Tesco Personal Finance Limited

Directors' Report and Financial Statements

31 December 2007

Registered in Scotland No 173199

Tesco Personal Finance Limited

Directors' Report and Financial Statements
31 December 2007

Directors and Advisers

Directors·	Andrew Thomas Higginson – Chairman Timothy Robert Ashdown Robert James Mackenzie Bulloch Iain Clink John William Melbourn CBE Christopher Paul Sullivan Laura Katharine Wade Gery Gordon Frances Pell
Secretary.	Alan Ewing Mills
Registered Office	24 St Andrew Square Edinburgh EH2 1AF
Telephone	0131 556 8555
Auditors.	Deloitte & Touche LLP Edinburgh
Bankers.	The Royal Bank of Scotland plc 36 St Andrew Square Edinburgh EH2 2YB

Directors' Report

The directors present their annual report and the audited financial statements for the year ended 31 December 2007

Principal activities

The Company is engaged in the provision of banking and other financial services

Review of the year

Business review

The directors are satisfied with the Company's performance in the year The Company continues to trade successfully within a difficult retail financial services market During the year the Company further expanded its customer base through its principal products personal loans, credit cards, savings accounts, investment products and general insurance

In the forthcoming year the Company intends to grow its existing customer base and introduce additional financial products and services

An interim dividend of £70,000,000 (2006 £60,000,000) was paid on 29 June 2007 and a final dividend of £50,000,000 (2006 £70,000,000) was paid on 28 December 2007

The directors do not anticipate any material change in either the type or level of activities of the Company The directors consider the Company to be in a strong financial position and confirm that the Company has adequate resources to continue in business for the foreseeable future Accordingly they continue to adopt the going concern basis in preparing the financial statements

Financial Performance

The Company's financial performance is presented in the Income Statement on Page 7

Income grew by £42,827,000 and expenses rose by £35,601,000 After impairment provisions of £116,368,000 the profit for the year was £180,585,000, an increase of 3% over 2006, profit before impairment provisions increased by 2%

The Company's cost income ratio for the year was 45 9% (2006 42 7%) The Company's net interest margin for 2007 was 3 9% (2006 4 3%) and the bad debt coverage at the year end was 5 1% (2006 4 8%)

At the year end the Company's financial position showed total assets of £8,144m, an increase of 9% over 2006, including income generating assets comprising investments of £259m and advances of £7,481m The net book value of property, plant and equipment was £19m compared with £15m at the end of the previous year The Company's risk asset ratio was 12 1% at the year end (2006 12 5%)

Other Matters

The Company is funded by facilities from The Royal Bank of Scotland plc It seeks to minimise its exposure to external financial risks other than credit risk, further information on financial risk management policies and exposures is disclosed in Note 25 to the financial statements

Directors' Report (continued)

Directors

The present directors and Secretary who have served throughout the year, except where noted below, are listed on page 1

From 1 January 2007 to date the following changes have taken place

Directors	*Appointed*	*Resigned*
G F Pell	2 February 2007	
N McLuskie		30 November 2007

No director had an interest in the share capital of the Company

Financial instruments

The major risks associated with the Company's business are market risk, liquidity risk, credit risk and operational risks The Company has established a comprehensive framework for managing these risks, which evolves as the Company's business activities change in response to market, credit, product and other developments The Company's policies for managing each of these risks and its exposure thereto are detailed in note 25 to the financial statements

Directors' responsibilities

The directors are required by the Companies Act 1985 and 2006 to prepare a directors' report and financial statements for each financial year and have elected to prepare them in accordance with International Financial Reporting Standards They are responsible for preparing financial statements that present fairly the financial position, financial performance, and cash flows of the Company In preparing those financial statements, the directors are required to

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the directors' report and financial statements comply with the Companies Act 1985 and 2006 They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

Directors' Report (continued)

Directors' statement as to disclosure of information to auditors

Each of the directors at the date of approval of this report confirms that

(1) so far as he/she is aware there is no relevant audit information of which the company's auditors are unaware, and

(2) the director has taken all the steps that he/she ought to have taken to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information

This confirmation is given and shall be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985

Directors' indemnities

In terms of Section 236 of the Companies Act 2006 Mr NC McLuskie, Mr I Clink, Mr R Bulloch, Mr G F Pell and Mr CP Sullivan have been granted Qualifying Third Party Indemnity Provisions by The Royal Bank of Scotland Group plc Mr A Higginson has been granted a Qualifying Third Party Indemnity Provision by Tesco PLC and Ms L Wade Gery a Qualifying Third Party Indemnity Provision by Tesco Stores Limited

Charitable and political donations

No donations were made by the Company during the year for political purposes (2006 £nil) The following charitable donations were made

Charitable organisation	**2007** **£**	**2006** **£**
SCOPE	250	
Fire Service Fund	300	
Breast Cancer	740	
National Deaf Children's Society		200
	1,290	200

Supplier payment policy

In the year ending 31 December 2007, the Company will continue to adhere to the following payment policy in respect of all suppliers The Company is committed to maintaining a sound commercial relationship with its suppliers Consequently, it is the Company's policy to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed

