

Tesco Personal Finance Limited

Directors' Report and Financial Statements

31 December 2000

Registered in Scotland No 173199



SCT SP9P146Q 0025
COMPANIES HOUSE 18/09/01

Tesco Personal Finance Limited

Directors' Report and Financial Statements 31 December 2000

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Directors and advisers

Directors:

Rowley Stuart Ager – Chairman
Norman Cardie McLuskie – Deputy Chairman
William Scott Black
Ian Hugh Chippendale
Kevin Paul Grace
Bernard Higgins
Andrew Thomas Higginson
Timothy John Rolit Mason
John William Melbourn
George Anthony Schofield

Secretary:

Alan Ewing Mills

Registered Office:

42 St Andrew Square
Edinburgh
EH2 2YE

Telephone:

0131 556 8555

Registered Auditors:

Deloitte & Touche
39 George Street
Edinburgh
EH2 2HZ

Bankers:

The Royal Bank of Scotland plc
36 St Andrew Square
Edinburgh
EH2 2YB

Directors' report 31 December 2000

Report of the Directors

The directors present their report for the fifteen month period ended 31 December 2000.

Principal activities

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

Review of business and future developments

During the period the Company further expanded its customer base through its principal products; personal loans, credit cards, savings accounts, investment products, and general insurance. The range of financial products was extended during the period with the launch of travel money, mortgage broking and further investment products.

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

The cost:income ratio for the period was 69.2% (1999: 101.1%).

Dividends

The directors do not recommend the payment of a dividend (1999: nil).

Directors

The present directors are listed on page 1.

The following directorate changes took place during the year.

Appointments	Date
K P Grace	27 October 2000

Resignations	Date
C G Smith	27 October 2000

Directors' Interests

No director had an interest in the shares of the Company.

On 29 November 1999 The Royal Bank of Scotland Group plc ('RBSG'), the company's ultimate holding company, announced an offer ('the Offer') to acquire the entire issued ordinary share capital of National Westminster Bank plc ('NatWest'), the terms of which were increased on 31 January 2000. On 14 February 2000 RBSG announced that the Offer had become unconditional as to acceptances and on 6 March 2000 the Offer was declared unconditional in all respects at which time RBSG acquired control of NatWest.

Directors' report
31 December 2000 (continued)

Directors' Interests (continued)

The following directors were beneficially interested in the 25p ordinary shares of The Royal Bank of Scotland Group plc, the ultimate holding company.

	As at 1 October 1999*	As at 31 December 2000
N C McLuskie	86,832	140,385
W S Black	43,575	100,675
J W Melbourn	77,624	77,624
I H Chippendale	4,681	17,689
G A Schofield	3,537	3,628
B Higgins	2,175	5,241

Options to subscribe for ordinary shares of 25p each in The Royal Bank of Scotland Group plc granted to and exercised by directors during the period to 31 December 2000 are included in the table below:-

	At 1 October 1999*	Post AVS adjustment	Granted during the period		Exercised During the period		At 31 December 2000
			Options	Price	Options	Price	
W S Black	116,168	125,218	10,000	12.87	1,858	2.97	
			150	12.40	295	4.61	
			452	9.85	42,056	3.70	
					20,493	4.96	
					45,236	5.58	25,882
I H Chippendale	63,551	68,469	35,000	12.87	2,114	4.61	
			150	12.40	48,467	5.58	
			983	9.85			54,021
B Higgins	58,009	83,047	^18,991	8.42			
			150	12.40			83,197
N C McLuskie	251,199	304,140	^30,861	8.42	533	2.97	
			150	12.40	144,536	4.96	
			90	9.85	49,544	5.58	
					20,479	3.98	
					16,175	3.70	73,113

* (or date of appointment if later)

^ (exercised or granted prior to AVS adjustment)

Directors' report
31 December 2000 (continued)

Outstanding options under The Royal Bank of Scotland Group plc executive share option scheme are exercisable between now and 10 May 2009. The exercise of those options granted since 1996 is subject to a performance condition whereby options may not normally be exercised unless the growth in The Royal Bank of Scotland Group plc adjusted earnings per share has exceeded the growth in the Retail Price Index over a three year period by an average of at least 2% per annum. This condition has been met for the years 1997, 1998 and 1999. This condition is reviewed annually.

