Tesco Personal Finance plc

Basel II Pillar 3 Disclosures
29th February 2012

1. Overview

1.1. Background

The European Union Capital Requirements Directive (Basel II) came into force on 1st January 2007, replacing the original Basel Accord (Basel I) agreed in 1988 by the Basel Committee on Banking Supervision. Implementation of Basel II in the UK has been achieved through a series of rules introduced by the Financial Services Authority (FSA). The Basel II framework consists of three "pillars":

Pillar 1 - sets out the minimum capital requirements firms are required to meet for credit, market and operational risk.

Pillar 2 - requires firms and supervisors to take a view on whether a firm should hold additional capital against risks considered under Pillar 1 that are not fully captured by the Pillar 1 process (e.g. credit concentration risk); those factors not taken into account by the Pillar 1 process (e.g. interest rate risk in the banking book, business and strategic risk); and factors external to the firm (e.g. business cycle effects).

Pillar 3 – aims to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on the scope of application, capital, risk exposures, risk assessment process and hence the capital adequacy of the firm.

1.2. Scope of Application

This document represents the Pillar 3 disclosures of Tesco Personal Finance plc ('TPF plc' or the 'Company') and is based on disclosure and accounting data for the 12 month period to 29th February 2012.

Tesco Personal Finance Group Limited ('TPFG' or 'TPF Group') is a UK based retail financial services organisation wholly owned by Tesco plc.

Tesco Personal Finance plc, trading as Tesco Bank, is a wholly owned subsidiary of TPFG, which provides a range of financial services and products to personal customers under the Tesco Bank brand, mainly through telephony and on-line sales channels, and through a small number of in-store branches.

The products currently offered by the Company include general insurance products, travel money, unsecured personal loans, savings accounts and credit cards. The Company also operates an ATM estate primarily located in Tesco stores. The Company has limited international exposure in Ireland.

Tesco Personal Finance Compare Limited ('Tesco Compare'), an internet based price comparison business, is also a wholly owned subsidiary of TPFG.

There are no material practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities among the parent and subsidiary members of the TPFG.

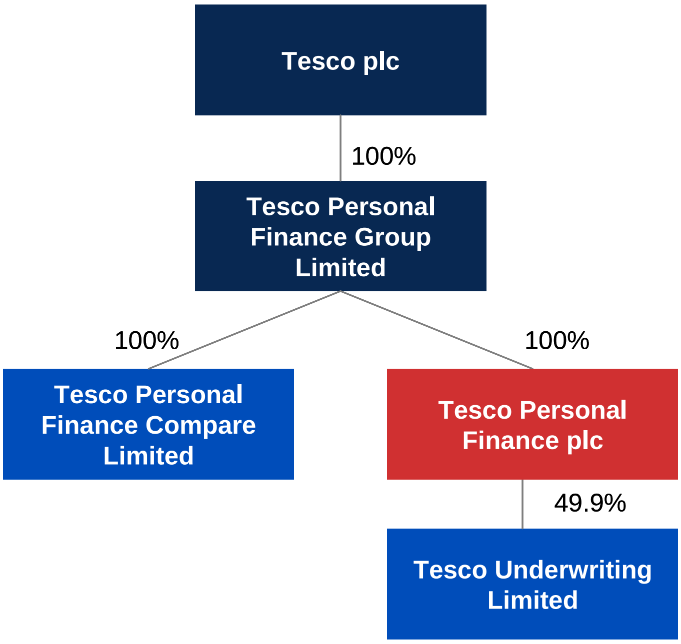
Tesco Underwriting Limited ('TU') is 49.9% owned by the Company and 50.1% owned by Ageas (UK) Limited. TU underwrites household and motor insurance and provides claims management for these policies.

1.2.1. Accounting Consolidation

TPFG operates as a holding company with 100% ownership of the Company and Tesco Compare with the Company holding 49.9% ownership of TU, as illustrated in Figure 1 below. Financial Statements are produced annually for the Company and TPFG as well as Tesco Compare and TU.

TU is treated as an associate and is proportionally consolidated using the equity method of accounting.

Figure 1: TPF Group Limited: Accounting Consolidation Structure



1.2.2. Prudential Consolidation

The Company does not form part of a Consolidation Group for Regulatory Reporting purposes and does not make use of the solo consolidation waiver provisions.

The Company's investments in TU and Royal Bank of Scotland Insurance Group Limited (RBS insurance) are treated as a deduction from total capital resources as shown in Table 1.

1.2.3. Comparison of Pillar 3 Disclosures with the Directors' Report & Financial Statements

These disclosures have been prepared in accordance with Basel II, Pillar 3 regulatory reporting requirements. There are a number of significant differences between accounting disclosure requirements and Pillar 3 disclosure requirements which means that information may not be directly comparable with the Directors' Report and Financial Statements. The main differences for the Company are summarised below:

- Pillar 3 exposure values are reported on the basis of Balance Sheet values, net of provisions, with off Balance Sheet exposures assigned credit conversion factors based on prescribed regulatory values which vary according to risk categories;
- Regulatory reporting rules require that the Company make certain deductions from capital resources, the most material of which relate to subordinated loans in favour of RBS insurance and TU and the Company's holdings in its TU insurance associate.

1.3. Disclosure Policy

The following sets out the Company's Disclosure Policy as applied to Basel II Pillar 3 Disclosures, including the information to be disclosed, frequency, media, location and verification.

1.3.1. Information to be disclosed

The Company's policy is to meet all required Pillar 3 disclosure requirements as detailed in Section 11 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU). The Company does not seek any exemption from disclosure on the basis of materiality or on the basis of proprietary or confidential information.

1.3.2. Frequency

The Company's policy is to publish the disclosures required on an annual basis. The information is published as soon as practical following publication of the annual Directors' Report and Financial Statements.

1.3.3. Medium and location of publication

The Company's Pillar 3 disclosures are published in the Investors Centre section of the Tesco plc corporate website: www.tescoplc.com/investors/results

1.3.4. Verification

The Company's Pillar 3 disclosures have been reviewed by the Audit Committee and approved by the Board. In addition, the Remuneration disclosures as detailed in Section 14 of this document have been reviewed by the Remuneration Committee. The disclosures are not subject to audit except where they are equivalent to those prepared under accounting requirements and disclosed in the TPFG / TPF plc annual Directors' Report and Financial Statements.

2. Document Structure

The document is structured to provide details of Risk Management Objectives and Policy in Section 3. This section is supplemented by a discussion of the Company's "Major Specific Risk Categories" in Sections 6.1, 7, 8, 9, 11 and 12. Capital Resources, the Finance and Treasury Control Framework and Compliance with BIPRU and the overall Pillar 2 rule are considered in Sections 4 and 5. Non Trading Book Exposures in Equities are discussed in Section 10 with Securitisation disclosures published in Section 13. Remuneration disclosures are provided in Section 14.

3. Risk Management Objectives and Policy

3.1. Approach to Risk Management

The Board has overall responsibility for the business. It agrees the strategy for the business, approves the Company's risk appetite as well as specific high level policies and the delegated authorities. Board approval is also required for the Company's business plans, budget, Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment (ILAA) and new material product lines. The Board monitor's the Company's risk management profile and capital adequacy position.

Management of profit volatility and development of a stable and prudent business compliant with regulations are amongst the key strategic business objectives. The Company is focussed on developing a strong savings franchise with reliable sources of funding within an overall culture of treating customers fairly.

The Company seeks to ensure that it has an integrated approach to Risk Management so that all areas of direction setting, organisation and control, decision making, risk appetite, risk identification, risk assessment and business operations are aligned. The Risk Management Framework is described below.

3.2. Risk Management Framework

During the year the Company has worked on the further development of its Risk Management Framework. The principal means by which the Company seeks to deliver effective risk management are contained in the Enterprise Wide Risk Management Framework (EWRMF). The EWRMF is designed to support the identification, assessment, management and control of the material risks that threaten the achievement of the Company's strategic business objectives.

The EWRMF can be broken down into the following five key elements:

i. Risk management strategy and appetite
ii. EWRMF components
iii. Integrated risk processes
iv. Major specific risk categories
v. Embedding risk within the organisation

These are described in further detail in sections 3.3, 3.4, 3.5, 3.6 and 3.7 below.

The EWRMF is documented in the Enterprise Wide Risk Management Manual (EWRMM) which provides a single point of reference in relation to the Company's approach to risk management.

3.3. Risk Management Strategy and Appetite

The Company has developed a risk strategy which is designed to support the successful delivery of strategic business objectives. The risk appetite reflects the level and type of risks that the Company is willing to take to deliver its strategic business objectives. The refinement and exposition of the Company's risk appetite communicates the Board's view on the type and quantum of risks that should be acquired, avoided, retained or removed and provides direction to be taken into account when making key decisions.

The Company measures risk appetite in both quantitative and qualitative terms with performance against these measures reported to the Asset and Liability Management Committee (ALCO), Risk Management Committee (RMC), Board Risk Committee (BRC) and to the Board as appropriate. Committee reporting includes stress testing and scenario analysis which is designed to inform senior management of required levels of capital and other financial resources, including liquidity, under various stressed economic and business scenarios.

3.4. Enterprise Wide Risk Management Framework Components

The scope of the EWRMF extends to all major specific risk categories faced by the Company and is underpinned by governance, controls, processes, systems and policies within the second-line Risk function and those of the first-line business areas (see section 3.4.2 below for further details about the 3 lines of defence model). The key components which collectively ensure that risks are managed and key control activities conducted are outlined below.

3.4.1. Governance

The Board has ultimate responsibility for all material risk matters, but has delegated to the Chief Executive the responsibility to manage the business and deliver against the strategy in an effective and controlled way. The Chief Executive has ultimate executive responsibility for acts and omissions of the Company and acts in accordance with the authority delegated from the Board. The Chief Executive is responsible for delivery of the overall strategy and management of risks in so doing. The Chief Executive manages the business through an Executive Committee (ExCo). The ExCo has further established its own sub-committees which manage specific areas of the business.

Formal arrangements for the management and control of and the business of the Company have been defined, with delegated authorities, approval bodies and roles and responsibilities documented.

A committee structure including BRC, Audit Committee, Remuneration Committee, ExCo, RMC, ALCO and Treating Customers Fairly Board (TCF Board) operated throughout the year as described below.

