TESCO PERSONAL FINANCE PLC

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 28 FEBRUARY 2010

COMPANY NUMBER SC173199

TESCO PERSONAL FINANCE PLC

Contents

TESCO PERSONAL FINANCE PLC

Directors and Advisers

Directors:	Iain Clink Shaun Doherty Bernard Higgins Andrew Higginson – Chairman Adrian Hill* Alison Horner* William Main* Raymond Pierce* Graham Pimlott* Laura Wade-Gery* *Indicates non-executive director
Secretary:	Jonathan Lloyd
Registered Office:	22 Haymarket Yards Edinburgh EH12 5BH
Auditors:	PricewaterhouseCoopers LLP Erskine House 68-73 Queen Street Edinburgh EH2 4NH
Bankers:	The Royal Bank of Scotland plc 36 St Andrew Square Edinburgh EH2 2YB

TESCO PERSONAL FINANCE PLC

Directors' Report

The Directors present their annual report and the audited financial statements for the year ended 28 February 2010.

Principal activities

The Company is engaged in the provision of banking, general insurance services and Automated Teller Machine (ATM) transactions.

Prior year comparatives

The Company changed its accounting reference date in the prior period from 31 December to 28 February and consequently the comparative figures presented within these accounts cover the 14 month period 1 January 2008 to 28 February 2009.

Review of business and future developments

The Company became a wholly owned subsidiary of Tesco plc in December 2008 following their purchase of the 50% shareholding previously owned by The Royal Bank of Scotland Group.

The Company was rebranded during the year with the trading name changed to Tesco Bank on 29 June 2009. The change to Tesco Bank recognises the objective of broadening the Company's banking proposition and communicates this clearly to its customers.

Following the change of control, the Company has entered into a period of significant change and investment as it develops and embeds its own infrastructure in order to allow it to migrate systems and customer support from The Royal Bank of Scotland Group infrastructure. This migration programme is expected to conclude within the next two years during which time The Royal Bank of Scotland Group will continue to support the business through the ongoing provision of systems and infrastructure. During the year good progress has been made in completing the recruitment of a high quality management team in all areas of the Company. All senior roles have now been filled.

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 delivering steady income growth, on a like for like basis, within the context of a challenging economic climate. Bad debts have risen during the year but are now showing signs of stabilising and they remain below industry averages. Significant investment in new systems and headcount growth has increased the cost base in line with the Company strategy to deliver the new infrastructure and prepare for a faster rate of growth.

The Company recognised a provision for customer redress during the year in respect of compensation for potential customer complaints. Further details of this provision are provided in note 30.

During the period the Company continued to grow its customer base through its principal products: personal loans, credit cards, savings accounts and general insurance.

As the Company migrates to its own infrastructure it expects to broaden the banking proposition through the introduction of various new products and services. Subject to regulatory approval it is anticipated that new savings products and mortgages will be launched by the end of the year to 28 February 2011, with current accounts to follow in the second half of 2011.

In September 2009 the Company signed an agreement with Fortis (UK) Ltd to help build the operational platform and technical expertise required to further develop the insurance business. Tesco Bank will be responsible for all commercial decision-making whilst benefiting from the expertise of Fortis in claims-handling and underwriting. The insurance contracts will be underwritten by Shoo 471 Limited, trading as Tesco Underwriting, which is 49.9% owned by the Company. The Company has also selected the core technology platforms for the banking products. The migration programmes for both sides of the business are progressing well; the Company expects to be writing insurance business under the new arrangement towards the end of 2010 and to have its own banking platform fully operational by mid-2011. New premises have been secured for Banking and Insurance operations in Glasgow and Newcastle, which will open in mid-2010.

Directors' Report (continued)

Other than the developments highlighted above, the Directors do not anticipate any additional material change in either the type or level of activities of the Company in the next financial year. The parent company, Tesco Personal Finance Group Limited, increased its investment in the Company by £230,000,000 during the year. Consequently 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 the Directors continue to adopt the going concern basis in preparing the financial statements.

An initial dividend on ordinary share capital of £2,800,000 was paid to the parent company in October 2009 and a final dividend of £150,000,000 was paid in February 2010.

Treating customers fairly

The Company supports the Financial Services Authority (FSA)'s Treating Customers Fairly initiative and has a clear set of principles for doing business. Significant consideration is given to this area in the existing business and also in developing new products and processes.

Financial performance

The Company's financial performance is presented in the income statement on page 9.

Total income fell overall by £114,707,000 against the prior period, however on an annualised basis and excluding the provision for customer redress total income increased by 13.8%.

Operating expenses increased by £4,655,000 against the prior period. On an annualised basis these increased by 18.5% as a result of the expenses required to build a stand alone banking and insurance infrastructure.

Impairment provisions on loans and advances increased by £23,114,000 or 34.2% on an annualised basis, primarily as a result of the challenging economic conditions.

After impairment provisions of £176,633,000, the profit before tax for the period was £16,971,000, an annualised decrease of 87.6% on the prior period. Annualised profit before tax excluding the provision for customer redress fell by 14.4% due to the growth in operating expenses and bad debts in the year.

The Company monitors its financial performance on a monthly basis and tracks a variety of Key Performance Indicators including the following:

	12 months to 28 February 2010	**14 months to 28 February 2009**
Cost:income ratio	60.6%	48.4%
Net interest margin	5.3%	3.1%
Bad debt asset ratio	4.1%	3.5%
Tier 1 capital ratio	12.9%	12.8%
Risk asset ratio	12.8%	11.9%

At the year end the Company's financial position showed total assets of £5,786,883,000, an increase of 1.9% over 2009. This total includes income generating assets comprising investments of £604,262,000 and loans and advances of £4,359,154,000. The net book value of property, plant and equipment and intangible assets was £121,453,000 compared with £23,675,000 at the end of the previous period.

The impact of the statement of financial position restatement in the prior period referred to in Note 2, Accounting Policies, is a reduction in Investment Securities of £588,000,000, with a related reduction in Deposits from Banks of £586,000,000. The remaining £2,000,000 which relates to capitalised third party costs on the issue of Medium Term Notes has been reclassified to Other Assets.

Directors' Report (continued)

Directors

The present Directors and Secretary who have served throughout the year, except where noted below, are listed on page 2.

Since 1 March 2009 to date the following changes have taken place:

	Appointed	Resigned
Raymond Pierce	24 April 2009	
Alison Horner	29 May 2009	
Paulette Rowe		28 August 2009

No Director had an interest in the share capital of the Company.

Risk management

The Company has established a risk framework to manage the risks arising across the Company's businesses, which evolves as the Company's business activities change. The risk framework is based around the following five primary risk types:

- Regulatory Risk
- Operational Risk
- Credit Risk
- Insurance Risk
- Treasury Risk (including market risk, principal risk, interest rate risk, liquidity risk and foreign exchange risk)

The Company's approach for managing each of these risks and its exposure thereto is detailed in note 38 within the financial statements. Risk management is delivered under a documented governance structure.

The Company is subject to significant legislative and regulatory oversight, including supervision by the FSA and is required to satisfy certain capital adequacy and liquidity ratios.

Capital and liquidity

The Company had a core Tier 1 capital ratio of 12.9% as at 28 February 2010 (2009: 12.8%). The funding and liquidity position of the business remained robust throughout the year with customer deposits at 28 February 2010 in excess of customer lending. This is further supported by a high quality liquid asset portfolio, net short-term wholesale cash and investment grade assets worth £1.3bn.

Directors' indemnities

In terms of Section 236 of the Companies Act 2006: Andrew Higginson has been issued with a Qualifying Third Party Indemnity Provision by Tesco plc; Graham Pimlott, Adrian Hill, William Main and Raymond Pierce have been issued with a Qualifying Third Party Indemnity Provision by Tesco Personal Finance Group Limited.

Charitable and political donations

No donations were made by the Company during the period for political purposes (2009: £nil). The Company actively supports charity activity and made the following charitable donations in the year:

Directors' Report (continued)

Charitable organisation	12 months to 28 February 2010 £	14 months to 28 February 2009 £
Breast Cancer	-	670
Barnados Scotland	-	3,760
Project Africa	-	500
Marie Curie	-	45,201
Muscular Dystrophy Campaign	63,266	-
Tartan Children's Charity	1,000	500
British Trust for Conservation Volunteers	-	1,056
	64,266	51,687

Supplier payment policy

In the year ended 28 February 2010, the Company continued to adhere to its 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 include 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.

Trade creditors of the Company for the year ended 28 February 2010 were equivalent to 27 days (2009: 28 days), based on the ratio of Company trade creditors at the end of the year to the amounts invoiced during the year by trade creditors.

Employees

The Company depends on the skills and commitment of its employees in order to achieve its objectives. There are clear processes for understanding and responding to employees' needs through the People Agenda Team, staff surveys and regular performance reviews. Business developments are communicated frequently to ensure that employees are well informed about the business of the Company. Ongoing training programmes also seek to ensure that employees understand the Company's objectives and strive to achieve them.

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

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

Auditors

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office.

Statement of disclosure to auditors

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

TESCO PERSONAL FINANCE PLC

Directors' Report (continued)

Statement of Directors' responsibilities

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

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

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

The Directors confirm that they have complied with the above requirements in preparing the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the Directors' report and financial statements comply with the Companies Act 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.

Each of the Directors as listed on page 2 confirm that, to the best of each person's knowledge and belief:

- the financial statements, prepared in accordance with IFRSs as adopted by the EU, give a true and fair value of the assets, liabilities, financial position and profit of the Company; and
- the Directors' report includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that they face.

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

Iain Clink

Iain Clink
Director
2 June 2010

TESCO PERSONAL FINANCE PLC

Independent Auditors' Report to the members of Tesco Personal Finance plc

We have audited the financial statements of Tesco Personal Finance plc (the Company) for the year ended 28 February 2010 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' responsibilities set out on page 7, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 28 February 2010 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

Catrin Thomas

Catrin Thomas (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
2 June 2010

TESCO PERSONAL FINANCE PLC

INCOME STATEMENT
FOR THE YEAR ENDED 28 FEBRUARY 2010

	Note	12 months to 28 February 2010 £'000	Restated 14 months to 28 February 2009 £'000
Interest and similar income	5	367,169	538,670
Interest expense and similar charges	5	(135,860)	(377,234)
Net interest income		231,309	161,436
Fees and commissions income	6	347,980	465,888
Fees and commissions expense	6	(120,988)	(15,793)
Net fees and commissions income		226,992	450,095
Dividend income		28,216	24,591
Net fair value gains/(losses) on derivatives	7	1,100	(30,972)
Realised gain on investment securities	8	139	-
Other operating income		4,235	1,548
Non-interest income		260,682	445,262
Total income		491,991	606,698
Administrative expenses	9	(292,041)	(285,178)
Depreciation and amortisation	10	(6,346)	(8,554)
Operating expenses		(298,387)	(293,732)
Impairment loss on loans and advances	17	(176,633)	(153,519)
Profit before tax		16,971	159,447
Income tax expense	12	2,278	(32,728)
Profit for the period		19,249	126,719
Profit attributable to:			
Equity holders of the parent		19,249	126,719
		19,249	126,719

The notes on pages 15 to 76 form an integral part of these financial statements.

TESCO PERSONAL FINANCE PLC

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 28 FEBRUARY 2010

	Note	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Profit for the period		19,249	126,719
Net gains on available for sale investment securities			
Unrealised net gains during period, before tax		1,163	-
Cash flow hedges			
Net (losses)/ gains arising on hedges recognised in other comprehensive income, before tax		(1,821)	446
Income tax relating to components of other comprehensive income	14	59	-
Total comprehensive income for the year		18,650	127,165
Total comprehensive income attributable to:			
Equity holders of the parent		18,650	127,165
		18,650	127,165

The notes on pages 15 to 76 form an integral part of these financial statements.