No director had an interest in any of the preference shares of The Royal Bank of Scotland Group plc for the period ended 31 December 2000. In addition, during this period none of the directors held a beneficial interest in the loan capital of The Royal Bank of Scotland Group plc or in the share or loan capital of any of the other subsidiaries of The Royal Bank of Scotland Group plc, including the Company.

As at 31 December 2000 the following Directors had an interest in the Additional Value Shares (AVS) of £0.01 each in The Royal Bank of Scotland Group plc.

	No of AVS at 31 December 2000
N C McLuskie	26,584
W S Black	47,041
J W Melbourn	77,624
I H Chippendale	5,521
G A Schofield	3,603
B Higgins	5,115

As at 31 December 2000 JW Melbourn also held interest in 320,764 Floating Rate Unsecured Loan Notes 2005 in The Royal Bank of Scotland Group plc.

Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. 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; and
- 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 that the Company will continue in business.

**Directors' report
31 December 2000 (continued)****Directors' Responsibilities (continued)**

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 financial statements comply with the Companies Act 1985. 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.

The directors confirm that these financial statements comply with the aforementioned requirements.

Charitable and political donations

No donations were made by the Company during the period for political or charitable purposes.

Share Capital

During the period the authorised share capital was increased by the creation of 268,000,000 ordinary shares of 10p each. The following allotments of ordinary shares of 10p each were made during the year.

Date	No.	Allottee	Price per share
17 November 1999	22,400,000	Tesco Personal Finance Group Limited	£1
29 February 2000	10,000,000	Tesco Personal Finance Group Limited	£1
13 March 2000	20,000,000	Tesco Personal Finance Group Limited	£1
19 April 2000	10,000,000	Tesco Personal Finance Group Limited	£1
31 May 2000	10,000,000	Tesco Personal Finance Group Limited	£1
22 August 2000	14,000,000	Tesco Personal Finance Group Limited	£1

Total proceeds amounted to £86,400,000.

Suppliers Payment Policy

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 by the Company to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract. The average duration of amounts owing to suppliers during the year was 20 days.

Directors' report
31 December 2000 (continued)

Auditors

PricewaterhouseCoopers resigned as Auditors on 31 March 2000. Deloitte & Touche were appointed on that date to fill the casual vacancy and resolutions to re-appoint them and to authorise the Directors to fix their remuneration will be proposed at the Annual General Meeting.

By order of the board



Alan Ewing Mills
Secretary
16 February 2001

Auditors' report to the members of Tesco Personal Finance Limited

We have audited the financial statements on pages 8 to 25 which have been prepared under the accounting policies set out on pages 10 and 11.

Respective responsibilities of directors and auditors

As described on page 4, the Company's directors are responsible for the preparation of financial statements, which are required to be prepared in accordance with applicable United Kingdom law and accounting standards. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

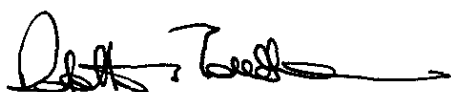
Basis of opinion

We conducted our audit in accordance with United Kingdom auditing standards 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 Company's circumstances, 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.

Opinion

In our opinion, the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2000 and of its profit for the period then ended and have been properly prepared in accordance with the Companies Act 1985.



Deloitte & Touche
Chartered Accountants and Registered Auditors
Edinburgh

16 February 2001

**Profit and loss account
for the fifteen months ended 31 December 2000**

		15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000 (Restated)
	Note		
Interest receivable:-			
Other interest receivable and similar income	4	164,096	79,920
Interest payable	5	(93,724)	(48,387)
Net interest income		70,372	31,533
Fees and commissions receivable		61,937	20,854
Fees and commissions payable		(13,236)	(4,102)
Other operating income		2,204	3,350
Non-interest income		50,905	20,102
Total income		121,277	51,635
Administrative expenses:-			
Staff costs	7	12,695	9,489
Premises and equipment		5,325	4,349
Other administrative expenses	8	60,915	34,954
Depreciation and amortisation	9	4,953	3,403
Operating expenses		83,888	52,195
Profit/(Loss) before provision for bad and doubtful debts		37,389	(560)
Provision for bad and doubtful debts	13	30,044	12,261
Profit/(Loss) on ordinary activities before tax		7,345	(12,821)
Tax on profit/(loss) on ordinary activities	10	2,141	(1,998)
Retained profit/(loss)	25	5,204	(10,823)

All the above amounts relate to continuing operations.

