TESCO PERSONAL FINANCE PLC

INTERIM FINANCIAL REPORT

FOR THE SIX MONTHS ENDED 31 AUGUST 2016

COMPANY NUMBER SC173199

CONTENTS

INTERIM MANAGEMENT REPORT

This Interim Financial Report comprises the Interim Management Report and the Interim Condensed Consolidated Financial Statements and accompanying notes. In the Interim Financial Report, unless specified otherwise, the 'Company' means Tesco Personal Finance plc and the 'Group' means the Company and its subsidiaries and joint venture included in the Interim Condensed Consolidated Financial Statements. The Group operates using the trading name of Tesco Bank.

Tesco Personal Finance plc is a wholly owned subsidiary of Tesco Personal Finance Group Limited, the share capital of which is wholly owned by Tesco PLC. A reconciliation of the results contained within the Interim Financial Report to the Tesco Bank results presented in the Tesco PLC Interim Results 2016/17 can be found on the Tesco PLC internet page http://www.tescoplc.com/media/895467/rns.pdf.

Cautionary Statement regarding forward-looking information

Where this document contains forward-looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of this report. These statements should be treated with caution due to the inherent risks and uncertainties underlying any such forward-looking information. The Group cautions users of these Interim Condensed Consolidated Financial Statements that a number of factors, including matters referred to in this document, could cause actual results to differ materially from those contained in any forward-looking statement. Such factors include, but are not limited to, those discussed under 'Principal risks and uncertainties' on pages 6 to 7 of this Interim Management Report.

Business Model

The Group is primarily focused on providing financial services and products to personal customers in the UK and the Republic of Ireland. The Company owns 49.9% of Tesco Underwriting Limited (TU), an authorised insurance company. TU is accounted for as a joint venture of the Group.

Headlines

- The Group serves 7.8m accounts, compared to 7.6m at 29 February 2016 and 7.6m at 31 August 2015, an increase of 2.6% in 6 months.
- Underlying profit before tax[1] is 8.0% higher at £115.3m (August 2015: £106.8m).
- The Group recognised an additional PPI provision charge of £45.0m (August 2015: £nil) during the period, and incurred organisational restructuring costs amounting to £21.8m (August 2015: £nil). Losses on financial instruments, movements on derivatives and hedge accounting were £2.5m (August 2015: £6.7m).
- Profit before tax was 54.0% lower at £46.0m (August 2015: £100.1m), reflecting the impact of the above charges. The full impact of business restructuring commenced during the period will be reflected in the full year results.
- Total underlying income has increased by 1.7% to £399.4m (August 2015: £392.7m).
- Underlying impairment charges have increased by 14.7% to £40.6m (August 2015 £35.4m). Credit quality remains good. The bad debt:asset ratio (BDAR) has remained flat year-on-year, at 0.9%.
- Customer lending has increased by 8.4% to £9.3bn (February 2016: £8.5bn).
- Customer Deposits are 9.6% higher at £8.1bn (February 2016: £7.4bn), and continue to be the main source of the Group's funding.
- The balance sheet remains strong and well positioned to support future lending growth from both a liquidity and capital stand point. At August 2016, the risk asset ratio was 19.9% (February 2016: 20.0%) and net stable funding ratio was 119.7% (February 2016: 131.8%).

1 Excluding PPI provision charge of £45.0m (August 2015: £nil), restructure costs of £21.8m (August 2015: £nil), and losses on financial instruments, movements on derivatives and hedge accounting of £2.5m (August 2015: £6.7m).

INTERIM MANAGEMENT REPORT (continued)

Strategic Priorities

The ambition of Tesco Bank is to 'be the bank for people who shop at Tesco'. In order to accelerate the Group's pursuit of this ambition, in the first half of the year the Group established the Customer 2020 programme. This programme, comprising a number of initiatives and expected to provide the framework for business change over several years, continues to put the Tesco customer at the heart of the Group's activities. The Group's strategy to deliver for the Tesco customer will be achieved by making banking and insurance easier; offering customers great value across all of the products offered by the Group; and earning their trust through the Group's actions. The Group aims to achieve this through targeted investment in technology and data to simplify processes, making life simpler for both customers and colleagues and driving efficiency that can be reinvested in the customer offer.

The Group continued to broaden its product range in the period, to serve more of the banking and insurance needs of Tesco customers. The introduction of a Tesco Bank Premium Credit Card provides customers with the fastest way to earn Tesco Clubcard points when they shop, along with travel related benefits in the form of enhanced exchange rates on travel money bought in store, and worldwide, annual, family travel insurance.

Changes to the services offered have made it easier for customers to bank and insure with the Group. The roll out of the PayQwiq mobile payment service to 600 Tesco stores in locations across the UK gives even more customers the opportunity to pay for their shopping quickly, easily and securely using the app with just one simple scan of their mobile phone. Digital Signatures on Loans was launched in the period, allowing customers to receive funds into their bank accounts within 24 hours.

The Group continues to deliver value to its customers and has helped even more customers to buy their home in the period. Since April 2016, Tesco Bank Mortgages have been available through 10 independent broker firms which are now actively placing business with Tesco Bank. Further expansion of the broker network is planned for the second half of the financial year.

The Group's commitment to offering attractive products and good service for customers has been rewarded with recognition as 'Personal Finance Provider of the Year', 'Best First-Time Buyer Mortgage Provider' and the 'Best Bank Mortgage Provider' at the 2016 Moneyfacts Awards, and 'Best Direct Lender' at the What Mortgage Awards 2016.

During the period, colleagues raised over £48,000 for the Group's charity partners and volunteered over 3,800 hours to their local communities.

Business Review

The initial activities in the Customer 2020 programme commenced in the first half and have resulted in a restructuring charge of £21.8m being recognised. This charge reflects an acceleration in the residual amortisation of the Group's insurance platform, redundancy costs and asset impairment related to the business simplification, and property related costs relating to the early exit from the Group's office in central Edinburgh. The Group's insurance platform will be replaced in 2017 with a new platform offering greater functionality for insurance customers. A further charge of approximately £10m, relating primarily to the accelerated software amortisation, is expected in the second half.

During the first six months, the business has continued to deliver growth across its primary products (Credit Cards, Personal Loans, Mortgages, Personal Current Accounts, Savings and Insurance), with total customer accounts now standing at 7.8m (February 2016: 7.6m), of which 5.5m (February 2016: 5.4m) are actively[1] in use by the Group's customers.

Mortgage balances grew by 11.1% reaching £1,855.7m (February 2016: £1,669.7m), while Credit Card balances increased by 4.2% and Personal Loans by 12.2%.

[1] An account whereby a debit or credit transaction has been completed in the previous month or an active policy is in force.

INTERIM MANAGEMENT REPORT (continued)

Customer Deposits of £8,111.0m (February 2016: £7,398.5m) continue to be the Group's primary source of funding. The Group's customer Deposits grew by 9.6% in the period reflecting the value offered to customers, with take-up of the Personal Current Account contributing towards this growth.

Income generated from insurance products has remained broadly in line with the previous year. There has been strong growth in Home insurance policies in the period, offset by smaller decreases in Motor and Pet policies.

Financial Performance

Statutory information is set out in the Interim Condensed Consolidated Financial Statements. To present a more meaningful view of business performance, the Group's results are also presented in this Interim Management Report on an underlying basis, excluding the impact of business restructuring announced during the period, customer redress provisions recognised and losses on financial instruments, movements on derivatives and hedge accounting.

The Group's financial performance is presented in the Interim Condensed Consolidated Income Statement on page 8. A summary of the Group's financial performance on an underlying basis is presented below.