The Board

Membership of the Board comprises the Chairman, every non-executive and every executive director. The Board has overall responsibility for the business. It sets the strategic aims for the business, in line with delegated authority from the shareholder and in some circumstances subject to shareholder approval, within a framework of prudent controls, which are designed to enable risk to be assessed and managed. The Board satisfies itself that financial controls and systems of risk management are robust.

Board Risk Committee

The BRC is comprised of all of the non-executive directors. The role of the BRC includes considering and recommending to the Board any changes to the Company's risk appetite and risk strategy.

Audit Committee

The Audit Committee is comprised of all of the non-executive directors. The role of the Audit Committee includes: reviewing and recommending to the Board for approval the financial statements; monitoring accounting policies and practices for compliance with relevant standards; reviewing the scope and results of the annual external audit; maintaining a professional relationship with and recommending the appointment, re-appointment and removal of the external auditors; examining arrangements in place to enable management to ensure compliance with requirements and standards under the regulatory system; overseeing the internal audit function and the internal audit programme and expressing an opinion on the effectiveness of internal controls.

To assess the effectiveness of the Company's control environment, the Board reviews the reports of the Audit Committee.

Remuneration Committee

The Remuneration Committee is comprised of all of the non-executive directors. The role of the Remuneration Committee is to: determine and approve remuneration arrangements for Remuneration Code Staff[1] within the Company; to approve a remuneration framework for employees of the Company below the leadership level; to ensure that, where appropriate, remuneration is aligned with the Tesco plc Group Reward Policy; to ensure the levels and structure of remuneration are designed to attract, retain and motivate the management talent needed to run the Company's business in a way which is consistent with the risk appetite and ongoing sustainability of the business; to monitor the talent planning process and to be compliant with all applicable legislation, regulation and guidelines.

Executive Committee

The ExCo is comprised of the Chief Executive, Chief Commercial Officer, Chief Financial Officer, Chief Operating Officer and the Chief Risk Officer (CRO). The ExCo provides general executive management of the business and facilitates cross-functional communication and liaison. The relevant ExCo member is responsible to the Chief Executive and through him to the Board, for managing performance in line with the Company's long term plan, the strategy, the annual budget and the risk appetite.

Risk Management Committee

The principal role of RMC is to ensure that there is effective management and control of all key risks and issues facing the Company.

Two sub-committees, the Fraud, Operational & Regulatory Risk Committee (FORRC) and the Credit Risk Management Committee (CRMC), support the RMC in discharging its duties.

Asset & Liability Management Committee

The principal role of the ALCO is to optimise the Company's balance sheet structure and to identify, manage and control the Company's balance sheet risks in the execution of its chosen business strategy.

The ALCO has two sub-committees, the Liquidity Management Forum (LMF) and the Contingency Funding Committee.

---

[1] Remuneration Code staff comprises categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on the firm's risk profile.

Treating Customers Fairly Board

The principal role of the TCF Board is to provide review and challenge relating to the delivery of fair outcomes for customers by each business area.

3.4.2. Three Lines of Defence

The Company's risk management approach follows the 'Three Lines of Defence' model where:

- **First line of defence** - Line Managers are responsible for establishing an effective control framework within their area of operations and identifying and controlling all risks so that they are within the organisational risk appetite and policy limits. They also devise appropriate key risk indicators, management information and assurance processes to render effective the control framework they operate.
- **Second line of defence** - the Risk Management function is responsible for proposing to the Board appropriate objectives and measures to define the Company's risk appetite and for devising the suite of policies necessary to control the business including the overarching framework and for independently monitoring the risk profile, providing additional assurance where required. With additional expertise in risk management, Risk will also provide frameworks, tools and techniques which will assist management in meeting their responsibilities, as well as acting as a central coordinator to identify enterprise wide risks and make recommendations to address them.
- **Third line of defence** - the Internal Audit function is responsible for the independent assessment of the effectiveness of the implementation of the risk and control measures across the business both in design and practice. They undertake specific reviews of business areas and functions.

3.4.3. Risk Identification

The Risk Identification process sets out to identify and define risk. It provides guidance in relation to the ways in which risks can be identified, the sources to investigate and research in order to identify new and emerging risks and sets out consistent principles which should be applied wherever the Company needs to identify risks.

3.4.4. Risk Assessment

The Risk Assessment process is the means through which the Company understands and estimates the effect of risk on the business and the processes, systems and controls that mitigate those risks to an acceptable level. The Risk Assessment process is the formal method undertaken to determine the potential impact that identified risks or events could have on the Company.

3.4.5. Policies

The Company's policy documents provide the rules and guiding principles that define its approach to control identified risks and are provided as a suite covering all aspects of risk within the EWRMF. The policy framework and accountabilities are the foundations that determine the way the Company has regard to risk when it carries out its business. Detailed accountabilities turn policies and appetite limits into individual limits and responsibilities.

3.4.6. Risk Management Function

The Risk Management function operates under the leadership of the CRO who reports directly to the Chief Executive and is a member of ExCo and the Board. The Risk teams reporting to the CRO have been staffed by people with specific expertise and structured to provide analysis, understanding and oversight of each of the major risks faced by the Company.

3.4.7. Stress Testing

Stress Testing is the process under which the Company's business plans are subjected to severe adverse impacts and that the implications of those stresses on the Company's business including projected capital and liquidity positions are understood. Stress Testing is a mandatory requirement of the FSA who require that banks implement their own stress testing processes.

3.4.8. Monitoring and Reporting

The Risk Management function is the focus and centralised location for integrated risk reporting across the Company. The Enterprise Wide Risk Management team act as risk integrators to ensure that: risk reporting and communications form a total risk perspective; aggregation and correlation issues are addressed; and risk coverage is viewed holistically so that issues do not fall between other functions.

The Company monitors and tracks current exposures against limits defined in the risk appetite and reports exceptions on a monthly basis to the ALCO and RMC and to each meeting of the BRC. Adherence to these limits is independently monitored, measured and reported using a suite of key indicators defined by each risk team responsible for managing the major specific risk categories faced by the Company. Decisions made at subordinate risk committees and forums are reported up to senior committees as appropriate.

3.5. Integrated Risk Processes

The Company's integrated risk processes include the linking of risk appetite to business plans and associated capital and liquidity requirements.

The Company is required to submit periodic ICAAP reports to the FSA which set out future plans, their impact on capital availability and requirements and the risks to capital adequacy under potential stress scenarios.

The Company is also required to submit to the FSA an ILAA which provides an ongoing assessment and quantification of the Company's liquidity risks, how the Company mitigates those risks and how much current and future liquidity is required based on business plans and under stress scenarios. The Company must demonstrate that it has sufficient liquidity and contingency plans to manage unexpected cash outflows.

Risk appetite helps to limit the risks which the business can accept in pursuit of its strategic objectives. Risk appetite is formally reviewed annually and is monitored on an ongoing basis for adherence. The Company's strategy, business plan and capital and liquidity plans are set with reference to risk appetite.

The integrated risk process documents define regulatory guidance and requirements, set out expectations and define the processes that are followed in the Company.

3.6. Major Specific Risk Categories

The major specific risk categories are discussed in Sections 6.1, 7, 8, 9, 11 and 12 of this document. Financial and Capital Risk & Controls are discussed in Sections 4 and 5.

3.7. Embedding Risk within the Organisation

Where risk management is effectively embedded, it becomes an intrinsic part of business planning and decision making ensuring that there is no direction taken without considering potential risks and comparing them against the Company's risk appetite.

3.7.1. Risk Culture

A strong company-wide risk culture is an important element of effective risk management. The Company aims to create a culture of risk awareness, openness and incentivisation of correct behaviours. A number of activities are undertaken to ensure consistency of message and appropriate cultural reinforcement. These activities include: non-executive education, briefings by the Risk Management function, modular risk training and reviews of incentive schemes.

3.7.2. Education & Awareness

The Board of Directors is made aware of the major aspects of the Company's risk profile and provides review and challenge to the EWRMF. Building effective awareness is a high-level priority for the Company's risk managers. Risk affects every member of staff and as such they are obliged to manage the risks in their area as part of their line of defence responsibilities. The Company uses a variety of channels to build risk awareness including: Company Intranet; induction and regular risk awareness programmes; Company magazine; risk briefings and general awareness sessions delivered to all levels of management.

3.7.3. Integrated Risk Approach

At a strategic level, the Board and BRC champion the process of risk management and are actively engaged in understanding the risks faced by the Company and in the ongoing monitoring of areas such as the Company's integrated risk processes, its risk profile and the risk management framework. At a tactical level: training ensures appropriate focus on managing risk; business units are required to comply with risk policies; performance is assessed against key risk drivers, limits and variance analysis; and the implementation and review of business operations embodies risk management principles.

3.7.4. Risk Assurance

Risk assurance is undertaken in a number of places within the Company, reflecting the 3 lines of defence risk management approach. Independent oversight and assurance is intended to provide comfort that the Company's risks are being effectively monitored and managed across all areas of the business in line with the risk framework and the Company's risk appetite.

The quarterly Risk and Control Self Assessment (RCSA) process plays a key role in the Company's approach to risk assurance. RCSA requires each business area to submit their own assurance assessment to the second line Risk team for oversight, review and challenge. As part of the RCSA process, business areas are required to provide evidence to support their assessment and management of key risks and performance of associated controls.

The RMC and the Audit Committee approve the annual Risk Assurance Plan which details business wide assurance review activities undertaken by the Risk Management function.

Additionally the Audit Committee obtain assurance about the internal control and risk management environment through an agreed programme of audits carried out by the Company's Internal Audit function. The role and responsibilities of Internal Audit are detailed below.

3.8. Internal Audit

The Internal Audit function supports the Audit Committee in providing an independent assessment of the adequacy and effectiveness of internal controls. Responsibility for Internal Audit within the Company lies with the Audit Director.

The role of Internal Audit is to assess the adequacy and effectiveness of internal systems and controls, procedures and policies. Internal Audit has the following responsibilities:

- to establish, implement and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the Company's systems, internal control mechanisms and arrangements;
- to report control weaknesses identified as a result of work carried out;
- to verify that actions are taken to address the reported control weaknesses; and
- to report to the Audit Committee in relation to internal audit matters.

