

Tesco Personal Finance Limited
Directors' Report and Financial Statements
31 December 2004
Registered in Scotland No. 173199



Tesco Personal Finance Limited

Directors' Report and Financial Statements 31 December 2004

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Directors and advisers

Directors:

Andrew Thomas Higginson – Chairman
Norman Cardie McLuskie – Deputy Chairman
Ian Hugh Chippendale
Iain Clink
Bernard Higgins
James Thomas Macdonald
Timothy John Rolit Mason
John William Melbourn CBE
Christopher Paul Sullivan
Kenneth Ian Towle
Laura Katharine Wade-Gery

Secretary:

Alan Ewing Mills

Registered Office:

42 St Andrew Square
Edinburgh
EH2 2YE

Telephone:

0131 556 8555

Registered Auditors:

Deloitte & Touche LLP
Edinburgh

Bankers:

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

Directors' report 31 December 2004

The directors present their annual report and the audited financial statements for the year ended 31 December 2004.

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.

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

The retained profit for the period was £41,742,067 (2003: retained profit £112,167,354) and this was transferred to reserves.

The cost: income ratio for the year was 41.0% (2003: 45.9%).

The directors do not anticipate any material change in either the type or level of activities of the company.

Dividends

An ordinary dividend of £100,000,000 was paid on 22 December 2004 (2003: nil).

Directors

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

From 1 January 2004 to date the following changes have taken place:

	Appointed	Resigned
Directors		
R S Ager		6 February 2004
W S Black		26 March 2004
J T Macdonald	26 March 2004	
C P Sullivan	26 March 2004	
L K Wade-Gery	30 April 2004	

Directors' report (continued)

31 December 2004

Directors' interests

The interests of the directors in the share and loan capital of the holding company at 31 December 2004 are disclosed in the report and accounts of the immediate parent, Tesco Personal Finance Group Limited.

Share capital

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

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;
- state whether applicable accounting standards have been followed; 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.

Directors' report (continued)
31 December 2004**Charitable and political donations**

No donations were made by the Company during the year for political purposes (2003; nil). The following charitable donations were made by the Company:

Charitable organisation	Year ended 31 December 2004	Year ended 31 December 2003
Yorkhill Childrens' Foundation	£500	-
Barnardos	-	£165,000
Tesco Triathlon	£3,000	£1,000
St Andrews Hospice Appeal	-	£300
Scottish Community Foundation	-	£100

Supplier payment policy

The company follows the policy and practice on payment of creditors determined by The Royal Bank of Scotland Group plc ('RBSG'), the company's ultimate controlling party, as outlined below.

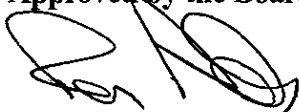
In the year ending 31 December 2005, RBSG will continue to adhere to the following payment policy in respect of all suppliers. RBSG is committed to maintaining a sound commercial relationship with its suppliers. Consequently, it is RBSG's policy to negotiate and agree terms and conditions with its suppliers, 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 or such other payment period as may be agreed.

At 31 December 2004, the company's trade creditors represented 24 days (2003 - 23 days) of amounts invoiced by suppliers.

Auditors

Deloitte & Touche LLP have expressed their willingness to continue in office as auditors and a resolution to re-appoint them will be proposed at the forthcoming Annual General Meeting.

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



Alan Ewing Mills

Secretary

4th February 2005

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 2004 which comprise the profit and loss account, the balance sheet and the related notes 1 to 34. 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 circumstances of the Company, consistently applied and adequately disclosed.

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2004 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
Edinburgh

4th February 2005

Tesco Personal Finance Limited

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Profit and loss account for the year ended 31 December 2004

	Note	Year ended 31.12.04 £'000	Year ended 31.12.03 £'000
Interest receivable and similar income	4	280,185	231,362
Interest payable	5	(141,427)	(104,454)
Net interest income		138,758	126,908
Fees and commissions receivable		284,972	228,717
Fees and commissions payable		(10,248)	(10,786)
Dividend income from shares in group undertakings	6	11,866	12,014
Other operating income	6	1,568	1,793
Non-interest income		288,158	231,738
Total income		426,916	358,646
Administrative expenses:-			
Staff costs	8	10,278	8,869
Premises and equipment		18,996	13,387
Other administrative expenses	9	141,669	138,718
Depreciation	10	4,250	3,594
Operating expenses		175,193	164,568
Profit before provisions for bad and doubtful debts		251,723	194,078
Provisions for bad and doubtful debts	14	54,297	39,212
Operating profit	10	197,426	154,866
Tax on profit on ordinary activities	11	55,684	42,699
Profit on ordinary activities after tax and attributable to ordinary shareholders		141,742	112,167
Ordinary dividends	27	100,000	-
Retained profit	28	41,742	112,167