	6 Months ended 31 August 2016 £m	6 Months ended 31 August 2015 £m	% Change
Net interest income	209.5	198.2	5.7
Underlying non-interest income	189.9	194.5	(2.4)
Total underlying income	**399.4**	**392.7**	**1.7**
Underlying operating expenses	(248.6)	(252.3)	1.5
Underlying impairment on loans and advances to customers	(40.6)	(35.4)	(14.7)
Share of profit of joint venture	5.1	1.8	183.3
Underlying profit before tax	**115.3**	**106.8**	**8.0**
Restructure costs[1]	(21.8)	–	–
Customer redress provision[2]	(45.0)	–	–
Losses on financial instruments, movements on derivatives and hedge accounting[2]	(2.5)	(6.7)	(62.7)
Profit before tax	**46.0**	**100.1**	**(54.0)**

1 Comprising amortisation charge of £12.2m (August 2015: £nil) presented within depreciation and amortisation, restructure costs of £8.5m (August 2015: £nil) presented within administrative expenses, and impairment on loans and advances to customers, following a strategic review of the Irish Credit Card book, of £1.1m (August 2015; £nil) presented within impairment on loans and advances to customers on page 8.

2 PPI provision charge of £45.0m (August 2015: £nil) is presented within operating expenses and losses on financial instruments, movements on derivatives and hedge accounting of £2.5m (August 2015: £6.7m) are presented within total income on page 8.

INTERIM MANAGEMENT REPORT (continued)

The Directors consider the following to be Key Performance Indicators for the Consolidated Income Statement:

	31 August 2016	29 February 2016	31 August 2015
Net interest margin [1]	3.9%	4.2%	4.2%
Underlying cost:income ratio [2]	62.2%	65.7%	64.2%
Cost:income ratio [3]	79.2%	66.6%	65.4%
Bad debt:asset ratio [4]	0.9%	0.8%	0.9%

1 Net interest margin is calculated by dividing net interest income by average interest bearing assets.

2 The underlying cost:income ratio is calculated by dividing underlying operating expenses by total underlying income.

3 The cost:income ratio is calculated by dividing operating expenses by total income (including non trading items).

4 The bad debt:asset ratio is calculated by dividing the impairment loss by the average balance of loans and advances to customers.

Underlying profit before tax is £115.3m, 8.0% higher than the prior year (August 2015: £106.8m).

Net interest income has increased by 5.7% to £209.5m (August 2015: £198.2m) due to the growth in customer lending of 8.4%.

Net interest margin has decreased to 3.9% (August 2015: 4.2%), reflecting the change in product mix in the period as a result of the growth in Mortgage lending.

Underlying non-interest income has decreased by 2.4% to £189.9m (August 2015: £194.5m), reflecting the full impact of the industry wide reduction in interchange rates which was phased in during the prior year, offset by growth in trading performance.

Underlying operating expenses have decreased by 1.5% to £248.6m (August 2015: £252.3m), reflecting both cost discipline across the business and confirmation of the Group's final contribution to the Financial Services Compensation Scheme's Specified Deposits Default levy.

Underlying impairment charges on loans and advances have increased by 14.7% to £40.6m (August 2015: £35.4m). Credit quality remains good with the increase reflecting a combination of balance growth and the implementation of a number of credit initiatives in recent years. These initiatives have been targeted at supporting the borrowing needs of Tesco customers in a profitable and controlled way. The impairment charge in the period benefited from an uplift in gains on sale of non-performing debt of £17.3m (August 2015: £5.9m). The Group's BDAR is in line with the prior year at 0.9%.

Profit before tax is 54.0% lower at £46.0m (August 2015: £100.1m).

INTERIM MANAGEMENT REPORT (continued)

The Group's Interim Condensed Consolidated Statement of Financial Position is presented on page 10. Selected extracts are presented below.

	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m
Loans and advances to customers	9,264.8	8,545.7	8,297.3
Total assets	11,927.2	10,998.6	10,574.6
Deposits from banks	173.7	82.0	445.6
Deposit from customers	8,111.0	7,398.5	6,580.8
Net assets	1,653.7	1,565.8	1,509.1

Loans and advances to customers have increased by 8.4% since year end, to £9,264.8m at 31 August 2016 (February 2016: £8,545.7m). Mortgage balances increased by 11.1%, Credit Card balances by 4.2% and Personal Loan balances by 12.2%.

Deposits from customers have increased by 9.6% to £8,111.0m (February 2016: £7,398.5m) since year end.

Deposits from banks have risen to £173.7m (February 2016: £82.0m) due to an increase in repurchase transactions in the period.

The balance sheet remains well positioned to support future lending growth from both a liquidity and capital standpoint. The Directors consider the following to be Key Performance Indicators for capital and liquidity reporting:

Capital and Liquidity Ratios

	31 August 2016	29 February 2016	31 August 2015
Tier 1 capital ratio [1]	16.6%	16.6%	15.6%
Risk asset ratio [2]	19.9%	20.0%	19.1%
Net stable funding ratio [3]	119.7%	131.8%	109.4%
Loan to deposit ratio [4]	114.2%	115.5%	126.1%

1 The tier 1 capital ratio is calculated by dividing total tier 1 capital at the end of the period by total risk weighted assets and is calculated in line with the Capital Requirements Regulation (CRR).

2 The risk asset ratio is calculated by dividing total regulatory capital by total risk weighted assets.

3 As of December 2015, the Board Risk Committee has monitored the Group's compliance with Net Stable Funding Ratio (NSFR) requirements under the Capital Requirements Directive IV (CRD IV) methodology. The NSFR, and comparative NSFR at February 2016 and at August 2015, is calculated by dividing available stable funding (including all funding sources, each weighted by a standardised stability factor) by required stable funding (including all assets and off-balance sheet commitments, each weighted by a standardised illiquidity factor).

4 The loan to deposit ratio is calculated by dividing loans and advances to customers by deposits from customers.

INTERIM MANAGEMENT REPORT (continued)

The Group's risk asset ratio remains above internal targets and regulatory requirements at 19.9% (February 2016: 20.0%) and leaves the Group well placed to support future growth.

The net stable funding ratio, a measure of the Group’s liquidity position remains strong at 119.7% as at 31 August 2016 (February 2016: 131.8%). The Group maintains a liquid asset portfolio of high quality securities of £1.7bn (February 2016: £1.5bn).

Principal risks and uncertainties

The Board of Directors has overall responsibility for determining the Group’s strategy and related Risk Appetite. The Board’s Risk Appetite comprises a suite of financial and reputational Risk Appetite statements, underpinned by corresponding measures with agreed triggers and limits. The Risk Appetite is formally reviewed by the Board on an annual basis.

The Board is also responsible for overall corporate governance which includes overseeing a robust and effective system of risk management and that the level of capital and liquidity held is adequate and consistent with the risk profile of the business. To support this, an Enterprise Wide Risk Management Framework (EWRMF) has been embedded across the Group and is underpinned by governance, controls, processes, systems and policies.

The Principal risks and uncertainties faced by the Group remain largely unchanged from those set out in the Tesco Personal Finance plc Annual Report and Financial Statements for the year ended 29 February 2016 (pages 7 to 10).

- **Credit risk** is the risk that a borrower or counterparty fails to repay the interest or capital on a loan or other financial instrument.

- **Operational risk** is the risk of loss resulting from ineffective or inadequately designed internal processes, system failure, improper conduct, human error or from external events including the threat of sophisticated Financial Crime activity. Of note is the industry-wide focus on IT security and cyber-crime.

- **Liquidity and Funding risk:** Liquidity risk is the risk that the Group has insufficient liquidity resources to meet its obligations as they fall due or can access these only at excessive cost. Funding risk is the risk that the Group does not have sufficiently stable and diverse sources of funding.

- **Market risk** is the risk that the value of the Group’s assets, liabilities, income or costs might vary due to changes in the value of financial market prices; this includes interest rates, foreign exchange rates and credit spreads.

- **Insurance risk** is accepted through the provision of insurance products in return for a premium. This risk may or may not occur as expected and the amount and timing of these risks are uncertain and determined by events outside of the Group’s control.

