	-	-	136,848
Derivative financial instruments	(1,287)	4,426	5,243	4,302	2,580	2,459	17,723
Loans and advances to banks	403,598	-	-	-	-	-	403,598
Loans and advances to customers	3,238,749	655,568	502,488	337,721	169,574	177,982	5,082,082
Investment securities – available for sale	229,560	202,097	64,447	134,110	80,078	225,119	935,411
Investment in and loan to associate	1,568	1,907	2,352	2,517	2,628	89,075	100,047
Other loans and receivables	-	258,500	-	-	-	-	258,500
Other assets	151,922	-	-	-	-	-	151,922
	4,160,958	1,122,498	574,530	478,650	254,860	494,635	7,086,131
Financial liabilities:							
Deposits from banks	36,200	-	-	-	-	-	36,200
Deposits from customers	4,897,752	173,121	3,438	-	-	-	5,074,311
Debt securities in issue	225,000	-	-	-	-	125,000	350,000
Net settled derivative contracts	25,491	11,690	674	595	(367)	(869)	37,214
Gross settled derivative contracts	210	66	-	-	-	-	276
Accruals and deferred income	183,439	-	-	-	-	-	183,439
Interest payment on borrowings	20,883	23,984	14,852	15,949	16,499	70,197	162,364
Other liabilities	18,067	-	-	-	-	-	18,067
Subordinated liabilities	-	-	-	-	-	190,000	190,000
	5,407,042	208,861	18,964	16,544	16,132	384,328	6,051,871
Gap analysis	(1,246,084)	913,637	555,566	462,106	238,728	110,307	1,034,260

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

Company 2012	Within 1 year £'000	Between 1 and 2 years £'000	Between 2 and 3 years £'000	Between 3 and 4 years £'000	Between 4 and 5 years £'000	Beyond 5 years £'000	Total £'000
Financial assets:							
Cash and balances at central banks	455,891	-	-	-	-	-	455,891
Loans and advances to banks	93,209	-	-	-	-	-	93,209
Loans and advances to customers	3,120,708	484,171	370,435	227,073	129,711	127,503	4,459,601
Investment securities – available for sale	271,814	127,778	249,111	252,633	134,879	409,720	1,445,935
Investment in and loan to associate	1,531	1,559	1,360	1,866	1,961	81,388	89,665
Other loans and receivables	-	258,500	-	-	-	-	258,500
Other assets	454,906	-	-	-	-	-	454,906
	4,398,059	872,008	620,906	481,572	266,551	618,611	7,257,707
Financial liabilities:							
Deposits from banks	77,706	-	-	-	-	-	77,706
Deposits from customers	5,089,409	249,180	51,198	-	-	-	5,389,787
Debt securities in issue	-	-	-	-	-	185,000	185,000
Net settled derivative contracts	6,794	11,345	9,341	12,213	4,068	7,903	51,664
Interest payment on borrowings	5,141	5,108	5,048	4,976	4,895	8,127	33,295
Other liabilities	106,138	-	-	-	-	-	106,138
Subordinated liabilities	-	-	-	-	-	330,000	330,000
	5,285,188	265,633	65,587	17,189	8,963	531,030	6,173,590
Gap analysis	(887,129)	606,375	555,319	464,383	257,588	87,581	1,084,117

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

Company 2011	Within 1 year £'000	Between 1 and 2 years £'000	Between 2 and 3 years £'000	Between 3 and 4 years £'000	Between 4 and 5 years £'000	Beyond 5 years £'000	Total £'000
Financial assets:							
Cash and balances at central banks	136,808	-	-	-	-	-	136,808
Derivative financial instruments	(1,287)	4,426	5,243	4,302	2,580	2,459	17,723
Loans and advances to banks	323,136	-	-	-	-	-	323,136
Loans and advances to customers	3,238,749	655,568	502,488	337,721	169,574	177,982	5,082,082
Investment securities – available for sale	229,560	202,097	64,447	134,110	80,078	225,119	935,411
Investment in and loan to associate	1,568	1,907	2,352	2,517	2,628	89,075	100,047
Other loans and receivables	-	258,500	-	-	-	-	258,500
Other assets	210,145	-	-	-	-	-	210,145
	4,138,679	1,122,498	574,530	478,650	254,860	494,635	7,063,852
Financial liabilities:							
Deposits from banks	36,200	-	-	-	-	-	36,200
Deposits from customers	4,897,752	173,121	3,438	-	-	-	5,074,311
Debt securities in issue	225,000	-	-	-	-	125,000	350,000
Net settled derivative contracts	25,491	11,690	674	595	(367)	(869)	37,214
Gross settled derivative contracts	210	66	-	-	-	-	276
Accruals and deferred income	183,439	-	-	-	-	-	183,439
Interest payment on borrowings	20,883	23,984	14,852	15,949	16,499	70,197	162,364
Other liabilities	7,850	-	-	-	-	-	7,850
Subordinated liabilities	-	-	-	-	-	190,000	190,000
	5,396,825	208,861	18,964	16,544	16,132	384,328	6,041,654
Gap analysis	(1,258,146)	913,637	555,566	462,106	238,728	110,307	1,022,198