TESCO PERSONAL FINANCE PLC

STATEMENT OF FINANCIAL POSITION
AS AT 28 FEBRUARY 2010

Company number SC173199

	Note	28 February 2010 £'000	Restated 28 February 2009 £'000
Assets			
Cash and balances with central banks	15	181,748	2,753
Loans and advances to banks	16	61,937	1,457,962
Loans and advances to customers	17	4,297,217	3,689,636
Derivative financial instruments	18	1,547	1,541
Investment securities:			
- Available for sale	19	604,262	-
- Loans and receivables	19	258,500	258,500
Prepayments and accrued income	20	91,000	82,717
Other assets	21	142,981	143,848
Investment in group undertaking	22	-	-
Investment in associate	23	2,857	-
Current income tax asset		18,451	5,272
Deferred income tax asset	24	4,930	11,631
Intangible assets	25	60,328	-
Property, plant and equipment	26	61,125	23,675
Total assets		5,786,883	5,677,535
Liabilities			
Deposits from banks	27	29,856	24,020
Deposits from customers	28	4,370,225	4,547,316
Debt securities in issue	29	224,390	224,550
Derivative financial instruments	18	64,759	42,265
Provisions for liabilities and charges	30	100,000	-
Accruals and deferred income	31	119,118	61,474
Other liabilities	32	12,836	36,995
Subordinated liabilities	33	190,000	160,000
Total liabilities		5,111,184	5,096,620
Equity			
Shareholders' funds:			
- Called up share capital	34	47,790	24,790
- Share premium account		430,110	223,110
- Retained earnings		152,952	287,569
- Other reserves	35	(153)	446
Subordinated notes	36	45,000	45,000
Total equity		675,699	580,915
Total liabilities and equity		5,786,883	5,677,535

The notes on pages 15 to 76 form an integral part of these financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 2 June 2010 and were signed on its behalf by:

B Higgins

Bernard Higgins
Director

TESCO PERSONAL FINANCE PLC

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 28 FEBRUARY 2010

	Share capital £'000	Share premium £'000	Retained earnings £'000	Subordinated notes £'000	Other reserves £'000	Total £'000
Balance at the beginning of the year	**24,790**	**223,110**	**287,569**	**45,000**	**446**	**580,915**
Comprehensive income						
Profit for the year	-	-	19,249	-	-	19,249
Other comprehensive income						
Net gains on available for sale investment securities	-	-	-	-	837	837
Net losses on cash flow hedges	-	-	-	-	(1,436)	(1,436)
Total comprehensive income	**-**	**-**	**19,249**	**-**	**(599)**	**18,650**
Transactions with owners						
Shares issued in the year	23,000	207,000	-	-	-	230,000
Dividends to ordinary shareholders	-	-	(152,800)	-	-	(152,800)
Dividends to other equity holders	-	-	(1,066)	-	-	(1,066)
Total transactions with owners	**23,000**	**207,000**	**(153,866)**	**-**	**-**	**76,134**
Balance at the end of the year	**47,790**	**430,110**	**152,952**	**45,000**	**(153)**	**675,699**

TESCO PERSONAL FINANCE PLC

STATEMENT OF CHANGES IN EQUITY
FOR THE PERIOD ENDED 28 FEBRUARY 2009

	Share capital £'000	Share premium £'000	Retained earnings £'000	Subordinated notes £'000	Other reserves £'000	Total £'000
Balance at the beginning of the period	**24,790**	**223,110**	**268,416**	**45,000**	**-**	**561,316**
Comprehensive income						
Profit for the period	-	-	126,719	-	-	126,719
Other comprehensive income						
Net gains on cash flow hedges	-	-	-	-	446	446
Total comprehensive income	**-**	**-**	**126,719**	**-**	**446**	**127,165**
Transactions with owners						
Dividends to ordinary shareholders	-	-	(104,000)	-	-	(104,000)
Dividends to other equity holders	-	-	(3,566)	-	-	(3,566)
Total transactions with owners	**-**	**-**	**(107,566)**	**-**	**-**	**(107,566)**
Balance at the end of the period	**24,790**	**223,110**	**287,569**	**45,000**	**446**	**580,915**

TESCO PERSONAL FINANCE PLC

CASH FLOW STATEMENT
FOR THE YEAR ENDED 28 FEBRUARY 2010

	Note	12 months to 28 February 2010 £'000	Restated 14 months to 28 February 2009 £'000
Operating activities			
Profit before taxation		16,971	159,447
Adjusted for:			
Non-cash items included in profit before taxation	44	164,391	120,626
Changes in operating assets and liabilities	44	(820,042)	(2,463,539)
Income taxes paid		(13,625)	(58,370)
Cash flows from operating activities		(652,305)	(2,241,836)
Investing activities			
Purchase of non-current assets		(68,741)	(11,682)
Purchase of available for sale investment securities		(482,304)	-
Sale of available for sale investment securities		50,004	-
Investment in associate	23	(2,857)	-
Cash flows from investing activities		(503,898)	(11,682)
Financing activities			
Proceeds from issue of debt securities		-	224,550
Proceeds from issue of subordinated liabilities		30,000	-
Proceeds from issue of share capital	34	230,000	-
Dividends paid to equity holders		(153,735)	(107,566)
Interest paid on subordinated liabilities		(2,663)	(11,985)
Cash flows from financing activities		103,602	104,999
Net decrease in cash and cash equivalents		(1,052,601)	(2,148,519)
Cash and cash equivalents at the beginning of the period		1,457,962	3,606,481
Cash and cash equivalents at the end of the period	43	405,361	1,457,962

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

1 Basis of preparation

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

2 Principal accounting policies

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

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

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

The Company receives insurance commission arising from the sale of insurance policies sold under the Tesco brand. The commission is variable and dependant upon the profitability of the underlying insurance policies.

Revenue recognition – customer loyalty programmes
The Company participates in the customer loyalty programme operated by Tesco Stores Limited. The programme operates by allowing customers to accumulate Clubcard points on products for future redemption in Tesco stores. The cost of providing Clubcard points to customers is recharged by Tesco Stores Limited to the Company and is treated as a deduction from revenue in the financial statements of the Company in the period the costs are incurred.

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

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

e) Property, plant and equipment
Items of plant, property and equipment are stated at cost less accumulated deprecation (refer 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 to the income statement on a straight-line basis so as to write off the depreciable amount of property, plant and equipment over their estimated useful lives. The depreciable amount is the

2 Principal accounting policies (continued)

cost of an asset less its residual value. Estimated useful lives for plant, property and equipment are:

• Plant and Equipment	2 to 8 years
• Fixture and Fittings	4 to 5 years
• Computer Hardware	3 to 7 years
• Leasehold Improvements	15 years

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

f) Intangible assets

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

• Computer software	3 years

Internally generated intangible assets – research and development expenditure
Research costs are expensed as incurred.

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

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

Following the initial recognition of development expenditure, the cost is amortised over the estimated useful lives of the assets created. Amortisation commences on the date that the asset is brought into use.

g) Impairment of property, plant and equipment and intangible assets
At each reporting date, the Company assesses whether there is any indication that its property, plant and equipment or intangible assets are impaired. If any such indication exists, the Company estimates the recoverable amount of the asset and the impairment loss if any. No property, plant and equipment or intangible assets were impaired as at 28 February 2010 (2009: nil).

h) Foreign currencies
The Company's financial statements are presented in Sterling, which is the functional currency of the Company.

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

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

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

2 Principal accounting policies (continued)

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

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

i) Taxation

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

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

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

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

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

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

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

j) Financial assets

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

2 Principal accounting policies (continued)

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

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

If an available-for-sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in the statement of comprehensive income is recognised in the income statement. Interest on available for sale assets is calculated using the effective interest method, and foreign currency gains and losses on monetary assets classified as available for sale are recognised in the income statement.

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

k) Financial liabilities
The Company classifies its financial liabilities in two categories: those held at amortised cost and derivatives which are held at fair value.

Financial liabilities measured at amortised cost are deposits from banks or customers, debt securities in issue for which the fair value option is not applied, and subordinated debts.

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

Collateral furnished by the Company under standard repurchase agreements is not derecognised because the Company retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met. This also applies to certain securitisation transactions in which the Company retains a portion of the risks.

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

n) Impairment of financial assets
The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as 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.

i) Financial assets carried at amortised cost - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the 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.

2 Principal accounting policies (continued)

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.

ii) Financial assets classified as available-for-sale – In the case of investment securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for available-for sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on investment securities are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

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

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

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

i) Hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges); or

ii) Hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (cash flow hedges).

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

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

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

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

2 Principal accounting policies (continued)

forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

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

Changes in fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The net result is included as ineffectiveness within net interest income.

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

Derivatives not in hedge accounting relationships
The gain or loss relating to derivatives classified as trading is recognised in the income statement within non interest income.

p) 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.

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

r) Investment in group undertaking
The Company's investment in its subsidiary is stated at cost less any impairment.

s) Provisions for liabilities and charges and contingent liabilities
A provision is recognised where there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated.

No contingent liabilities have been recognised in the financial statements.

t) Borrowings
Borrowings are recognised initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

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

2 Principal accounting policies (continued)

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

v) Leases
If the lease agreement transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings.

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

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

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

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

x) Employee benefits
The Company accounts for pension costs on a contributions basis in line with the requirements of IAS 19. The Company makes contributions to the Tesco plc scheme.

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

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

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

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

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

Investments in associates are carried in the statement of financial position at cost, less any impairment in value.

2 Principal accounting policies (continued)

aa) Standards, amendments and interpretations, which became effective in 2009 and are relevant to the Company

The following standards, amendments and interpretations, which became effective in 2009 are relevant to the Company:

i) IFRS 8, 'Operating segments' (effective 1 January 2009) – IFRS 8, replaces IAS 14, 'Segmental reporting'. Under the requirements of the revised standard, the Company's external segment reporting will be based on the internal reporting to the Board of Directors (in its function as chief operating decision-maker). The application of IFRS 8 does not have any material effect for the Company but has an impact on segmental disclosure.

ii) IAS 1 (revised), 'Presentation of financial statements' (effective 1 January 2009) – IAS 1 (revised) requires each component of owner changes in equity to be presented in the statement of changes in equity, whereas non-owner changes in equity are presented in the statement of other comprehensive income. This amendment relates to disclosure rather than measurement, as such there is no impact on retained earnings. The changes are reflected in the statement of other comprehensive income and statement of changes in equity.

iii) Amendment to IAS 39, 'Financial instruments: Recognition and measurement', and IFRS 7, 'Financial instruments: Disclosures' on the 'Reclassification of financial assets' (effective 1 July 2008) – The amendment was introduced as a result of the recent financial crisis. It permits entities to reclassify derivative financial instruments, non-derivative financial liabilities and financial instruments designated at initial recognition at fair value through the profit and loss, out of this category. This has had no impact on the Company.

iv) Improvements to IFRS (2008) (most amendments effective 1 January 2009) – These improvements contain numerous amendments to IFRS that the IASB considers non-urgent but necessary. This has had no material impact on the accounting policies of the Company.

v) Amendment to IAS 32, 'Financial instruments: Presentation', and IAS 1, 'Presentation of financial statements' on 'Puttable financial instruments and obligations arising on liquidation' (effective 1 January 2009) – It is now required that certain financial instruments that previously met the definition of financial liability be classified as equity. This has had no impact on the Company.

vi) Amendment to IFRS 2, 'Share based payments' on 'Vesting conditions and cancellations' (effective 1 January 2009) – These changes relate mainly to the definition of vesting conditions and the regulations for the cancellation of a plan by a party other than the Company. As a result of the amended definition of vesting conditions, non-vesting conditions should now be considered when estimating the fair value of the equity instrument granted. There is no material impact on the financial statements of the Company by applying the amendment to IFRS 2.

vii) Amendment to IFRS 7, 'Financial instruments: Disclosures' (effective 1 January 2009) – The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The adoption of this amendment relates to presentation rather than measurement. These changes have been incorporated in the risk disclosure in the notes to the financial statements.

viii) IFRIC 13, 'Customer loyalty programmes relating to IAS 18 'Revenue' (effective 1 July 2008 but EU endorsed for use 1 January 2009) – This interpretation clarifies that where goods or services are sold together with a customer loyalty incentive, the arrangement is a multiple element arrangement. The adoption of this interpretation is explained in the revenue recognition accounting policy in this note to the financial statements and details of the resulting prior period restatement are in part ae below.

2 Principal accounting policies (continued)

ab) Standards and interpretations issued but not yet effective
The following standards and interpretations have been issued and are mandatory for the Company's accounting periods beginning on or after 1 March 2010 or later periods and are expected to be relevant to the Company:

- IFRS 3, 'Business combinations' (effective annual periods beginning 1 July 2009);
- IAS 27, 'Consolidated and separate financial statements' (effective annual periods beginning 1 July 2009);
- IAS 39, 'Financial instruments; Recognition and measurement' (effective annual periods beginning 1 July 2009);
- IFRIC 17, 'Distributions of non cash assets to owners' (effective annual periods beginning 1 July 2009); and
- IFRS 9, 'Financial instruments' (effective annual periods beginning 1 January 2013, not yet adopted by the EU).

ac) Early adoption standards
The Company did not early-adopt any new or amended standards in the year ended 28 February 2010.

ad) Restatement of statement of financial position
In order to align with emerging industry practise the Treasury Bills and related Medium Term Notes previously recognised have been restated in the February 2009 statement of financial position. These balances arose as a result of a securitisation and associated sale and repurchase agreement entered into as part of the Bank of England Special Liquidity Scheme during the period ended 28 February 2009.

The impact of the change in the prior period is a reduction in Investment Securities of £588m, with a related reduction in Deposits from Banks of £586m. The remaining £2m which relates to capitalised third party costs on the issue of the Medium Term Notes has been reclassified to Other Assets.

This restatement does not impact the Company's ability to access liquidity through the Bank of England Special Liquidity Scheme or to repo the Treasury Bills issued to the Company.

ae) Restatement of income statement
i) IFRIC 13 'Customer loyalty programmes' was adopted by the Company during the year. This has resulted in the reclassification of Clubcard marketing costs in the current and prior period to treat these costs as a deduction from revenue. The impact of this change in the prior period is a reduction in fee and commission income of £70,728,000, with a related reduction in marketing expense.

ii) The Company enters into securitisation transactions in which it sells Medium Term Notes to a Special Purpose Entity (SPE) and issues securities backed by the cash flows from the securitised credit card receivables. In order to align with emerging industry practise the impact of transactions with the SPE have been restated in the income statement of the Company in the current and prior period. The impact of this change in the prior period is a reduction in total income of £24,772,000, with a related reduction in administrative expenses.

3 Critical accounting estimates and judgements in applying accounting policies

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,

3 Critical accounting estimates and judgements in applying accounting policies (continued)

assumptions or models that differ from those adopted by the Company would affect its reported results.

a) 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 28 February 2010, gross loans and receivables totalled £4,611,208,000 (2009: £3,939,214,000) and loan impairment provisions amounted to £313,991,000 (2009: £249,578,000).