- **Legal and Regulatory Compliance risk** is the risk of consequences arising as a result of non-compliance with laws and regulatory requirements as defined by external regulators.

- **Conduct risk** is the risk of business conduct leading to poor customer outcomes. These can arise as a result of an overly aggressive sales strategy, poor management of sales processes, credit assessments and processes or failure to comply with other regulatory requirements.

- **Capital risk** is the risk that the Group holds regulatory capital which is of insufficient quality and quantity to enable it to absorb losses.

INTERIM MANAGEMENT REPORT (continued)

- **Business risk** is the risk to the Group arising from changes in its business including risks to earnings as well as broader risks of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, industry, regulatory or other factors.
- **Political and economic risks:** Following the EU referendum result, the political and economic outlook for the UK is uncertain. The Group has actively considered the potential risks associated with the UK's exit from the EU and their impact on both the UK financial services market and the Group itself. While the timing and terms of any agreement with the EU remain uncertain, the Group continues to have sufficient capital resources to allow it to cope with a severe economic stress. The Group will continue to monitor the wider economic environment, particularly to assess the impact on credit risk to the Group.

INTERIM CONDENSED CONSOLIDATED INCOME STATEMENT (UNAUDITED)

FOR THE SIX MONTHS ENDED 31 AUGUST 2016

	Note	6 Months ended 31 August 2016 £m	6 Months ended 31 August 2015 £m
Interest and similar income	3	301.0	281.8
Interest expense and similar charges	3	(91.5)	(83.6)
Net interest income		**209.5**	**198.2**
Fees and commissions income	4	201.2	209.3
Fees and commissions expense	4	(15.6)	(15.4)
Net fees and commissions income		**185.6**	**193.9**
Losses on financial instruments, movements on derivatives and hedge accounting		(2.5)	(6.7)
Realised gain on investment securities		4.3	0.6
Net other income		**1.8**	**(6.1)**
Total income		**396.9**	**386.0**
Administrative expenses		(217.1)	(209.4)
Provision for customer redress	10	(45.0)	–
Depreciation and amortisation		(52.2)	(42.9)
Operating expenses		**(314.3)**	**(252.3)**
Impairment on loans and advances to customers	5	(41.7)	(35.4)
Operating profit		**40.9**	**98.3**
Share of profit of joint venture		5.1	1.8
Profit before tax		**46.0**	**100.1**
Income tax credit/(charge)	6	26.6	(19.9)
Profit for the period attributable to owners of the parent		**72.6**	**80.2**

INTERIM CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (UNAUDITED)

FOR THE SIX MONTHS ENDED 31 AUGUST 2016

	6 months ended 31 August 2016 £m	6 months ended 31 August 2015 £m
Profit for the period	72.6	80.2
Items that may be reclassified subsequently to the income statement		
Unrealised net gain on available-for-sale investment securities before tax	8.4	2.9
Net gains/(losses) arising on cash flow hedges before tax	1.1	(2.7)
Tax relating to items that may be reclassified subsequently to the income statement	(5.0)	(0.1)
Share of other comprehensive income/(expense) of joint venture	11.3	(3.1)
Total items that may be reclassified subsequently to the income statement	**15.8**	**(3.0)**
Total comprehensive income for the period attributable to owners of the parent	**88.4**	**77.2**

INTERIM CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION (UNAUDITED)

AS AT 31 AUGUST 2016

	Note	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m
Assets				
Cash and balances with central banks		784.2	564.9	563.4
Loans and advances to customers	8	9,264.8	8,545.7	8,297.3
Derivative financial instruments		30.7	29.3	24.6
Investment securities:				
- Available-for-sale		955.5	983.6	738.1
- Loans and receivables		34.1	34.1	34.1
Prepayments and accrued income		58.2	43.1	71.9
Current income tax asset		18.5	1.7	–
Other assets		287.4	277.3	308.0
Investment in joint venture		92.5	76.1	78.5
Intangible assets		327.6	363.9	379.7
Property, plant and equipment		73.7	78.9	79.0
Total assets		**11,927.2**	**10,998.6**	**10,574.6**
Liabilities				
Deposits from banks		173.7	82.0	445.6
Deposits from customers		8,111.0	7,398.5	6,580.8
Debt securities in issue	9	1,208.2	1,206.6	1,199.4
Derivative financial instruments		178.2	150.5	79.3
Provisions for liabilities and charges	10	96.5	58.2	79.0
Accruals and deferred income		108.9	128.2	110.9
Current income tax liability		–	–	23.0
Other liabilities		134.2	142.8	276.1
Deferred income tax liability		27.8	31.0	36.4
Subordinated liabilities and notes	11	235.0	235.0	235.0
Total liabilities		**10,273.5**	**9,432.8**	**9,065.5**
Equity and reserves attributable to owners of parent				
Share capital	12	122.0	122.0	122.0
Share premium account	12	1,097.9	1,097.9	1,097.9
Retained earnings		391.4	318.8	263.3
Other reserves		42.4	27.1	25.9
Total equity		**1,653.7**	**1,565.8**	**1,509.1**
Total liabilities and equity		**11,927.2**	**10,998.6**	**10,574.6**

INTERIM CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

FOR THE SIX MONTHS ENDED 31 AUGUST 2016

	Note	Share capital £m	Share premium £m	Retained earnings £m	Subordinated notes £m	Other reserves £m	Total equity £m
Balance at 1 March 2016		**122.0**	**1,097.9**	**318.8**	**–**	**27.1**	**1,565.8**
Comprehensive income							
Profit for the period		–	–	72.6	–	–	72.6
Net gains on available-for-sale investment securities		–	–	–	–	3.0	3.0
Net gains on cash flow hedges		–	–	–	–	1.5	1.5
Share of other comprehensive income of joint venture		–	–	–	–	11.3	11.3
Total comprehensive income		**–**	**–**	**72.6**	**–**	**15.8**	**88.4**
Transactions with owners							
Share based payments		–	–	–	–	(0.5)	(0.5)
Total transactions with owners		**–**	**–**	**–**	**–**	**(0.5)**	**(0.5)**
Balance at 31 August 2016		**122.0**	**1,097.9**	**391.4**	**–**	**42.4**	**1,653.7**
Balance at 1 March 2015		122.0	1,097.9	183.1	45.0	22.6	1,470.6
Comprehensive income/(expense)							
Profit for the period		–	–	80.2	–	–	80.2
Net gains on available for sale investment securities		–	–	–	–	2.2	2.2
Net losses on cash flow hedges		–	–	–	–	(2.1)	(2.1)
Share of other comprehensive expense of joint venture		–	–	–	–	(3.1)	(3.1)
Total comprehensive income		**–**	**–**	**80.2**	**–**	**(3.0)**	**77.2**
Transactions with owners							
Reclassification of subordinated notes to liabilities		–	–	–	(45.0)	–	(45.0)
Share based payments		–	–	–	–	6.3	6.3
Total transactions with owners		**–**	**–**	**–**	**(45.0)**	**6.3**	**(38.7)**
Balance at 31 August 2015		**122.0**	**1,097.9**	**263.3**	**–**	**25.9**	**1,509.1**

INTERIM CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

FOR THE SIX MONTHS ENDED 31 AUGUST 2016

	Note	6 months ended 31 August 2016 £m	6 months ended 31 August 2015 £m
Operating Activities			
Profit before tax		**46.0**	**100.1**
Adjusted for:			
Non-cash items included in operating profit before taxation		147.2	80.2
Changes in operating assets and liabilities		(20.3)	(628.5)
Income taxes recovered		1.6	4.1
Cash flows generated from/(used in) operating activities		**174.5**	**(444.1)**
Investing Activities			
Purchase of Intangible assets and Property, plant and equipment		(16.1)	(15.0)
Purchase of available-for-sale investment securities		(37.2)	(79.7)
Sale of available-for-sale investment securities		99.8	178.6
Cash flows generated from investing activities		**46.5**	**83.9**
Financing Activities			
Net proceeds received in association with issuance of debt securities	9	–	298.6
Interest paid on subordinated liabilities and notes		(2.2)	(2.2)
Cash flows (used in)/generated from financing activities		**(2.2)**	**296.4**
Net increase/(decrease) in cash and cash equivalents		**218.8**	**(63.8)**
Cash and cash equivalents at beginning of period		**551.8**	**613.3**
Cash and cash equivalents at end of period	14	**770.6**	**549.5**

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Interim Condensed Consolidated Financial Statements for the six months ended 31 August 2016 were approved by the Directors on 3 October 2016.

