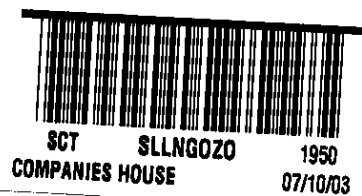


Tesco Personal Finance Limited

Directors' Report and Financial Statements

31 December 2002

Registered in Scotland No 173199



Tesco Personal Finance Limited

Directors' Report and Financial Statements 31 December 2002

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Directors and advisers

Directors:

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

Secretary:

Alan Ewing Mills

Registered Office:

42 St Andrew Square
Edinburgh
EH2 2YE

Telephone:

0131 556 8555

Registered Auditors:

Deloitte & Touche
Edinburgh

Bankers:

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

Directors' report 31 December 2002

The directors present their annual report and the audited financial statements for the year ended 31 December 2002.

Principal activities

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

Review of business and future developments

During the year the Company further expanded its customer base through its principal products; personal loans, credit cards, savings accounts, investment products, and general insurance. During the year, the Company also extended its range of financial products launching an electrical warranties product and extending its life insurance product to Eire.

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

The cost: income ratio for the year was 49% (2001: 57.1%).

Dividends

The directors do not recommend the payment of a dividend.

Directors

The present directors are listed on page 1.

Mr Kevin Paul Grace resigned as a director of the company on 4 October 2002.

Mr Iain Clink and Mr Andrew William Dewhurst were appointed as directors of the Company on 28 March 2002.

Directors' interests

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

Directors' report (continued)
31 December 2002

Directors' interests (continued)

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

	At 31 December 2002	At 1 January 2002 or date of appointment if later
N C McLuskie	150,037	145,213
W S Black	95,376	92,830
J W Melbourn	76,656	76,656
I H Chippendale	19,240	18,560
I Clink	9,722	9,604
A W Dewhurst	68	68
G A Schofield	3,792	3,708
B Higgins	352	5,350

Options to subscribe for ordinary shares of 25p each in The Royal Bank of Scotland Group plc granted to and exercised by directors during the year to 31 December 2002 are included in the table below:-

	At 1 January 2002 or date or appointment	Granted during the year		Exercised during the year		At 31 December 2002
		Options	Price	Options	Price	
W S Black	35,332	8,600	18.18	-	-	43,932
I H Chippendale	54,171	-	-	-	-	54,171
I Clink	37,671	246	12.35	10,284 118	11.18 10.06	27,515
B Higgins	103,747	24,300	18.18	27,314 30,208	9.33 11.18	70,525
N C McLuskie	95,190	22,100 335	18.18 12.35	1,046 149	4.61 10.06	116,430

Directors' report (continued)
31 December 2002**Directors' interests (continued)**

No director had an interest in any of the preference shares, other than as disclosed below, of The Royal Bank of Scotland Group plc for the year ended 31 December 2002. In addition, other than as disclosed below, during that year none of the directors held a beneficial interest in the loan capital of The Royal Bank of Scotland Group plc or in the share or loan capital of any of the other subsidiaries of The Royal Bank of Scotland Group plc, including the Company.

As at 31 December 2002 the following Directors had an interest in the Additional Value Shares (AVS) of £0.01 each in The Royal Bank of Scotland Group plc.

	No of AVS At 31 December 2002	No of AVS At 1 January 2002 or date of appointment if later
N C McLuskie	26,584	26,584
W S Black	47,041	47,041
J W Melbourn	77,624	77,624
I Clink	9,319	9,319
I H Chippendale	5,521	5,521
A W Dewhurst	68	68
G A Schofield	3,603	3,603
B Higgins	52	5,115

As at 31 December 2002 J W Melbourn also held interest in 193,464 (2001: 220,964) Floating Rate Unsecured Loan Notes 2005 in The Royal Bank of Scotland Group plc.

Directors' report (continued)
31 December 2002**Directors' responsibilities**

United Kingdom company law requires the directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

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

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

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

Charitable and political donations

No donations were made by the Company during the year for political purposes. The following charitable donations were made by the Company:

Charitable organisation	Amount
Cystic Fibrosis	£112,722
Marie Curie	£200
Child Victims of Crime	£200

Share capital

No changes were made to the share capital during the year.