Expected maturity dates do not differ significantly from the contract dates, except for deposits from customers which are all retail in nature. These deposits are repayable on demand on a contractual basis. However historical trends show that these deposits have tended to be very stable with actual maturities being significantly longer than the contracted maturity. The Group continuously monitors retail deposit activity to ensure that it understands expected maturity flows. These instruments form a stable funding base for the Group's operations because of the broad customer base and the historical behaviours exhibited.

g) Financial / Capital Risk and Controls

The Finance and Treasury functions are responsible for the Financial Governance of the Group and its Financial, Management, Statutory, Regulatory and Treasury reporting. A number of measures are employed to identify and manage the risks inherent in these processes through the operation of the Group's Risk and Control Self Assessment framework, designed to comply with:

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

- Statutory, Regulatory and disclosure requirements;
- The Group's policies;
- Internal reporting, monitoring and self assessment systems;
- Reporting and monitoring requirements of governing committees and boards; and
- First line of defence responsibilities.

h) Other price risk

Other price risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market prices. The Group has available for sale investment securities that are held at fair value on the statement of financial position.

The table below demonstrates the Group's exposure to this other price risk as at 29 February 2012. Included in the table is the impact of a 10% shock in market prices on the Group's available for sale investment securities.

Group and Company 2012	Fair value	Impact of 10% shock	Value after 10% shock
Impact of 10 % shock in market prices	2012 £'000	2012 £'000	2012 £'000
Available for sale:			
Government-backed investment securities	73,035	(7,304)	65,731
Gilts	541,354	(54,135)	487,219
Supranational investment securities	406,755	(40,675)	366,080
Other investment securities	201,348	(20,135)	181,213
Certificates of deposit *	35,023	(13)	35,010
Asset-backed securities	45,216	(4,522)	40,694
	1,302,731	(126,784)	1,175,947
Group and Company 2011	Fair value	Impact of 10% shock	Value after 10% shock
Impact of 10 % shock in market prices	2011 £'000	2011 £'000	2011 £'000
Available for sale:			
Government-backed investment securities	80,223	(8,023)	72,200
Gilts	188,059	(18,806)	169,253
Supranational investment securities	225,535	(22,553)	202,982
Other investment securities	112,696	(11,270)	101,426
Certificates of deposit *	170,057	(68)	169,989
Asset-backed securities	73,261	(7,326)	65,935
	849,831	(68,046)	781,785

* Certificates of Deposit are valued based on current market yield; a 10% shock to the yield does not have a 10% difference to the valuation.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 RISK MANAGEMENT (continued)

FORBEARANCE

Forbearance is relief granted by a lender to assist customers in financial difficulty through arrangements to temporarily allow the customer to pay something other than the contractual amounts due where financial distress would prevent satisfactory repayment within the original terms and conditions of the contract. These temporary arrangements may be initiated by the customer or the Group. The main aim of forbearance is to return the customer to a position which meets their contractual obligations.

Group and Company 2012	Gross Loans and Advances subject to Forbearance Programmes 2012 £'000	Forbearance programmes as a proportion of total Loans and Advances 2012 %	Proportion of Forbearance Programmes covered by impairment provision 2012 %
Credit Cards	9,288	0.4	66.6
Loans	50,554	2.6	64.6

Group and Company 2011	Gross Loans and Advances subject to Forbearance Programmes 2011 £'000	Forbearance programmes as a proportion of total Loans and Advances 2011 %	Proportion of Forbearance Programmes covered by impairment provision 2011 %
Credit Cards	10,352	0.4	62.1
Loans	47,966	2.2	64.8

TESCO PERSONAL FINANCE PLC

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40 FINANCIAL INSTRUMENTS

The following tables analyse the financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39.

Group 2012	Loans and receivables £'000	Other (amortised cost) £'000	Derivatives used for hedging £'000	Available for sale £'000	Total £'000
Assets:					
Cash and balances at central banks	455,809	-	-	-	455,809
Loans and advances to banks	93,132	-	-	-	93,132
Loans and advances to customers	4,423,582	-	-	-	4,423,582
Derivative financial instruments	-	-	19,522	-	19,522
Investment securities classified as available for sale	-	-	-	1,302,731	1,302,731
Investment securities classified as loans and receivables	292,931	-	-	-	292,931
Other assets	454,815	-	-	-	454,815
	5,720,269	-	19,522	1,302,731	7,042,522
Liabilities:					
Deposits from banks	-	77,706	-	-	77,706
Deposits from customers	-	5,389,787	-	-	5,389,787
Debt securities in issue	-	197,849	-	-	197,849
Derivative financial instruments	-	-	71,186	-	71,186
Accruals and deferred income	-	132,370	-	-	132,370
Other liabilities	-	106,139	-	-	106,139
Deferred income tax liability	-	28,770	-	-	28,770
Subordinated liabilities	-	330,000	-	-	330,000
	-	6,262,621	71,186	-	6,333,807

All derivative financial instruments are held for economic hedging purposes, although not all derivatives are designated as hedging instruments under the terms of IAS 39.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