1. Basis of Preparation

These Interim Condensed Consolidated Financial Statements have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and with International Accounting Standard (IAS) 34 'Interim Financial Reporting' as endorsed by the European Union. The accounting policies applied are consistent with those described in the Consolidated Financial Statements of the Group for the year ended 29 February 2016, except as described below. The Interim Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements of the Group for the year ended 29 February 2016, which have been prepared in accordance with International Financial Reporting Standards (IFRS) and the IFRS Interpretations Committee interpretations (IFRIC) as endorsed by the European Union.

In preparing these Interim Condensed Consolidated Financial Statements, the estimates, judgements and assumptions involved in the Group's accounting policies were the same as those which applied to the Consolidated Financial Statements for the year ended 29 February 2016, except as set out below.

These Interim Condensed Consolidated Financial Statements have been reviewed, not audited, and do not constitute Statutory Financial Statements as defined in section 434 of the Companies Act 2006. The Consolidated Financial Statements for the year ended 29 February 2016 were approved by the Board of Directors on 11 April 2016 and have been filed with the Registrar of Companies. The report of the auditors on those Financial Statements was unqualified, did not contain an emphasis of matter paragraph and did not contain any statement under section 498 of the Companies Act 2006.

Intangible Assets

In the period to 31 August 2016 the Group reassessed the useful life of certain of its intangible fixed assets, reducing the expected life to a maximum of one year. This reduction in useful life reflects the impact of business restructuring commenced during the period. The impact of this change has been to increase the amortisation charge by £12.2m in the current period, primarily arising from an acceleration in the residual amortisation of the Group's insurance platform which will be replaced in 2017. The amortisation charge for the second half of the year will increase by £8.8m. As this represents a change in accounting estimate, no prior year adjustment is required.

Going Concern

The Directors have completed an assessment of the Group's going concern status, taking into account both current and projected performance, including projections for the Group's capital and funding position and having regard to the Group's risk profile. As a result of this assessment, the Directors consider the Group to be in a satisfactory financial position and have a reasonable expectation that the Group has adequate resources to continue in business for the foreseeable future. Accordingly, the Directors continue to adopt the going concern basis in preparing the Interim Condensed Consolidated Financial Statements.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

1. Basis of Preparation (continued)

Adoption of new and amended International Financial Reporting Standards

During the period to 31 August 2016, the Group has adopted the following new accounting standards and amendments to standards which became effective with relevant EU endorsement for annual periods beginning on or after 1 January 2016:

Annual Improvements

The Annual Improvements process covers minor amendments to IFRS that the IASB consider non-urgent but necessary.

The Annual Improvements 2012-2014 process resulted in several minor changes to standards which are effective for annual periods beginning on or after 1 January 2016. There has been no impact on the Group as a result of the adoption of these amendments.

Amendment to IFRS 11, 'Joint arrangements: Acquisition of an interest in a joint operation'

This amendment is effective for annual periods beginning on or after 1 January 2016. It provides new guidance on how to account for the acquisition of an interest in a joint venture. The impact of this amendment on the Group is dependent on any future acquisitions.

Amendments to IAS 16 and IAS 38, 'Property, plant and equipment and intangible assets: Clarification of acceptable methods of depreciation and amortisation'

These amendments are effective for annual periods beginning on or after 1 January 2016. They clarify that the use of revenue based methods to calculate depreciation and amortisation of assets is not appropriate. There has been no impact on the Group as a result of the adoption of these amendments.

Amendment to IAS 27, 'Equity method in separate financial statements'

This amendment is effective for annual periods beginning on or after 1 January 2016. It allows entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. There has been no impact on the Group as a result of the adoption of this amendment.

Amendments to IFRS 10, IFRS 12 and IAS 28, 'Investment entities: Applying the consolidation exception'

These amendments are effective for annual periods beginning on or after 1 January 2016, subject to EU endorsement. They clarify the accounting for interests in investment entities and application of the consolidation exemption. There has been no impact on the Group as a result of the adoption of these amendments.

Amendment to IAS 1, 'Presentation of financial statements: Disclosure initiative'

This amendment is effective for annual periods beginning on or after 1 January 2016. It clarifies some of the requirements for disclosure within the financial statements. There has been no impact on the Group as a result of the adoption of this amendment.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

2. Segmental Reporting

Following the measurement approach of IFRS 8 'Operating segments', the Group's operating segments are reported in accordance with the internal reporting provided to the Board of Directors, which is responsible for allocating resources to the operating segments and assessing their performance.

During the period, the Group underwent an organisational restructure in order to improve customer focus. The restructure combined the Banking and Insurance businesses together into a single function enabling reporting of business results to the Board of Directors, as chief operating decision maker, to be streamlined to a single segment focussed upon the customer.

The reportable segments at 31 August 2016 have therefore reduced from two segments (Banking and Insurance) to one segment, covering all of the Group's activities. Accordingly, prior periods have been restated to present a single reportable segment, the results of which are set out in the Consolidated Income Statement and Consolidated Statement of Financial Position.

Although the Group serves customers in the Republic of Ireland, this is incorporated within the UK geographic sector for the purpose of internal reporting, reflecting the size and scale of this part of the business. There are no significant seasonal fluctuations that affect the Group's results.

3. Net interest income

	6 months ended 31 August 2016 £m	6 months ended 31 August 2015 £m
Interest and similar income		
Loans and advances to customers	288.7	270.9
Loans and advances to banks	1.5	1.3
Interest on investment securities	10.8	9.6
	301.0	**281.8**
Interest expense and similar charges		
Deposits from customers	(58.6)	(49.8)
Deposits from banks	(3.7)	(1.9)
Debt securities in issue	(13.8)	(18.7)
Interest rate swap expenses	(13.2)	(11.0)
Subordinated liabilities and notes	(2.2)	(2.2)
	(91.5)	**(83.6)**

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

4. Net fees and commissions income

	6 months ended 31 August 2016 £m	6 months ended 31 August 2015 £m
Fees and commissions income		
Banking income	127.0	136.1
Insurance income	63.9	64.7
Other income	10.3	8.5
	201.2	**209.3**
Fees and commissions expense		
Banking expense	**(15.6)**	**(15.4)**

5. Impairment on loans and advances to customers

	6 months ended 31 August 2016 £m	6 months ended 31 August 2015 £m
Increase in impairment allowance, net of recoveries* (refer to note 8)	39.8	33.7
Amounts written off during the year as uncollectible	1.9	1.7
	41.7	**35.4**

*Recoveries include £17.3m (August 2015: £5.9m) received through the sale of non-performing debt to third parties.

6. Income tax expense

The tax charge in the Interim Condensed Consolidated Income Statement is based on Management's best estimate of the full year effective tax rate based on expected full year profits to 28 February 2017 and recognising the non deductibility of an additional PPI provision recognised in the period. This is offset by an estimated tax credit of £48.0m relating to Group Relief being made available to the Group from the Tesco PLC tax group.