At 31 December 2007, the Company's trade creditors represented 24 days (2006 24 days) of amounts invoiced by suppliers

Auditors

Deloitte & Touche LLP have expressed their willingness to continue in office as auditors

Approved by the Board of Directors and signed on behalf of the Board

Alan Ewing Mills
Secretary
27 March 2008

Independent auditors' report to the members of Tesco Personal Finance Limited

We have audited the financial statements of Tesco Personal Finance Limited ("the Company") for the year ended 31 December 2007 which comprise the income statement, the statement of changes in equity, the balance sheet, the cash flow statement, and the related Notes 1 to 33 These financial statements have been prepared under the accounting policies set out therein

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Directors' Report

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 We also report to you whether, in our opinion, the information given in the directors' report is consistent with the financial statements In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed

We read the directors' report for the above year and consider whether it is consistent with the audited financial statements We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements Our responsibilities do not extend to any information outside the directors' report

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements

Independent auditors' report to the members of Tesco Personal Finance Limited (continued)

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union of the state of the company's affairs as at 31 December 2007 and of its profit for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the financial statements

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Edinburgh, United Kingdom
27 March 2008

Income Statement
For the year ended 31 December 2007

	Note	2007 £'000	2006 £'000
Interest receivable and similar income		496,559	462,781
Interest payable	3	(361,600)	(312,730)
Net interest income		134,959	150,051
Fees and commissions receivable		403,175	343,880
Fees and commissions payable		(13,153)	(11,961)
Dividend income from shares in group undertakings		22,252	22,370
Other operating income		1,336	1,402
Non interest income		413,610	355,691
Total income		548,569	505,742
Administrative expenses			
Staff costs	4	11,834	11,180
Premises and equipment		34,567	30,689
Other administrative expenses		199,895	167,903
Depreciation and amortisation		5,320	6,243
Operating expenses		251,616	216,015
Operating profit before provisions for bad and doubtful debts		296,953	289,727
Provisions for bad and doubtful debts	10	116,368	114,588
Operating profit before tax	5	180,585	175,139
Tax on operating profit	7	45,612	44,922
Profit for the year		134,973	130,217
Profit attributable to:			
Ordinary shareholders		131,806	127,517
Holders of other equity instruments		3,167	2,700
		134,973	130,217

Statement of Changes in Equity
For the year ended 31 December 2007

	Share capital £'000	Share premium £'000	Equity reserve £'000	Retained earnings £'000	Total £'000
At 1 January 2007	24,790	223,110	45,000	256,610	549,510
Changes in equity for 2007					
Profit for the period			3,167	131,806	134,973
Dividends			(3,167)	(120,000)	(123,167)
At 31 December 2007	24,790	223,110	45,000	268,416	561,316

Statement of Changes in Equity
For the year ended 31 December 2006

	Share capital £'000	Share premium £'000	Equity reserve £'000	Retained earnings £'000	Total £'000
At 1 January 2006	24,790	223,110	45,000	259,093	551,993
Changes in equity for 2006					
Profit for the period			2,700	127,517	130,217
Dividends			(2,700)	(130,000)	(132,700)
At 31 December 2006	24,790	223,110	45,000	256,610	549,510

Tesco Personal Finance Limited

Balance Sheet
As at 31 December 2007

	Note	2007 £'000	2006 £'000
Assets			
Cash and balances at central banks		3,457	3,494
Loans and advances to banks	9	4,035,481	3,765,599
Loans and advances to customers	10	3,445,925	3,273,419
Equity investments	11	258,500	258,500
Intangible assets	13	4,508	3,206
Property, plant and equipment	14	18,971	15,040
Other assets	15	323,835	133,028
Prepayments and accrued income	17	53,358	34,046
Total assets		8,144,035	7,486,332
Liabilities			
Deposits by banks	18	4,299,799	4,263,405
Customer accounts	19	2,735,597	2,396,959
Other liabilities	20	273,746	33,763
Accruals and deferred income	21	113,577	82,695
Subordinated liabilities	22	160,000	160,000
Total liabilities		7,582,719	6,936,822
Equity			
Called up share capital	23	24,790	24,790
Share premium account		223,110	223,110
Equity reserve	24	45,000	45,000
Profit and loss account		268,416	256,610
Total equity		561,316	549,510
Total liabilities and equity		8,144,035	7,486,332
Memorandum items			
Other commitments	29	5,939,594	5,546,226

The financial statements were approved by the board of directors and authorised for issue on 27 March 2008 and were signed on its behalf by