There were no other recognised gains or losses in the period, other than the profit for the period as reported above, and therefore no separate statement of total recognised gains and losses has been presented.

There is no difference between profit on ordinary activities before taxation and the retained profit for the period stated above, and their historical cost equivalents.

**Balance sheet
at 31 December 2000**

	Note	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000 (Restated)
Assets			
Cash and balances at central banks		1,570	142
Treasury and eligible bank bills	11	64,805	53,231
Loans and advances to banks	12	17,793	197,254
Loans and advances to customers	13	1,649,075	846,422
Tangible fixed assets	15	14,594	10,163
Other assets	16	68,656	31,700
Prepayments and accrued income	17	6,547	5,464
Total assets		1,823,040	1,144,376
Liabilities			
Deposits by Banks	18	265,046	-
Customer accounts	19	1,246,331	977,071
Other liabilities	20	20,619	5,293
Accruals and deferred income	21	26,831	14,403
Loan capital	22	65,000	40,000
Called up share capital	23	23,790	15,150
Share premium reserve	24	214,110	136,350
Profit and loss account	25	(38,687)	(43,891)
Equity shareholders' funds	26	199,213	107,609
Total liabilities		1,823,040	1,144,376
Memorandum items			
Other commitments	28	1,305,035	391,295

The financial statements on pages 8 to 25 were approved by the board of directors on 16 February 2001 and were signed on its behalf by:



Rowley Stuart Ager
Chairman



Norman Cardie McLuskie
Deputy Chairman

**Notes to the financial statements
for the fifteen months ended 31 December 2000****1 Principal accounting policies**

The financial statements have been prepared in accordance with applicable Accounting Standards in the United Kingdom and the Statements of Recommended Accounting Practice issued jointly by the British Bankers' Association and the Irish Bankers' Federation. A summary of the more important accounting policies which have been applied consistently, is set out below. The financial statements are prepared in accordance with Part VII, Chapter II of, and Schedule 9 to, the Companies Act 1985. The Company has taken advantage of the exemption from preparing cashflow statements conferred by Financial Reporting Statement No 1 (Revised) on the grounds that it is a wholly owned subsidiary.

Basis of accounting

The financial statements have been prepared under the historical cost convention and in compliance with section 226 of, and schedule 9 to, the Companies Act 1985.

Restatement

In order to comply with a change of accounting policy adopted by the Company's ultimate parent company there has been a restatement of prior year profit and loss items such that:

- 1) Fraud losses, formerly included in provisions for bad and doubtful debts are included in administrative expenses.
- 2) Credit card processing costs, formerly included in administrative expenses are now reported in fees and commissions payable.

Tangible Fixed Assets

The cost of tangible fixed assets is their purchase cost, together with any incidental expenses of acquisition.

Costs relating to technology projects deemed to having enduring benefit are capitalised and depreciated over their expected useful economic lives.

Depreciation is calculated so as to write off the cost of tangible assets, less their estimated residual values, over expected lives of the assets, generally between two and five years.

Taxation

Provision is made for taxation at current rates on the taxable profits of the Company. Certain items of income and expenditure are accounted for in different periods for financial reporting purposes and for taxation purposes. Deferred taxation is provided on the liability method in respect of timing differences to the extent that they are likely to crystallise in the foreseeable future.

1 Principal accounting policies (continued)

Operating leases

Operating lease rentals are charged to the profit and loss account on a straight line basis over the lease term.

Loans and advances

Loans and advances are valued at cost less any amounts written off and specific and general provisions.

Specific provisions are made against loans and advances held by the Company when, as a result of a detailed appraisal of the portfolio, it is considered that recovery is doubtful. A general provision is made against loans and advances to cover bad and doubtful debts which have not been separately identified but are known from experience to be present in any portfolio of advances.

Loans and advances classified as bad debts are written off in part or in whole when there is no realistic prospect of recovery.

Derivative transactions

Derivative transactions comprise interest rate swaps for hedging purposes.