An Audit Plan is submitted to the Audit Committee for approval on an annual basis. The Audit Director makes regular reports to the Audit Committee on progress against the Audit Plan and key audit findings. The scope of work of Internal Audit covers the whole of the TPF Group, including the Company and Tesco Underwriting. The annual Audit Plan is risk based, focusing on the areas of highest risk.

3.9. Hedging and Mitigating Risk

The Company's Risk Management Framework sets out how risk is managed across the business. Further information in relation to policies, strategies and processes for hedging and mitigating risk are discussed in Sections 5.3, 6.1, 7, 8, 9, 11 and 12 in relation to each of the major specific risk categories.

4. Capital Resources

The Board has ultimate responsibility for the Company's capital management and capital allocation. The Board reviews and approves the Capital Management Policy on an annual basis. Day to day responsibility for capital planning and other aspects of capital management are delegated to the Treasurer with stress testing and preparation of the Company's ICAAP falling within the remit of the Chief Risk Officer. The ALCO (chaired by the CEO) is the main body responsible for monitoring all aspects of capital planning and has delegated authority to approve capital injections into subsidiaries of TPFG. The Board is kept informed via a monthly update on the capital plan.

The Finance and Treasury functions are responsible for the Financial Governance of the Company and its Financial, Management, Statutory, Regulatory and Treasury reporting. A number of measures are employed to identify and manage the risks inherent in these processes through the operation of the Company's Risk and Control Self Assessment framework, designed to comply with:

- Statutory, Regulatory and disclosure requirements;
- The Company's policies;
- Internal reporting, monitoring and self assessment systems;
- Reporting and monitoring requirements of governing committees and boards; and
- First line of defence responsibilities.

The main elements of the control framework including the key risks, the main controls and monitoring, reporting and governance arrangements are detailed in the Finance / Capital Risk Management & Controls manual which forms part of the Company's EWRMM.

The Financial Services Authority, in its capacity as supervisor sets targets for, and monitors, the capital adequacy of the Company. Capital adequacy returns are submitted quarterly to the FSA.

During the 12 month accounting period to 29th February 2012 the Company complied with the capital requirements determined by the FSA.

Table 1 shows the Company's capital resources as at 29th February 2012.

4.1. Capital Resources

The Company's capital resources are shown in Table 1. Information on the composition and main features of the Company's capital resources and components thereof are provided in the following sub-sections.

Table 1: Capital Resources

Total Capital Resources	February 2012 (£k)	February 2011 (£k)
Tier 1 Capital		
Equity Capital	1,034,900	923,400
Verified and Other Reserves	16,256	52,626
Intangible Assets	(336,995)	(215,275)
Total Tier 1	**714,161**	**760,751**
Tier 2		
Upper Tier 2		
Undated Subordinated Debt	45,000	45,000
Collective Provisions	21,154	17,626
Lower Tier 2		
Dated Subordinated Debt	330,000	190,000
Total Tier 2	**396,154**	**252,626**
Deductions from Total Capital Resources	(364,639)	(364,863)
Total Capital Resources	**745,676**	**648,514**
Risk Weighted Assets	**4,672,636**	**4,787,753**
Core Tier 1 Ratio	**15.28%**	**15.89%**
Total Capital Ratio	**15.96%**	**13.55%**

4.1.1. Core Tier 1 Capital

The Company's Tier 1 capital is wholly comprised of Core Tier 1 capital resources. Equity capital comprises share capital and the share premium account, as detailed in Table 2 below. Verified and Other reserves include previously audited Profit and Loss Account reserves, equity capital contribution for Share Based Payment schemes and interim verified profits less dividends paid.

Table 2: Share Capital and Share Premium

Share Capital & Share Premium	February 2012 (£k)	February 2011 (£k)
Authorised		
Ordinary shares of 10p each	Unlimited	Unlimited
Allotted, Called up & Fully Paid		
Ordinary shares of 10p each	103,490	92,340
Share Premium Account	931,410	831,060
Total	**1,034,900**	**923,400**

During the year the Company issued 111,500,000 (2011: 445,500,000) ordinary shares to the parent company, TPFG, for a total consideration of £111,500k (2011: £445,500k).

4.1.2. Hybrid Capital

The Company does not have any forms of hybrid capital.

4.1.3. Deductions from Tier 1 Capital Resources

Intangible assets relate to Computer Software and "Work in Progress" which relates primarily to the internal development of IT software assets as part of the migration to a new infrastructure for the Company.

4.1.4. Tier 2 Capital Resources

All dated and undated subordinated debt is issued to TPFG who, in turn, have issued the same amount to Tesco plc. Details of subordinated liabilities are provided in Table 3: below. Collective provisions are included as Upper Tier 2 capital resources in accordance with GENPRU 2.2.187 to 2.2.189.

Table 3: Subordinated Liabilities

Subordinated Liabilities	February 2012 (£k)	February 2011 (£k)
Undated floating rate notes	45,000	45,000
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	30,000
Floating rate subordinated loan maturing 2021	140,000	0
Floating rate subordinated loan maturing 2022	95,000	95,000
	375,000	235,000

4.1.5. Capital Resources that provide for an incentive to be redeemed

The undated floating rate notes have no fixed maturity date and may not be repaid except under certain conditions such as the winding up of the Company. The dated 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 3 month LIBOR plus a range of 60 to 225 basis points.

4.1.6. Innovative Tier 1 Capital Resources

The Company does not have any forms of innovative Tier 1 capital resources.

4.1.7. Deductions from Tier 2 Capital Resources

There are no deductions from Tier 2 capital resources.

4.1.8. Deductions from Total Capital Resources

The deductions from total capital resources relate to capital deducted loans and the investment in associate.

4.1.9. Tier 3 Capital Resources

The Company does not have any Tier 3 capital resources.

5. Compliance with BIPRU and the overall Pillar 2 Rule

5.1. Approach to assessing adequacy of Internal Capital

Capital is held to provide sufficient resources to absorb losses. The Company aims to maintain a minimum risk asset ratio which will ensure that sufficient capital is held to support the risk profile during stressed conditions (subject to any additional minimum within Individual Capital Guidance (ICG) from FSA).

The Company has adopted the Standardised Approaches to the calculation of Pillar 1 minimum capital requirements for Credit and Operational Risk. The Company does not currently have a Trading Book but does calculate a Market Risk position risk requirement in respect of foreign currency in the non-trading book.

Capital adequacy is monitored daily by Treasury with monthly reporting provided to the Board and to the ALCO. In addition, capital planning forms a key element of the Company's Budgeting and Long Term Plan (LTP) processes. As part of the LTP, the Treasury function prepare a forward looking capital plan covering the current financial year and a further four years which is approved by ALCO and the Board. The first year of the plan is revised for each reforecast and reported to ALCO and the Board. The capital plan is a living process with the latest iteration submitted monthly to the Board for noting. The capital plan forecasts for the Company show that sufficient capital resources continue to be available to support delivery of business and strategic objectives.

An integrated part of the capital planning process is the stress testing framework that explores the resilience of the Company in the face of adverse scenarios. This framework covers both capital and liquidity stress testing with results presented to ALCO, RMC, BRC and the Board for challenge and approval. The latest stress testing results show that the Company maintains sufficient capital resources under the scenarios approved by the Board.

The FSA sets ICG for each bank following completion of the ICAAP which is the Company's internal assessment of capital adequacy designed to address the requirements under Pillar 2 of the Basel II framework. The ICAAP process considers all of the risks faced by the Company, the likely impact of them if they were to occur, how these risks can be mitigated and the amount of capital that it is prudent to hold against them both currently and in the future. The Company performs a full ICAAP regularly with approval provided by the Board.

The ICAAP process forms a key part of the capital adequacy assessment and to complement the full ICAAP process a monthly ICAAP Monitor is produced and presented to the ExCo detailing the current risk profile and directional movements in the profile together with supporting commentary.

The Company has continued to maintain capital resources in excess of its ICG.

5.2. Pillar 1 Capital Requirements

Table 4 shows the overall Pillar 1 minimum capital requirements and risk weighted assets for the Company under the Standardised Approaches to Credit and Operational Risk. The Company does not operate a Trading Book and therefore has no trading risk exposure but it does calculate a small foreign exchange position risk capital requirement.

Table 4: Pillar 1 Capital Requirements and Risk Weighted Assets

Minimum Capital Requirements 29 February 2012 (£k) Exposure Class	Capital Requirement	Risk Weighted Assets
Central Government and Central Banks	-	-
Multilateral Development Banks	-	-
Institutions	3,673	45,920
Corporates	8,662	108,278
Retail	274,156	3,426,944
Past due	1,858	23,223
Covered Bonds	632	7,905
Securitisation Positions	727	9,085
Collective Investment undertakings	1,491	18,642
Other Assets	18,270	228,372
Total Credit Risk Minimum Capital Requirement under Pillar 1	**309,469**	**3,868,369**
Total Market Risk Minimum Capital Requirement under Pillar 1	**178**	**2,220**
Total Operational Risk Minimum Capital Requirement under Pillar 1	**64,164**	**802,047**
Total Pillar 1 Capital Requirements	**373,811**	**4,672,636**

Minimum Capital Requirements 28 February 2011 (£k) Exposure Class	Capital Requirement	Risk Weighted Assets
Central Government and Central Banks	-	-
Multilateral Development Banks	-	-
Institutions	4,342	54,272
Corporates	8,951	111,881
Retail	282,431	3,530,387
Past due	1,700	21,249
Securitisation Positions	1,175	14,689
Collective Investment undertakings	4,995	62,441
Other Assets	17,003	212,540
Total Credit Risk Minimum Capital Requirement under Pillar 1	**320,597**	**4,007,459**
Total Market Risk Minimum Capital Requirement under Pillar 1	**-**	-
Total Operational Risk Minimum Capital Requirement under Pillar 1	**62,423**	**780,293**
Total Pillar 1 Capital Requirements	**383,020**	**4,787,753**

5.3. Counterparty Credit Risk

Counterparty Credit Risk (CCR) may be defined as the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. Such transactions relate to contracts for financial derivative instruments, securities financing transactions and long settlement transactions. All financial derivative transactions are governed by industry standard International Swaps and Derivatives Association (ISDA) Master Agreements, supplemented by ISDA Credit Support Annexes for a number of counterparties. Information relating to policies used in management of Wholesale Credit Risk, which includes Counterparty Credit Risk, is provided in Section 6.1.2.