All the above amounts relate to continuing operations. There were no other recognised gains or losses in the year, other than the profit for the year as reported above and therefore no separate statement of total recognised gains and losses has been presented. There is no difference between profit on ordinary activities before taxation and the retained profit for the year stated above, and their historical cost equivalents. Movements on profit and loss account reserves are shown in note 28.


**Balance sheet
at 31 December 2004**

	Note	31.12.04 £'000	31.12.03 £'000
Assets			
Cash and balances at central banks		3,060	3,234
Loans and advances to banks	13	3,391,629	123
Loans and advances to customers	14	3,147,137	2,892,450
Shares in group undertakings	12	-	-
Tangible fixed assets	16	15,811	12,774
Other assets	17	342,447	264,156
Prepayments and accrued income	18	27,607	10,519
Total assets		6,927,691	3,183,526
Liabilities			
Deposits by banks	19	3,863,174	273,128
Customer accounts	20	2,281,206	2,211,530
Other liabilities	21	38,963	33,705
Accruals and deferred income	22	77,298	39,585
Subordinated liabilities	23	205,000	205,000
Called up share capital	24	24,790	24,790
Share premium account	25	223,110	223,110
Profit and loss account	28	214,150	172,408
Equity shareholders' funds	29	462,050	420,308
Total liabilities		6,927,691	3,183,256
Memorandum items			
Commitments	31	5,170,130	4,617,162

Shares in group undertakings detailed in the prior and current year above relates to a 100% shareholding in TPF ATM Services Limited amounting to £2.

The financial statements were approved by the board of directors on 4 February 2005 and were signed on its behalf by:


Andrew Thomas Higginson
Chairman


Norman Cardie McLuskie
Deputy Chairman

Notes to the financial statements for the year ended 31 December 2004

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 is a wholly owned subsidiary of another company incorporated in Great Britain and is therefore exempt from the requirement to prepare group financial statements by virtue of s228 of the Companies Act 1985. Consolidated financial statements are prepared by Tesco Personal Finance Group Limited. Accordingly, the financial statements present information about the Company as an individual undertaking and not as a group. The Company has taken advantage of the exemption from preparing a cash flow statement 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.

Depreciation is calculated so as to write off the cost of tangible fixed 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 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.

1 Principal accounting policies (continued)

Loans and advances

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

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 receivable in relation to services provided by the Group are recognised when earned. Fees and commissions 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 Limited 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 sub group 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 and similar income

	Year ended 31.12.04 £'000	Year ended 31.12.03 £'000
Loans and advances to banks	28,287	751
Loans and advances to customers	251,898	230,611
	<u>280,185</u>	<u>231,362</u>

5 Interest payable

	Year ended 31.12.04 £'000	Year ended 31.12.03 £'000
Loans and advances to customers	86,167	70,162
Subordinated liabilities	10,991	8,794
Amounts payable to group companies	44,269	25,498
	<u>141,427</u>	<u>104,454</u>

6 Other income

	Year ended 31.12.04	Year ended 31.12.03
	£'000	£'000
Income from TPF ATM Services Ltd	11,866	12,014
Other income	<u>1,568</u>	<u>1,793</u>
	<u>13,434</u>	<u>13,807</u>

7 Directors' emoluments

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

	Year ended 31.12.04	Year ended 31.12.03
	£'000	£'000
Directors' fees	11	22
Other emoluments	169	422
Pension contributions	<u>37</u>	<u>23</u>
Total	<u>217</u>	<u>467</u>

Highest paid director

The highest paid director during 2004 was James Thomas Macdonald (2003: Iain Clink).

	Year ended 31.12.04	Year ended 31.12.03
	£'000	£'000
Other emoluments	153	266
Pension contributions	<u>36</u>	<u>12</u>
Total	<u>189</u>	<u>278</u>

Defined benefit pension:

Accrued pension per annum at end of year	5	42
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8 Staff costs

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 162 (2003: 135).