Derivative transactions are accounted for in accordance with the item or items being hedged. Consequently, profits or losses on hedges are recognised on a similar accounting basis as the profits or losses on the underlying item or items being hedged. Therefore they are recognised in the financial statements as adjustments to the profit or loss item or items being hedged. To the extent necessary to achieve a common timing of income recognition on the item or items being hedged, deferred realised gains and losses are included in the balance sheet under "Accruals and deferred income" and "Prepayments and accrued income".

Interest

Interest income is recognised on each loan using the earning rules appropriate to the type of loan agreement. Interest expense is recognised on an accruals basis.

Fees and commissions

Fees and commissions in relation to services provided by the Company are recognised when earned. Expenses payable are charged to the profit and loss account immediately.

2 Holding Company

The Company's ultimate parent company is The Royal Bank of Scotland Group plc which is incorporated in Scotland. Financial statements for The Royal Bank of Scotland Group plc can be obtained from The Royal Bank of Scotland Group plc, 42 St Andrew Square, Edinburgh. The Company's intermediate holding company is Tesco Personal Finance Group Limited whose financial statements can be obtained at the same address.

3 Segmental reporting

The Company's results are generated from the provision of banking and other financial services mainly within the United Kingdom.

4 Interest receivable

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Loans and advances to banks	5,018	12,237
Loans and advances to customers	156,203	49,742
Amounts receivable from group companies	2,875	17,941
	<u>164,096</u>	<u>79,920</u>

5 Interest payable

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Customer accounts	69,319	43,777
Subordinated loan	2,356	1,081
Amounts payable to group companies	22,049	3,529
	<u>93,724</u>	<u>48,387</u>

6 Directors' emoluments

During the period, two of the directors received emoluments paid by or recharged to the Company as detailed below:

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Aggregate emoluments	<u>20</u>	<u>20</u>

7 Employee information

The Company currently does not have any direct employees. Staff working for the Company 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 period was 376 (1999: 414).

Staff costs recharged for the period are as follows:

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Wages and salaries	8,817	6,551
Social security costs	654	426
Pension costs	931	639
Other costs including temporary staff	2,293	1,873
	<u>12,695</u>	<u>9,489</u>

8 Other Expenses

An analysis of other expenses incurred by the Company is detailed below:

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Technology, consulting and outsourcing costs	23,242	13,203
Marketing, printing and stationery	29,919	16,121
Postage and other costs	7,754	5,630
	<u>60,915</u>	<u>34,954</u>

9 Profit/(Loss) on ordinary activities before taxation

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Profit/(Loss) on ordinary activities before taxation is stated after charging:		
Depreciation charge for period	4,953	3,403
Auditors' remuneration:-		
Audit services	34	48
Non-audit services	27	77

10 Tax on profit/(loss) on ordinary activities

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
UK Corporation Tax on profits for the year at 30%	2,981	-
Amount received from surrender of losses to other group companies	(840)	(1,998)
	2,141	(1,998)

The Company has no deferred tax liability at the period end.

11 Treasury and eligible bank bills

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Other eligible bills	64,805	53,231
Fair value of eligible bills (based on current market value at the period end)	65,234	53,477

The gain over purchase cost of the eligible bills has been taken to the profit and loss account and included in "Prepayments and accrued income" in the balance sheet.

12 Loans and advances to banks

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Repayable on demand:		
Loans and advances to The Royal Bank of Scotland plc	17,793	15,254
Repayable three months or less:		
Loans and advances to The Royal Bank of Scotland plc	-	137,000
Loans and advances to other banks	-	45,000
	<u>17,793</u>	<u>197,254</u>

13 Loans and advances to customers

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
On demand or at short notice	2,168	2,240
Remaining maturity:		
Three months or less	952,730	311,081
One year or less but over three months	256,189	146,932
Five years or less but over one year	456,882	390,956
Over five years	17,934	9,572
	<u>1,685,903</u>	<u>860,781</u>
Bad debt provision	<u>(36,828)</u>	<u>(14,359)</u>
	<u>1,649,075</u>	<u>846,422</u>

Provision for bad and doubtful debts

	15 month period ended 31.12.00 Specific £'000	15 month period ended 31.12.00 General £'000	12 month period ended 30.09.99 Specific £'000	12 month period ended 30.09.99 General £'000
Opening balance	9,994	4,365	1,969	1,941
Amounts written off	(7,575)	-	(1,812)	-
Charge to profit and loss account	28,806	1,238	9,837	2,424
Closing balance	<u>31,225</u>	<u>5,603</u>	<u>9,994</u>	<u>4,365</u>

14 Interest in suspense

In certain cases, interest is not being applied where its recoverability is in doubt.