40 FINANCIAL INSTRUMENTS (continued)

Group 2011	Loans and receivables £'000	Other (amortised cost) £'000	Derivatives used for hedging £'000	Available for sale £'000	Total £'000
Assets:					
Cash and balances at central banks	136,848	-	-	-	136,848
Loans and advances to banks	403,598	-	-	-	403,598
Loans and advances to customers	4,679,184	-	-	-	4,679,184
Derivative financial instruments	-	-	16,378	-	16,378
Investment securities classified as available for sale	-	-	-	849,831	849,831
Investment securities classified as loans and receivables	292,931	-	-	-	292,931
Other assets	142,668	-	-	-	142,668
	5,655,229	-	16,378	849,831	6,521,438
Liabilities and equity:					
Deposits from banks	-	36,200	-	-	36,200
Deposits from customers	-	5,077,464	-	-	5,077,464
Debt securities in issue	-	350,031	-	-	350,031
Derivative financial instruments	-	-	37,369	-	37,369
Accruals and deferred income	-	185,151	-	-	185,151
Other liabilities	-	18,067	-	-	18,067
Deferred income tax liability	-	5,022	-	-	5,022
Subordinated liabilities	-	190,000	-	-	190,000
	-	5,861,935	37,369	-	5,899,304

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

40 FINANCIAL INSTRUMENTS (continued)

Company 2012	Loans and receivables	Other (amortised cost)	Derivatives used for hedging	Available for sale	Total
	£'000	£'000	£'000	£'000	£'000
Assets:					
Cash and balances at central banks	455,766	-	-	-	455,766
Loans and advances to banks	93,132	-	-	-	93,132
Loans and advances to customers	4,423,582	-	-	-	4,423,582
Derivative financial instruments	-	-	19,522	-	19,522
Investment securities classified as available for sale	-	-	-	1,302,731	1,302,731
Investment securities classified as loans and receivables	292,931	-	-	-	292,931
Other assets	454,906	-	-	-	454,906
	5,720,317	-	19,522	1,302,731	7,042,570
Liabilities:					
Deposits from banks	-	77,706	-	-	77,706
Deposits from customers	-	5,389,787	-	-	5,389,787
Debt securities in issue	-	197,849	-	-	197,849
Derivative financial instruments	-	-	71,186	-	71,186
Accruals and deferred income	-	132,370	-	-	132,370
Other liabilities	-	106,138	-	-	106,138
Deferred income tax liability	-	28,787	-	-	28,787
Subordinated liabilities	-	330,000	-	-	330,000
	-	6,262,637	71,186	-	6,333,823

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

40 FINANCIAL INSTRUMENTS (continued)

Company 2011	Loans and receivables £'000	Other (amortised cost) £'000	Derivatives used for hedging £'000	Available for sale £'000	Total £'000
Assets:					
Cash and balances at central banks	136,808	-	-	-	136,808
Loans and advances to banks	323,136	-	-	-	323,136
Loans and advances to customers	4,679,184	-	-	-	4,679,184
Derivative financial instruments	-	-	16,378	-	16,378
Investment securities classified as available for sale	-	-	-	849,831	849,831
Investment securities classified as loans and receivables	292,931	-	-	-	292,931
Other assets	200,891	-	-	-	200,891
	5,632,950	-	16,378	849,831	6,499,159
Liabilities and equity:					
Deposits from banks	-	36,200	-	-	36,200
Deposits from customers	-	5,077,464	-	-	5,077,464
Debt securities in issue	-	350,255	-	-	350,255
Derivative financial instruments	-	-	37,369	-	37,369
Accruals and deferred income	-	185,151	-	-	185,151
Other liabilities	-	24,919	-	-	24,919
Deferred income tax liability	-	5,022	-	-	5,022
Subordinated liabilities	-	190,000	-	-	190,000
	-	5,869,011	37,369	-	5,906,380

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

40 FINANCIAL INSTRUMENTS (continued)

Fair values

The following table shows the carrying values and the fair values of financial instruments.

Group	2012		2011	
	Carrying value £'000	Fair value £'000	Carrying value £'000	Fair value £'000
Financial assets:				
Cash and balances with central banks	455,809	455,809	136,848	136,848
Loans and advances to banks	93,132	93,132	403,598	403,598
Loans and advances to customers	4,423,582	4,459,777	4,679,184	4,674,972
Derivative financial instruments	19,522	19,522	16,378	16,378
Investment securities - available for sale	1,302,731	1,302,731	849,831	849,831
Investment securities - loans and receivables	292,931	295,012	292,931	289,423
Financial liabilities:				
Deposits from banks	77,706	77,706	36,200	36,200
Deposits from customers	5,389,787	5,413,072	5,077,464	5,084,161
Debt securities in issue	197,849	209,315	350,031	358,412
Derivative financial instruments	71,186	71,186	37,369	37,369
Deferred income tax liability	28,770	28,770	5,022	5,022
Subordinated liabilities	330,000	387,695	190,000	190,978

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NOTES TO THE FINANCIAL STATEMENTS

40 FINANCIAL INSTRUMENTS (continued)

Company	2012		2011	
	Carrying value £'000	Fair value £'000	Carrying value £'000	Fair value £'000
Financial assets:				
Cash and balances with central banks	455,766	455,766	136,808	136,808
Loans and advances to banks	93,132	93,132	323,136	323,136
Loans and advances to customers	4,423,582	4,459,777	4,679,184	4,674,972
Derivative financial instruments	19,522	19,522	16,378	16,378
Investment securities - available for sale	1,302,731	1,302,731	849,831	849,831
Investment securities - loans and receivables	292,931	295,012	292,931	289,423
Financial liabilities:				
Deposits from banks	77,706	77,706	36,200	36,200
Deposits from customers	5,389,787	5,413,072	5,077,464	5,084,161
Debt securities in issue	197,849	209,315	350,255	358,637
Derivative financial instruments	71,186	71,186	37,369	37,369
Deferred income tax liability	28,787	28,787	5,022	5,022
Subordinated liabilities	330,000	387,695	190,000	190,978

a) Cash and balances with central banks and loans and advances to banks

The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

b) Loans and advances to customers

Loans and advances are net of charges for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

c) Derivative financial instruments

Fair values are obtained from valuation techniques (for example for swaps and currency transactions) including discounted cash flow models using observable market data.