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. These portfolios include credit card receivables and other personal advances. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends.

b) Provision for customer redress
The Company has recognised a provision for potential customer redress. The calculation of this provision involves estimating a number of variables, principally the level of customer complaints which may be received and the level of any compensation which may be payable to customers. A change in key assumptions around these factors could impact the reported provision amount.

c) Insurance reserves
The Company recognises insurance commission arising from the sale of general insurance policies sold under the Tesco brand. The level of commission is dependent upon the profitability of the underlying insurance policies, which is in turn dependent on the level of reserves held by the insurance trading partner to underwrite the policies in place. Calculation of the required level of insurance claims reserves is dependent on a detailed actuarial review. Management also undertakes an assessment of other risks which are outside the scope of this review but that are inherent in assessing potential claims liabilities. A change in the estimate of any of the key variables in this calculation could have the potential to significantly impact the reserve balance recognised which would therefore also impact the insurance commission revenue recognised in the income statement.

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

4 Operating Segments

In the year to 28 February 2010 the Company has prepared segmental reporting for the first time in accordance with IFRS 8, 'Operating segments'.

Segment information for the 14 months to 28 February 2009 that is reported as a comparative has been restated to conform to the requirements of IFRS 8.

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

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

4 Operating Segments (continued)

The Company has two main operating segments:
- Retail banking - incorporating loans, credit cards, savings accounts and ATMs; and
- Insurance - incorporating motor, home, pet, travel and other insurance products.

There are no transactions between the operating segments.

Segment assets and liabilities comprise operating assets and liabilities, being the majority of the statement of financial position, but exclude items such as taxation.

The insurance business acts as a selling agent for insurance policies and therefore recognises insurance commission in relation to these. No expenses or balance sheet assets or liabilities are allocated to the insurance business.

a) Segment results of operations

	Retail banking £'000	Insurance £'000	Total £'000
At 28 February 2010			
Interest and similar income	367,169	-	367,169
Interest expense and similar charges	(135,860)	-	(135,860)
Fees and commissions income	206,592	141,388	347,980
Fees and commissions expense	(120,988)	-	(120,988)
Dividend income	28,216	-	28,216
Net fair value gains on derivatives	1,100	-	1,100
Realised gain on investment securities	139	-	139
Other operating income	4,235	-	4,235
Administrative expenses	(292,041)	-	(292,041)
Depreciation and amortisation	(6,346)	-	(6,346)
Impairment loss on loans and advances	(176,633)	-	(176,633)
(Loss)/Profit before tax	(124,417)	141,388	16,971
Total assets	5,763,502	-	5,763,502
Total liabilities	5,111,184	-	5,111,184

	Retail banking £'000	Insurance £'000	Total £'000
At 28 February 2009			
Interest and similar income	538,670	-	538,670
Interest expense and similar charges	(377,234)	-	(377,234)
Fees and commissions income	237,028	228,860	465,888
Fees and commissions expense	(15,793)	-	(15,793)
Dividend income	24,591	-	24,591
Net fair value losses on derivatives	(30,972)	-	(30,972)
Other operating income	1,548	-	1,548
Administrative expenses	(285,178)	-	(285,178)
Depreciation and amortisation	(8,554)	-	(8,554)
Impairment loss on loans and advances	(153,519)	-	(153,519)
(Loss)/Profit before tax	(69,413)	228,860	159,447
Total assets	5,660,632	-	5,660,632
Total liabilities	5,096,620	-	5,096,620

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

4 Operating Segments (continued)

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

	Total management reporting £'000	Consolidation and adjustments £'000	Total consolidated £'000
At 28 February 2010			
Interest and similar income	367,169	-	367,169
Interest expense and similar charges	(135,860)	-	(135,860)
Fees and commissions income	347,980	-	347,980
Fees and commissions expense	(120,988)	-	(120,988)
Dividend income	28,216	-	28,216
Net fair value gains on derivatives	1,100	-	1,100
Realised gain on investment securities	139	-	139
Other operating income	4,235	-	4,235
Administrative expenses	(292,041)	-	(292,041)
Depreciation and amortisation	(6,346)	-	(6,346)
Impairment loss on loans and advances	(176,633)	-	(176,633)
Profit before tax	16,971	-	16,971
Total assets	5,763,502	23,381	5,786,883
Total liabilities	5,111,184	-	5,111,184

	Total management reporting £'000	Consolidation and adjustments £'000	Total consolidated £'000
At 28 February 2009			
Interest and similar income	538,670	-	538,670
Interest expense and similar charges	(377,234)	-	(377,234)
Fees and commissions income	465,888	-	465,888
Fees and commissions expense	(15,793)	-	(15,793)
Dividend income	24,591	-	24,591
Net fair value losses on derivatives	(30,972)	-	(30,972)
Other operating income	1,548	-	1,548
Administrative expenses	(285,178)	-	(285,178)
Depreciation and amortisation	(8,554)	-	(8,554)
Impairment loss on loans and advances	(153,519)	-	(153,519)
Profit before tax	159,447	-	159,447
Total assets	5,660,632	16,903	5,677,535
Total liabilities	5,096,620	-	5,096,620

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

5 Net Interest Income

	12 months to 28 February 2010 £'000	Restated 14 months to 28 February 2009 £'000
Interest and similar income		
Loans and advances to customers	329,826	343,002
Loans and advances to banks	18,030	195,577
Fair value hedge ineffectiveness	9,824	-
Interest on investment securities	7,161	-
Other	2,328	91
	367,169	538,670
Interest expense and similar charges		
Deposits from customers	(91,307)	(149,478)
Deposits from banks	(41,335)	(214,721)
Subordinated liabilities	(3,218)	(11,985)
Fair value hedge ineffectiveness	-	(1,050)
	(135,860)	(377,234)

6 Net fees and commissions income

	12 months to 28 February 2010 £'000	Restated 14 months to 28 February 2009 £'000
Fees and commissions income		
Banking fees and commission	203,848	213,544
Insurance income	141,388	228,860
Other fees	2,744	23,484
	347,980	465,888
Fees and commissions expense		
Banking expenses	(14,399)	(13,329)
Other expenses	(6,589)	(2,464)
Provision for customer redress (refer note 30)	(100,000)	-
	(120,988)	(15,793)

NOTES TO THE FINANCIAL STATEMENTS

7 Net fair value gains/(losses) on derivatives

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Net gains/(losses) arising on derivatives not designated as hedging instruments under the terms of IAS 39.	1,100	(30,972)

In the prior period, £29,259,000 of the fair value loss was due to the decrease in swap rates between 28 October 2008, the date on which new hedge arrangements were put in place and 19 December 2008, the date on which hedge accounting was applied to these arrangements.

8 Realised gain on investment securities

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Financial assets classified as available for sale		
Realised gain on disposals	139	-

9 Administrative Expenses

	12 months to 28 February 2010 £'000	Restated 14 months to 28 February 2009 £'000
Staff Costs (refer below)	49,741	20,344
Premises and equipment	50,003	42,866
Marketing	12,058	12,632
Auditors' remuneration (refer below)	194	431
Early repayment expenses	-	38,335
Other administrative expenses	180,045	170,570
	292,041	285,178

Early repayment expenses of £38,335,000 in the prior period relate to the cost of unwinding borrowings and placings with The Royal Bank of Scotland Group in October 2008. These costs represent the movement in interest rates on funds borrowed to hedge interest rate risk (when the Company was 50% owned by The Royal Bank of Scotland Group) from the date the borrowings were taken out until the date of unwind. Unwinding these borrowings was a requirement of the share purchase agreement relating to change of ownership.

The average monthly number of persons (excluding executive Directors) employed by the Company during the year was 432 (2009: 180).

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

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

9 Administrative Expenses (continued)

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Wages and salaries	33,575	13,062
Social security costs	2,177	1,799
Pension costs	1,589	1,342
Other costs including temporary staff	12,400	4,141
	49,741	20,344

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

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Fees payable to the Company's auditors for the audit of the annual accounts	160	142
Fees payable for the audit of the Company's subsidiaries pursuant to legislation	19	17
	179	159
Fees payable to the Company's auditors for other assurance services	15	-
Fees payable to the Company's auditors for due diligence services	-	272
	15	272

10 Depreciation and amortisation

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Depreciation of property, plant and equipment (refer note 26)	6,241	6,069
Amortisation of intangible assets (refer note 25)	105	2,485
	6,346	8,554

11 Directors' emoluments

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

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Total emoluments received by Directors	3,477	1,876
Number of Directors to whom retirement benefits are accruing under defined benefit schemes	-	1

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 £1,529,000 (2009: £804,000). At 28 February 2010, the accrued pension, under a defined benefit scheme, for the highest paid Director was £ nil (2009: £ nil).

12 Income tax expense

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Current tax charge for the period	(9,810)	30,575
Current tax under / (over) provided on profits for prior periods	446	(248)
Total current tax	(9,364)	30,327
Deferred tax charge for the period	7,204	2,401
Deferred tax over provided on profits for prior periods	(118)	-
Total deferred tax	7,086	2,401
Income tax expense	(2,278)	32,728

The UK standard rate of corporation tax for the year ended 28 February 2010 was 28%. In the prior period the rate for the period 1 January 2008 to 31 March 2008 was 30% and from 1 April 2008 was 28%, this resulted in a blended tax rate for the period of 28.4%.

The actual tax charge for the current year and the previous period differs from the standard rate for the reasons set out in the following reconciliation.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

12 Income tax expense (continued)

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Profit before taxation	16,971	159,447
Tax on profit at standard rate	4,752	45,283
Factors affecting charge for the year:		
Group relief surrendered without payment	-	(4,371)
Income not subject to tax	(7,900)	(6,986)
Expenses not deductible for tax purposes	18	63
Adjustment to prior periods – current tax	445	(248)
Adjustment to prior periods – deferred tax	(118)	-
Share based payments	824	-
Other tax adjustments	(299)	(1,013)
Income tax expense	(2,278)	32,728

13 Distributions to equity holders

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Ordinary dividend paid	152,800	104,000
Interest paid on subordinated notes included within equity	1,066	3,566
	153,866	107,566

On 19 October 2009 an interim dividend of £2,800,000, being £0.94 per ordinary share was paid.

On 26 February 2010 a further dividend of £0.31 per ordinary share was paid, resulting in a total dividend payment for the year of £152,800,000.

In the prior period, an interim dividend of £0.32 per ordinary share was paid on 30 June 2008, a further dividend of £0.16 per ordinary share was paid on 19 December 2008, and a final dividend of £0.16 per ordinary share was paid on 19 January 2009. This resulted in a total dividend payment for the period of £104,000,000.

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

14 Income tax effects relating to components of other comprehensive income

28 February 2010	Before tax amount £'000	Tax (expense)/ benefit £'000	Net of tax amount £'000
Net gains on available for sale investment securities	1,163	(326)	837
Cash flow hedges	(1,821)	385	(1,436)
Other comprehensive income for the year	(658)	59	(599)
28 February 2009			
Cash flow hedges	446	-	446
Other comprehensive income for the period	446	-	446

15 Cash and balances with central banks

	28 February 2010 £'000	28 February 2009 £'000
Mandatory reserve deposits held with the Bank of England	3,330	2,753
Other balances held with the Bank of England	178,418	-
	181,748	2,753

Mandatory reserve deposits are not available for use in the Company's day to day operations and are non-interest bearing. Other balances are subject to variable interest rates based on central banks' base rates.

16 Loans and advances to banks

	28 February 2010 £'000	28 February 2009 £'000
Loans and advances to banks	61,937	1,457,962
Current (due within 12 months)	61,937	1,457,962
Non-current (due after 12 months)	-	-

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

NOTES TO THE FINANCIAL STATEMENTS

17 Loans and advances to customers

	28 February 2010 £'000	28 February 2009 £'000
Unsecured lending	4,583,444	3,929,633
Fair value hedge	27,764	9,581
Gross loans and advances to customers	4,611,208	3,939,214
Less: allowance for impairment	(313,991)	(249,578)
Net loans and advances to customers	4,297,217	3,689,636
Current (due within 12 months)	2,372,405	2,089,596
Non-current (due after 12 months)	1,924,812	1,600,040

As at the year end £1,458,764,000 of the credit card portfolio was securitised (2009: £1,468,430,000)

Fair value hedge adjustments amounting to £27,764,000 (2009: £9,581,000) relate to adjustments reflecting interest rate risk which offset the fair value movement on derivatives which have been designated against loans and advances to customers for the purposes of hedge accounting.

The following table shows impairment provisions for loans and advances:

	28 February 2010 Total £'000	28 February 2009 Total £'000
At beginning of period	249,578	184,395
Amounts written off	(118,394)	(88,387)
Recoveries of amounts previously written off	10,430	6,978
Charge to the income statement	176,633	153,519
Unwind of discount	(4,256)	(6,927)
At end of period	313,991	249,578

18 Derivative Financial Instruments

Strategy in using derivative financial instruments

The Board has authorised the use of derivative financial instruments for the purpose of supporting the strategic and operational business activities of the Company and reducing the risk of loss arising from changes in interest and foreign exchange rates. All use of derivative instruments within the Company is to hedge risk exposure, and the Company does not hold trading positions in derivatives. Not all derivatives are designated as hedging instruments under the terms of IAS39. Those derivatives that are not designated as hedging instruments are classified as held for trading derivatives in line with IAS39.

a) Fair value hedges

At 28 February 2010 the Company had a portfolio of micro hedge relationships in place with an aggregate notional principal of £1,923,702,000 (2009: £1,173,000,000).

18 Derivative Financial Instruments (continued)

The Company has the following risk management objective to create economically effective hedges:

Pay fixed rate interest rate swaps are transacted to hedge the interest rate risk inherent in writing fixed rate customer loans and holdings of fixed rate investment securities protecting against fluctuations in the fair value of the loans and investment securities due to movements in the benchmark LIBOR index. Each swap is defined as hedging one or more fixed rate loan or investment security.