The 2016 budget announced a further reduction in the primary rate of corporation tax to 17% from 1 April 2020 and the Finance Act implementing this reduction is now enacted. However, substantive enactment had not taken place at the reporting date and this change is not therefore reflected in the half year results but will be reflected in the full year results where relevant. The change is expected to reduce the Group's effective tax rate, which includes the 8% Banking Surcharge, in the medium term.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

7. Capital expenditure and commitments

In the six months ended 31 August 2016 there were additions to property, plant and equipment and intangible assets of £16.1m (August 2015 £12.9m). Commitments for capital expenditure contracted for but not provided at 31 August 2016 were £1.1m (February 2016: £0.6m) on property, plant and equipment and £2.6m (February 2016: £0.3m) on intangible assets.

The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

8. Loans and advances to customers

	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m
Secured Mortgage lending	1,857.6	1,671.8	1,490.1
Unsecured lending	7,539.4	6,997.5	6,944.5
Fair value hedge adjustment	37.5	30.3	12.2
Gross loans and advances to customers	**9,434.5**	**8,699.6**	**8,446.8**
Less: allowance for impairment	(169.7)	(153.9)	(149.5)
Net loans and advances to customers	**9,264.8**	**8,545.7**	**8,297.3**

At 31 August 2016, the Group had undrawn Personal Current Account overdraft commitments of £4.9m (February 2016: £3.0m), Credit Card commitments totalling £11,353.2m (February 2016: £11,767.7m), Mortgage commitments of £114.5m (February 2016: £90.5m) and other commitments of £5.4m (February 2016: £5.6m).

At the period end, £2,595.5m (February 2016: £2,629.5m) of the Credit Card portfolio had its beneficial interest assigned to a securitisation structured entity, Delamare Cards Receivables Trustee Limited, for use as collateral in securitisation transactions.

At the period end, Delamare Cards MTN Issuer plc had £1,800.0m (February 2016: £1,800.0m) notes in issue in relation to securitisation transactions, of which £800.0m (February 2016: £800.0m) related to externally issued notes (refer to note 9). At the period end the Group owned £1,000.0m (February 2016: £1,000.0m) of Credit Card backed bonds issued by Delamare Cards MTN Issuer plc.

Loans and advances prepositioned with Bank of England

	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m
Credit Card backed notes*	596.7	778.8	–
Unsecured Personal Loans	1,084.9	1,248.4	1,412.7
Total assets prepositioned with Bank of England	1,681.6	**2,027.2**	**1,412.7**

*Issued by Delamare Cards MTN Issuer plc

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

8. Loans and advances to customers (continued)

Loans and advances pledged with Bank of England to collateralise Funding for Lending Scheme (FLS) drawings

	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m
Credit Card backed notes*	180.0	–	800.0
Secured Mortgage lending	505.6	577.4	–
Unsecured Personal Loans	–	–	281.9
Total assets pledged as collateral with Bank of England	685.6	577.4	1,081.9
Collateralised FLS Drawings	489.0	389.0	639.0

*Issued by Delamare Cards MTN Issuer plc

Fair value hedge adjustments

Fair value hedge adjustments amounting to £37.5m (February 2016: £30.3m) are in respect of fixed rate Loans and Mortgages. These adjustments are largely offset by derivatives, which are used to manage interest rate risk and are designated as fair value hedges within loans and advances to customers.

Allowance for impairment

The following table shows impairment provisions for loans and advances to customers:

	6 months to 31 August 2016 £m	6 months to 29 February 2016 £m	6 months to 31 August 2015 £m
At beginning of period	153.9	149.5	139.5
Amounts written off	(22.8)	(25.0)	(22.3)
Increase in allowance, net of recoveries*, charged to the Interim Condensed Consolidated Income Statement in the period (refer to note 5)	39.8	30.5	33.7
Foreign currency translation	0.1	0.2	–
Unwind of discount	(1.3)	(1.3)	(1.4)
At end of period	169.7	153.9	149.5

* Recoveries include £17.3m received through the sale of non-performing debt to third parties (February 2016: £19.7m, August 2015: £5.9m).

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

9. Debt securities in issue

	Interest rate	Par value £m	Term (years)	Maturity date	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m
Fixed rate retail bond – issued 24 February 2011	5.2%	125.0	7.5	2018	130.8	132.3	133.9
RPI bond – issued 16 December 2011	1.0%	65.7	8	2019	66.3	65.7	65.3
Fixed rate retail bond – issued 21 May 2012	5.0%	200.0	8.5	2020	213.1	210.9	203.4
Floating rate AAA bond (A1) [1]	1M LIBOR + 0.45%	150.0	5	2019	149.6	149.6	149.5
Floating rate AAA bond (A2) [2]	1M LIBOR + 0.65%	350.0	7	2021	349.1	348.9	348.7
Floating rate AAA bond (A1) [3]	1M LIBOR + 0.65%	300.0	5	2020	299.3	299.2	298.6
					1,208.2	**1,206.6**	**1,199.4**

All Floating Rate Bonds were issued by Delamare Cards MTN Issuer plc and are listed on the Irish Stock Exchange.

[1] This Bond was issued on 6 June 2014. The scheduled redemption date of this Bond is 2017.

[2] This Bond was issued on 6 June 2014. The scheduled redemption date of this Bond is 2019.

[3] This Bond was issued on 13 May 2015. The scheduled redemption date of this Bond is 2018.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

10. Provision for liabilities and charges

	Customer redress provision £m	Insurance provision £m	Other provisions £m	Total £m
6 months to 31 August 2016				
At beginning of period	51.1	4.3	2.8	58.2
Charged to Interim Condensed Consolidated Income Statement	45.0	0.3	10.4	55.7
Utilised during the period	(15.1)	–	(2.3)	(17.4)
At end of period	**81.0**	**4.6**	**10.9**	**96.5**

Customer redress provision – Payment Protection Insurance

Of the total customer redress provision balance at 31 August 2016, £70.8m (February 2016: £34.6m) has been provided for customer redress in respect of potential customer complaints arising from historic sales of Payment Protection Insurance (PPI).

In August 2016 the FCA issued an update to its initial proposals published in November 2015 and a further Consultation Paper (CP16/20, 'rules and guidance on payment protection insurance complaints: feedback on CP15/39 and further consultation'). This Paper confirms the original proposal for a 2 year deadline for PPI claims (ending June 2019), supported by an FCA led communications campaign. Whilst a time bar was anticipated when the provision balance was assessed at February 2016, this represents a 14 month extension from the previous assumption of April 2018 and reflects the timeframe within which the FCA expects to publish its final guidance.

The FCA Paper also consults on rules and guidance on the handling of PPI complaints in light of the Supreme Court's decision in Plevin v Paragon Personal Finance Limited ('Plevin'). The new consultation proposes that both up-front commission arrangements and profit share arrangements should be considered in the calculation of total commission for Plevin complaints.

The Group increased its PPI provision by £45.0m during the period to reflect:

- the impact on current claim volumes of the proposed extension to the time bar;
- an updated assessment of the current claim rate;
- the impact on the expected cost of redress from new rules proposed in the FCA paper regarding Plevin; and
- additional costs expected to be incurred in respect of the Group's contribution to the FCA's communications campaign.

Although a significant degree of uncertainty remains with regard to the final FCA rules and the ultimate cost of settling PPI complaints, in particular the volume of complaints arising from customers ahead of any confirmed deadline, the provision balance represents management’s best estimate at the reporting date of that cost. The PPI provision will continue to be monitored as trends in complaint volumes and levels of redress develop.

This balance provides redress capacity at current run rates (average of last 3 months) for a total of 39 months.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

10. Provision for liabilities and charges (continued)

The table below details for each key assumption, actual data to 31 August 2016, forecast assumptions used in assessing the PPI provision adequacy and a sensitivity assessment demonstrating the impact on the provision of a variation in the future experience.