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

	Year ended 31.12.04 £'000	Year ended 31.12.03 £'000
Wages and salaries	7,505	6,287
Social security costs	683	676
Pension costs	548	563
Other costs including temporary staff	1,542	1,343
	<u>10,278</u>	<u>8,869</u>

9 Other administrative expenses

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

	Year ended 31.12.04 £'000	Year ended 31.12.03 £'000
Technology, consulting and outsourcing costs	79,860	79,360
Marketing, printing and stationery	51,116	49,648
Postage and other costs	10,693	9,710
	<u>141,669</u>	<u>138,718</u>

10 Profit on ordinary activities before tax

	Year ended 31.12.04 £'000	Year ended 31.12.03 £'000
Profit on ordinary activities before taxation is stated after charging:		
Depreciation charge for year	4,250	3,594
Auditors' remuneration:-		
Audit services	67	63
Non-audit services	3	18
	<u>3</u>	<u>18</u>

11 Tax on profit on ordinary activities

	Year ended 31.12.04 £'000	Year ended 31.12.03 £'000
UK corporation tax charge for the year	55,707	42,894
Tax (over)/under provided on profits on prior year	(504)	1,114
Total current tax	<u>55,203</u>	<u>44,008</u>
Deferred taxation – origination and reversal of timing differences	481	(1,309)
	<u>55,684</u>	<u>42,699</u>

The standard rate of tax for the year, based on the UK standard rate of corporation tax is 30% (2003: 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.

	Year ended 31.12.04 £'000	Year ended 31.12.03 £'000
Profit on ordinary activities before taxation	197,426	154,866
Tax on profit on ordinary activities at standard rate	59,228	46,459
Factors affecting charge for the year:		
Other movements in deferred tax	1,253	1,475
Non-taxable items	(3,560)	(3,604)
Capital allowances in excess of depreciation	(1,214)	(1,436)
Current taxation adjustments relating to prior periods	<u>(504)</u>	<u>1,114</u>
Total current tax	<u>55,203</u>	<u>44,008</u>

12 Shares in Group undertakings

At 31 December 2004 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

	31.12.04	31.12.03
	£'000	£'000
Loans and advances to The Royal Bank of Scotland plc		
Remaining maturity:		
Three months or less	3,066,629	123
One year or less but over three months	25,000	-
Five years or less but over one year	129,000	-
Over five years	171,000	-
	<u>3,391,629</u>	<u>123</u>

14 Loans and advances to customers

	31.12.04	31.12.03
	£'000	£'000
Repayable on demand or at short notice	1,727	1,786
Remaining maturity:		
Three months or less	1,784,141	1,606,380
One year or less but over three months	532,713	495,518
Five years or less but over one year	832,284	792,251
Over five years	104,347	84,252
	<u>3,255,212</u>	<u>2,980,187</u>
Provision for bad and doubtful debts	<u>(108,075)</u>	<u>(87,737)</u>
	<u>3,147,137</u>	<u>2,892,450</u>

14 Loans and advances to customers (continued)

Provision for bad and doubtful debts

	31.12.04	31.12.04	31.12.03	31.12.03
	Specific	General	Specific	General
	£'000	£'000	£'000	£'000
Opening balance	61,809	25,928	52,044	24,645
Amounts written off	(39,977)	-	(33,763)	-
Recoveries of amounts written off in previous periods	6,018	-	5,599	-
Charge to profit and loss account	<u>52,699</u>	<u>1,598</u>	<u>37,929</u>	<u>1,283</u>
Closing balance	<u>80,549</u>	<u>27,526</u>	<u>61,809</u>	<u>25,928</u>

15 Interest in suspense

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

	31.12.04	31.12.03
	£'000	£'000
Loans and advances on which interest is not being applied:		
- before specific provisions	<u>114,106</u>	<u>70,513</u>
- after specific provisions	<u>65,637</u>	<u>39,506</u>

Tesco Personal Finance Limited

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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 2004	1,194	2,967	25,271	11,448	40,880
Additions	-	40	7,247	-	7,287
As at 31 December 2004	1,194	3,007	32,518	11,448	48,167
Depreciation					
At 1 January 2004	1,183	2,775	12,713	11,435	28,106
Provided during the year	11	110	4,124	5	4,250
As at 31 December 2004	1,194	2,885	16,837	11,440	32,356
Net book value at 31 December 2004	-	122	15,681	8	15,811
Net book value at 31 December 2003	11	192	12,558	13	12,774

17 Other assets

	31.12.04 £'000	31.12.03 £'000
Amounts falling due within one year:		
Amounts payable by The Royal Bank of Scotland plc	54,042	29,019
Amounts payable by other group companies	276,355	222,606
Deferred tax (see note 26)	12,050	12,531
	342,447	264,156

Amounts payable by other group companies includes an interest free subordinated loan of £255,000,000 (2003: £211,000,000) made to Direct Line Group Limited, a wholly owned subsidiary of The Royal Bank of Scotland Group plc.