The total fair value of derivatives held within fair value hedges at 28 February 2010 was a net liability of £56,406,000 (2009: £36,784,000).

b) Cash flow hedges
The Company designated three interest rate swaps (2009: one) as cash flow hedges and used these swaps to hedge the variability in cash flows associated with floating rate borrowings.

The total fair value of derivatives included within cash flow hedges as at 28 February 2010 was a net liability of £1,391,000 (2009: net asset of £446,000).

In 2010, there is no ineffectiveness recognised in the income statement that arises from the cash flow hedge (2009: nil).

There were no transactions for which cash flow hedge accounting had to be ceased in 2010 or 2009 as a result of the highly probable cash flows no longer being expected to occur.

c) Derivatives not in hedge relationships
The Company has the following derivative contracts not in hedge relationships:

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

The total fair value of derivatives not in hedge relationships as at 28 February 2010 was a net liability of £5,415,000 (2009: £4,386,000).

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

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

18 Derivative Financial Instruments (continued)

Derivatives in accounting hedge relationships	**Notional 28 February 2010 £'000**	**Asset Fair value 28 February 2010 £'000**	**Liability Fair Value 28 February 2010 £'000**
Derivatives designated as fair value hedges			
Interest rate swaps	1,923,702	-	(56,406)
Derivatives designated as cash flow hedges			
Interest rate swaps	155,000	-	(1,391)
	2,078,702	-	(57,797)
Derivatives not in hedge accounting relationships			
Interest rate derivatives			
Interest rate swaps	350,000	597	(2,856)
Currency derivatives			
Forward foreign exchange contracts	57,412	219	(1,005)
Cross currency Swaps	107,517	731	(3,101)
	514,929	1,547	(6,962)
	2,593,631	1,547	(64,759)

Derivatives in accounting hedge relationships	**Notional 28 February 2009 £'000**	**Asset Fair value 28 February 2009 £'000**	**Liability Fair Value 28 February 2009 £'000**
Derivatives designated as fair value hedges			
Interest rate swaps	1,173,000	279	(37,063)
Derivatives designated as cash flow hedges			
Interest rate swaps	100,000	446	-
	1,273,000	725	(37,063)
Derivatives not in hedge accounting relationships			
Interest rate derivatives			
Interest rate swaps	460,000	-	(5,123)
Currency derivatives			
Forward foreign exchange contracts	28,554	816	(79)
	488,554	816	(5,202)
	1,761,554	1,541	(42,265)

NOTES TO THE FINANCIAL STATEMENTS

18 Derivative Financial Instruments (continued)

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

	Assets 28 February 2010 £'000	Assets 28 February 2009 £'000	Liabilities 28 February 2010 £'000	Liabilities 28 February 2009 £'000
Current (due within 12 months)	390	816	(13,858)	(5,202)
Non-current (due after 12 months)	1,157	725	(50,901)	(37,063)
	1,547	1,541	(64,759)	(42,265)

19 Investment securities

	28 February 2010 £'000	Restated 28 February 2009 £'000
Available for sale:		
Government-backed investment securities	244,743	-
Other investment securities	97,685	-
Certificates of deposit	165,006	-
Asset-backed securities	96,828	-
	604,262	-
Loans and receivables:		
Loan to the Royal Bank of Scotland Insurance Group Limited	258,500	258,500
Current (due within 12 months)	223,970	-
Non-current (due after 12 months)	638,792	258,500

Available for sale
Included in investment securities are fixed-interest investment securities of £322,205,000 (2009: £nil) and variable-interest investment securities amounting to £282,057,000 (2009: £nil).

Loans and receivables
The loan comprises an interest free subordinated loan of £258,500,000 made to the Royal Bank of Scotland Insurance Group Limited, a wholly owned subsidiary of The Royal Bank of Scotland plc. During the year impairment charges of £nil (2009: £nil) were recognised on the loan.

Assets pledged as collateral
Available for sale investment securities with a market value of £10,074,000 (2009: nil) are pledged as collateral under repurchase agreements with other banks. All collateral agreements mature within 12 months.

20 Prepayments and accrued income

	28 February 2010 £'000	28 February 2009 £'000
Prepayments	4,341	1,102
Accrued income	86,659	81,615
	91,000	82,717

All amounts are receivable within one year.

21 Other assets

	28 February 2010 £'000	Restated 28 February 2009 £'000
Amounts due from Tesco Group subsidiaries	2,560	19,681
Amounts due from subsidiary undertaking	9,485	-
Other assets	130,936	124,167
	142,981	143,848

All amounts are receivable within one year.

22 Investment in Group undertaking

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

23 Investment in associate

Details of the Company's associate are as follows:

Name of company	Nature of business	Place of incorporation	Ownership interest 28 February 2010	Ownership interest 28 February 2009
Shoo 471 Limited (trading name 'Tesco Underwriting')	Insurance	England	49.9%	-

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

	Total £'000
At 1 March 2009	-
Additions	2,857
At 28 February 2010	2,857

The investment in associate is non-current.

24 Deferred income tax asset

The deferred tax asset can be analysed as follows:

	Accelerated capital allowances £'000	Other £'000	Total £'000
At 1 March 2009	830	10,801	11,631
Charged to the income statement	(5,643)	(1,443)	(7,086)
Credited to equity	-	385	385
At 28 February 2010	(4,813)	9,743	4,930

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

The Directors consider that there will be sufficient future profits to support recognition of the deferred tax asset.

25 Intangible assets

	Work in Progress £'000	Computer Software £'000	Total £'000
At 1 January 2008			
Cost	-	6,092	6,092
Accumulated amortisation	-	(1,584)	(1,584)
Net book value	-	**4,508**	**4,508**
Period ended 28 February 2009			
Opening net book value	-	4,508	4,508
Additions	-	820	820
Amounts written off	-	(2,843)	(2,843)
Amortisation	-	(2,485)	(2,485)
Closing net book value	-	-	-
At 28 February 2009			
Cost	-	-	-
Accumulated amortisation	-	-	-
Net book value	-	-	-
Year ended 28 February 2010			
Opening net book value	-	-	-
Additions	59,875	558	60,433
Amortisation	-	(105)	(105)
Closing net book value	**59,875**	**453**	**60,328**
At 28 February 2010	-	-	-
Cost	59,875	558	60,433
Accumulated amortisation	-	(105)	(105)
Net book value	**59,875**	**453**	**60,328**

25 Intangible assets (continued)

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

Intangible asset balances are non-current.

26 Property, plant and equipment

	Work in Progress £'000	Plant & Equipment £'000	Fixtures & Fittings £'000	Computer Hardware £'000	Computer Software £'000	Leasehold Improvements £'000	Total £'000
At 1 January 2008							
Cost	-	1,631	3,868	49,426	11,822	-	66,747
Accumulated depreciation	-	(1,231)	(3,082)	(31,993)	(11,470)	-	(47,776)
Net book value	**-**	**400**	**786**	**17,433**	**352**	**-**	**18,971**
Period ended 28 February 2009							
Opening net book value	-	400	786	17,433	352	-	18,971
Additions	-	4,493	-	6,369	-	-	10,862
Amounts written off	-	-	-	(89)	-	-	(89)
Depreciation charge	-	(247)	(208)	(5,262)	(352)	-	(6,069)
Closing net book value	**-**	**4,646**	**578**	**18,451**	**-**	**-**	**23,675**
At 28 February 2009							
Cost	-	6,124	3,868	55,553	-	-	65,545
Accumulated depreciation	-	(1,478)	(3,290)	(37,102)	-	-	(41,870)
Net book value	**-**	**4,646**	**578**	**18,451**	**-**	**-**	**23,675**
Year ended 28 February 2010							
Opening net book value	-	4,646	578	18,451	-	-	23,675
Additions	33,643	867	1,550	7,590	-	299	43,949
Transfers	-	(2,951)	-	-	-	2,951	-
Disposals	-	-	(31)	(227)	-	-	(258)
Depreciation charge	-	(520)	(321)	(5,238)	-	(162)	(6,241)
Closing net book value	**33,643**	**2,042**	**1,776**	**20,576**	**-**	**3,088**	**61,125**
At 28 February 2010							
Cost	33,643	4,040	5,387	62,916	-	3,250	109,236
Accumulated depreciation	-	(1,998)	(3,611)	(42,340)	-	(162)	(48,111)
Net book value	**33,643**	**2,042**	**1,776**	**20,576**	**-**	**3,088**	**61,125**

Work in progress related primarily to the fit-out of the new customer call centres and the development of IT infrastructure assets.

During the year the Company has taken the decision to classify leasehold improvements as a separate asset category and as a result £2,951,000 was transferred from plant and equipment into this category.

Property, plant and equipment balances are non-current.

NOTES TO THE FINANCIAL STATEMENTS

27 Deposits from banks

	28 February 2010 £'000	Restated 28 February 2009 £'000
Deposits from banks	29,856	24,020

All amounts owed are repayable within one year.

28 Deposits from customers

	28 February 2010 £'000	28 February 2009 £'000
Deposits from Tesco Personal Finance Group companies	13,489	9,495
Retail deposits	4,356,736	4,537,821
	4,370,225	4,547,316

All amounts owed are repayable within one year.

29 Debt Securities in issue

	28 February 2010 £'000	28 February 2009 £'000
Floating rate bond maturing in 2012	224,390	224,550

On 27 February 2009 the Company issued a nominal £225,000,000 3 year floating rate bond guaranteed by the Commissioners of Her Majesty's Treasury. Interest payable is based on three month LIBOR plus 50 basis points.

30 Provisions for liabilities and charges

	28 February 2010 £'000	28 February 2009 £'000
At the beginning of the period	-	-
Charged to the income statement	100,000	-
At the end of the period	100,000	-

The provision balance relates to a provision for customer redress in respect of potential customer complaints. This is likely to be utilised over several years, although the timing of utilisation is uncertain. Hence the balance is classified as non-current at year end.

31 Accruals and deferred income

	28 February 2010 £'000	28 February 2009 £'000
Amounts accrued to Tesco plc	580	1,357
Amounts accrued to Tesco Group subsidiaries	1,335	5,422
Other accruals and deferred income	117,203	54,695
	119,118	61,474

All amounts accrued are repayable within one year.

32 Other liabilities

	28 February 2010 £'000	28 February 2009 £'000
Amounts owed to Tesco Group subsidiaries	3,359	25,322
Other liabilities	9,477	11,673
	12,836	36,995

All amounts owed are repayable within one year.

33 Subordinated liabilities

	28 February 2010 £'000	28 February 2009 £'000
Floating rate subordinated loan maturing 2017	30,000	30,000
Floating rate subordinated loan maturing 2018	35,000	35,000
Floating rate subordinated loan maturing 2020	30,000	-
Floating rate subordinated loan maturing 2022	95,000	95,000
	190,000	160,000

Subordinated liabilities comprise loan capital issued to Tesco Personal Finance Group Limited.

The floating rate subordinated loans are repayable, in whole or in part, at the option of the issuer, prior to maturity, on conditions governing the debt obligation. Interest payable is based on three month LIBOR plus a range of 50 to 160 points.

NOTES TO THE FINANCIAL STATEMENTS

34 Called up share capital

	28 February 2010 Number	28 February 2009 Number
Authorised		
Ordinary shares of 10p each	Unlimited	500,000

	28 February 2010 £'000	28 February 2009 £'000
Allotted, called up and fully paid		
Ordinary shares of 10p each	47,790	24,790

During the year the Directors passed a resolution to amend the authorised share capital from 500,000,000 Ordinary shares of 10p each to unlimited Ordinary shares of 10p each.

During the year the Company issued 230,000,000 new shares to the parent company, Tesco Personal Finance Group Limited, for total consideration of £230,000,000.

35 Other reserves

	28 February 2010 £'000	28 February 2009 £'000
Cash flow hedge reserve	(990)	446
Available for sale reserve	837	-
	(153)	446

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

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

36 Subordinated notes

	28 February 2010 £'000	28 February 2009 £'000
Undated floating rate note	45,000	45,000

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

NOTES TO THE FINANCIAL STATEMENTS

37 Employee benefit liability

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

IAS 19 requires that where there is no policy or agreement of sharing the cost of the IAS 19 charge across the subsidiaries that the sponsoring employer recognises the net defined benefit cost of a defined benefit scheme. The sponsoring employer is Tesco plc and the principal pension plan is the Tesco plc pension scheme. The scheme is a funded defined benefit scheme in the UK, the assets of which are held as a segregated fund and administered by trustees. Tesco plc has recognised the appropriate net liability of the scheme. Towers Watson Limited, an independent actuary, using the projected unit method, carried out the latest triennial actuarial assessment of the scheme as at 31 March 2008. The following disclosures relate to the Tesco plc pension scheme.

Principal assumptions

The valuations used for IAS 19 have been based on the most recent actuarial valuations and updated by Towers Watson to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes as at 28 February 2010. The major assumptions, on a weighted average basis, used by the actuaries were as follows:

	2010 %	2009 %	2008 %
Rate of increase in salaries	3.6	3.7	5.0
Rate of increase in pensions in payment*	3.4	3.1	3.5
Rate of increase in deferred pensions*	3.6	3.2	3.5
Rate of increase in career average benefits	3.6	3.2	3.5
Discount rate	5.9	6.5	6.4
Price inflation	3.6	3.2	3.5

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

The main financial assumption is the real discount rate, i.e. the excess of the discount rate over the rate of price inflation. If this assumption increased/decreased by 0.1%, the UK defined benefit obligation would decrease/increase by approximately £140,000,000 and the annual UK current service cost would decrease/increase by approximately £17,000,000.