Andrew Thomas Higginson
Chairman

Robin Bulloch
Director

Tesco Personal Finance Limited

Cash Flow Statement
For the year ended 31 December 2007

	Note	2007 £'000	2006 £'000
Operating activities			
Operating profit before taxation		180,585	175,139
Adjustments for			
Depreciation		5,320	6,243
Interest on subordinated liabilities		10,471	8,689
Provision for impairment losses		18,088	19,401
Other non cash items		11,570	728
Net cash inflow from trading activities	30	226,034	210,200
Changes in operating assets and liabilities	30	226,775	(31,056)
Net cash flows from operating activities before tax		452,809	179,144
Income taxes paid		(38,773)	(49,827)
Cash flow from operating activities		414,036	129,317
Investing activities			
Purchase of fixed assets		(10,553)	(7,870)
Cash flows from investing activities		(10,553)	(7,870)
Financing activities			
Increase in subordinated loan advance			(3,500)
Decrease in balance at central banks		37	47
Decrease / (increase) in loans and advances to banks		10,000	(48,000)
Dividends paid		(123,167)	(132,700)
Interest on subordinated liabilities		(10,471)	(8,689)
Cash flows from financing activities		(123,601)	(192,842)
Net (decrease) / increase in cash and cash equivalents		279,882	(71,395)
Cash and cash equivalents 1 January		3,326,599	3,397,994
Cash and cash equivalents 31 December	9	3,606,481	3,326,599

Notes to the Financial Statements

1 Principal accounting policies

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board (IASB), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB and endorsed by the European Union (EU) The date of transition to IFRS for the Company and the date of its opening IFRS balance sheet was 1 January 2004

Accounting convention

The Company is incorporated in the UK and registered in Scotland The financial statements have been prepared on the historical cost basis

Revenue recognition

Interest income on financial assets that are classified as loans and receivables 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 terms of a financial instrument are considered when estimating future cash flows

Fees in respect of services 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 application of this policy to significant fee types is outlined below

Card related services fees from credit card business include

Interchange received as issuer, the Company receives a fee (interchange) each time a cardholder purchases goods and services The Company also receives interchange fees from other card issuers for providing cash advances through its Automated Teller Machine networks These fees are accrued once the transaction has taken place

Late payment fees as issuer, the Company receives a fee each time a cardholder is late making a scheduled payment These fees are accrued once the transaction has taken place

Balance transfer fees as issuer, the Company receives a fee when a cardholder transfers a balance from another card issuer These fees are accrued once the transaction has taken place

Insurance commission the Company receives commission on the sale of an insurance contract The commission is accrued over the term of the policy

Intangible assets

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses Amortisation is charged to profit or loss using methods that best reflect the economic benefits over their estimated useful lives and is included in depreciation and amortisation The estimated useful lives are as follows,

Computer software development 3 years

Notes to the Financial Statements

1 Principal accounting policies (continued)

Plant, property and equipment

Items of plant, property and equipment are stated at cost less accumulated deprecation (see below) and impairment losses Where an item of plant and equipment comprises major components having different useful lives, they are accounted for separately

Depreciation is charged through profit or loss 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 Estimated useful lives for plant, property and equipment are between two and five years

At each reporting date, the Company assesses whether there is any indication that its plant and equipment are impaired If any such indication exists, the Company estimates the recoverable amount of the asset and the impairment loss if any

Foreign currencies

The Company's financial statements are presented in sterling, which is the functional currency of the Company

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date Foreign exchange differences arising on translation are recognised in profit or loss Non monetary items denominated in foreign currencies that are stated at fair value are translated into sterling at foreign exchange rates ruling at the dates the values were determined

Taxation

Provision is made for taxation at current enacted rates on taxable profits, arising in income or in equity Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes, except in relation to overseas earnings where remittance is controlled by the Company

Deferred tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available in future against which the deductible temporary differences can be utilised

Financial assets and liabilities

Financial assets are classified either as loans and receivables or as available for sale

Loans and receivables – non derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables except those that are classified as held for trading or designated as fair value through profit or loss 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 (see note above) less any impairment losses

Available for sale – financial assets that are not classified as held for trading, designated at fair value through profit or loss, or loans and receivables are classified as available for sale Financial assets can be designated as available for sale on initial recognition Available for sale financial assets are initially recognised at fair value plus directly related transaction costs They are subsequently measured at fair value except where fair value becomes insufficiently reliable to warrant an unquoted equity instrument to be measured at fair value, then the instrument is measured at cost Exchange differences resulting from retranslating the amortised cost of monetary available for sale financial assets denominated in a foreign currency are recognised in profit or loss Other changes in the fair value of available for sale financial assets are reported in a separate component of shareholders' equity Interest is calculated using the effective interest rate (see note above) and is recognised in profit or loss

All financial liabilities have been measured at amortised cost using the effective interest method (see note above)

Notes to the Financial Statements

1 Principal accounting policies (continued)

Impairment of financial assets

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as available for sale or loans and receivables 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

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 receivable has been incurred, the Company 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 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 current observable data, to reflect the effects of current conditions not affecting the period of historical experience

Impairment losses are recognised in profit or loss 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 period the amount of the impairment loss reduces and the reduction can be ascribed 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

Capital instruments

The Company 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 Company after the deduction of liabilities The components of a compound financial instrument issued by the Company are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits with banks together with short term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of changes in value

Investments in subsidiaries

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

Notes to the Financial Statements

2 Critical accounting policies and key sources of estimation uncertainty

The reported results of the Company are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements The Company's principal accounting policies are set out above United Kingdom company law and IFRS require the directors, in preparing the Company'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, International Accounting Standard ("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 Company'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 Company would affect its reported results