d) Financial assets classified as available for sale investment securities

Financial assets classified as available for sale investment securities are carried at fair value based on market prices or broker/dealer price quotations.

e) Investment securities held as loans and receivables

Fair values are based on quoted prices where available or by using discounted cash flows applying market rates.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

40 FINANCIAL INSTRUMENTS (continued)

f) Deposits from customers and banks

The estimated fair value of customer accounts and deposits from banks represents the discounted amount of estimated future cash flows expected to be paid. Expected cash flows are discounted at current market rates to determine fair value.

g) Debt securities in issue and subordinated liabilities

The estimated fair value of debt securities in issue and subordinated liabilities is calculated using a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity.

Fair value hierarchy

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Group's market assumptions. These two types of inputs have created the following fair value hierarchy:

i) Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, London Stock Exchange, Frankfurt Stock Exchange, New York Stock Exchange) and exchange traded derivatives like futures (for example, Nasdaq, S&P 500).

ii) Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes the majority of the OTC derivative contracts, traded loans and issued structured debt. The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg and Reuters.

iii) Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

This hierarchy requires the use of observable market data when available. The Group considers relevant and observable market prices in its valuations where possible.

Group and Company 2012	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets classified as available for sale	541,354	761,377	-	1,302,731
Derivative financial instruments	-	19,522	-	19,522
Total assets	541,354	780,899	-	1,322,253
Derivative financial instruments	-	(71,186)	-	(71,186)
Total liabilities	-	(71,186)	-	(71,186)
Group and Company 2011	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets classified as available for sale	188,059	661,772	-	849,831
Derivative financial instruments	-	16,378	-	16,378
Total assets	188,059	678,150	-	866,209
Derivative financial instruments	-	(37,369)	-	(37,369)
Total liabilities	-	(37,369)	-	(37,369)

There were no significant transfers between Level 1 and Level 2 of the fair value hierarchy.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

41 ASSET QUALITY

Internal reporting and oversight of risk assets is principally differentiated by credit ratings. Internal ratings are used to assess the credit quality of borrowers. Customers are assigned credit ratings, based on various credit grading models that reflect the probability of default.

Expressed as an annual probability of default, the upper and lower boundaries and the midpoint for each of the asset (both customer and treasury) quality grades are as follows:

Asset Quality Grade	Annual probability of default		
	Minimum %	Midpoint %	Maximum %
AQ1	0.00	0.10	0.20
AQ2	0.21	0.40	0.60
AQ3	0.61	1.05	1.50
AQ4	1.51	3.25	5.00
AQ5	5.01	52.50	100.00

Group 2012	AQ1 £'000	AQ2 £'000	AQ3 £'000	AQ4 £'000	AQ5 £'000	Accruing past due £'000	Non- accrual £'000	Impairment provision £'000	Total £'000
Assets:									
Cash and balances at central banks	455,809	-	-	-	-	-	-	-	455,809
Loans and advances to banks	93,132	-	-	-	-	-	-	-	93,132
Loans and advances to customers	629,201	982,423	872,085	693,234	1,163,709	73,139	194,422	(184,631)	4,423,582
Investment securities:									
- available for sale	1,302,731	-	-	-	-	-	-	-	1,302,731
- loans and receivables	292,931	-	-	-	-	-	-	-	292,931
	2,773,804	982,423	872,085	693,234	1,163,709	73,139	194,422	(184,631)	6,568,185
Commitments	4,471,232	1,716,465	661,643	426,484	146,730	-	-	-	7,422,554

Group 2011	AQ1 £'000	AQ2 £'000	AQ3 £'000	AQ4 £'000	AQ5 £'000	Accruing past due £'000	Non- accrual £'000	Impairment provision £'000	Total £'000
Assets:									
Cash and balances at central banks	136,848	-	-	-	-	-	-	-	136,848
Loans and advances to banks	403,598	-	-	-	-	-	-	-	403,598
Loans and advances to customers	604,554	469,898	932,307	1,676,732	892,616	72,779	212,119	(181,821)	4,679,184
Investment securities:									
- available for sale	849,831	-	-	-	-	-	-	-	849,831
- loans and receivables	292,931	-	-	-	-	-	-	-	292,931
	2,287,762	469,898	932,307	1,676,732	892,616	72,779	212,119	(181,821)	6,362,392
Commitments	4,254,414	1,600,981	645,146	444,288	182,505	-	-	-	7,127,334