Rates of return on scheme assets

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

	2010		2009		2008	
	Long term rate of return %	Market value £m	Long term rate of return %	Market value £m	Long term rate of return %	Market value £m
Equities	8.7	2,521	8.9	1,482	8.9	2,205
Bonds	5.1	1,233	5.5	1,080	5.7	901
Property	7.0	343	7.3	342	7.3	351
Other (alternative assets)	8.7	484	8.9	383	8.9	512
Cash	4.1	115	3.7	133	4.5	120
Total market value of assets		4,696		3,420		4,089

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

NOTES TO THE FINANCIAL STATEMENTS

37 Employee benefit liability (continued)

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

	2010 £m	2009 £m	2008 £m
Opening fair value of plan assets	3,420	4,089	4,007
Expected return	265	338	301
Actuarial gains and (losses)	733	(1,270)	(465)
Contributions by employer	415	376	340
Actual Member Contributions	9	8	7
Foreign Currency translation differences	(2)	11	9
Benefits paid	(144)	(132)	(112)
Acquisitions	-	-	2
Closing fair value of plan assets	4,696	3,420	4,089

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

	2010 £m	2009 £m	2008 £m
Opening defined benefit obligation	4,914	4,927	4,957
Current service cost	391	428	461
Interest cost	313	313	254
Loss/(gain) on change of assumptions	1,052	(760)	(672)
Experience losses	1	117	21
Foreign currency translations differences	-	13	8
Benefits paid	(144)	(132)	(112)
Actual member contributions	9	8	7
Past service gains	-	-	-
Acquisitions	-	-	3
Closing defined benefit obligation	6,536	4,914	4,927

Summary of movements in deficit during the year

	2010 £m	2009 £m	2008 £m
Deficit in scheme at the beginning of the year	1,494	838	950
Current service cost	391	428	461
Past service gains	-	-	-
Other finance expense/(income)	48	(25)	(47)
Contributions by employer	(415)	(376)	(340)
Foreign currency translation differences	2	2	(1)
Actuarial loss/(gain)	320	627	(186)
Acquisitions through business combinations	-	-	1
Deficit in scheme at the end of the year	1,840	1,494	838

History in movements
The historical movement in defined benefit pension schemes assets and liabilities and history of experience gains and losses are as follows:

NOTES TO THE FINANCIAL STATEMENTS

37 Employee benefit liability (continued)

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Total market value of assets	4,696	3,420	4,089	4,007	3,448
Present value of liabilities relating to unfunded schemes	(54)	(39)	(34)	(27)	(17)
Present value of liabilities relating to partially funded schemes	(6,482)	(4,875)	(4,893)	(4,930)	(4,642)
Pension deficit	(1,840)	(1,494)	(838)	(950)	(1,211)
Experience gains/(losses) on scheme assets	733	(1,270)	(465)	82	309
Experience losses on plan liabilities	(1)	(117)	(20)	(41)	(24)

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

The liability in Tesco plc as at 28 February 2010 was £12,000,000 (2009: £10,000,000), which was determined in accordance with the advice of independent actuaries. £700,000 (2009: £700,000) has been charged to the Tesco plc income statement and £500,000 (2009: £500,000) of benefits were paid.

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

	2010 £m	2009 £m	2008 £m
Effect of 1.0% increase in assumed medical cost rate on			
Service and interest cost	0.1	0.1	0.1
Defined benefit obligation	1.5	1.6	1.6
Effect of 1.0% decrease in assumed medical cost rate on			
Service and interest cost	(0.1)	(0.1)	(0.1)
Defined benefit obligation	(1.5)	(1.3)	(1.3)

Expected Contributions
Tesco plc and its subsidiaries expect to make contributions of approximately £430,000,000 to defined benefit pension schemes in the year ending 28 February 2011.

38 Risk Management

Risk appetite
The Company defines risk appetite as the level of risk that the Company is willing to accept in delivering the strategy for the business. Risk is set by the Board providing a linkage between strategic objectives and the risk management framework and acting as a key reference point for decision-making and planning across the business.

Risk appetite is defined against a number of main activities undertaken by the Company. Risk appetite is defined as being: minimal, low, moderate or high. Performance is tracked against risk appetite using a suite of Key Indicators, which are reported frequently to the Board.

The risk appetite statement is as follows:

- The Company has a low appetite for risks that could result in reputational damage or adverse customer impact specifically those risks relating to financial crime, financial control or regulatory and legal compliance.

- The Company has a moderate appetite for the financial risks inherent in developing and launching new products, entering new markets and those associated with maintaining its existing product portfolio.

NOTES TO THE FINANCIAL STATEMENTS

38 Risk management (continued)

The business and financial objectives that form the Company's business plans and risk appetite are approved by the Board.

Risk model
The Chief Executive, with the support of the Finance and International Director and Risk Director has primary responsibility for identifying, assessing, monitoring, mitigation and reporting of risks to the Company's businesses and for designing and operating suitable systems and controls for the Company.

The Company recognises the 'Three Lines of Defence' Model, as follows:

i) First Line of Defence – The business and functional units which, through the identification and assessment of risk and adherence to internal controls, effectively deliver the Risk Management Framework.

ii) Second Line of Defence – This comprises the Risk function, Treasury and other central functions including Legal and Information Security who have responsibility for the design and custodianship of the risk and internal control frameworks. These areas devise the relevant policies, establish and communicate the processes and oversee effective implementation and adherence to each policy.

iii) Third Line of Defence – Internal Audit comprise the Third Line, providing independent assurance over the risk and internal controls frameworks. This is delivered via a programme of audit activity agreed with and overseen by the Audit Committee.

The Board, Board Risk Committee, Risk Management Committee (RMC) and Asset and Liability Management Committee (ALCo) approves the policies and monitor the performance and risk profile.

Risk Framework
The Company has established a comprehensive risk framework to manage the risks arising across the Company's businesses. The risk framework is based around the following five primary risk types:

- Regulatory Risk
- Operational Risk
- Credit Risk
- Insurance Risk
- Treasury Risk (including Market Risk, Interest Rate Risk, Liquidity Risk and Foreign Exchange Risk)

Risk Management Governance
A committee structure including the Board, Audit Committee, Executive Committee, RMC, and ALCo operated throughout the financial year as described below. Subsequent to the year end a Board Risk Committee and a Remuneration Committee (RemCo) have been established in line with the recommendations of the Walker Report. The Board has delegated responsibility for the day to day identification of risks and managing them effectively to the Executive Committee, RMC and ALCo.

- The Board

The Board is responsible for approval of the Company's business plans; approval of the Internal Capital Adequacy Assessment Programme (ICAAP); approval of Risk Appetite; approval of Treating Customers Fairly policy; approval and oversight of the risk and control processes of the Company; and approval of any material new product lines.

The Board monitors the Company's risk management profile and capital adequacy position.

The Board has appointed Non Executive Directors who provide insight and challenge to plans and performance.

38 Risk management (continued)

• Audit Committee

The role of the Audit Committee is to review the Company's financial statements, its internal control systems and assurance, its internal audit function and the work undertaken by the external auditors.

• Board Risk Committee

The role of the Board Risk Committee is forward looking to anticipate future risks and also to align the business strategy (including new products) with risk appetite and to satisfy itself that adequate policies and processes are in place to promptly identify, assess and control the risks.

• Tesco Bank Remuneration Committee (RemCo)

The role of RemCo is to determine and approve remuneration arrangements for the executive Directors and senior management and approve a remuneration framework for employees below the leadership level; and to ensure the levels and structure of remuneration are designed to attract, retain, and motivate the management talent needed to run the business of the Company in a way which is consistent with the risk appetite and ongoing sustainability of the business and to be compliant with all applicable legislation and guidelines.

• Executive Committee

This is the senior decision making forum below the Board. Its' responsibilities include planning, monitoring of performance, product development and monitoring of risks. A number of sub-committees have been established, where appropriate, to oversee and monitor activity in specific areas of activity. One change during the year was the creation of a sub-committee which focuses on the aspects of treating customers fairly.

• Risk Management Committee (RMC)

RMC is a sub-committee of the Board Risk Committee. The role of the RMC is to co-ordinate the risk management activities within the Company, including regulatory, operational (including fraud), credit, insurance and regulatory risks. The RMC approves appropriate policies and procedures to enable the effective management of risk for the Company and recommends them to the Board Risk committee for approval on behalf of the Board.

• Asset & Liability Management Committee (ALCo)

ALCo is a sub-committee of the Board Risk Committee. The role of the ALCo is to ensure that the balance sheet is managed effectively. The main areas of responsibility include capital management, liquidity and funding risk management, large exposures, interest rate risk in the banking book (IRRBB), non trading foreign exchange risk management and intra group limits. ALCo approves policies and processes in this area and recommends them to the Board Risk Committee for approval on behalf of the Board.

The legal department provides advice in respect of corporate governance and commercial issues and company secretarial services to the Board and committees, with support from Tesco plc legal department on specialist advice as and when required.

Role of Internal Audit
The Company has a dedicated Internal Audit function. The Internal Audit Director reports to the Chairman of the Audit Committee, who is a Non-Executive Director of the Board.

Internal Audit supports the Audit Committee in providing an independent assessment of the design, adequacy and effectiveness of internal controls.

38 Risk management (continued)

Regulatory Risk
Regulatory risk relates to the risks caused by non-compliance with financial regulators requirements. Material breaches could result in censure, fines, reputational damage or other liability arising from such failures to comply. Although the Company's main regulator is the Financial Services Authority (FSA), there are a range of other regulators and codes of best practice that oversee regulated financial services businesses in locations in which the Company operates.

Regulatory Risk undertake an ongoing compliance monitoring programme approved by the RMC; they ensure that the business adheres to regulatory rules and requirements, including the Company's Risk Management Policies and the FSA Handbook; co-ordinate regulatory risk reporting and work closely with the Royal Bank of Scotland Group (RBS) that provides outsourced services, particularly in the area of Anti-Money Laundering (AML).

The Company has a compliance guide which outlines all applicable compliance procedures including FSA requirements for example: AML, complaints, Treating Customers Fairly, Insurance Conduct of Business sourcebook, significant influence approved persons.

Operational risk
Operational Risk is the risk of loss caused by human error, ineffective or inadequately designed processes, system failure or improper conduct (including criminal activity).

The Company has adopted the Standardised Approach as prescribed under the FSA Prudential Regulation calculating the capital requirements for operational risk.

A significant amount of services and processes are provided by third party service providers and the key operational risk to the Business is a failure by an outsourced provider. The Company has established a structure for governance involving committees at various levels with key partners to ensure compliance with terms of the contract, in order to minimise any loss. It is impossible to implement processes for all eventualities therefore an additional capital requirement is maintained.

The services provided by third parties are managed through a series of Commercial Services Agreements (CSAs) covering operational, technology and support functions undertaken on its behalf by outsource partners. These CSAs describe servicing standards, performance reporting and escalation procedures.

Ultimately, the CSAs provide the Company with termination rights in the event of material or repeated breaches performance by outsource partners. The Company may terminate the CSAs in the event of material breaches or repeated breaches of any obligations under the CSAs.

The Company maintains an operational risk framework overseen by a dedicated unit within Risk to monitor and manage this risk area, as well as to ensure that it meets its statutory, regulatory and supervisory responsibilities.

The framework includes the following:

- A risk and control assessment process is used by the business to identify, assess, manage, monitor and report its operational risks. The information enables the business to assess its residual risk exposure and determine its approach to managing risk;
- A notifiable event process which is a formal escalation process used to inform appropriate senior management of events which have or could give risk to a financial, customer or reputational impact;
- Contingency and business continuity plans to ensure the Company's ability to operate on an ongoing basis and limit losses in the event of severe business disruption;
- Loss data management process to capture, classify, record and analyse the business's operational risk losses;
- A change risk management process to ensure that all new products and all material variations to existing products are subject to a comprehensive risk assessment prior to launch;
- Policies and processes to minimise exposure to financial crime, including fraud and money laundering;
- Control assurance testing to monitor the effectiveness of internal controls, and

38 Risk management (continued)

• *Information security policy and procedures.*

Oversight is provided primarily by the RMC.

Credit risk

Credit risk is the risk of financial loss of a customer, client or market counterparty defaulting on its obligations. Credit risk arises principally from the Company's lending activities but also from placement of contractual surplus funds with other banks and money market funds, investments in transferable securities, interest rate derivatives and foreign exchange. Credit risk may also arise when an adverse change in an entity's credit rating causes a fall in the fair value of the Company's investments in the entity's financial instrument.

The Company is exposed to country risk, and credit risk may arise when there are difficulties in the country where the exposure is domiciled, thus reducing the value of the assets, be it loans or investments, or where the counterparty is the country itself.

Credit Risk activities are governed by a policy framework which defines the requirements across the Company. Primary responsibility for the management of credit risk lies with the commercial and operational teams as the 'First Line of Defence'.

The Company's Credit Risk department is a specialist function holding the following key responsibilities:

- Defining the credit risk framework through a *suite of credit risk policies;*
- Oversight of all credit risk activities;
- Reporting of credit risk management information to ALCo, RMC, the Board Risk Committee, the Board and other stakeholders;
- Development and monitoring of credit risk models; and
- Assessment of credit risk elements of the ICAAP.

Credit Risk is responsible for reporting and monitoring of the credit risk in consumer lending. Monthly management information reports are provided to the RMC for the main lending portfolios with a summary report provided to the Board Risk Committee. Key performance metrics are tracked against triggers and limits with adverse trends likely to breach any limits investigated and actioned appropriately.

a) Loans and advances (including undrawn loan commitments and guarantees)

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

A dedicated risk management team have the day to day responsibility for managing the credit quality of the lending portfolio. The deployment and execution of credit strategies sits within the RBS infrastructure, managed through the relevant CSA; however the Company has full ownership of its own credit policy. Regular reporting to the RMC, Board Risk Committee, Executive Committee and the Board ensures that the Company has adequate oversight of this activity and sufficient insight to the performance of the portfolio.