Loan impairment provisions

The Company's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of 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 31 December 2007, gross loans and receivables totalled £3,630m (2006 £3,440m) and loan impairment provisions amounted to £184m (2006 £166m)

The Company's loan impairment provisions are established on a portfolio basis taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends The most significant factors in establishing these provisions are the expected loss rates and the related average life These portfolios include credit card receivables and other personal advances including mortgages The future credit quality of these portfolios is subject to certainties 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, the unemployment level, payment behaviour and bankruptcy trends

Notes to the Financial Statements

3 Interest payable

	2007 £'000	2006 £'000
Loans and advances to customers	129,895	99,178
Subordinated liabilities	10,397	8,763
Other amounts payable The Royal Bank of Scotland Group plc and its subsidiaries	221,308	204,789
	361,600	312,730

4 Staff costs

The Company does not have any direct employees Staff working for Tesco Personal Finance Limited have contracts with Tesco PLC or The Royal Bank of Scotland plc and their remuneration is recharged to the Company as appropriate

The average monthly number of persons (excluding executive directors) seconded to the Company during the year was 176 (2006 161)

Staff costs (including executive directors) recharged for the year are as follows

	2007 £'000	2006 £'000
Wages and salaries	8,598	8,394
Social security costs	957	775
Pension costs	1,192	666
Other costs including temporary staff	1,087	1,345
	11,834	11,180

Notes to the Financial Statements

5 Operating profit before tax

	2007 £'000	2006 £'000
Operating profit before tax is stated after taking account of the following		
Auditors' remuneration		
Fees payable to the company's auditors for the audit of the company's annual accounts	74	74
Fees payable to the company's auditors for other services to the company		
Other attest services	12	21
Directors' emoluments (see note 6)	296	270

6 Directors' emoluments

The remuneration of the directors recharged to the Company during the year was as follows

	2007 £'000	2006 £'000
Total emoluments received by directors	296	270
Number of directors to whom retirement benefits are accruing under defined benefit schemes	1	2

Performance related bonuses are awarded on the basis of measuring annual performance against certain specified financial targets, which include both corporate performance objectives and key strategic objectives

The total emoluments of the highest paid director were £282,000 (2006 £226,000) At 31 December 2006, the accrued pension, under a defined benefit scheme, for the highest paid director was £30,707 (2006 £8,000)

7 Tax on operating profit

	2007 £'000	2006 £'000
UK corporation tax charge for the year	42,214	43,092
Tax under / (over) provided on profits for prior years	115	(455)
	42,329	42,637
Total current tax		
Deferred tax	3,283	2,285
	45,612	44,922

Notes to the Financial Statements

7 Tax on operating profit (continued)

The standard rate of tax for the year, based on the UK standard rate of corporation tax is 30% (2006 30%) The actual tax charge for the current and the previous year differs from the standard rate for the reasons set out in the following reconciliation

	2007 £'000	2006 £'000
Profit on ordinary activities before taxation	180,585	175,139
Tax on profit on ordinary activities at standard rate	54,176	52,542
Factors affecting charge for the year		
Non deductible items		
Non taxable items	(8,679)	(7,521)
Adjustments relating to prior periods	115	(99)
Total tax	45,612	44,922

8 Distributions to equity holders

	2007 £'000	2006 £'000
Ordinary dividend paid	120,000	130,000
Interest paid on undated loan capital included within equity	3,167	2,700
	123,167	132,700

On 29 June 2007 an interim dividend of £0 28 (2006 £0 24) per ordinary share was paid

On 28 December 2007 a final dividend of £0 20 (2006 £0 28) per ordinary share was paid, resulting in a total dividend payment of £120,000,000 (2006 £130,000,000)

9 Loans and advances to banks

	2007 £'000	2006 £'000
Loans and receivables to The Royal Bank of Scotland plc		
Remaining maturity.		
Three months or less	3,614,481	3,335,599
One year or less but over three months	33,000	36,000
Five years or less but over one year	182,000	177,000
Over five years	206,000	217,000
	4,035,481	3,765,599

Included within cash and cash equivalents is £3,606,481 (2006 £3,326,599) for loans and receivables to banks which had a maturity on original acquisition of less than three months

Notes to the Financial Statements

10 Loans and advances to customers

	2007 £'000	2006 £'000
Loans and receivables		
Remaining maturity		
Repayable on demand or at short notice	1,551	1,444
Three months or less	2,026,341	1,985,959
One year or less but over three months	33,153	500,975
Five years or less but over one year	958,535	842,954
Over five years	610,740	108,394
	3,630,320	3,439,726
Impairment provision for loans and advances	(184,395)	(166,307)
	3,445,925	3,273,419

The following table shows impairment provisions for loans and advances classified as loans and receivables

	2007 Total £'000	2006 Total £'000
At 1 January	166,307	146,906
Amounts written off	(102,105)	(95,987)
Recoveries of amounts previously written off	12,454	8,712
Charge to the income statement	116,368	114,588
Unwind of discount	(8,629)	(7,912)
At 31 December	184,395	166,307