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

41 ASSET QUALITY (continued)

Company 2012	AQ1 £'000	AQ2 £'000	AQ3 £'000	AQ4 £'000	AQ5 £'000	Accruing past due £'000	Non- accrual £'000	Impairment provision £'000	Total £'000
Assets:									
Cash and balances at central banks	455,766	-	-	-	-	-	-	-	455,766
Loans and advances to banks	93,132	-	-	-	-	-	-	-	93,132
Loans and advances to customers	629,201	982,423	872,085	693,234	1,163,709	73,139	194,422	(184,631)	4,423,582
Investment securities:									
- available for sale	1,302,731	-	-	-	-	-	-	-	1,302,731
- loans and receivables	292,931	-	-	-	-	-	-	-	292,931
	2,773,761	982,423	872,085	693,234	1,163,709	73,139	194,422	(184,631)	6,568,142
Commitments	4,471,232	1,716,465	661,643	426,484	146,730	-	-	-	7,422,554

Company 2011	AQ1 £'000	AQ2 £'000	AQ3 £'000	AQ4 £'000	AQ5 £'000	Accruing past due £'000	Non- accrual £'000	Impairment provision £'000	Total £'000
Assets:									
Cash and balances at central banks	136,808	-	-	-	-	-	-	-	136,808
Loans and advances to banks	323,136	-	-	-	-	-	-	-	323,136
Loans and advances to customers	604,554	469,898	932,307	1,676,732	892,616	72,779	212,119	(181,821)	4,679,184
Investment securities:									
- available for sale	849,831	-	-	-	-	-	-	-	849,831
- loans and receivables	292,931	-	-	-	-	-	-	-	292,931
	2,207,260	469,898	932,307	1,676,732	892,616	72,779	212,119	(181,821)	6,281,890
Commitments	4,254,414	1,600,981	645,146	444,288	182,505	-	-	-	7,127,334

During the year ended 29 February 2012 the loans portfolio was migrated to the Group's new IT operating platform. At the time of this migration there was also a change made to the methodology by which the Group measures customer risk in relation to outstanding loan balances. The new methodology is considered to be a better predictor of risk for internal reporting and monitoring purposes. This same risk measure is used to prepare the above asset quality disclosure for the year ended 29 February 2012, and as a result this has revised the categorisation of some customer accounts since the prior year end. The Group is unable to restate the prior year data on a comparable basis using this new methodology as it is considered to be impracticable to recreate this information. To aid understanding, therefore, it is key to note that despite this change in methodology and the resulting impact on the data presented, the Group does not believe that there has been any significant change in the underlying quality of the loans portfolio year on year.

Refer to note 42 for further details of non-accrual loans.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

42 PAST DUE AND IMPAIRED FINANCIAL ASSETS

At 29 February 2012, the Group and Company's non-accrual loans amounted to £194,422,000 (2011: £212,119,000). Loan impairment provisions of £184,631,000 (2011: £181,821,000) were held against these loans.

Group and Company	2012 £'000	2011 £'000
Gross income not recognised but which would have been recognised under the original terms of non-accrual loans	<u>12,902</u>	<u>8,002</u>

The following assets were past due at the balance sheet date but not considered impaired:

Group and Company 2012	Past due 1-29 days £'000	Past due 30-59 days £'000	Past due 60-89 days £'000	Past due more than 90 days £'000	Total £'000
Loans and advances to customers	49,569	13,883	9,687	-	73,139

Group and Company 2011	Past due 1-29 days £'000	Past due 30-59 days £'000	Past due 60-89 days £'000	Past due more than 90 days £'000	Total £'000
Loans and advances to customers	53,642	12,663	6,474	-	72,779

43 COMMITMENTS

a) Undrawn credit card commitments

The amounts shown below are intended to provide an indication of the volume of business transacted and not of the underlying credit or other risks.

Group and Company	2012 £'000	2011 £'000
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than one year	<u>7,422,554</u>	<u>7,127,334</u>

Under an undrawn credit card commitment the Group agrees to make funds available to a customer in the future. Undrawn credit card commitments, which are usually for a specified term, may be unconditionally cancellable or may persist, providing all facility conditions are satisfied or waived.

b) Capital commitments

At 29 February 2012 the Group and Company had capital commitments related to property, plant and equipment of £213,000 (2011: £1,476,000) and intangible assets of £1,726,000 (2011: £431,000). This is in respect of IT software development and building fit-out purchases. The Group's management is confident that future net revenues and funding will be sufficient to cover this commitment.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

43 COMMITMENTS (continued)

c) Operating lease commitments

The future minimum lease payments under non-cancellable operating leases are as follows:

Group and Company	2012 £'000	2011 £'000
No later than one year	5,159	3,146
Later than one year and no later than five years	20,807	20,306
Later than five years	65,886	69,632
	91,852	93,084

44 CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition:

Group	2012 £'000	2011 £'000
Cash and balances with central banks* (refer note 16)	450,721	132,608
Loans and advances to banks (refer note 17)	93,132	403,598
Certificates of deposit (refer note 20)	35,023	170,057
	578,876	706,263

Company	2012 £'000	2011 £'000
Cash and balances with central banks* (refer note 16)	450,678	132,568
Loans and advances to banks (refer note 17)	93,132	323,136
Certificates of deposit (refer note 20)	35,023	170,057
	578,833	625,761

* Mandatory reserve deposits held within the Bank of England are not included within cash and cash equivalents for the purposes of the cash flow statement as these do not have a maturity of less than three months.