In managing credit risk provisioning and impairment the Group apply IFRS, specifically International Accounting Standard 39: Financial Instruments (IAS 39) which requires that financial assets are assessed for impairment. The Company applies a collective impairment provisioning model that segments provisions into the latent (good) book and the bad book based upon the approved definition of default operated on both the credit card and loans portfolio. Key drivers of the provision model are subject to significant controls testing.

NOTES TO THE FINANCIAL STATEMENTS

38 Risk management (continued)

b) Counterparty Exposure - Investment securities classified as available-for-sale
The Company operates a control framework relating to the placement of funds with individual banks, funds and the UK government, as well as the investment in high quality bonds. The framework sets counterparty based on credit-worthiness. The Company uses Fitch, Moody's and Standard & Poor's as External Credit Assessment Intuitions (ECAIs) as part of the credit assessment criteria. All limits are approved via the RMC and any exceptions or overrides to this policy must be explicitly agreed by the RMC.

The day to day management of the Treasury operations is overseen by the Risk function and the RMC.

The Company has not recognised any impairment losses in connection with its financial assets classified as available-for-sale as at 28 February 2010 (2009: £nil).

See note 39 for an analysis of investment securities by rating agency designation, based on Standard & Poor's ratings or their equivalent.

c) Counterparty Credit Risk
Counterparty credit risk can be defined as the risk of loss arising from a counterparty failing to settle an open or unsettled transaction. This includes unsettled bond transactions, foreign exchange, derivatives, and money market transactions. The risk associated with each type of instrument varies from instrument to instrument depending on market practice, the nature of the settlement, collateral and netting arrangements, legal documentation, the existence of a central clearing house and other factors.

The Company in its ordinary course of business uses over the counter (OTC) derivatives and forward foreign exchange transactions to hedge exposures to market risk, e.g. interest rate and foreign exchange risk. Counterparty risk occurs when a counterparty defaults in its obligation to deliver under the respective transaction. The risk is mitigated by offsetting amounts due to the same counterparty ("Netting benefits"). Further details of the Company's exposure to counterparty credit risk for OTC derivative contracts and foreign exchange are provided in note 18.

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

	Maximum exposure	
	28 February 2010 £'000	**28 February 2009 £'000**
Cash and balances with central banks	181,748	2,753
Loans and advances to banks	61,937	1,457,962
Loans and advances to customers	4,297,217	3,689,636
Derivative financial instruments	1,547	1,541
Investment securities		
- Available for sale	604,262	-
- Loans and receivables	258,500	258,500
Other assets	142,981	143,848
Prepayments and accrued income	91,000	82,717
	5,639,192	5,636,957

38 Risk management (continued)

Credit risk exposures relating to undrawn loan commitments are as follows:

	Maximum exposure	
	28 February 2010 £'000	28 February 2009 £'000
Undrawn loan commitments	6,464,509	5,732,229

The above table represents a worse-case scenario of credit risk exposure to the Company at 28 February 2010 and 2009. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the statements of financial position.

As shown above, 77.3% of the total maximum exposure is derived from loans and advances to banks and customers (2009: 91.3%); 10.7% represents investments in financial assets classified as available for sale (2009: nil).

Management is confident in its ability to continue to control the credit risk to the Company resulting from both its loan and advances portfolio and investment securities classified as available for sale based on the following:

- 21.5% of the loans and advances portfolio is categorised in the top two grades of the internal rating system (2009: 26.1%);
- 98.3% of the loans and advances portfolio are considered to be neither past due nor impaired (2009: 98.4%); and
- 100% of the investment securities classified as available for sale and other bills have at least an A-credit rating.

e) Concentration of credit risk exposures – geographical sectors

At 28 February 2010	UK £'000	Europe (ex. UK) £'000	Other £'000	Total £'000
On balance sheet				
Cash and balances with central banks	181,748	-	-	181,748
Loans and advances to banks	11,937	50,000	-	61,937
Loans and advances to customers	4,264,784	32,433	-	4,297,217
Derivative financial instruments	1,547	-	-	1,547
Investment securities:				
- Available for sale	409,495	194,767	-	604,262
- Loans and receivables	258,500	-	-	258,500
Other assets	142,981	-	-	142,981
Prepayments and accrued income	88,928	2,072	-	91,000
	5,359,920	279,272	-	5,639,192
Undrawn loan commitments	6,417,946	46,563	-	6,464,509
	11,777,866	325,835	-	12,103,701

NOTES TO THE FINANCIAL STATEMENTS

38 Risk management (continued)

At 28 February 2009	UK £'000	Europe (ex. UK) £'000	Other £'000	Total £'000
On balance sheet				
Cash and balances with central banks	2,753	-	-	2,753
Loans and advances to banks	1,457,962	-	-	1,457,962
Loans and advances to customers	3,658,075	31,561	-	3,689,636
Derivative financial instruments	1,541	-	-	1,541
Investment securities:				
- Available for sale	-	-	-	-
- Loans and receivables	258,500	-	-	258,500
Other assets	143,848	-	-	143,848
Prepayments and accrued income	82,717	-	-	82,717
	5,605,396	31,561	-	5,636,957
Undrawn loan commitments	5,682,572	49,657	-	5,732,229
	11,287,968	81,218	-	11,369,186

f) Concentration of credit risk exposures – industry sectors

At 28 February 2010	Financial institutions £'000	Individuals £'000	Wholesale and retail trade £'000	Total £'000
On balance sheet				
Cash and balances with central banks	181,748	-	-	181,748
Loans and advances to banks	61,937	-	-	61,937
Loans and advances to customers	-	4,297,217	-	4,297,217
Derivative financial instruments	1,547	-	-	1,547
Investment securities:				
- Available for sale	604,262	-	-	604,262
- Loans and receivables	258,500	-	-	258,500
Other assets	127,322	-	15,659	142,981
Prepayments and accrued income	3,274	87,726	-	91,000
	1,238,590	4,384,943	15,659	5,639,192
Undrawn loan commitments	-	6,464,509	-	6,464,509
	1,238,590	10,849,452	15,659	12,103,701

NOTES TO THE FINANCIAL STATEMENTS

38 Risk management (continued)

At 28 February 2009	Financial institutions £'000	Individuals £'000	Wholesale and retail trade £'000	Total £'000
On balance sheet				
Cash and balances with central banks	2,753	-	-	2,753
Loans and advances to banks	1,457,962	-	-	1,457,962
Loans and advances to customers	-	3,689,636	-	3,689,636
Derivative financial instruments	1,541	-	-	1,541
Investment securities:				
- Available for sale	-	-	-	-
- Loans and receivables	258,500	-	-	258,500
Other assets	123,987	-	19,861	143,848
Prepayments and accrued income	-	82,717	-	82,717
	1,844,743	3,772,353	19,861	5,636,957
Undrawn loan commitments	-	5,732,229	-	5,732,229
	1,844,743	9,504,582	19,861	11,369,186

See Asset quality (note 40) and Past due and impaired (note 41) for further credit risk analysis

Insurance Risk

Current arrangements
Insurance contracts entered into by customers of the Company are currently underwritten by a subsidiary of RBS. The Company is exposed to insurance risk indirectly through its profit sharing commission arrangement with RBS. The profit sharing commission receivable by the Company is exposed to credit, regulatory and operational risk within RBS. The services of RBS in relation to insurance are closely monitored and the related risks are managed through the risk framework used across the Company.

The Company's key accounts are Private Motor and Home insurance.

The Motor account's key risk exposures are:

- Frequency and severity of claims. The main causes of Motor insurance claims are third party injury, third party damage, accidental damage and theft of vehicle. The key risk factors that drive claims experience are age of driver(s), sex, driving experience, type of vehicle, use of vehicle and area;
- Pricing of Motor insurance. Setting prices at too low a level will result in writing unprofitable business, whilst setting prices too high will result in less business written. Both pricing outcomes affect overall profitability;
- External issues such as weather conditions and the social economic and legislative background;
- Reinsurance failure; and
- Adequacy of claims reserves.

Home insurance is exposed to similar risks as the Motor account, in terms of pricing sensitivity and claims experience. The main causes of Home insurance claims are theft, flood, escape of water, fire, storm, subsidence and accidental damage. The Home account's key risk factors are:

- Volatility of weather conditions; and
- Exposure concentrated in geographic areas that could be affected by localised weather events.

Future arrangements
The Company has entered into an agreement with Fortis Insurance Limited (FIL) to establish Tesco

Notes to the Financial Statements

38 Risk Management (continued)

Underwriting (TU). TU will underwrite Motor and Home insurance contracts under the Tesco brand from the middle of the current financial year. The Company owns 49.9% of TU and will be exposed to that proportion of the insurance underwriting risk by virtue of this shareholding.

The Company will itself undertake insurance intermediary activity, including sales, servicing and marketing of Motor products and Home products.

A range of other personal insurance products offered by the Company will continue to be sold, serviced and underwritten by insurance providers under white-label arrangements, replacing the existing RBS agreements.

The Company's risk management framework and policies are being adapted to operate under the new business model.

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 Company does not undertake traded market risk and its principal exposure is to interest rate risk in the banking book (IRRBB).

Interest Rate Risk
IRRBB arises where there is potential for changes in benchmark interest rates (that embed little or no credit risk) to result in a movement in the Company's banking book net interest income. The Company has established limits that describe its risk appetite in this area and stress tests are performed using sensitivity to fluctuations in underlying interest rates in order to monitor this risk.

The main drivers of interest rate risk are:

- Differences in the re-pricing terms of an entity's assets and liabilities;
- Changes in the yield curve that lead to changes in income ;
- Imperfectly matched offsetting positions in two similar but not identical markets – so-called basis risk; and
- Optionality, enabling a customer to exit a deal early prior to the contractual maturity date.

The IRRBB policy is owned by ALCo and controlled by Treasury. The main policy objectives are to:

i) Manage the overall IRRBB of the Company by:

- minimising the sensitivity at product, balance or business level of net interest income to changes in benchmark interest rates; and
- ensuring that IRRBB arising in the Company is transferred to the market or managed efficiently by Treasury within approved limits.

ii) To ensure that compliance with evolving regulatory IRRBB requirements is maintained within each jurisdiction in which the Company operates, including requirements set out as part of an ICAAP.

There are two key risk measures used within the Company. These are:

- Value at Risk (VaR); and
- Net interest income sensitivity (NII).

The different methodologies can be summarised as:

- VaR – is a technique that produces estimates of the potential negative change in the value of a portfolio over a specified time horizon at given confidence levels. For internal risk management

Notes to the Financial Statements

38 Risk Management (continued)

purposes, the Company uses a time horizon of one trading day and a confidence level of 95%. The Company use historical interest rate models in computing VaR. This approach assumes that risk factor changes observed in the past are a good estimate of those likely to occur in the future and is, therefore, limited by the relevance of the historical data used.

	28 February 2010 £'000	28 February 2009 £'000
Interest Rate VaR	74	96

- NII Sensitivity – this measures the effect of a 1.0% interest rate shock on the next 12 months net interest income, based on the re-pricing gaps in the existing portfolio

	28 February 2010	28 February 2009
NII Sensitivity	(0.93%)	(1.45%)

In addition to the two key risk measures outlined above the Group also monitors the contractual interest rate sensitivity gap.

The table below summarises the contractual interest rate sensitivity gap for the Company as at 28 February 2010. 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.

NOTES TO THE FINANCIAL STATEMENTS

38 Risk Management (continued)

28 February 2010	Within 3 months £'000	After 3 months, but within 6 months £'000	After 6 months, but within 1 year £'000	After 1 year, but within 5 years £'000	After 5 years £'000	Non – interest bearing funds £'000	Total £'000
Assets:							
Loans & advances to banks	240,355	-	-	-	-	3,330	243,685
Loans & advances to customers	1,888,609	316,299	557,436	1,474,244	60,629	-	4,297,217
Investment securities	371,262	75,000	-	158,000	-	-	604,262
Other assets	-	-	-	-	-	641,719	641,719
Total assets	2,500,226	391,299	557,436	1,632,244	60,629	645,049	5,786,883
Liabilities and equity:							
Deposits from banks	29,856	-	-	-	-	-	29,856
Deposits from customers	4,343,850	4,727	4,330	17,318	-	-	4,370,225
Other liabilities	193,675	11,971	23,942	191,515	-	100,000	521,103
Subordinated liabilities	190,000	-	-	-	-	-	190,000
Shareholders' equity	45,000	-	-	-	-	630,699	675,699
Total liabilities and equity	4,802,381	16,698	28,272	208,833	-	730,699	5,786,883
On balance sheet Interest rate sensitivity gap	(2,302,155)	374,601	529,164	1,423,411	60,629	(85,650)	-
Notional value of derivatives	1,189,702	511,500	(450,000)	(1,197,202)	(54,000)	-	-
Cumulative Interest rate sensitivity gap	(1,112,453)	886,101	79,164	226,209	6,629	(85,650)	-

38 Risk Management (continued)

28 February 2009	Within 3 months £'000	After 3 months, but within 6 months £'000	After 6 months, but within 1 year £'000	After 1 year, but within 5 years £'000	After 5 years £'000	Non – interest bearing funds £'000	Total £'000
Assets:							
Loans and advances to banks	1,460,715	-	-	-	-	-	1,460,715
Loans and advances to customers	1,291,000	222,000	474,000	842,000	57,000	803,636	3,689,636
Other assets	-	-	-	-	-	527,184	527,184
Total assets	2,751,715	222,000	474,000	842,000	57,000	1,330,820	5,677,535
Liabilities and equity:							
Deposits from banks	24,020	-	-	-	-	-	24,020
Deposits from customers	4,547,316	-	-	-	-	-	4,547,316
Other liabilities	-	-	-	169,366	-	195,918	365,284
Subordinated liabilities	160,000	-	-	-	-	-	160,000
Shareholders' equity	45,000	-	-	-	-	535,915	580,915
Total liabilities and equity	4,776,336	-	-	169,366	-	731,833	5,677,535
On balance sheet Interest rate sensitivity gap	(2,024,621)	222,000	474,000	672,634	57,000	598,987	-
Notional value of derivatives	694,000	849,000	(270,000)	(1,239,000)	(34,000)	-	-
Cumulative Interest rate sensitivity gap	(1,330,621)	1,071,000	204,000	(566,366)	23,000	598,987	-

Liquidity risk

Liquidity risk is the risk that the Company is unable to meet its payment obligations as they fall due. The Company has a defined liquidity risk policy and contingency funding, the Company's policy is prudent and in excess of the minimum requirements set out by the FSA. The Company maintains a specific liquid asset portfolio of high quality marketable assets, currently Supranational, Government issued or guaranteed debt, and adequacy is monitored daily. The Company also has a large pool of surplus cash resources that are invested in a range of marketable assets. In addition, it can utilise £250m of committed bank funding which is available via two loan syndicated facilities, neither of which was drawn in the financial year. The Company's lending activities are predominately funded by retail customer deposits. Stress testing of current and forecast balance sheets is carried out to ensure that the Company retains sufficient liquidity at all times.