Notes to the Financial Statements

11 Equity investments

	2007 £'000	2006 £'000
Loan to Direct Line Group Limited	258,500	258,500

During the year impairment charges of £nil were recognised on the loan

The loan comprises an interest free subordinated loan of £258,500,000 made to Direct Line Group Limited, a wholly owned subsidiary of The Royal Bank of Scotland plc This loan has been classed as an equity investment as there is no interest received and there is no fixed repayment date

12 Investments in Group undertakings

Shares in group undertakings in the current and prior year relates to a 100% shareholding in TPF ATM Services Limited which is incorporated in Scotland, amounting to £2

13 Intangible assets

	Computer Software Development £'000
Cost	
At 1 January 2007	3,504
Additions	2,588
At 31 December 2007	6,092
Amortisation	
At 1 January 2007	298
Charged during the year	1,286
At 31 December 2007	1,584
Net book value	
At 31 December 2007	4,508
At 31 December 2006	3,206

Notes to the Financial Statements

14 Property, plant and equipment

	Plant & Equipment £'000	Fixtures & Fittings £'000	Computer Hardware £'000	Computer Software £'000	Total £'000
Cost					
At 1 January 2007	1,279	3,007	42,674	11,822	58,782
Additions	352	861	6,752		7,965
At 31 December 2007	1,631	3,868	49,426	11,822	66,747
Depreciation					
At 1 January 2007	1,194	2,965	28,113	11,470	43,742
Charged during the year	37	117	3,880		4,034
At 31 December 2007	1,231	3,082	31,993	11,470	47,776
Net book value					
At 31 December 2007	400	786	17,433	352	18,971
At 31 December 2006	85	42	14,561	352	15,040

15 Other assets

	2007 £'000	2006 £'000
Amounts payable by The Royal Bank of Scotland plc ("RBS")	255,041	95,260
Amounts payable by other companies within the RBS group	54,762	20,453
Deferred tax (see note 16)	14,032	17,315
	323,835	133,028

16 Deferred taxation

The deferred tax asset can be analysed as follows

	Accelerated capital allowances £'000	Other £'000	Total £'000
At 1 January 2007	2,289	15,026	17,315
Charged to the income statement	(621)	(2,662)	(3,283)
At 31 December 2007	1,668	12,364	14,032

The directors consider that there will be sufficient future profits to support recognition of the deferred tax asset Included within the charge for the year is £1,015,000 relating to the change in the rate of UK Corporation tax from 30% to 28% from 1 April 2008

Notes to the Financial Statements

17 Prepayments and accrued income

	2007 £'000	2006 £'000
Amounts payable by Tesco PLC	221	135
Amounts payable by The Royal Bank of Scotland plc	3,772	2,122
Other prepayments and accrued income	49,365	31,789
	53,358	34,046

18 Deposits by banks

	2007 £'000	2006 £'000
Amortised cost		
Remaining maturity:		
Three months or less	1,210,594	1,458,039
One year or less but over three months	958,000	713,000
Five years or less but over one year	526,865	451,216
Over five years	1,604,340	1,641,150
	4,299,799	4,263,405

All deposits by banks are repayable to companies within The Royal Bank of Scotland plc group

19 Customer accounts

	2007 £'000	2006 £'000
Repayable on demand:		
Amortised cost	2,735,597	2,396,959

20 Other liabilities

	2007 £'000	2006 £'000
Amounts owed to Tesco PLC	13,603	1,101
Amounts owed to The Royal Bank of Scotland plc	225,590	5,249
Corporation tax	22,771	19,215
Other liabilities	11,782	8,198
	273,746	33,763

All amounts owed are repayable within one year

Notes to the Financial Statements

21 Accruals and deferred income

	2007 £'000	2006 £'000
Amounts accrued to Tesco PLC	13,430	4,837
Amounts accrued to The Royal Bank of Scotland plc	48,882	40,195
Other accruals and deferred income	51,265	37,663
	113,577	82,695

All amounts accrued are repayable within one year

22 Subordinated liabilities

	2007 £'000	2006 £'000
Amortised Cost		
Floating rate subordinated loan maturing 2008		20,000
Floating rate subordinated loan maturing 2009		20,000
Floating rate subordinated loan maturing 2010		25,000
Floating rate subordinated loan maturing 2011		30,000
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 2022	95,000	
	160,000	160,000

Subordinated liabilities comprise loan capital issued in equal proportions by Tesco PLC and The Royal Bank of Scotland plc

The fixed term loan capital is 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 range of 60 to 160 points

23 Called up share capital

	2007 £'000	2006 £'000
Authorised		
500,000,000 Ordinary shares of 10p each	50,000	50,000

	2007 £'000	2006 £'000
Allotted, called up and fully paid		
247,900,000 Ordinary shares of 10p each	24,790	24,790