As at 29th February 2012 the Company has no public credit rating and therefore has no requirement to post additional collateral in the event of a ratings downgrade. There is also no exposure to credit derivative transactions.

The Company in its ordinary course of business uses over the counter (OTC) derivatives and forward foreign exchange transactions to hedge exposures, i.e. interest rate and foreign exchange risk. The CCR mark to market method is used to measure exposure value and details of exposures are provided in Table 5 below.

Table 5: Measure for exposure value under the CCR Mark to Market Method

Counterparty Credit Risk Exposures: CCR Mark to Market Method	February 2012 (£k)	February 2011 (£k)
Interest-rate contracts	33,200	26,810
Contracts concerning foreign currency rates and gold	4,802	7,125
Contracts concerning equities	-	-
Contracts concerning precious metals except gold	-	-
Contracts concerning commodities other than precious metals	-	-
Total	**38,002**	**33,935**

Regulatory capital calculations do not incorporate netting benefits and there is no use of collateral in calculating net derivatives credit exposure. This is demonstrated in Table 6 below.

Table 6: Net Derivative Credit Exposure

Net Derivative Credit Exposure	February 2012 (£k)	February 2011 (£k)
Gross Positive Fair Value of Contracts[1]	19,522	16,378
Less: Netting benefits	-	-
Netted current credit exposure	19,522	16,378
Less: Collateral Held	-	-
Net Derivatives Credit Exposure	**19,522**	**16,378**

[1] Excludes add-on for Potential Future Credit Exposure

6. Credit Risk and Dilution Risk

6.1. Credit Risk

Credit risk is the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. The Company's aim in relation to credit risk is to seek to lend responsibly, ensuring that the credit risk profile remains within agreed volatility parameters.

Credit risk arises principally from the Company's retail lending activities but also from placement of surplus funds with other banks and money market funds, investments in transferable securities and interest rate and foreign exchange derivatives. In addition, credit risk arises from contractual arrangements with third parties where payments and commissions are owed to the Company for short periods of time. Credit risk may also materialise when an adverse change in an entity's credit rating causes a fall in the fair value of the Company's investment in that entity's financial instrument.

The CRO and his direct report, the Director of Credit Risk, are responsible for: the development and oversight of the credit risk management framework; developing credit risk policies, tools and frameworks across the business and instilling a positive risk management culture; managing effective credit risk strategies; providing oversight of credit risk activities undertaken by the first line; and credit performance monitoring.

The Credit Risk function maintains a suite of policies defining the minimum requirements for the management of credit activities across the lifecycle. Credit risk policies include Credit Risk Policy and Minimum Standards, Wholesale Credit Risk Policy, Model Development, Collections and Recoveries and Provisioning. All credit risk policies are subject to annual review by the RMC.

Credit Risk policies are supported by a range of process and procedures manuals that cover the activities undertaken through the credit lifecycle that require manual intervention. Good management information is critical for the effective management of credit risk. A suite of management information is produced for different audiences within the governance framework. Crucial within this suite are Key Risk Indicators, with supporting limits and tolerances, that allow the Company to track performance against appetite and identify any trends that could act as an early warning that performance may move outside risk appetite in the future.

6.1.1. Retail Credit Risk

The Company's credit policy is defined via the credit risk policy framework. Through this, standards and limits are 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.

A dedicated credit risk management team have the day to day responsibility for managing the credit quality of the lending portfolio. As at 29th February 2012, the deployment and execution of credit strategies for the credit card portfolios sat within The Royal Bank of Scotland Group plc (RBS) infrastructure, managed through the relevant Commercial Services Agreement. During the year the personal loan portfolios were migrated from RBS to the Company's infrastructure. The Company has full ownership of its credit risk appetite and its credit policy. Responsibility for setting scorecard parameters, and the process for dealing with exceptions, lies with the Director of Credit Risk, reporting to the CRO. Regular reporting to the RMC, ExCo, BRC and the Board provides oversight of this activity and insight to the performance of the portfolio.

6.1.2. Wholesale Credit Risk

The Company maintains a limits-based framework for managing exposure to counterparty credit risk. These limits and the framework are set out in the Wholesale Credit Risk Policy which is approved by the RMC. The Treasurer is responsible for ensuring that Treasury complies with counterparty credit risk limits, with the Counterparty Credit Risk Manager and the Insurance and Market Risk Director providing independent oversight that these limits are adhered to.

The control framework defines approved country, counterparty and instrument types and maturity profiles. The Company's risk appetite focuses on counterparties with strong capacity to meet financial commitments and requires approved counterparties to have upper investment grade ratings. Counterparty types include financial institutions, sovereigns and supranationals with approved instrument types including cash, certificates of deposit, bonds, treasury bills, gilts, repurchase agreements, money market funds and asset backed securities / covered bonds. Country limits are derived using External Credit Assessment Institutions (ECAI) ratings and economy size. Interest rate and foreign exchange derivatives are also used to hedge exposures.

The framework sets limits on the amounts that can be lent based on counterparty credit-worthiness, instrument type and remaining tenor. As part of the credit assessment process for wholesale credit risk exposures, the Company continues to use Fitch, Moody's and Standard & Poor's as ECAIs with Fitch ratings used to determine regulatory capital requirements under the Standardised Approach to Credit Risk. All material limits are approved via the RMC and any exceptions or overrides to the Company's policy must be explicitly agreed by the RMC.

Daily monitoring of exposures is undertaken by the Counterparty Credit Risk Manager with monthly reporting of Key Risk Indicators provided to RMC.

As at 29th February 2012 the Company has not recognised any impairment losses in connection with these financial assets. There is therefore no requirement to establish credit reserves for wholesale credit risk exposures.

The Wholesale Credit Risk Policy provides that credit risk mitigation techniques are applied to reduce credit risk exposure. Industry standard ISDA Master Agreements are in place with all derivative counterparties, Global Master Repurchase Agreements are in place for all repurchase agreements and ISDA Credit Support Annexes (CSA's) have been executed with a number of counterparties with plans in place to have CSA's executed with all derivative counterparties. Use is also made of Delivery Versus Payment (DVP) arrangements when settling transactions. As at the end of February 2012 no additional credit risk mitigation has been taken.

Wrong Way Risk

Wrong way risk is defined as the risk that occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty.

The Company's Wholesale Credit Risk Policy prohibits the repurchase counterparty and issuer of the collateral being the same, or related, entities. Where collateral is posted under a derivative CSA the exposure to the issuer of the collateral is managed within the limit framework detailed in Section 6.1.2 above. The Company has no exposure to wrong-way risk.

6.1.3. Third Party Credit Exposures

The Company has a number of contracts with third parties that involve the payment of fees or commissions to TPF plc. Credit exposure arises through the risk that these payments may not be made. The requirements for management of these exposures are detailed in the Wholesale Credit Risk Policy with a limits framework in place to manage these exposures. The Counterparty Credit Risk Manager is responsible for reporting these exposures and any limit breaches to RMC.

6.1.4. External Credit Assessment Institutions' Assessments

Issue credit assessments are used for investments in specific obligations, mainly Asset Backed Securities / Covered Bonds and Government Guaranteed Bonds, where there are adjustments to the issuer's general rating that reflect factors specific to the investment.

Issuer credit assessments are generally used for other forms of lending where the assessment concerns the general capacity and willingness of the counterparty to meet their obligations. Ratings are obtained from market sources with processes in place to assign appropriate ratings to exposures and to monitor rating actions. The Company complies with the credit quality assessment scale with the appropriate issue or issuer rating used to determine the risk weights applied under the Standardised Approach to Credit Risk. Capital is assigned according to BIPRU requirements as explained in Section 5 above.

The exposure values, excluding undrawn commitments and derivative exposures, associated with each credit quality step are shown by exposure class in Table 7 below. Undrawn credit card commitments, which attract a zero per cent credit conversion factor, were £7,422,554k as at 29th February 2012 (2011 £7,127,334k).

Table 7: Analysis of Exposures by Credit Quality Step

Exposure Values 2012	Credit Quality Step 1 (£k)	Credit Quality Step 2 (£k)	Credit Quality Step 3 (£k)	Credit Quality Step 4 (£k)	Credit Quality Step 5 (£k)	Credit Quality Step 6 (£k)	Unrated (£k)	Total (£k)
Fitch Assessment	**AAA to AA-**	**A+ to A-**	**BBB+ to BBB-**	**BB+ to BB-**	**B+ to B-**	**CCC+ and below**		
Central Governments or Central Banks	1,239,934							1,239,934
Multilateral Development Banks	386,078							386,078
Institutions	17,644	112,962						130,606
Corporates		1,140	15,922				91,786	108,848
Retail Claims							4,569,259	4,569,259
Past Due Items							23,223	23,223
Covered Bonds		39,526						39,526
Securitisation Positions	45,423							45,423
Collective Investment Undertaking	93,209							93,209
Other							260,076	260,076
Total exposures pre mitigation	**1,782,288**	**153,628**	**15,922**	**-**	**-**	**-**	**4,944,344**	**6,896,182**
Total exposures post mitigation	**1,782,288**	**153,628**	**15,922**	**-**	**-**	**-**	**4,944,344**	**6,896,182**

Exposure Values 2011	Credit Quality Step 1 (£k)	Credit Quality Step 2 (£k)	Credit Quality Step 3 (£k)	Credit Quality Step 4 (£k)	Credit Quality Step 5 (£k)	Credit Quality Step 6 (£k)	Unrated (£k)	Total (£k)
Fitch Assessment	**AAA to AA-**	**A+ to A-**	**BBB+ to BBB-**	**BB+ to BB-**	**B+ to B-**	**CCC+ and below**		
Central Governments or Central Banks	510,585							510,585
Multilateral Development Banks	228,641							228,641
Institutions	251,861	10,814						262,675
Corporates		982	154				111,236	112,372
Retail Claims							4,707,183	4,707,183
Past Due Items							21,249	21,249
Covered Bonds								
Securitisation Positions	73,444							73,444
Collective Investment Undertaking	312,207							312,207
Other							220,890	220,890
Total exposures pre mitigation	**1,376,738**	**11,796**	**154**	**-**	**-**	**-**	**5,060,558**	**6,449,246**
Total exposures post mitigation	**1,376,738**	**11,796**	**154**	**-**	**-**	**-**	**5,060,558**	**6,449,246**

6.1.5. Credit Risk: Past Due and Impaired Assets

The Company considers exposures to be past due where a customer does not make their minimum contractual monthly payment. For accounting purposes, an asset is considered to be impaired where the customer is more than 90 calendar days past due in interest or principal payments or where there is earlier objective evidence of impairment (for example, bankruptcy, insolvency or a declaration of financial hardship). For regulatory reporting purposes, BIPRU defines the Past Due Exposure Class as items that are past due more than 90 days.