Directors' report (continued)
31 December 2002

Suppliers payment policy

The Company is committed to maintaining a sound commercial relationship with its suppliers. Consequently, it is the Company's policy to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking by the Company to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract. The average duration of amounts owing to suppliers during the year was 28 days.

Auditors

A resolution to re-appoint Deloitte & Touche and to authorise the directors to fix their remuneration will be proposed at the Annual General Meeting.

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



Alan Ewing Mills

Secretary

14 February 2003

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

We have audited the financial statements of Tesco Personal Finance Limited for the year ended 31 December 2002 which comprise the profit and loss account, the balance sheet and the related notes 1 to 33. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibility is to audit the financial statements in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

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

We read the directors' report for the above year and consider the implications for our report if we become aware of any apparent misstatements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2002 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche

Deloitte & Touche
Chartered Accountants and Registered Auditors
Edinburgh

14 February 2003

**Profit and loss account
for the year ended 31 December 2002**

		Year ended 31.12.02 £'000	Year ended 31.12.01 Restated* £'000
	Note		
Interest receivable:-			
Other interest receivable and similar income	4	198,907	185,818
Interest payable	5	(87,043)	(84,839)
Net interest income		111,864	100,979
Fees and commissions receivable		160,948	94,750
Fees and commissions payable		(14,251)	(9,542)
Other income	6	6,962	1,647
Non-interest income		153,659	86,855
Total income		265,523	187,834
Administrative expenses:-			
Staff costs	8	10,233	11,129
Premises and equipment		10,167	6,692
Other administrative expenses	9	105,722	79,572
Depreciation	10	4,108	9,874
Operating expenses		130,230	107,267
Profit before provisions for bad and doubtful debts		135,293	80,567
Provisions for bad and doubtful debts	14	41,176	40,093
Operating profit and profit on ordinary activities before tax		94,117	40,474
Tax on profit on ordinary activities	11	26,799	8,864
Retained profit	26	67,318	31,610

All the above amounts relate to continuing operations.

* The profit and loss account for the year ended 31 December 2001 has been restated for the adoption of FRS 19.

In addition to the profit for the year as reported above, a prior period adjustment (see note 26) resulted in an increase of £7,555,314 to the brought forward balance on the profit and loss account.

**Profit and loss account
for the year ended 31 December 2002 (continued)**


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


**Balance sheet
at 31 December 2002**

	Note	Year ended 31.12.02 £'000	Year ended 31.12.01 Restated* £'000
Assets			
Investment in subsidiary	12		
Cash and balances at central banks		2,124	1,715
Loans and advances to banks	13	161	8,130
Loans and advances to customers	14	2,433,289	2,025,806
Tangible fixed assets	16	9,079	7,077
Other assets	17	192,769	113,106
Prepayments and accrued income	18	8,838	9,165
Total assets		2,646,260	2,164,999
Liabilities			
Deposits by Banks	19	41,827	73,310
Customer accounts	20	2,051,378	1,695,144
Other liabilities	21	33,784	29,059
Accruals and deferred income	22	41,130	31,663
Loan capital	23	170,000	95,000
Called up share capital	24	24,790	24,790
Share premium reserve	25	223,110	223,110
Profit and loss account	27	60,241	(7,077)
Equity shareholders' funds	28	308,141	240,823
Total liabilities		2,646,260	2,164,999
Memorandum items			
Commitments	30	3,015,257	2,222,115

* The balance sheet as at 31 December 2001 has been restated for the adoption of FRS 19.

The financial statements were approved by the board of directors on 14 February 2003 and were signed on its behalf by:


Rowley Stuart Ager
Chairman


Norman Cardie McLuskie
Deputy Chairman

**Notes to the financial statements
for the year ended 31 December 2002****1 Principal accounting policies**

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

Basis of accounting

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

Tangible fixed assets

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

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

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

Taxation

Certain items of income and expenditure are accounted for in different periods for financial reporting purposes and for taxation purposes. The Company has adopted FRS19 Deferred Tax. The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. A deferred tax asset is recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable profits from which the future reversal of the underlying timing differences can be deducted. The directors consider that there will be sufficient future profits to support recognition of the deferred tax asset.