			Sensitivity	
Assumption	**Cumulative actual**	**Future expected**	**Change in assumption**	**Consequential change in provision £m**
Customer initiated complaints settled	99,200	51,000	+/- 1,000 complaints	+/- 1.1
Average redress per valid claim	£1,850	£1,100	+/- £100	+/- 5.1

Customer redress provision – Credit Card Protection

The Group holds a provision of £0.6m (February 2016: £4.6m) in respect of customer redress relating to the historic sale of certain cardholder protection products to Credit Card customers.

The level of provision held is based on Management's best estimate of the cost of completing the redress programme at the reporting date, relating to the compensation to be paid under an industry-wide scheme of arrangement that closed on 18 March 2016. All compensation amounts have now been issued to impacted customers. A small remaining provision has been retained, and will be monitored by Management over the second half of the financial year.

Customer redress provision – Consumer Credit Act

The Group holds a provision of £9.6m (February 2016: £11.9m) in respect of customer redress relating to instances where certain requirements of the Consumer Credit Act for post contract documentation were not fully complied with.

In arriving at the provision required, the Group has considered the legal and regulatory position with respect to these matters and has sought legal advice which it took into account when making its judgement. The provision represents Management's best estimate at the reporting date of the cost of concluding the redress programme for Loan and Credit Card customers, and in making the estimate Management have exercised judgement as to both the timescale for completing the redress campaign and the final scope of any amounts payable.

Insurance provision

The insurance provision relates to insurance policy cancellation by customers.

Other provisions

Other provisions relate to restructuring costs arising from the Customer 2020 programme. Management expects to utilise around £4.5m of this provision in the second half of the year, with the remaining balance being utilised over the period to 31 December 2018.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

11. Subordinated liabilities and notes

	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m
Floating rate subordinated loans maturing 2030	190.0	190.0	190.0
Undated floating rate notes	45.0	45.0	45.0
Total	**235.0**	**235.0**	**235.0**

Subordinated liabilities and notes comprise loan capital issued to Tesco Personal Finance Group Limited. This includes £190.0m (February 2016: £190.0m) of subordinated loans maturing in 2030 and £45.0m (February 2016: £45.0m) of undated notes with no fixed maturity date.

Both the dated and undated amounts are included in the Group's qualifying subordinated debt for regulatory capital reporting at 31 August 2016 (refer to note 15) which is consistent with the treatment at February 2016 year end.

12. Share capital and share premium

The Company did not issue any shares during the period to 31 August 2016 (August 2015: nil).

	31 August 2016 Number	31 August 2016 £m	29 February 2016 Number	29 February 2016 £m	31 August 2015 Number	31 August 2015 £m
Authorised						
Ordinary shares of 10p each	Unlimited		Unlimited		Unlimited	
Allotted, called up and fully paid						
Ordinary shares of 10p each	1,219,900,000	122.0	1,219,900,000	122.0	1,219,900,000	122.0

The following table shows the aggregate movement in share capital and share premium in the period.

	Share capital			Share premium account		
	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m
At beginning and end of period	122.0	122.0	122.0	1,097.9	1,097.9	1,097.9

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

13. Fair values

Except as detailed in the following table, the Directors consider that the carrying value amounts of financial assets and financial liabilities recorded on the Interim Condensed Consolidated Statement of Financial Position are approximately equal to their fair values.

	31 August 2016		29 February 2016		31 August 2015	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets:						
Loans and advances to customers	9,264.8	9,440.7	8,545.7	8,825.3	8,297.3	8,342.0
Investment securities - loans and receivables	34.1	56.8	34.1	43.3	34.1	38.6
	9,298.9	**9,497.5**	**8,579.8**	**8,868.6**	**8,331.4**	**8,380.6**
Financial liabilities:						
Deposits from customers	8,111.0	8,141.6	7,398.5	7,406.5	6,580.8	6,567.0
Debt securities in issue	1,208.2	1,195.6	1,206.6	1,186.3	1,199.4	1,184.4
Subordinated liabilities	235.0	239.8	235.0	204.7	235.0	194.7
	9,554.2	**9,577.0**	**8,840.1**	**8,797.5**	**8,015.2**	**7,946.1**

The only financial assets and financial liabilities which are carried at fair value on the Interim Condensed Consolidated Statement of Financial Position are available-for-sale investment securities and derivative financial instruments. The valuation techniques and inputs used to derive fair values at the period end are described below, and remain unchanged since 29 February 2016.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where an active market is considered to exist, fair values are based on quoted prices. For instruments which do not have active markets, fair value is calculated using present value models, which take individual cash flows together with assumptions based on market conditions and credit spreads, and are consistent with accepted economic methodologies for pricing financial instruments.

In each case the fair value is calculated by discounting future cash flows using benchmark, observable market interest rates.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

13. Fair values (continued)

The table below categorises all financial instruments held at fair value (recurring measurement) and the fair value of financial instruments held at amortised cost according to the method used to establish the fair value disclosed.

As at 31 August 2016	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets carried at fair value				
Financial assets classified as available-for-sale	954.0	–	1.5	955.5
Derivative financial instruments:				
Interest rate swaps	–	29.6	–	29.6
Cross currency swaps	–	1.0	–	1.0
Forward foreign currency contracts	–	0.1	–	0.1
Financial assets carried at amortised cost				
Loans and advances to customers	–	–	9,440.7	9,440.7
Investment securities – loans and receivables	–	56.8	–	56.8
Total	**954.0**	**87.5**	**9,442.2**	**10,483.7**
Financial liabilities carried at fair value				
Derivative financial instruments:				
Interest rate swaps	–	170.3	–	170.3
Cross currency swaps	–	6.8	–	6.8
Forward foreign currency contracts	–	1.1	–	1.1
Financial liabilities carried at amortised cost				
Deposits from customers	–	–	8,141.6	8,141.6
Debt securities in issue	1,195.6	–	–	1,195.6
Subordinated liabilities	–	239.8	–	239.8
Total	**1,195.6**	**418.0**	**8,141.6**	**9,755.2**
As at 29 February 2016				
Financial assets carried at fair value				
Financial assets classified as available-for-sale	980.1	–	3.5	983.6
Derivative financial instruments:				
Interest rate swaps	–	25.4	–	25.4
Cross currency swaps	–	3.9	–	3.9
Financial assets carried at amortised cost				
Loans and advances to customers	–	–	8,825.3	8,825.3
Investment securities – loans and receivables	–	43.3	–	43.3
Total	**980.1**	**72.6**	**8,828.8**	**9,881.5**
Financial liabilities carried at fair value				
Derivative financial instruments:				
Interest rate swaps	–	144.8	–	144.8
Forward foreign currency contracts	–	1.2	–	1.2
Cross currency swaps	–	4.5	–	4.5
Financial liabilities carried at amortised cost				
Deposits from customers	–	–	7,406.5	7,406.5
Debt securities in issue	1,186.3	–	–	1,186.3
Subordinated liabilities	–	204.7	–	204.7
Total	**1,186.3**	**355.2**	**7,406.5**	**8,948.0**

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

13. Fair values (continued)

As at 31 August 2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets carried at fair value				
Financial assets classified as available-for-sale	738.1	–	–	738.1
Derivative financial instruments:				
Interest rate swaps	–	18.0	–	18.0
Cross currency swaps	–	6.6	–	6.6
Financial assets carried at amortised cost				
Loans and advances to customers	–	–	8,342.0	8,342.0
Investment securities – loans and receivables	–	38.6	–	38.6
Total	**738.1**	**63.2**	**8,342.0**	**9,143.3**
Financial liabilities carried at fair value				
Derivative financial instruments:				
Interest rate swaps	–	77.8	–	77.8
Forward foreign currency contracts	–	0.7	–	0.7
Cross currency swaps	–	0.8	–	0.8
Financial liabilities carried at amortised cost				
Deposits from customers	–	–	6,567.0	6,567.0
Debt securities in issue	1,184.4	–	–	1,184.4
Subordinated liabilities	–	194.7	–	194.7
Total	**1,184.4**	**274.0**	**6,567.0**	**8,025.4**

There are three levels to the hierarchy as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (for example, as prices) or indirectly (for example, derived from prices).