Details of past due and impaired exposures (gross of provisions), value adjustments and provisions and the net charge for the period, by industry type are provided in Table 8. Similar information for past due and impaired exposures by geography is provided in Table 9 below.

Table 8: Past Due and Impaired Exposures by Industry

	Impaired and Past Due exposures by Industry Type 28 February 2012				
	Financial Institutions (£k)	Governments (£k)	Individuals (£k)	Wholesale and retail trade (£k)	Total (£k)
Past Due not Impaired					
1-29 days	-	-	49,569	-	49,569
30-59 days	-	-	13,883	-	13,883
60-89 days	-	-	9,687	-	9,687
90 days or more	-	-	-	-	-
Total	-	-	73,139	-	73,139
					-
Impaired Exposures	-	-	186,700	-	186,700
					-
Impairment Provisions	-	-	184,631	-	184,631
					-
Net Impairment Charge	-	-	124,511	-	124,511

	Impaired and Past Due exposures by Industry Type 28 February 2011				
	Financial Institutions (£k)	Governments (£k)	Individuals (£k)	Wholesale and retail trade (£k)	Total (£k)
Past Due not Impaired					
1-29 days	-	-	53,642	-	53,642
30-59 days	-	-	12,663	-	12,663
60-89 days	-	-	6,474	-	6,474
90 days or more	-	-	-	-	-
Total	-	-	72,779	-	72,779
					-
Impaired Exposures	-	-	185,571	-	185,571
					-
Impairment Provisions	-	-	181,948	-	181,948
					-
Net Impairment Charge	-	-	131,356	-	131,356

Table 9: Past Due and Impaired Exposures by Geography

	Impaired and Past Due exposures by Geography 28 February 2012			
	Uk (£k)	Europe (£k)	Other (£k)	Total (£k)
Past Due not Impaired				
1-29 days	47,187	2,382		49,569
30-59 days	13,295	587		13,883
60-89 days	9,496	191		9,687
90 days or more	-			-
Total	69,979	3,160	-	73,139
Impaired Exposures	183,595	3,105		186,700
Impairment Provisions	181,326	3,305		184,631
Net Impairment Charge	123,132	1,378		124,511

	Impaired and Past Due exposures by Geography 28 February 2011			
	Uk (£k)	Europe (£k)	Other (£k)	Total (£k)
Past Due not Impaired				
1-29 days	50,858	2,784	-	53,642
30-59 days	12,207	456	-	12,663
60-89 days	6,407	67	-	6,474
90 days or more	-	-	-	-
Total	69,472	3,307	-	72,779
Impaired Exposures	182,743	2,827	-	185,571
Impairment Provisions	178,666	3,282	-	181,948
Net Impairment Charge	129,661	1,695	-	131,356

6.1.6. Credit Risk: Value Adjustments and Provisions

Credit risk provisioning and impairment is the responsibility of the Board. Day to day responsibility for impairment provisions lies with the Chief Financial Officer and the Chief Risk Officer.

In managing credit risk provisioning and impairment the Company apply IFRS, specifically International Accounting Standard 39: Financial Instruments (IAS 39) which requires that financial assets are assessed for impairment. Loan impairment provisions are established to recognise incurred impairment losses. 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.

The Company applies a collective impairment provisioning model that segments provisions into the latent (good) book and the impaired (bad) book based upon the approved definition of default operated on both the credit card and loans portfolios. Good book provisions are held where there is objective evidence of impairment on an account (e.g. missed payments) but the account does not yet meet the Company's definition of default. Impairment provisions are established on a portfolio basis taking into account the level of arrears, security, past loss experience and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates.

Table 10 shows the reconciliation of changes in provisions for loans and advances. This table excludes impairment losses of £5,483k (2011 £414k) arising on amounts due from the insurance business.

Table 10: Analysis of Impairment provisions for loans and advances

Impairment Provisions for Loans & Advances	February 2012 (£k)	February 2011 (£k)
Opening Balance	181,821	313,991
Amounts written off	(120,187)	(268,252)
Recoveries of amounts previously written off	7,811	8,636
New impairment provisions less releases charged to the income statement	119,028	130,942
Unwind of discount	(3,842)	(3,496)
Provisions as at 28 February	**184,631**	**181,821**

Provisions for impaired loans and advances at 29th February 2012 were £163,477k (2011: £164,276k).

There are no further value adjustments in relation to credit risk. Non-credit risk value adjustments are disclosed in Note 19 of the Directors' Report and Financial Statements.

6.1.7. Credit Risk: Analysis by Exposure Class

Table 11 shows the credit risk exposure, excluding off Balance Sheet exposures and the derivative exposures detailed in Section 5.3 above, as at the financial year end together with average credit risk exposure values across the financial year from 1st March 2011 to 29th February 2012. The exposure is shown gross before taking into account the effects of credit risk mitigation but is reported net of impairment provisions.

Off-Balance sheet exposures relate to undrawn credit card commitments and have an exposure value as at 29th February 2012 of £7,422,544k (2011 £7,127,334k). Average undrawn exposure values for March 2011 to February 2012 were £7,180,928k (March 2010 to February 2011 £6,840,049k).

Table 11: Credit Risk: Analysis by Exposure Class

Exposure Class	Maximum Exposure Value		Average Exposure Value	
	February 2012 (£k)	February 2011 (£k)	Mar 11 - Feb 12 (£k)	Mar 10 - Feb 11 (£k)
Central Governments or Central Banks	1,239,934	510,585	1,021,137	494,347
Multilateral Development Banks	386,078	228,641	326,054	150,555
Institutions	130,606	262,675	232,176	265,757
Corporates	108,848	112,372	151,088	202,606
Retail Claims	4,569,259	4,707,183	4,715,636	4,475,666
Past Due Items	23,223	21,249	9,696	62,520
Covered Bonds	39,526		6,075	-
Securitisation Positions	45,423	73,444	51,648	83,934
Collective Investment Undertaking	93,209	312,207	135,707	137,449
Other	260,076	220,890	244,819	177,990
Total	**6,896,182**	**6,449,246**	**6,894,036**	**6,050,824**

6.1.8. Credit Risk: Analysis by Geography

Table 12 provides the geographic distribution of the Company's exposures by asset class. The Company is primarily focussed on providing financial services and products to UK personal customers although there is limited exposure in the Republic of Ireland. The Company sells credit cards into the Republic of Ireland where it is an authorised 'credit institution' under Irish law and is directly regulated by the Irish Financial Regulator in respect of this activity.

Table 12: Credit Risk: Analysis by Geography

Exposure Class	Geographic Location (29 February 2012)			
	UK (£k)	Europe (ex. UK) (£k)	Other (£k)	Total (£k)
Central Governments or Central Banks	1,011,565	220,963	7,406	1,239,934
Multilateral Development Banks		288,457	97,621	386,078
Institutions	130,606			130,606
Corporates	108,116	348	384	108,848
Retail Claims	4,537,419	31,840		4,569,259
Past Due Items	23,168	55		23,223
Covered Bonds	39,526			39,526
Securitisation Positions	45,423			45,423
Collective Investment Undertaking	50,035	43,174		93,209
Other	260,076			260,076
Total	**6,205,934**	**584,837**	**105,411**	**6,896,182**

Exposure Class	Geographic Location (28 February 2011)			
	UK (£k)	Europe (ex. UK) (£k)	Other (£k)	Total (£k)
Central Governments or Central Banks	396,933	113,652		510,585
Multilateral Development Banks		181,375	47,266	228,641
Institutions	262,675			262,675
Corporates	110,460	1,772	140	112,372
Retail Claims	4,674,180	33,003		4,707,183
Past Due Items	21,249	-		21,249
Securitisation Positions	73,444			73,444
Collective Investment Undertaking	50,028	262,179		312,207
Other	220,890			220,890
Total	**5,809,859**	**591,981**	**47,406**	**6,449,246**

6.1.9. Credit Risk: Analysis by Industry type

The distribution of exposures by industry type is provided in Table 13. The Company is primarily focussed on providing financial services and products to UK personal customers although it also has exposure to wholesale counterparties as detailed in Section 6.1.2 above.

Table 13: Credit Risk: Analysis by Industry Type

Exposure Class	Industry Type (29 February 2012)				
	Financial Institutions (£k)	Government (£k)	Individuals (£k)	Wholesale and retail trade (£k)	Total (£k)
Central Governments or Central Banks		1,239,934			1,239,934
Multilateral Development Banks	386,078				386,078
Institutions	130,606				130,606
Corporates				108,848	108,848
Retail Claims			4,569,259		4,569,259
Past Due Items			23,223		23,223
Covered Bonds	39,526				39,526
Securitisation Positions	45,423				45,423
Collective Investment Undertaking	93,209				93,209
Total	**694,842**	**1,239,934**	**4,592,482**	**108,848**	**6,636,106**

Exposure Class	Industry Type (28 February 2011) Financial Institutions (£k)	Government (£k)	Individuals (£k)	Wholesale and retail trade (£k)	Total (£k)
Central Governments or Central Banks		510,585			510,585
Multilateral Development Banks	228,641				228,641
Institutions	262,675				262,675
Corporates				112,372	112,372
Retail Claims			4,707,183		4,707,183
Past Due Items			21,249		21,249
Securitisation Positions	73,444				73,444
Collective Investment Undertaking	312,207				312,207
Total	**876,967**	**510,585**	**4,728,432**	**112,372**	**6,228,356**

Note that Other Assets have been excluded from these tables.

6.1.10. Credit Risk: Exposure by Residual Maturity

An analysis of residual maturity of exposures, on a contractual basis, is provided in Table 14.