Operating leases

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

1 Principal accounting policies (continued)

Loans and advances

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

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

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

Derivative transactions

Derivative transactions comprise interest rate swaps for hedging purposes.

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

Interest

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

Fees and commissions

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

2 Holding company

The Company's ultimate parent company is The Royal Bank of Scotland Group plc which is incorporated in Scotland. Financial statements for The Royal Bank of Scotland Group plc can be obtained from The Royal Bank of Scotland Group plc, 42 St Andrew Square, Edinburgh, EH2 2YE. The Company's intermediate holding company is Tesco Personal Finance Group Limited whose financial statements can be obtained at the same address. Tesco Personal Finance Limited is exempt from the obligation to prepare group accounts.

The smallest sub group into which the Company is consolidated is Tesco Personal Finance Group which has as its parent company The Royal Bank of Scotland plc, a company incorporated in Great Britain and registered in Scotland. Copies of the consolidated financial statements for this subgroup can be obtained from The Royal Bank of Scotland Group plc, 42 St Andrew Square, Edinburgh EH2 2YE.

3 Segmental reporting

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

4 Interest receivable

	Year ended 31.12.02 £'000	Year ended 31.12.01 £'000
Loans and advances to banks	213	3,188
Loans and advances to customers	196,531	179,463
Amounts receivable from group companies	2,163	3,167
	<u>198,907</u>	<u>185,818</u>

5 Interest payable

	Year ended 31.12.02 £'000	Year ended 31.12.01 £'000
Customer accounts	65,021	65,977
Loan capital	2,997	2,092
Amounts payable to group companies	19,025	16,770
	<u>87,043</u>	<u>84,839</u>

6 Other income

	Year ended 31.12.02	Year ended 31.12.01
	£'000	£'000
Other income	1,458	1,647
Income from ATM Services Ltd	<u>5,504</u>	<u>-</u>
	<u>6,962</u>	<u>1,647</u>

7 Directors' emoluments

The remuneration of the directors paid by or recharged to the Company during the year was as follows:

	Period ended 31.12.02	Year ended 31.12.01
	£'000	£'000
Directors fees	22	22
Other emoluments	<u>359</u>	<u>-</u>
Total	<u>381</u>	<u>22</u>

Highest paid director

The highest paid director during 2002 was Andrew William Dewhurst who was appointed to the Board on 28 March 2002 (2001: John William Melbourn and George Anthony Schofield).

	Period ended 31.12.02	Year ended 31.12.01
	£'000	£'000
Total emoluments	211	11
Defined benefit pension:		
Accrued pension per annum at end of year	64	-

8 Employee information

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

The average monthly number of persons (excluding executive directors) seconded to the Company during the year was 265 (2001: 363).

Staff costs recharged for the year are as follows:

	Year ended 31.12.02 £'000	Year ended 31.12.01 £'000
Wages and salaries	7,646	6,974
Social security costs	509	484
Pension costs	674	679
Other costs including temporary staff	1,404	2,992
	<u>10,233</u>	<u>11,129</u>

9 Other expenses

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

	Year ended 31.12.02 £'000	Year ended 31.12.01 £'000
Technology, consulting and outsourcing costs	47,556	32,048
Marketing, printing and stationery	48,959	38,214
Postage and other costs	9,207	9,310
	<u>105,722</u>	<u>79,572</u>

10 Profit on ordinary activities before taxation

	Year ended 31.12.02 £'000	Year ended 31.12.01 £'000
Profit on ordinary activities before taxation is stated after charging:		
Depreciation charge for year	4,108	9,874
Auditors' remuneration:-		
Audit services	56	41
Non-audit services	331	188

Exceptional Items

During the prior year, exceptional costs totalling £12.9m were expensed in respect of a major technology project. Of this, £9.6m has been included within operating expenses and £3.3m is included in the depreciation charge.