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Loans and advances on which interest is not being applied:		
- before specific provisions	23,409	4,160
- after specific provisions	13,814	1,775

15 Tangible Fixed Assets

	Plant & Equipment £'000	Fixtures & Fittings £'000	Computer Hardware £'000	Computer Software £'000	Total £'000
Cost					
At 1 October 1999	1,072	2,043	6,867	6,118	16,100
Additions	-	537	3,642	5,415	9,594
Disposals	-	-	384	101	485
As at 31 December 2000	1,072	2,580	10,125	11,432	25,209
Depreciation					
At 1 October 1999	382	695	2,241	2,619	5,937
Provided during the period	289	691	1,943	2,030	4,953
Disposals	-	-	194	81	275
As at 31 December 2000	671	1,386	3,990	4,568	10,615
Net book value at 31 December 2000	401	1,194	6,135	6,864	14,594
Net book value at 30 September 1999	690	1,348	4,626	3,499	10,163

16 Other assets

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Amounts falling due within one year:		
Amounts recoverable from surrender of losses to Group companies	-	4,556
Amounts payable by The Royal Bank of Scotland plc	35,562	13,991
Amounts payable by other Group companies	33,094	13,153
	<u>68,656</u>	<u>31,700</u>

Amounts payable by other Group companies includes an interest free subordinated loan of £27,900,000 (1999: £11,500,000) made to Direct Line Group Limited, a wholly owned subsidiary of Royal Bank of Scotland Group plc.

17 Prepayments and accrued income

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Amounts falling due within one year:		
Amounts payable by Tesco PLC	232	2,099
Amounts payable by The Royal Bank of Scotland plc	249	766
Other prepayments and accrued income	6,066	2,599
	<u>6,547</u>	<u>5,464</u>

18 Deposit by banks

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
With agreed maturity dates or periods of notice, by remaining maturity		
- Three months or less	97,296	-
- One year or less but over three months	167,750	-
- Five years or less but over one year	-	-
- Over five years	-	-
	<u>265,046</u>	<u>-</u>

19 Customer accounts

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Repayable on demand	<u>1,246,331</u>	<u>977,071</u>

20 Other liabilities

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Amounts owed to Tesco PLC	1,156	726
Amounts owed to The Royal Bank of Scotland plc	11,327	569
Other liabilities	8,136	3,998
	<u>20,619</u>	<u>5,293</u>

21 Accruals and deferred income

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Amounts owed to Tesco PLC	2,533	852
Amounts owed to The Royal Bank of Scotland plc	2,564	1,002
Other accruals and deferred income	21,734	12,549
	<u>26,831</u>	<u>14,403</u>

22 Loan capital

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Floating rate subordinated loan maturing 2008	20,000	20,000
Floating rate subordinated loan maturing 2009	20,000	20,000
Floating rate subordinated loan maturing 2010	25,000	-
	<u>65,000</u>	<u>40,000</u>

The 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 seventy five basis points.

23 Called up share capital

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Authorised		
500,000,000 Ordinary shares of 10p each	<u>50,000</u>	<u>23,200</u>
Allotted, called up and fully paid		
237,900,000 Ordinary shares of 10p each	<u>23,790</u>	<u>15,150</u>

During the year the authorised share capital was increased by the creation of 268,000,000 ordinary shares of 10p each. The following allotments of ordinary shares of 10p each were made during the year.

Date	No.	Allottee	Price per share
17 November 1999	22,400,000	Tesco Personal Finance Group Limited	£1
29 February 2000	10,000,000	Tesco Personal Finance Group Limited	£1
13 March 2000	20,000,000	Tesco Personal Finance Group Limited	£1
19 April 2000	10,000,000	Tesco Personal Finance Group Limited	£1
31 May 2000	10,000,000	Tesco Personal Finance Group Limited	£1
22 August 2000	14,000,000	Tesco Personal Finance Group Limited	£1

Total proceeds amounted to £86,400,000.