Table 14: Credit Risk exposure by residual maturity

Exposure Class	Residual Maturity (Contractual) (29 February 2012) On Demand (£k)	Repayable in 3 months or less (£k)	Repayable between 3 months and 1 year (£k)	Repayable between 1 and 5 years (£k)	Repayable over 5 years (£k)	Undated (£k)	Total (£k)
Central Governments or Central Banks	424,101	40,136	76,980	398,503	295,126	5,088	1,239,934
Multilateral Development Banks		22,117	24,715	234,766	104,480		386,078
Institutions		58,928	36,606	9,311	25,761		130,606
Corporates		108,848					108,848
Retail Claims	2,429,845	259,229	507,392	1,236,859	135,934		4,569,259
Past Due Items	2,236	6,918	4,985	8,495	589		23,223
Covered Bonds		137		26,924	12,465		39,526
Securitisation Positions		7,947		27,789	9,687		45,423
Collective Investment Undertaking	93,132	77					93,209
Other	5,445	150,314	16,471	87,846			260,076
Total	**2,954,759**	**654,651**	**667,149**	**2,030,493**	**584,042**	**5,088**	**6,896,182**

Exposure Class	Residual Maturity (Contractual) (28 February 2011) On Demand (£k)	Repayable in 3 months or less (£k)	Repayable between 3 months and 1 year (£k)	Repayable between 1 and 5 years (£k)	Repayable over 5 years (£k)	Undated (£k)	Total (£k)
Central Governments or Central Banks	120,854	4,513	25,095	222,366	133,517	4,240	510,585
Multilateral Development Banks		3,106		166,196	59,339		228,641
Institutions		64,282	165,211	18,893	14,289		262,675
Corporates		112,372					112,372
Retail Claims	2,453,107	155,312	461,558	1,475,090	162,116		4,707,183
Past Due Items	7,930	4,390	3,164	5,391	374		21,249
Securitisation Positions		183	7,193	48,735	17,333		73,444
Collective Investment Undertaking	312,122	85					312,207
Other	3,060	112,027	16,706	89,097			220,890
Total	**2,897,073**	**456,270**	**678,927**	**2,025,768**	**386,968**	**4,240**	**6,449,246**

6.1.11. Credit Risk Mitigation

The retail products offered by the Company are currently unsecured consumer lending products and no credit risk mitigation is obtained in relation to these products. Policies are in place which allow the use of credit risk mitigation to reduce Counterparty Credit Risk. As at end February 2012 no use has been made of collateral other than industry standard ISDA agreements, ISDA Credit Support Annexes used in relation to financial derivative transactions and Global Master Repurchase Agreements used in relation to repurchase transactions. Similarly, the Company has not made use of on or off-balance sheet netting.

There is currently no use of credit risk mitigation in regulatory capital calculations.

6.2. Dilution Risk

The Company has no exposure to dilution risk.

7. Market Risk

Market risk is defined as the risk that the value of the Company's income, liabilities, assets or costs might vary due to changes in the value of financial market prices; this includes interest rates, foreign exchange rates, credit spreads and equities. The Company has no Trading Book. Market risk arises in the following ways in the Company:

- Interest rate risk in the Company's retail portfolios, its ATM income and in its funding activities arises from the different repricing characteristics of non-trading assets and liabilities, hereafter referred to as interest rate risk in the banking book (IRRBB);
- Foreign exchange exposures that arise from foreign currency investments, foreign currency loans, deposits, income and other foreign currency contracts;
- Interest rate and credit spread risk in the investment portfolios of the Company's insurance companies TU and RBS insurance; and
- Investment risk relating to the Company's pension obligations.

Control of market risk exposure is managed by ALCO, which makes regular reports to the RMC and Board. The Market and Liquidity Risk team provides review and challenge of policies and procedures relating to market risk across the Company. Market and Liquidity Risk are responsible for oversight and monitoring of the Asset & Liability Management (ALM) and Market Execution teams within Treasury.

7.1. Interest Rate Risk in the Banking Book

IRRBB is the main market risk that could affect the Company's net interest income and arises where there is potential for changes in benchmark interest rates (that embed little or no credit risk) which results in a movement in the Banking Book net interest income.

IRRBB may arise for a number of reasons, for example:

- Repricing Risk – related to the timing differences in the maturity (for fixed rate) and repricing (for floating rate) of the Company's assets, liabilities and off balance sheet positions;
- Yield Curve Risk - risk that earnings from banking book products are adversely affected by movement in the yield curve due to the timing mismatch in the repricing of assets, liabilities and off balance sheet positions;
- Basis Risk - risk arising from the imperfect correlation between changes in interest rate indices, such as between LIBOR and Base rate or between Base rate and Administered rates;
- Customer Optionality – risk that a loss in value arises because the take up of a fixed rate product, e.g. personal fixed rate loans, are different from expectations (recruitment risk) or the repayment behaviour of customers differs from expectations (prepayment risk), due to, or combined with, a movement in interest rates.

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 Board have delegated authority for detailed approval of IRRBB to the ALCO. High level risk appetite and policies are recommended for approval by the ALCO to the Board. The ALCO have delegated responsibility to the ALM team to ensure that the Company's IRRBB Risk Appetite is effectively managed. The IRRBB policy is owned and monitored by Treasury and approved by ALCO. The main policy objectives are to:

1. Manage the overall IRRBB of the Company by:
    - Identifying, assessing, controlling and reporting the Company's interest rate risk exposure within risk appetite parameters;
    - 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.

2. 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 the ICAAP process.

Non traded interest rate risk primarily arises from the consumer lending portfolios and retail deposits. Hedging strategies are implemented as required to ensure that the Company remains within stated risk appetite.

The main hedging instruments used are interest rate swaps and the residual exposure is reported to the ALCO monthly using two key risk measures:

- Economic value of equity sensitivity to 200 basis point movements across the yield curve. This is then expressed as a percentage change from the base present value of equity; and
- net interest income sensitivity to an instantaneous 1% parallel movement in interest rates.

The different methodologies can be summarised as:

Economic Value of Equity (EVE) – the EVE approach focuses on the value of the Company in today's interest rate environment and its sensitivity to changes in interest rates. This is done by scheduling the cash flows of all assets and liabilities and applying a set of discount rates to develop the present values. The present value of equity is derived by calculating the difference between the present value of assets and liabilities (Equity = Assets - Liabilities). The EVE calculation for the Company is subject to sensitivity analysis comprising +200 and -200 basis point movements across the yield curve. This is then expressed as a percentage change from the base present value of equity.

Net Interest Income (NII) Sensitivity – This measures the effect of a 100 basis point interest rate shock on the next 12 months NII, based on the re-pricing gaps in the existing portfolio.

Measure	February 2012	February 2011
Economic Value of Equity (EVE)	(7.84%)	(8.47%)
NII Sensitivity	(1.26%)	(0.62%)

7.2. Foreign Exchange Risk

The Company invests in non-GBP denominated bonds, and may raise funding from the wholesale markets in currencies other than GBP. Foreign exchange (FX) exposure arises if these exposures are not hedged. FX exposure may also arise through the Company's EUR-denominated Irish credit card exposure, through the cash held in tills and in transit from the Travel Money business and through invoices received which are denominated in foreign currencies.

All foreign currency exposure is hedged such that no material net exposure results. This exposure is reflected in the foreign currency position risk requirement detailed in Section 5.2 above.

7.3. RBS Insurance and TU Investment Portfolios

The RBS insurance portfolio is part of Direct Line Insurance Group (formerly RBS Insurance Group Limited) although the Company is exposed to any fluctuation in the value of the portfolio. Both the TU and the RBS insurance portfolios are predominantly comprised of Bonds and short term cash investments.

The main risks in the two portfolios relate to changes in: (i) interest rates affecting fair value arising as a proportion of the bonds are fixed rate in nature, (ii) credit quality, as the range of assets held are issued by a variety of institutions with different credit characteristics.

Portfolio management is undertaken by the RBS insurance and TU investment committees. The Company's ALM team monitors high-level risk information and the performance of the portfolios and reports this to the ALCO on a monthly basis. Risk provides oversight and challenge.

7.4. Pension Risk

Pension Risk may be defined as: the risk to a firm caused by its contractual or other liabilities to or with respect to a pension scheme (whether established for its employees or those of a related company or otherwise).

The Company is a participating employer in the Tesco plc Pension Scheme (the Scheme) which is accounted for on a contributions only basis as described in Note 38 to the Company's Directors' Report and Financial Statements.

8. Liquidity and Funding Risk

Liquidity risk is the risk that the Company has insufficient cash resources to meet its obligations as they fall due or can do so only at excessive cost. Liquidity is the on-going ability to accommodate liability maturities and withdrawals, fund asset growth, and otherwise meet contractual obligations through unconstrained access to funding at reasonable market rates. The Company seeks to maintain a conservative liquidity and funding profile ensuring that it is able to meet its financial obligations under stressed conditions.

The Board approves the Liquidity Risk Management Policy framework (LRMP) and delegates to the CEO and thence, through ExCo and the ALCO, the day to day responsibility for complying with the framework which is in turn delegated to the Treasurer. The LRMP provides a framework to enable the Company to manage liquidity risk in a structured and prudent manner, as approved by the Board.

The Company sets limits to maintain liquidity risk exposures within its Liquidity Risk Appetite. These limits are a core component of the LRMP. The key liquidity measures monitored on a daily basis are the Individual Liquidity Guidance (ILG) ratio, the Net Stable Funding Ratio (NSFR) and the Net Wholesale Funding Outflow. The ILG ratio requires the Company to maintain sufficient high quality liquid assets to meet liquidity requirements during periods of market dislocation and stress. The NSFR measure is designed to enable the Company to fully fund long term and illiquid assets by an appropriate combination (size and maturity) of stable liabilities. The ratio does not give any credit for short-term wholesale funding thereby lessening refinancing risk. Management of the Net Wholesale Funding Outflow is designed to restrict high concentrations of wholesale cash outflows and to spread wholesale funding maturities.

The Treasurer is responsible for ensuring that all liquidity and funding measures are managed within policy and appetite. Liquidity management information is provided on a regular basis to the Liquidity Management Forum, the ALCO and the Board, with any exceptions highlighted. The Market and Liquidity Risk team provides review and challenge of policies and procedures relating to funding and liquidity risk.