11 Tax on profit on ordinary activities

	Year ended 31.12.02 £'000	Year ended 31.12.01 Restated £'000
UK corporation tax charge for the year	30,328	17,248
Tax over / (under) provided on profits on prior year	138	(829)
Total current tax	30,466	16,419
Deferred taxation – origination and reversal of timing differences	(3,667)	(7,555)
	<u>26,799</u>	<u>8,864</u>

Adoption of FRS 19 has required a change in the method of accounting for deferred tax. As a result, the comparative figure for the tax on profit on ordinary activities for 2001 has been restated from the previously reported amount of £16,419,265 to £8,863,951. The impact of adopting FRS 19 on the 2002 accounts is a decrease to the tax charge of £3,666,679.

In the prior year, the tax charge was higher than expected primarily as a result of the exceptional technology costs.

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

11 Tax on profit on ordinary activities (continued)

	Year ended 31.12.02 £'000	Year ended 31.12.01 £'000
Profit on ordinary activities before taxation	94,116	40,474
Tax on profit on ordinary activities at standard rate	28,235	12,142
Factors affecting charge for the year:		
Non-deductible items	4,235	1,780
Non-taxable items	(1,651)	-
Capital allowances in excess of depreciation	(491)	3,326
Current taxation adjustments relating to prior periods	138	(829)
Total actual amount of current tax	<u>30,466</u>	<u>16,419</u>

12 Investment in subsidiary

At 31 December 2002 the Company held shares in the following subsidiary company, which is incorporated in Great Britain, registered in Scotland. The subsidiary has only one class of ordinary share, and has issued share capital of £2.

Name	% Holding	Principal Activity
TPF ATM Services Limited	100	Provision of Automated Teller Services

13 Loans and advances to banks

	31.12.02 £'000	31.12.01 £'000
Repayable on demand:		
Loans and advances to The Royal Bank of Scotland plc	<u>161</u>	<u>8,130</u>

14 Loans and advances to customers

	31.12.02 £'000	31.12.01 £'000
On demand or at short notice	1,853	1,998
Remaining maturity:		
Three months or less	1,420,075	1,160,590
One year or less but over three months	369,196	315,865
Five years or less but over one year	668,948	576,293
Over five years	49,906	31,604
	<u>2,509,978</u>	<u>2,086,350</u>
Provision for bad and doubtful debts	<u>(76,689)</u>	<u>(60,544)</u>
	<u>2,433,289</u>	<u>2,025,806</u>

Provision for bad and doubtful debts

	31.12.02 Specific £'000	31.12.02 General £'000	31.12.01 Specific £'000	31.12.01 General £'000
Opening balance	49,457	11,087	31,225	5,603
Amounts written off	(25,031)	-	(16,377)	-
Charge to profit and loss account	<u>27,618</u>	<u>13,558</u>	<u>34,609</u>	<u>5,484</u>
Closing balance	<u>52,044</u>	<u>24,645</u>	<u>49,457</u>	<u>11,087</u>

15 Interest in suspense

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

	31.12.02 £'000	31.12.01 £'000
Loans and advances on which interest is not being applied:		
- before specific provisions	<u>36,519</u>	<u>27,125</u>
- after specific provisions	<u>21,912</u>	<u>11,665</u>

16 Tangible fixed assets

	<u>Plant & Equipment</u> £'000	<u>Fixtures & Fittings</u> £'000	<u>Computer Hardware</u> £'000	<u>Computer Software</u> £'000	<u>Total</u> £'000
Cost					
At 1 January 2002	1,194	2,771	12,164	11,437	27,566
Additions	-	122	6,037	11	6,170
Disposals	-	-	(146)	-	(146)
As at 31 December 2002	1,194	2,893	18,055	11,448	33,590
Depreciation					
At 1 January 2002	967	2,107	6,278	11,137	20,489
Provided during the period	193	491	3,133	291	4,108
Disposals	-	-	(86)	-	(86)
As at 31 December 2002	1,160	2,598	9,325	11,428	24,511
Net book value at 31 December 2002	34	295	8,730	20	9,079
Net book value at 31 December 2001	227	664	5,886	300	7,077