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NOTES TO THE FINANCIAL STATEMENTS

45 CASH INFLOW FROM OPERATING ACTIVITIES

Group	Note	2012 £'000	2011 £'000
Loan impairment charges	10	119,028	130,942
Depreciation and amortisation	9	44,545	19,391
Profit on disposal of investment securities	7	(4,749)	(564)
Provision for customer redress	31	57,400	(50,000)
Impairment loss on amounts due from insurance business	10	5,483	414
Share of (profit)/loss of associate	24	(5,269)	6,821
Insurance policy cancellation provision	31	3,795	-
Equity settled share based payments	36	7,172	-
Interest on subordinated liabilities	4	4,461	3,193
Fair value movements		7,170	(9,216)
Non cash items included in operating profit before taxation		239,036	100,981
Net movement in mandatory balances with central banks		(848)	(910)
Net movement in loans and advances to customers		146,168	(525,167)
Net movement in prepayments and accrued income		36,131	(17,919)
Net movement in other assets		(317,630)	(66,497)
Net movement in deposits from banks		41,506	6,344
Net movement in deposits from customers		312,323	717,346
Net movement in accruals and deferred income		(53,063)	52,552
Provisions utilised		(22,331)	(10,523)
Net movement in other liabilities		88,073	8,555
Changes in operating assets and liabilities		230,329	163,781

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

45 CASH INFLOW FROM OPERATING ACTIVITIES (continued)

Company	Note	2012 £'000	2011 £'000
Loan impairment charges		119,028	130,942
Depreciation and amortisation		44,545	19,391
Profit on disposal of investment securities		(4,749)	(564)
Provision for customer redress	31	57,400	(50,000)
Impairment loss on amounts due from insurance business		5,483	414
Insurance policy cancellation provision	31	3,795	-
Equity settled share based payments	36	7,172	-
Interest on subordinated liabilities		4,461	3,193
Fair value movements		6,946	(8,991)
Non cash items included in operating profit before taxation		244,081	94,385
Net movement in mandatory balances with central banks		(848)	(910)
Net movement in loans and advances to customers		146,168	(525,167)
Net movement in prepayments and accrued income		68,320	(20,676)
Net movement in other assets		(259,498)	(58,431)
Net movement in deposits from banks		41,506	6,344
Net movement in deposits from customers		312,323	707,239
Net movement in accruals and deferred income		(53,063)	47,869
Provisions utilised		(22,331)	(10,523)
Net movement in other liabilities		78,350	12,082
Changes in operating assets and liabilities		310,927	157,827

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

46 CAPITAL RESOURCES

The following table analyses the Company's regulatory capital resources (being the regulated entity):

	2012 £'000	2011 £'000
Movement in tier 1 capital:		
At the beginning of the year	760,751	570,524
Ordinary shares issued	111,500	445,500
Profit attributable to shareholders	64,608	61,824
Other reserves	7,172	-
Ordinary dividends	(108,150)	(162,150)
Intangible assets	(121,720)	(154,947)
At the end of the year	714,161	760,751
Composition of regulatory capital		
Tier 1 capital:		
Shareholders funds and non-controlling interests	714,161	760,751
Tier 2 capital:		
Qualifying subordinated debt	375,000	235,000
Other interests in tier 2 capital	21,154	17,626
	396,154	252,626
Supervisory deductions:		
Other deductions*	(364,639)	(364,863)
Total regulatory capital	745,676	648,514
Total risk weighted assets (unaudited)	4,672,636	4,787,753
Tier 1 ratio	15.28%	15.89%
Risk asset ratio (unaudited)	15.96%	13.55%

*Other deductions relate to capital deducted loans and the investment in associate.

It is the Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the FSA. The Group carried regulatory capital resources in excess of its capital requirements throughout the year.

Capital Management

Regulatory capital is reported monthly to the ALCO and the Board. Capital adequacy is monitored daily by the Treasury department.

Internal Capital Adequacy Assessment Process (ICAAP)

The Group undertakes an ICAAP which is an internal assessment of its capital needs. The ICAAP is performed periodically and is supplemented by a program of capital and liquidity stress testing. The ICAAP and stress testing scenarios are presented to the Board and the ExCo for challenge and approval.

The outcome of the ICAAP covers all material risks to determine the capital requirement over a twelve month horizon and includes stressed scenarios over a three to five year period. Where capital is deemed as not being able to mitigate a particular risk, such as liquidity risk, alternative management actions are identified and described in the ICAAP document.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

46 CAPITAL RESOURCES (continued)

The Board approved ICAAP is submitted to the FSA on a regular basis, which forms the basis of the Individual Capital Guidance set by the FSA. The Group has continued to maintain a capital buffer over the FSA's minimum regulatory capital requirements.

47 RELATED PARTY TRANSACTIONS

During the year the Group had the following transactions with related parties:

a) Transactions involving Directors and other key connected persons

For the purposes of IAS 24 "Related Party Disclosures", key management personnel comprise Directors of the Group. The captions in the Group's primary financial statements include the following amounts attributable, in aggregate, to key connected persons.

Group and Company	2012 £'000	2011 £'000
Loans and advances to customers		
At the beginning of the year	41	45
Loans issued during the year	22	28
Loan repayments during the year	(35)	(32)
Loans outstanding at the end of the year	<u>28</u>	<u>41</u>
Interest income earned	1	1
Deposits from customers		
Deposits at the beginning of the year	393	489
Deposits received during the year	1,313	75
Deposits repaid during the year	(9)	(171)
Deposits at the end of the year	<u>1,697</u>	<u>393</u>
Interest expense on deposits	5	4

No provisions have been recognised in respect of loans and advances to related parties (2011: nil).

b) Remuneration of key management personnel

The amount of remuneration recharged to the Group in relation to the Directors is set out below in aggregate. Further information about the remuneration of Directors is provided in note 11.