24 Equity reserve

	2007 £'000	2006 £'000
Amortised cost		
Equity reserve	45,000	45,000

The equity reserve comprises an undated floating rate subordinated loan which has no fixed maturity date and may not be repaid except under certain conditions such as the winding up of Tesco Personal Finance Limited

25 Risk Management

Risk Management

The major risks associated with the Company's businesses are market risk, liquidity risk, credit risk and operational risk The Company has established a comprehensive framework for managing these risks which is continually evolving as the Company's business activities change in response to market, credit, product and other developments

The Company has established clear risk policies, including limits, reporting lines and control procedures This framework is designed to provide tight control and is reviewed regularly by both Executive and Board Committees Responsibility for the control of risk within the Company is vested in the Risk Management Committee (RMC) The RMC establishes the strategy, policies and procedures for managing risk within the Company

Market Risk

Market risk is the risk that changes in interest rates, foreign exchange rates, equity prices and other rates, prices, volatilities, correlations or other market conditions, such as liquidity, will have an adverse impact on the Company's financial condition or results

The principal market risk to which the Company is exposed is interest rate risk Mismatches between the repricing dates of the Company's assets and liabilities account for most of the interest rate risk associated with its commercial banking activities

Insurance Risk

The Company is exposed to insurance risk indirectly through its profit sharing commission arrangement with The Royal Bank of Scotland Group plc Insurance risk is the risk of fluctuations in the timing, frequency or severity of insured events, relative to the expectations at the time of underwriting

The frequency and severity of claims and the sources of uncertainty for the key classes that the Company is exposed to are as follows

a) Motor insurance contracts
Claims experience is quite variable, due to a wide range of factors, but the principal ones are age, sex and driving experience, type and nature of vehicle, use of vehicle and area There are many sources of uncertainty that will affect the Company's experience under motor insurance including operational risk, reserving risk, premium rates not matching claims inflation rates, the weather, the social, economic and legislative environment and reinsurance failure risk

b) Property insurance contracts
The major causes of claims for property insurance are theft, flood, escape of water, fire, storm, subsidence and various types of accidental damage The major source of uncertainty is the volatility of weather

Notes to the Financial Statements

25 Risk Management (continued)

Interest Rate Risk

Interest rate risk arises where assets and liabilities in the Company's banking activities have different repricing dates Company policy seeks to minimise the sensitivity of net interest income to changes in interest rates Potential exposures to interest rate movements in the medium to long term are measured and controlled through position and sensitivity limits Short term exposures are measured and controlled in terms of net interest income sensitivity over 12 months to a 1 5% parallel movement in interest rates Risk is managed through arm's length cash transactions

The table below summarises the contractual interest rate sensitivity gap for the Company as at 31 December 2007 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

2007	Within 3 months	After 3 months, but within 6 months	After 6 months, but within 1 year	After 1 year, but within 5 years	After 5 years	Non – interest bearing funds	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Loans & advances to banks	3,618	15	18	182	202		4,035
Loans & advances to customers	775	805	363	830	108	565	3,446
Other assets						663	663
Total assets	4,393	820	381	1,012	310	1,228	8,144
Liabilities and equity							
Customer accounts	2,736						2,736
Deposits by banks	1,394	1,023	418	1,301	164		4,300
Other liabilities						387	387
Subordinated liabilities	160						160
Shareholders' equity	45					516	561
Total liabilities and equity	4,335	1,023	418	1,301	164	903	8,144
Interest rate sensitivity gap	58	(203)	(37)	(289)	146	325	

Notes to the Financial Statements

25 Risk Management (continued)

2006	Within 3 months	After 3 months, but within 6 months	After 6 months, but within 1 year	After 1 year, but within 5 years	After 5 years	Non – interest bearing funds	Total
	£m	£m	£m	£m	£m	£m	£m
Assets							
Loans & advances to banks	3,339	12	24	177	213		3,765
Loans & advances to customers	848	762	307	814	107	435	3,273
Other assets						448	448
Total assets	4,187	774	331	991	320	883	7,486
Liabilities and equity							
Customer accounts	2,397						2,397
Deposits by banks	1,664	869	340	1,206	184		4,263
Other liabilities						116	116
Subordinated liabilities	160						160
Shareholders' equity	45					505	550
Total liabilities and equity	4,266	869	340	1,206	184	621	7,486
Interest rate sensitivity gap	(79)	(95)	(9)	(215)	136	262	

Liquidity risk

Liquidity risk is the risk that the Company is unable to meet its payment obligations as they fall due The Company's liquidity risk is managed on a consolidated basis within The Royal Bank of Scotland Group and adheres to the liquidity requirements set by the Financial Services Authority (FSA) from time to time In the UK, the FSA requires the Company to be able to meet its sterling obligations without recourse to the wholesale markets for a period of at least five business days To meet regulatory requirements a diversified portfolio of high quality liquid and marketable assets is maintained Cash flow commitments and marketable asset holdings are measured and managed on a daily basis The Company has credit facilities from The Royal Bank of Scotland plc sufficient to meet all foreseeable outflow requirements as they fall due and its liquidity risk is further mitigated by its well diversified retail deposit base