17 Other assets

	31.12.02	31.12.01
	£'000	£'000
		Restated
Amounts falling due within one year:		
Amounts payable by the Royal Bank of Scotland plc	6,531	22,826
Amounts payable by other group companies	175,016	82,725
Deferred tax (see note 26)	11,222	7,555
	192,769	113,106

Amounts payable by other group companies includes an interest free subordinated loan of £165,000,000 (2001: £77,300,000) made to Direct Line Group Limited, a wholly owned subsidiary of The Royal Bank of Scotland Group plc.

18 Prepayments and accrued income

	31.12.02 £'000	31.12.01 £'000
Amounts falling due within one year:		
Amounts payable by Tesco PLC	167	431
Amounts payable by The Royal Bank of Scotland plc	93	50
Other prepayments and accrued income	<u>8,578</u>	<u>8,684</u>
	<u>8,838</u>	<u>9,165</u>

19 Deposits by banks

	31.12.02 £'000	31.12.01 £'000
With agreed maturity dates or periods of notice, by remaining maturity		
- Three months or less	<u>41,827</u>	<u>73,310</u>

20 Customer accounts

	31.12.02 £'000	31.12.01 £'000
Repayable on demand	<u>2,051,378</u>	<u>1,695,144</u>

21 Other liabilities

	31.12.02 £'000	31.12.01 £'000
Amounts owed to Tesco PLC	1,918	1,298
Amounts owed to The Royal Bank of Scotland plc	2,845	9,017
Other liabilities	<u>29,021</u>	<u>18,744</u>
	<u>33,784</u>	<u>29,059</u>

22 Accruals and deferred income

	31.12.02 £'000	31.12.01 £'000
Amounts owed to Tesco PLC	8,364	5,789
Amounts owed to The Royal Bank of Scotland plc	3,892	2,453
Other accruals and deferred income	28,874	23,421
	<u>41,130</u>	<u>31,663</u>

23 Loan capital

	31.12.02 £'000	31.12.01 £'000
Floating rate subordinated loan maturing 2008	20,000	20,000
Floating rate subordinated loan maturing 2009	20,000	20,000
Floating rate subordinated loan maturing 2010	25,000	25,000
Floating rate subordinated loan maturing 2011	30,000	30,000
Floating rate subordinated loan maturing 2017	30,000	-
Undated floating rate subordinated loan	45,000	-
	<u>170,000</u>	<u>95,000</u>

The fixed term loan capital is repayable, in whole or in part, at the option of the issuer, prior to maturity, on conditions governing the debt obligation. Interest payable is based on three month libor plus a range of sixty to one hundred and twenty basis points.

The perpetual loan capital has no fixed maturity date and may not be repaid except under certain conditions such as the winding up of Tesco Personal Finance Ltd or, at certain agreed dates.

24 Called up share capital

	31.12.02 £'000	31.12.01 £'000
Authorised		
500,000,000 Ordinary shares of 10p each	<u>50,000</u>	<u>50,000</u>
	31.12.02 £'000	31.12.01 £'000
Allotted, called up and fully paid		
247,900,000 Ordinary shares of 10p each	<u>24,790</u>	<u>24,790</u>

25 Share premium reserve

	31.12.02 £'000	31.12.01 £'000
Opening balance	223,110	214,110
Premium paid on shares issued during the period	-	9,000
Closing balance	<u>223,110</u>	<u>223,110</u>

26 Deferred taxation

	31.12.02 £'000	31.12.01 £'000
Provision for deferred taxation consists of the following amounts:		
Capital allowances in excess of depreciation	3,828	4,229
Other timing differences	7,394	3,326
At 1 January 2002 as restated	<u>11,222</u>	<u>7,555</u>

The adoption of FRS 19 Deferred Taxation has required changes in the method of accounting for deferred tax assets and liabilities. Adoption of FRS 19 has affected the prior year only. As a result of these changes in accounting policy the comparatives have been restated as follows:

	Other Assets £'000	P&L Reserves £'000	Shareholders Funds £'000
At 1 January 2002 as previously reported	-	(14,632)	233,268
Adoption of FRS 19	7,555	7,555	7,555
At 1 January 2002 as restated	<u>7,555</u>	<u>(7,077)</u>	<u>240,823</u>

A deferred tax asset is recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable profits from which the future reversal of the underlying timing differences can be deducted. The directors consider that there will be sufficient future profits to support recognition of the deferred tax asset.