Stress testing and reverse stress testing of current and forecast Balance Sheets is conducted to inform the Company of required liquidity resources and the circumstances that would result in liquidity resources being exhausted.

As part of the FSA's liquidity framework the Company is required to complete an ILAA submission to the FSA. The ILAA is approved by the ALCO and Board before submission.

9. Operational Risk

Operational Risk is the potential error, loss, harm or failure caused by ineffective or inadequately defined processes, system failure, improper conduct, human error or from external events. The Company aims to minimise all operational risks and reputational impacts.

The CRO, and his direct report, the Head of Operational Risk, are responsible for: developing and maintaining the operational risk framework; working with the business to ensure they understand their first line responsibilities and how they must execute them within the framework; embedding policies, tools and frameworks across the business and instilling a positive risk management culture; and independently monitoring, assessing and reporting on operational risk profiles and losses. In addition, the Head of Operational Risk also has responsibility for fraud risk management (internal and external to the business) and anti-money laundering (AML).

One of the biggest operational risks run by the Company over the past three years has been the Transformation programme under which the Company has set up a banking and insurance infrastructure and processes separate from RBS. The Company migrated its savings and loans business and its insurance business from RBS during 2010 and 2011. The last remaining element of the Transformation programme is to build systems and capability to run the Company's credit card business. This migration is planned to complete during the first half of the 2012/13 financial year. In the short term the Transformation programme generates an elevated level of risk. Given the profile of Transformation Risk, a separate Risk team, reporting directly to the CRO, provides added second line assurance and risk coverage

The Company assesses its operational risk capital requirement using the Standardised Approach.

10. Non trading book exposures in Equities

The Company's non trading exposure in equities relates to the investment in TU who underwrite Motor and Home insurance contracts under the Tesco Bank brand. TU is an associate of the Company which has a 49.9% equity share. This equity position in the non-trading book is held for strategic objectives. The Company values the investment in TU at cost less any provision for impairment. At 29th February 2012 this investment was valued at £71,708k (2011 £71,708k) and accounted for all non-trading book equities.

11. Insurance Risk

The Company defines insurance risk as the risk accepted through insurance products in return for a premium. These risks may or may not occur and the amount and timing of these risks are uncertain and determined by events outside of our control (e.g. flood or car crash). The Company's aim is to actively manage insurance risk exposure with particular focus on those risks that impact profit volatility.

Insurance risk is typically categorised in the following way:

- Underwriting risk – Related to the selection and pricing (or quantification) of the risk currently being transferred from customers to an insurer; and
- Reserving risk – Related to valuation and management of financial resources sufficient to pay claims for the risk already transferred from customers to an insurer.

The Company is exposed to insurance risks through its ownership of 49.9% of TU, an authorised insurance company, and through its historic distribution arrangement with RBS insurance.

Since late 2010 the majority of new and renewal business policies for Home and Motor Insurance products sold by the Company have been underwritten by TU. The Company provides marketing, sales and distribution of these products with TU providing underwriting, reserving and claims management. The key insurance risks within TU relate to Underwriting Risk and specifically the potential for a major weather event to generate significant claims on Home insurance or the cost of settling bodily injury claims on Motor insurance. Exposure to these risks, and pricing risks, are actively managed within TU with close monitoring of performance metrics and the use of reinsurance to limit TU's exposure above pre-determined limits. The Company conducts oversight of these exposures as a significant shareholder in TU.

Additional capacity is provided by a panel of third party providers for those Motor and Home customers who fall outside the desired TU underwriting footprint. The Company has also distributed Pet, Travel, Life, Health, Dental and Breakdown insurance on a 'white label' basis for other providers. The Company does not carry the insurance risk associated with these products.

The primary risk that the Company remains exposed to through its previous relationship with RBS insurance is Reserving Risk – the risk that claims reserves are insufficient to cover the ultimate cost of those insurance claims that have not yet been settled. This is particularly relevant to Motor Insurance claims where the ultimate cost of large bodily injury claims is uncertain and the time taken to settle such claims can vary significantly depending on the severity of the injury. This risk is, in part, mitigated by the use of reinsurance to limit the Company's exposure to the cost of individual claims above certain pre-determined limits. However, the nature of this exposure results in the process of estimating the ultimate cost of these claims carrying a degree of uncertainty.

The Company stopped selling Payment Protection Insurance (PPI) from 1 October 2011 (product underwritten by RBS insurance). However, while the Motor and Home back books have migrated from RBS insurance to TU, legacy PPI policies currently remain with RBS insurance.

The insurance risk team is responsible for designing and implementing the insurance risk framework which seeks to: provide an effective and consistent approach to insurance risk management and to the management of counterparties, including TU, RBS insurance and white label providers; understand and manage the potential volatility of the insurance results; measure the extent to which the insurance business within the Company is being conducted in accordance with the risk appetite and policies; to provide subject matter expert support to the business in identifying, assessing and managing risk in accordance with the Company's EWRMF; and to monitor the performance of TU and the effectiveness of insurance risk management.

TU operates a separate risk framework with dedicated risk and compliance teams and a suite of TU risk policies. TU is working to implement Solvency II in accordance with regulatory timelines. Solvency II aims to establish an enhanced set of capital and risk management standards across the European insurance industry.

12. Legal and Regulatory Compliance Risk

Legal & regulatory compliance risk is the risk of consequences arising as a result of non-compliance with the laws and regulations affecting the Company's governance, prudential arrangements, business activities, risk management and its conduct with customers. The Company's aim is to meet all legal and regulatory requirements and minimise any reputational impact by maintaining an effective control framework. Where legal or regulatory requirements are not met effective remediation plans will be put in place.

The CRO, and his direct report, the Director of Compliance & Regulatory Risk, together with a dedicated regulatory risk team are responsible for: regulatory risk management policies and processes; ensuring that regulatory risks are identified and managed appropriately; monitoring, challenge and oversight of regulatory risk and compliance across the Company's business; and providing guidance and advice to enable the business to operate in a compliant manner. Regulatory risk's scope includes FSA regulations and the Office of the Information Commissioner requirements (for Data Protection Act) as well as internal regulatory risk management policies.

As part of the Company's Policy Framework, regulatory risk is responsible for a number of policies and the Compliance Manual which sets out the scope of the Company's regulatory responsibilities and its approach to managing regulatory risk across the business. The Compliance Manual is approved through RMC.

The Company's Legal function provides advice and support on all aspects of law and associated policies, including Statutory Compliance Policy, Competition Policy, Bribery and Corruption and Information Retention.

13. Securitisation and Covered Bonds

13.1. Securitisation and Covered Bond Roles, Objectives, Involvement and Accounting Treatment

The Company has acted as an originator of securitisations, for the purpose of accessing the Bank of England's Special Liquidity Scheme. On the 19 May 2011 the Company repaid all of its originated credit card backed securities after exiting the Special Liquidity Scheme earlier in the year. As at 29th February 2012 the Company's securitisation programme 'Delamare Cards MTN Issuer Plc' holds £1,224m of originated credit card receivables on trust for the sole benefit of the Company

The Company also operates within the securitisation and covered bond markets as an investor, purchasing certain securitisation and covered bond issuances for the purposes of diversifying its wholesale assets as part of managing its overall diversified funding plan. As an investor, the Company invests directly in third party asset backed securities and it does not hold any re-securitisation positions.

The Company does not act as a sponsor to any securitisations and it does not provide liquidity facilities to either originated asset backed securities or any third parties involved in securitisation activity.

The Company's involvement in securitisation and covered bond activity is summarised in Table 15.

Table 15: Securitisation and Covered Bond Involvement

Total Outstanding Securitisation Exposure as at 29 February 2012				
Securitisation Role / Exposure Type	Exposure Value (£k)	Impaired Exposures (£k)	Past Due Exposures (£k)	Securitation Losses recognised in period (£k)
Originated Securitisations				
Credit Card Receivables (ABS)	-	-	-	-
Invested Securitisations				
Residential Mortgage Backed Securities (RMBS)	45,423	-	-	-
Residential Mortgage Backed Covered Bonds	39,526	-	-	-

Total Outstanding Securitisation Exposure as at 28 February 2011				
Securitisation Role / Exposure Type	Exposure Value (£k)	Impaired Exposures (£k)	Past Due Exposures (£k)	Securitation Losses recognised in period (£k)
Originated Securitisations				
Credit Card Receivables (ABS)	1,165,600	-	-	-
Invested Securitisations				
Residential Mortgage Backed Securities (RMBS)	73,444	-	-	-
Residential Mortgage Backed Covered Bonds	-	-	-	-

Originated securitisation transactions typically involve the sale of a group or portfolio of ring fenced loans to another entity, often known as a special purpose entity ('SPE'). For accounting purposes the SPE's are consolidated when the substance of the relationship indicates control. In assessing control all relevant quantitative and qualitative aspects are considered.

Invested positions are held as Available For Sale (AFS) assets on the Balance Sheet.

13.2. Risks inherent in Securitised and Covered Bond Assets

There are a number of inherent risks in purchasing certain securitised notes including the performance of the underlying assets, the explicit support of the Issuer and its financial stability and volatility in the market value of securitised notes.

The Company has established monitoring processes for investing in securitisation notes. It conducts reviews of Investor Reports by Issuers and an assessment is made of securitised asset performance (notably including arrears levels), operational risk, cash flow analysis, market prices / yields, legal analysis and counterparty risk at both programme and Issuer levels through quantitative and qualitative analysis.

The risks inherent in Covered Bonds relate primarily to the financial strength of the issuer and also to the underlying assets used as collateral for the bonds. A pre-purchase assessment of the Issuer's financial strength is undertaken together with an assessment of the bond structure and underlying assets, including areas such as arrears levels and collateral arrangements. An annual review of the Issuer's financial strength is undertaken.

13.3. Approach to Calculating Risk Weighted Exposure Amounts

The Company adopts the Standardised Approach in relation to all types of securitisation and covered bond exposures.

The Company assesses whether originated securitisations meet the prudential significant risk transfer tests contained within BIPRU 9. If significant risk transfer is not achieved the underlying assets are risk weighted. There are no originated securitisation exposures as at 29th February 2012.

For invested positions the Company calculates risk weighted exposure amounts using the credit quality steps prescribed in BIPRU 9 for securitisations and BIPRU 3.4 for Covered Bond exposures. Fitch Ratings are the nominated ECAI used for assessment of regulatory capital.