Derivative financial instruments which are categorised as Level 2 are those which either:

- Have future cash flows which are on known dates and for which the cash flow amounts are known or calculable by reference to observable interest and foreign currency exchange rates; or
- Have future cash flows which are not pre-defined, but for which the fair value of the instrument has very low sensitivity to changes in estimate of future cash flows.

In each case the fair value is calculated by discounting future cash flows using benchmark, observable market interest rates.

Available-for-sale investment securities which are categorised as Level 2 are those where no active market exists or where there are quoted prices available for similar instruments in active markets.

Fair values of investment securities classified as loans and receivables are based on quoted prices, where available, or by using discounted cash flows applying market rates.

The estimated fair value of subordinated liabilities is calculated using a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity.

13. Fair values (continued)

Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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

The estimated fair value of deposits from customers represents the discounted amount of estimated future cash flows expected to be paid. Expected cash flows are discounted at current market rates to determine fair value.

The estimated fair value of financial assets classified as available-for-sale, being the Group's interest in VISA Europe, is reflected in the table on page 24. The valuation of £3.5m at 29 February 2016 represented the Group's best estimate at that time of the value of its equity investment in VISA Europe Limited. Following closing of the deal by VISA Inc to acquire VISA Europe Limited on 21 June 2016, the Group disposed of its investment in VISA Europe Limited for consideration of £4.2m. This gain has been recognised in the Condensed Consolidated Statement of Comprehensive Income, within gain on sale of investment securities.

As part of the transaction, the Group also acquired an interest in preferred stock issued by VISA Inc during the period, the estimated fair value of which is £1.5m at 31 August 2016. The preferred stock may be convertible into Class A Common Stock of VISA Inc at certain future dates, the earliest point being June 2020. Conversion is contingent on future events, principally related to the outcome of interchange litigation against VISA Europe Limited. As such, the valuation of £1.5m reflects both an illiquidity discount and the risk of a reduction in the conversion rate to VISA Inc Common Stock. The reduction in the conversion rate is the most significant unobservable input to the valuation.

There were no transfers between Level 1 and Level 2 during the period (August 2015: no transfers).

There were no transfers between Level 2 and Level 3 during the period (August 2015: no transfers).

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

14. Cash and cash equivalents

For the purposes of the Interim Condensed Consolidated Statement of Cash Flows, cash and cash equivalents comprise the following balances with short term maturities from the date of acquisition:

	31 August 2016 £m	29 February 2016 £m	31 August 2015 £m
Cash and balances with central banks [1]	770.6	551.8	549.5
	770.6	**551.8**	**549.5**

1 Mandatory reserve deposits held within the Bank of England of £13.6m (February 2016: £13.1m, August 2015: £13.9m) are not included within cash and cash equivalents for the purposes of the Interim Condensed Consolidated Cash Flow Statement as these do not have short term maturities.

15. Capital resources

On 27 June 2013 the final CRD IV rules were published in the Official Journal of the European Union. Following the publication of the CRD IV rules, the Prudential Regulatory Authority (PRA) issued a policy statement on 19 December 2013 detailing how the rules will be enacted within the UK with corresponding time frames for implementation. The CRD IV rules are currently being phased in. The following tables analyse the regulatory capital resources of the Company (being the regulated entity) applicable as at the period end and also the "end point" position, once all of the rules contained within CRD IV have come into force:

	Transitional 6 months to 31 August 2016 £m	Transitional 6 months to 29 February 2016 £m	Transitional 6 months to 31 August 2015 £m
Movement in common equity tier 1 capital:			
At the beginning of the period	1,217.6	1,125.2	1,041.1
Profit attributable to shareholders	67.3	111.3	78.4
Gains/(losses) on liabilities arising from own credit	0.8	(1.9)	–
Other reserves	2.4	(0.7)	8.5
Ordinary dividends/Foreseeable dividends	(29.1)	(24.3)	(25.7)
Movement in intangible assets	36.2	15.8	22.9
Movement in material holdings	–	3.4	–
Deferred tax liabilities related to intangible assets	(5.9)	(11.2)	–
At the end of the period	**1,289.3**	**1,217.6**	**1,125.2**

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

15. Capital resources (continued)

	End Point 31 August 2016 £m	Transitional 31 August 2016 £m	Transitional 29 February 2016 £m	Transitional 31 August 2015 £m
Common equity tier 1				
Shareholders' equity (accounting capital)	1,633.4	1,633.4	1,562.1	1,501.7
Regulatory adjustments				
Losses on liabilities arising from own credit	–	–	–	(0.1)
Unrealised gains on cash flow hedge reserve	–	–	1.6	1.4
Adjustment to own credit/Additional Value Adjustments	(1.2)	(1.2)	(1.9)	–
Foreseeable dividends	(29.1)	(29.1)	–	(25.7)
Intangible assets	(327.6)	(327.6)	(363.9)	(379.7)
Deferred tax liabilities related to intangible assets	20.6	20.6	26.5	37.8
Material holdings in financial sector entities	–	(6.8)	(6.8)	(10.2)
Core tier 1 capital	**1,296.1**	**1,289.3**	**1,217.6**	**1,125.2**
Tier 2 capital (instruments and provisions)				
Undated subordinated notes	45.0	45.0	45.0	45.0
Dated subordinated notes net of regulatory amortisation	190.0	190.0	190.0	190.0
Collectively assessed impairment provisions	49.6	49.6	44.6	37.3
Tier 2 capital (instruments and provisions) before regulatory adjustments	**284.6**	**284.6**	**279.6**	**272.3**
Regulatory adjustments				
Material holdings in financial sector entities	(34.1)	(27.3)	(27.3)	(23.9)
Total regulatory adjustments to tier 2 capital (instruments and provisions)	**(34.1)**	**(27.3)**	**(27.3)**	**(23.9)**
Total tier 2 capital (instruments and provisions)	**250.5**	**257.3**	**252.3**	**248.4**
Total Capital	**1,546.6**	**1,546.6**	**1,469.9**	**1,373.6**
Total risk weighted assets (unaudited)	7,763.3	7,763.3	7,345.9	7,193.2

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

15. Capital resources (continued)

	End Point 31 August 2016	**Transitional 31 August 2016**	Transitional 29 February 2016	Transitional 31 August 2015
Common equity tier 1 ratio (unaudited)	16.7%	16.6%	16.6%	15.6%
Tier 1 ratio (unaudited)	16.7%	16.6%	16.6%	15.6%
Total capital ratio (unaudited)	19.9%	19.9%	20.0%	19.1%

The table below reconciles shareholders' equity of the Group to shareholders' equity of the Company:

	6 months to 31 August 2016 £m	6 months to 29 February 2016 £m	6 months to 31 August 2015 £m
Tesco Personal Finance plc (Group) shareholders' equity	1,653.7	1,565.8	1,509.1
Share of joint venture's retained earnings	(9.3)	(5.2)	(9.7)
Subsidiaries' retained earnings	–	1.2	–
Share of joint venture's available-for-sale reserve	(11.0)	0.3	2.3
Tesco Personal Finance plc (Company) shareholders' equity	**1,633.4**	**1,562.1**	**1,501.7**

It is the Group's policy to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the PRA.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

15. Capital resources (continued)

Leverage ratio (unaudited)

The Basel III reforms include the introduction of a capital leverage measure as defined as the ratio of tier 1 capital to total exposure. This is intended to reinforce the risk based capital requirements with a simple, non-risk based 'backstop' measure. The Basel Committee on Banking Supervision (BCBS) have proposed that final adjustments to the definition and calibration of the leverage ratio be carried out in 2017, with a view to migrating to a Pillar 1 treatment in 2018. In January 2015 the European Commission revised the CRD IV leverage rules to closely align to the Basel III Leverage Framework.