18 Prepayments and accrued income

	31.12.04 £'000	31.12.03 £'000
Amounts falling due within one year:		
Amounts payable by Tesco PLC	466	162
Other prepayments and accrued income	<u>27,141</u>	<u>10,357</u>
	<u>27,607</u>	<u>10,519</u>

19 Deposits by banks

	31.12.04 £'000	31.12.03 £'000
With agreed maturity dates or periods of notice, by remaining maturity:		
Three months or less	1,369,629	273,128
One year or less but over three months	537,000	-
Five years or less but over one year	289,283	-
Over five years	<u>1,667,262</u>	<u>-</u>
	<u>3,863,174</u>	<u>273,128</u>

All deposits by banks are repayable to another Group undertaking.

20 Customer accounts

	31.12.04 £'000	31.12.03 £'000
Repayable on demand	<u>2,281,206</u>	<u>2,211,530</u>

21 Other liabilities

	31.12.04 £'000	31.12.03 £'000
Amounts owed to Tesco PLC	2,502	2,270
Amounts owed to The Royal Bank of Scotland plc	1,870	1,829
Corporation Tax	27,793	23,340
Other liabilities	<u>6,798</u>	<u>6,266</u>
	<u>38,963</u>	<u>33,705</u>

All amounts owed are repayable within one year.

22 Accruals and deferred income

	31.12.04 £'000	31.12.03 £'000
Amounts owed to Tesco PLC	4,302	4,510
Amounts owed to The Royal Bank of Scotland plc	31,610	4,385
Other accruals and deferred income	41,386	30,690
	<u>77,298</u>	<u>39,585</u>

All amounts owed are repayable within one year.

23 Subordinated liabilities

	31.12.04 £'000	31.12.03 £'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	30,000
Floating rate subordinated loan maturing 2018	35,000	35,000
Undated floating rate subordinated loan	45,000	45,000
	<u>205,000</u>	<u>205,000</u>

Subordinated liabilities comprise loan capital issued by the holding company.

The fixed term loan capital is repayable, in whole or in part, at the option of the issuer, prior to maturity, on conditions governing the debt obligation. Interest payable is based on three month LIBOR plus a range of 60 to 160 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

	31.12.04 £'000	31.12.03 £'000
Authorised		
500,000,000 Ordinary shares of 10p each	<u>50,000</u>	<u>50,000</u>
	31.12.04 £'000	31.12.03 £'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 account

	31.12.04 £'000	31.12.03 £'000
Opening balance	223,110	223,110
Closing balance	<u>223,110</u>	<u>223,110</u>

26 Deferred taxation

	31.12.04 £'000	31.12.03 £'000
Provision for deferred taxation consists of the following amounts:		
Capital allowances in excess of depreciation	2,723	3,709
Other timing differences	9,327	8,822
Closing balance	<u>12,050</u>	<u>12,531</u>

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

27 Ordinary dividends

	31.12.04 £'000	31.12.03 £'000
Dividend paid	<u>100,000</u>	<u>-</u>

On 22 December 2004 a dividend of £0.403 per ordinary share was paid, resulting in a total dividend payment of £100,000,000.

28 Profit and loss account

	31.12.04 £'000	31.12.03 £'000
Opening balance	172,408	60,241
Retained profit for the year	<u>41,742</u>	<u>112,167</u>
Closing balance	<u>214,150</u>	<u>172,408</u>

29 Reconciliation of movements in shareholders' funds

	31.12.04 £'000	31.12.03 £'000
Profit for the year	41,742	112,167
Opening shareholders' funds	420,308	308,141
Closing shareholders' funds	<u>462,050</u>	<u>420,308</u>

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

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 cash instruments or interest rate swaps.