Notes to the Financial Statements

25 Risk Management (continued)

The following table shows cash flows payable up to a period of 20 years on an undiscounted basis

2007	0 3 months £m	3 12 months £m	1 3 years £m	3 5 years £m	5 10 years £m	10 20 years £m	Total £m
Deposits by banks	1,211	958	235	291	1,604		4,299
Customer accounts	2,736						2,736
Other liabilities	274						274
Accruals & deferred income	114						114
Subordinated liabilities	30	35			95		160
	4,365	993	235	291	1,699		7,583

2006	0 3 months £m	3 12 months £m	1 3 years £m	3 5 years £m	5 10 years £m	10 20 years £m	Total £m
Deposits by banks	1,458	713	197	254	1,641		4,263
Customer accounts	2,397						2,397
Other liabilities	34						34
Accruals & deferred income	83						83
Subordinated liabilities	95	30	35				160
	4,067	743	232	254	1,641		6,937

Credit risk

Credit risk arises where the possibility exists of a counterparty defaulting on its obligations Credit risk arises principally from the Company's lending activities but also from other transactions involving on and off balance sheet instruments Limits have been established for all counterparties based on their respective credit ratings The limits and proposed counterparties are reviewed and approved by the RMC and Board of the Company

The management of individual credit risk is devolved to the operational business unit The RMC ensures that appropriate policies are established and adhered to

Further details of the Company's exposure to credit risk is provided in note 27 and 28

Operational risk

Operational risk is the risk of unexpected losses attributable to human error, systems failures, external events, fraud or inadequate internal control and procedures The Company manages this risk through systems and procedures to monitor transactions and positions, the documentation of transactions and periodic review by internal audit The Company also maintains contingency facilities to support operations in the event of disasters

Notes to the Financial Statements

26 Financial Instruments

The following tables analyse the financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39 Non financial assets and liabilities are shown separately

2007	Loans and receivables	Other (amortised cost)	Non financial assets/liabilities	Total
	£m	£m	£m	£m
Assets				
Cash and balances at central banks	3			3
Loans & advances to banks	4,035			4,035
Loans & advances to customers	3,446			3,446
Equity investments	259			259
Intangible assets			5	5
Property, plant and equipment			19	19
Other assets	324			324
Prepayments and accrued income			53	53
	8,067		77	8,144
Liabilities and equity				
Deposits by banks		4,300		4,300
Customer accounts		2,736		2,736
Other liabilities		274		274
Accruals and deferred income			113	113
Subordinated liabilities		160		160
		7,470	113	7,583
Equity				561
				8,144

26 Financial Instruments (continued)

2006	Loans and receivables	Other (amortised cost)	Non financial assets/liabilities	Total
	£m	£m	£m	£m
Assets				
Cash and balances at central banks	3			3
Loans & advances to banks	3,766			3,766
Loans & advances to customers	3,273			3,273
Equity investments	259			259
Intangible assets			3	3
Property, plant and equipment			15	15
Other assets	133			133
Prepayments and accrued income			34	34
	7,434		52	7,486
Liabilities and equity				
Deposits by banks		4,263		4,263
Customer accounts		2,397		2,397
Other liabilities		34		34
Accruals and deferred income			83	83
Subordinated liabilities		160		160
		6,854	83	6,937
Equity				549
				7,486

Notes to the Financial Statements

26 Financial Instruments (continued)

Fair values

The following table shows the carrying values and where different the fair values of financial instruments on the Company's balance sheet

	2007		2006	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Loans and advances to banks				
Loans and receivables	4,039	4,041	3,769	3,769
Loans and advances to customers				
Loans and receivables	3,445	3,445	3,273	3,273
Equity investment				
Available for sale	259	259	259	259
Financial liabilities				
Deposits by banks				
Amortised cost	4,300	4,303	4,263	4,251
Deposits by customers				
Amortised cost	2,736	2,736	2,397	2,397
Subordinated debt				
Amortised cost	160	160	160	160

27 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 quality grades are as follows

Asset Quality Grade	Annual probability of default Minimum %	Midpoint %	Maximum %	S&P equivalent
AQ1	0 00	0 10	0 20	AAA to BBB
AQ2	0 21	0 40	0 60	BB+ to BB
AQ3	0 61	1 05	1 50	BB to BB+
AQ4	1 51	3 25	5 00	B+ to B
AQ5	5 01	52 50	100 00	B and below

Notes to the Financial Statements

27 Asset Quality (continued)

2007	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	Accruing past due £m	Non accrual £m	Impairment provision £m	Total £m
Assets									
Cash and balances at central banks	3								3
Loans & advances to banks	4,035								4,035
Loans & advances to customers	89	785	916	926	594	75	245	(184)	3,446
Equity Investments	259								259
	4,386	785	916	926	594	75	245	(184)	7,743
Commitments	1,533	2,785	1,109	378	135				5,940
Total off balance sheet	1,533	2,785	1,109	378	135				5,940