Table 16 reports the Company's invested non-trading book securitisation and covered bond positions, capital resources requirements, credit quality steps and risk weight bands.

Table 16: Securitisation Capital Resources Requirements

Total Outstanding as at 29 February 2012			
Credit Quality Step/Exposure Type	Exposure (£k)	Risk Weight (%)	Capital Resource Requirement (£k)
Credit Quality Step 1			
Residential Mortgage Backed Securities (RMBS)	45,423	20%	727
Credit Quality Step 2			
Residential Mortgage Backed Covered Bond	39,526	20%	632

Total Outstanding as at 28 February 2011			
Credit Quality Step/Exposure Type	Exposure (£k)	Risk Weight (%)	Capital Resource Requirement (£k)
Credit Quality Step 1			
Residential Mortgage Backed Securities (RMBS)	73,444	20%	1,175
Credit Quality Step 2			
Residential Mortgage Backed Covered Bond	-	-	-

14. Remuneration

14.1. Approach to remuneration

The Company structures its approach to reward based on that used across the wider Tesco plc Group, maintaining consistency where appropriate, but tailored to fit the financial services industry in line with both industry specific commercial need and external regulatory requirements. Reward is structured to incentivise people to meet strategic business objectives, whilst ensuring actual awards are based on the success of both business and individual performance, promoting an environment of sound risk taking.

The Company externally benchmarks its reward annually to ensure it is aligned to the market and is adequate to recruit and retain qualified and experienced staff. Variable reward is split between short and long-term incentives, both of which involve deferral periods, performance adjustments and the use of Tesco plc shares to create alignment with the wider Tesco plc Group. In addition, subject to a transition period of 5 years (from April 2011), all senior directors are required to maintain a shareholding equivalent to 1 x fixed salary in order to secure a continuous focus on the long-term performance of the Tesco plc Group. The use of several specific measures to assess performance for short-term schemes means that importance is placed on growing profits sustainably in line with the risk appetite of the Company, focussing on how capital investment can deliver long-term success and create shareholder value. The Company's balanced scorecard, referred to as the Steering Wheel, includes measures designed to reflect the values of the Tesco plc Group, particularly around operational efficiency and the focus on customer and staff loyalty.

The Company has adopted a five tier 'work levels' grading structure which is used across most of the Tesco plc Group. This structure ranges from junior staff at Work Level 1 through to directors at Work Level 4 and senior directors at Work Level 5. Roles are allocated to a work level using seven key indicators which include role complexity, level of decision making and budgetary management. The reward structure used is aligned to this work level structure. This five level approach creates a flat, broad organisational structure with few layers of management and broad spans of control. All staff of the Company at Work Level 4 and above have been identified as Code Staff along with a small number of Work Level 3 managers. The list of Code Staff is reviewed annually by the Remuneration Committee.

14.2. Decision making process for remuneration policy

Two Governance groups review, govern and implement the general principles of the Remuneration Policy. The Remuneration Committee is appointed by the Board and from 1st March 2012 will consist of three independent non-executive directors of the Company. Members of the Remuneration Committee are members of either or both of Audit and Board Risk Committees, which ensures they receive regular updates on key risk profiles and issues relating to the Company. The Company's Chief Executive and Chairman also attend meetings at the request of the Committee.

The Remuneration Committee's role is to determine remuneration policy for Code Staff, directly oversee remuneration arrangements for the senior directors within the Company's leadership team and all Code Staff, as well as staff in the key control functions of Risk, Compliance and Audit independently of other business areas. The Remuneration Committee seeks to ensure that the levels and structures of remuneration are designed to attract, retain and motivate management talent needed to run the business in a way which is consistent with the risk appetite and ongoing sustainability of the business and to be compliant with the applicable legislation and regulation.

In performing its duties, the Remuneration Committee is supported by the Personnel Director of TPFG and a representative from the Tesco plc Group Reward team within the Tesco plc Group Personnel division who may also provide further information to assist the Remuneration Committee with their duties. Representatives from the Company's Risk and Finance functions are invited to attend the Remuneration Committee at appropriate times. Where appropriate the Committee also draws on external consultants to provide advice and guidance. In 2011/12 the Committee received independent advice from Freshfields Bruckhaus Deringer LLP, Price Waterhouse Coopers and Deloitte UK.

A separate executive committee, People Matters Group (PMG), exists to manage the day-to-day human resources operations of the Company and covers such areas as talent planning, recruitment, performance and development. It makes decisions on reward matters for all staff below Work Level 4 not covered by the Remuneration Code, including pay and bonus awards, and makes recommendations on Code Staff for the Remuneration Committee to review. The PMG is made up of, amongst others, the Chief Executive and Human Resources Director of the Company.

The Remuneration Committee met four times during the 2011/12 financial year and the PMG met nine times.

14.3. Link between pay and performance

The overall aim is to ensure an appropriate alignment between pay and total reward in line with the risk profile of the Company and it has set its risk appetite accordingly. At an operating level, the Company's risk appetite has been translated into Key Performance Indicators (KPIs) within the business, which build up into an overall assessment in the Company's steering wheel, as well as within its individual remuneration arrangements in a number of ways including:

- An appropriate combination of fixed and variable pay, benchmarked annually, ensuring the Company's fixed-variable ratios on remuneration are controlled and do not encourage inappropriate risk taking behaviour.
- Basing variable performance measures on a combination of balanced measures, including qualitative and quantitative factors. The use of the Company Steering Wheel as a way of assessing short-term performance is viewed as a balanced way of ensuring that stakeholders are considered as part of business performance (as opposed to solely financial measures) and that decisions are not taken for short-term financial gain to the detriment of other aspects of the business.
- Ensuring that all employees of the Company, including Code Staff, have a set of annual objectives and a clear personal development plan. Managers use objectives to communicate the required level of performance and to set expectations. They are a key part of how employee performance is managed. Performance development plans focus on the skills and behaviours appropriate to enable staff to do their jobs well and to help them fulfil their potential. An employee's progress is reviewed on a regular basis and every employee receives an annual performance rating. Individual objectives, performance reviews and personal development plans for all Code Staff are shared with the Remuneration Committee as part of the process for determining variable award levels.
- The basis of assessment for the short-term bonus is adjusted for people in control functions, so greater emphasis is placed on the performance of the control function. The remuneration for Code Staff in key control functions are overseen by the Remuneration Committee.

- Maximum award levels are determined as percentages of salary, which are pre-set for the whole Company based on work level. Awards are mathematically driven based on both business and personal performance. Weak individual performance – as identified through the annual ratings system – results in reduced or zero awards. Rewards are not increased over and above this calculation, and therefore the opportunity for an individual to benefit from increased rewards outside of this core structure does not exist.
- There is a strong share based element to the variable reward offered to support long-term commitment to sustainable performance, with all Code Staff subject to levels of deferral.
- All incentive awards include a clawback facility at the discretion of the Remuneration Committee.

14.4. Design and structure of the remuneration system

The Company delivers its reward via a combination of fixed pay, variable pay and other benefits. All Code Staff at the Company participate in the variable reward schemes, along with other managers at their work level (in line with the approach used across the wider Tesco plc Group). Non-executive Directors, all of whom are Code Staff, do not participate in any variable pay arrangements.

14.4.1. Base salaries

- Fixed reward which reflects the size of the role, individual skills, experience and performance, as well as the remuneration at other similar companies.

14.4.2. Short-term reward

- Short-term bonus

- A one year scheme designed to incentivise and reward managers for attainment of financial and strategic business objectives achieved in the financial year.
- Performance for all staff is assessed against a combination of the Company's financial measures and steering wheel, the performance of the Tesco plc Group and individual performance.
- Awards are made in the form of compulsory deferred shares, voluntary deferred shares and cash, the percentages of which element vary by work level. All Code Staff receive a share bonus deferral in line with the Remuneration Code requirements.
- Awards for Code Staff are subject to performance adjustment at the discretion of the Remuneration Committee. This can be made by one or a combination of; adjusting levels of award prior to payment; applying clawback to existing awards; reducing or lapsing unvested share awards.

14.4.3. Long-term reward

- Long-term bonus

- A three year scheme rewarding long-term shareholder value creation, designed to reward the performance of the wider Tesco plc Group. Awards are made based on a percentage of salary, which vary based on work level.
- Performance is assessed against a matrix of financial measures assessed at Tesco plc Group level. Vesting levels range from 0%-100% depending on overall Tesco plc Group business performance.
- These rewards are subject to claw-back and performance adjustment at the discretion of the Remuneration Committee for misconduct or losses which result from excessive risk being taken, or if the Company's performance is significantly worse than the Tesco plc Group performance (on which the performance measures are based).

- Other schemes

In addition to the long-term bonus, certain members of the Company's senior director population participate in a long-term incentive scheme which will deliver rewards based on long-term sustainable profit growth and annual strategic business objectives encompassing certain customer, operational, people and financial metrics over a five year period. This award will vest, subject to the Remuneration Committee's assessment of performance, in 2015. Any awards paid will be made net of the cumulative amounts paid to eligible participants under other bonus and share based arrangements in the preceding five years.

14.5. Remuneration for Code Staff in 2011/12

Fixed and variable remuneration breakdown for all Code Staff (the Company's senior directors, non-executive directors, Chairman of the Company and those whose actions have a material impact on the risk profile of the Company) is shown in Table 17 below:

Table 17: Code Staff remuneration for 2011/12

Year to 29th February 2012	Senior Management[4]	Other Code Staff[4]	Total
Total number of Code Staff	11	16	27
Fixed reward (£m)[2]	3.1	3.6	6.7
Variable reward (£m)[3]	1.2	0.5	1.7
Total remuneration (£m)	4.3	4.1	8.4

Notes
[2] Includes base salary (and in the case of non-executive directors any fees), benefits in kind and any other cash payments paid in the year.

[3] Where payable other than in cash, the variable remuneration has been valued for the purposes of this table using the following methods:
Annual bonus award – The value of any cash payments and / or deferred shares on date of approval of award
Performance share plan – an expected value of 50% of the value of the grant.

[4] Senior management refers to all senior directors operating within Work Level 5, non-executive directors and the Chairman of the Company. Other Code Staff includes directors at Work Level 4 and senior managers at Work Level 3.