30 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 and does not reflect the behaviouralised repricing used in the company's asset and liability management methodology. 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 and advances to banks	3,070	8	17	129	171	-	3,395
Loans and advances to customers	872	685	370	832	104	284	3,147
Other assets	-	-	-	-	-	386	386
Total Assets	3,942	693	387	961	275	670	6,928
Liabilities:							
Customer accounts	2,281	-	-	-	-	-	2,281
Deposits by banks	1,575	657	386	1,148	97	-	3,863
Other liabilities	-	-	-	-	-	117	117
Subordinated liabilities	205	-	-	-	-	-	205
Shareholders' funds	-	-	-	-	-	462	462
Total Liabilities	4,061	657	386	1,148	97	579	6,928
On balance sheet gap	-119	36	1	-187	178	91	-
Off-balance sheet items affecting interest rate sensitivity	-	-	-	-	-	-	-
Interest rate sensitivity gap	-119	36	1	-187	178	91	-
Cumulative interest rate sensitivity gap	-119	-83	-82	-269	-91	-	-

30 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. Cash flow commitments and marketable asset holdings are measured and managed on a daily basis. The Company has credit facilities from the Royal Bank of Scotland 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

All non trading derivative positions are established internally through transactions with a fellow group company, The Royal Bank of Scotland plc.

At 31 December 2004, the Company had entered into one interest rate swap, with the notional principal amount of £2,300,000,000 (2003: £5,273,054,000) to hedge the risk associated with the products offered by the Company. Of these swaps £2,300,000,000 (2003: £3,187,450,000) expire within one year and £0 (2003: £393,000,000) expire between one and five years and £0 (2003: £1,692,604,000) expire between five and ten years. The net replacement cost of the contracts at 31 December 2004 was £-7,723 (2003: £881,556) of which £-7,723 (2003: £7,540,505) relates to contracts expiring within one year and £0 (2003: -£3,729,130) relates to contracts expiring between one and five years and £0 (2003: £-2,929,809) expire between five and ten years. This is represented by assets with a fair value of £0 and liabilities of £7,723. Fair values represent the current market value of these instruments. The carrying value of these instruments in the balance sheet is £47,348 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 £0 (2003: £46,649,703).

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 (2003: nil).

Deferred profits on financial instruments

At 31 December 2004, the Company had deferred profits amounting to £1,190,000 (2003: nil). £153,200 will be recognised within 12 months.

Tesco Personal Finance Limited

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Fair values of financial assets and liabilities

Fair values for financial assets and liabilities where there is a liquid and active market are shown above.

31 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.

	31.12.04 £'000	31.12.03 £'000
Formal standby facilities, credit lines and other commitments to lend:		
Less than one year	<u>5,170,130</u>	<u>4,617,162</u>

32 Arrangements with directors and approved persons

At 31 December 2004, 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>72</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.

33 Controlling parties

The Royal Bank of Scotland 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.

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

34 Related party transactions

During the year the Company received interest and other income of £28,285,875 (2003: £750,871) from The Royal Bank of Scotland plc. Interest in respect of wholesale borrowing paid to The Royal Bank of Scotland plc amounted to £40,019,132 (2003: £10,846,786).

In addition, the Company incurred recharges from The Royal Bank of Scotland plc, and its subsidiaries, totalling £45,733,892 (2003: £46,530,502) for the provision of services.

Tesco PLC have recharged the Company an amount totalling £29,634,813 (2003: £25,090,970) for the provision of services.

The Company received fees from Tesco PLC for the managing of certain financial products during the period of £1,568,309 (2003: £1,793,147).

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

The Company received no additional subordinated loan capital from The Royal Bank of Scotland plc (2003: £17,500,000) during the year.

The Company received no additional subordinated loan capital from Tesco PLC (2003: £17,500,000) during the year.

The Company also increased the subordinated loan to Direct Line Group Limited, a fellow group company, to £255,000,000 (2003: £211,000,000) during the year. In addition, fees of £140,063,842 relating to insurance business underwritten by Direct Line Group Limited were received during the year (2003: £98,768,805).

TPF Services Limited Liability Partnership recharged the Company £33,759,792 (2003: £33,130,003) for the management of the ATM network.

The Company charged TPF ATM Services Limited £226,290 (2003: £184,163) for the provision of management services.

The Company received £11,866,202 (2003: £12,013,932) from TPF ATM Services in respect of dividends.