24 Share Premium Reserve

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Opening balance	136,350	76,500
Premium paid on shares issued during the period	77,760	59,850
Closing balance	<u>214,110</u>	<u>136,350</u>

25 Profit and loss account

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Opening balance	(43,891)	(33,068)
Retained profit/(loss) for the period	5,204	(10,823)
Closing balance	<u>(38,687)</u>	<u>(43,891)</u>

26 Reconciliation of movements in shareholders' funds

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Opening shareholders' funds	107,609	51,932
Shares issued during the period	86,400	66,500
Profit/(loss) for the period	5,204	(10,823)
Closing shareholders' funds	<u>199,213</u>	<u>107,609</u>

27 Derivatives and other Financial Instruments
Risk management

The Company is exposed to a number of risks through its normal operations, the most significant of which are credit risk, interest rate risk and liquidity risk. Responsibility for the control of risk within the Company is vested in the Risk Management Committee (RMC), a sub committee of the Board of Directors reporting directly to the Board. The RMC establishes the strategy, policies and procedures for managing risk within the Company. These policies are ratified by the Board.

Objectives, policies and strategies

The Company's policy is not to undertake any trading activities. Consequently, it is the policy to use derivative instruments only to hedge risk on the Banking Book and not to trade speculatively for financial gain. The RMC reviews regularly the Company's exposure to interest rate risk and the policy is to use derivatives or other financial instruments to maintain this exposure within levels considered prudent. The objective is to reduce the effect of fluctuating interest rates on net interest income.

27 Derivatives and other Financial Instruments (continued)**Credit risk**

Credit risk arises where the possibility exists of a counterparty defaulting on its obligations. The Company lends surplus funds to the interbank market. 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.

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

Interest rate risk

Interest rate risk arises as a result of timing differences on the re-pricing of assets and liabilities, and unexpected changes in the slope and shape of the yield curves. Exposure to interest rate movements arises when there is a mismatch between interest rate sensitive assets and liabilities. The Company closely monitors interest rate movements, the interest rate and re-pricing maturity structure of its interest bearing assets and liabilities and the level of non interest bearing assets and liabilities. In order to reduce the effect of fluctuating interest rates on net interest income, interest rate risk is assessed and hedged via interest rate swaps or other derivatives transactions.

Interest rate sensitivity gap

The following table shows the contractual re-pricing terms for each category of asset and liability, together with management's estimate of the interest rate sensitivity gap for the Company as at 31 December 2000. This does not reflect the potential impact of early repayment or withdrawal. Transactions without defined contractual re-pricing terms are shown according to management's expectations. Major changes in position can be, and are, made promptly as market outlooks change. In addition, significant variations in interest rate sensitivity may exist within the re-pricing periods presented.

27 Derivatives and other Financial Instruments (continued)

Interest rate sensitivity gap (continued)

	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 to banks	19.4	-	-	-	-	-	19.4
Loans to customers	818.6	93.8	163.9	456.8	17.9	98.0	1,649.0
Treasury and & other eligible bills	64.8	-	-	-	-	-	64.8
Other assets	-	-	-	-	-	89.8	89.8
Total Assets	902.8	93.8	163.9	456.8	17.9	187.8	1,823.0
Liabilities:							
Customer accounts	1,246.3	-	-	-	-	-	1,246.3
Loans from banks	265.0	-	-	-	-	-	265.0
Other liabilities	-	-	-	-	-	47.5	47.5
Loan capital	65.0	-	-	-	-	-	65.0
Shareholders' funds	-	-	-	-	-	199.2	199.2
Total Liabilities	1,576.3	0.0	0.0	0.0	0.0	246.7	1,823.0
On balance sheet gap	(673.5)	93.8	163.9	456.8	17.9	(58.9)	0.0
Off-balance sheet items affecting interest rate sensitivity	656.8	(88.8)	(157.2)	(460.2)	(16.6)	66.0	0.0
Interest rate sensitivity gap	(16.7)	5.0	6.7	(3.4)	1.3	7.1	0.0
Cumulative interest rate sensitivity gap	(16.7)	(11.7)	(5.0)	(8.4)	(7.1)	0.0	0.0

Liquidity risk

Liquidity risk is the risk that the Company is unable to meet its payment obligations as they fall due. The Company manages this by maintaining a portfolio of high quality liquid assets within the framework set by the supervising authority, the FSA. Monthly reports are made to the FSA covering liquidity.