Details of contractual maturities for assets and liabilities form an important source of information for the management of liquidity risk. In order to more accurately reflect the expected behaviour of the Company's liabilities measurement and modelling of each is constructed. This forms the foundation of the liquidity controls.

In December 2008 the Company participated in the Bank of England Special Liquidity Scheme. This involved the Company gaining access to Treasury Bills which can be used to support the Company's liquidity position. Under the current arrangement this scheme will terminate in January 2012. The Company has created a funding plan to ensure that liquidity is maintained at appropriate levels following cessation of the scheme.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

38 Risk Management (continued)

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

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

At 28 February 2010	Within 1 year £'000	Between 1 – 2 years £'000	Between 2 – 3 years £'000	Between 3 – 4 years £'000	Between 4- 5 years £'000	Beyond 5 years £'000	Total £'000
Financial assets							
Financial investments – Principal	455,090	65,549	187,939	11,950	106,350	7,058	833,936
Interest receipts	7,159	8,156	9,367	5,370	5,276	718	36,046
Loans and advances to customers	3,061,061	513,174	413,260	287,098	165,211	166,410	4,606,214
Equity investments	-	-	-	-	-	258,500	258,500
Trade and other receivables	224,497	-	-	-	-	-	224,497
	3,747,807	586,879	610,566	304,418	276,837	432,686	5,959,193
Financial liabilities							
Deposits from banks	29,856	-	-	-	-	-	29,856
Deposits from customers	4,370,225	-	-	-	-	-	4,370,225
Debt securities in issue	-	224,390	-	-	-	-	224,390
Net settled derivative contracts	40,988	17,328	3,153	(1,059)	381	(358)	60,433
Gross settled derivative contracts	876	(179)	1,624	-	-	-	2,321
Accruals and deferred income	119,118	-	-	-	-	-	119,118
Interest payment on borrowings	8,107	11,437	8,169	9,328	10,118	67,806	114,965
Trade and other payables	12,837	-	-	-	-	-	12,837
Subordinated liabilities	-	-	-	-	-	190,000	190,000
	4,582,007	252,976	12,946	8,269	10,499	257,448	5,124,145
Gap analysis	(834,200)	333,903	597,620	296,149	266,338	175,238	835,048

NOTES TO THE FINANCIAL STATEMENTS

38 Risk Management (continued)

At 28 February 2009	Within 1 year £'000	Between 1 – 2 years £'000	Between 2 – 3 years £'000	Between 3 – 4 years £'000	Between 4- 5 years £'000	Beyond 5 years £'000	Total £'000
Financial assets							
Financial investments – Principal	1,428,613	-	29,218	-	-	-	1,457,831
Interest receipts	2,198	-	-	-	-	-	2,198
Loans and advances to customers	2,524,157	378,506	297,162	213,892	118,855	147,483	3,680,055
Equity investments	-	-	-	-	-	258,500	258,500
Trade and other receivables	226,565	-	-	-	-	-	226,565
	4,181,533	378,506	326,380	213,892	118,855	405,983	5,625,149
Financial liabilities							
Deposits from banks	24,020	-	-	-	-	-	24,020
Deposits from customers	4,547,316	-	-	-	-	-	4,547,316
Debt securities in issue	-	-	224,550	-	-	-	224,550
Net settled derivative contracts	1,000	19,000	23,000	2,000	-	-	45,000
Accruals and deferred income	-	61,474	-	-	-	-	61,474
Interest payment on borrowings	3,000	11,000	31,000	15,000	34,000	30,000	124,000
Other liabilities	36,995	-	-	-	-	-	36,995
Subordinated liabilities	-	-	-	-	65,000	95,000	160,000
	4,612,331	91,474	278,550	17,000	99,000	125,000	5,223,355
Gap analysis	(430,798)	287,032	47,830	196,892	19,855	280,983	401,794

Foreign exchange risk

Foreign exchange risk is the risk that the sterling value of net income from asset and liabilities that are denominated in foreign currency changes as a consequence of changes to foreign exchange rates. The Company has a Euro denominated credit card portfolio and holdings of Euro and USD denominated investment securities. These are subject to limited foreign exchange risk as the majority of this risk has been eliminated through the use of a series of foreign exchange swaps and cross currency swaps.

The table below summarises the Company's exposure to foreign currency exchange rate risk at 28 February 2010. Included in the table are the Company's financial instruments at carrying amounts, categorised by currency.

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

38 Risk Management (continued)

Maximum exposure At 28 February 2010	**EUR £'000**	**USD £'000**	**GBP £'000**	**Total £'000**
Assets:				
Cash and balances with central banks	-	-	181,748	181,748
Loans and advances to banks	-	-	61,937	61,937
Loans and advances to customers	32,433	-	4,264,784	4,297,217
Derivative financial instruments	951	-	596	1,547
Investment securities				
- Available for sale	113,457	18,115	472,690	604,262
- Loans and receivables	-	-	258,500	258,500
Other assets	-	-	142,981	142,981
Prepayments and accrued income	1,124	5	89,871	91,000
Total assets	147,965	18,120	5,473,107	5,639,192
Liabilities:				
Deposits by banks	-	-	29,856	29,856
Deposits by customers	-	-	4,370,225	4,370,225
Debt securities in issue	-	-	224,390	224,390
Derivative financial instruments	5,596	750	58,413	64,759
Accruals and deferred income	-	4,474	114,644	119,118
Other liabilities	-	-	12,836	12,836
Subordinated liabilities	-	-	190,000	190,000
Total liabilities	5,596	5,224	5,000,364	5,011,184

Maximum exposure At 28 February 2009	**EUR £'000**	**USD £'000**	**GBP £'000**	**Total £'000**
Assets:				
Cash and balances with central banks	-	-	2,753	2,753
Loans and advances to banks	961	-	1,457,001	1,457,962
Loans and advances to customers	31,561	-	3,658,075	3,689,636
Derivative financial instruments	816	-	725	1,541
Investment securities				
- Available for sale	-	-	-	-
- Loans and receivables	-	-	258,500	258,500
Other assets	-	-	143,848	143,848
Prepayments and accrued income	-	-	82,717	82,717
Total assets	33,338	-	5,603,619	5,636,957
Liabilities:				
Deposits by banks	8,015	-	16,005	24,020
Deposits by customers	-	-	4,547,316	4,547,316
Debt securities in issue	-	-	224,550	224,550
Derivative financial instruments	79	-	42,186	42,265
Accruals and deferred income	-	-	61,474	61,474
Other liabilities	-	-	36,995	36,995
Subordinated liabilities	-	-	160,000	160,000
Total liabilities	8,094	-	5,088,526	5,096,620

NOTES TO THE FINANCIAL STATEMENTS

38 Risk Management (continued)

Other price risk

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

The table below demonstrates the Company's exposure to this other price risk as at 28 February 2010. Included in the table is the impact of a 10 percent shock in market prices on the Company's available for sale investment securities.

	28 February 2010 £'000	28 February 2009 £'000
Available for sale:		
Government-backed investment securities	244,743	-
Other investment securities	97,685	-
Certificates of deposit	165,006	-
Asset-backed securities	96,828	-
	604,262	-

Impact of 10 % shock in market prices

	28 February 2010 £'000	28 February 2009 £'000
Available for sale:		
Government-backed investment securities	220,269	-
Other investment securities	87,917	-
Certificates of deposit	164,974	-
Asset-backed securities	87,138	-
	560,298	-

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 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.

At 28 February 2010	Loans and receivables £'000	Other (amortised cost) £'000	Derivatives used for hedging £'000	Available for Sale £'000	Non financial assets/liabilities £'000	Total £'000
Assets:						
Cash and balances at central banks	181,748	-	-	-	-	181,748
Loans and advances to banks	61,937	-	-	-	-	61,937
Loans and advances to customers	4,297,217	-	-	-	-	4,297,217
Derivative financial instruments	-	-	1,547	-	-	1,547
Investment securities classified as available for sale	-	-	-	604,262	-	604,262
Investment securities classified as loans and receivables	258,500	-	-	-	-	258,500
Prepayments and accrued income	91,000	-	-	-	-	91,000
Other assets	142,981	-	-	-	26,238	169,219
Intangible assets	-	-	-	-	60,328	60,328
Property, plant and equipment	-	-	-	-	61,125	61,125
	5,033,383	-	1,547	604,262	147,691	5,786,883
Liabilities and equity:						
Deposits from banks	-	29,856	-	-	-	29,856
Deposits from customers	-	4,370,225	-	-	-	4,370,225
Other liabilities	-	112,836	-	-	-	112,836
Debt securities in issue	-	224,390	-	-	-	224,390
Accruals and deferred income	-	119,118	-	-	-	119,118
Subordinated liabilities	-	190,000	-	-	-	190,000
Derivative financial instruments	-	-	64,759	-	-	64,759
	-	5,046,425	64,759	-	-	5,111,184
Equity						675,699
						5,786,883

NOTES TO THE FINANCIAL STATEMENTS

39 Financial Instruments (continued)

At 28 February 2009	Loans and receivables £'000	Other (amortised cost) £'000	Derivatives used for hedging £'000	Available for Sale £'000	Non financial assets/liabilities £'000	Total £'000
Assets:						
Cash and balances at central banks	2,753	-	-	-	-	2,753
Loans and advances to banks	1,457,962	-	-	-	-	1,457,962
Loans and advances to customers	3,689,636	-	-	-	-	3,689,636
Derivative financial instruments	-	-	1,541	-	-	1,541
Investment securities classified as loans and receivables	258,500	-	-	-	-	258,500
Prepayments and accrued income	-	-	-	-	82,717	82,717
Other assets	160,751	-	-	-	-	160,751
Property, plant and equipment	-	-	-	-	23,675	23,675
	5,569,602	-	1,541	-	106,392	5,677,535
Liabilities and equity:						
Deposits from banks	-	24,020	-	-	-	24,020
Deposits from customers	-	4,547,316	-	-	-	4,547,316
Debt securities in issue	-	-	224,550	-	-	224,550
Derivative financial instruments	-	-	42,265	-	-	42,265
Accruals and deferred income	-	-	-	-	61,474	61,474
Other liabilities	-	36,995	-	-	-	36,995
Subordinated liabilities	-	160,000	-	-	-	160,000
	-	4,768,331	266,815	-	61,474	5,096,620
Equity						580,915
						5,677,535

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

39 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 statement of financial position.

	28 February 2010		28 February 2009	
	Carrying value £'000	Fair value £'000	Carrying value £'000	Fair value £'000
Financial assets:				
Cash and balances with central banks	181,748	181,748	2,753	2,753
Loans and advances to banks	61,937	61,937	1,457,962	1,457,962
Loans and advances to customers	4,297,217	4,325,096	3,689,636	3,689,636
Investment securities – Available for sale	604,262	604,262	-	-
Investment securities - Loans and receivables	258,500	243,500	258,500	258,500
Derivative financial instruments	1,547	1,547	1,541	1,541
Financial liabilities:				
Debt securities in issue	224,390	223,427	224,550	224,550
Deposits from banks	29,856	29,856	24,020	24,020
Deposits from customers	4,370,225	4,370,225	4,547,316	4,547,316
Derivative financial instruments	64,759	64,759	42,265	42,265
Subordinated liabilities	190,000	207,319	160,000	160,000

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

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

b) Loans and advances to customers

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

c) Financial assets classified as available-for-sale investment securities

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

d) Derivative financial instruments

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

e) Customer accounts and deposits from banks

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand.

NOTES TO THE FINANCIAL STATEMENTS

39 Financial Instruments (continued)

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

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

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

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

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

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

At 28 February 2010	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets classified as available for sale	-	604,262	-	604,262
Derivative financial instruments	-	1,547	-	1,547
Total assets	**-**	**605,809**	**-**	**605,809**
Derivative financial instruments	-	(64,759)	-	(64,759)
Total liabilities	**-**	**(64,759)**	**-**	**(64,759)**

At 28 February 2009	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Derivative financial instruments	-	1,541	-	1,541
Total assets	**-**	**1,541**	**-**	**1,541**
Derivative financial instruments	-	(42,265)	-	(42,265)
Total liabilities	**-**	**(42,265)**	**-**	**(42,265)**

40 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.