Group and Company	2012 £'000	2011 £'000
Salaries and other short-term employee benefits	3,390	3,338
Termination benefits	-	-
Post employment benefits	-	-
Other long term benefits	-	-
Share based payments	-	-
Total emoluments	<u>3,390</u>	<u>3,338</u>

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

47 RELATED PARTY TRANSACTIONS (continued)

c) Trading transactions

During the year, the Group entered into the following transactions with related parties:

Group	2012 Tesco plc and subsidiaries £'000	2012 Tesco Underwriting Limited £'000	2011 Tesco plc and subsidiaries £'000	2011 Tesco Underwriting Limited £'000
Interest received and other income	1,333	1,515	1,203	662
Interest paid	(4,470)	-	(3,203)	-
Provision of services	(76,615)	-	(78,952)	-

Company	2012 Tesco plc and subsidiaries £'000	2012 Tesco Underwriting Limited £'000	2011 Tesco plc and subsidiaries £'000	2011 Tesco Underwriting Limited £'000
Interest received and other income	1,333	1,515	1,203	662
Dividend income	-	-	3,726	-
Interest paid	(4,470)	-	(3,203)	-
Provision of services	(76,615)	-	(78,952)	-

Balances owing to/from related parties are identified in notes 20, 22, 32, 33 and 34.

For the year ended 29 February 2012 the Group generated the majority of its insurance commission from the sale and service of Motor and Home Insurance policies underwritten by Tesco Underwriting Limited, an associated company and therefore related party. Customer premiums on such sales are collected directly by the Group and the net premium is remitted to Tesco Underwriting Limited.

d) Ultimate parent undertaking

The Company's ultimate parent undertaking and controlling party is Tesco plc which is incorporated in England. The financial statements for Tesco plc can be obtained from its registered office at Tesco House, Delamare Road, Cheshunt, Hertfordshire EN8 9SL.

e) Immediate parent undertaking

The Company's immediate parent company is Tesco Personal Finance Group Limited which is incorporated in Scotland. Financial statements for Tesco Personal Finance Group Limited can be obtained from its registered office at 22 Haymarket Yards, Edinburgh, EH12 5BH. The smallest group into which the Company is consolidated is Tesco Personal Finance Group Limited and the largest group is Tesco Plc.

48 CONTINGENT LIABILITIES

The Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) is the UK statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS has borrowed from HM Treasury to fund these compensation costs associated with institutions that failed in 2008 and will receive receipts from asset sales, surplus cash flow and other recoveries from these institutions in the future. The initial borrowings from HM Treasury are on an interest only basis and, as from 1 April 2012, this has increased from 12 month LIBOR plus 30 basis points to 12 month LIBOR plus 100 basis points. The FSCS meets its obligations by raising management expense levies which will be capped based on limits advised by the FSA. These include amounts to cover the interest on its borrowings and compensation levies on the industry.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

48 CONTINGENT LIABILITIES (continued)

Each deposit-taking institution contributes in proportion to its share of total protected deposits. As at 29 February 2012 the Group has accrued £5,449,000 (2011: £3,384,000) in respect of its current obligation to meet expenses levies, based on indicative costs published by the FSCS.

If the FSCS does not receive sufficient funds from the failed institutions to repay HM Treasury in full it will raise compensation levies. At this time it is not possible to estimate the amount or timing of any shortfall resulting from the cash flows received from the failed institutions and, accordingly, no provision for compensation levies, which could be significant, has been made in these financial statements.

49 SHARE BASED PAYMENTS

The Group charge for the year recognised in respect of share-based payments is £2,944,000 (2011: £6,162,000), which is made up of share option schemes and share bonus payments. Of this amount £1,725,000 (2011: £2,104,000) will be equity settled and £1,219,000 (2011: £4,058,000) cash settled.

a) Share Option Schemes

The Group had two option schemes in operation during the year, both of which are equity-settled schemes using Tesco plc shares:

i) The Discretionary Share Option Plan (2004) was adopted by Tesco plc on 5 July 2004. This scheme permits the grant of approved, unapproved and international options in respect of ordinary shares to selected executives. Options are normally exercisable between three and ten years from date of grant at a price not less than the middle-market quotation or average middle-market quotations of an ordinary share for the dealing day or three dealing days preceding the date of grant. The exercise of options will normally be conditional on the achievement of a specified performance target related to the annual percentage growth in earnings per share over a three year period. There will be no discounted options under this scheme.

ii) The Savings-related Share Option Scheme (1981) permits the grant to employees of options in respect of ordinary shares linked to a building society/bank save-as-you-earn contract for a term of three or five years with contributions from employees of an amount between £5 and £250 per four-weekly pay period. Options are capable of being exercised at the end of the three or five-year period at a subscription price not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceding the offer date.