27 Derivatives and other Financial Instruments (continued)**Non trading derivatives**

The Company has established, during the period, non trading derivative positions internally through transactions with a fellow group company, The Royal Bank of Scotland plc.

At 31 December 2000, the Company had entered into several interest rate swaps, with the total notional principal amount of £1,154,516,000 (1999: £766,867,000) to hedge the risk associated with the products offered by the Company. Of these swaps £30,730,000 (1999: nil) expire within 1 year and £339,670,000 (1999: £387,000,000) expire between one and five years and £784,116,000 (1999: £379,867,000) expire between five and ten years. The net replacement cost of the contracts at 31 December 2000 was £5,402,280 (1999: £2,574,503) of which £57,468 (1999: nil) relates to contracts expiring within 1 year and £2,229,282 (1999: £283,705) relates to contracts expiring between one and five years and £3,115,530 (1999: £2,290,798) expire between five and ten years. This is represented by assets with a fair value of £12,022,888 and liabilities of £6,620,608. Fair values represent the current market value of these instruments. The carrying value of these instruments in the balance sheet is £269,393 being the accrued interest at the balance sheet date.

The underlying principal amount reflects the value of the business transacted and not the underlying credit or market risks. Under current Bank of England Guidelines the credit equivalent amount for these transactions using the original exposure method is £25,482,978 (1999: £10,222,472).

The risk involved in derivatives include market and credit risk. Market risk is the risk of loss arising from adverse changes in value as a result of movements in market prices.

Trading derivatives

The Company had no trading derivatives during the year.

Fair values of financial assets and liabilities

Fair values for financial assets and liabilities where there is a liquid and active market are shown - non trading derivatives (refer above), treasury and eligible bank bills (refer note 11).

28 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.

	15 month period ended 31.12.00 £'000	12 month period ended 30.09.99 £'000
Formal standby facilities, credit lines and other commitments to lend:		
Less than one year	1,303,789	390,949
There are annual commitments under non-cancellable operating leases. These are disclosed as follows:		
Land and buildings		
Operating leases which expire:		
Greater than 5 years	346	346
Other:		
Operating leases which expire:		
Greater than 5 years	900	-
Total Commitments	<u>1,305,035</u>	<u>391,295</u>

29 Arrangements with directors and officers

At 31 December 2000, the aggregate amounts outstanding under transactions, arrangements and agreements entered into by the Company in the normal course of business and at normal commercial terms with Directors and Officers of the Company were as follows:

	No of Persons	£'000
Loans to Directors and Officers	<u>9</u>	<u>47</u>

The above information is presented in accordance with the requirements laid down in the Banking Act 1987.

30 Controlling parties

The Royal Bank of Scotland Group plc and Tesco PLC hold an equal number of shares in the Company. One of the shares held by Tesco PLC is non voting and as a consequence The Royal Bank of Scotland Group plc is the ultimate controlling company.

Accounts for the ultimate parent company can be obtained from The Royal Bank of Scotland Group plc, 42 St Andrew Square, Edinburgh EH2 2YE.

31 Related party transactions

During the period the Company received interest and other income of £2,875,478 (1999: £17,940,654) from The Royal Bank of Scotland plc. Interest in respect of wholesale borrowing paid to The Royal Bank of Scotland plc amounted to £15,854,684 (1999: nil).

In addition, the Company incurred recharges from The Royal Bank of Scotland plc, and its subsidiaries, totalling £ 32,420,826 (1999: £14,702,235) for the provision of services.

Tesco PLC have recharged the Company an amount totalling £17,981,532 (1999: £8,951,982) for the provision of services.

The Company received fees from Tesco PLC for the managing of certain financial products during the period of £2,130,076 (1999: £3,217,184).

The above transactions are charged in accordance with the Shareholder's Agreement between Tesco PLC and The Royal Bank of Scotland plc.

The Company received additional subordinated loan capital from The Royal Bank of Scotland plc totalling £12,500,000 during the period.

The Company received additional subordinated loan capital from Tesco PLC totalling £12,500,000 during the period.

The Company also increased the subordinated loan to Direct Line Group Limited to £27,900,000 (1999: £11,500,000) during the year. In addition, fees of £16,633,146 relating to insurance business underwritten by Direct Line Group Limited were received during the period (1999: £2,743,475).