In the interim, the Group has published the estimated leverage ratio on a fully transitional CRD IV basis.

Exposures for leverage ratio (unaudited) **2016**	**End Point 31 August 2016 £m**	**Transitional 31 August 2016 £m**	**Transitional 29 February 2016 £m**
Total balance sheet exposures	11,867.0	11,867.0	10,973.4
Removal of accounting value of derivatives and Securities Financing Transactions (SFTs)	(27.5)	(27.5)	(27.8)
Exposure value for derivatives and SFTs	9.2	9.2	57.9
Off balance sheet: unconditionally cancellable (10%)	1,136.4	1,136.4	1,177.7
Off balance sheet: other (20%)	22.9	22.9	18.1
Other regulatory adjustment – including intangible assets	(376.9)	(376.9)	(363.9)
Material holdings in financial sector entities	–	(6.8)	(6.8)
Total	**12,631.1**	**12,624.3**	**11,828.6**
Common equity tier 1	**1,296.1**	**1,289.3**	**1,217.6**
Leverage ratio	**10.3%**	**10.2%**	**10.3%**

The Company's estimated end point leverage ratio is 10.3% (February 2016: 10.3%). The Basel Committee's minimum ratio of 3.0% is proposed to become a Pillar 1 requirement by 1 January 2018.

Capital Management

The Group operates an integrated risk management process to identify, quantify and manage risk in the Group. The quantification of risk includes the use of both stress and scenario testing. Where capital is considered to be an appropriate mitigant for a given risk this is identified and reflected in the Group's internal capital assessment. The capital resources of the Group are regularly monitored against the higher of this internal assessment and regulatory requirements. Capital adequacy and performance against the Capital plan is monitored daily by Treasury, with monthly reporting provided to the Board, Asset and Liability Management Committee and Capital Management Forum.

During the period capital and leverage regulations continued to evolve. The PRA updated its Pillar 2 capital methodologies in July 2016 following the publication of its prudential requirements for implementation of ring-fencing. The PRA will assess Credit risk, Market risk, Operational risk, Counterparty credit risk, Credit concentration risk, Interest Rate Risk in the Banking Book and Pension obligation risk to inform the setting of a firm's Pillar 2A individual capital. These methodologies will continue to be managed as part of the Bank Internal Capital Adequacy Assessment Process. The PRA general safety and soundness objectives in relation to continuity of core services in the UK and ring-fencing of Bank activities where core deposits are in excess of £25bn are due to be implemented from 1 January 2019. The Group's forecasts indicate that the Group will not exceed this threshold and will not automatically be required to ring-fence the Group's core activities by the 2019 implementation date.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

15. Capital resources (continued)

The BCBS issued revisions to the Basel III leverage ratio framework which included revisions for derivative exposures, off balance sheet items and prudent valuation adjustments. The revision also noted that further clarity on general and specific provisions which are permitted to be deducted from leverage exposures was required. In August 2016, a European Banking Authority (EBA) report recommended a minimum Pillar 1 leverage of 3% to be applied to all credit institutions in scope for CRD IV requirements by 1 Jan 2018. The EBA also recommended a potential cap on the use of Additional Tier 1 capital for Globally systemically important institutions and recommended that the inclusion of Tier 2 capital would not be appropriate in the leverage capital measure.

The PRA leverage statement in August 2016, invited firms which are currently subject to the UK leverage ratio framework to apply for a temporary modification to allow firms to exclude from the calculation of the total exposure measure those assets constituting claims on central banks. The Group is subject to the CRR reporting and disclosure requirements and is not currently subject to the UK leverage ratio framework.

The European Commission's minimum requirements for own funds and eligible liabilities (MREL)

An interim EBA report on MREL in July 2016, endorsed the key MREL principles that each bank MREL should be set at a level necessary and sufficient to implement the resolution strategy by absorbing losses and recapitalising the institution. The EBA preferred option is for MREL to be calculated as a percentage of Risk Weighted Assets and also to strengthen the existing powers of local regulatory authorities such as the PRA. In the UK, the PRA and Bank of England are yet to confirm how MREL will be applied to institutions such as the Group. Further guidance on MREL is expected in the second half of the financial year.

16. Related party transactions

The Group’s related party transactions during the interim period were entered into in the normal course of business. Transactions for this period are not significant to an understanding of the Group’s financial position or performance, and are similar in nature to those for the year ended 29 February 2016.

17. Ultimate parent undertaking

The Group’s ultimate parent undertaking and controlling party is Tesco PLC which is incorporated in England.

18. Events after the reporting period

There have been no significant events between 31 August 2016 and the date of approval of this Interim Financial Report which would require a change to or additional disclosure in this Interim Financial Report.

RESPONSIBILITY STATEMENT

The Directors listed below confirm that to the best of their knowledge these Interim Condensed Consolidated Financial Statements have been prepared in accordance with IAS 34 as endorsed by the European Union.

The Interim Condensed Consolidated Financial Statements and Interim Management Report contained herein includes a fair review of the information required by DTR 4.2.7, namely an indication of important events that have occurred during the first six months and their impact on the Interim Condensed Consolidated Financial Statements, and a description of the Principal risks and uncertainties for the remaining six months of the financial year.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors of Tesco Personal Finance plc as at the date of this announcement are as set out below.

By order of the Board,

Peter Bole
Director
3 October 2016

Directors:	Graham Pimlott - Independent Non-Executive Chairman Karl Bedlow - Chief Customer Officer Peter Bole* - Chief Financial Officer Feike Brouwers - Chief Risk Officer John Castagno - Independent Non-Executive Director Iain Clink - Deputy Chief Executive Robert Endersby - Independent Non-Executive Director Bernard Higgins - Chief Executive Simon Machell - Independent Non-Executive Director James McConville - Independent Non-Executive Director David McCreadie - Managing Director Deanna Oppenheimer - Non-Executive Director Raymond Pierce - Senior Independent Non-Executive Director
Company Secretary:	Michael Mustard

*Resigned on 3 October 2016. Declan Hourican was appointed as Chief Financial Officer on 3 October 2016 subject to regulatory approval.

INDEPENDENT REVIEW REPORT TO TESCO PERSONAL FINANCE PLC

We have been engaged by Tesco Personal Finance plc (“the Company”) to review the Interim Condensed Consolidated Financial Statements in the Interim Financial Report for the six months ended 31 August 2016 which comprises the Interim Condensed Consolidated Income Statement, the Interim Condensed Consolidated Statement of Comprehensive Income, the Interim Condensed Consolidated Statement of Financial Position, the Interim Condensed Consolidated Statement of Changes in Equity, the Interim Condensed Consolidated Statement of Cash Flows and related notes 1 to 18. We have read the other information contained in the Interim Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the Interim Condensed Consolidated Financial Statement.

This report is made solely to the Company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Company those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company, for our review work, for this report, or for the conclusions we have formed.

Directors’ responsibilities

The Interim Financial Report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the Interim Financial Report in accordance with the Disclosure and Transparency Rules of the United Kingdom’s Financial Conduct Authority.

As disclosed in note 1, the Annual Financial Statements of the Company are prepared in accordance with IFRS as adopted by the European Union. The Interim Condensed Consolidated Financial Statements included in this Interim Financial Report have been prepared in accordance with International Accounting Standard 34 'Interim Financial Reporting' as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Company a conclusion on the Interim Condensed Consolidated Financial Statements in the Interim Financial Report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the Interim Condensed Consolidated Financial Statements in the Interim Financial Report for the six months ended 31 August 2016 are not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom’s Financial Conduct Authority.

Deloitte LLP
Chartered Accountants and Statutory Auditor
Edinburgh, United Kingdom
3 October 2016