27 Profit and loss account

	31.12.02 £'000
Opening balance	(7,077)
Retained profit for the period	67,318
Closing balance	<u>60,241</u>

The opening balance as of 1 January 2002 has been restated for the adoption of FRS 19. See note 26 for details.

28 Reconciliation of movements in shareholders' funds

	31.12.02 £'000	31.12.01 £'000
Profit for the period	67,318	31,610
Opening shareholders' funds	240,823	209,213
Closing shareholders' funds	<u>308,141</u>	<u>240,823</u>

The opening shareholders' funds at 1 January 2002 as previously reported amounted to £233,267,850 before the prior year adjustment of £7,555,314 arising from the adoption of FRS 19. The adjustment above is the restatement as indicated in note 26.

29 Derivatives and other Financial Instruments

Risk management

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

Objectives, policies and strategies

The Company's policy is not to undertake any trading activities. Consequently, it is the policy to use derivative instruments only to hedge risk on the Banking Book and not to trade speculatively for financial gain. The RMC reviews regularly the Company's exposure to

29 Derivatives and other Financial Instruments (continued)

interest rate risk and the policy is to use derivatives or other financial instruments to maintain this exposure within levels considered prudent. The objective is to reduce the effect of fluctuating interest rates on net interest income.

Credit risk

Credit risk arises where the possibility exists of a counterparty defaulting on its obligations. The Company lends surplus funds to the interbank market. Limits have been established for all counterparties based on their respective credit ratings. The limits and proposed counterparties are reviewed and approved by the RMC and Board.

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

Interest rate risk

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

29 Derivatives and other Financial Instruments (continued)

Interest rate sensitivity gap

The following table shows the contractual re-pricing terms for each category of asset and liability, together with management's estimate of the interest rate sensitivity gap for the Company as at 31 December 2002. This does not reflect the potential impact of early repayment or withdrawal. Transactions without defined contractual re-pricing terms are shown according to management's expectations. Major changes in position can be, and are, made promptly as market outlooks change. In addition, significant variations in interest rate sensitivity may exist within the re-pricing periods presented.

	Within 3 months	After 3 months, but within 6 months	After 6 months, but within 1 year	After 1 year, but within 5 years	After 5 years	Non - interest bearing funds	Total
	£m	£m	£m	£m	£m	£m	£m
Assets:							
Loans to banks	2	-	-	-	-	-	2
Loans to customers	570	682	235	669	50	304	2,510
Treasury and other eligible bills	-	-	-	-	-	-	-
Other assets	-	-	-	-	-	211	211
Total Assets	572	682	235	669	50	515	2,723
Liabilities:							
Customer accounts	2,051	-	-	-	-	-	2,051
Loans from banks	42	-	-	-	-	-	42
Other liabilities	-	-	-	-	-	152	152
Loan capital	170	-	-	-	-	-	170
Shareholders' funds	-	-	-	-	-	308	308
Total Liabilities	2,263	0	0	0	0	460	2,723
On balance sheet gap	(1,691)	682	235	669	50	55	-
Off-balance sheet items affecting interest rate sensitivity	1681	(728)	(239)	(672)	(50)	7	-
Interest rate sensitivity gap	(10)	(46)	(4)	(3)	-	62	-
Cumulative interest rate sensitivity gap	(10)	(56)	(60)	(63)	(62)	-	-