The following table reconciles the number of share options outstanding and the weighted average exercise price (WAEP):

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NOTES TO THE FINANCIAL STATEMENTS

49 SHARE BASED PAYMENTS (continued)

	Savings-related share option scheme Options	Savings-related share option scheme WAEP (pence)	Approved share option scheme Options	Approved share option scheme WAEP (pence)	Unapproved share options scheme Options	Unapproved share options scheme WAEP (pence)
Outstanding at 28 February 2010	85,133	328.00	452,985	339.77	493,845	345.54
Granted	78,188	386.00	518,822	419.80	964,321	419.80
Forfeited	(16,561)	328.82	(114,307)	389.29	(128,583)	409.94
Exercised	(198)	328.00	-	-	(8,540)	338.40
Outstanding as at 28 February 2011	146,562	358.81	857,500	381.59	1,321,043	393.17
Granted	240,804	364.00	-	-	-	-
Forfeited	(32,396)	349.67	(67,752)	398.50	(70,179)	415.12
Exercised	-	-	-	-	-	-
Outstanding as at 29 February 2012	354,970	363.16	789,748	380.14	1,250,864	391.94

None of the above share options were exercisable as at 29 February 2012 (2011: nil).

There were no share options exercised during the financial year. The average Tesco plc share price during the year ended 29 February 2012 was 385.43p.

The fair value of share options is estimated at the date of grant using the Black-Scholes option pricing model. The following table gives the assumptions applied to the options granted in the respective periods shown. No assumption has been made to incorporate the effects of expected early exercise.

	2012 Savings-related share option scheme	2012 Executive Share Option Schemes	2011 Savings-related share option scheme	2011 Executive Share Option Schemes
Expected Dividend Yield (%)	4.10%	-	3.50%	3.50%
Expected Volatility (%)	23 – 27%	-	26 – 30%	25%
Risk free interest rate (%)	1.5 – 1.8%	-	1.6 – 2.2%	3.20%
Expected life of option (years)	3 or 5	-	3 or 5	6
Weighted average fair value of options granted (pence)	68.62	-	93.49	77.88
Probability of forfeiture (%)	14 – 15%	-	14 – 15%	10%
Share price (pence)	404.00	-	436.00	419.80
Weighted average exercise price (pence)	364.00	-	386.00	419.80

Volatility is a measure of the amount by which a price is expected to fluctuate in the period. The measure of volatility used in Tesco plc option pricing models is the annualised standard deviation of the continuously compounded rates of return on the share over a period of time. In estimating the future volatility of Tesco plc's share price, the Tesco plc Board considers the historical volatility of the share price over the most recent period that is generally commensurate with the expected term of the option, taking into account the remaining contractual life of the option.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

49 SHARE BASED PAYMENTS (continued)

b) Share Bonus Schemes

Eligible UK employees are able to participate in Shares in Success, an all-employee profit sharing scheme. Each year, Tesco plc shares are awarded as a percentage of earnings up to a statutory maximum of £3,000.

Senior management also participates in performance-related bonus schemes. The amount paid to employees is based on a percentage of salary and is paid partly in cash and partly in Tesco plc shares. Bonuses are awarded to eligible employees who have completed a required service period and depend on the achievement of corporate targets. The accrued cash element of the bonus at the balance sheet date is £588,000 (2011: £3,440,000).

Selected senior management participate in the selected senior management Performance Share Plan. Awards made under this plan will normally vest three years after the date of the award for nil consideration. Vesting will normally be conditional on the achievement of specified performance targets related to the return on capital employed over a three year performance period.

Senior management participate in the senior management Performance Share Plan 2011. Awards made under this plan will normally vest three years after the date of the award for nil consideration. Vesting will normally be conditional on the achievement of specified performance targets related to the return on capital employed and earnings per share over a three year performance period.

The fair value of shares awarded under these schemes is their market value on the date of the award. Expected dividends are not incorporated into the fair value.

The number of Tesco plc shares and weighted average fair value (WAFV) of share bonuses awarded during the year were:

	2012	2012	2011	2011
	Shares number	WAFV (pence)	Shares number	WAFV (pence)
Shares in Success	183,322	416.26	99,935	416.23
Executive Incentive Scheme	356,317	415.98	415,253	398.93
Performance Share Plan	1,006,904	387.50	297,431	402.86

c) Long Term Incentive Scheme

Certain members of the Group's senior management participate in a long term incentive scheme which may reward eligible members based on long term sustainable profit growth and annual corporate objectives encompassing certain customer, operational, people and financial metrics. Part of the award is a cash bonus based on a range of profitability targets for the year ending 28 February 2015, with the extent of the award being scaled between a minimum and maximum profitability targets. If the minimum profitability target is achieved, members can also become eligible for an award based on the achievement of the corporate objectives. The corporate objectives are annual targets and their achievement will be approved by the Remuneration Committee on an annual basis. The corporate objective award will be made in the form of "notional" shares linked to the share price of Tesco plc and as such is classified as a cash settled share based payment award. The fair value of the corporate objectives award is based on the quoted price of Tesco plc shares. Any award paid in 2015 will be made net of the cumulative amounts paid to eligible members under other bonus and share based payment arrangements.

There is no charge recognised in the consolidated income statement in respect of this long term incentive scheme for the year ended 29 February 2012 (2011: £nil). This reflects the significant uncertainty at year end as to whether or not the minimum qualifying criteria will be met in 2015. Progress against these criteria will be monitored on an ongoing basis and the Group will commence accruing the relevant charge in the consolidated income statement if in future it becomes more likely than not that the relevant criteria will be met.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

50 EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

On 26 April 2012 the Group received a capital injection of £45,000,000 from its parent company, Tesco Personal Finance Group Limited.