2006	AQ1 £m	AQ2 £m	AQ3 £m	AQ4 £m	AQ5 £m	Accruing past due £m	Non accrual £m	Impairment provision £m	Total £m
Assets									
Cash and balances at central banks	3								3
Loans & advances to banks	3,766								3,766
Loans & advances to customers	76	813	793	751	689	83	234	(166)	3,273
Equity Investments	259								259
	4,104	813	793	751	689	83	234	(166)	7,301
Commitments	911	2,969	1,147	300	219				5,546
Total off balance sheet	911	2,969	1,147	300	219				5,546

Notes to the Financial Statements

28 Past due and impaired financial assets

At 31 December 2007, the Company's non accrual loans amounted to £245m (2006 £234m) Loan impairment provisions of £184m (2006 £166m) were held against these loans

	2007 £'000	2006 £'000
Gross income not recognised but which would have been recognised under the original terms of non accrual loans	19,622	16,034

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

2007	Past due 1 29 days £m	Past due 30 59 days £m	Past due 60-89 days £m	Past due more than 90 days £m	Total £m
Loans & advances to customers	41	20	14		75
	41	20	14		75

2006	Past due 1 29 days £m	Past due 30 59 days £m	Past due 60 89 days £m	Past due more than 90 days £m	Total £m
Loans & advances to customers	43	22	18		83
	43	22	18		83

There are no loans that have been renegotiated in the past 12 months that would otherwise have been past due or impaired

Notes to the Financial Statements

29 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

	2007 £'000	2006 £'000
Undrawn formal standby facilities, credit lines and other commitments to lend		
Less than one year	5,939,594	5,546,226

Under a loan commitment the Company agrees to make funds available to a customer in the future Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, providing all conditions in the loan facility are satisfied or waived

30 Cash inflow from operating activities

	2007 £'000	2006 £'000
Operating profit before taxation	180,585	175,139
Depreciation and amortisation	5,320	6,243
Interest on subordinated liabilities	10,471	8,689
Increase in prepayments and accrued income	(19,312)	(5,118)
Increase / (decrease) in accruals and deferred income	30,882	5,846
Provision for bad and doubtful debts	18,088	19,401
Net cash inflow from trading activities	226,034	210,200
Net (Increase) / decrease in deposits with banks	36,394	(213,635)
Net decrease / (increase) in customer accounts	148,044	186,486
Net increase in other assets	(194,090)	(4,075)
Net increase in other liabilities	236,427	168
Changes in operating assets and liabilities	226,775	(31,056)

Notes to the Financial Statements

31 Capital resources

The following table analyses the Company's regulatory capital resources at 31 December

	2007 £'000	2006 £'000
Movement in tier 1 capital		
At 1 January	485,855	487,926
Profit attributable to shareholders	124,935	127,929
Ordinary dividends	(120,000)	(130,000)
At 31 December	490,790	485,855
Composition of regulatory capital		
Tier 1 capital		
Shareholders funds and minority interests	490,790	485,855
	490,790	485,855
Tier 2 capital		
Qualifying subordinated debt	205,000	180,000
Other interests in tier 2 capital	50,572	45,265
	255,572	225,265
Supervisory deductions		
Other deductions	(258,500)	(258,500)
Total regulatory capital	487,862	452,620

It is the company'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 Company has regard to the supervisory requirements of the Financial Services Authority ("FSA") The FSA uses Risk Asset Ratio ("RAR") as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk weighted assets (the assets and off balance sheet exposures are 'weighted' to reflect the inherent credit and other risks), by international agreement, the RAR should be not less than 8% with a tier 1 component of not less than 4% The Company has complied with the FSA's capital requirements throughout the year

Notes to the Financial Statements

32 Related party transactions

During the year the Company had the following transactions with related parties

(a) Transactions involving directors and other key management personnel

For the purposes of IAS 24 "Related Party Disclosures", key management comprise directors of the company and members of the Group Executive Management Committee The captions in the Group's primary financial statements include the following amounts attributable, in aggregate to key management

	2007 £'000	2006 £'000
Loans and advances to customers	19	48
Customer accounts	67	22

(b) Remuneration of key management personnel

The amount of remuneration recharged to the Company in relation to the directors and other key management personnel is set out below in aggregate Further information about the remuneration of directors is provided in note 6

	2007 £'000	2006 £'000
Short term employee benefits	1,080	1,103
Retirement benefits	126	134
	1,206	1,237

(c) Trading transactions

During the year, group companies entered into the following transactions with related parties who are not members of the Company

	2007 The Royal Bank of Scotland plc £'000	2007 Tesco PLC £'000	2006 The Royal Bank of Scotland plc £'000	2006 Tesco PLC £'000
Interest received and other income	399,622	1,335	328,864	1,402
Interest paid	(215,701)	(6,923)	(204,446)	
Provision of services	(61,102)	(37,873)	(53,790)	(37,736)

The amounts owed by and owed to members of the The Royal Bank of Scotland plc and Tesco PLC groups are disclosed in earlier notes

33 Holding company

The Company's ultimate 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 24 St Andrew Square, Edinburgh, EH2 1AF The smallest and largest group into which the Company is consolidated is Tesco Personal Finance Group Limited