29 Derivatives and other Financial Instruments (continued)**Liquidity risk**

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

Non trading derivatives

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

At 31 December 2002, the Company had entered into several interest rate swaps, with the total notional principal amount of £4,724,199,000 (2001: £1,476,507,000) to hedge the risk associated with the products offered by the Company. Of these swaps £3,003,260,000 (2001: £83,160,000) expire within 1 year and £275,570,000 (2001: £306,960,000) expire between one and five years and £1,445,369,000 (2001: £1,086,387,000) expire between five and ten years. The net replacement cost of the contracts at 31 December 2002 was £17,817,881 (2001: £6,726,860) of which £6,741,103 (2001: £361,162) relates to contracts expiring within 1 year and -£68,342 (2001: £1,033,508) relates to contracts expiring between one and five years and £11,145,121 (2001: £5,332,190) expire between five and ten years. This is represented by assets with a fair value of £32,799,106 and liabilities of £14,981,225. Fair values represent the current market value of these instruments. The carrying value of these instruments in the balance sheet is £8,053,823 being the accrued interest at the balance sheet date.

The underlying principal amount reflects the value of the business transacted and not the underlying credit or market risks. Under current Bank of England Guidelines the credit equivalent amount for these transactions using the original exposure method is £55,857,491 (2001: £34,000,839).

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

Trading derivatives

The Company had no trading derivatives during the year.

Fair values of financial assets and liabilities

Fair values for financial assets and liabilities where there is a liquid and active market are shown; non trading derivatives (refer above).

30 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.

	31.12.02 £'000	31.12.01 £'000
Formal standby facilities, credit lines and other commitments to lend:		
Less than one year	<u>3,014,911</u>	<u>2,220,869</u>
There are annual commitments under non-cancellable operating leases. These are disclosed as follows:		
Land and buildings		
Operating leases which expire:		
Greater than 5 years	346	346
Other		
Operating leases which expire:		
Greater than 5 years	<u>-</u>	<u>900</u>
	<u>346</u>	<u>1,246</u>
Total Commitments	<u>3,015,257</u>	<u>2,222,115</u>

31 Arrangements with directors and approved persons

At 31 December 2002, the aggregate amounts outstanding under transactions, arrangements and agreements entered into by the Company in the normal course of business and at normal commercial terms with directors and approved persons of the Company were as follows:

	No of Persons	£'000
Loans to directors and approved persons	<u>13</u>	<u>54</u>

The above information is presented in accordance with the requirements laid down in the Companies Act 1985 and the Financial Services and Markets Act 2000.

32 Controlling parties

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

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

33 Related party transactions

During the year the Company received interest and other income of £2,163,308 (2001: £3,167,439) from The Royal Bank of Scotland plc. Interest in respect of wholesale borrowing paid to The Royal Bank of Scotland plc amounted to £520,944 (2001: £7,071,947).

In addition, the Company incurred recharges from The Royal Bank of Scotland plc, and its subsidiaries, totalling £39,367,137 (2001: £35,742,406) for the provision of services.

Tesco PLC have recharged the Company an amount totalling £21,381,952 (2001: £15,444,621) for the provision of services.

The Company received fees from Tesco PLC for the managing of certain financial products during the period of £1,458,494 (2001: £1,779,473).

The above transactions are charged in accordance with the Shareholder's Agreement between Tesco PLC and The Royal Bank of Scotland plc and are thus not necessarily charged at arms length.

The Company received additional subordinated loan capital from The Royal Bank of Scotland plc totalling £37,500,000 during the year.

The Company received additional subordinated loan capital from Tesco PLC totalling £37,500,000 during the year.

The Company also increased the subordinated loan to Direct Line Group Limited, a fellow group company, to £165,000,000 (2001: £77,300,000) during the year. In addition, fees of £67,188,051 relating to insurance business underwritten by Direct Line Group Limited were received during the year (2001: £27,990,310).

TPF Services Limited Liability Partnership recharged the Company £15,612,945 (2001: nil) for the management of the ATM network.

The Company charged TPF ATM Services Limited £82,396 (2001: nil) for the provision of management services.

The Company received £5,504,126 (2001: nil) from TPF ATM Services in respect of dividends.