40 Asset Quality (continued)

Since publishing last year's results, the Company has moved from an advanced capital measurement approach to a standardised methodology and now assign asset quality bands using a simple bureau score based model for loans and behavioral score based model for credit cards. In order to provide a true comparison of the current asset quality of the portfolio against last year we have provided last year's numbers re-stated using the new methodology.

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

28 February 2010	AQ1 £'000	AQ2 £'000	AQ3 £'000	AQ4 £'000	AQ5 £'000	Accruing past due £'000	Non-accrual £'000	Impairment provision £'000	Total £'000
Assets:									
Cash and balances at central banks	181,748	-	-	-	-	-	-	-	181,748
Loans and advances to banks	61,937	-	-	-	-	-	-	-	61,937
Loans and advances to customers	524,323	398,753	797,699	1,564,265	877,505	75,488	373,175	(313,991)	4,297,217
Investment securities classified as available for sale	604,262	-	-	-	-	-	-	-	604,262
Loans and receivables	258,500	-	-	-	-	-	-	-	258,500
	1,630,770	398,753	797,699	1,564,265	877,505	75,488	373,175	(313,991)	5,403,664
Commitments	3,926,169	1,328,772	572,768	452,360	184,440	-	-	-	6,464,509

40 Asset Quality (continued)

Restated 28 February 2009	AQ1 £'000	AQ2 £'000	AQ3 £'000	AQ4 £'000	AQ5 £'000	Accruing past due £'000	Non-accrual £'000	Impairment provision £'000	Total £'000
Assets:									
Cash and balances at central banks	2,753	-	-	-	-	-	-	-	2,753
Loans and advances to banks	1,457,962	-	-	-	-	-	-	-	1,457,962
Loans and advances to customers	553,286	409,024	1,060,161	992,549	551,015	81,888	291,291	(249,578)	3,689,636
Loans and receivables	258,500	-	-	-	-	-	-	-	258,500
	2,272,501	409,024	1,060,161	992,549	551,015	81,888	291,291	(249,578)	5,408,851
Commitments	3,102,999	1,450,837	744,146	305,088	129,159	-	-	-	5,732,229

41 Past due and impaired financial assets

At 28 February 2010, the Company's non-accrual loans amounted to £373,175,000 (2009: £292,291,000). Loan impairment provisions of £313,991,000 (2009: £249,578,000) were held against these loans.

	28 February 2010 £'000	28 February 2009 £'000
Gross income not recognised but which would have been recognised under the original terms of non-accrual loans	29,400	24,736

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

28 February 2010	Past due 1-29 days £'000	Past due 30-59 days £'000	Past due 60-89 days £'000	Past due more than 90 days £'000	Total £'000
Loans & advances to customers	55,383	12,662	7,443	-	75,488

28 February 2009	Past due 1-29 days £'000	Past due 30-59 days £'000	Past due 60-89 days £'000	Past due more than 90 days £'000	Total £'000
Loans & advances to customers	57,562	15,430	8,896	-	81,888

NOTES TO THE FINANCIAL STATEMENTS

42 Commitments

a) Undrawn loan 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.

	28 February 2010 £'000	28 February 2009 £'000
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than one year	6,464,509	5,732,229

Under an undrawn loan commitment the Company agrees to make funds available to a customer in the future. Undrawn 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.

b) Capital commitments
At 28 February 2010 the Company had capital commitments of £39,224,000 (2009: £5,645,000). This is in respect of IT software development and building fit-out purchases. The Company's management is confident that future net revenues and funding will be sufficient to cover this commitment.

c) Operating lease commitments
The future minimum lease payments under non-cancellable operating leases are as follows:

	28 February 2010 £'000	28 February 2009 £'000
No later than one year	743	-
Later than one year and no later than five years	18,234	3,654
Later than five years	74,750	14,616
	93,727	18,270

43 Cash and cash equivalents

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

	28 February 2010 £'000	28 February 2009 £'000
Cash and balances with central banks	178,418	-
Loans and advances to banks	61,937	1,457,962
Certificates of deposit	165,006	-
	405,361	1,457,962

NOTES TO THE FINANCIAL STATEMENTS

44 Cash inflow from operating activities

	12 months to 28 February 2010 £'000	14 months to 28 February 2009 £'000
Loan impairment charges	58,239	65,132
Depreciation and amortisation	6,346	8,554
Loss on disposal of property, plant and equipment	258	2,932
Profit on disposal of investment securities	(139)	-
Provision for customer redress	100,000	-
Interest on subordinated liabilities	3,218	11,985
Fair value movements	(3,531)	32,023
Non cash items included in operating profit before taxation	164,391	120,626
Net movement in mandatory balances with central banks	(577)	704
Net movement in loans and advances to banks	-	428,920
Net movement in loans and advances to customers	(647,437)	(299,616)
Net movement in prepayments and accrued income	(8,283)	(29,359)
Net movement in other assets	10,351	165,955
Net movement in deposits from banks	5,836	(4,275,779)
Net movement in deposits from customers	(177,091)	1,775,850
Net movement in accruals and deferred income	21,317	(16,234)
Net movement in other liabilities	(24,158)	(213,980)
Changes in operating assets and liabilities	(820,042)	(2,463,539)

TESCO PERSONAL FINANCE PLC

NOTES TO THE FINANCIAL STATEMENTS

45 Capital resources

The following table analyses the Company's regulatory capital resources at 28 February 2010:

	28 February 2010 £'000	28 February 2009 £'000
Movement in tier 1 capital		
At the beginning of the period	521,234	490,790
Ordinary shares issued	230,000	-
Profit attributable to shareholders	31,406	131,456
Ordinary dividends	(152,800)	(100,000)
Intangible assets	(59,316)	(1,012)
At the end of the period	570,524	521,234
Composition of regulatory capital		
Tier 1 capital:		
Shareholders funds and non-controlling interests	570,524	521,234
Tier 2 capital:		
Qualifying subordinated debt	235,000	205,000
Other interests in tier 2 capital	20,650	18,465
	255,650	223,465
Supervisory deductions:		
Other deductions*	(262,721)	(258,500)
Total regulatory capital	563,453	486,199

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

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 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.

Capital Management
On 19 December 2008 Tesco Plc acquired the whole share capital of the parent company, Tesco Personal Finance Group Limited, at which time the Company adopted the standardised approach to both credit and operational risk in order to calculate the Pillar 1 minimum capital requirement under Basel II.

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

Internal Capital Adequacy Assessment Process
The Company undertakes an Internal Capital Adequacy Assessment Process (ICAAP) which is an internal assessment of its capital needs. The ICAAP is performed annually and is supplemented by a program of

45 Capital resources (continued)

capital and liquidity stress testing. The ICAAP and stress testing scenarios are presented to ALCo, RMC and the Board for challenge and approval.

The outcome of the ICAAP covers all material risks to determine the capital requirement over a 12 month horizon and includes stressed scenarios over a three to five year period. Where capital is deemed as not being able to mitigate a particular risk, such as liquidity risk, alternative management actions are identified and described in the ICAAP document.

46 Related party transactions

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

a) Transactions involving Directors and other key connected persons
For the purposes of IAS 24 "Related Party Disclosures", key management comprise Directors of the Company. The captions in the Company's primary financial statements include the following amounts attributable, in aggregate to key connected persons.

	28 February 2010 £'000	28 February 2009 £'000
Loans and advances to customers		
At the beginning of the period	15	19
Loans issued during the period	33	-
Loan repayments during the period	(3)	(4)
Loans outstanding at the end of the period	45	15
Interest income earned	4	-
Deposits from customers		
Deposits at the beginning of the period	412	67
Deposits received during the period	128	345
Deposits repaid during the period	(51)	-
Deposits at the end of the period	489	412
Interest expense on deposits	8	2

No provisions have been recognised in respect of loans and advances to related parties (2009: nil).

NOTES TO THE FINANCIAL STATEMENTS

46 Related party transactions (continued)

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 11.

	28 February 2010 £'000	28 February 2009 £'000
Short-term employee benefits	3,477	2,698
Retirement benefits	-	119
	3,477	2,817

c) Trading transactions
During the year, the Company entered into the following transactions with related parties:

	28 February 2010 Tesco Plc and subsidiaries £'000	28 February 2009 The Royal Bank of Scotland plc £'000	28 February 2009 Tesco Plc and subsidiaries £'000
Interest received and other income	3,069	519,919	1,678
Interest paid	(3,218)	(210,819)	(8,178)
Provision of services	(75,708)	(85,203)	(59,247)

Prior to 19 December 2008 the Company was 50% owned by the Royal Bank of Scotland plc. The Company became a wholly owned subsidiary of Tesco plc on 19 December 2008 and consequently the Royal Bank of Scotland plc ceased to be a related party from that date.

d) Ultimate parent undertaking
The Company's ultimate parent company is Tesco plc which is incorporated in England. The financial statements for Tesco plc can be obtained from its registered office at Tesco House, Delamare Road, Chesunt, Hertforshire EN8 9SL.

47 Immediate parent undertaking

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

NOTES TO THE FINANCIAL STATEMENTS

48 Contingent Liabilities

The Financial Services Compensation Scheme
The Financial Services Compensation Scheme is the UK statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS has borrowed from HM Treasury to fund these compensation costs associated with institutions that failed in 2008 and will receive receipts from asset sales, surplus cash flow and other recoveries from these institutions in the future.

The FSCS meets its obligations by raising management expense levies. These include amounts to cover the interest on its borrowings and compensation levies on the industry. Each deposit-taking institution contributes in proportion to its share of total protected deposits.

As at 28 February 2010 the Company has accrued £5,106,000 (2009:£3,405,000) in respect of its current obligation to meet expenses levies.

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

49 Share based payments

The Company charge for the year recognised in respect of share-based payments is £4,261,000 (2009: £534,000), which is made up of share option schemes and share bonus payments. Of this amount £2,851,000 (2009: £483,000) will be equity settled and £1,410,000 (2009: £51,000) cash settled.

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

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

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

TESCO PERSONAL FINANCE PLC

Notes to the Financial Statements

49 Share based payments (continued)

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

For the year ended 28 February 2010	Savings-related share option scheme	Savings-related share option scheme	Approved share option scheme	Approved share option scheme	Unapproved share options scheme	Unapproved share options scheme
	Options	WAEP (pence)	Options	WAEP (pence)	Options	WAEP (pence)
Outstanding at 28 February 2009	-	-	7,025	427.00	39,813	427.00
Granted	85,133	328.00	481,420	338.40	522,474	338.40
Forfeited	-	-	(35,460)	338.40	(68,442)	338.40
Exercised	-	-	-	-	-	-
Outstanding as at 28 February 2010	85,133	328.00	452,985	339.77	493,845	345.54

None of the above share options were exercisable as at 28 February 2010.

For the period ended 28 February 2009	Approved share option schemes	Approved share option schemes	Unapproved share options scheme	Unapproved share options scheme
	Options	WAEP (pence)	Options	WAEP (pence)
Outstanding at 31 December 2007	-	-	-	-
Granted	7,025	427.00	39,813	427.00
Forfeited	-	-	-	-
Exercised	-	-	-	-
Outstanding as at 28 February 2009	7,025	427.00	39,813	427.00

None of the above share options were exercisable as at 28 February 2009.

No share options were exercised throughout the year.

Notes to the Financial Statements

49 Share based payments (continued)

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

	2010 Savings-related share option scheme	2010 Executive Share Option Schemes	2009 Executive Share Option Schemes
Expected Dividend Yield (%)	3.6%	3.9%	3.3%
Expected Volatility (%)	26 - 31%	25%	25%
Risk free interest rate (%)	2.0 - 2.8%	3.3%	4.4%
Expected life of option (years)	3 or 5	6	6
Weighted average fair value of options granted (pence)	86.69	64.23	94.18
Probability of forfeiture (%)	14 - 15%	10%	0%
Share price (pence)	378.00	345.10	427.00
Weighted average exercise price (pence)	328.00	338.40	427.00

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

b) Share Bonus Schemes

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

Senior management also participates in performance-related bonus schemes. The amount paid to employees is based on a percentage of salary and is paid partly in cash and partly in Tesco plc shares. Bonuses are awarded to eligible employees who have completed a required service period and depend on the achievement of corporate targets. The accrued cash element of the bonus at the balance sheet date is £990,000 (2009: £51,000)

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

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

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

	2010 Shares number	2010 WAFV (pence)	2009 Shares number	2009 WAFV (pence)
Shares in Success	78,441	349.66	-	-
Executive Incentive Scheme	64,893	356.05	-	-
Performance Share Plan	93,958	374.00	94,646	353.76

Notes to the Financial Statements

50 Events after the Balance Sheet date

Since the year end the Company's subsidiary, TPF ATM Services Limited, has been placed into voluntary liquidation. This is following a review of the corporate structure in relation to the management of the ATM business which was undertaken during the year. This structure was originally created in order to provide Tesco Stores Ltd with a greater share of the profits than they would have received through the joint venture structure with the Royal Bank of Scotland group in return for Tesco Bank ATM exclusivity at Tesco stores.

Following change of control there is no longer a need to maintain the structure as all profit ultimately flows up to Tesco plc and therefore the decision has been taken to place TPF ATM Services Limited, and its subsidiary TPF Services Limited Liability Partnership, into voluntary liquidation. The relevant legal filings will be made in due course.